

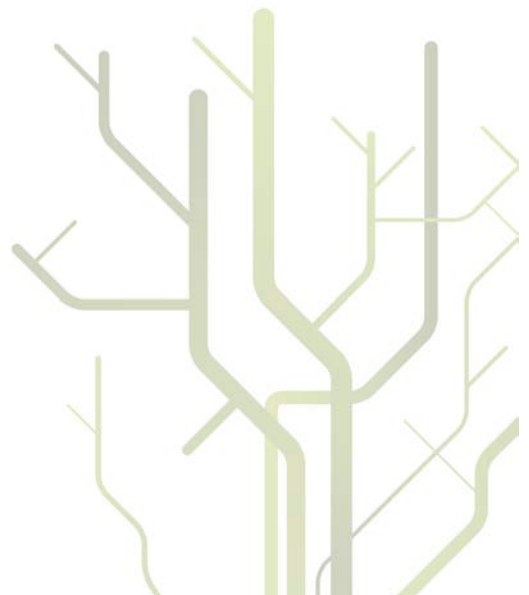
Foreigners in the Russian petroleum sector: the cases of Sakhalin-II and TNK-BP



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Foreigners in the Russian petroleum sector: the cases of Sakhalin-II and TNK-BP

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Summary

This thesis is an attempt to better understand the sometimes tumultuous relations between international oil companies (IOCs) and the Russian state by examining conflicts over regulatory practices and the enforcement of environmental regulations, and their interpretation in the Western media. This research focuses on two cases, one involving Royal Dutch Shell, the majority owner of company Sakhalin Energy, and the other involving BP's Russian joint venture, TNK-BP. The two cases were selected as windows on the changing relationship between the state and IOCs in Russia during a specific political era – the first two presidencies of Vladimir Putin. This was also a period during which oil prices rose steadily and remained at historically high levels. Such periods tend to strengthen the hand of oil-producing states and strain their relations with IOCs.

Sakhalin Energy is the operator of the Sakhalin II project, and was until December 2006 controlled by Shell and later by the Russian state company Gazprom. TNK-BP was the main owner of the Kovykta natural gas field which was central to the conflict – initially between the Russian authorities and a united TNK-BP and later on between the Western and Russian shareholders in TNK-BP. In the cases of both BP and Shell, the Russian authorities accused the IOCs of violating formal regulations, such as environmental regulations.

The sanctions that the Russian authorities imposed on the IOCs and their motivations for doing so were the subject of extensive discussion among IOCs, other Western actors and the Western media. This dissertation aims to find out how Western actors such as the media and IOCs understand the rules of the game in Russia, relating it to Alena Ledeneva's work. Ledeneva (2006) outlines a framework explaining the enforcement of regulations and regulatory practices in Russia and their use and abuse for informal purposes. Her main point is that law enforcement practices in Russia differ from those in the West because in Russia regulations are often used selectively and manipulatively for purposes unrelated to the actual legal dispute. Ledeneva's framework is written from a Russian perspective, assuming that Russians understand law enforcement and regulatory pressure in Russia as selective and manipulative. The lack of respect for the law among the Russian public, in combination with the great difficulty of complying with the complicated legal framework, results in a situation in which the law can be used against anyone at any time. The two cases analysed in this dissertation are

clear examples of this phenomenon. On the background of shortcomings in Russia's legal and regulatory system, such as incoherency and the use of informal practices to bypass complicated formal procedures, the Russian authorities were effectively able to pressure Shell and BP into giving up control over major oil and gas projects.

The analysis of both conflicts shows that regulatory pressure on Shell and BP increased gradually, until both companies ultimately gave in, resulting in a reduction or take-over of their shares in oil and gas projects by Gazprom. It also shows that both companies actively involved the public in their conflicts with the Russian authorities by launching public debate emphasizing the negative aspects of the investment climate and the impact on foreign investment in Russia, in unsuccessful attempts to put counter-pressure on Russian policy-makers. The storylines in the Western media made clear these negative impacts by stressing how the enforcement of formal regulations in Russia is driven by ulterior motives. However, uncertainty remains as to whether these storylines were the direct result of the influence of BP and Shell and their strategies towards the Western media.

Both Shell and TNK-BP clearly understood that the core issue was not the violation of environmental regulations or licence agreements, but competing interests in large-scale oil and gas projects. Both companies faced situations in which full compliance with the formal rules was impossible due to the shortcomings of the law itself. For Shell, compliance with the regulations would have meant violating the company's own environmental action plan. Similarly, complying with the licence agreements of the Kovykta field was impossible without the approval of gas exports to China from the field.

Both Shell and BP appeared to understand Russian society as Ledeneva stipulates that it works, as a system of interconnected formal and informal levels in which the informal level is dominant. However, their strategy of challenging the authorities within this system by publicly pressuring them indicates that they either still failed to understand the system fully, or misread the policy shift towards foreign companies in the petroleum sector, or overestimated their own strength. Most likely it was a combination of these misconceptions that got the two companies entangled in protracted conflict. Moreover, Western actors forgot an important lesson that has been repeated many times in the past around the world: when oil prices rise, oil-producing states tend to lean forward and IOCs need to be prepared for tough negotiations.

Foreword

This thesis was submitted for the PhD degree at the Department of Sociology, Political Science and Community Planning at the University of Tromsø in February 2013.

I would like to thank all the interviewees who provided valuable information enabling me to analyse two sensitive cases. One of the main challenges was to find key persons, such as company representatives or governmental officials, who were willing to contribute information.

I would like to express my gratitude to Maria Lvova. Without her support it would have been impossible to carry out this research. My supervisors Hans-Kristian Hernes and Indra Øverland have been of great help throughout the work process. I am indebted to both of them. My fellow PhD students in Tromsø have been inspiring discussants and supporters throughout the period of work on the dissertation, in particular Brigit Dale, Berit Kristoffersen and Maria Hammer. Marcus Buck has read through my manuscript, providing useful suggestions to the overall structure and argument. Finally, and above all, I want to thank Alf Håkon Hoel for providing me the opportunity to complete this PhD in an inspiring, multidisciplinary setting.

Tromsø, February 2013

Sander Goes

1. Introduction and research questions

Ever since the onset of *perestroika* in the 1980s, Russia's economy and society have been undergoing continuous reform. The post-communist transformation has been characterized by change in political and economic institutions alike (Gehlbach 2010:6). During the latest wave of changes, initiated during Putin's first two terms as President of the Russian Federation (2000–2008), the country made a remarkable progress. Since 2001, it has been counted as one of the five big emerging economies, or BRICS countries (O'Neill 2001).¹ Oil and gas exports combined with some of the world's largest reserves of hydrocarbon and rising oil prices have strengthened Russia's position on the global stage and provided the starting point for economic growth. Russia is now the world's second biggest oil exporter and by far the biggest exporter of natural gas (Moe 2010:283). All in all, it is the world's biggest energy exporter.

According to Russia's '*Energy Strategy of Russia for the Period up to 2020*' (hereafter: *Energy Strategy*), the country holds one third of the world's natural gas reserves and one tenth of all oil reserves (Ministry of Energy RF 2003:2). The two decades after the collapse of the Soviet Union saw the discovery of some 20 new gas fields, containing a combined total of over 500 billion m³ (Ahn and Jones 2008:108). However, further development of the oil and gas complex in Russia will be essential if the country is to realize its ambition of developing its natural resources according to the guidelines and objectives outlined in the above-mentioned Energy Strategy.

Russia's impressive oil and gas reserves, including the Bovanenkovo, Shtokman and Samotlor fields, combined with a scarcity of easily available oil and gas elsewhere in the world, make it attractive for private international oil companies (IOCs) to invest in upstream projects in the country. Such reserves have become harder to find elsewhere in the world because of depletion, resource nationalism, environmental concerns or local and regional conflicts. However, international investment in Russia's natural resources sector is held back by weaknesses in the Russian regulatory framework and legal and political unpredictability (Moe and Rowe 2008:9). This dissertation is meant as a contribution to the debate, examining the challenges IOCs face in connection with their operational activities in Russia, how Russia is in

¹ The 'BRICS countries' are Brazil, Russia, India, China and, since 2012, South Africa, all seen as having reached the stage of rapid economic development.

need of foreign investment and increased state control over Russian natural resources and revenues.

Throughout history, the relationship between oil-producing states and private oil investors has been variable, and periodically conflictual (Noreng 1997:129). Since the early 1970s, the nature of the relationship between oil companies and the state in which they operate has often been influenced by the oil price, and as such is an area of tension where opposing interests often arise (Bremmer and Johnston 2009:155; Domjan and Stone 2010:35). During the 1990s, extensive oil and gas reserves combined with the disarray of the national economy created opportunities for IOCs to participate in developing the oil and gas sector, securing highly profitable agreements with the Russian government.

This thesis seeks to explain the sometimes strained relations between IOCs and the Russian state. I examine the relationship between the state (as the regulator and enforcer of the rule) and IOCs (as part of the regulated community), where the task of the former is either to enact sanctions against offenders for violation of formal rules, or to secure compliance. The relationship between states and IOCs in terms of law enforcement will be discussed in detail.

This research deals with two cases of conflict between the Russian authorities and IOCs – Royal Dutch Shell and BP. Sakhalin Energy is the operator of the Sakhalin II project, which until December 2006 was controlled by Shell with a 55 per cent stake. As for BP, it established the joint venture TNK-BP with a Russian private oil company in 2003, whereby TNK and BP each controlled a 50 per cent stake of the joint venture. TNK-BP was the main owner of the Kovykta natural gas field.

Shell came into conflict with the Russian authorities after the announcement of cost overruns in the Sakhalin II project in July 2005. This was followed in 2007 by a tussle between the Russian authorities and TNK-BP over the development of the Kovykta field. In both cases, the Russian authorities accused the IOCs of violating formal rules, such as environmental regulations, and licence agreements. The sanctions that the Russian authorities imposed on the IOCs and their motivations for doing so have been the subject of extensive discussion among IOCs, the media and experts. I chose the two cases because they illustrate the evolving relation between the state and oil companies in Russia within a specific time period. Moreover, both

cases provide a context for examining the underlying causes of what are usually closed negotiations between the Russian state and IOCs.

The main objective of this dissertation is to answer the following research question:

How do Western actors interpret and deal with regulatory and law enforcement practices in the Russian petroleum sector?

This is operationalized through the following subsidiary research questions:

- 1. How do IOCs understand regulatory pressure and law enforcement practices in Russia?*
- 2. How does the Western media interpret regulatory pressure and law enforcement practices against IOCs in Russia?*
- 3. Do Western actors understand regulatory practices and law enforcement the same way as Ledeneva stipulates that Russian actors would interpret them and in what ways do their understandings differ?*

The first subsidiary research question, concerning how IOCs understand law enforcement practices and regulatory pressure in Russia, will be addressed through an analysis of the decisions and actions taken by BP and Shell in response to the regulatory pressure exerted by the Russian authorities. Enforcement practices and regulatory pressure against Shell and TNK-BP occurred publicly between 2006 and 2008. By identifying the strategies of Shell and TNK-BP in their interaction with the Russian authorities I intend to bring out how these IOCs have understood enforcement mechanisms and regulatory pressure in Russia. Did they involve the public? Or did they decide to solve the problem in closed negotiations with the Russian authorities? Was the chosen strategy successful? Answers to these questions have been drawn from interviews and, most importantly, annual reports and other company publications.

To answer the second subsidiary research question, how the media interprets law enforcement practices and regulatory pressure in Russia, I conduct a discourse analysis of the coverage of these cases in two major newspapers from the two countries where Shell and BP are headquartered, the Netherlands and the UK. The use of content analysis as an analytical approach to analyse media coverage will be detailed in the next chapter.

