



Office of Russian and Eurasian Analysis



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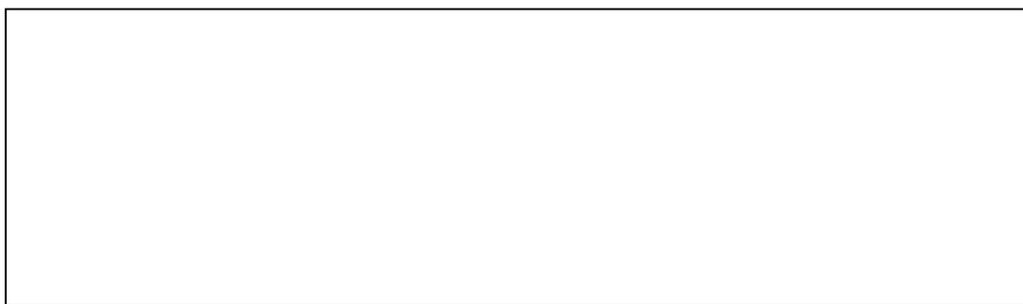
Caspian Energy Update

25 March 1997

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The possibilities for production and export of Caspian oil and gas resources continue to advance, albeit with some snags, with the signing of new production agreements and progress on transportation routes, heightening the need for cooperation among regional players to resolve potential bottlenecks.

- ***New Production Agreements Signed.*** Several new production agreements have been signed over the last several months in Azerbaijan and Turkmenistan, including the first two consortiums in Azerbaijan to exclude Lukoil.
- ***Western Route Breaks Ground as Northern Route Breaks Down.*** The Azerbaijan International Operating Company (AIOC) will soon award contracts for the construction of the Western route for early oil, while Transneft has delayed acceptance of Azerbaijani oil through the northern route.
- ***AIOC Studies Options for Main Oil Export Pipeline.*** The AIOC is currently studying five options for a main oil pipeline, but a final decision on a pipeline route is still several years away and will be influenced by a number of political as well as commercial factors, including access to the Bosphorus.



This is one of a series of aperiodic updates on developments in the extraction and transportation of oil and gas in the Caspian Sea basin and distributed to a select group of US policy officials responsible for this issue. It is prepared by analysts in the Office of Russian and Eurasian Analysis, National Imagery and Mapping Agency, and Office of Transnational Security and Technology Issues. Our analysis is indicated in bold italicized type. Comments are welcome and may be directed to Chief, ORE,



[redacted]

Production Developments [redacted]

No Room for Lukoil in New Consortiums [redacted]

Underscoring the growing momentum of foreign investment in Caspian oil and gas projects, Azerbaijan has concluded two new contracts in the last three months. Aside from their commercial value, a key significance of the new deals is that they do not include Lukoil or any other Russian company--*a sign that Azerbaijan's confidence in its position on Caspian demarcation and other disputes with Moscow has likely grown to the point that it no longer feels compelled to bring Russian companies into every project.* Press reports also indicate that President Aliyev has become disillusioned with Lukoil's ability to influence Russian policy.

- [redacted] the pace of signings with foreign oil companies is picking up as a result of the Azerbaijani State Oil Company's (SOCAR) growing professionalism and experience. The negotiations are less politicized, [redacted] [redacted] with negotiating authority increasingly vested in SOCAR Director of Foreign Investments Aleskerov, and the only real bottleneck in the process now is the sheer number of proposals on SOCAR's plate. [redacted]

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Project Developments In Brief [redacted]

North Absheron Operating Company Established. On 14 December, Baku signed a \$2 billion deal with several Western companies to develop the Dan-Ulduzu and Ashrafi offshore prospects...includes Amoco (30 percent), Unocal (25.5 percent), Japan's Itochu (20 percent), Saudi Arabia's Delta (4.5 percent), and SOCAR (20 percent)...estimated recoverable resources of 800 million barrels of oil and 50 billion cubic meters (bcm) of natural gas...expected peak production of 150,000 barrels per day (b/d) by 2007.

French Lead Fifth Consortium. On January 13, Baku signed a \$2 billion deal for the offshore Lenkoran-Deniz and Talysh-Deniz concessions...consortium headed by French firms ELF (40 percent) and Total (10 percent)...SOCAR to hold 20 percent...while not finalized, Mobil may get 25 percent and the German firm Deminex the remaining 5 percent [redacted] recoverable oil resources are estimated at 500-600 million barrels of oil.

Mobil and Monument Join Forces in Turkmenistan. Turkmenistan granted Mobil and Monument Oil of Great Britain exclusive rights to negotiate a production-sharing agreement (PSA) for a 20,000-sq-km onshore region south of the Cheleken peninsula...Mobil estimates area contains 1 billion barrels of oil, [redacted]

Potential Movement on Kazakstankaspiishelf Impasse. Kazakstani President Nazarbayev is angry over the delay in negotiations for a PSA to explore and develop part of Kazakstan's section of the Caspian Sea. [redacted] expect a PSA in the next three months.. [redacted]

Lukoil to Join Tengizchevroil. Chevron announced in February that it would sell 5 percent of its share of Kazakstan's Tengiz oilfield to Lukoil, according to press reporting...terms not announced...negotiations have been slow because of Lukoil's reluctance to pay the market price, estimated at \$210 million.

CPC Update. The Caspian Pipeline Consortium (CPC) was formally restructured in December...Amoco announced in March that it would finance Kazakstan's share in return for space in the pipeline... start of construction has been delayed until September... negotiations with four Russian regions continue over rights-of-way, according to press reports.. [redacted]

[redacted] .could delay planned 1999 startup date. [redacted]

This box is classified [redacted]

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Recent Transportation Initiatives []

Transneft's Muddling on the Northern Route []

The continued failure of Russia's state-owned pipeline monopoly Transneft to fulfill its obligations on handling Azerbaijani oil exports through the North Caucasus Pipeline system is hurting its reputation in the region and seriously undermining Russia's goal of winning the competition for the main export pipeline. Transneft was obligated to begin handling Azerbaijani oil exports as early as last December, according to a 1996 agreement signed by Premier Chernomyrdin, but it has thus far refused to accept any oil and has given mixed signals about when it might be ready to start, according to press []

Much of the blame for the delays stems from difficulties with the Chechens, who control one-tenth of the pipeline and want a share of the transit revenues. *Transneft has made a bad situation worse by trying to wiggle out of its contractual responsibilities.* In January, the company rejected the first shipment of Azerbaijani oil, claiming that the transit agreement only applied to Azerbaijan International Operating Company (AIOC) oil, which is not scheduled to begin production until August. Transneft reversed itself in February, stating publicly it would begin accepting oil once it had signed an agreement with the Chechens. In March, however, it demanded a higher transit fee for handling all non-AIOC oil, according to press reports.

