

The Russian Oil and Gas Report

June 2, 2004

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FEATURE STORIES

THE KREMLIN EXCOMMUNICATES OLIGARCHS FROM NATURAL RESOURCES

The Financial Times writes that the Kremlin gradually excommunicates oligarchs from natural resources. "In the non-resource sector, the state is quite happy to let the free market generate growth and diversification," says Roland Nash, head of research at Renaissance Capital, a Moscow investment bank. "But it seems very clear that Putin wants to make sure the state calls the shots in the natural resource sector."

According to the newspaper, "While Mikhail Khodorkovsky has been in detention for seven months awaiting a fraud and tax evasion trial due to start next week, investors and business executives have been busy adapting to a more assertive state role in Russia's natural resource sector."

The Financial Times writes, "One of the most important signs of a change in the oil industry in the past few months is in tax payments. After years of opaque accounting and aggressive tax minimization schemes, Russian companies are portraying themselves - and acting - as upstanding corporate citizens. LUKoil, a YUKOS competitor that reached a settlement with inspectors over a tax optimization scheme in Kazakhstan, has indicated it will not deviate from the statutory nominal rate of 24% corporate tax."

"Foreign companies operating in Russia are making similar moves. Bob Dudley, the chief executive of TNK-BP, the oil group in which BP owns 50%, says: "We recognize that tax is going to go up and we are fully prepared to comply. It should be 24%.""

"Viktor Vekselberg, one of TNK-BP's biggest Russian shareholders, went a step farther, buying Malcolm Forbes's collection of nine Faberge eggs for \$100 million and then lending them to the Kremlin for an exhibition."

The Financial times continues, "Putin, in his state of the nation address last week, warned companies against tax dodging and raised another issue: state control of the oil pipeline network and, by implication, production. Priorities have shifted radically since YUKOS planned a year ago to help build oil links from Western Siberia to Murmansk and Eastern Siberia to China."

"The prospects of confiscating Khodorkovsky's stake if he is convicted, and of bankruptcy of the company, have raised the possibility that the state may pass YUKOS on to another company closer to the state, or create a holding company." Vlada Rusakova of Gazprom says that her company will take part in acquisition of YUKOS assets if they are offered for sale.

"Already rivals are eyeing parts of YUKOS. The region of Yakutia has awarded Surgutneftegaz the right to develop a field previously explored by YUKOS. Alexei Miller, the head of Gazprom, has talked about the importance of patriotism in the allocation of new licenses."

The newspaper concludes, "Foreign companies eyeing the Russian market argue that the Kremlin is balancing its desire for direct control of natural resources with the prospect of more technology, capital and efficiency from abroad. But many are betting the state will assert more control, preferring to allocate multi-nationals minority stakes or the prospect of joint ventures."



THE COURT ALMOST SPARED SIBNEFT OF YUKOS

Sibneft that is accelerating breakup with YUKOS is one step to this goal. On May 31, the instance of appeals of the Moscow Arbitration Court confirmed the verdict on annulling of the additional issue of YUKOS shares. Henceforth 57.5% of Sibneft shares should return to their former owners when these shares are defrozen.

In October 2003, YUKOS acquired a 92% stake in Sibneft for \$3 billion a 26.01% of its own shares. In the framework of this deal, in autumn 2003 YUKOS placed 1 billion shares or 37% of the authorized capital. In the course of the placing affiliates of Millhouse Capital received 17% of YUKOS shares and YUKOS became owner of

57.5% of Sibneft shares.

In November 2003, after arrest of CEO of co-owner of YUKOS Mikhail Khodorkovsky, his new partners headed by Chukotka Governor Roman Abramovich started demanding termination of the already completed deal of merger of the two companies. Millhouse Capital representing their interests managed to come to agreement about this with Group MENATEP only in February 2004. Sources close to negotiations stated that the matter about a mirror deal: for a 92% stake in Sibneft YUKOS would receive back \$3 billion and 26.01% of its own shares. In any case, YUKOS did not start any corporate actions for fulfillment of this

plan.

However, former owners of Sibneft accelerated termination of the deal through the court. At the end of January, offshore subsidiaries of Millhouse Capital appealed to the Moscow Arbitration Court demanding invalidation of the additional issue of YUKOS shares organized during the merger. Under the lawsuit the court froze the 57.5% stake of Sibneft belonging to YUKOS. With these 57.5% Millhouse Capital paid for 17% of YUKOS shares. The 17% stake in YUKOS was also frozen.

In early March, the court supported Millhouse Capital and annulled the additional issue of YUKOS shares. Then representatives of Sibneft explained that this corresponded to the breakup plan but YUKOS appealed against this verdict.

The appeal did not help and on May 31 the court confirmed validity of the verdict on invalidation of the additional issue. A source who has been present at the court hearing says, "This means that the verdict issued by the arbitration court back on March 1 comes into effect. In five days the Federal Service of Financial Markets should make a decision on invalidation of the additional issue and return of a 57.5% stake in Sibneft to its former owners."

A source close to shareholders of Sibneft comments, "We are content with the court verdict. Along with this, we are prepared to continue negotiations with YUKOS on the mirror deal of shares return. We have not spent the \$3 billion and this sum is preserved. We are ready to return this sum to YUKOS in case of complete closing of the deal for exchange of 92% of shares for 26.01%. But even if YUKOS remains a shareholder of Sibneft after invalidation of the additional issue we agree with this because this does not hinder our management of the company."

Oleg Osipenko, CEO of the lawyer company Rincon-

Gamma, says that so far it is impossible to fulfill the court verdict because 57.5% of Sibneft shares are arrested also under the claim of the Tax Ministry against YUKOS worth \$3.4 billion. Osipenko adds, "In this case the arrest imposed under the lawsuit of the Tax Ministry is a priority." The lawyer adds that this circumstance gives a chance to YUKOS to defend its interests in the instance of appeals. According to Press Secretary of YUKOS Alexander Shadrin, the company will act in this very manner. A source close to shareholders of Sibneft states that shareholders of Sibneft prefer waiting until the verdict of the Tax Ministry and "company's lawyers will seek opportunities for continuation of the mirror deal after regulation of the disputes with the Tax Ministry."

Analysts presume that henceforth the future of Sibneft depends only on agreement of its former owners with the Kremlin. Analyst Dmitry Lukashov of Aton comments, "Everything depends on whether the Presidential Administration has permitted Sibneft to break up with YUKOS." Valery Nesterov from Troika Dialog is convinced that there will be such permit. The analyst explains, "The state will switch on the green light for Sibneft. Having annulled the additional issue Sibneft will return \$3 billion to YUKOS like it is stipulated by the second part of the mirror deal. YUKOS will pay this money to the budget."