Whereas subsidiary questions 1 and 2 are largely empirical in scope, the third question relates to the dissertation’s theoretical framework. In explaining the enforcement of public law in Russia and its use and abuse for political and other purposes, Alena Ledeneva (2006) has argued that enforcement practices in Russia differ from those in the Western world because in Russia the law can be used selectively and manipulatively for purposes unrelated to the actual legal dispute. Thus, the third subsidiary research question is whether Western actors understand regulatory practices and the enforcement of formal rules, for example in relation to business conflicts, the same way as Ledeneva stipulates that Russian actors would interpret them. Ledeneva’s concept of selective law enforcement was formulated from a Russian perspective, assuming that the phenomenon is systemic and that Russians understand the enforcement of formal rules as a manipulative game where other objectives than enforcement of the rule in question are served. Ledeneva provides many examples of attempts to enforce formal rules that have been motivated not by the logic of the law, but by commercial, political or personal interest (Ledeneva 2006:25). This means that Russian actors are constantly navigating between formal rules and informal norms (Ledeneva 2006:15). It is pertinent to examine how Western actors such as the media and IOCs understand or interpret the enforcement of formal rules in Russia (See Figure 1.)

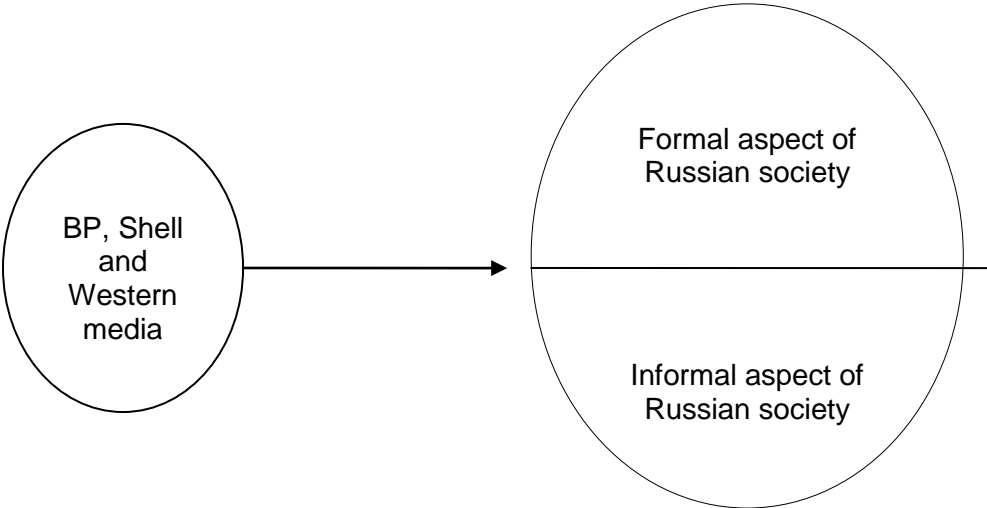


Figure 1: In Russia, Western actors are confronted with the formal and informal aspects of Russian society.

The following hypothetical example is an attempt to clarify these perspectives. An investigation conducted by Russian governmental agencies shows that company X, owned by Russians, has violated formal environmental regulations. Company X realizes that these inspections were driven by ulterior, non-official motives – for example, corrupt interests of

police officers or political interests of local officials. Rather than complying with the formal rules, the company in question seeks to deal with these informal motives, perhaps by satisfying or fighting off those groups or individuals behind the pressure because they understand that the enforcement of formal regulations was not the main reason for the inspections.

In a parallel hypothetical example, regulatory agencies accuse company Z, owned by Western investors, of violating a similar formal rule. Again the accusation is driven by informal interests rather than the rules as such. The Western owners, unfamiliar with the concept of selective enforcement as part of informal practices in Russia, respond by complying, or at least trying to comply, with the formal rules. This dissertation, however, will show – in line with Ledeneva's approach – that compliance with the formal rules is practically impossible due to shortcomings in the Russian legal system. As a result, Western companies may find themselves caught between the difficulties of complying with formal regulations and the accusations of violating them, because they fail to grasp the concept of selective enforcement and its drivers. On the other hand, we should note that not all enforcement practices in Russia are subject to such selectivity. Ledeneva (2006:3) argues that only insiders with sufficient power over the decision-making process can apply such informal practices, at the expense of outsiders. Thus part of the time the rules as such are enforced, or not enforced, but this is determined by random factors rather than informal interests. This makes the situation even more confusing for foreign companies.

Thus, rule enforcement in Russia is different from that in Western society. As with any country undergoing economic and political change, the conclusions of Ledeneva's study might not be the same if that study was repeated today. Ledeneva's main book on this subject was published in 2006, based on fieldwork conducted between 1997 and 2003 (Ledeneva 2006:6). Her study provides examples of selective law enforcement in connection with the embezzlement of state property and tax evasion (Ledeneva's framework will be presented in greater detail in Chapter 3).

Can Ledeneva's findings be applied to oil and gas projects, a highly profitable and strategically important sector in today's Russia which she deals with only in passing? The sector is both profitable and strategically important because successfully developed oil and

gas projects channel revenues to the state coffers, and strengthen the country's economy.² Moreover, knowledge and insights related to the technological and commercial details of the oil industry and spin-off effects such as industrial development including goods and services for the oil industry are an additional surplus from the petroleum sector (Noreng 1997:129).

'Regulatory pressure' is here defined as the *threat* of imposing sanctions, without necessarily implementing them, whereas 'law enforcement' is defined as imposing sanctions against an offender. States have a range of institutions that exercise authority. In this study, the term 'the (Russian) authorities' is often used to refer to the agency operating on behalf of the Russian state in dealing with particular issues – such as the governmental environmental watchdog Rosprirodnadzor, which is responsible for the enforcement of environmental regulations.

It is far from easy to define the concept of regulations or law. Laws can be identified as statutes, legislation, and rules enacted by legislatures. Richard Macrory (2008) provides a more detailed overview of two key elements that need to be included in a definition of the concept of regulations. First, regulatory agencies should exercise 'sustained and focused control over activities that are socially valued'; second 'regulations should be clearly enforceable by a legal sanction' (Macrory 2008:155). The term 'regulations' in this dissertation refers to both elements in this definition.

1.1 Relations between oil-producing states and IOCs

From the early 1990s until today, the relationship between the Russian state and IOCs has been transformed in terms of state control and investment opportunities for foreign investors. This dissertation contributes to the literature by clarifying our understanding of the interaction between the Russian state and IOCs in greater detail.

Paul Stevens (2008:6–8) argues that the interaction between the oil-producing states and IOCs is characterized by a cycle that starts with the opening up of areas for exploitation and is followed by a process of renegotiation of agreements and sometimes (re)nationalization. Such

² Approximately half of the revenues of Russia's state budget come from the petroleum sector (Moe 2010:282). Gaddy and Ickes (in Domjan and Stone 2010:40) identify three means of distributing the resource rent: profits to owners and shareholders, formal taxes to the government, and informal 'taxes', varying from bribes to 'voluntary' contributions to causes favoured by the government.

processes are influenced by the perceived role of the state in the operation of the national economy or a concern that the IOCs are taking too large a share of the cake (Stevens 2008:6–8; Bremmer and Johnston 2009:149–150). In Russia, for example, popular opinion held that the sell-off of oil resources in the early 1990s was outrageous.

Figure 2 shows that the conflicts between Shell/TNK-BP and the Russian authorities, in 2006 and 2007 respectively, occurred during a period when oil prices were moving towards unforeseen heights. In contrast, when oil prices were relatively low between 1996 and 2004, there was greater emphasis on cooperation between the Russian state and the IOCs, rather than renegotiation of Production Sharing Agreements (PSAs) or renationalisation of the oil industry.³ Similar examples can be found around the world. For example in the Netherlands, when the Groningen gas field was discovered in 1959, the Dutch government and the operators ExxonMobil and Shell agreed on licence agreements for developing the field. Then when the gas price rose in the 1970s, the government adjusted the agreement (Op Het Veld 2009:21).

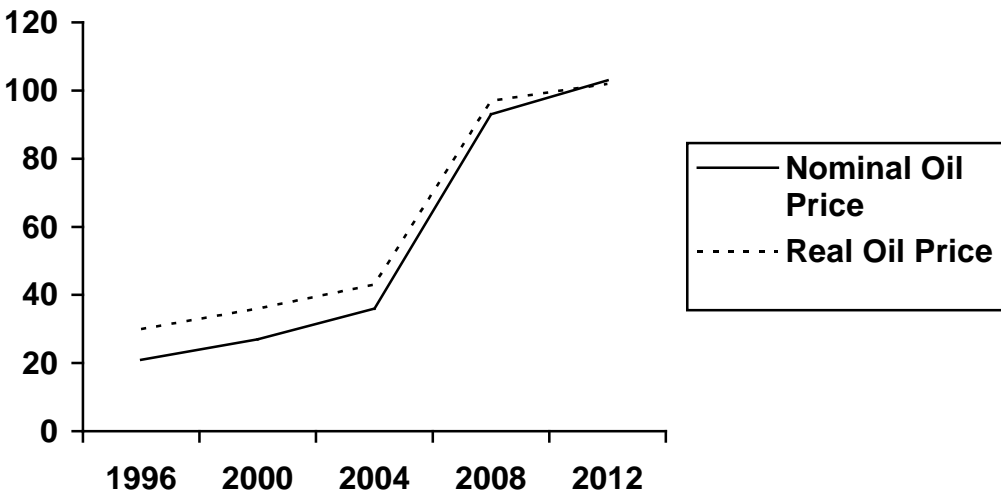


Figure 2: Developments in the nominal and real oil price, 1996–2012.⁴

³ A PSA is a commercial contract between investor and the state that allows the investor to undertake large scale, long term and high risk investments while the government retains rights and ownership of the natural resources. The purpose of the PSA is to define the terms and conditions for the exploration and development of natural resources, replacing existing tax and license regimes with a contract based arrangement. Therefore, each PSA is aligned to an individual project and has specific conditions.

⁴ US Energy Information Administration; available at: <http://205.254.135.24/EMEU/steo/realprices/index.cfm> (accessed September 2011).

In the literature, renegotiation of generous contracts and other forms of state intervention have come to be known as ‘resource nationalism’.⁵ Resource nationalism has been variously defined. The International Energy Forum defines it as ‘governments wanting to make the most of their national endowment’.⁶ In this dissertation, however, I follow Stevens arguing that resource nationalism consists of two components: limiting the operations of IOCs, and asserting a greater national control over natural resource development (Stevens 2008:5).

The ‘obsolescing bargain’ (Vernon 1971:46) refers to the same phenomenon: once foreign investors have invested large sums in finding resources and establishing extractive operations, the bargaining power shifts to the oil-producing states, especially when the price of the commodity in question is high (Vernon 1971:51–55). Oil-producing states, often developing countries, succeed in wresting control from IOCs, especially in the extractive industries, either by establishing national oil companies (NOCs) or securing more favourable terms for the host country (higher taxes, greater ownership share, increased local content, etc.). On the other hand, Klapp (cited in Austvik 2012:330) argues that developing countries have limited financial resources and therefore IOCs and banks are able to limit the national oil policies of these states.

According to Op Het Veld (2009:48), resource nationalism will continue as long as there is a scarcity of oil and gas in the world. It has been argued that besides the oil price, the concept of permanent sovereignty, a growing dissatisfaction within early signed oil deals in emerging exporting countries and the desire to secure national interests more efficiently than market forces have done all contribute to a nationalization of the oil industry (Stevens 2008:11; Noreng 1997:127). As Austvik (2012:317) has pointed out, the higher the potential awards, whether profits or political control compared to the costs, the more attractive will it be for the oil-producing state to intervene in the petroleum industry as entrepreneurs themselves. My

⁵ However, the term ‘resource nationalism’ is rejected by for instance Ryggvik (2007), who argues that it has often been used by states feeling that their companies operate under worse terms. Available at: http://morgenbladet.no/2007/oljens_herre (accessed August 2012).

