

THE FUTURE OF NATIONAL OIL COMPANIES IN RUSSIA AND HOW THEY MAY IMPROVE THEIR GLOBAL COMPETITIVENESS

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I. INTRODUCTION

In 2009, fifteen of the twenty largest oil companies were

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majority owned by nation states.¹ National Oil Companies (NOCs) have vastly increased in importance and size over the last several decades. In the 1970s, NOCs controlled less than ten percent of the world's oil and gas reserves; that number has increased to more than ninety percent in 2012.² This huge swing in percentage of control over the world's oil and gas reserves toward greater NOC control and less control by the major International Oil Companies (IOCs)³ has significant implications for the international energy market. Some have distinguished between NOCs and hybrid NOCs based on ownership percentage, but this Article will only distinguish between IOCs (majority privately owned and controlled) and NOCs (majority government owned or controlled).

IOCs seek to maximize shareholder value,⁴ achieve production efficiency,⁵ and enhance profitability,⁶ which benefits consumers by preventing shortages and ensuring more predictable prices.⁷ NOCs often have conflicting goals because of the added government control and influence. The objectives of NOCs have been known to include politically motivated wealth re-distribution, wealth creation for the nation, job creation, general economic development, economic and energy security, foreign and strategic policy and alliance building, participation in national level politics, and vertical integration.⁸ These noncommercial goals often conflict with a NOC's commercial

1. Valeria Marcel, *States of Play*, FOREIGN POL'Y (Sept./Oct. 2009), http://www.foreignpolicy.com/articles/2009/08/17/states_of_play?page=full.

2. JORGE LEIS ET AL., NATIONAL OIL COMPANIES RESHAPE THE PLAYING FIELD 1 (2012).

3. ROBERT PIROG, CONG. RESEARCH SERV., RL34137, THE ROLE OF NATIONAL OIL COMPANIES IN THE INTERNATIONAL OIL MARKET 2 (2007) (indicating the five largest IOCs are ExxonMobil, BP, Shell, Chevron, and Total).

4. *Id.* at 5 ("In the oil industry, maximization of shareholder value is taken to mean that the value of oil resources should be maximized through managing production, exploration, and development activities to assure a functioning market.").

5. *Id.*

6. *See id.* ("They also have the motivation to achieve productive efficiency to hold down costs to enhance the profitability of any given revenue level.").

7. *Id.*

8. *See id.* at 5-9; JAMES A. BAKER III INST. FOR PUB. POL'Y RICE UNIV., THE CHANGING ROLE OF NATIONAL OIL COMPANIES IN INTERNATIONAL ENERGY MARKETS 4 (2007) [hereinafter THE CHANGING ROLE OF NATIONAL OIL COMPANIES].

goals such as the ability to maximize the value of its reserves, replace reserves, expand its production, and perform in a technically efficient manner.⁹

Not all NOCs are equal; some have been very successful in combining commercial goals and noncommercial state interests to create economic value and a globally competitive company. The most successful NOCs bring global standards home in regards to managerial and operational standards,¹⁰ domestic suppliers,¹¹ and industries related to oil and gas.¹² Norway's Statoil is an exemplar of this model. In response to declining domestic reserves, Statoil expanded internationally—today nearly twenty-five percent of Statoil's total production comes from outside of Norway¹³—while also building research institutions in Norway and fostering a profitable domestic oil and gas industry.¹⁴ Russia and its NOCs have not been known for balancing state responsibilities with commercial interests in past years, but since both Gazprom and Rosneft went public in 2006—allowing private ownership of shares¹⁵—the balance has become more equitable.¹⁶ Russia is known for exerting control over most aspects of its NOCs, but as both Rosneft and Gazprom have grown they have become more commercially oriented and

9. THE CHANGING ROLE OF NATIONAL OIL COMPANIES, *supra* note 8, at 4.

10. José de Sá & John McCreery, *How National Oil Companies Can Fuel Economic Development*, FORBES (May 1, 2012, 8:20 AM), <http://www.forbes.com/sites/baininsights/2012/05/01/how-national-oil-companies-can-fuel-economic-development>.

11. *See id.* (“[T]o improve the R & D capabilities among local suppliers, Norway offered preferential access to new concession blocks to oil companies that invested more heavily in R & D with Norwegian researchers in Norwegian institutions, spurring Statoil to increase its investments in those companies. The more critical the technology and the greater the investment, the more preferential was the access to new blocks.”).

12. *Id.*

13. Interview by Matt Insley with Stephen Bull, Vice President, Strategy for Dev. and Prod. in N. Am. Onshore, Statoil (June 20, 2012), <http://dailyresourcehunter.com/video-series/statoil-best-kept-energy-secrets-north-america/>.

14. de Sá & McCreery, *supra* note 10.

15. *IPO*, ROSNEFT, <http://www.rosneft.com/Investors/structure/IPO/> (last visited Feb. 10, 2013); *Shares*, GAZPROM, <http://www.gazprom.com/investors/stock> (last visited Feb. 22, 2013).

16. Scott Rose & Ryan Chilcote, *BP's Rosneft Deal Shows Russia Ceding Control, Shuvalov Says*, WASH. POST (Jan. 21, 2013, 9:57 AM), <http://washpost.bloomberg.com/Story?docId=1376-MGX1L46TTDS001-2QOL1QOC2U4UMRP5ARBM17JRJE>.

less politically controlled.¹⁷

The Russian oil and gas sector and its history since the collapse of the Soviet Union will be explained in Part I, which will focus on government influence over the oil and gas sectors and the history of both Rosneft and Gazprom. Part II will cover the experiences of LUKOIL and Statoil and how their respective histories provide lessons for Russian NOCs as they continue to evolve. Finally, this Article will explore the lessons to be learned from Statoil and LUKOIL to the experiences of Rosneft and Gazprom, outline state ownership reforms and methods of international expansion that have been implemented, are in the process of implementation, and should be implemented in the near future by Gazprom and Rosneft.

II. RUSSIA

“The role of the country in the global energy markets largely determines its geopolitical influence.”¹⁸

“The goal of Russia’s energy policy is to ensure . . . strengthening of its global economic positions.”¹⁹

Before the 1990s and the collapse of its political machinery, the Soviet Union had built a large energy industry and exported its success to other socialist countries, including but not limited to Algeria, Cuba, Iraq, Iran, Libya, Syria, and Vietnam.²⁰ During this period, oil exports were a vital source of income and a defining attribute of the foreign policy of the Soviet Union.²¹ It built the world’s longest oil pipeline between 1960 and 1964 (Druzhba pipeline), bringing oil to East Germany, Poland,

17. See Arthur Max, *U.S. Gas Boom Hits Gazprom, Now Looking East to Counter Europe Decline*, ENERGYWIRE (Nov. 6, 2012), <http://www.eenews.net/energywire/2012/11/06/archive/2?terms=gazprom> (noting that Putin has power over companies like Gazprom, but that politically inspired spending is being brought under control).

18. Nina Poussenkova, *The Global Expansion of Russia’s Energy Giants*, 63 J. INT’L. AFF. 103, 108 (2010) [hereinafter *Global Expansion*] (quoting Energy Strategy of Russia up to 2020, Decree No. 1234-p (Aug. 28, 2003) (issued by the Government of the Russian Federation)).

19. *Id.* This 2009 Statement was an attempt to soften the 2003 statement by Russia about its energy strategy up to 2030. *Id.*

20. *Id.* at 103–04.

21. *Id.* at 104.

Czechoslovakia and Hungary.²² A second branch, doubling the quantity of oil exports, was built between 1969 and 1974.²³ Western Europe wanted access to Soviet gas reserves but was concerned they would become dependent and thereby less secure with Soviet control of the gas supply.²⁴ This led to the failure of negotiations between Eni—an Italian oil and gas company—and the Soviet Union in 1966.²⁵ The West eventually did gain access to those reserves in 1973 when Soviet gas reached West Germany, France, and Finland due to a “gas for pipes” deal struck in 1970 between the Soviet Union and West Germany.²⁶

After the collapse of the Soviet Union there was a mad dash to privatize the Russian oil and gas sector. With the demise of the Soviet system in Russia, many political elites traded their party credentials for top-paying positions at rapidly privatizing former state-owned enterprises.²⁷ In 1995, in order to finance the government and the 1996 Presidential campaign, the Russian government implemented a “loans for shares” program in which banks made “loans” to the government in exchange for shares in state oil companies.²⁸ The loans were never repaid and these became bargain purchases of many of the largest state assets.²⁹ The privatization process began to reverse in 2000 when Vladimir Putin was elected President, but by then, many of Russia’s energy assets were held privately.³⁰

22. *Global Expansion*, *supra* note 18, at 104.

23. *Id.*

24. *See id.* (“[T]he West was worried that the communists would make Europe addicted to Soviet gas.”).

25. *Id.*

26. *Id.*

27. *See* discussion *infra* Parts I.A, I.B.

28. Alessandra Stanly, *Russian Banking Scandal Poses Threat to Future of Privatization*, N.Y. TIMES (Jan. 26, 1996), <http://www.nytimes.com/1996/01/28/world/russian-banking-scandal-poses-threat-to-future-of-privatization.html?pagewanted=all&src=pm>.

29. *See* JERRY F. HOUGH, THE LOGIC OF ECONOMIC REFORM IN RUSSIA 207–08 (2001) (explaining the “loans for shares” program, noting that every participant knew the Russian government did not intend to repay them, and highlighting the sham “auction” process that took place to satisfy the government’s debt).

30. *See* Ira W. Lieberman, *The Rise and Fall of Russian Privatization*, 90 CONTEMP. STUDIES IN ECON. & FIN. ANALYSIS 261, 333–34 (2008).

President Vladimir Putin has historically seen energy production as a path to “restore Russia’s lost greatness after the collapse of the Soviet Union,”³¹ characterizing the guiding principle for the oil and gas industry when he said, “[t]he basic strategic tasks for the natural resources sector involve achieving the transition to a rational combination of administrative and economic methods of government regulation in the sphere of resource exploitation.”³²

Below is a short history of the two major Russian NOCs (Rosneft and Gazprom), including their challenges and successes over the last two decades.

A. *Rosneft*

“Rosneft’s true ambition is to become not the world’s largest publicly traded oil producer, but rather ‘the most efficient’ . . . ”³³

Rosneft faced huge obstacles as a state run company in the fervor of privatization. When Presidential Decree Number 1403 kicked off privatization of the Russian oil industry, Rosneft was to act as a state oil company and manage 259 of 301 oil enterprises operating in Russia.³⁴ While this gave Rosneft over sixty percent of domestic oil production, it soon began to lose its most attractive assets.³⁵ In August 1995, it was forced to sell Nizhnevartovksneftegas to Tyumen Oil Company and was deprived of four other assets in favor of Sibneft, a company believed by some observers to be a proxy for funding Boris Yeltsin’s 1996 Presidential campaign.³⁶ Not even local Russian

31. Andrew E. Kramer, *Putin’s Grasp of Energy Drives Russian Agenda*, N.Y. TIMES, Jan. 29, 2009, at A1, available at <http://www.nytimes.com/2009/01/29/world/europe/29putin.html?pagewanted=all>.