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NEW NATURAL RESOURCES MINISTER TRUTNEV THREATENS OIL COMPANIES WITH LARGE-SCALE RE-DIVISION OF FIELDS

Having returned from the meeting with Vladimir Putin, Natural Resources Minister Yury Trutnev threatened oil companies with a large-scale re-division of oil fields. Like his predecessor Vitaly Artukhov, Trutnev promises to revoke licenses from "negligent owners" that do not develop the reserves.

According to the estimate Brunswick UBS made in March 2004 on the basis of the data submitted by companies, Tatneft has reserves sufficient for 34 years, Gazprom has reserves for 32 years, LUKoil for 28 years, Surgutneftegaz for 23 years and YUKOS for 22 years.

The new Natural Resources Minister, who formerly was Governor of the Perm Region, announced his intention to reform the natural resources development system in Russia almost immediately after his appointment in March. On May 31, Trutnev discussed the concept of the new bill on natural resources with President Putin. This bill is being prepared by the Natural Resources Ministry. Having returned from the Kremlin, the minister shared his plans.

According to Trutnev, the Natural Resources Ministry

is going to increase the degree of use of the reserves the rights for which are granted to companies. The minister is indignant, "In the 1990s, the state issued the licenses but did not get anything in return. Besides the increase in capitalization of companies the country did not benefit anything from lending of its resources. As a result, a Russian company has 100-150% more reserves than a Western company. For example, TNK-BP has reserves sufficient for 60 years." The minister also does not like the fact that in 2003 oil production by Russian companies exceeded refilling of natural resources by 100%.

The minister is going to reduce the reserves of Russian companies to the "Western level" by two methods: economic and administrative. Trutnev wants to revive the idea of charging of a tax on reserves being on balance of companies but being unused. This may be a special tax or payment of renting of a field. The Natural Resources Ministry did not decide how it would manage to arrange administrative confiscation of licenses yet. The minister presumes that the state may act through the court.

Trutnev's predecessor Vitaly Artukhov frequently scared oil companies with mass confiscation of licenses too. The former minister was probably inspired by Putin's words. In summer 2002, Putin complained that "some of our companies" have reserves "for 25 and even 30 years ahead and are already prepared to trade in these resources increasing their capitalization at expense of the country." However, Trutnev admits that the crusade of Artukhov against the companies breaching the license agreements has ended with nothing. According to Trutnev, in 2003 the Natural Resources Ministry issued 96 notifications about revoking of licenses but did not return a single field to the state (there are 16,000 licenses for natural resources development are in effect in Russia). In any case, the minister admits that "40% of all valid licenses issued between 1992 and 1005 are licenses on nothing."

Trutnev concludes, "I wish to force the companies to get rid of unused reserves or to use them." According to him, it is possible to sell licenses for natural resources development on the secondary market to other companies or to return them to the state undistributed fund for sale at a new auction.

Vice President of TNK-BP Vladimir Ruga is surprised, "We always act in the framework of Russian legislation and do not breach it."

In any case, experts do not expect that the initiatives of the Natural Resources Ministry will impact capitalization of oil companies. Chief analyst of Aton Steven Dashevsky said that Rosneft and LUKoil already returned "spare licenses to the state voluntary and this did not influence their capitalization." Valery Nesterov from Troika Dialog

says that "investors working in Russia have already got used to the risk of legislation amendment." Dashevsky adds that the most important thing is that state officials should not have a possibility to interpret the new law in an arbitrary manner.

It was impossible to obtain a comment of the tax Ministry on the new tax initiatives of Trutnev. Six months ago, when the Economic Development and Trade Ministry proposed the bill on the tax on reserves, the Finance Ministry shared its opinion. At any rate, an official of the Economic Development and Trade Ministry doubts that it will be possible to reanimate the idea, "There was a task to collect more taxes from oil companies. The government did this by a different method. Hardly anyone will return to this idea now."

Sergei Shtogrin, deputy chair of the budget committee of the Duma does not understand why it is necessary to destroy the existing system of taxation of the oil industry. He is surprised, "If the entire economic sense of this idea is to prevent idling of the fields, it is sufficient to set deadlines for development of a field in a license agreement. If a company fails to observe the deadlines, the license will be revoked and the field sold at a new auction. What do taxes have to do with this?"

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INDUSTRY EVENTS

OPEC MAY ABOLISH OIL PRODUCTION QUOTAS

OPEC may temporarily abolish the oil production quotas to lower the prices that have reached record levels. Simultaneously some member states of the cartel wish to fix broader price brackets. Experts remark that even the maximum use of OPEC capacity may be insufficient for meeting of global demand.

The cartel members are debating abolishment of the oil production quotas on the eve of the summit of June 3 to be held in Beirut, report sources close to the cartel. Representatives of OPEC warn that negotiations are continued and abolishment of the quotas, as well as official increase of the price brackets cannot be a settled matter.

The idea to temporarily abolish the oil production quotas appeared in the circumstances when world's largest oil consumer US and world's largest oil exporter Saudi Arabia do their best to lower the oil prices. In any case, even this measure will hardly result in a large increase of energy resources supplies to the global markets. At

present, majority of OPEC member states produce the maximum possible quantities of oil. In May, according to President of OPEC Purnomo Yusgiantoro, the cartel members exceeded the aggregate production quota of 23.5 million barrels per day by 2.3-2.5 million barrels per day. However, this proposal only adjusts the size of the quota to real production. Along with this, abolishment of OPEC quota may have psychological influence on the oil markets and will send a signal them showing that oil producers are going to keep the prices below \$40 per barrel.

Some OPEC members are afraid that lifting of limitations on production may lead to collapse of oil prices. That is why they propose raising of the official oil price brackets that now amount to \$22-28 per barrel. Oil Minister of Qatar al-Attiyah proposes increase of the lower border of the brackets from \$22 to \$28 per barrel. According to the minister, Iran proposes increase of the

lower border of the brackets by \$8 to \$30 per barrel. Venezuela insists on the brackets of \$30-35 per barrel. According to these countries, increasing the lower border of the brackets they will protect themselves from prices decrease and will compensate for the losses caused by the dollar devaluation.

Even if OPEC countries use their production capacity to the maximum extent it is not clear if they will be able to meet the global demand. According to International Energy Agency, by the end of 2004 global demand for oil will grow to 82.5 million barrels per day in comparison to the current 78.7 million barrels per day. Among the OPEC member states only Saudi Arabia can increase oil production significantly. It promises to increase daily output to 9.1 million barrels by June and to fully use its capacity of 10.5 million barrels per day later. A source

close to OPEC explains, "We cannot solve the problem of high oil prices on our own. We need assistance of other producers and countries that consume oil to lower their appetites." US Secretary of Energy Spencer Abraham announced that he obtained promises from Mexico, Nigeria and Russia regarding increase of production. However, according to experts, not a single of these countries can increase production significantly in the near future.