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- [] Transneft's actions have damaged its reputation among Western oil companies in the region and provoked sharp criticism from Azerbaijani officials, including President Aliyev, who stated publicly in March that the main export pipeline would transit Georgia, not Russia. []

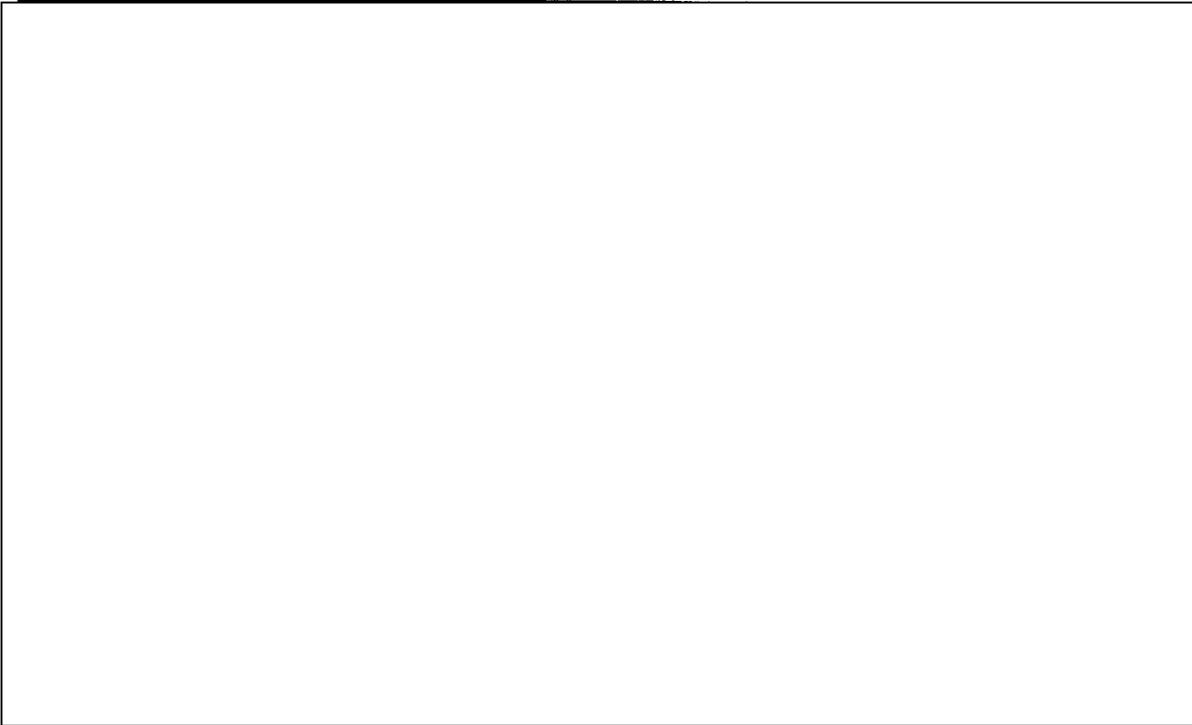
Despite its unpredictable behavior, Transneft has strong incentives to ensure the success of the northern oil export route, and it probably has the resources to overcome the technical and financial challenges.

- The company has begun refurbishing the pipeline, which was not heavily damaged during the Chechnya conflict, and could complete this work within three to four months; []
- Until the pipeline is fully operational, [] Transneft could route initial oil flows through alternative routes, including by barge or train. []

If Transneft can get the pipeline operating, its success would strengthen Russia's stake in Caspian oil projects, provide a steady source of revenues for Chechnya, and could help Transneft become a more professional player.



- Failure on Transneft's part will undermine Moscow's chances for winning a share of the region's much larger oil exports expected after 2000.
- *While neither Moscow nor Grozny would benefit from further combat operations, there are still risks that rogue elements in Chechnya could try to target the oil pipeline to sabotage the peace treaty.* 



Continued Progress on Western Route 

Progress on the Western route for early oil continues to stay on schedule, according to press reports, with actual construction set to begin this month and finish by the end of 1998. The AIOC took final bids in February from three consortiums and two companies vying to lay the \$300 million pipeline from the oilfields 920 kilometers across Azerbaijan and Georgia, to a new Black Sea port facility at Supsa, according to SOCAR officials.

- Bidders include US, Azerbaijani, Georgian, Turkish, Australian, French, and Italian firms. The AIOC is expected to pick winners soon and may choose separate applicants for the 480-km section in Azerbaijan and the 440-kilometer Georgian stretch, or could award a single contract for both. 

Meanwhile, Georgia's importance as a transport corridor for both bringing equipment into and exporting oil from the region continues to grow.



- According to press reports, the AIOC used the rail corridor from Batumi and Poti to Baku to import more than 70,000 tons of supplies in 1996--well over half of its total imports since starting up operations more than two years ago.
- While reporting on precise volumes is conflicting, it appears that at least several thousand tons of Kazakstani crude oil have been shipped by rail across Azerbaijan and Georgia to the Black Sea for export, and SOCAR officials indicated in February that they were considering crude exports along the same route later this year, according to press reports.

The Main Oil Pipeline: Options and Obstacles

To meet its contract obligation to present a study on options for a main oil pipeline to SOCAR by June, the AIOC is studying the economic viability of five different pipeline options. The costs for these options range from \$1.5-3.3 billion, and each has the capacity to carry up to 1.2 million b/d, according to AIOC officials.

The options for the pipeline routes fall into two groups, depending on whether they terminate at the Black Sea. The two options in the less-expensive Black Sea group are economically competitive with each other. The other group consists of three cost-competitive options: two options to the Mediterranean and one to the Persian Gulf.