32. Kaj Hobér, *Law and Policy in the Russian Oil and Gas Sector*, 27 J. ENERGY & NAT. RESOURCES L. 420, 427 (2009) (quoting Putin).

33. *With BP Buy-In, Rosneft Refocuses on Finances*, ENERGYWIRE (Nov. 5, 2012), <http://www.eenews.net/energywire/2012/11/05/archive/10?terms=rosneft> [hereinafter *BP Buy-In*] (quoting Igor Sechin).

34. NINA POUSSENKOVA, JAMES A. BAKER III INST. FOR PUB. POL’Y RICE UNIV., LORD OF THE RIGS: ROSNEFT AS A MIRROR OF RUSSIA’S EVOLUTION 3 (2007) [hereinafter LORD OF THE RIGS].

35. *Id.* at 4–5.

36. *See id.* (noting the belief that Sibneft was created to fund Yeltsin’s campaign).

government trusted the state-run company; Rosneft lost management of a sizeable Moscow refinery and Mosnefteproduct marketing to the mayor of Moscow in February 1997.³⁷

Further exacerbating Rosneft's troubles with the state, the government prevented Rosneft from expanding internationally into a German refinery.³⁸ In 2000, Rosneft, Surgutneftegas, and Megionneftegas (all Russian companies) were to be shareholders and suppliers of crude to the Leuna-2000 refinery built in Germany by France's Elf Aquitaine, but the Russian government delayed preparation of documents for so long the deal fell apart.³⁹ As of 2010, the Leuna-2000 refinery continues operations without Russian crude.⁴⁰

While Rosneft did benefit from the ability to handle sales of the state's shares of Production Sharing Agreements, it lagged behind its privatized counterparts by failing to foster the commercial principles that flourished in Russia in the 1990s.⁴¹ Rosneft was seen as one of the least efficient oil companies in the sector.⁴²

Rosneft struggled to resist privatization during most of the 1990s. The CEO, Alexander Putilov, was fired and made Chairman of the Board, in which position he subsequently fought with the new CEO over privatization.⁴³ Prior to dismissal of the Chernomyrdin government, the government approved a plan for privatization through sale of seventy-five percent plus one share of Rosneft stock for \$2.1 billion plus \$400 million of investment conditions.⁴⁴ However, the auction was shunned by

37. See *id.* at 7–8 (indicating that past gasoline crises made Muscovites distrustful of the company, which made it easy for the Mayor to assume operations authority).

38. See *id.* at 9–10 (describing the breakdown of negotiations because of conflicts with Russian authorities' interests).

39. *Global Expansion*, *supra* note 18, at 105.

40. *Id.*

41. LORD OF THE RIGS, *supra* note 34, at 10.

42. *Id.* at 11, 82. As of 2002, Rosneft ranked nearly last of the eight major Russian oil companies in everything except gas output and number of idle wells. *Id.*

43. *Id.* at 17–18.

44. *Id.* at 18. Ownership of seventy-five plus one percent in any company in Russia gives the shareholder a super-majority allowing it to vote through any major decisions. JAMES HENDERSON, OXFORD INST. FOR ENERGY STUDIES, ROSNEFT-ON THE ROAD TO GLOBAL NOC STATUS? 9 n.12 (2012), available at <http://www.oxfordenergy.org/wpcms/>

foreign investors and labeled “ridiculously inflated” by the CEO of Yukos.⁴⁵ An outside group (Alliance Group) was brought in to turn Rosneft around to make it more attractive for sale;⁴⁶ but when the Board of Directors delayed in signing a contract with Alliance Group for a couple weeks in August 1998, the August 17 financial crisis struck and the government was dismissed.⁴⁷ On August 27, the Alliance Group announced it could not manage Rosneft and the turn-around was abandoned.⁴⁸

In October 1998, Sergei Bogdanchikov, the former director of Sakhalinmorneftegas, was appointed the head of Rosneft.⁴⁹ In 2000, Vladimir Putin became president of Russia and Rosneft was poised to forward his goal of state control over the Russian energy sector.⁵⁰ Under Bogdanchikov and with the backing of the new Russian government under President Putin, Rosneft consolidated its assets.⁵¹ Rosneft acquired more than seventy-five percent of the shares in its remaining assets, but used tiered pricing structures, completely devaluing the remaining shares and paying a portion of the previous market value for the remaining shares.⁵² These consolidations failed to protect minority shareholders, who found themselves exploited by the state NOC.

Shortly after these consolidations Rosneft targeted private Russian IOC, Yukos, for acquisition.⁵³ At the turn of the 21st

wp-content/uploads/2012/01/WPM_44.pdf.

45. LORD OF THE RIGS, *supra* note 34, at 18–19.

46. *Id.* at 19–20.

47. *Id.* at 20.

48. *Id.*

49. *Id.* at 22.

50. *Id.* at 23.

51. LORD OF THE RIGS, *supra* note 34, at 25–26 (“In March 2000, Rosneft got permission from the RF Anti-Monopoly Ministry to increase its stake in subsidiaries to 75% and began to buy their shares through affiliated companies. This process was accompanied by many scandals in the best Russian traditions . . . The state company selected assets itself, priced them itself using unclear methodology and took them away”).

52. *See id.* at 26–29.

53. *See* Arkady Ostrovsky, *Putin Defends Rosneft Purchase of Yukos Unit*, FIN. TIMES (Dec. 22, 2004), <http://www.ft.com/intl/cms/s/0/73657840-5462-11d9-a749-00000e2511c8.html#axzz2PVViCWJ4> (describing the acquisition of Yukos as “part of a plan to turn the company into a ‘balanced, national energy corporation”).

century Yukos was quickly becoming the largest Russian oil company and one of the largest private IOCs in the world.⁵⁴ It produced 589.11 million barrels of oil equivalent (BOE) in 2003 and had just struck large deals to export to both China and the United States.⁵⁵ Yukos started its first shipment to Texas in July of 2002 and was planning to export up to 255.5 million BOE a year to the United States.⁵⁶ By May 2003, Yukos entered into a long-term contract with the China National Petroleum Corporation (CNPC) to export 146 million BOE of East Siberian crude per year through 2010, at which time the export amount would increase to 219 million BOE per year.⁵⁷

The CEO of Yukos, Mikhail Khodorkovsky, challenged Putin and his party, United Russia, by donating to opposing political parties and taking positions opposed to Putin's.⁵⁸ In 2003, Khodorkovsky was arrested, and his company was accused of crimes including tax evasion by the Russian government.⁵⁹ Yukos was assessed more taxes than its total income for certain years; and most of its assets, including its largest, Yuganskneftegaz, were sold off to satisfy its "tax deficiency" at a fraction of their value to Baikalfinansgroup, which quickly merged with state-owned Rosneft.⁶⁰ The redistribution of Yukos' assets is seen by international observers to have marked the

54. Mike Olsen, *Russia: Contractually Solving the Hold-up Problem for International Oil Companies*, ASS'N OF INT'L PETROLEUM NEGOTIATORS, <https://www.aipn.org/userfiles/file/Student%20Writing%20Papers/Mike%20Olsen%20final.pdf> (last visited Apr. 20, 2013) ("Yukos was the largest Russian private oil company by reserves and market capitalization in 2003.").

55. See *Global Expansion*, *supra* note 18, at 110 (noting Yukos' 80.7 million ton production). One ton of oil is equivalent to 7.3 BOE. Rod Walton, *Energy Industry Glossary*, TULSA WORLD (Mar. 2, 2012), http://www.tulsaworld.com/news/article.aspx?articleid=20120302_222_0_TheEne528922.

56. *Global Expansion*, *supra* note 18, at 110 (citing a planned export of thirty-five million tons of oil).

57. *Id.* (starting at twenty million tons and then increasing to thirty million tons).

58. Jason M. Waltrip, *The Russian Oil and Gas Industry After Yukos: Outlook for Foreign Investment*, 17 *TRANSNAT'L L. & CONTEMP. PROBS.* 575, 582 (2008).

59. *Id.* at 582–83.

60. Brenden Marino Carbonell, *Cornering the Kremlin: Defending Yukos and TNK-BP from Strategic Expropriation by the Russian State*, 12 *U. PA. J. BUS. L.* 257, 267 (2009). Chinese banks lent Rosneft six billion dollars for the acquisition of Yuganskneftegaz. *Global Expansion*, *supra* note 18, at 111.

beginning of Russian re-nationalization of the oil industry.⁶¹

The nationalization of Yukos' assets by Rosneft allowed Rosneft to step into the shoes of Yukos in its relations with China. Rosneft and CNPC signed an agreement during an official visit by Putin to build a refinery capable of handling seventy-three million BOE per year and 300 to 400 fuel stations in China.⁶²

In 2004, Igor Sechin, seen as "the second most powerful person in Russia" was appointed the Chairman of Rosneft's Board of Directors.⁶³ Sechin's appointment to the Board did not give Rosneft the appearance of separation between itself and the Russian state because of Sechin's close relationship with Putin.⁶⁴ However, when Rosneft was preparing to hold its Initial Public Offering in 2006, it nominated independent directors to the Board of Directors for the first time in its history.⁶⁵ In an effort to increase its attractiveness for investors, Rosneft increased its transparency and identified key risks for investors—some of which remain risks today.

They were connected with Yuganskftegas acquisition: huge debts and consolidation threats (lawsuits of minority shareholders who are unhappy with share swap ratios). Interestingly, it also named the actions of the RF government which created a difficult business climate in Russia and could have affected the oil and gas companies in Russia "through informal channels". In addition, the interests of the RF government as the key shareholder may not have coincided with the interests of other shareholders.⁶⁶

Since the acquisition of Yukos, Rosneft has seen significant

61. See *Global Expansion*, *supra* note 18, at 110 ("[O]ne of the reasons given by the Russian government for expanding the state's role in the economy is that Russia needs mega-companies capable of competing internationally as national champions; Rosneft and Gazprom perfectly fit this category.").

62. *Id.* at 111.

63. *LORD OF THE RIGS*, *supra* note 34, at 60.

64. See *A Look at Igor Sechin, Putin's Man Behind the Rise of Rosneft to Heights of Oil Industry*, FOXNEWS (Oct. 22, 2012), <http://www.foxnews.com/world/2012/10/22/look-at-igor-sechin-putin-man-behind-rise-rosneft-to-heights-oil-industry/>.

65. *LORD OF THE RIGS*, *supra* note 34, at 72–73.