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RUSSIA WILL NOT INCREASE OIL EXPORT

Finance Minister Alexei Kudrin says that Russia is not going to limit oil production and export even if oil prices start decreasing. Kudrin adds that Russia has a special position among G8 countries being an oil exporter, whereas its partners in G8 are oil importers.

Kudrin also states, "Russia has a special position among the oil exporting countries. Whereas OPEC member states limit oil production to maintain high prices, in the last few years Russia announced that it would not limit oil production even should the prices decrease."

He added, "We will follow the global trends. If the price is high we will increase production to enjoy it but if the price falls we will not create artificial obstacles for such decrease of prices that may lead to slowing down of economic growth in the world."

According to Kudrin, he participates in working out of the text of the final communiqué of the latest meeting of G8 ministers in New York in May. The minister said, "I

influenced correction of the communiqué of G8 to make all countries increase oil production for stabilization of prices on the global market."

Kudrin adds that growth of gasoline prices in Russia may be connected with high prices of crude oil on foreign markets. Hence, said the minister, in April the Duma and the Federation Council made a decision on raising of oil export duties according to proposal of the government. The minister is convinced that this measure will allow regulation of the situation and reduction of growth in fuel prices on the domestic market.

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INCREASE OF THE STATE SHARE IN GAZPROM WILL REQUIRE \$5 BILLION

Member of the Executive Board of Gazprom Olga Pavlova reported at a meeting with company's shareholders in Novy Urengoi that the state would need about \$5 billion for acquisition of 16.5% of Gazprom shares being on the balance of company's subsidiaries.

Previously, Economic Development and Trade Minister German Gref announced that the state planned to increase its stake in Gazprom. He said, "There are such plans but I cannot say yet how and in which form this will happen."

According to Pavlova, shares belonging to subsidiaries "can potentially be offered for sale and acquired by the state" but this will cost very much. So far, there is no spare \$5 billion in the budget, which means that it will be necessary to seek other options.

CEO of Gazprom Alexei Miller also says that the state share in the company should be increased. According to

Miller, "the role of the state should grow, preserving of integrity of Gazprom is important if Russia is going to compete against the leading foreign players."

Speaking about the structure of Gazprom's equity, Pavlova said that as of May 7 a 38.17% stake in Gazprom belonged to the state, 36.28% belonged to legal entities, 13.85% to private individuals and 11.5% to foreign shareholders.

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GAZPROM IS PREPARED TO BUY ASSETS OF YUKOS

Gazprom does not rule out its participation in acquisition of YUKOS shares, states member of the Executive Board and director of the strategic development department of Gazprom Vlada Rusakova. She said, "If assets of YUKOS are offered for sale we will participate in the acquisition."

According to Rusakova, now Gazprom produces 10 million tons of liquid hydrocarbons a year. By 2015, the company plans to increase their production to 20-25

million tons a year.

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TNK-BP CALLS ON ESTABLISHMENT OF A CONSULTATIVE BODY FOR DEVELOPMENT OF PIPELINES

TNK-BP advocates establishment of a consultative body for coordination of pipelines development. Executive Director of TNK-BP German Khan announced this at the third international pipeline forum in Moscow.

Khan added, "It would be more correct and expedient if a kind of working body was formed from representatives of the companies to conduct such regular coordination." According to him, the consultative body should also include representatives of scientific community. He added, "We support such coordination."

According to him, management of Transneft organizes regular meetings with managers of the leading Russian oil companies dedicated to this issue.

According to Khan, between 2005 and 2010 there will be a serious gap between the opportunities of oil production increase and opportunities of its transportation.

Khan said that combined schemes connected with use of railways "are less profitable and are very cumbersome for the oil companies." With regard to the costs, "this is a manifold growth in comparison to the pipelines," said Khan.

According to Khan, oil companies including TNK-BP advocate quick determination of the main tasks related to acceleration of creation of new pipeline routes.

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PRODUCTION AND TRANSPORTATION PROJECTS

TRANSNEFT FOUND ANOTHER ROUTE BYPASSING BOSPORUS

On May 28, the Board of Directors of Transneft approved participation of the company in preparation of the project for construction of the Trans-Frakian oil pipeline Kyinkei-Ibrikhaba. The extremely tense situation in the area of Bosphorus and Dardanelles straits due to bad weather and limitations on passage of tankers imposed by Turkish authorities causes the need to seek new routes for deliver of Russian oil to international markets. Bearing in mind the current situation Transneft participates in consideration of the project for transportation of Russian hydrocarbons via the oil pipeline Kyinkei-Ibrikhaba bypassing Bosphorus and Dardanelles.

In June 2003, the Turkish group Anadolu presented

this project in Russian Energy Ministry. Transneft and Anadolu signed a memorandum of understanding in December. The companies formed a working group that also included representatives of TNK-Bp Management and Tatneft for joint study of the project and analysis of its feasibility.

The pipeline will cross the European part of Turkey from Kyinkei on the southwestern coast of the Black Sea to Ibrikhaba on the coast of the Aegean Sea. The planned capacity of the pipeline is 60 million tons a year. The project includes construction of a new 193-kilometer pipeline with diameter of 1,220 millimeters, one main and one interim oil pumping stations, terminals in Kyinkei and

Ibrikhaba. Construction of all objects will take two years. According to preliminary estimates, investments in the project will amount to about \$900 million. The oil transportation price of the pipeline (including transshipment in ports) will amount to \$7.47 per ton during the period of credits repayment and \$3.04 per ton after completion of these payments. The price was calculated for the following scheme of the project financing: 100% of borrowings at 7% a year for seven years.

Experts of Giprotuboprovod institute did a comparative analysis of the transportation costs of Russian (Caspian) oil through the port of Novorossiysk to North American market and drew a conclusion that the Kynkei-

Ibrikhaba route was one of the most competitive ones. According to the institute, economic efficiency of the project may be compared to efficiency of oil transportation by tankers through the straits. The interest of both parties, Russia and Turkey, allows significant reduction of political risks of the project.

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TNK RELEASED RESULTS OF THE FIRST COMPREHENSIVE RESERVES AUDIT

On June 01, TNK-BP released the results of the first comprehensive audit of the company's reserves. The audit reflects TNK-BP's exploration, production and development activities during 2003 and describes the resulting reserves position as of December 31, 2003. This is the first such audit across all of TNK-BP's assets since its formation on August 29, 2003 and establishes a consolidated reserves baseline for the company.

The independent international company DeGolyer and McNaughton conducted the audit to the criteria stipulated by both the United States Securities and Exchange Commission (SEC) and the Society of Petroleum Engineers (SPE).

The audit confirms that as at December 31, 2003, under the standards set by the SEC, TNK-BP's total proved reserves increased from 4.1 to 4.3 billion barrels of oil equivalent. Of these, proved developed reserves grew from 3.2 to 3.4 billion barrels.