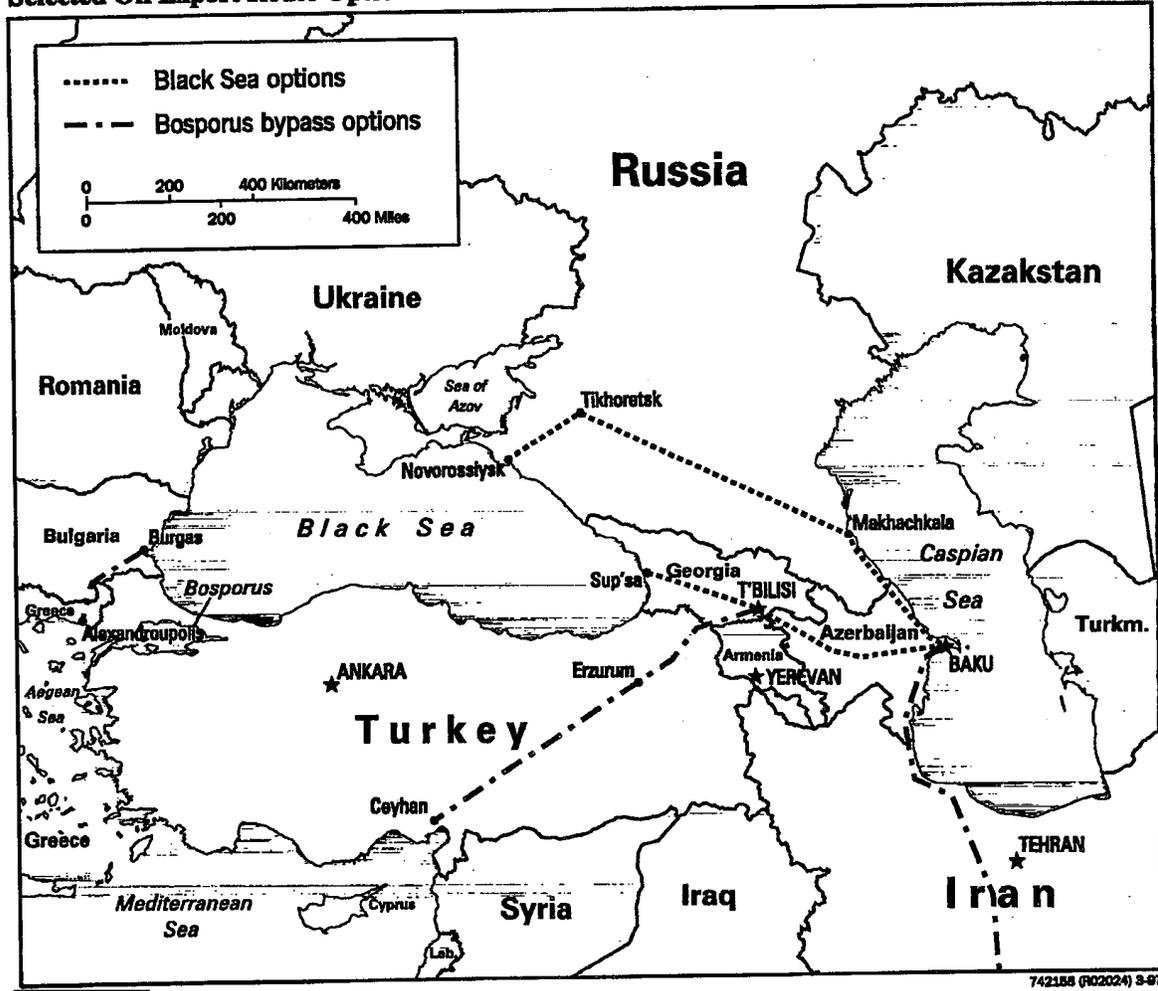
- The two Black Sea pipeline options--feeding a Georgian or a Russian port--are the least expensive because they follow the same pipeline corridors that are being established to export initial oil volumes through Russia and Georgia. These two options, however, require unimpeded use of the Bosphorus Straits, which remains problematic.

The more expensive options bypass the Bosphorus but involve new, longer pipeline corridors and in two cases new port construction.

- One option is a new pipeline from the Black Sea town of Burgas, Bulgaria to a new terminal on the Mediterranean at Alexandroupolis, Greece. This option includes the construction of a main oil pipeline to either Supsa or Novorossiysk.
- A second option is a pipeline that follows the Georgian early oil corridor to T'bilisi, then runs southwest across Turkey to the Mediterranean port of Ceyhan on Turkey's southern coast.
- The third non Black Sea option is a trans-Iranian pipeline from Iran's northern coast on the Caspian south to the Persian Gulf. AIOC executives admitted that this option probably is a nonstarter because of US policy,

A final decision on a pipeline route is several years away. On the basis of its production schedule and early oil export capacity, the AIOC does not anticipate the need for a main oil line until between 2004 and 2006, giving it until 2001 to negotiate a contract and to secure financing.

Selected Oil Export Route Options



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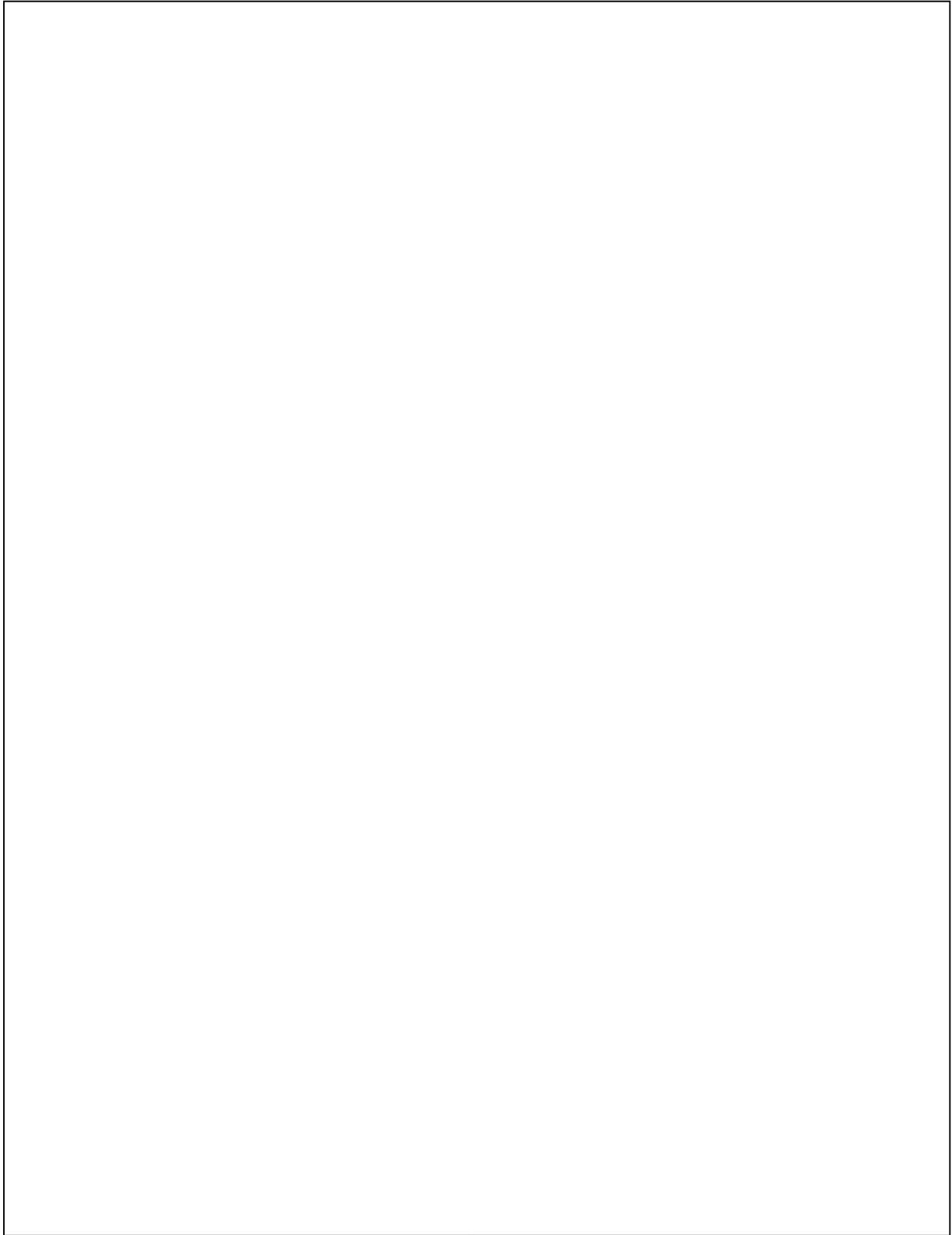
According to AIOC officials, President Aliyev is expecting a decision earlier than the company's projected timeline. Moreover, the AIOC will need additional volumes from other offshore projects just getting under way to justify a main oil pipeline. [REDACTED]