⁶ ‘*Global Dialogue to Meet the Global Energy Challenge*’, in Second International Energy Week Main Session in Moscow. Available at: <http://www.ief.org/Speeches/Pages/DialogueforGlobalEnergySecurity1.aspx> (accessed January 2012).

point is not that the host states are necessarily the culprits, but rather that they will tend to press harder when commodity prices are high.

Bremmer and Johnston (2009:150–152) identify four varieties of resource nationalism: a revolutionary type driven by political reasons, an economic type driven by a desire to improve economic terms, a legacy type for reasons related to cultural identity, and finally a more soft type using arbitrary tactics rather than tearing up existing agreements. Moreover, Domjan and Stone (2010:59) have introduced the concept of *internal* resource nationalism, which targets not only foreign investors but domestic actors as well – as has been the case in Russia after the Yukos takeover.

Examples of resource nationalism include the renegotiation of oil deals and the re-nationalization of oil and gas industry assets. Oil-producing states often prefer renegotiation when they themselves lack the necessary technology to develop natural resources, for example regarding the development of offshore gas fields. In recent years, however, internationally operating supply companies such as Schlumberger and Halliburton (based in Paris and Houston/Dubai respectively) have grown in importance. They use their technological advantages to participate in the extraction of natural resources without normally controlling a share of a particular project. This has made developing countries less dependent on IOCs like Shell, BP and ExxonMobil for developing their natural resources. Re-nationalization often occurs in connection with the establishment of NOCs, such as PDVSA (Petróleos de Venezuela SA) and Gazprom or Rosneft (Russia), subsequently providing these state companies access to existing oil and gas projects. National oil companies have an advantage over private ones because the links of communication are likely to be particularly close. Moreover, state participation in the industry enhances the role of the government, from being mere tax collector to also taking part in the accumulation of capital (Noreng 1997:127). Finally, through a national oil company, the state can influence the price of petroleum (Noreng 1997:131).

The interaction between the oil-producing state and IOCs changes as a result of (re)nationalization or renegotiation. IOCs are forced to cooperate more closely with national oil companies and/or accept less favourable terms. If the line for how much IOCs are willing to pay, in order to gain – or retain – access to natural resources, is crossed, then IOCs may decide

to leave the country – as ExxonMobil did in Venezuela in 2007 after the expropriation of their Venezuelan assets by the Chavez government, or as BP did in Libya in 1974.⁷

One of the first documented examples of resource nationalism in the petroleum sector can be found in Venezuela in 1948. The growing dissatisfaction with the advantageous fiscal terms for the companies resulted in a profit tax in addition to the previous lump sum royalty (Stevens 2008:10). Saudi Arabia, on the other hand, started a process of seizing control through the participation of NOCs in oil and gas projects in 1967. This process began with negotiations which provided the NOC a 25 per cent stake in projects. Later on, in 1982, their share was increased to 51 per cent (Stevens 2008:16). Examples of discriminatory state policy can be found in Norway where the state has managed to keep most of the profits from oil and gas activities through regulative, legal and political measures (Ryggvik 2009:70–79; Tamnes 2010:260; Austvik 2010:114–118). As one Russian interviewee noted, when speaking of the perceived difficult conditions faced by foreign companies in Russia:

Norway used exactly the same procedure to set up conditions for the Americans who wanted to develop the oil and gas sector in Norway 35 years ago. I was told a lot of stories by the top managers of Statoil, who were there from the beginning. The Americans came and said, we will develop everything here for you. The Norwegians agreed but added that 50 per cent of the company should be controlled by Statoil. The Americans answered: What's Statoil? It's our national oil company the Norwegians responded. Statoil at that time had only 8 people working there, can you imagine! The Norwegians said you have to do this and that. If you don't want that, get out of here. In the end the Americans accepted Statoil and things became as they are now (Russian oil and gas industry expert, interview with author in Murmansk, December 2009).

Austvik (2012:330) emphasises that the role of the state in strategic sectors depends on how states are bound in their policy-making by various cultures, histories and path-dependent behaviours. According to Russia's official strategy for the energy sector, the strengthening of

⁷ News release 'ExxonMobil corporation announces estimated record 2008 results' published by ExxonMobil, 30 January 2009. Available at: http://www.exxonmobil.com/Corporate/Files/news_release_earnings4q08.pdf (accessed September 2011). BP left Libya in 1974 after the expropriation of BP's Libyan operations by Muammar Qaddafi. See 'Some you win, some you lose', *The Economist* print edition, May 31 2007. Available at: <http://www.economist.com/node/9257851> (accessed September 2011).

control in the development of natural resources and strengthening of Russia's position in the oil and gas markets are both essential components of state's energy policy (Ministry of Energy RF 2003:2–12).

Today, everywhere in the world oil-exporting states are demanding a bigger share of the profits, whether through re-nationalization of the oil and gas industry, or through the renegotiation of agreements such as in Nigeria and Kazakhstan. In Kazakhstan, the Italian company ENI (Ente Nazionale Idrocarburi) was in 2008 forced by the authorities to renegotiate earlier established oil deals. The aim of the state has been to improve economic terms and long-term economic benefit for the country by increasing the state share of ownership in major projects and by placing more of the burden of cost overruns and delays on IOCs like ENI and Shell (Domjan and Stone 2010:51–52).

Resource nationalism may prove costly: for example, it could affect Foreign Direct Investment (FDI) in the oil-producing state. Additional state involvement in the upstream sector might undermine investor confidence and thus investment. The data presented here will show that IOCs played the FDI card, albeit unsuccessfully, as one way to pressure the Russian authorities to refrain from re-negotiating in the oil and gas sector.

As noted, Russia's difficult economic situation – and the relatively low oil price in the 1990s – forced the state to sign agreements with IOCs for the development of its hydrocarbon resources. As Stevens has argued, 'A poor deal today is a renegotiation of unilateral change tomorrow' (Stevens 2008:27). Fifteen years later, key Russian actors considered the agreements from the 1990s unfair and began demanding a greater share of the oil and gas profits. Under Putin's two presidential periods the Russian federal government took several steps to secure state control over the petroleum industry.

Again, this is not some kind of Russian exceptionalism, but a type of resource nationalism that has occurred, and occurs, elsewhere as well. As one interviewee explained:

When you're operating in the oil and gas businesses, you're working in a geopolitical sphere and are subject to political influence (Representative of NOC, interview with author in February 2010).

Neither resource nationalism nor nationalization is unique to Russia, but is found in most areas of the world rich in natural resources. Interview respondents confirm that resource nationalism occurs in one form or another in almost all oil-producing states. The interesting point is how IOCs deal with this, according to the same respondent:

When issues occurred [between IOCs and the Russian authorities], ExxonMobil started negotiations with the Russians without kicking up a fuss. In contrast, they acknowledge the political situation in Russia. These negotiations are common in all oil-producing states and not typically Russian. The main question is how much money needs to be paid. This is a significantly different approach to the noisy one Shell opted to take. You have to negotiate and recognize the political situation. Oil and gas projects are long-term projects covering a 20–30 year period and subject to political commotions. This is a fact and is true for all the areas in the world where you find oil or gas. Similar problems can be seen in Venezuela and Nigeria and in the Netherlands when the procedure time for obtaining the necessary permits was extended during the oil crisis in the 1980s. Denying is naïve. You can either accept it and see it as a challenge or regard it as a problem and stay away. There is a geopolitical sphere which is subject to political influence in the areas where companies operate. You can adapt to it or leave because you will not be able to control the political factor anyway (Representative of NOC, interview with author in February 2010).

This and other interviews indicated that among different companies and across different countries there are different approaches towards conducting business in the petroleum sector in Russia. These differences are not necessarily between IOCs, but also among their home states – a view confirmed by Meijknecht, who examined asset swaps and the extent of political support for Gazprom across EU states. Meijknecht (2008:11–12) and Øverland and Jensen (2011:389) show that there is political support in France, Germany and Italy for close energy relationships with Russia (for example, by giving Gazprom access to downstream markets) while there is a lack of such support in the United Kingdom.

In order to ensure revenues from successful oil and gas projects in the future, the Russian government will need to invest significantly in the development of new oil and gas projects and the efficiency of existing projects. The government has estimated that capital investments for the reconstruction and development of the energy sector could be in the order of USD 400 to

510 billion in the decade from 2010 to 2020 (Ministry of Energy RF:21). Neither the Russian government, nor Russian state companies alone have this kind of capital at their disposal. The investments by foreign companies remain essential.

In the 1990s, Russia became more open to foreign investments and foreign ownership of energy resources, due to a combination of low oil prices, Russia's difficult economic situation and the weak position of the Kremlin. Then, during President Putin's second term of office (2004–2008), the Russian government regained control of the petroleum sector. Putin's views on energy policy were made clear in his *Kandidat nauk* (PhD) degree in economics in 1997. The dissertation itself is classified and not accessible. However, two years after defending his dissertation, Putin (1999:6–7) published an article in which he explains his view of the role of natural resources in Russia's economy in a broader context and argues that natural resources will ensure the country's economic development and strengthen its international position (see also Balzer 2005:218). According to the Energy Strategy: 'the State energy policy must be directed on the change from the role of supplier of raw material resources to the role of substantive member of the world energy market' (sic) (Ministry of Energy RF 2003:12).

This means that Russia's energy policy is to provide the country a strong position on the global energy market. In order to achieve this, the state intends to:

foster the participation of Russian joint-stock companies in development and realization of the great international projects to transport of gas, oil and energy, both in Western and Eastern lines (Energy Strategy 2003:12).

Several steps have been taken by the Russian government to ensure state control in the development of natural resources (Ahn and Jones 2008:130; Olcott 2004:17; van Agt 2009:7). Examples are the stripping of regional authority, influence in energy projects and modifications within the government's administrative apparatus, both in general terms in the petroleum sector and more specifically by the appointment of Putin-minded or former Putin administration officials in key positions (Olcott 2004:18).⁸ Moreover, a 2005 amendment to the 1992 law on

⁸ In 2001, Putin appointed three high-level executives at Gazprom: Dmitry Medvedev (Chairman), Aleksei Miller (President), and Igor Yusufov (Board of Directors). Other examples are the appointment of Yuri Trutnev to lead the Ministry of Natural Resources in 2004 and Sergei Kiriyenko who in 2005 was appointed to head the Federal Atomic Energy Agency.

Russia's subsoil prohibits foreign ownership of 'strategic' resources with a stake of 50 per cent plus one share (Ahn and Jones 2008:134), followed by new federal law on foreign investment in 'strategic' sectors adopted in April 2008. According to this law, all the resources on the Russian continental shelf are to be reserved for state companies (Moe and Rowe 2008:10).⁹ It defines 42 industries as 'strategic', including the military and security, fishing and seafood production and precious metals and hydrocarbons industries (Wilson Rowe and Moe 2009:109). Moreover, private investors need approval from the Russian government before acquiring more than a 50 per cent stake in a strategic company, with a stricter level of 25 per cent for companies owned by foreign governments or international organizations (Moe 2010:288; Moe and Rowe 2008:10). Both laws restructured the country's portfolio of oil and gas projects, limiting the operations of foreign and private oil companies and strengthening federal government control over Russian natural resources. In the long term these laws might prove to hamper the development of onshore and offshore energy projects by holding back investment (Wilson Rowe and Moe 2009:110).

In the Russian context, resource nationalism easily becomes intertwined with phenomena specific to post-Soviet societies: the almost total fusion of the formal and informal spheres, and of business and politics resulting in informal practices such as the selective enforcement of formal rules. As Chapter 3 will show, also the enforcement of formal regulations in Russia is often about politics.