Under SPE criteria, total proved reserves decreased from 9.4 to 9.0 billion barrels. SPE proved developed reserves moved from 6.1 to 6.0 billion barrels of oil equivalent.

Both sets of figures are broadly consistent with the company's previously stated estimates based on its assessments of the heritage company reserves positions. The audit results do not reflect any reserves or resources associated with the ownership of 50% of Slavneft by the shareholders of TNK-BP.

During 2003, TNK-BP grew production by 13.8% to 63.8 million tons (average daily production 1.276 million barrels of oil per day). Based on SEC criteria TNK-BP

replaced 133% of this production with new proved reserves. This replacement ratio is an increase on the average of 25-35% year on year replacement ratio achieved by the heritage companies in 2001-2002 and reflects TNK-BP's strengthening commitment to create a sustainable production base by continually replacing production with new reserves. Under SPE standards, TNK-BP replaced 83% of its production.

President and CEO of TNK-BP, Robert Dudley said: "This is clearly good news and confirms our previous estimates of TNK-BP's primary reserves base. DeGolyer and McNaughton is a highly respected and independent company and we value the deliberately conservative approach they have taken in this first company-wide audit. The work to identify new reserves is vital to extending the life of our company and to helping sustain the communities where we operate. "

"The audit also demonstrates the first results of our drive to consistently replace more reserves than we produce each year. This process will accelerate as we see further results from the full scale deployment and application of technology and investment across the asset base", he concluded.

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CONTRACTS AND CONCESSIONS

UKRAINE AGREED WITH RUHRGAS ON PRINCIPLES OF PARTICIPATION IN THE GAS TRANSPORTATION CONSORTIUM

The PR service of Neftegaz Ukrainy announced achievement of agreements with the German company Ruhrgas on principles of Ruhrgas participation in the gas transportation consortium of Russia, Ukraine and Germany. However, it is impossible to speak about a breakthrough yet because the parties have not issued a joint statement usual in such cases. Moreover, neither Gazprom nor Ruhrgas comment on results of the negotiations yet and representatives of the Ukrainian company refuse to add anything to the small press release.

On May 28, top managers of the three companies negotiated in Kiev "On the issue of models of functioning of the international consortium for management and development of the Ukrainian gas transportation system and participation of the German party in it," reported the PR service of Neftegaz Ukrainy. According to the company's PR service, negotiations were held at the level of deputy CEOs of companies, most likely among Yuri Komarov (Gazprom), Vladimir Trikolich (Neftegaz Ukrainy) and Jochen Weise (Ruhrgas). It is believed that in the near future Weise may become the CEO of Ruhrgas.

About the model of entrance of the German company into the consortium, which belongs to Gazprom and Neftegaz Ukrainy on the parity basis now, the PR service of Neftegaz Ukrainy also says that the model fully complies with the statement of Ukrainian and Russian presidents and German chancellor released in St. Petersburg. This statement dealt with the need to increase natural gas supplies to Europe and improvement of reliability of the gas transit. It is impossible to find out how this will look

like organizationally and what will be the share in capital of the consortium will be offered to the German corporation. It is possible that no detailed agreements have been reached yet.

Press Secretary of Neftegaz Ukrainy Konsantin Borodin stated that "The German party was proposed the terms and it accepted them." According to the press release, Ruhrgas undertook the obligation to buy additional 20 billion cubic meters of gas until 2010, which Gazprom undertook to supply to the new gas pipeline built by that time in the territory of Ukrainy by the consortium.

Until recently, Gazprom refused to speak about construction of the Novopskov-Uzhgorod pipeline with capacity of 15-30 billion cubic meters a year worth \$1.5-2.2 billion as long as the parties did not agree on reassigning of the existing gas transportation system for management to the consortium. According to Borodin, this issue was not discussed at the meeting and there were no reasons for rapid changing of stance of the Russian company. Hence, it is too early to speak about the guarantees of gas supplies via the new route yet as well as about guarantees of gas purchase by Ruhrgas until signing of a contract or at least a preliminary agreement.

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GAZPROM TO NEGOTIATE WITH RUSSIAN GOVERNMENT ON SHTOKMANOVSKOE FIELD

In the near future Gazprom will start discussing the production sharing agreement on the Shtokmanovskoe gas condensate field with the Russian government. This field is chosen as the main raw materials base for supplies of liquefied natural gas (LNG) to the US. CEO of Gazprom Alexei Miller announced this at his working meeting with US Secretary of Energy Spencer Abraham. The meeting was dedicated to cooperation in LNG production technologies and LNG supplies to the American market.

Gazprom plans to export about 90% of LNG from the Shtokmanovskoe field to the US and 10-15% of the LNG from this field will probably be exported to European countries.

According to the preliminary business plan of the Shtokmanovskoe project prepared by ConocoPhillips, which is considered as a possible partner of Gazprom and Rosneft, investments in the project will amount to \$10-15 billion. The first phase of the project implies production of 30 billion cubic meters of gas a year. It is planned that 25-26 billion cubic meters of this quantity will be processed at the LNG plant. The remaining part of produced natural gas will be supplied to the domestic market.

The license for development of the Shtokmanovskoe field belongs to Sevmorneftegaz registered on the parity basis by Rosneft-Purneftegaz and Rosshelf subsidiaries of

Rosneft and Gazprom at the end of December 2001 on the parity basis.

Recoverable reserves of the Shtokmanovskoe amount to 3.2 trillion cubic meters of gas and 27 million tons of oil. Beginning of commercial development of the field is scheduled for 2010.

The US is one of the world's most promising LNG markets. In 2003, the US increased LNG import by more than 100% from 4.8 million tons in 2002 to 11 million tons. According to the Energy Information Administration of the US Department of Energy, by 2010 this figure will reach 47 million tons. Gas production in the US will not cover the needs of the country and the country will need significant increase of the gas import.

At present, there are four LNG terminals in the US with an aggregate capacity of 18 million tons a year. It is planned to build ten new terminals on the eastern and western coast with the aggregate capacity of about 60 million tons of LNG a year.

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GAZPROM STARTED NEGOTIATIONS WITH ISRAEL ON GAS SUPPLIES AND INFRASTRUCTURE CONSTRUCTION

Sergei Kupriyanov, the Press Secretary of the CEO of Gazprom, reported that Gazprom started negotiations with Israel on supplies of Russian gas through Turkey (with use of the Blue Stream pipeline) and construction of gas transportation infrastructure in Israel.

According to Kupriyanov, the negotiations began according to the initiative of the Israeli party. At present, the share of gas in the energy balance of Israel amounts to about 1% and the main sources of fuel are coal and fuel oil.

CEO of Gazprom Alexei Miller met with Israeli Minister of Infrastructure Yossi Paritzky. Kupriyanov adds that

Gazprom plans to negotiate with the Israeli Energy Company and Israeli Gas Company.

According to Kupriyanov, the negotiations are at the initial stage and there are no certain agreements yet.