The AIOC does not prefer one option over the others publicly, [REDACTED]
[REDACTED] Several major issues must be cleared for any option to emerge as the preferred one.

- ***The Black Sea options are most viable if Turkey drops its objections to increased traffic in the Bosphorus and measures are adopted to allow increased volumes of oil to transit the Bosphorus.*** The AIOC reported last month that the Turks are tendering for the installation of a modern vehicle traffic system in the Bosphorus.
- ***AIOC's ability to obtain outside financing may be affected by the Caspian demarcation dispute.*** The World Bank has expressed reluctance to support any pipeline option until the demarcation issue is resolved, whereas the European Bank for Reconstruction and Development has expressed no such reservations.
- ***Prospects for various options could be damaged by flareups of regional strife in territories that the pipeline would cross.*** [REDACTED]

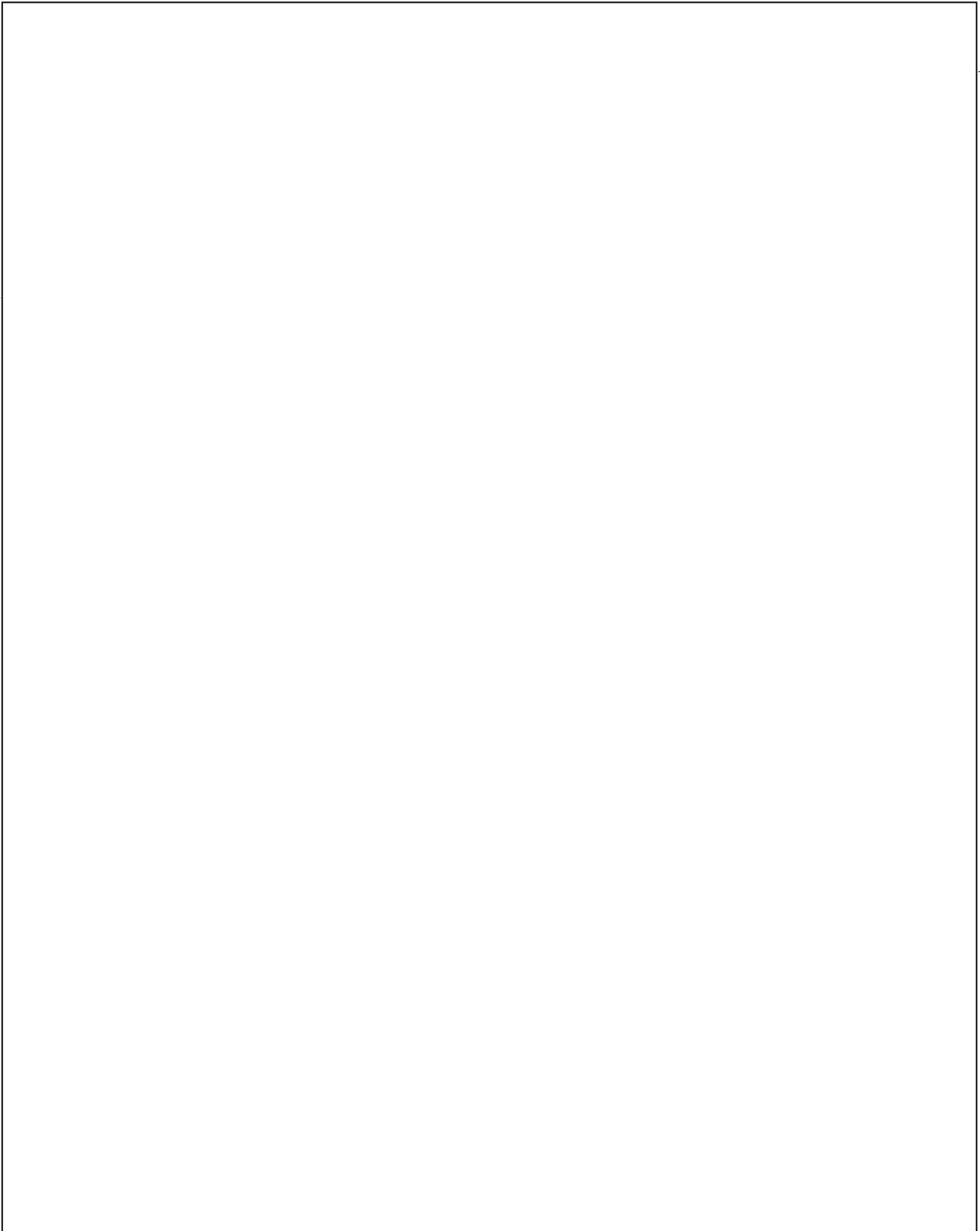
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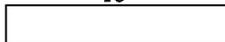