Although regulatory pressure and law enforcement is an important window on the interaction between the oil-producing state and IOCs, it should be emphasized that this thesis does not attempt to present or explain legal or judicial theoretical approaches as such. In Russia, as Chapter 3 will show, much of what seems to be law is actually not really about law. Hence, this thesis is not so much about law as about the political regulation of the petroleum sector, the relationship between Russia as a host state and IOCs and the relationship between the formal and informal levels of society in Russia.

Therefore analysing enforcement and regulatory practices in Russia requires an interdisciplinary approach, one that can include frameworks on enforcement practices as well

⁹ The draft law on Russia's subsoil defines 'strategic' as deposits from any oil field containing over one billion barrels or any gas field containing over one trillion cubic meters of gas, or any reserves close to military bases.

as concepts of political science and sociology. Ledeneva's framework of selective law enforcement, discussed in Chapter 3, is the most widely recognized approach that addresses both perspectives.

1.2 The relevance of this dissertation

Why is this dissertation important? First, this dissertation is a contribution to the debate on the challenges that IOCs face in Russia, the need for foreign investment and the increased state control over Russian natural resources. Further, the aim is to contribute to our knowledge of the interaction between oil-producing states and oil companies by trying to develop and understand the often closed negotiations between the state and IOCs. This research can also contribute to our knowledge of how Western actors such as the media and IOCs understand and respond to events in Russia and the entanglement of the informal and formal levels of Russian society.

A stable investment climate, characterized by a stable government, corporate governance including respect for the rights of minority shareholders, (relatively) low exploration costs and workable regulatory and tax regimes – these are important prerequisites for IOCs wishing to invest in the oil and gas sector (Gyetvay 2000:22). As noted, conflicts between state and company as a result of resource nationalism inevitably affect the willingness of foreign investors to invest in a particular country. IOCs take into account the political and commercial risks that might affect future investment. Uncertainties regarding regulations or political circumstances could affect the decision-making process of IOCs by increasing the risks relative to expected profits, thereby discouraging investment.

The sensitivity in terms of data collection for this study is discussed in Chapter 2, which covers methodological issues. The conflicts between Shell/BP and the Russian authorities are discussed in detail in Chapters 4 and 5. Chapter 6 analyses the contents of company reports published by Shell/Sakhalin Energy and TNK-BP, and also attempts to ascertain whether these companies did indeed violate formal regulations – as they were accused of doing – and whether it would have been possible to comply with the formal law. The dominant storyline in the media on these cases, based on an analysis of British and Dutch newspaper coverage, is presented in Chapters 7 and 8. In Chapter 9, I discuss the main findings of the research and examine the strategies employed by the two IOCs in response to enforcement practices and

regulatory pressure in Russia. Finally, the conclusions of this dissertation are presented in Chapter 10, together with suggestions for further research.

2 Research method

This chapter presents the research method employed to answer the research questions outlined in the previous chapter. Section 2.1 discusses the data collection and discourse analysis, and storylines are discussed briefly in section 2.2. Section 2.3 presents William Gamson and Andre Modigliani's constructionist approach which is developed for the analysis of media discourse, which is used in this dissertation to examine how the media in the home countries interpret the enforcement of formal regulations and regulatory pressure against international oil companies (IOCs) in Russia.

2.1 Data collection

From the start of this project in the spring of 2007 until the summer of 2012, I made four fieldwork trips to the Russian Federation. In addition, from August 2011 until April 2012 I lived permanently in Arkhangelsk. Living as a foreigner in Russia, in addition to the field trips carried out previously, provided me with information and experiences of daily-life situations that were helpful in writing this dissertation. Before plunging into the details of the methodology behind this dissertation, I will make a few brief points about the general topic and area of study.

This thesis is, as mentioned, a study of the interaction between the oil-producing state and IOCs operating in Russia. This interaction is based on the active role taken by the oil-producing state as the legitimate owner of hydrocarbon resources on its territory.¹⁰ Conflicts and disputes involving enforcement and regulatory practices, like those between the Russian authorities and Shell/BP, can bring out aspects of the relationship between state and IOCs which are otherwise hidden from the public view, and make it possible to say something about the relation between oil-producing states and the IOCs operating in these states.

The history of state oil company interaction has shown that the use of legal instruments together with the opportunities given to IOCs to develop oil and gas projects are good indicators of the nature of this interaction process. Legal sanctions or regulatory pressure will

¹⁰ Article 2.1 and 2.2 of the 1958 Convention on the Continental Shelf provide coastal states with the exclusive rights for the exploitation of its natural resources.

impact on the business climate, assuming that the main objective of companies is to ensure profits, and compliance with the formal regulations is a secondary – often costly – objective. Hence, the enforcement of formal rules, either by back-tax bills or allegations of violations of environmental regulations affects the primary goals of private profit-maximizing firms. Zealous rule enforcement or unpredictability in the legal system could affect the attractiveness of a particular state for IOCs investment consequently reducing that state's incoming FDI, as noted in the previous chapter.

The timeframe covered in this dissertation is from 1 January 2000 until 1 October 2008. It includes the period from establishment until the change of ownership of Shell's project on Sakhalin, the development of BP's joint venture in Russia in general and the Kovykta field, controlled by TNK-BP until June 2007, in particular. The period studied also includes the cases of regulatory pressure and enforcement exerted by the Russian authorities against both IOCs between 2005 and 2008, as well as Putin's first two periods as President of the Russian Federation.

The relationship between states and IOCs, for example in terms of negotiations over licence agreements or conflicts over production targets, is a process to which the public (here represented by academics, the media and NGOs) have limited or no access. As stock market listed oil companies are reluctant to contribute data or comment directly on the research questions (see appendix I), the data collection involved in a project like this was a challenge.

This research is based on the following sources:

- Content analysis of reports and other official publications released by Shell, BP, Sakhalin Energy and TNK-BP covering company operations in Russia during the research period, such as sustainability reports, annual reports, press releases and other company-related reports.
- Qualitative in-depth interviews with experts working outside of Shell/Sakhalin Energy and TNK-BP who are familiar with the cases, or experts who are not directly affiliated with either company but who nonetheless deal with them at some level – for example, representatives of other IOCs/NOCs, governmental officials and representatives of petroleum industry associations.

- Discourse analysis of newspaper articles on TNK-BP and Sakhalin Energy's operations in Russia during 2000 –2008.

The in-depth interviews conducted, during the first stages of this research, underscored the sensitivity of the topic of this thesis. It was difficult to obtain interviews with representatives of the IOC in question. However, those interviews conducted proved valuable in order to gain knowledge connected to the cases presented in Chapters 4 and 5, providing part of the data upon which this dissertation builds. Interviewees included NGO staff, journalists, governmental officials, representatives of petroleum associations and representatives of national and international oil companies. The interviews were conducted face-to-face between February 2009 and September 2010. Interviewees are listed in general terms in the appendix; in order to ensure anonymity, respondents' names and companies/institutions are omitted. In total, 18 interviews were conducted with Western actors and 10 with Russians. Different questions were put to different respondents, depending on their area of expertise. The questions are listed in appendix I. One main conclusion from the interviews was that both Shell and BP deliberately involved the public (scientists, businessmen and of course the media) in their conflict with the Russian authorities when other strategies proved to be ineffective, as Chapter 9 will show.

The sensitivity of the research topic meant that both BP and Shell were reluctant to comment directly on any questions concerning the interaction between them and the Russian state.¹¹ As a result and given the difficulty of conducting interviews with representatives of these companies, I consulted alternative sources in order to see how TNK-BP and Shell have understood the regulatory pressure and law enforcement practices exerted by the Russian authorities. In combination with the in-depth interviews, Shell, Sakhalin Energy and TNK-BP's own reports and publications proved valuable for surveying the decision-making process and the overall course of events in the cases analysed in Chapter 4 and 5, and for drawing the conclusions presented in Chapter 10. The content of these documents helped me to understand

¹¹ Shell made it clear that the company would not comment on any questions from my side related to my research topic, apart from the documents and reports published on the company's internet site (telephone conversation with a representative of Shell on 12 March 2009). Due to the sensitivity of the issue, BP was reluctant to comment on any questions concerning the relationship between the company and the Russian state (e-mail received from a representative of BP, 25 January 2011).

how both companies have interpreted the regulatory pressure exerted by the Russian authorities – for example, how Shell responded to selective enforcement practices.

By using materials published by companies (annual reports) as well as qualitative interviews, enforcement practices and regulatory pressure in Russia can be analysed and explained, helping to assess what actors might associate with these practices and how IOCs dealt with, for example, sanctions issued by Russian regulatory agencies. Annual reports are considered to be valuable documents to which policy-makers respond or attempt to influence (George and Bennett 2005:97). However, erroneous interpretations can arise if the researcher fails to grasp the context of these reports (George and Bennett 2005:99). Therefore, it is important to identify the circumstances surrounding the release of such documents to the public, and to understand that annual reports are intended to be in line with the political and personal goals of those who control their publication. We return to these issues in Chapter 6.

To see how enforcement practices were understood by the media, I conducted a discourse analysis of the coverage of the two cases by four newspapers, two from each IOC home country. Discourse analysis is a method suitable for showing how the media interpret specific phenomena, and will be explained in detail in the following sections. By providing extensive coverage of, for example the conflicts between IOCs and the Russian state, the media often publicly disclose what is usually a closed negotiation process between state and IOC. And, being print media, newspapers also have the advantage of providing relatively thought-through commentary compared to spoken media.

Using newspaper articles as a source of data makes it possible to draw conclusions on the perspective of a given newspaper. Hence, a discourse analysis of the relevant available data should assess which storyline dominates the media coverage and debate. For example one storyline could be that the company involved has violated environmental norms, whereas another one could portray that same company as a victim of selective enforcement practices.

The analysis of the Western media coverage focuses on newspapers from the two countries where the two IOCs are headquartered: the UK (BP/Shell) and the Netherlands (Shell).

The UK newspapers selected were the *Financial Times* and *The Guardian*, and from the Netherlands *Financieel Dagblad* and *De Volkskrant* (henceforth *Volkskrant*). The digital

archives of these four newspapers yielded more hits on a search with the keywords ‘Shell AND Russia’ and ‘BP AND Russia’, than any other daily newspapers in the two countries. In addition, the newspapers examined represent a range of political perspectives and include newspapers focusing on business (*Financieel Dagblad* and *Financial Times*), and daily newspapers targeting broader audiences and with a left of centre perspective (*Volkskrant* and *The Guardian*). Sampling from these newspapers gave a sub-set of relevant articles, in this study referred to as ‘packages’, which were analysed in order to understand the content and context in detail and finally to assess the dominant storyline. The time available in combination with the work involved in conducting a discourse analysis limited the selection to two daily newspapers in each country. We return to the dominant storylines of these newspapers in Chapters 7 and 8.

Two separate searches with ‘Shell AND Russia’ and ‘BP AND Russia’ resulted in a long list of newspaper articles, letters and comments concerning the operations of Shell and BP in Russia. A broad and thorough search was undertaken to ensure that no relevant newspaper articles were excluded. For example, a search with the terms ‘Shell AND enforcement’ or ‘BP AND law’ might have excluded newspaper articles describing the disagreement between Shell and the Russian authorities as a negotiation process, overlooking the regulatory pressure exerted by the Russian enforcement agencies. Next, irrelevant newspaper articles were excluded, such as articles on Gazprom’s gas monopoly in Russia or on the impact of the attack on Yukos without referring to the impact on Shell’s operations at the Sakhalin II field.