66. *Id.* at 74.

growth. It will nearly double its daily production of barrels of oil through its acquisition of TNK-BP.⁶⁷ Sechin stepped down as the Chairman of the Board to give the board a greater appearance of separation between the Russian state and the NOC.⁶⁸ Rosneft more than tripled its daily production in barrels of oil from 2004 to 2005 and became the largest oil producer in Russia in 2007⁶⁹—a position it maintains today.⁷⁰ In 2012, Russian oil production reached a high of 10.375 million barrels per day from a peak of 11.4 million barrels per day in 1987, just prior to the collapse of Soviet era production.⁷¹

B. Gazprom

Just like at Rosneft, the head of Gazprom is seen as a political appointment. Alexei Miller, the current CEO (since 2001), Deputy Chairman of the Board of Directors (since 2005) and Dimitri Medvedev, Chairman of Gazprom's Board of Directors (since 2000) are both seen as some of Putin's most trusted lieutenants.⁷² Unlike Rosneft, Gazprom's problems haven't stemmed from domestic political opposition; rather, the challenges facing Gazprom have come from its status as an extension of Russia's foreign policy and market maker in Europe.

Upon the collapse of the Soviet Union, energy suppliers suffered from nonpayment by Russian customers, and it was vital to Gazprom's survival to find customers outside of Russia.⁷³ The shipments to Western European customers helped Gazprom

67. Lukas Alpert, *Energy Markets: Russia Pumped Most Oil in 2012 Since Soviet Era*, ENERGYWIRE (Jan. 4, 2013), available at <http://www.eenews.net/energywire/2013/01/04/7>.

68. See *Deputy PM Sechin Steps Down as Rosneft Chairman*, REUTERS (Apr. 11, 2011), <http://www.reuters.com/article/2011/04/11/russia-rosneft-sechin-idUSLDE73A28K20110411> (detailing the process of forcing state employees such as Sechin to leave the boards of companies).

69. HENDERSON, *supra* note 44, at 8.

70. *Id.*

71. Alpert, *supra* note 67.

72. *Alexey Miller Biography*, GAZPROM, <http://www.gazprom.com/about/management/board/miller/> (last visited Jan. 30, 2013); *Profile: Dmitry Medvedev*, BBC NEWS (May 7, 2008), <http://news.bbc.co.uk/2/hi/europe/7136556.stm>; Max, *supra* note 17.

73. *Global Expansion*, *supra* note 18, at 105–06.

subsidize gas deliveries to the new Russia and former Soviet Republics to maintain political influence in those countries.⁷⁴ To get into Europe, Gazprom first formed a joint venture (JV), Wingas, with BASF's subsidiary Wintershall, which owned about 2,000 kilometers of pipelines and a large underground storage facility for gas, which it supplied to Germany.⁷⁵ By the mid-1990s, Gazprom had formed JVs with companies in France, Italy, and Finland;⁷⁶ by 1995, it supplied twenty-one percent of the Western European market and fifty-five percent of the Eastern European market without disruption;⁷⁷ “[a]nalysts admitted, therefore, that ‘Gazprom always behaved as a responsible member of the European gas club.’”⁷⁸

While Gazprom did not show an interest in the upstream business in the Caspian region, its pipelines were essential to the central Asian economies. “Gas industries in landlocked Kazakhstan and Turkmenistan (the latter being the largest gas producer in Central Asia) were tied to Gazprom’s pipeline network, meaning that their economies depended on Russia, who could potentially bar them from European markets.”⁷⁹ All of this activity appeared to some observers to be an attempt by Gazprom to gain as much control over gas prices in Europe as possible.⁸⁰ In 2004, Gazprom retaliated against the Belarusian government for refusing to give Gazprom its pipeline infrastructure at book value in exchange for cheap gas.⁸¹ On January 1, 2004, Gazprom shut off gas deliveries to Belarus—for which it was a monopoly supplier—showing a willingness to be aggressive with foreign clients.⁸²

74. *See id.* (“Shipments to solvent European consumers permitted Gazprom to subsidize its loss-making gas deliveries within Russia and to the former soviet republics, the latter for political reasons.”).

75. *Id.* at 106–07.

76. *Id.* at 107.

77. *Id.*

78. *Id.*

79. *Global Expansion*, *supra* note 18, at 107.

80. *See id.* at 116–18 (describing Gazprom’s control activities, such as switching off gas supplies to unwilling customers and offering discounts to loyal countries).

81. *Id.* at 117.

82. *Id.*

On December 31, 2006, with the threat of again shutting off supply, Gazprom and Belarus entered into a five-year gas supply contract and Gazprom purchased fifty percent of the Belarusian pipeline company, Beltransgaz, for market value and Belarus received the lowest gas prices of all the former Soviet states.⁸³

During the same period, Gazprom raised gas prices in Armenia from sixty-five to seventy dollars in 2005,⁸⁴ to \$110 in 2006;⁸⁵ and Georgia, who did not cede control of its energy infrastructure to Gazprom, saw gas prices increase from sixty dollars in 2005⁸⁶ to \$110 in 2006, and \$235 by October 2006.⁸⁷ Possibly the biggest threat to Gazprom as a supplier of gas to Europe was its public dispute with Ukraine, during which it shut off supplies to Ukraine in 2006 and again in 2009—interrupting deliveries to Ukraine and other European countries for whom Ukraine was a supplier has caused Europeans to look elsewhere in hopes of replacing Russian gas.⁸⁸ Eighteen European states other than Ukraine were adversely affected because of their large dependence on Russian gas.⁸⁹

Gazprom has shown more interest in expanding its export pipeline construction than its reserves in recent years.⁹⁰ Much of its interest in pipelines stems from Russia's geopolitical aspirations. Gazprom built the Nord Stream pipeline⁹¹ as a

83. *Id.*

84. *Id.*

85. *Global Expansion*, *supra* note 18, at 117. All gas price references are per trillion cubic feet.

86. *Id.*

87. *Id.* This price of \$235 tcm was termed the “political price” Gazprom was imposing on Georgia. Diana Petriashvili, *Gazprom Makes the Georgian Government Pay*, EURASIANET (Jan. 8, 2007), <http://www.eurasianet.org/departments/insight/articles/eav010907.shtml>.

88. Max, *supra* note 17.

89. Aleksei Tarasov, *The Making of Empires: Russia's Gas-Exporting Pipelines v Nabucco*, 4 J. WORLD ENERGY L. & BUS. 77, 78 (2011) (listing all of the other eighteen European States that were affected and the ways those States were affected).

90. *Global Expansion*, *supra* note 18, at 114.

91. Tarasov, *supra* note 89, at 77. Ownership in 2005 consisted of the Russian Gazprom (fifty-one percent) and two German companies, Wintershall (24.5%) and E.ON (24.5%). *Id.* In 2008, a Dutch company Gasunie bought 4.5% from both the German companies; and in an agreement between France's GDF Suez and Gazprom on

commercial project to seemingly reduce its dependence on Ukraine as a transit country—because Ukraine often siphoned gas from transit pipelines for its own use and sale.⁹² But in 2005, former German Chancellor Gerhard Schroeder was made Shareholders' Committee Chairman and an alleged former friend who served in East Germany with Putin, Board Chairman of Dresdner Bank Matthias Warnig, became its managing director, giving it the appearance of a political project rather than a commercial project.⁹³

The South Stream pipeline was to be built after the Nord Stream, and in 2008, Russia scored a coup when it struck agreements with four countries—Bulgaria, Serbia, Hungary, and Greece—through which the pipeline would pass.⁹⁴ However, it has had to contend with a competing Nabucco pipeline in southern Europe that could help make Europe more independent of Russian gas.⁹⁵ In 2010 Putin had intervened, signing an agreement with Turkey forbidding the Nabucco pipeline to pass through Turkish territorial waters in exchange for supporting another pipeline to be built within Turkey.⁹⁶ By the end of 2012, the Nabucco pipeline was officially killed and

March 2, 2010, GDF acquired a nine percent interest. *Id.*

92. Maxim Tkachenko, *Russia Launches Major New Gas Pipeline to Europe, Bypasses Ukraine*, CNN (Sept. 7, 2011), <http://edition.cnn.com/2011/WORLD/europe/09/06/russia.new.pipeline/index.html?iref=allsearch>.

93. *Global Expansion*, *supra* note 18, at 115 (noting Gazprom's explanation that "Nord Stream is a politically important project for us, and it is essential that people with authority and weight in global community head it").

94. Press Release, South Stream, Gazprom and Bulgarian Energy Holding Sign Agreement on FS for Bulgarian Section of South Stream (Oct. 22, 2010), <http://www.south-stream.info/en/press/news/news-item/gazprom-i-bolgarskii-ehnergeticheskii-kholding-podpis-1/>; Press Release, South Stream, Gazprom and Srbijagas Sign Basic Cooperation Agreement in the framework of South Stream Project Implementation (May 15, 2009), <http://www.south-stream.info/en/press/news/news-item/gazprom-i-serbijagaz-podpisali-bazovoe-soglashenie/>; Press Release, South Stream, Gazprom and MFB Sign Cooperation Agreement Within South Stream Project (Mar. 10, 2009), <http://www.south-stream.info/en/press/news/news-item/gazprom--i-mfb-podposali-soglashenie-o-sotrudnichestve-v/>; Press Release, South Stream, Gazprom and DESFA Sign Basic Cooperation Agreement in the Framework of South Stream Project Implementation (May 15, 2009), <http://www.south-stream.info/en/press/news/news-item/gazprom-i-desfa-podpisali-bazovoe-soglashenie-o-sotrudn/>.

95. *Global Expansion*, *supra* note 18, at 116.

96. *Id.*

the South Stream was set to start construction on December 7, 2012.⁹⁷

While acquiring control of supply routes to Europe in an attempt to be a market maker, Gazprom has concurrently sought to prevent supply from other nations, or at least act as the middleman between Europe and outside producing nations.⁹⁸ Further, its goal to expand internationally for production has been mostly limited to other nations with significant political instability. Examples of this include working with PDVSA—the Venezuelan NOC—in South America,⁹⁹ seeking since 2006 to expand into Libya,¹⁰⁰ announcing its intent to produce gas in Nigeria in 2008,¹⁰¹ participating in operations in Iran since 1997,¹⁰² and it actively sought to prevent Iranian gas from being supplied to the Nabucco pipeline.¹⁰³

When faced with significant opposition from Western European countries over Russian control of their gas markets, Russia used to be able to viably threaten to send its gas to China and the United States, but that dynamic has changed. While Russia sought to prevent Turkmen gas from heading to Europe, Turkmen gas was diverted to China and has overtaken Russian control of the Chinese market.¹⁰⁴ Further, shale gas production has not only eliminated the United States as a viable consumer of potential Liquefied Natural Gas (LNG) from Russia, it has caused Russia to face significant competition in the European market.¹⁰⁵ With increased international competition, Russia may need to reconsider the gas export monopoly granted to

97. Matthew Hulbert, *Gazprom Tightens Control Over European Supply*, FORBES (Nov. 26, 2012, 2:51 PM), <http://www.forbes.com/sites/matthewhulbert/2012/11/26/gazprom-takes-southern-corridor-spoils/>.