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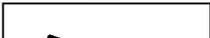
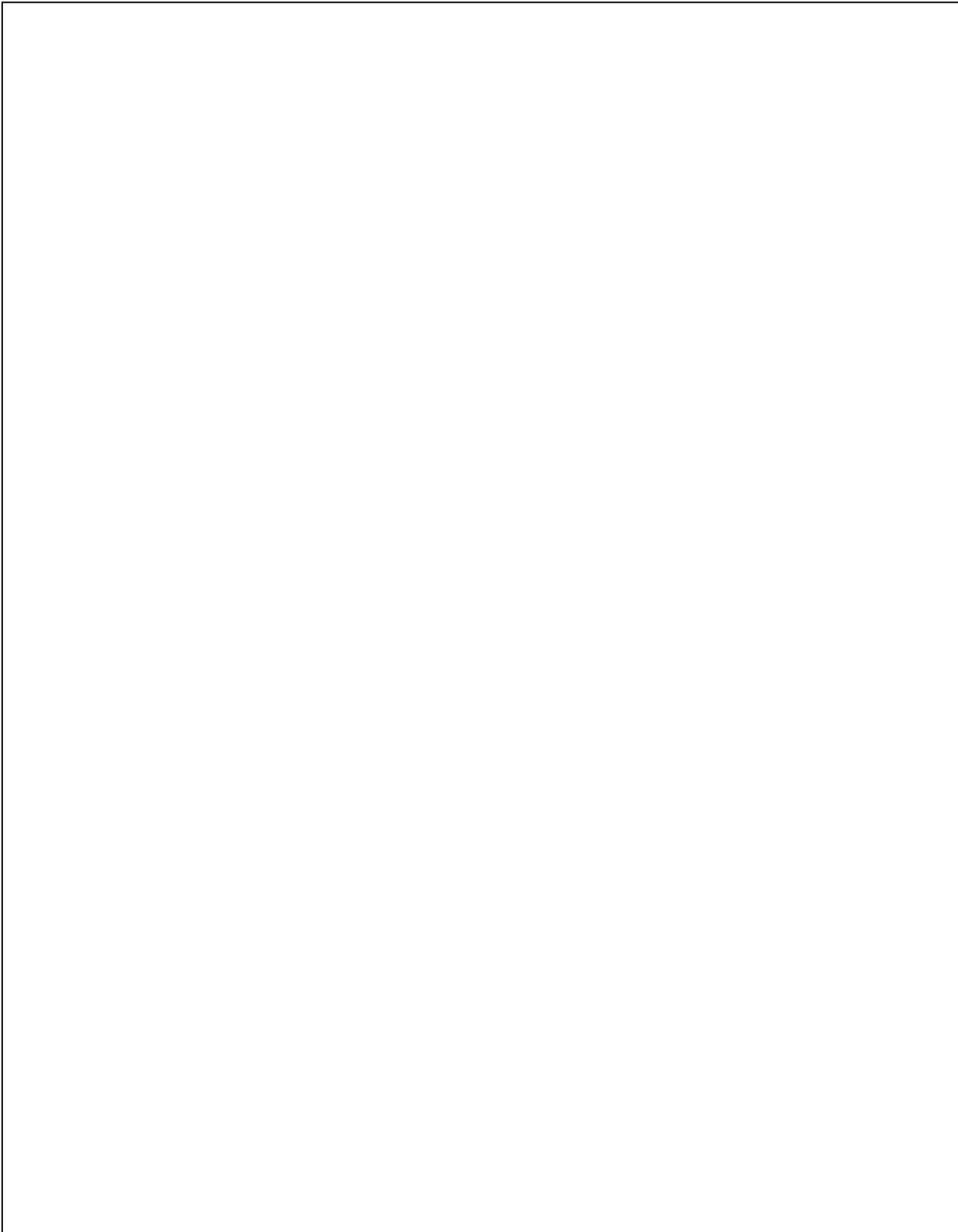


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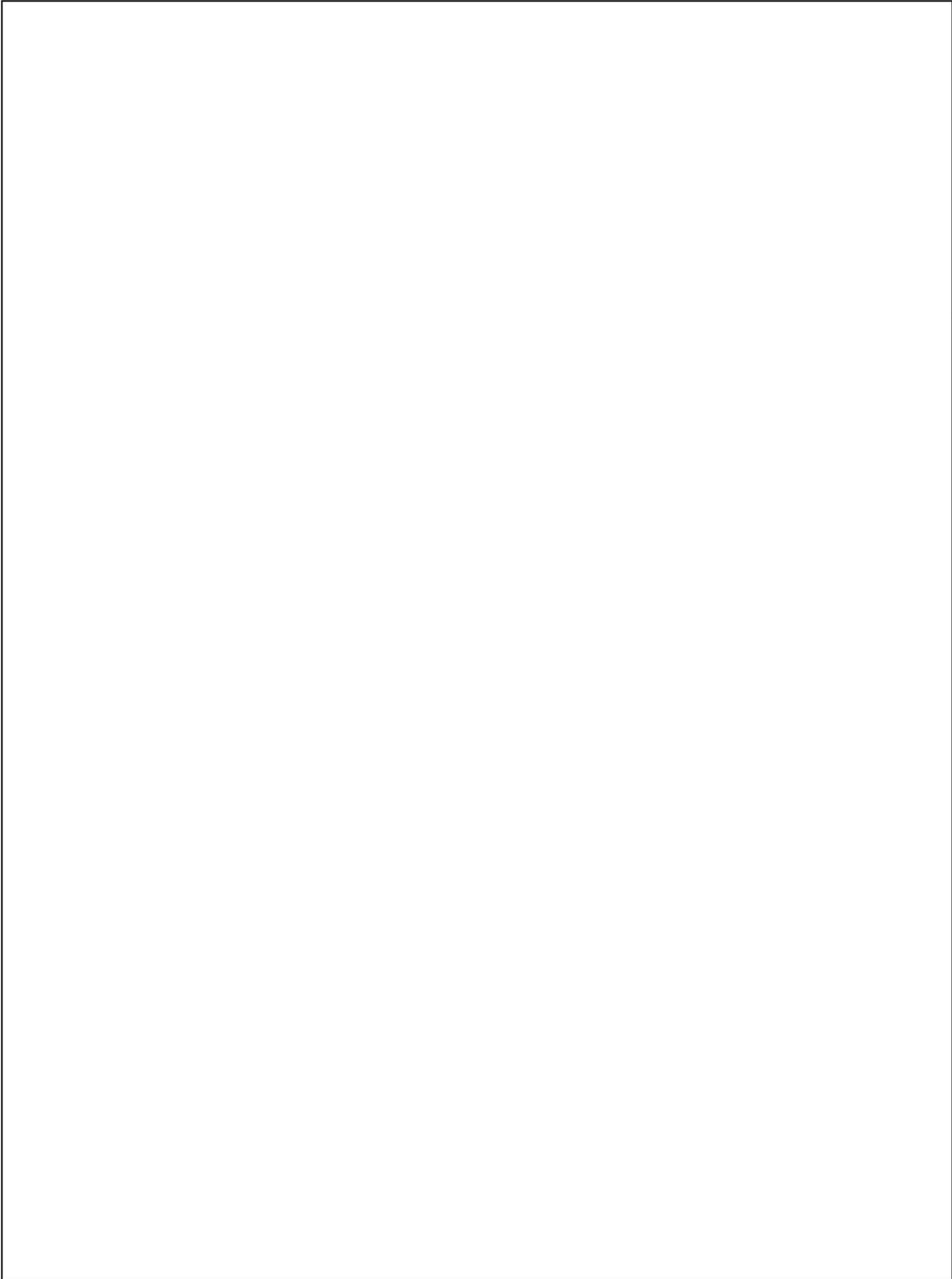
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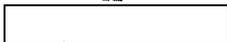