Newspaper articles reporting on regulatory pressure by the Russian authorities against Shell/Sakhalin Energy and BP started to appear in August/September 2006. Before that, no newspaper articles reporting on legal infringements or related disputes involving these two oil majors and the Russian state were published in the four newspapers.

However, a discourse analysis of mass media content as outlined above is not free from constraints. One drawback is that the findings in themselves are insufficient representations of reality: what they show is how reality is grasped by the media. As Iver Neumann has put it, they do not present the world as it is, but rather reveals our understanding of the world (Neumann 2001:33). People could impose certain perspectives on reality when editors or journalists comment on events from their perspective because of political or economic interests. In addition, due to administrative routines or inaccuracy, articles may contain

misprints and statistical and/or factual mistakes. Documents like newspaper articles, but also annual reports, are ‘social facts, produced, shared and used in socially organized ways’ (Atkinson and Coffey 2004:58). Documents are not transparent representations of decision-making processes. Nevertheless, they construct meaning and provide useful social facts or constructions that can help us to understand cultural values, since these documents are a part of social interaction. In the following section, I offer a brief introduction to the theory of discourse analysis and the concept of storylines.

2.2 Discourse analysis and storylines

Discourses are thought to produce or reflect specific ideas, concepts or statements, and in daily parlance often referred to as ‘discussion’ (Hajer 1995:44). In the scientific/academic world, however, discourse analysis as an analytical framework is difficult to locate within one philosophical school since it is applied in varying ways and there is no agreement on when the concept first appeared, or on its definition.

Maarten Hajer (1995:62) defines storylines as ‘narratives on social reality through which elements from many different domains are combined and that provide actors with a set of symbolic references that suggest a common understanding’. Geir Hønneland has expressed this more simply as ‘the way one talks around here’ (Hønneland 2003:10).

The works of Hajer (1995) and John Dryzek (1997) provide useful manuals for grasping the basic principles of the concept of discourse analysis. Hajer shows how the acid rain storyline over time has become a political reality. Based on the assumption that the way we think about the environment can change quite dramatically over time, Dryzek presents an overview of major environmental discourses through the 20th century by a categorization of these discourses varying from industrialism to a more environmentally oriented discourse (Dryzek 1997:5).

Discourse analysis is of interest to scholars and researchers since it can help us to understand why a particular understanding of problems at some point gains dominance and is seen as authoritative, while other understandings are discredited (Hajer 1995:44). Complex problems like climate change for example, involve not only ecological complexes, but also questions of cost, technological development, ethical problems and social and economic strategies.

Consequently, publications related to climate change incorporate various discursive elements, such as biodiversity, engineering, accounting and philosophy. In the ensuing ‘battle for hegemony’, actors try to ensure support for their representation of reality, with the final objective of transferring a particular discourse into institutional arrangements, or ‘discourse institutionalization’ (Hajer 1995:60–61). Hajer (1995:72) terms this process the ‘argumentative approach’.

The difference between discourse theory and discourse analysis has been laid out by Howarth and contributors (2005:5–9). Whereas discourse theory is ‘problem driven’ and associated with the political circumstances of a problem, discourse analysis constitutes ‘one particular set of techniques that can help us to understand and explain empirical phenomena which have already been constituted as meaningful objects of analysis’ (Howarth, ed., 2005:318). There are countless other definitions as well, but common to all definitions and conceptions is that discourse analysis should be understood as practices that lead subjects to view and speak of the world in specific ways.

Analysing ‘talk and text in context’ (van Dijk in Howarth, ed., 2005:318) seems to refer to a type of research activity conducted from a post-modernist viewpoint, aimed at examining the influence of language on human behaviour and society. Here, language is not regarded as a medium for subjects to express their preferences, but as a communicative practice that influences actor perceptions of interests (Hønneland 2003:11).

How to conduct discourse analysis in practice? Neumann notes that a methodology for conducting discourse analysis has not been developed due to the influence of post-positivist philosophers, such as Feyerabend’s criticism of methodology as summed up in his slogan *anything goes!* (Neumann cited in Hønneland 2003:6). Hajer’s argumentative approach, however, introduces the concept of *storylines*.

The argumentative approach focuses on how discourses are maintained and transformed (Hajer 1995:61), and here the concept of a storyline is a key element. The main point is that by including a specific element, for example a metaphor, one effectively pictures the storyline. Moreover, storylines position subjects in a discussion by reducing the complexity of the problem and making possible ‘the clustering of knowledge’ (Hajer 1995:36). Storylines become a permanent feature within a debate, and, according to Hajer, affect public policy and

cause political change by the rise of new political claims. Useful examples can also be found in the work of Dryzek (1997) and of Gamson and Modigliani (1989).

2.3 Media discourse according to Gamson and Modigliani

The research method of this study is based mainly on the work of Gamson and Modigliani (1989). Their approach allows the researcher to identify how phenomena within the media are created and shaped. Gamson and Modigliani examined public opinion on the issue of nuclear power in the United States by conducting an analysis of the media discourse. To understand how media, and to a certain degree IOCs themselves, have understood enforcement practices in Russia, this dissertation uses newspaper articles to reconstruct meaning, following the method outlined by Gamson and Modigliani (1989:10).

In addition to storylines, Gamson and Modigliani introduce the term ‘packages’. Media discourse can be conceived of as a set of interpretive packages that give meaning to an issue, each package representing its own discourse. Gamson and Modigliani developed a method that selects the dominant storyline – the package to receive most attention in media coverage after a calculation of all packages appearing within a given period.

Gamson and Modigliani define media packages as ‘a set of interpretive packages that give meaning to an issue’ (Gamson and Modigliani 1989:3). A package constitutes a basic idea or meaning over a certain period making news events more accessible and understandable by incorporating them into a storyline or scenario. Here it should be recognized that the prominence of packages is highly variable and constantly adapted to accommodate new events. Interpretive packages depicting, for example, enforcement practices in Russia as subject to informal interests are not ideas that appear suddenly and then remain present for a longer period: they are often developed over time. According to Gamson and Modigliani (1989:5–8), changes in the prominence of packages can be explained in terms of cultural resonances, sponsor activities and media norms and practices.

We can take the controversy in Norway for and against oil and gas industry in the Barents Sea as example. Rather than arguing for the economic benefit of such activities, the storyline has been that ‘Norway should not back away from extracting oil and gas from the Barents Sea because of the environment. On the contrary, Norway should get a move on and help the

Russians operate in a more environmentally friendly way' (Jensen 2011:7). This storyline brings forward 'an environmental argument' in order to promote the development of the oil and gas industry in the High North, and has successfully managed to adopt the opponents' main argument in order to justify drilling (Jensen 2011:7).

Gamson and Modigliani's method is based on the lessons of the article 'The nature of belief systems in mass publics' (Converse 1964). That article warned against the common practice at that time of drawing conclusions about public opinion based on simplified dichotomies such as 'for' or 'against' (Gamson and Modigliani 1989:36). Their constructionist model builds on the argument that a genuine methodology for examining storylines should include the variety in the positions and arguments rather than being based on a simplified dichotomy of two opposite positions. The analysis I present in the following chapters, for example, will show a package depicting the enforcement of formal regulations in Russia as subject to informal interests (emphasizing, however, that violations leave the IOCs susceptible to legal action). This stands in contrast to an interpretive package that would depict enforcement practices as externally politically motivated.

2.4 Conclusion

This chapter has outlined the method used for collecting the necessary data, followed by a brief introduction to the concept of discourse analysis and Gamson and Modigliani's model for examining media discourse. Their model forms the basis for the method used here to explore how the Western media have interpreted the interaction between Russia, as an oil-producing state, and IOCs operating in Russia, in terms of regulatory pressure and law enforcement practices.

As explained, the enforcement practices exerted by the Russian authorities against IOCs form the main subject of analysis that will enable us to draw conclusions on the interaction between IOCs and the state. The next chapter discusses two opposing perspectives, distinguishing the enforcement of formal rules in Russia introduced by Ledeneva's concept of selective law enforcement (Ledeneva 2006) from frameworks that deal with other impartial enforcement strategies (Macrory 2008; Hawkins 1984; Cohen 1999).

3. The enforcement of formal regulations

In coordinated market economies, formal institutions play an important role in regulating and coordinating interactions between industry and the state among others. As in all industrial sectors, IOCs operating in the petroleum sector need to comply with formal regulations. Violation of these norms should lead to sanctions that ensure that businesses that have sought to cut costs by non-compliance do not gain an unfair advantage over businesses that comply with the regulations. Such sanctions can serve to put the offender in a worse position than actors who complied with the norms. Under normal circumstances, legal sanctions provide agencies operating on behalf of the state with the possibility of enforcing compliance through formal law. Companies that break the formal rules can find themselves in trouble with these state agencies. Thus, enforcement mechanisms underpin the interaction between state and company.

However, as we shall see, enforcement practices in Russia sometimes differ from enforcement practices as they are normally conducted in the Western world. Attempts to enforce the rules in the latter are normally motivated by the logic of the law, not by commercial, political or personal interests. This chapter will discuss two theoretical approaches and answer the following questions: how are enforcement mechanisms conducted in Russia? In what ways do they differ from Western perspectives on enforcement practices? And why is a study of enforcement practices from a Russian perspective relevant for explaining the relationship between the Russian state and international oil companies? In order to understand enforcement mechanisms in general, a brief introduction to the concept of law is first necessary.

3.1 The concept of law

Law can be understood as the statutes, constitutional clauses and rules enacted by legislatures. However, Jeffrey Kahn claims that laws may also provide the necessary principles for the organization of human relations, or as Berman (cited in Kahn 2002:54) has argued, ‘the state is not only the creator but also a creature of law’. Kahn distinguishes between states governed by *laws* and those ruled by *law*. The state governed by laws is in the literature also defined as one governed by the rule of law, or a *Rechtsstaat*. The *Rechtsstaat*, as explained by Jackson and Sørensen (2003:107), establishes and enforces the rule of law that respects the rights of

citizens to life, liberty and property, and citizens are protected against the arbitrary exercise of authority. The rule of law is by UN Secretary-General defined as ‘a principle of governance in which all persons, institutions and entities, public and private, including the state itself, are accountable to laws that are publicly promulgated, equally enforced and independently adjudicated, and which are consistent with international human rights norms and standards’ (UN Security Council 2004). A.V. Dicey (cited in Kahn 2002:55) argues that a law must meet certain criteria in order to be accepted in a state characterized by the rule of law, such as legitimacy, predictability, stability, fairness, efficiency and the repudiation of secrecy in promulgating laws and regulations. Such rule of law, or *Rechtsstaat*, is important to foreign investors and to economic development. By contrast, in states ruled by law, the law serves as a tool of governance, which can result in selective application of it.

Hans-Joachim Lauth (2000:45) has argued that the rule of law, and thus democracy, is undermined by informal institutions, because informal institutions disregard formal rules. Corruption is perhaps the best known example of such an informal institution. Garzon Valdes (cited in Lauth 2000:34–36) defines corruption as ‘the violation of an obligation by a decision-maker, in order to obtain an extra-positional private benefit from the agent who bribes or is being extorted, in exchange for benefits granted to the briber or the extorted whose value exceeds the cost of the bribe or the extorted amount or service’. Informal institutions are explained in greater detail later in this chapter.

In his study emphasizing the enforcement of environmental regulations, Macrory (2008:155) argues that formal regulations need to include at least two key elements. Firstly, regulatory agencies should exercise control over undesirable activities. Furthermore, regulations should be enforceable by legal sanction. State agencies employ sanctions against the violation of regulations in order to alter actor’ behaviour by modifying the set of behavioural alternatives through the delivering – or threatening to deliver – sanctions (regulatory pressure). In order to ensure this, the state uses formal institutions which Lauth (2000:23) defines as ‘controlling organized organs of the state, exercising their power based on formal norms and principles as a result of political processes’. The actors subjected to regulation are not actually forced to accept the formal regulations, but compliance is typically an outcome of rational calculation when the costs offset the profits (Lauth 2000:24). In addition to cost–benefit calculations, actors may decide to comply with the law because they feel the law is legitimate (Tyler 2006:3) – or because they feel fear rather than respect the law (Gerstein 1970:484; Iakovlev in

Ledeneva 2006:26–27). Such fear and disrespect for rules in today’s Russia are discussed in detail in the following sections.