98. See, e.g., *Global Expansion*, *supra* note 18, at 118 (noting Gazprom's prior dependence on Central Asian gas and the various agreements it will accept to prevent alternative gas routes like those that had been contemplated by Turkmenistan and the United States).

99. *Id.* at 108.

100. *Id.* at 119.

101. *Id.*

102. *Id.*

103. *Id.*

104. *Global Expansion*, *supra* note 18, at 120.

105. Max, *supra* note 17.

Gazprom if it wants to increase Russian competition on the international market or alter its strategy for striking a political and commercial balance.¹⁰⁶

III. LESSONS FROM LUKOIL AND STATOIL

Both Gazprom and Rosneft can learn from the stories of LUKOIL, a private Russian IOC and Statoil, the Norwegian NOC. LUKOIL offers an insight into how a private Russian IOC can succeed internationally and Statoil offers lessons as to how a NOC forced to compete on the global market can compete and remain a NOC.

A. LUKOIL

After the collapse of the Soviet Union, LUKOIL was the first Russian oil and gas company to enter the post-Iron Curtain economies of Europe.¹⁰⁷

Though its CEO, Vagit Alekperov, preferred to position LUKOIL as a Western-style corporation driven by commercial rather than political goals, the company often acted as petroleum ambassador of Russia and to a certain extent it even determined Russia's policy toward the Caspian region. Alekperov's close ties with Victor Chernomyrdin, Russia's prime minister for most of the 1990s, helped LUKOIL's advances abroad.¹⁰⁸

At the time, LUKOIL faced the problem of insolvent customers in Russia, and needed to both reduce its production costs and find solvent customers.¹⁰⁹ The immediate answer was for LUKOIL to expand into the Caspian region where drilling costs were lower, daily output was higher, and it could control

106. Federal'nyi Zakon RF Rossiskoe federacii po eksportu gasza [Federal Law of the Russian Federation on Gas Exports], ROSSIISKAI GAZETA [ROS. GAZ.] July 18, 2006, No. 117-FZ (Russian law granting Gazprom exclusive right to export natural gas from Russia); Ryan Chilcote et al., *Russia's Medvedev Says Gazprom May Lose Gas-Export Monopoly*, BLOOMBERG (Jan. 23, 2013), <http://www.bloomberg.com/news/2013-01-23/russia-s-medvedev-says-gazprom-may-lose-its-gas-export-monopoly.html> (evaluating Russia's potential losses if the natural gas monopoly remains).

107. *Global Expansion*, *supra* note 18, at 104.

108. *Id.* at 104–05.

109. *Id.* at 105.

export routes from the landlocked region.¹¹⁰

LUKOIL's international expansion strategy has mostly been through former Soviet Union states. Its first upstream investment was in Azerbaijan in 1994,¹¹¹ followed by the purchase of downstream business in Romania, Bulgaria, Ukraine, and the USA.¹¹² It has since expanded further in the Caspian largely through asset purchases and individual partnerships and JVs with partners in each country.¹¹³ LUKOIL and ARCO created a JV, LUKARCO, in 1995, at which time ARCO also acquired a 7.99% equity interest in LUKOIL.¹¹⁴ The JV started with a pipeline and some upstream assets in the Caspian region and was intended to seek and purchase additional assets with contributions by both LUKOIL and ARCO.¹¹⁵ However, ARCO was sold to BP, the equity interest in LUKOIL was sold in 2001, and LUKARCO was eventually dissolved in 2009 without ever having acquired any additional assets.¹¹⁶

After the demise of LUKARCO, LUKOIL sought a relationship with ConocoPhillips in 2004. ConocoPhillips purchased a thirty percent interest in Naryanmarneftegas JV in 2005, a JV with LUKOIL, with upstream projects in Timan Pechora oil and gas province and a twenty percent equity interest in LUKOIL in 2007.¹¹⁷ The relationship was short-lived, however, and in 2010 in an apparent attempt to streamline itself, ConocoPhillips decided to sell the twenty percent equity interest in LUKOIL.¹¹⁸ In 2012, LUKOIL bought ConocoPhillips's thirty percent interest in NaryanmarNeftegas

110. *Id.*

111. *Id.* at 106.

112. HENDERSON, *supra* note 44, at 43.

113. *Id.*

114. *Id.* at 43–44.

115. *Id.*

116. *Id.* at 44.

117. *Id.*

118. Edward Klump, *ConocoPhillips to Sell Lukoil Stake After Posting Profit Gain*, BLOOMBERG (July 28, 2010, 3:06 PM), <http://www.bloomberg.com/news/2010-07-28/conoco-sells-7-6-lukoil-stake-back-to-russian-explorer-for-3-44-billion.html>.

JV.¹¹⁹

LUKOIL lost its status in the 2000s as the flagship Russian oil company to Rosneft, but LUKOIL has been successful in expanding internationally. In the late 2000s, LUKOIL possessed interests in Colombia, Venezuela, Côte d'Ivoire, Ghana, Egypt, Saudi Arabia, Kazakhstan, Uzbekistan, and Azerbaijan;¹²⁰ and it has an eighty-five percent interest in the Iraqi West Kurna-2, where it has a consortium with Statoil, which controls the remaining fifteen percent.¹²¹

B. Statoil

Norway has successfully avoided the resource curse (known as the “Dutch Disease”)¹²² while also creating a successful NOC in Statoil. Since going public in 2001, Statoil’s stock has climbed roughly 22.3% a year.¹²³ During the same period, ExxonMobil’s has climbed an average of 11.4% per year.¹²⁴

The Norwegian Continental Shelf (NCS) acted as the impetus for the creation of Statoil.¹²⁵ A year after the first application to explore the NCS in 1962, the Norwegian government declared national sovereignty and ownership over the NCS.¹²⁶ The regulatory framework and a settlement of the border between UK, Denmark, and Norway occurred in 1965,

119. OGJ Editors, *Lukoil Buys Out ConocoPhillips Share of Russian Venture*, OIL & GAS J. (Aug. 22, 2012), <http://www.ogj.com/articles/2012/08/lukoil-buys-out-conocophillips-share-of-russian-venture.html>.

120. *Global Expansion*, *supra* note 18, at 108.

121. *Id.*

122. RICHARD GORDON & THOMAS STENVOLL, JAMES A. BAKER III INST. FOR PUB. POL’Y RICE UNIV., *STATOIL: A STUDY IN POLITICAL ENTREPRENEURSHIP* 3 (2007). “Dutch Disease, which afflicted the Netherlands in the 1970s, refers to how a sudden and large investment in a country’s resources sector can adversely affect other sectors of that country’s economy, causing poverty, unemployment, high inflation, unfavorable exchange rates, and the squandering of resources revenues by the government.” ERNEST E. SMITH ET AL., *INTERNATIONAL PETROLEUM TRANSACTIONS* 266 (3d ed. 2010).

123. Gretchen Morgenson, *Enriching a Few at the Expense of Many*, N.Y. TIMES (Apr. 9, 2011), http://www.nytimes.com/2011/04/10/business/10gret.html?pagewanted=all&_r=0.

124. *Id.*

125. GORDON & STENVOLL, *supra* note 122, at 19.

126. *Id.*

and a year later exploration for oil and gas began.¹²⁷ In the initial licensing rounds the Norwegian government did not restrict licensing, and IOCs dominated the bid rounds.¹²⁸ The initial investment by IOCs limited the reconnaissance investment required by Norway and Norwegian oil and gas companies.¹²⁹ The Cod gas field was discovered in 1968 and Ekofisk in 1969, which immediately sparked interest in the NCS.¹³⁰ In the second bid round “[s]teps were taken to introduce a *carried interest* or direct participation by the Norwegian state in the fields to be explored.”¹³¹

The carried interest element of the licenses in Norway was significant. The carried interest would vary on a sliding scale between fifty and eighty percent.¹³² The Norwegian government, in debating whom to appoint trustee of the government interest, had to decide whether to promote a new large private company, promote the growth of the existing Norwegian private company Norsk Hydro, or create a state owned company.¹³³ Norway eventually chose the latter largely due to the fear that a private company would be in control of the nation’s resources and its interests would primarily promote international capital.¹³⁴ In the summer of 1971, Norway created the “ten oil commandments,” one of which was the creation of the national oil company (NOC), Statoil.¹³⁵ Additionally, the oil

127. *Id.* at 20.

128. *Id.*

129. *Id.*

130. *Id.*

131. GORDON & STENVOLL, *supra* note 122, at 20.

132. HENDERSON, *supra* note 44, at 35.

133. GORDON & STENVOLL, *supra* note 122, at 21.

134. *Id.*

135. *Id.* at 22. The oil commandments were as follows:

1. that national supervision and control must be ensured for all operations in the Norwegian Continental Shelf;
2. that petroleum discoveries are exploited in a way that makes Norway as independent as possible of others for its supplies of crude oil;
3. that new industry is developed on the basis of petroleum;
4. that the development of an oil industry must take necessary account of existing industrial activities and the protection of nature and the environment;
5. that flaring of exploitable gas on the Norwegian Continental Shelf must not be accepted, except during brief periods of testing;
6. that petroleum from the Norwegian Continental Shelf must as a main rule be

commandments served as the basis for creating Norwegian Petroleum Directory (NPD) to regulate the Norwegian oil and gas sector.¹³⁶ The separation between Statoil and NPD was important to separate the commercial interests and the regulatory interests of the state.¹³⁷ Statoil was founded with the functions of managing Norway's participation interests in the oil and gas licenses and pipelines, and to "serve as a conduit for technology transfer and economic development."¹³⁸

Participation occurs on a carried interest basis. On reaching a specified production level, the licensee will assign an agreed-on percentage of its rights and duties to Statoil, the national oil company, which will obtain a carried working interest. That is, the state will obtain a share of exploration and development costs, provided the 50 per cent of such costs may be recouped by the oil company's share of production. Norwegian oil companies are, however, excluded from carrying Statoil's share during exploration.¹³⁹

Statoil benefited by not bearing any of the exploration risks

landed in Norway, except in those cases where socio-political considerations dictate a different solution; 7. that the State becomes involved at all appropriate levels, and contributes to a coordination of Norwegian interests in Norway's petroleum industry as well as the creation of an integrated Norwegian oil community which sets its sights both nationally and internationally; 8. *that a State oil company be established which can look after the government's commercial interests and pursue appropriate collaboration with domestic and foreign oil interests*; 9. that a pattern of activities is selected north of the 62nd parallel which reflects the special socio-political conditions prevailing in that part of the country; and 10. that large Norwegian petroleum discoveries could present new tasks for Norway's foreign policy.