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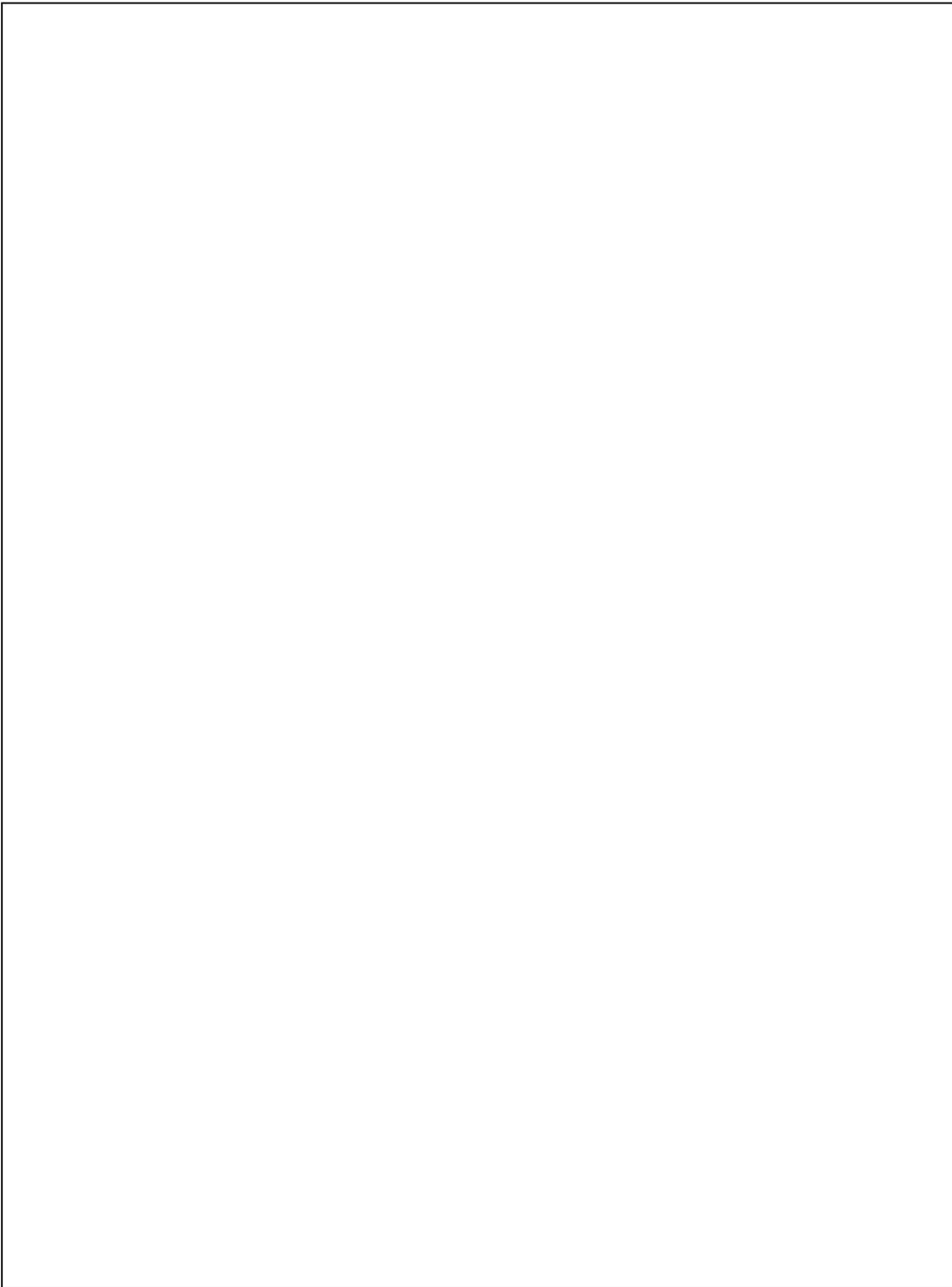