3.2 Why do actors obey the rules?

Legal philosopher Hans Kelsen (cited in Gerstein 1970:480) claimed that the main characteristic of a legal system is that ‘officials exercise coercive control over people under the authorization of a system of rules which justifies such coercion’. Kelsen emphasized the use of force by officials, although Hart (cited in Gerstein 1970:481), Gerstein (1970:401) and later on Tyler (2006:3) have stressed the importance of people’s internal behaviour rather than a one-sided focus on external behaviour, such as whether enforcement agencies are successful in their sanctions against offenders. Tyler’s study, which concludes that people comply with the regulations because they regard the law as legitimate, is based on a normative perspective and should be distinguished from the instrumental approach. Tyler argues that in democratic societies the legal system cannot function if it influences people only by manipulating rewards and costs (Tyler 2006:22). He stresses the importance of what people regard as just and moral, as opposed to what is in their self-interest, thus emphasizing the normative perspective of why people comply with the law (Tyler 2006:3).

The instrumental perspective emphasizes the importance of personal gains and losses, for example penalties vs. obeying the rules. In this perspective the likelihood of being punished for not complying with the rules, often in combination with the size of the sanctions regulatory agencies impose, will affect people’s behaviour.

To clarify the differences between the normative and instrumental approach, Tyler offers the example of the illegal use of cocaine. If people refrain from taking such drugs because they think formal rules ought to be obeyed, then it is normative authority that shapes their behaviour. If, however, they do so because they fear punishment by the law, then instrumental perspectives (deterrence) are dominating their behaviour. Similarly if an individual refrains from drug use due to health fears or fear of disapproval engendered by the surroundings, working through the influence of social groups (Tyler 2006:25).

The normative approach recognizes the legitimacy of the legal authority by bringing behaviour in line with the regulations of that authority (Tyler 2006:25). This means that

people's trust in the authorities, in rules and institutions is essential for their continuing loyalty toward the authority. Levi and Stoker (2000:497–498) quote Miller and Listhaug as defining trust as 'a reflection of evaluations of whether or not political authorities and institutions are performing in accordance with normative expectations held by the public'. The expression of trust in government is a judgement that the legal system is responsive and will do what is necessary, thereby confirming the legitimacy of the legal system. Lack of trust in the authorities could affect the legitimacy of the authority as well as the implementation of regulations, since both depend on the context and particularly the degree of public support for enforcement mechanisms.

Several studies have shown a lack of public support of the state and low demand for law in post-Soviet Russia (see Hendley 1997:131; Ledeneva 2006:25). Iakovlev has stressed the contradiction between the law and justice in Russia:

That conscience and ethics are supposed to be the basic part of law-consciousness and that public morals are supposed to be the foundations of law are taken for granted in Western legal culture. In the Russian cultural tradition a tragic contradiction existed between the law and conscience, between morals and the law. In a situation where the law is equated only with the power of a tyrannical state, where the law is not respected but only feared, the idea of fairness is contrasted to existing laws (Iakovlev in Ledeneva 2006:26–27).

The literature on why organizations comply with the law generally follow the instrumental approach, stressing that firms respond to both positive and negative incentives, and that if sanctions are sufficiently high, the threat of being punished for noncompliance should be an adequate reason for organizations to comply with the formal rules (Cohen 1999:3). Moreover, organizations – often large, publicly traded firms – comply with the law because the market encourages them to do so by buying their products, or forces them since these firms are vulnerable to criticism from the civil society. The latter approach has been documented in the theory of ecological modernization outlined by Mol (2001).

3.3 Western perspectives on the enforcement of regulations

After a general outline of the concept of law and why actors obey rules in the previous sections, the objective of this and the following sections is to explain the methods regulatory agencies utilize in order to enforce regulations, according to Western perspectives.

Establishing formal institutions (laws and regulations) is the first step in the enforcement of norms. The role of institutions is emphasized by Douglass North:

In the straightforward neoclassical story, the gains from trade are realized with zero transaction costs. That is, the parties to exchange costlessly know everything about the other party and enforcement is perfect. No institutions are necessary in a world of complete information. With incomplete information, however, cooperative solutions will break down unless institutions are created that provide sufficient information for individuals to police deviations. There are two parts to an institution's assuring cooperation. First, it is necessary to know when punishment is required. By making available the relevant information, institutions make possible the policing of defections. Typically they economize on information, so, for example, players need no longer know the entire past history of any partner. Second, because punishment is often a public good in which the community benefits but the costs are borne by a small set of individuals, institutions must also provide incentives for those individuals to carry out punishment when called to do so (North 1990:57).

North (1990:33) also argues that enforcement entails no problem if it is in the interests of both parties to live up to agreements. But without institutional constraints, self-interested behaviour will occur when there is uncertainty as to whether the other party will find it in his or her interest to live up to the agreement.

Increased monitoring and inspections can raise compliance (Cohen 1999:47), so the existence of enforcement policies, like monitoring and inspections, is an effective method to achieve required standards (Telle 2004:3; Eckert 2004:257). This point has been confirmed by Macrory (2008), Hawkins (1984), Becker (1968) and Cohen (1999), who all argue that enforcement of regulations based on a sanctions-capable regime is necessary to prevent the regulatory system from being undermined.

Enforcement is commonly regarded as an action that the regulated community can expect from a regulator when a breach of the regulations has been identified. Actors who break the formal regulations will be punished by regulatory agencies whose main task is to ensure that all actors within a society comply with the regulations, or to punish those who do not. In this study, regulatory control is focused on organizational deviance. The regulation of organizations or economic enterprises is necessary when the government cannot be confident that the organization in question will achieve the performance levels desired by the society (Macrory 2008:11).

As briefly outlined in the introduction, the Russian authorities used environmental regulations in order to exert pressure on IOCs operating in Russia. Therefore, sections 3.3 and 3.4 focus on various enforcement strategies as regards environmental regulations. These Western perspectives, written by Western researchers, are considered to be more ideal, impartial types of enforcement practices where laws are produced consciously and enforced by mechanisms created for purposes of such enforcement. Cohen (1999), Macrory (2008) and Hawkins (1984) have developed several concepts concerning the enforcement of environmental regulations. These practices are quite distinct from the type employed in Russia as outlined by Ledeneva (2006). By contrast, Ledeneva explains the enforcement of regulations in Russia from a Russian perspective, by introducing the concept of selective enforcement of regulations as part of informal practices in contemporary Russia. Her framework is outlined in section 3.5.

3.3.1 Styles and strategies for enforcing environmental regulations

Cohen (1999) distinguishes between two enforcement styles that regulatory agencies use to enforce environmental regulations: *deterrence* and *cooperation*. He (1999:7) argues that compliance is more likely to be achieved by the cooperation style when individuals and organizations believe the rules are legitimate and fairly applied. A similar distinction has been outlined by Hawkins (1984), who terms the two approaches the *penalty* style and the *compliance* style.

The penalty style aims to secure compliance with formal regulations by focusing on the ability of the authorities to influence the costs of breaking the law. Offenders are to be punished. Conformity with the regulations may be a result of application of the penalty style, but is not

necessarily the main objective (Hawkins 1984:4). Sanctions need to demonstrate that breaking the law will not be tolerated. The sanction imposed should put offenders in a worse position than if they had complied with the regulations (Macrory 2008:37).

The compliance or cooperation style, outlined by Hawkins (1984) and Cohen (1999), is characterized by a more conciliatory approach. This style has been defined as more remedial, aimed at securing compliance with the regulations and preventing non-compliance, rather than at punishing those who break a particular rule. In contrast to the penalty style, the cooperation approach is based on social repair, on maintaining good relation and bargaining to achieve conformity with regulations. The assumption here is that offenders do not always violate the regulations deliberately. Regulatory agencies, therefore, provide offenders with assistance, to ensure compliance with the regulations. The main objective is not to impose sanctions on the offender that could affect the relationship between enforcement officials and law-breakers, and consequently the willingness of the society and politicians to develop, defend and enforce environmental regulations. As Hawkins (1984:8) explains, the main difference between the two styles is that the compliance style allows justice to be done in the process of negotiating conformity, whereas in a sanctions system justice has been accomplished when a fine or other penalty has been imposed.

Macrory (2008:25–26; 2008:47) argues that formal sanctions act as a deterrent against future breaches and send a wider message to the regulated sector. However, he notes, an enforcement style that relies solely on financial penalties has certain limitations when the objective is to secure behavioural change. Further as regards sanctions, relatively small financial penalties can easily be absorbed by large companies, or even worse, become a calculated part of their regular expenses (Macrory 2008:100–101).

Besides regulatory pressure, defined above as the threat to impose sanctions, regulatory agencies have a range of sanctions at their disposal for punishing or bringing an offender to compliance. The establishment of regulations is a first and necessary step. Environmental regulation may take various forms, from the imposition of fixed product standards such as vehicle emission requirements to requiring a licence permit for particular activities, and with detailed conditions set by the authorities.

In general, the enforcement of environmental regulations is characterized by the following features and principles (Macrory 2008:23; Hawkins 1984:3; Reiss and Biderman cited in Hawkins 1984:14):

1. The enforcement of environmental rules overlaps with criminal, civil and public law.
2. Environmental regulations are based on a substantial body of international agreements and by the development of fundamental environmental principles, such as the precautionary principle and the polluters pay principle.
3. The population of deviants is potentially knowable, in contrast to the situation with many traditional enforcement activities.
4. Environmental conflicts are rarely fought in public or end up in court: they tend to involve negotiations which rely on bargaining or other forms controlled by the parties themselves. Companies prefer not to get involved in a 'painful' open process that could harm their reputation and prestige. Indeed, Macrory even argues that reputational sanctions could have a greater impact on a company's policy than financial penalties (Macrory 2008:129).
5. Examples of sanctions to enforce compliance with environmental regulations are criminal prosecution, licence revocation, licence suspension, financial penalties, statutory notices and persuasion (Hawkins 1984:19; Macrory 2008:51). Statutory notices – a written statement elaborated by the regulator where the offender will be ordered to carry out certain measures within a particular period of time – are a frequently used sanction that provides the offender with the possibility to rectify the breach or include remediation provisions to repair the damage caused by the breach.

Both Macrory and Hawkins focus on the enforcement of environmental regulations. Their studies are particularly relevant here since the regulatory agencies in Russia, as noted in the first chapter, used enforcement mechanisms towards Shell (Sakhalin Energy) and to a less degree BP's joint venture with TNK in an attempt to enforce environmental regulations. Even in cases where the law provides general statements or formulates clear prohibitions, it is often up to the regulatory agencies to shape policy, fill in the details when federal authorities map out the general frame. How then do regulatory agencies enforce the rules?

There are several theories that provide insight into how environmental enforcement agencies operate in order to achieve their targets. Cohen (1999:8–11) identifies the following strategies

of enforcement behaviour: net political support maximization, bureaucratic behaviour theory, maximizing social welfare, maximizing compliance without regard to compliance costs, maximizing environmental benefits and a median voter model with asymmetric information about enforcement effort and compliance costs.

In the theory regarding net political support maximization, the agency seeks to maximize the difference between the number of supporters and the number of detractors of its enforcement policy (Cohen 1999:8) By imposing the least amount of regulatory burden on organizations, the agency will be reluctant to conduct enforcement when the cost of compliance are very high, for example when people lose their jobs as their factory is in danger of closing because the burden of complying with environmental regulations is too high.