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INVESTMENT FRONTIERS

TATNEFT REFUSES TO PAY FOR 65.8% OF SHARES IN THE TURKISH PETROCHEMICAL HOLDING TUPRAS

Tatneft does not hurry to pay for a 65.8% stake of the Turkish petrochemical holding Tupras. The company states that it will pay for the shares only when the Turkish court lifts the ban on closing of the deal. Analysts presume that this may mean the failure of the deal.

Tupras includes four refineries and a petrochemical plant. Tupras accounts for about 85% of oil refining in Turkey. A 65.8% stake in Tupras belongs to the Turkish government and 34.2% of shares are in free float. In 2003, Tupras processed 23.3 million tons of oil. In 2003, revenue of Tupras amounted to \$13.8 billion and net profit amounted to \$295.8 million. In 2003, Tatneft supplied 2.8 million tons of oil to Tupras.

In February, the supreme privatization council of Turkey announced results of the tender for sale of a 65.8% stake in Tupras. Consortium consisting of the German company Efremov Kautschuk affiliated with Tatneft and Turkish corporation Zorlu won the tender. For the state-owned stake of Tupras the consortium offered \$1.302 billion. On May 24 Petroleum Workers Union appealed to the administrative court of Ankara demanding prohibition of privatization of Tupras. On the same day the court prohibited sale of Tupras shares to the consortium headed by Tatneft. Then the privatization council of Turkey that had organized the deal announced that it would appeal to the regional court with a request to lift the ban from the deal.

May 28 was the deadline for payment for Tupras shares. However, the payment was not made. Efremov Kautschuk and Zorlu postponed the payment because the court of Ankara suspended the deal. A source in Tatneft explains, "As long the ban is not lifted we will not pay

anything." According to the source, the controversy may end not later than in two weeks. If the court does not lift the ban the expectation will last until hearing of the case. Deputy Director of Tupras Tonkei Onbizin says it may take one or two months.

Analyst of Sovlink Michael Boboshko says that the action of Tatneft and Zorlu will aggravate the situation related to the deal. The analyst explains, "This may be used against them because the partners actually have not observed the terms of the tender. That is why the Turkish party may invalidate the deal." According to the analyst, this will be only useful for Tatneft because it will not have controlling interest in Tupras and will not be able to consolidate its financial results in its balance anyway. Boboshko concludes, "It would be better if they built the same plant nearby and managed it quietly."

Natalia Odintsova, director of the analytical department of Prospect investment company is not as pessimistic. She presumes that the deal will be closed successfully. If this does not happen, the failure of the deal will have negative impact on all of its participants. For example, says the expert, this will influence the reputation of Turkey. Tatneft will not receive stable sales for its exported oil.

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EXIMBANK US PREPARED TO FINANCE COMPLETION OF ODESSA-BRODY PROJECT

Ukrainian Deputy Prime Minister and President of Eximbank US Merrill discussed the plans for crediting of projects in Ukraine. Merrill stresses that Eximbank US considers cooperation with Ukraine to be one of its priorities. He adds that "support of American jobs" is a term for such cooperation, meaning support of import of American goods and guarantees of credit return by the Ukrainian party.

Merrill reports that he has a permit from the US Congress for crediting totaling \$100 billion. For example, the bank can already open credit lines worth \$6 billion. According to the President of the bank, the matter is about readiness to issue credits to energy and transport sectors, for financing of direct use of the Odessa-Brody oil pipeline

and its extension to the Polish city of Plotsk.

Speaking about the Odessa-Brody oil pipeline, the President of Eximbank US spoke about the interest of the US in operation of this pipeline. Merrill said, "We are interested in diversification of oil supplies to the West." He stressed that first of all he meant an alternative to oil supplies from the Middle Eastern countries.

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AMERICAN INVESTORS MAY TAKE PART IN CONSTRUCTION OF THE OIL PIPELINE TO MURMANSK

American investors may take part in construction of the oil pipeline from Western Siberia to Murmansk if the Russian government supports the project, reports US Ambassador to Russia Alexander Vershbow.

Vershbow expressed the interest of the US in construction of this pipeline. He stated, "It is not important for us if state-run or private companies of Russia build the pipeline. The result is important, that is an opportunity for the US to receive Siberian oil."

According to Vershbow, if the Russian government

supports the Western Siberia-Murmansk pipeline project "there will also be American investors who will take part in the project development."

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THE BAN ON SALE OF TUPRAS LIFTED

The Turkish court lifted the ban on sale of the petrochemical holding Tupras to the consortium of Tatneft and Turkish industrial holding Zorlu. Representatives of Tatneft say that henceforth nothing hinders closing of the deal but keep silent about the date of the payment.

In February, the supreme privatization council of Turkey announced results of the tender for sale of a 65.8% stake in Tupras. Consortium consisting of the German company Efremov Kautschuk affiliated with Tatneft and Turkish corporation Zorlu won the tender. For the state-owned stake of Tupras the consortium offered \$1.302 billion. On May 24 Petroleum Workers Union appealed to the administrative court of Ankara demanding prohibition of privatization of Tupras. On the same day the court prohibited sale of Tupras shares to the consortium headed by Tatneft. After that Tatneft announced that it would not pay for the shares as long as the ban was not lifted.

The Turkish privatization council, which had organized

the deal for sale of Tupras, appealed to the court requesting lifting of the ban. On May 31, this request was allowed. Thus, nothing prevents closing of the deal for acquisition of Tupras shares by the Russian-Turkish consortium anymore.

One of the top managers of Tatneft says, "We are ready to fulfill our obligations" but does not name the date of the payment. It is only known that the Russian company already drew a \$375-million credit from CSFB and BNP Paribas for this purpose. The loan was issued as bridge financing for placing of the future bond of Tatneft. Overall Tatneft needs to pay over \$650 million for Tupras. Zorlu needs to pay the same sum. Representatives of Zorlu were not available for comments. Meanwhile, according to the terms of the tender the Russian-Turkish consortium had to pay for Tupras shares until May 28.

Analyst Valery Nesterov of Troika Dialog calls the verdict of the Turkish court expected. According to him, the maximum what the court could do was to postpone the

deal for a few weeks. According to the expert, this project of the Russian company is ambiguous. He explains, "Tatneft that is not very strong financially undertakes heavy financial obligations. Investors are also concerned about other projects, for example, the further fate of the Nizhnekamsk refinery construction." Among the positive aspects of the deal Nesterov names strengthening of vertical integration of Tatneft. According to him, this deal may determine the fate of Tatneft in many aspects.

Maria radian from AVK group considers the news about lifting of the bank on privatization positive in general. However, she also speaks about "dark sides of

this deal." The expert notes, "For example, affiliation of Tatneft with Efremov Kautschuk is not clear, profitability of oil refining is low and it is not known if the company has enough money to pay for the shares."