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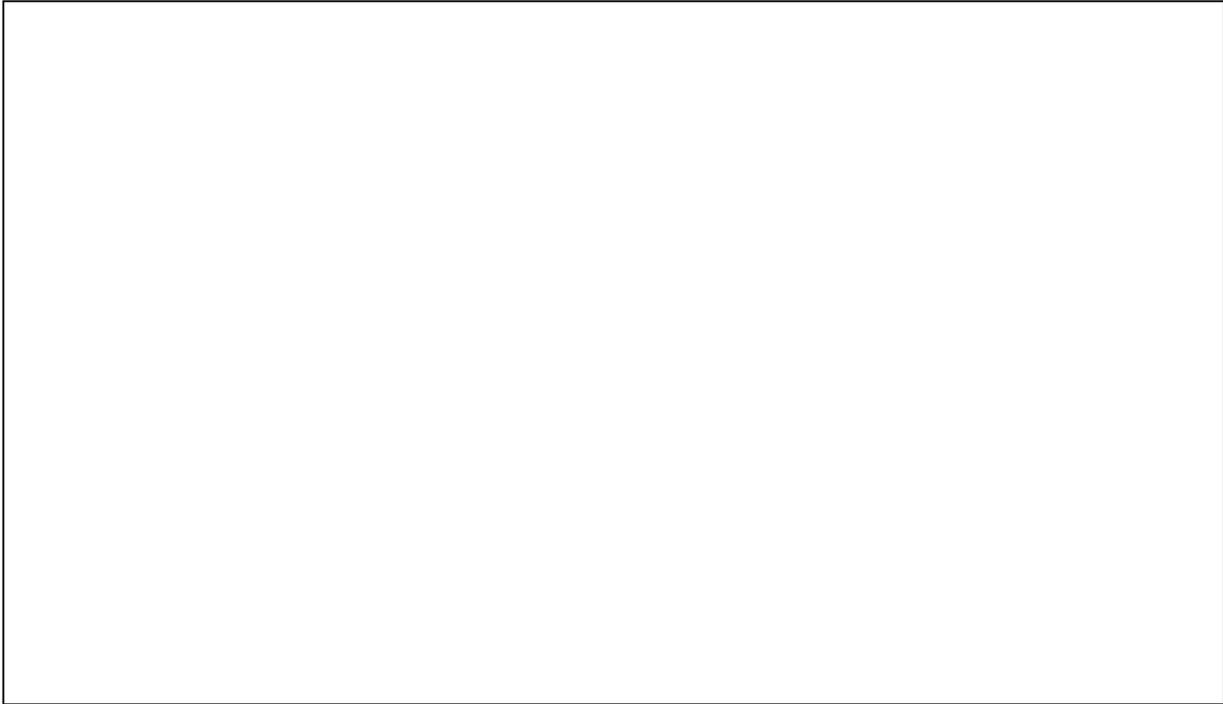
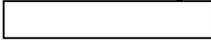
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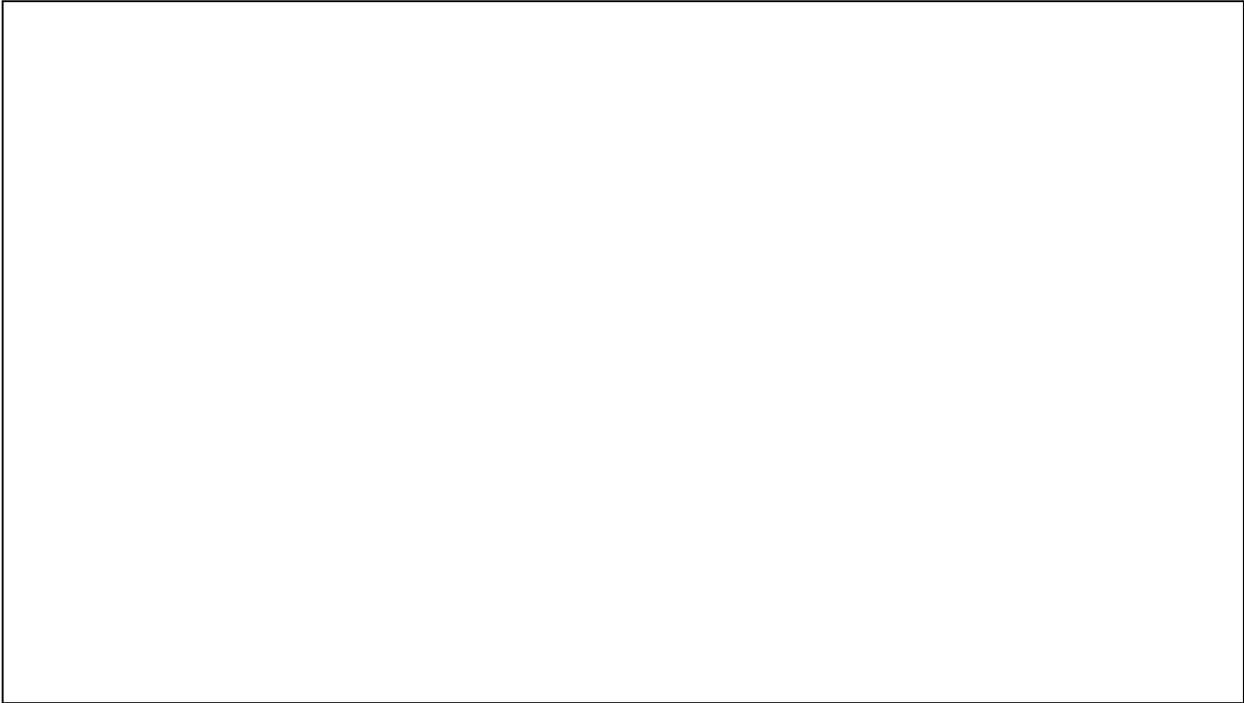
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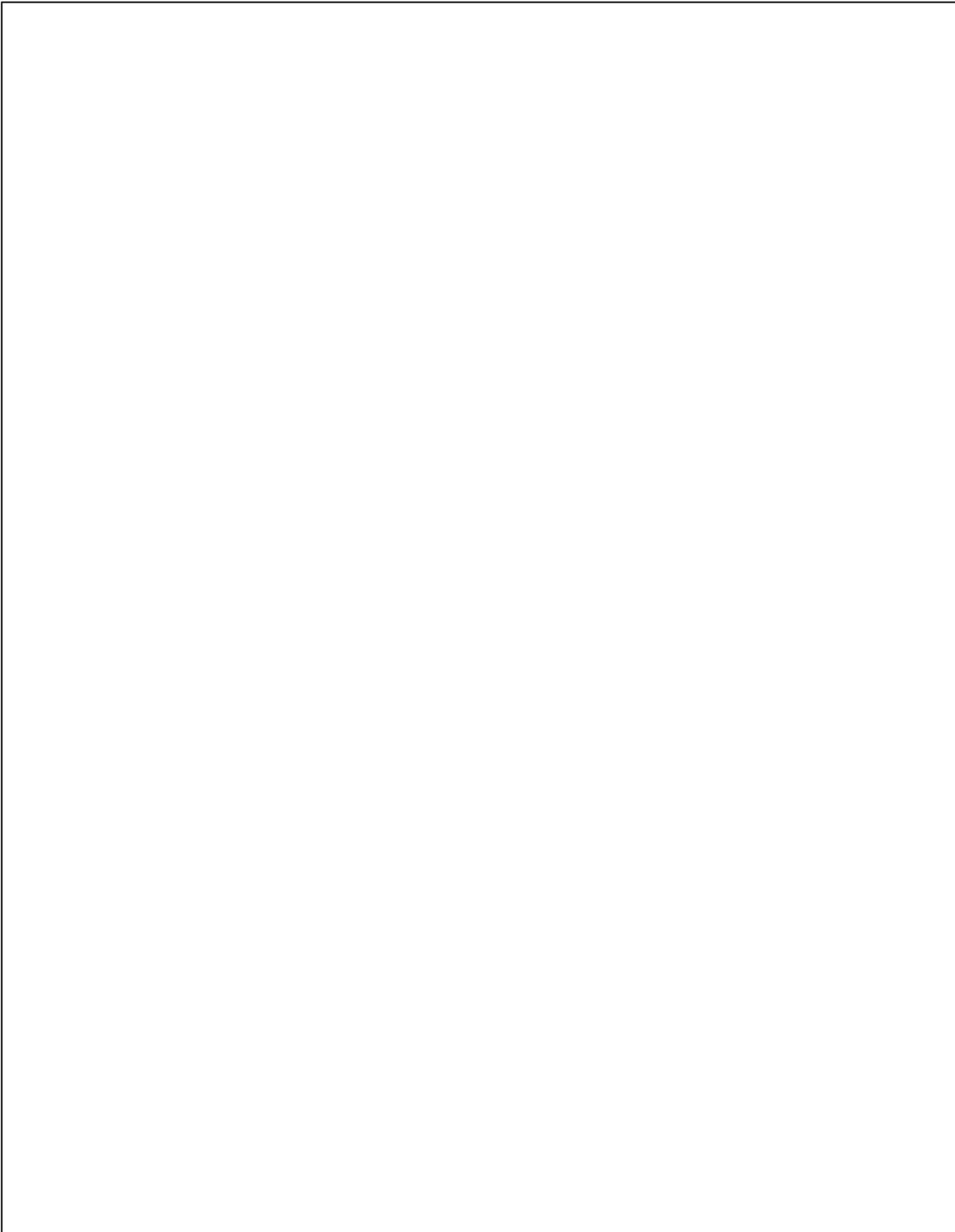
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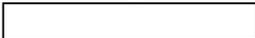
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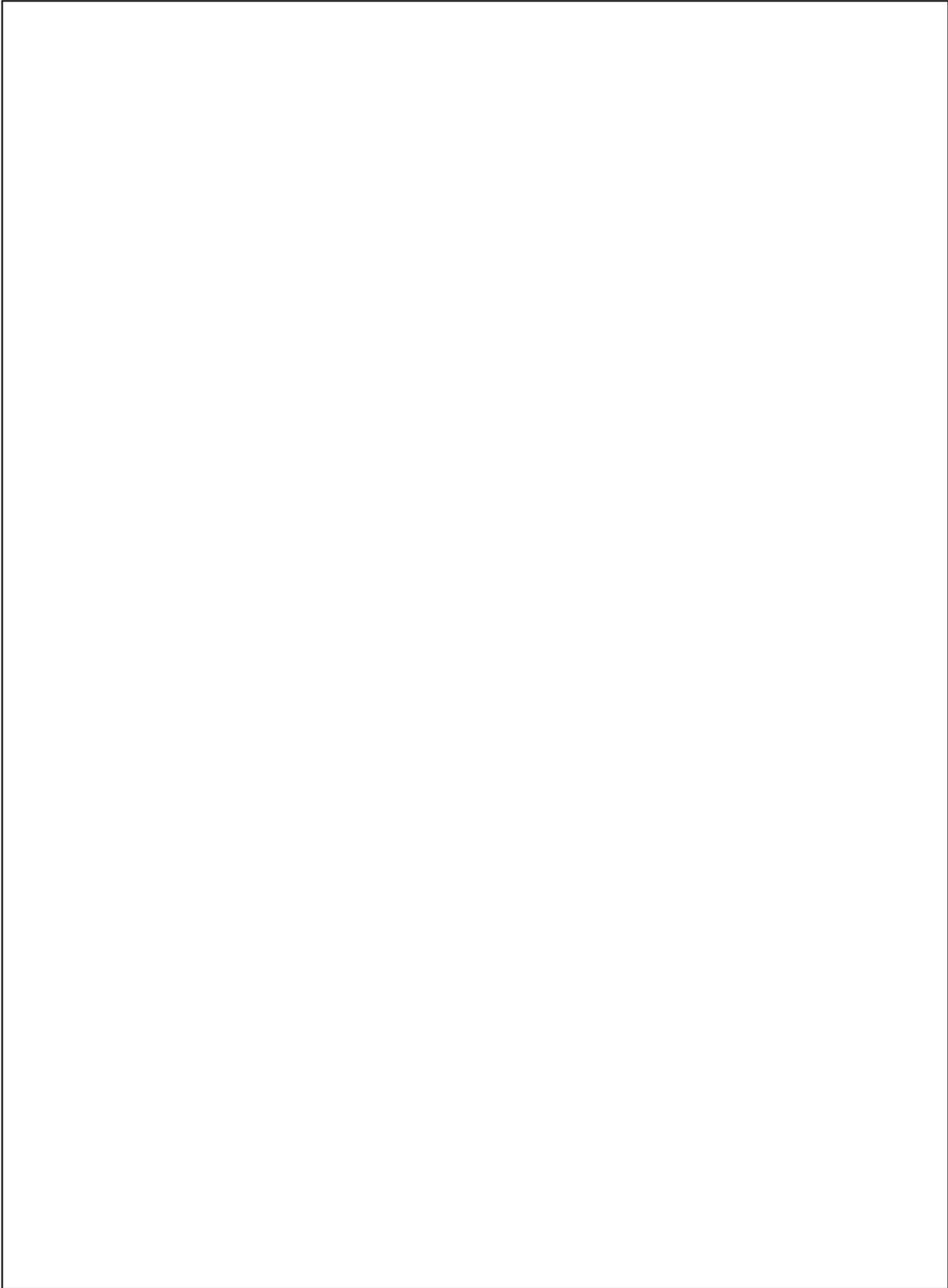