Tina Hunter, *Sustainable Socio-Economic Extraction of Australian Offshore Petroleum Resources Through Legal Regulation: Is It Possible?*, 29 J. ENERGY & NAT. RESOURCES L. 209, 225 n.109 (2011) (emphasis added).

136. GORDON & STENVOLL, *supra* note 122, at 22.

137. *See id.* (explaining an important feature of the system in Statoil which ultimately promoted the privatization of Statoil). The politicians in Norway were forbidden from sitting on the board of Statoil to ensure this separation between regulation and commercial activity. HENDERSON, *supra* note 44, at 35.

138. GORDON & STENVOLL, *supra* note 122, at 23.

139. SMITH ET AL., *supra* note 122, at 462 (quoting Peter Cameron, *North Sea Oil Licensing: Comparisons and Contrasts*, 4 OIL & GAS L. & TAX. REV. 99–106 (1984–1985)).

because its participation interest would not vest until after the well was discovered.¹⁴⁰

Statoil first became an operator of the Gullfaks field in 1981, at which point its CEO, Arne Johnsen, increased the investments of the company.¹⁴¹ Statoil became an integrated company in the 1980s with the purchase of ExxonMobil's Esso distribution network in Sweden and Denmark.¹⁴² Statoil's increased activity allowed it to promote the Norwegian economy by utilizing the domestic "oil service, engineering, and contract construction" industries.¹⁴³ The accelerated growth of Statoil and the benefit provided to the domestic economy vastly enhanced Statoil's political power. Accompanying the increase in political power was increased political scrutiny and complaints that Norway was an unattractive place to invest because of Statoil's growing dominance.¹⁴⁴

In 1985, to reduce Statoil's political power and make the country a more attractive investment, the state created the State's Direct Financial Interest (SDFI) to control the state's fifty percent participation interest.¹⁴⁵ Statoil still managed the interest but it was only granted ownership of twelve percent of the state's participation interest, it was no longer permitted to book the remaining thirty-eight percent state interest in the reserves.¹⁴⁶ While this harmed the value of Statoil, the creation of SDFI clearly distinguished between the state's pro-active investments in Statoil and passive investments in SDFI.¹⁴⁷ Another blow to Statoil was an unsuccessful plank of Arne Johnsen's attempt at vertical integration. Statoil purchased and

140. GORDON & STENVOLL, *supra* note 122, at 23.

141. This was also partly because all unspent net profits were transferred to the Norwegian treasury. *See id.* at 24.

142. *Id.* at 24–25.

143. The state also put requirements in licenses that domestic firms must be used in development and production. *Id.* at 25.

144. *Id.* at 27 (quoting Einar Stensnæs) ("In general, there were concerns that Statoil would become too strong within the Norwegian economy and also politically. There was thus a wish to reduce Statoil's power and size."); HENDERSON, *supra* note 44, at 35.

145. HENDERSON, *supra* note 44, at 35–36.

146. GORDON & STENVOLL, *supra* note 122, at 27–28.

147. *Id.* at 28.

sought to expand the Mongstad oil refinery.¹⁴⁸ Project cost overruns were nearly sixty percent higher than initial estimates and the CEO Arne Johnsen was forced to resign.¹⁴⁹

The new CEO, Harald Norvik,¹⁵⁰ assumed leadership with fewer reserves, less available oil on the NCS, and increased political pressure. With this reality he sought to diversify the company's portfolio at home by intensifying its interests in natural gas and expanding operations internationally. As a NOC, Statoil was an attractive ally for BP. Their partnership had several benefits: Statoil achieved vertical integration with new downstream and upstream projects¹⁵¹ and the start-up costs, including human resource demands, were reduced for Statoil with a well-established IOC as a partner.¹⁵² The alliance was also beneficial for BP because strategic relationships with NOCs are known to assist in earning access to a country's resources, which in this case was the Troll gas field.¹⁵³ Statoil added Kazakhstan, Vietnam, China, Nigeria, Azerbaijan, and Angola as a result of the BP alliance.¹⁵⁴ Statoil remains involved in all of those countries except Vietnam.¹⁵⁵ Vertical integration and international expansion were important advances made by Statoil under Norvik, however, with slumping oil prices in the late 1990s, an ambitious domestic project in Aasgard field ran \$2.6 billion over original budget estimates by completion.¹⁵⁶ Because Statoil was still 100% state owned at the time, criticism

148. *Id.*

149. *Id.* at 29.

150. *Id.*

151. *Id.* at 30 (noting several international projects conducted with BP).

152. GORDON & STENVOLL, *supra* note 122, at 30.

153. See JORGE LEIS ET AL., *supra* note 2, at 1, 10 (noting the dramatic reversal of power from IOCs to NOCs and the need of IOCs to work with NOCs and national governments, keeping their relevance by helping on complex projects and pursuing "partner of choice strategies to secure production-sharing contracts"); see also Olsen, *supra* note 54, at 1–2 (highlighting the "holdout problem" for IOCs given the large investment required and unequal power held in sovereign because of that IOCs large, project specific investment).

154. HENDERSON, *supra* note 44, at 36 n.31.

155. *Statoil Worldwide*, STATOIL, <http://www.statoil.com/en/About/Worldwide/Pages/default.aspx> (last visited Jan. 9, 2012).

156. GORDON & STENVOLL, *supra* note 122, at 32.

by the then-oil minister resulted in the resignation of Norvik as CEO.¹⁵⁷ Halfway out the door in 1999, Mr. Norvik took the opportunity to advocate for consideration of privatization.¹⁵⁸

With an increased international presence¹⁵⁹ and the subsequent need to compete better internationally, Statoil management saw privatization as a way to increase competitiveness.¹⁶⁰ In 2000 it was determined Statoil would be privatized and acquire fifteen percent of SFDIs participating interest, it would lose the ownership and the ability to control prices in the pipeline infrastructure which was to be opened for all to use equally.¹⁶¹ Subsequently Statoil was listed on the New York Stock Exchange (NYSE) and the Oslo Stock Exchange.¹⁶² This imposed additional governance and transparency requirements on Statoil, increasing its attractiveness to investors.¹⁶³ Since being listed on the NYSE, Statoil has been forced to respond to a maturing hydrocarbon industry in Norway, merging with Norsk Hydro in 2007 in a “merger” characterized by Statoil CEO Helge Lund “driven very much by

157. *Id.*

158. *Id.* at 32–33.

159. Silvano Tordo et al., *National Oil Companies and Value Creation* 117 (World Bank, Working Paper No. 218, 2011).

160. GORDON & STENVOLL, *supra* note 122, at 33. A study released by the Baker Institute in its 2007 *The Changing Role of National Oil Companies in International Energy Markets* conference examines the effect of political influence on NOCs and concludes, “an increase in the political discount premium encourages greater employment, increased output and a higher cash flow in the short run, but ultimately result in lower employment output and cash flows in the long run.” PETER HARTLEY & KENNETH B. MEDLOCK III, JAMES A. BAKER III INST. FOR PUB. POL’Y RICE UNIV., A MODEL OF THE OPERATION AND DEVELOPMENT OF A NATIONAL OIL COMPANY 51 (2007); *see also* STACY L. ELLER ET AL., JAMES A. BAKER III INST. FOR PUB. POL’Y RICE UNIV., EMPIRICAL EVIDENCE ON THE OPERATIONAL EFFICIENCY OF NATIONAL OIL COMPANIES 33 (2007) (concluding that “the relative technical inefficiencies of various NOC’s, which are observed when one considers only commercial objectives, are largely the result of governments exercising control over the distribution of rents”).

161. GORDON & STENVOLL, *supra* note 122, at 34.

162. *Statoil Listed*, STATOIL (June 18, 2001), <http://www.statoil.com/en/NewsAndMedia/News/2001/Pages/StatoilListed.aspx>.

163. *Compliance With NYSE Listing Rules*, STATOIL, <http://www.statoil.com/en/about/corporategovernance/statementofcorporategovernance/pages/default.aspx> (last updated Mar. 22, 2010).

growth and growth initiatives.”¹⁶⁴ While driven by growth, the merger was also driven by resource constraints faced by the two companies:

- Rising barriers to entry into new investment opportunities,
- Limited availability of experienced human resources, and
- Scarcity of key physical, oil-related capital services, such as deep-water drilling rigs.¹⁶⁵

Statoil has since expanded around the world and diversified its risk to be less country-specific, but it has also faced the reality of not being given the preferential access to prospects as it was given in Norway.¹⁶⁶ Even with the increased international presence and lack of preferential access, the state has maintained majority control—currently 70.26%¹⁶⁷—and thus Statoil has reaped the benefits of increased transparency and stricter corporate governance requirements while also avoiding the influence of international capital.

There are several key lessons to be learned from Norway and Statoil’s experience: (a) the way in which it has evolved from a fledgling company, requiring preference by the state, to a NOC competitive on the international stage with other NOCs and IOCs;¹⁶⁸ (b) the way in which Norway avoided the “Dutch Disease,” which is regarded as inevitable for many exporting nations;¹⁶⁹ (c) when Statoil wanted to expand internationally it needed to improve its efficiency and reduce operating costs, and today it has a reputation for innovative techniques useful for

164. GORDON & STENVOLL, *supra* note 122, at 36.

165. *Id.* at 39.

166. *Id.* at 40.

167. This is including a sixty-seven percent stake held by the Norwegian State and a 3.26% stake held by the Norwegian National Insurance Fund. *Major Shareholders, STATOIL*, <http://www.statoil.com/annualreport2011/en/shareholderinformation/pages/majorshareholders.aspx> (last visited Jan. 9, 2013).

168. See GORDON & STENVOLL, *supra* note 122, at 1, 23 (noting that during its startup, it was clear that Norwegian government policy gave the firm a good starting foundation, and today, Statoil is an effective Norwegian producer and a leading international competitor).

169. See *id.* at 19, 48 (stating that multiple policies “were implemented to limit the potentially adverse effects of [Dutch Disease]”).

deep-water exploration and production;¹⁷⁰ (d) even though Statoil maintains independence from government control, it is still responsive to Norway's needs domestically and internationally;¹⁷¹ and finally, (e) it has become a key player in the global gas market as the second largest provider to Europe in 2010, and its production split almost equally between oil and gas.¹⁷²

IV. FUTURE

Russian NOCs Rosneft and Gazprom have a significant advantage, nearly all companies that want to expand into arctic exploration have to go through a Russian NOC.¹⁷³ The U.S. Geological Survey estimates the Arctic contains ninety billion barrels of oil, 1,699 trillion cubic feet of natural gas, and forty-four billion barrels of natural gas liquids, most of which lies within Russian territory in the arctic.¹⁷⁴ Further, Rosneft and Gazprom are two of only three companies "all state owned or state controlled, which are qualified to bid for licenses in the region."¹⁷⁵ On top of this the Russian politicians—Putin (President) and Medvedev (Prime Minister)—have an interest in improving the efficiency of its NOCs and the profitability of its domestic energy reserves.¹⁷⁶ While Moscow's oil funds helped it

170. HENDERSON, *supra* note 44, at 37–38 (noting that in expanding internationally, Statoil made investments in several countries in order to gain experience in developing new areas, and that its experience of operating challenging fields in Norway has given Statoil a reputation for technological advances, which makes it an attractive partner for companies in remote or challenging areas and deep-water regions).