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CORPORATE DYNAMICS

SIBIR ENERGY MAY BE SOLD TO SIBNEFT

According to The Sunday Times, Sibir Energy (SE) is preparing to explain how its partner in Sibneft-Yugra joint venture in the form of Sibneft has managed to dilute the share of Se from 50% to less than 1%. Along with this, owners of SE will not try to restore their rights in Sibneft-Yugra through the court. According to unofficial information, very soon SE will be sold to Sibneft.

Sibneft-Yugra was established at the end of 2002. In Sibneft-Yugra 50% stakes belonged to Yugraneft subsidiary of Se and Sibneft-Noyabrskneftegaz, the main upstream subsidiary of Sibneft. To the authorized capital of the joint venture Yugraneft contributed the licenses for development of the Yuzhno-Priobskoe and Vostochno-Palyanovskoe oil fields (Khanty-Mansiysk Autonomous Area) with recoverable reserves of about 290 million tons. Noyabrskneftegaz received its stake in exchange for future investments and became the operator of the joint venture.

On April 19, SE controlled by President of Moscow Oil Company Shalva Chigirinsky requested the London Stock Exchange to suspend the trade in SE securities due to the problems with the company's share in Sibneft-Yugra. Later it turned out that the stake of SE In this joint venture was almost fully diluted in a mysterious way.

According to The Sunday Times, SE is considering a possibility to persecute Sibneft through the court but does not wish to do this because the controversy will be long and expensive. Meanwhile, stake of SE in Sibneft-Yugra had to become the company's contribution to the Moscow Oil and Gas Company (MOGC) being established in cooperation with the Moscow Mayor's Office. MOGC had to become operator of all oil assets of the municipal authorities, primarily the Moscow refinery, instead of Moscow Oil Company. At the end of April, the Board of

Directors of MOGC decided that not later than on May 31 SE had to start "procedure of temporary substitution of the asset" contributed to the authorized capital of MOGC. However, on May 31 a source close to MOGC reported that beginning of substitution was postponed indefinitely.

Along with this, in the last few days it has been rumored among London-based brokerages that Sibneft is going to buy out SE from its current owners at the market price at the moment of suspension of trade in SE shares, namely at about \$489 million. The brokers proceed from the assumption that this is a very beneficial proposal because if trade in Se shares is restarted their price will be seriously lowered (at least by 20%). According to one of the traders, Sibneft also possesses big cash reserves that it is obviously not going to the owner of 92% of its shares (YUKOS) in the form of dividends. That is why Sibneft needs to buy new assets.

Representatives of Sibneft once again refused to comment on Sibneft-Yugra situation and rumors on acquisition of SE, Representatives of MOGC, which may not be established in the initially planned form because of these events, do not comment on the news. Representatives of SE proposed the journalists to wait until publication of the official report confirming that it would be published in a few days.

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LITHUANIAN PARLIAMENT MEMBERS DOUBT LEGALITY OF PRIVATIZATION OF MAZEIKIU NAFTA

Overseas problems may be added to the problems of YUKOS in Russia. A commission of Lithuanian parliament drew a conclusion that the oil corporation Mazeikiu nafta (MN) where YUKOS had controlling interest had been privatized incorrectly. In any case, local officials say that nobody is going to take MN from YUKOS.

Mazeikiu nafta includes the Mazeikiiai refinery with capacity of 12 million tons a year, sea export terminal Butinge with capacity of 8 million tons a year and Birzai trunk oil pipeline. YUKOS has a 53.7% stake in MN and Lithuanian government has 40.66% of MN shares.

In 1999, Lithuania granted MN for management to the American company Williams International Co. (WIC). WIC became owner of 26.85% of MN shares having bought out the additional issue. In the course of additional issue in 2002 YUKOS bought the same stake. After that the Russian company acquired the stake of WIC and increased its share in MN to 53.7%.

Scandals related to MN have continued during all this time. Many Lithuanian politicians called the agreement with WIC predatory for the republic and the process of its approval even resulted in a governmental crisis. In 1999, Prime Minister Rolandas Paksas unwilling to sign the agreement resigned. (Recently Paksas lost the post of the President of Lithuania as a result of impeachment.) The Lithuanian parliament even organized a special commission to investigate into the privatization. Parliament members plan to study results of the commission's work. The commission drew a conclusion that MN actually was not privatized. An official of the Lithuanian government reported that according to the commission the state did not receive anything from reassigning of MN shares to private owners. The source explains, "Investors bought not the state-owned stake but shares of additional issues and it was the company that received all money in this case." The source presumes that if the signs of a crime are detected materials of the check may be forwarded to the prosecutor's office.

Between 1998 and 2002, WIC and other companies earned about 100 million euros on running of MN. During this period MN bore loss of 217.2 million euros. In any case, the official presumes that any claims will hardly be

stated against YUKOS. Interfax news agency points out that the draft conclusion of the commission "contains critique of activities of Rolandas Paksas, who was the Prime Minister then" and the blame for the form of MN privatization is laid on the previous parliament and former President Valdas Adamkus, who "exerted political influence on significant decisions."

Official representatives of MN refuse to comment on the news. One of the managers of MN states that the parliamentary commission is organized specifically to investigate into the terms for reassigning of shares to the American company. Nonetheless, the YUKOS affair worries Lithuania. Chair of the Lithuanian parliament Arturas Paulauskas announced after appearance of information about the search for co-owners of YUKOS that Lithuania did not rule out a possibility of buyout of MN shares from YUKOS. An official of the Lithuanian government explains that Lithuania is afraid of possible irregularities in oil supplies to MN. He adds, "The company lives due to this, pays of taxes and returns credits. Uninterrupted oil supplies are important for the government as a creditor. If there is a threat to supplies, we will seek alternative suppliers."

Press Secretary of YUKOS Alexander Shadrin states that Lithuania need not be afraid of irregularities in supplies. Says Shadrin, "Privatization of MN pursued the goal of provision of uninterrupted oil supplies and to achieve profitability of the company. These goals were achieved under the management of YUKOS." Analyst of NIKoil Lev Snykov recommends waiting for the verdict of the parliament. According to Snykov, there may be negative consequences for YUKOS only if the parliament comes to conclusion that the Russian company owns MN illegally.

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COMPANY PROFILES

STANDARD & POOR'S PLACED RATING OF SIBNEFT ON CREDITWATCH WITH NEGATIVE IMPLICATIONS

Standard & Poor's Ratings Services revised the implications of the CreditWatch status of its 'B' long-term corporate credit rating on Sibneft to negative from developing.

The revision reflects Standard & Poor's concerns about potential implications for Sibneft of the fiscal and legal pressures on Sibneft's 92% shareholder, YUKOS.

These have been mounting following the court decision on a \$3.4 billion tax claim against YUKOS (subject to an appeal) and a freeze of the company's assets (including its 92% stake in Sibneft).