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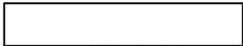


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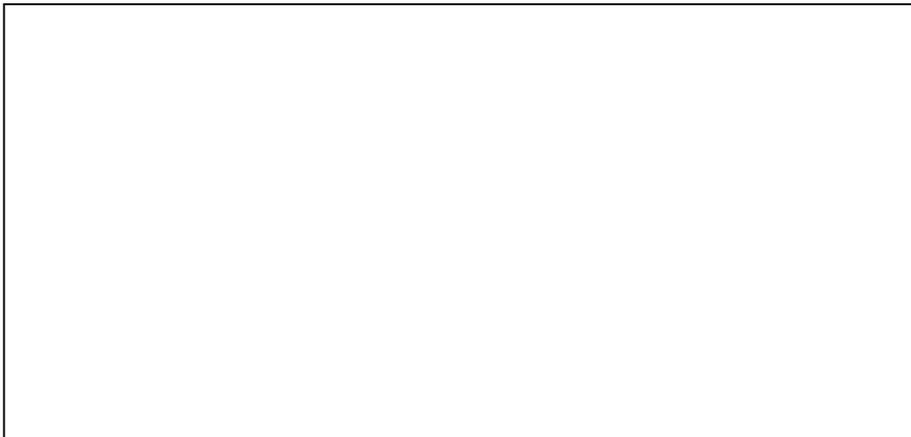
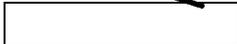


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