171. *Id.* at 37.

172. *Id.* at 38 (noting Statoil has the LNG Snohvit project in the Arctic, shale gas operations in the United States, and major gas interests in Azerbaijan and Algeria).

173. See Guy Chazan, *Russia Moots Arctic Oil Licenses for West*, FIN. TIMES (Oct. 4, 2012), <http://www.ft.com/cms/s/0/19b4e2ae-0e18-11e2-8d92-00144feabdc0.html#axzz2IGaOvex7> (noting that Russia is now considering allowing western companies to own oil licenses in order to explore its Arctic waters).

174. CIRCUM-ARCTIC RESOURCE APPRAISAL: ESTIMATES OF UNDISCOVERED OIL AND GAS NORTH OF THE ARCTIC CIRCLE (USGS ed., 2008) [hereinafter U.S. Geological Survey], available at <http://pubs.usgs.gov/fs/2008/3049/fs2008-3049.pdf>.

175. HENDERSON, *supra* note 44, at 41.

176. See MICHAEL RATNER ET AL., CONG. RESEARCH SERV., R42405, EUROPE'S ENERGY SECURITY: OPTIONS AND CHALLENGES TO NATURAL GAS SUPPLY

to survive the 2008–2009 economic crisis, it is predicted that Russia will face fiscal and trade deficits by 2015.¹⁷⁷ Further, with Putin's commitment of \$320 billion in social spending and wage increases,¹⁷⁸ the government will need to find new sources of revenue, which includes increasing the profitability of Rosneft and Gazprom.

A. Share of Government Involvement

In a 2007 symposium on NOCs at Rice University, several studies were released on the effect of state ownership and influence over NOCs. One study found “if the government places weight on the benefits of a particular special interest, resource rents will tend to be redistributed toward that special interest. This alters the investment patterns of the NOC and results in an outcome that can be described as operationally inefficient.”¹⁷⁹ State objectives obfuscate the commercial objectives of NOCs and decrease their overall profitability,¹⁸⁰ and if Russia plans on reversing the coming twin deficits it will need to increase the operational efficiencies of Rosneft and Gazprom.

LUKOIL, as a private oil company, is one of the largest IOCs

DIVERSIFICATION 10 (2012) (explaining that top Russian leaders' economic success is “heavily dependent on the massive wealth generated by [Gazprom's] energy exports to Europe”); *Medvedev Confirms Course Towards Privatization of State Property*, ITAR-TASS NEWS AGENCY (Oct. 14, 2012), <http://itar-tass.com/en/c32/545528.html> (documenting Medvedev's comment that “privatization is a key factor of Russia's economic development”).

177. Matthew Hulbert, *A Weak Russia is a Dangerous Russia for BP*, FORBES (Oct. 22, 2012), <http://www.forbes.com/sites/matthewhulbert/2012/10/22/a-weak-russia-is-a-dangerous-russia-for-bp/> (“[I]f the numbers are right, Russia is heading towards a twin deficit economy, where the government budget and external trade balance are negative. The heart of the forecast sees Russia's current account balance shrinking from \$79.9bn in 2012 to around \$25bn in 2013 and into outright \$8.8bn deficit in 2015, predicated on estimated oil prices of \$104/b at that stage.”).

178. *Id.*

179. ELLER ET AL., *supra* note 160, at 33. It should be noted while this applies for all firms in general, when the study was done in 2007, Russian firms tended to be ranked with low levels of technical efficiency regardless of government ownership.

180. *Id.* at 21 (“[G]overnment ownership reduces the ability of a firm to produce revenues for a given quantity of inputs[,]” which “is consistent with the notion that government objectives skew the objective of the NOC away from pure commercial motives.”).

in the world.¹⁸¹ On a list of the World's largest oil and gas companies based on annual production, LUKOIL is the 18th largest in the world.¹⁸² However, its founder, current President, and member of the Board of Directors Vagit Alekperov is a former Soviet deputy oil minister and consults regularly with Putin.¹⁸³ LUKOIL is a model of what it has taken to succeed in Russia, acute business and political acumen, while also being competitive on the international market. When looking at corporate governance reform, LUKOIL illuminates a path to remaining competitive and committed to commercial goals—increasing shareholder value—while also balancing state interests represented by the company.

A recent example of Russian noncommercial state interests harming its NOCs can be seen with the commissioning of the East Siberia-Pacific Ocean (ESPO) pipeline by Rosneft.¹⁸⁴ The pipeline will both expand Russia's footprint into the Asia-Pacific region for crude deliveries while at the same time showing Europe it has attractive export opportunities.¹⁸⁵ However, the project has been labeled a "geopolitical project" by Putin and as of 2010, "construction costs of the ESPO's first stage grew from \$6.6 [billion] to \$14.5 billion and Transneft's crude deliveries to China will be loss-making due to the pumping tariff established by the state."¹⁸⁶ This butts against Statoil's experience where each time it had a major project go over budget the CEO was replaced and the Norwegian government reconsidered its role in Statoil and sought to improve the efficiency of Statoil.¹⁸⁷

181. Christopher Helman, *The World's Biggest Oil Companies*, FORBES (July 16, 2012), <http://www.forbes.com/sites/christopherhelman/2012/07/16/the-worlds-25-biggest-oilcompanies/>.

182. *Id.*

183. *Id.*; *Board of Directors: Board of Directors elected at the Annual General Shareholders Meeting on June 27, 2012*, LUKOIL OIL CO., http://www.lukoil.com/back/staff_head_6_5dep_20_.html (last visited Apr. 4, 2013).

184. *Global Expansion*, *supra* note 18, at 111–12.

185. *Id.* at 112.

186. *Id.* at 111–12.

187. *See supra* note 141–158 and accompanying text; *see also* HENDERSON, *supra* note 44, at 35–36 (explaining how concerns about Statoil's growing management power and a scandal about cost over-runs at one of its refineries led to a change in strategy and a new CEO).

Perhaps the cost over-runs of the ESPO will serve as the impetus for reform of NOCs in Russia.

Russian NOCs—particularly Gazprom—have been suspected of politically cutting off gas when countries begin looking towards the West.¹⁸⁸ However, with the shale gas revolution in the United States, it is becoming untenable for Russia to keep control of the European market. In the first half of 2012, coal imports to Europe from the United States increased by 31.5% at two-thirds the cost of the year before.¹⁸⁹ This growth of coal use may be short lived,¹⁹⁰ but the impact of shale gas from the United States is already influencing the psyche of the global gas market towards a free market pricing system.¹⁹¹

The Russian government only has a 50.002% interest in Gazprom¹⁹² and a 69.5% equity interest in Rosneft.¹⁹³ While these would both appear to be similar to the sixty-seven percent equity interest the Norwegian state has in Statoil,¹⁹⁴ the dynamic between Statoil and the government is a zero tolerance policy in relation to political interference with strategic and

188. See Tarasov, *supra* note 89, at 77–78 (describing the Nord Stream project as a way for Gazprom to “cut-off ‘disloyal’ Western-looking neighbours”).

189. Max, *supra* note 17.

190. *Id.* The EU Emissions Trading System (ETS) is expected to increase prices in 2013, the majority of credits will be auctioned off rather than given out free of charge, making U.S. coal more expensive and likely decreasing its competitiveness in Europe. Nathanael Massey, *Coal Use Rises in Europe, but Carbon Pricing, Regulations Could Slow its Ascent*, CLIMATEWIRE (Nov. 8, 2012), <http://www.eenews.net/climatewire/2012/11/08/archive/3?terms=gazprom>.

191. Max, *supra* note 17. Further harming Gazprom’s position as a “market maker” is its small share of the global LNG market, “[d]espite sitting on 30% of global gas supplies, Russian LNG production accounts for less than 5% of global share. Moscow has become a fringe LNG player in a globalising gas world.” Hulbert, *supra* note 97.

192. *Shares*, GAZPROM, <http://www.gazprom.com/investors/stock/> (last visited Jan. 17, 2013).

193. *Shareholder Structure*, ROSNEFT, http://www.rosneft.com/Investors/structure/share_capital/ (last visited April 14, 2013). This is down from about a seventy-five percent interest at the start of 2013 due to a purchase by BP in relation to the BP-TNK acquisition by Rosneft. See Darya Korsunskaya, *Russia mulls 19 percent Rosneft stake sale in 2013: economy minister*, REUTERS (Apr. 11, 2013), <http://uk.reuters.com/article/2013/04/11/us-russia-rosneft-privatisation-idUKBRE93A0DH20130411>.

194. *Major Shareholders*, STATOIL, <http://www.statoil.com/annualreport2011/en/shareholderinformation/pages/majorshareholders.aspx> (last visited Feb. 2, 2013).

operational management decisions.¹⁹⁵ The Russian state has not, until recently, given even the allusion of separation between the state and its NOCs. Further, the Russian government has shown a willingness to abuse minority shareholders.¹⁹⁶

When Rosneft was privatized in 2006, only two of the nine directors of the Board of Directors were politically independent.¹⁹⁷ In 2011, after the insistence by President Dmitry Medvedev that government representatives no longer serve on the boards of companies they regulate, Igor Sechin stepped down as the Chairman of the Board of Directors.¹⁹⁸ In May 2012, after Putin's reelection, Sechin became CEO of Rosneft and is currently the only politician who sits on the Board of Directors of Rosneft, however, seven of the other eight members have close relationships with the Russian government.¹⁹⁹

Russia is taking steps to allow the further privatization of the company and is looking to decrease its ownership in Rosneft to about 50.5% in 2013.²⁰⁰ In its purchase of TNK-BPBP received 12.84% of Rosneft's shares with the option to purchase an additional 5.66%—which it exercised.²⁰¹ Decreasing the state's interest below seventy-five percent plus one removed the state's ability to unilaterally control strategic decisions of the company, but Russia has still managed to control Gazprom with only a 50.002% interest so drastic changes may not occur. An additional step Russia may consider for both Rosneft and Gazprom is placing the shares on one of the larger stock

195. HENDERSON, *supra* note 44, at 47.

196. *Id.* See Ksenia Galouchko et al, *Prosperity Urges TNK-BP Investors to Fight Rosneft's Cash Pull*, BLOOMBERG (Mar. 28, 2013), <http://www.businessweek.com/news/2013-03-28/prosperity-urges-tnk-bp-investors-to-fight-rosneft-s-cash-pull> (noting Rosneft's cash pulling in lieu of dividends from recently acquired TNK-BP has the decreased share value by twenty-six percent, significantly harming minority shareholders).