"This raises uncertainty over Sibneft's status in the event of a YUKOS default or bankruptcy, further complicates the reversal of the Sibneft takeover by

YUKOS, and increases uncertainty over Sibneft's shareholding structure," said Standard & Poor's credit analyst Elena Anankina. "If YUKOS were allowed by the court - which is not currently the case - to sell its stake in Sibneft (fully or partially) to pay taxes or debt, we would be concerned that Sibneft might increase its leverage considerably to finance a stock repurchase by the company or its former shareholders."

The negative CreditWatch implications on Sibneft also highlight Standard & Poor's concerns over the company's aggressive corporate governance practices and financial policy. Indeed, it is unusual that YUKOS, a 92% shareholder, does not have any effective control over Sibneft's management, assets, or cash flows, as illustrated by several failures to elect its representatives to Sibneft's

board of directors. Although the rating on YUKOS does not act as a formal constraint for Sibneft, this situation illustrates aggressive corporate governance practices, which put pressure on Sibneft's rating.

The CreditWatch status of Sibneft will be resolved when the company's shareholding structure, financial policy, and corporate governance practices are clarified.

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RUSSIAN COUNTER-INTELLIGENCE IS CURIOUS ABOUT FOREIGN MANAGERS OF TNK-BP

A year after acquisition of TNK, British Petroleum has problems in Russia. Federal Security Service (FSS) agents started getting curious about foreign managers of TNK-BP.

TNK-BP was established in September 2003. It belongs on the parity basis to British Petroleum and consortium of Alfa group and Access/Renova. The new company registered on the British Virgin Islands include a 96% stake in TNK, 99% in ONACO and 82% in SIDANCO, as well as stakes in RUSIA Petroleum and Rospan, a chain of gasoline stations and a 50% stake in Slavneft. The main oil field of TNK-BP is Samotlor. TNK-BP plans to increase production at Samotlor by 40% in five years. At the end of 2001, TNK drew credits worth more than \$400 million under guarantees of Eximbank US for this purpose.

Several managers of TNK-BP say that the FSC is sending inquiries and is doing checks in the company.

According to Russian legislation, information about reserves of oil fields and maps of oil tracts are attributed to state secrets and cannot be disclosed to foreigners. A representative of TNK-BP is surprised, "How can we not to disclose this information if foreigners work as top managers for the company?" there are 1,400 people working for the headquarters of TNK-BP, more than 100 of them being foreigners. These are mostly top managers, majority of them working in Russia under provisional contracts.

Managing Director of TNK-BP Victor Vekselberg confirms, "We really have problems because everything

related to natural resources belongs to the category of state secrets. For example, the topmost manager is obliged to have access to this information but only a Russian citizen can receive such access according to the law." President of TNK-BP is British citizen Robert Dudley.

It was impossible to receive comments from the FSC. A source close to FSC presumes that the counter-intelligence service probably sends inquiries to the company proceeding from clause 5 of the law "on state secret" and presidential decree No. 1203 of 1995 where the list of the information constituting state secret indicates reserves of "strategic kinds" of natural resources including oil. The source adds, "To solve the problem it will be necessary to revise the resolution of the government on strategic kinds of natural reserves."

According to Vekselberg, TNK-BP is going to propose amendments to the legislation simplifying work of foreigners for Russian companies. Says Vekselberg, "There are many unanswered questions in regulation of activities of foreign citizens in the territory of Russia. We are simply on the cutting edge of this problem."

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MINISTRY OF INDUSTRY AND ENERGY THREATENS TNK-BP TO PROHIBIT OIL PRODUCTION ON SAMOTLOR FIELD

On May 28, Sergei Oganessian, Director of the Federal Energy Agency subordinated to the Ministry of Industry and Energy announced that oil production at the Samotlor field (Khanty-Mansiysk Autonomous Area) might be

prohibited for TNK-BP because the company did not have the plan for Samotlor development approved by the government. State officials are discontent with the actual oil production at the licensed tracts exceeding the figures

written in the license agreements. Practically any large oil company has such breaches. Representatives of TNK-BP reported that they did not receive any official notifications about breaches in development of Samotlor.

Samotlor field was discovered in 1965. Its commercial development began in 1971 (then its reserves amounted to 3 billion tons of oil). The peak of production was registered in 1983 when output of the field amounted to 160 million tons of oil. During all years of development the overall production at Samotlor totaled 2.2 billion tons. The field is currently developed by Samotlorneftegaz belonging to TNK-BP. In 2003, Samotlorneftegaz produced about 18 million tons of oil.

Oganesyan announced, "At some fields of the largest companies oil production is 100-200% bigger than the norm, which is not acceptable. The same companies have a huge inactive fund of wells amounting to 40-60% of the overall number of wells. The relevant state power bodies should be ready to take very serious quick and efficient measures."

In 2003, production of Samotlorneftegaz grew by 10% in comparison to 2002. This is not the highest growth figure in the industry. For example, Yuganskneftegaz of YUKOS increased production by 16% and Slavneft-Megionneftegaz increased production by 26%.

Press Secretary of TNK-BP Vladimir Bobylev commented on Oganesyan's statement, "The license for development of the field is valid until 2013. Approximately once in five years the natural resources developer is obliged to present a new plan for development of the field taking into account use of new technologies and changing of production volumes. Preparation of the new plan began in 2003, the plan was submitted to the central commission for development of oil and gas fields of the Ministry of Industry and Energy in April. The plan will be finally approved in 2005."

YUKOS IS SEEKING A NEW CEO

Shareholders of YUKOS decided to change the CEO of the company. CEO Simon Kukes may resign already in June 2004. The reason is absence of positive changes in negotiations between the company and the authorities. It is possible that state officials are interested in appointment of former Chair of the Central Bank Victor Gerashchenko as the head of YUKOS.

A source close to shareholders of YUKOS reported that decision on dismissal of Kukes was actually made at the moment when Gerashchenko agreed to become the Chair of the Board of Directors. Negotiations with Gerashchenko were held by one of the company's shareholders Vasily Shakhnovsky acquainted with Gerashchenko according to banking business. Former CEO of YUKOS Mikhail Khodorkovsky approved this decision.

Press Secretary of YUKOS Alexander Shadrin states that he does not know anything about a possible changing of the company's CEO. A source in the executive Board of YUKOS says that "at the level of managers this issue was

Formally, the Ministry of Industry and Energy cannot demand TNK-BP to stop oil production at Samotlor. Only the Natural Resources Ministry, which has issued the license for development of the field, can do this. Rinat Gizatullin, director of the PR service of the Natural Resources Ministry, comments, "The Natural Resources Ministry has nothing to do with the decisions made by the central commission for development of oil and gas fields. The ministry has no claims against activities of TNK-Bp on Samotlor. The Natural Resources Ministry has not conducted and is not going to conduct unplanned checks at this field."