The bureaucratic behaviour theory outlined by Niskanen (cited in Cohen 1999:9), describes the relationship between the bureaucratic agency and the legislative body, resulting in an agency driven by budget maximization in terms of salaries, perks, and stature. Here regulatory agencies benefit from larger budgets.

Regulatory agencies can seek to maximize compliance with the rules, without regard to the costs involved. Maximizing social welfare on the other hand forces the agency to balance the cost of compliance against the benefits of compliance (Cohen 1999:10).

A fifth theory explored by Cohen concerns regulatory agencies seeking to maximize environmental benefits. According to this theory, agencies focus on those activities that provide the highest environmental payoff per dollar of enforcement effort (Cohen 1999:11).

Finally, in the median voter model, legislature and voters have asymmetric information about the costs of enforcement mechanisms. The voters demand stringent regulations, but are not in a position to calculate the associated enforcement costs. This brings an asymmetry between the letter of the law and its application resulting in a situation where environmental regulations are more stringent than what is socially optimal (Cohen 1999:11).

The theories outlined above describe not only the enforcement style, but more importantly, the strategy behind enforcement styles that the regulatory agencies select in order to achieve their goals whether through compliance with the law or increasing their budget. Ledeneva's

framework of selective enforcement, explained in section 3.5 below, could be seen as an additional theory of enforcement behaviour, thereby adding a theory framework to the enforcement strategies discussed in this section.

3.3.2 Politics and the enforcement of environmental regulations

Cohen (1999:23) defines pollution as a ‘conditionally deterred offense’, indicating that the offender often will be punished only when the social costs exceed the social benefits of the violation. By contrast, there are other offences, such as theft and rape, that are ‘unconditionally deterred’: offenses that society in question would never condone, regardless of the private benefit to the offender (Cohen 1999:23). Therefore, Cohen suggests, enforcement practices are subject to politics. The main point is that there is no consensus among political actors on environmental policy or enforcement strategy, such as the extent to which environmental regulations should be enforced. This is in contrast to other criminal activities such as kidnapping or robbery. If, for example, somebody steals a DVD-player, there will be consensus among all political actors that this is a ‘clear crime’ that needs to be punished. When it comes to the breach of pollution regulations, there is often discussion about the use of the term ‘crime’, not to mention the kind of sanction that should be imposed. Talk of ‘environmental crime’ is considered appropriate only where ‘clearly blameworthy conduct exists, where there is a calculated breach of regulation, or where there was carelessness or recklessness in handling it’ (Hawkins 1984:11). And when it comes to the enforcement of environmental regulations it is difficult and sometimes even impossible to establish a satisfactory causal link between the event and the harm done.

Thus, strategies for the enforcement of environmental regulations are often subject to political discussions. The struggle for political consensus and moral mandate between opposing political actors threatens the legitimacy of the regulatory agency and affects the effectiveness of their enforcement strategy. As Hawkins (1984:11–12) has argued; ‘enforcement agencies are not secured on a perceived moral and political consensus about the ills they seek to control’. By contrast, security service agencies like the police enjoy a relatively secure moral mandate, since according to traditional codes there is rarely any ‘good’ reason for non-compliance (Hawkins 1984:12). Environmental enforcement agencies often find themselves operating in a difficult political environment where they must balance between environmental and economic interests.

Note that the enforcement strategies outlined above all have been formulated from a Western perspective. The involvement of political and other informal agendas in the enforcement of environmental regulations provides the starting point for the following sections. In these sections the framework of selective enforcement introduced by Ledeneva is conceptualized. Her approach adds a new perspective by introducing an enforcement strategy written from a *Russian* perspective. This strategy provides an excellent example of political interference into enforcement practices. However, before turning to Ledeneva's framework in section 3.5, a more general introduction into laws and legislation in the Russian society is needed.

3.4 Differences between formal and informal practices

So far the enforcement and compliance with regulations have been presented from a basically Western perspective. The following sections examine the relationship between regulations and society in Russia, and conclude that the enforcement of regulations is regarded differently in Russia than in the general Western-based theories outlined above. Russians fear the law, but they also find it difficult to comply with. This contradiction will be investigated in the present and following sections.

Colson (cited in North 1990:38) argues that the absence of formal rules leads to the development of informal structures. She refers to the development of early societies:

Whether we call them customs, laws, usages, or normative rules seems of little importance. What is important is that communities such as the Tonga do not leave their members free to go their own way and explore every possible avenue of behaviour. They operate with a set of rules or standards which define appropriate action under a variety of circumstances. The rules, by and large, operate to eliminate conflict of interests by defining what it is people can expect from certain of their fellows.

The establishment of new legal institutions in Russia after the dissolution of the Soviet Union has been extraordinary. A constitutional court has been created and the criminal justice system has improved (Hendley 1999:132). One result of the collapse of the Soviet Union is that Russians, at least in theory, enjoy civil and economic rights, and there exist procedural

mechanisms to enforce these rights (Hendley 1999:132). With the third and last part of the new constitution in place in 2002, the rights of Russian citizens to own property and the improvement of due-process rights were established in writing.¹² The constitution provides the basis for a judicial system with the general court, headed by the Supreme Court, where most day-to-day legal business matters such as property disputes are dealt with.

However, the effectiveness of these institutions is strongly influenced by the institutional transformations that have taken place during the post-Soviet period. Various shortcomings in the coherency of law, the extent of delays in judicial process, the arbitrary application of the law and the non-transparency of Russia's economy all influence the effectiveness of its legal system. Ledeneva (2006:10) argues that the Russian economy is non-transparent because the rules of the game are not easily recognized or understood. Moreover, due to these shortcomings and the practical constraints they entail, the ability of the rule of law to function coherently has been subverted by a set of informal practices.

Furthermore, Hans-Joachim Lauth (2002:22) argues that a single focus on official political institutions, such as formal rules, is insufficient for understanding the relevant forms of political behaviour. This argument, later taken up by Ledeneva, is grounded on the discrepancy between actual individual behaviour, and the expected behaviour based on norms established in formal institutions. Informal institutions are vital to real-life processes. They can, according to Lauth, be systematically analysed using a neo-institutionalist framework.¹³

It is necessary to explain informal practices in order to understand the enforcement strategy from a Russian perspective, as outlined in the next section. North has argued that our life and economy are being ordered by formal laws and property rights. Formal rules include political

¹² In its opening chapter on fundamental rights, the constitution proclaims 'the individual and his rights and freedoms are the supreme value' (Art. 2). To this are added the citizen's right to own private property (Art. 8.2), including property in land (Art. 9.2). Chapter 2 on human rights spells out a person's property rights in more detail. Private ownership is protected by law, property may be bought and sold freely, and the state may take private property for public use ('eminent domain') with or without the permission of the owner only if full compensation is paid in advance (Art. 35) (Sharlet 2005:130–147).

¹³ Institutions are in classical political science understood as 'controlling organized organs of state, often extended by the inclusion of intermediary organizations and of fundamental, formal norms and principles of political processes' (Lauth 2000:23).

(and judicial) rules, economic rules, and contracts (North 1990:47). However, formal rules make up only a small, albeit important, part of our interaction with others. Informal constraints are, says North (1990:36–37), part of our culture, embedded in our daily interactions with others from family relationships to business activities.¹⁴ Examples are codes of conduct, norms of behaviour and conventions. Informal constraints are culturally determined and will not shift immediately into formal rules. Thus there is a clear difference between formal rules and informal constraints, or in Ledeneva’s terminology, ‘informal practices’ (North 1990:45).

The main difference between formal and informal institutions is that the former are guaranteed by state agencies and disobedience is sanctioned by that state. Informal institutions are, notes Lauth (2000:24), ‘based solely on the fact of their existence and of their effectiveness’. Another important feature of informal institutions is that they are dependent upon the existence of formal institutions, for example by exploiting them for personal interests (Lauth 2000:26). Lauth (2000:28–29) discusses several examples of informal institutions, such as corruption, violent exertion of influence, civil disobedience and clientelism. Various forms of clientelism are distinguished, of which ‘patronage’ is most relevant for this study. Patronage is characterized by a network that extends from the sphere of bureaucracy into societal domains where formal institutions are used for the implementation of personal objectives, such as material interests. Ledeneva’s concept of informal practices in Russia, described below is closely related to Lauth’s concept of patronage.

3.5 Informal practices in Russia

Ledeneva (2006:11–22) argues that informal practices are important and necessary because they compensate for the defects in the formal system in a society where the rules of the game are consistently incoherent. Informal practices are by Ledeneva (2006:22) defined as ‘a regular sets of players’ strategies that infringe on, manipulate, or exploit formal rules and that make use of informal norms and personal obligations for pursuing goals outside the personal

¹⁴ For a definition of culture see Boyd and Richerson (cited in North 1990:37): ‘Culture can be defined as the transmission from one generation to the next, via teaching and imitation of knowledge, values and other factors that influence behaviour.’

domain'; formal rules are defined (2006:17) as 'juridical or quasi-juridical rules that are consciously produced and enforced by mechanisms created for purposes of such enforcement'. A clear example of informal practices in Russia can be found in Gelman's article discussing the informal mechanisms of political parties prior to elections during the 1990s (1998:179–194).

Ledeneva (2006:1) argues that, during the 1990s, politics in Russia and the country's economy were dependent on the functioning of informal practices. As a result, informal practices have become widespread, recognized and reported upon in every region in Russia. The selective enforcement of formal rules as outlined in the next section is just one example.

Informal practices have their roots in the planned economy of the Soviet system, where a range of informal practices were essential for the system to continue functioning (Ledeneva 2006:1). Today, in a country that has adopted the principles of market economy, informal practices are still necessary to get things done (Ledeneva 2006:178). Informal practices are an outcome of the distrust of formal institutions. A study conducted by Hendley (cited in Ledeneva 2006:25), for example, shows a lack of public support of the state and low demand for law in Russia in the 1990s. Tyler (2006) and Levi and Stoker (2004:477–500) concluded that trust in governmental officials and their legitimacy increase the likelihood that citizens comply with the demands (regulations) of a society. Tyler (2006) and Levi and Stoker (2000:493) argue that when the government is perceived as trustworthy, for example by its enforcing property rights, citizens are more likely to comply with governmental demands. However, the result of the shortcomings in Russia's current legal system, combined with general apathy toward the law as well as the distrust of state institutions, is that the people are far from eager to obey the rules in order to protect and enforce their interests (Hendley 1999:131; Kahn 2002:59).

Another reason for prevalence of informal practices in Russia is, according to Pastukhov (2002), the complexity of Russian bureaucracy. Pastukhov sees the inability of state bureaucracy to meet the socio-economic requirements of the state as a main cause of problems with the Russian legal system. The time required to comply with all the necessary requirements often results in citizens, organizations and bureaucracy itself being unable to meet their obligations. This makes it attractive, indeed and often necessary, for these actors to circumvent formal procedures through informal practices.

Informal practices are characterized by their ‘double-edged relationship’ to the market and democracy: on the one hand they support the formal framework through the application of formal laws; on the other hand, they circumvent the formal system through the manipulation of sanctions available to formal institutions (Ledeneva 2006:3). Moreover, informal practices are beneficial to a particular group of people, at the expense of outsiders who do not have the possibility to conduct or influence these practices. For example, a medium-sized firm may not have the access, in terms of personal contacts or financial resources, to achieve its goals through informal practices that as a large state-owned company has.

It is instructive to compare Ledeneva’s definition of informal practices with Lauth’s definition of informal institutions. Lauth (2000:24) argues that informal institutions are not laid down in writing, but are publicly recognizable and correspondingly well known. What informal practices, according to Ledeneva, and informal institutions, as outlined by Lauth, have in common, is that their existence and effectiveness in circumventing formal processes provides them a degree of ‘social acceptance lending them a basic measure of legitimacy’ (Lauth 2000:24).