197. HENDERSON, *supra* note 44, at 48.

198. *Id.* at 49.

199. *Id.* (noting that "government influence remains high"); see also *Board of Directors*, ROSNEFT, <http://www.rosneft.com/Investors/governance/board/> (last visited Apr. 20, 2013)

200. Korsunskaya, *supra* note 193.

201. *Id.*

exchanges, which have strict corporate governance policies.²⁰²

The low amount of “free float” shares²⁰³ of Rosneft have decreased the number of potential investors because many investors are prohibited from investing in companies with too low of a “free float.”²⁰⁴ If the state were to decrease state ownership and increase the free float of Rosneft shares and possibly even list Rosneft and Gazprom on an international stock exchange this would help to increase the value of the shares, allow the raising of large amounts of funds through the issuing of stock,²⁰⁵ help separate the NOCs from the perceived political risk of Russian government control,²⁰⁶ and help the state raise revenue through the sale of part of its equity interest of the leading Russian oil (Rosneft) and gas (Gazprom) producers.

B. Global Expansion

Cheap and easy reserves seem to be coming to an end in Russia. As of 2010 “new greenfield projects will be implemented in Russia’s East Siberia, the Far East and in the Arctic in scarcely populated regions with no infrastructure and extremely difficult geological and climatic conditions.”²⁰⁷ This and the shrinking Russian budget²⁰⁸ and trade surplus²⁰⁹ leads to a

202. For example, the New York Stock Exchange or London Stock Exchange. Rosneft’s GDRs (Global Depository Receipts) are currently listed on the London Stock Exchange, but Rosneft is not forced to oblige to the strict corporate governance rules required by a full listing. See HENDERSON, *supra* note 44, at 51.

203. “The free float of a company is defined as the percentage of its shares that can be freely traded on an open market, and specifically would not include any shares held by the home government.” *Id.* at 51 n.52.

204. *Id.* at 50–51.

205. See *id.* (noting that Petrobas raised seventy billion dollars in the biggest share issue in global financial market history in 2010, ten years after its initial listing on the New York Stock Exchange).

206. See *id.* at 51–52 n.55 (noting that if a company has over fifty percent free float, and the state ownership is below fifty percent, the company may be listed as one of the 100 companies with the largest market capitalization—the FTSE 100—on the London Stock Exchange, which may interest a new range of investors).

207. *Global Expansion*, *supra* note 18, at 108.

208. See HENDERSON, *supra* note 44, at 49 (noting that there is a need to generate revenues for the Russian budget).

209. Hulbert, *supra* note 177.

need to go abroad in search of cheaper reserves, which can be complicated because the NOCs are viewed as implementing state policy.

In the 2012–2013 World Economic Forum Global Competitiveness Report, Russia ranks 67th on the Global Competitiveness Index.²¹⁰ The Index ranks countries based on twelve pillars,²¹¹ because of the low government debt and budget surplus Russia scored well in the market size (7th) and macroeconomic (22nd) factors, however its weak goods market efficiency (134th), financial market development (130th), public institutions (133rd), business sophistication (119th), and innovation (85th, down from 57th in 2010–2011) scores significantly harmed its global competitiveness.²¹²

The report directly links Russia's low score to weak competition caused by inefficient antimonopoly policies,²¹³ high restrictions on trade and foreign ownership²¹⁴—in the Russian oil industry ownership of a “strategic energy development project” must be under at least fifty percent Russian control²¹⁵—and lack of trust in the financial system.²¹⁶ Further, when business executives were asked to rank the five most

210. KLAUS SCHWAB, WORLD ECON. FORUM, THE GLOBAL COMPETITIVENESS REPORT 2012–2013 13 (2012) (ranking is out of 144 total countries).

211. The twelve pillars are: (a) Institutions, (b) Infrastructure, (c) Macroeconomic environment, (d) Health and primary education, (e) Higher education and training, (f) Goods market efficiency, (g) Labor market efficiency, (h) Financial market Development, (i) Technological readiness, (j) Market size Pillar, (k) Business sophistication, and (l) Innovation. *Id.* at 8.

212. *Id.* at 27–28.

213. *Id.*

214. *Id.*

215. “Strategic” is a term to be interpreted by the Russian government. *Id.* It is not *per se* required by law that a Russian owned firm be in control of at least fifty percent of any license in a “strategic” drilling operation. Natalya Morozova, *Russia Implements New Law Regarding Foreign Investment*, OIL & GAS FIN. J. (May 1, 2009), <http://www.ogfj.com/articles/print/volume-6/issue-5/capital-perspectives/russia-implements-new-law-regarding-foreign-investment.html>. However, “there ha[s] always been an unspoken fifty percent cap placed on foreign ownership in a JVC.” James W. Skelton, Jr., *Status of Russian Petroleum Legislation*, 30 HOUS. J. INT'L L. 315, 323 (2008). The new requirement that a foreign investor must obtain the consent of a special committee headed by the Prime Minister before having over fifty percent control in a license is seen as an effective prohibition on majority foreign ownership. *Id.* at 324–25.

216. SCHWAB, *supra* note 210, at 28.

problematic factors of doing business in the Russian economy the top three were corruption—by a large margin—inefficient government bureaucracy, and access to financing.²¹⁷

This Article discusses the competitiveness of the Russian economy because a strategy being used by Rosneft and other NOCs is strategic relationships with other IOCs and NOCs—access to domestic reserves in exchange for global expansion opportunities, cost carrying, technology transfer, and assistance with improving expertise in niche plays.²¹⁸ The strategic relationships entered into in 2012²¹⁹ show interest in Russian oil and gas even with the above listed competitive problems of the Russian economy. If Russia seeks to prevent the future twin deficits it will need to improve the global competitiveness of its domestic economy as well as its NOCs.

LUKOIL had difficulty when seeking international

217. *Id.* at 304.

218. With Eni, Rosneft will explore two blocks in the Barents Sea and one in the Black Sea in exchange for Eni's offshore technological expertise, Eni carrying Rosneft through the initial geological works, and the future participation by Rosneft in Eni's international projects. Press Release, Rosneft, Rosneft and Eni Join Forces to Explore Fields in the Barents and Black Seas (Apr. 25, 2012), *available at* http://www.rosneft.com/news/pressrelease/eni_all_press_releases/. With ExxonMobil, Rosneft will explore and develop the Kara and Black Seas and west Siberian tight oil in exchange for technological expertise, the creation of The Arctic Research and Design Center for Offshore Developments, and equity interests in some of ExxonMobil's North American projects (a thirty percent equity interest in the La Escara Ranch project in West Texas, a thirty percent equity interest in twenty blocks held by ExxonMobil in the western part of the Gulf, and a thirty percent equity interest in Canada's Cardium reserves in the Western Canada Basin in Alberta, Canada). Press Release, Rosneft, Rosneft and ExxonMobil Announce Progress in Strategic Cooperation Agreement (Apr. 16, 2012), *available at* http://www.rosneft.com/news/pressrelease/exxonmobil_all_press_releases/. Finally, with Statoil, Rosneft will explore and develop oil and gas in the Barents Sea and Sea of Okhotsk in exchange for use of Russian ice-class vessels and drilling platforms, Statoil's carrying of Rosneft in the exploration phase, Russian participation in offshore Norway, and potentially joint projects to develop Russian tight oil. Press Release, Rosneft, Rosneft and Statoil Advance Strategic Cooperation with the Signing of Agreements on Joint Bidding for Licenses in the Norwegian Section of the Barents Sea and Joint Technical Evaluation of Tight Oil Resources in Russia (June 21, 2012), *available at* http://www.rosneft.com/news/pressrelease/statoil_all_press_releases/; Press Release, Rosneft, Rosneft and Statoil Agree on Joint Offshore Operations in the Barents Sea and Sea of Okhotsk (May 5, 2012), *available at* http://www.rosneft.com/news/pressrelease/statoil_all_press_releases/ [hereinafter Rosneft Press Releases].

219. *See supra* note 218 and accompanying text.

expansion through JV partners Arco and ConocoPhillips. However, these experiences showed a desire by IOCs to partner with Russian NOCs or Russian companies viewed favorably by the Russian government. The view that LUKOIL was the flagship oil company in Russia helped it to form the JVs with the IOCs and when it sought to purchase upstream assets in former Soviet countries.²²⁰ Now that Rosneft has taken the mantle of “flagship” Russian oil company, it has a wealth of suitors willing to give access to reserves outside of Russia in exchange for access to Russian reserves.²²¹ This is important because even if Russia begins production in the Arctic and West Siberia, its net oil production is expected to remain between 9.5 and ten million barrels per day with brownfield sites decreasing production.²²²

Statoil saw its reserve base maturing, and sought to expand internationally to prevent a stagnant reserve base at best and shrinking reserves at worst.²²³ Statoil’s alliance with BP and partnership with other IOCs has assisted Statoil in acquiring a large international upstream presence.²²⁴ Currently about twenty-five percent of Statoil’s total production comes from reserves outside of Norway.²²⁵

Russian NOCs may be well served as they seek to expand internationally because Russia possesses the ninth largest oil

220. See ISABEL GORST, JAMES A. BAKER III INST. FOR PUB. POL’Y RICE UNIV., LUKOIL: RUSSIA’S LARGEST OIL COMPANY 1 (2007).

221. See, e.g., *TNK-BP: Bidding to Open this Week—Rosneft Likely Suitors*, ROGTEC MAGAZINE (Oct. 16, 2012), <http://www.rogtecmagazine.com/blog/tnk-bp-bidding-to-open-this-week-rosneft-likely-suitors/>.

222. Hulbert, *supra* note 177.

223. Power Hedge, *Statoil: International Discoveries Strengthen Reserves and Provide Growth Potential*, SEEKING ALPHA (Oct. 4, 2012), <http://seekingalpha.com/article/903901-statoil-international-discoveries-strengthen-reserves-and-provide-growth-potential>.

224. GORDON & STENVOLL, *supra* note 122, at 30 (noting production from assets acquired during Statoil’s alliance with BP are a major part of Statoil’s current international output); *Statoil in Brief*, STATOIL, <http://www.statoil.com/en/about/inbrief/pages/default.aspx> (last visited Feb. 22, 2013) (“Statoil is an international energy company with operations in 35 countries.”).