Claims of Oganesyan against TNK-BP appeared in mid-May. Then the prosecutor's office of Saratov set charges according to three articles of the Criminal Code against Stanislav Turev, CEO of Saratovneftegaz belonging to TNK-BP, and arrested former General Director of Saratovneftegaz Alexander Kosyak. The managers were accused that since 2000 Saratovneftegaz was producing oil at four fields in the Saratov Region without any license under their supervision.

At the end of May, Minister of Industry and Energy Victor Khristenko met with the management of TNK-BP. The content of this meeting is not known but the minister and the top managers of the company have reportedly parted not as the best friends. It is possible that the claims of Oganesyan against the company appeared right after this meeting.

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not discussed."

The source presumes, "Now the company needs a person that can talk to the government in the same language, persuade and give guarantees. Kukes cannot do this. Western investors understand him much better than Russian officials." According to the source, Kukes was efficient on the post of CEO of TNK because its shareholders negotiated with authorities and with each other independently and the CEO fulfilled mostly representative functions. In YUKOS everything is just the opposite. The major owners of the company, shareholders of Group MENATEP, are either in prison or in emigration except for Shakhnovsky. Owners of 26% of YUKOS shares, former owners of Sibneft (now 92% of its shares belong to YUKOS) want a breakup. After notification of creditors of YUKOS about a possible event of default and the allowed lawsuit of the Tax Ministry worth \$3.4 billion against the company it is already impossible to sooth Western investors down with verbal statements.

Kukes still combines the posts of CEO and Chair of the Board of Directors of YUKOS. After the shareholders' meeting these posts will most likely belong to different people. Gerashchenko will be curator of negotiations if he is elected for the post of the Chair of the Board of Directors. Thus, the post of CEO will be cleared of the political component and the CEO will be able to focus on management of the company.

Executive Director of the managing company YUKOS-Moscow Steven Theede suits this role in YUKOS best of all. In November 2003, this structure received the functions of coordination of all current production and financial activities of YUKOS. Then the Board of Directors of YUKOS-Moscow elected Kukes as CEO of YUKOS. With regard to Theede, YUKOS nominated him for the post of President of Sibneft.

There is only one argument against Theede, whom sources close to Group MENATEP call the most likely but probably not the only candidate. Theede is an American. If YUKOS is seriously going to start a dialog with the authorities it may have problems. In any case, President of Sibneft Yevgeny Shvidler and Simon Kukes also have American citizenship. At any rate, it is commonly known that all negotiations with the authorities are held by shareholders of Sibneft. Shareholders of YUKOS have no such possibility. That is why they need to find a good negotiator able to defend their interests professionally.

Appointment of Theede as the CEO of YUKOS may be

taken as the next stage of protection. The source presumes that the authorities are more interested in replacing of Kukes both on the post of the CEO and Chair of the Board of Directors with Gerashchenko, who already has a "plan for company's salvation." But this is not beneficial for the company. A source close to Group MENATEP explains, "Gerashchenko is good as a strong political figure but as a manager of an oil company he is weak. It is crazy to make him a manager."

At any ate, this personnel configuration is impossible without approval of the authorities. On May 27, Deputy CEO of YUKOS Yury Beilin reported that until the end of the year the company would be able to pay maximum 60-70% of the sum of \$3.4 billion that the court obliged the company to pay to the budget. Beilin added, "If there is no good will of the government YUKOS will go broke already in 2004." Nether shareholders of YUKOS nor creditors connected with them have practically any chances to come to agreement with an external manger appointed by the state.

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YUGANSKNEFTEGAZ UNDERTAKES FINANCIAL LIABILITIES OF YUKOS

On May 31, YUKOS released a resolution of the shareholders' meeting of its Yuganskneftegaz subsidiary. On May 21, Yuganskneftegaz undertook being of a guarantor under two credits drawn by YUKOS worth \$2.6 billion. The overall size of the liabilities of YUKOS guaranteed by Yuganskneftegaz amounts to \$5 billion. Representatives of YUKOS reported that the company decided to provide additional guarantees under credits to banks and the banks were quite content with the guarantee of Yuganskneftegaz. Assets of the Yuganskneftegaz cost about \$2 billion. This will not be sufficient to pay off creditors if they demand to return the money at once.

YUKOS announced drawing of long-term credits worth 42.6 billion in September 2003. Societe Generale acted as coordinator, agent and authorized organizer of the \$1-billion credit. The consortium of the banks that issued the credit to YUKOS also included nine Western crediting organizations. At the same time Societe Generale also issued a \$1.6-billion credit to YUKOS. According to financial statements of YUKOS for 2003 according to US GAAP, the money was allocated to the company through Societe Generale by Group MENATEP, the major shareholder of YUKOS.

Both credits were issued on similar terms. Each of them was issued in two equal installments for three and five years and was covered with oil export revenue. The

three-year installments were issued at LIBOR+1.5% and the five-year installments were issued at LIBOR+1.75% (for the first three years) to LIBOR+2% (for the last two years).

In April and May, YUKOS received notifications from banks about possible event of default on both credits. In their notifications the banks confirmed that the company was able to conduct export trading operations connected with the issued creditors without any limitations. Along with this, the creditor banks may use their rights regarding the banking accounts turnover of which is used as collateral under the credits.

Due to the threat of default banks demanded additional guarantees from YUKOS. The guarantees were given y Yuganskneftegaz, the largest upstream subsidiary of YUKOS. The relevant decision was made at the shareholders' meeting of Yuganskneftegaz on May 21.

Yuganskneftegaz accounts for 62% of oil production of YUKOS without Sibneft. All shares of Yuganskneftegaz belong to YUKOS.

Yuganskneftegaz undertook liabilities of YUKOS under both credits including their return, payment of interest and possible penalties. The collateral is provided for the entire period necessary to pay off the credits. The overall sum of collateral amounts to \$5 billion: \$2 billion for the \$1-billion credit and \$3 billion for the \$1.6-billion credit.

According to analyst Dmitry Lukashov of Aton, this

step of YUKOS may make reception of money easier for creditors if the company encounters new unforeseen circumstances, for example, bankruptcy or new tax claims. Senior lawyer of prospect investment company Eldar Nazmutdinov says that the next step of Yuganskneftegaz will be signing of agreements of guarantee on both credits with banks. The lawyer explains, "Because YUKOS and Yuganskneftegaz are separate companies, such step should sooth the creditors down. The main claims of the Tax Ministry are set against YUKOS and not against Yuganskneftegaz so far."

The overall value of the liabilities undertaken by Yuganskneftegaz is 150% bigger than the value of its assets (59 billion rubles as of April 1). This sum will be insufficient to pay off the credits if the banks demand immediate payment from YUKOS. However, according to Shadrin, creditors are fully content with the guarantees provided by Yuganskneftegaz.

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