225. Interview by Matt Insley with Stephen Bull, *supra* note 13.

reserves and the largest gas reserves in the world.²²⁶ Further, Rosneft and Gazprom are two of only three Russian oil and gas companies allowed to bid for reserves in the Russian arctic.²²⁷ This gives Rosneft an advantage similar to that given to Statoil at its inception—Statoil was guaranteed equity interests in domestic reserves, helping it to learn from the major IOCs through participating with them on projects in Norway.²²⁸ In 2012, Rosneft imitated Statoil's method to acquire global expansion, skill, and technology expertise through strategic agreements with foreign IOCs and NOCs, gaining access to the vast quantities of oil and gas in the arctic.²²⁹

It is dangerous to conduct exploration and development activities alone as only one party incurs all the risk. If a Russian NOC can successfully partner with foreign NOCs or IOCs it can both gain a partner on its domestic projects—which will reduce its risk—and achieve global expansion.²³⁰ Rosneft is already testing these waters with new strategic alliances entered into in 2012 with Statoil, Eni, and ExxonMobil.²³¹ Only time will tell if these will be successful. LUKOIL's prior experience showed

226. *Russia: Country Analysis Brief*, U.S. ENERGY INFO. ADMIN. (Oct. 16, 2012), <http://www.eia.gov/countries/country-data.cfm?fips=RS>.

227. HENDERSON, *supra* note 44, at 41.

228. *See id.* at 35 (noting that while Statoil was not given exclusive right to bid, it was given a large stake in all exportation licenses issued).

229. *Compare supra* text accompanying note 218 (noting the technology and capital sharing between Rosneft and ExxonMobil in the arctic region), *with* GORDON & STENVOLL, *supra* note 122, at 23 (“[Statoil] had access to exploration expertise of the major participants without the need for a large exploratory budget or staff.”). The U.S. Geological Survey estimates the Arctic contains ninety billion barrels of oil, 1,699 trillion cubic feet of natural gas, and forty-four billion barrels of natural gas liquids, most of which lies within Russian territory in the arctic. U.S. Geological Survey, *supra* note 174.

230. A potential problem with this solution can be seen in 2006 when Gazprom initially sought a partner amongst Norsk Hydro, Statoil, Chevron, ConocoPhillips, and Total to develop the Shtockman reserves—estimated to have 3.2 trillion cubic meters of gas reserves—but it did not receive any offers of assets “that would correspond in terms of quality and volume to Shtockman’s reserves,” so Gazprom’s CEO announced Gazprom would develop the field alone. *Global Expansion*, *supra* note 18, at 113–14. Though development is still not complete, Gazprom did not end up developing the field alone, as Total became a partner in July 2007 and Statoil became a partner in October 2007. *Id.* at 114.

231. *See* Rosneft Press Releases, *supra* note 218 (showing the three strategic partnerships entered into by Rosneft in 2012).

being Russia's flagship does not ensure long-lasting partnerships, but LUKOIL's experience also shows it is a good way to gain an international presence, as LUKOIL is now present in several countries with a significant presence in the Caspian region.²³²

The international expansion strategy may also help Gazprom adjust to a more competitive international market, becoming more efficient and less reliant on a dominant market position. Gazprom relies heavily on pipelines for transportation of its gas reserves and it is falling behind in what appears to be the future of the gas market, LNG.²³³ The Asian market is not locked into the Russian gas monopoly and LNG from Qatar, Australia, and possibly the United States will make the Asian markets very competitive.²³⁴ The mobility of LNG could also mean European markets may decrease their share of Russian gas if Gazprom continues to act as a tool of state policy. Gazprom is the second largest oil and gas company in the world,²³⁵ and despite having the largest worldwide gas reserves, Gazprom is only the eighth largest LNG producer.²³⁶

Gazprom can leverage its domestic gas reserves to gain expertise as Statoil did with its natural gas reserves. Today Statoil has significantly expanded its natural gas production out of Norway and has the first operating LNG facility, Snohvit, in the Arctic.²³⁷ An alliance with Statoil, with its LNG experience in the Arctic, could provide Gazprom expertise in Arctic exploration and LNG conversion.²³⁸ Further, with the potential

232. *Global Expansion*, *supra* note 18, at 108.

233. *Gazprom Pipeline Gas Remains Key to Europe*, 107 *OIL & GAS J.* (Apr. 4, 2009), available at <http://www.ogj.com/articles/print/volume-107/issue-16/transportation/gazprom-pipeline-gas-remains-key-to-europe.html>.

234. PFC ENERGY, *LNG MARKETS STUDY 7* (2012), available at <http://www.arcticgas.gov/sites/default/files/documents/lng-canada-12-6-pfc-energy-study-global-lng-mkt.pdf>.

235. Helman, *supra* note 181.

236. James Marson, *Gazprom LNG Venture to Target Asia*, *WALL ST. J.* (Jan. 10, 2013), <http://online.wsj.com/article/SB10001424127887324081704578233512266013682.html>.

237. HENDERSON, *supra* note 44, at 38.

238. See Scott Weeden, *NOCs Tackle Global Resources Through Competition, Collaboration*, *E&P.COM* (Aug. 3, 2012), <http://www.epmag.com/item/NOCs-tackle-global->

shale gas reserves in Russia if Gazprom forms an alliance like the Rosneft-Exxon²³⁹ and Rosneft-Statoil²⁴⁰ alliances giving Rosneft the possibility of producing tight oil in western Siberia, it can bring global standards home to Russia and make Russian fracking a competitive market with Gazprom and Rosneft acquiring the skills and expertise to frac.

Towards the end of 2012, Gazprom announced its intentions to expand its LNG capacity.²⁴¹ After the collapse of a Gazprom-led consortium to develop the world's largest offshore gas reserves in Shtokman, it will produce in conjunction with Russia's leading independent gas producer, OAO Novatek, an LNG facility on the Yamal Peninsula in the Arctic to export to the Asian market and decrease its dependence on the European market.²⁴² If Gazprom does not expand its Russian LNG dramatically it may face more competition from global LNG and face increased calls by Russian gas producers to take away Gazprom's role as sole Russian gas exporter.²⁴³

V. CONCLUSION

Russian NOCs—namely Gazprom and Rosneft—have had a turbulent history since the collapse of the Soviet Union. In recent years Rosneft has seen a meteoric rise in its total production and market share in Russia while Gazprom has maintained most of its market power through the exclusive right to export Russian gas and its position as market maker in Europe's gas market.²⁴⁴

The Russian government is expected to have both a budget

resources-competition-collaboration_104689 (pointing to beneficial partnerships between NOCs with development resources and companies with LNG experience like Statoil).

239. See Rosneft Press Releases, *supra* note 218 (Rosneft-Exxon press release showing potential and business partnerships for Rosneft-Exxon).

240. See *id.* (Rosneft-Statoil press release noting the Rosneft-Statoil relationship).

241. *Gazprom to Focus on Global LNG*, NATURAL GAS EUROPE (Sept. 5, 2012, 6:18 PM), <http://www.naturalgaseurope.com/gazprom-focus-on-global-lng>.

242. Marson, *supra* note 236.

243. *Putin Orders Gazprom Rival to Collaborate on LNG*, REUTERS (Nov. 19, 2012), <http://www.reuters.com/article/2012/11/19/russia-lng-idUSL5E8MJDKR20121119>.

244. Ewa Paszyc, *Gazprom's Position on the Russian Gas Market Weakening*, OSW (Feb. 23, 2012), <http://www.osw.waw.pl/en/publikacje/osw-commentary/2012-02-23/gazprom-s-position-russian-gas-market-weakening>.

and trade deficit by 2015²⁴⁵ and the Russian energy sector needs about \$2.5 trillion in investments over the next twenty-five years, about seventy billion dollars annually will need to be spent on the oil and gas infrastructure and technology to keep up with projected domestic and foreign demand.²⁴⁶ If Russia expects to meet these needed investments and prevent the twin deficits, it will need to attract foreign capital. Since the early 2000s, the reemergence of the Russian NOCs has coincided with increased influence of politics on the oil and gas sector. However, the influence of politics has also created instability in the Russian oil and gas sector²⁴⁷ and discouraged foreign investment.²⁴⁸

If Russia changes its active investment role in the NOCs to more of a passive investment role as Norway did with Statoil, it can help ensure a more competitive domestic environment and increase the attractiveness of Russian NOCs and domestic reserves to foreign investors. Russia does not need to abandon its interests in Rosneft and Gazprom—Norway still controls sixty-seven percent of Statoil²⁴⁹—but placing them on an international stock exchange, decreasing its total interest in them, or creating a program like Norway's SFDI can all encourage increased domestic competition and ensure Russia has a steady stream of income by maintaining a passive equity interest in its reserves.

The recent posture of the Russian government to further privatize Rosneft and Gazprom along with the strategic

245. Charles Clover, *Russia Faces End of Petrodollar Surplus*, FIN. TIMES (Oct. 3, 2013, 9:30 PM), <http://www.ft.com/intl/cms/s/0/313c4ffc-0d6e-11e2-bfcb-00144feabdc0.html#axzz2JsOSGLY8>.

246. *Russia Must Invest USD 100 Billion a Year to Meet Domestic and International Demand For Its Energy Resources*, INT'L ENERGY AGENCY (Nov. 16, 2011), <http://www.iea.org/newsroomandevents/news/2011/november/name,19885,en.html>.

247. See generally Olsen, *supra* note 54, at 4, 10 (outlining the hold-up problem faced by many IOCs in Russia).

248. Richard Weitz, *Sakhalin Seizure Risks Discouraging Foreign Investment in Russia's Energy Infrastructure*, WORLD POLITICS REV. (Dec. 26, 2006), <http://www.worldpoliticsreview.com/articles/434/sakhalin-seizure-risks-discouraging-foreign-investment-in-russias-energy-infrastructure>.

249. *Shareholders*, STATOIL (Sept. 9, 2007), <http://www.statoil.com/en/investorcentre/share/shareholders/pages/stateownership.aspx>.

relationships entered into, primarily by Rosneft, will dictate the future of the Russian energy industry's global presence. Rosneft is on the ascension with its recent acquisition of TNK-BP—expected to nearly double its daily output²⁵⁰—and the strategic relationships entered into in 2012.²⁵¹ Gazprom has the advantage of being the second largest oil and gas company in world production,²⁵² but its failure to adopt LNG on a large scale stands to threaten its market position. Any steps taken toward privatization and global expansion are unlikely to fix Russia's current economic trajectory, but the large strategic relationships and acquisitions of 2012 offer Rosneft and Gazprom the opportunity to become the most efficient world producers and offer the Russian state the opportunity to strengthen its global economic position.²⁵³

250. *Russian Oil Giant Rosneft Posts Record Profit in 2012*, DAILY SUN, http://www.daily-sun.com/index.php?view=details&archieiv=yes&arch_date=03-02-2013&type=Russian-oil-giant-Rosneft-posts-record-profit-in-2012&pub_no=398&cat_id=3&menu_id=3&news_type_id=1&index=14 (last visited Feb. 22, 2013).

251. *See supra* note 218 and accompanying text.

252. Helman, *supra* note 181.

253. *BP Buy-in*, *supra* note 33.