However, informal *practices* should be distinguished from informal *institutions*. Ledeneva’s definition of informal practices does not include social norms, traditions or other informal patterns of behaviour that do not fit into the formal order (Ledeneva 2006:3). Informal institutions do, according to Helmke and Levitsky: they define informal institutions as ‘socially shared rules, usually unwritten, that are created, communicated, and enforced outside officially sanctioned channels’ (Helmke and Levitsky cited in Ledeneva 2006:17). North (1990:3) defines institutions as ‘the rules of the game in a society or the humanly devised constraints that shape human interaction’. His definition includes social norms in contrast to Ledeneva’s definition of informal practices. Hence, North (1990:4–5) distinguishes analysing informal practices from analysing informal institutions, as is clear in the following quotation:

The purpose of the rules is to define the way the game is played. But the objective of the team within that set of rules is to win the game – by a combination of skills, strategy and coordination; by fair and sometimes by foul means. Modelling the strategies and skills of the team as it develops is a separate process from modelling the creation, evolution, and consequences of the rules. Separating the analysis of the

underlying rules from the strategy of the players is a necessary prerequisite to building a theory of institutions (North 1990:4–5).

Following North's example, the underlying rules are the formal component of law enforcement; the selectivity of enforcement in Russia is the strategy players use to achieve personal objectives outside the legal domain. The strategy of the players – in this dissertation, they are Western actors – is discussed in Chapter 9. According to Ledeneva (2006:20), it is the focus on players' ability to manipulate the rules that distinguishes informal practices from informal institutions. She argues that it is also the players who benefit from these strategies in dealing with conflicts between formal rules and informal interests (Ledeneva 2006:20). This dissertation is an attempt to examine how players understand and interpret enforcement and regulatory practices against IOCs in Russia, and whether these players understand enforcement practices the same way as Ledeneva expects Russian actors to interpret them.

Informal practices occur when relatively large numbers of citizens or potential users subvert the formal framework, which might be environmental requirements or tax regulations. When problems occur, Russians do not go to court but resort to informal mechanisms (Hendley 1999:134). These informal mechanisms should be understood as informal practices that governmental and private actors use in order to serve their interests.

Kahn (2002:59) seeks to identify the relation between shortcomings in the law and the impact on individual behaviour by referring to a report published in 1994 by legal experts from the Parliamentary Assembly of the Council of Europe.¹⁵ They concluded:

In Soviet times, laws could be completely disregarded – party politics and 'telephone justice' reigned supreme. While it cannot be said that laws are ignored as a matter of course in present times, they are disregarded if a 'better' solution to a particular problem seems to present itself (Kahn 2002:59).

Also other scholars have taken up the challenge of addressing the shortcomings of the formal framework in Russian society. Sharlet (2005:130–147) emphasizes the shortcomings of Russia's legal system by focusing on the following: imperfect regulations, implementation

¹⁵ Russia has been a member of the Council of Europe since 1996.

problems, aberrant police behaviour, law restrictions for dealing with terrorism in the aftermath of the Beslan tragedy in 2004, and selective prosecution.

Examples of informal practices in Russia are also cited in a 2009 report from the Parliamentary Assembly of the Council of Europe. This report describes that, despite President Putin's numerous statements on the importance of distinguishing between political interests and court decisions, challenges remain in reducing judicial corruption and political pressure to ensure convictions in certain cases.¹⁶ The report of the Council of Europe also explains methods used to ensure the conviction of a person such as 'telephone justice', a method also documented by Ledeneva (2008). Ledeneva (2008:236) defines telephone justice as a method where a judge receives 'instructions' from a higher official. Hendley (1999:131) uses the term 'telephone law' to describe the ability of the party elite to manipulate the outcome of court procedures. Furthermore, official procedures like performance evaluations, disciplinary mechanisms as well as searches and seizures contribute to the weak independence of judges vis-à-vis governmental officials and court chairpersons (Parliamentary Assembly 2009:6). The report notes for example that the number of judges dismissed from their functions is 'comparatively high' (Parliamentary Assembly 2009:4).

The next section discusses Ledeneva's framework of selective enforcement as one of the informal practices prevalent in Russian society, and most relevant for this study. Selective enforcement shows how political interference in enforcement and regulatory practices occur, subsequently affecting the efficiency, and more important, the outcome of public law enforcement in Russia.

3.5.1 Selective law enforcement

As with any bureaucracy, motivations for prosecution were not always driven by sound environmental policy reasons (Macrory 2008:177).

¹⁶ For additional information consult: Parliamentary Assembly of the Council of Europe, *Allegations of politically motivated abuses of the criminal justice system in Council of Europe member states*, published by Committee on Legal Affairs and Human Rights, June 2009.

With this quote in mind, this section presents Ledeneva's framework of selective enforcement (Ledeneva 2006). A study of enforcement practices from a Russian perspective is essential if we seek to understand how Western actors understand and interpret these practices and whether they interpret regulatory and enforcement practices the same way as Ledeneva expects that Russian actors interpret them. In the conflicts between IOCs and the Russian authorities that are central to this dissertation, one could suspect that control over the development of natural resources was achieved by legal claims that the IOCs were violating formal rules. Selective enforcement practices, as this chapter illustrates, provide further grounds for this interpretation.

As noted, the enforcement of formal regulations is, besides public management, also a tool for the Russian authorities, and in some cases private actors, to influence or regulate favourable outcomes – including a particular outcome in the development of the oil and gas industry. The latter was to become evident in the conflicts between the Russian state and Shell and BP, as this dissertation shows.

The practice of selective enforcement is a heritage of the Soviet system where rules were enforced by the authorities 'only when necessary' (Ledeneva 2006:13). The drawbacks of Russia's legal system as outlined above, lead to a situation where compliance with formal rules was – and still is – extremely complicated and often impossible.

The use of formal regulations to ensure informal objectives may also occur in Western states. However, in Russia, such practices are more common, and often a result of the shortcomings of the legal system. North emphasizes the difference in enforcement practices between developed countries and Third World countries. Although Russia should by no means be regarded as a Third World country, its legal system shows similarities with North's description of legal systems in Third World countries, for example in terms of the ineffectiveness of the courts and the judicial system. North argues that developed countries are characterized by effective judicial systems including well-specified bodies of law and agents such as lawyers, arbitrators, and mediators, and there is confidence that the merits of a case will influence outcomes, rather than private payoffs (North 1990:59). The outcome of enforcement practices in developing countries, on the other hand, is uncertain, not only because of ambiguity of legal doctrine but also because of uncertainty with respect to behaviour of the agent (North 1990:59). In Russia, the enforcement of regulations is characterized by other motives than enforcing the principles

established in the law. These motives are what Ledeneva (2006:17) defines as ‘informal norms such as customs, codes and ethics that are by-products of various forms of social organisation for example family, personal network, neighbourhood and community’.

In addition to ‘selective enforcement’ Ledeneva (2006:13; 47–49) uses the terms ‘suspended punishment’, ‘administrative resource’, and ‘strategic noninterventions’ to describe the abuse of formal regulations. Other scholars such as Sharlet (2002:130–147) and Bradshaw (2006:6) introduced the terms ‘administrative leverage to pressure foreign companies’ or ‘selective prosecution’ referring to the conviction of Russian oligarchs. Further on in the present study, the term selective enforcement will be used in describing and explaining these practices. When it comes to informal practices in Russia, Ledeneva distinguishes selective enforcement from more impartial enforcement strategies as discussed earlier in this chapter, because selective enforcement includes the use of formal regulations as an instrument to achieve informal objectives. In this context, selective enforcement should be understood as a process initiated by public actors to serve informal interests not intended by formal written rules: consequently, the law becomes an instrument for accomplishing informal interests. The literature has numerous examples of selective enforcement in Russia, such as: daily life situations (d’Hamecourt 2006), privatization processes (Janssen 2004) and administrative raids and interference in court cases (Ledeneva 2006:173). In addition, the 2009 report from the Council of Europe provides clear examples of politically motivated interventions in Russia’s criminal justice system.¹⁷

3.5.2 Selective enforcement and shortcomings in Russia’s legal system

Selective enforcement is most salient in combination with high levels of non-compliance and other shortcomings of Russia’s legal system. Less relevant is whether the law in question is difficult to comply with or not. What matters more is that the same laws apply to all actors equally, for example that one company is not forced to purchase a sand filter in order to reduce water pollution while other companies are not. Or one company is formally punished for the violation of informal codes, while others are not.

¹⁷ This report outlines several high-profile cases, such as the second trial of Mikhail Khodorkovsky and Platon Lebedev, the proceedings against the managers and lawyers of HSBC/Hermitage, the investigation into the murder of Anna Politkovskaya, the prosecution of Yuri Samodurov and several other judges.

Where high levels of voluntary compliance are the norm in Western countries, this is not the case in Russia. The pervasiveness of rule violation in Russia is, according to Ledeneva, the most important basis for selective enforcement.

Anybody can be framed and found guilty of some violation of the formal rules because the economy operates in such a way that everyone is bound to disregard at least some of these rules (Ledeneva 2006:13).

In order to ensure an effective functioning of society, ‘the lawgiver must be able to anticipate that the citizenry as a whole will...generally observe the body of rules he has promulgated’ (Fuller cited in Tyler 2006:19). Effective societal functioning requires that citizens comply with the decisions of the legal authorities (Tyler 2006:20). Again, in Russia this is not the case. Citizens in Russia, according to Ledeneva, do not trust the law or the authorities and act upon that. One example is the widespread violation of tax regulations, which makes it practically impossible to punish everyone (Ledeneva 2006:13). Such widespread violation of formal rules shows a lack of legitimacy for the formal law.

Ledeneva argues that people in Russia violate formal regulations, not only because they do not trust the authorities, but also because of the complexity and incoherency of formal rules. For example:

More than 80 per cent of commodities are subject to state certification before they are put on sale. This was the way things were done in the state-centralized economy, and little has changed since. The certification procedures are impossible to follow, and the state standards often contradict one another or are mutually exclusive because they are produced by different ministries. Moreover, not everyone can acquire the published standards. For example, the State Committee of Standardization sells its published volume of norms and procedures for 230,000 rubbles (more than 7,000 USD). Most entrepreneurs cannot afford such a sum, opting instead to pay for inevitable violations once caught (Kliamkin and Pastukhov in Ledeneva 2006:24).

A second example offered by Ledeneva concerns Production Sharing Agreements (PSAs). A PSA is an agreement between the state and the oil company over the legal and fiscal terms in relation to developing an oil or gas project. To manage the risk involved in operating in

politically unstable places and guarantee a profitable return, foreign investors often require the protection of a PSA for the lifetime of the project. The following example shows the difficulty of complying with the terms of PSAs and also provides an explanation for why these terms (formal rules) need to be so complicated:

Take, for example, a PSA lobby. Naturally, those who pushed it through were interested in the existence of this piece of legislation, as they would then become consultants to large international clients. Why would they want this law to be simple and easy to follow, why? Naturally they shape it in a way that will create various possibilities for themselves. In this sense, our specialists are extremely intelligent (Ledeneva 2006:186–187).

So, in order to get things done, people are forced to employ informal practices outside formal institutions. Any attempt to modify the formal structure by establishing new formal rules, without taking up the problems of non-transparency, will simply result in new informal activities to deal with these new rules (Ledeneva 2006:13–14).

The result of the widespread violation of rules is that everybody is under the threat of punishment for violation of these regulations because it is simply impossible to punish everyone. The actual punishment may be ‘suspended’ but can be enforced at any time (Ledeneva 2006:13). This provides regulatory agencies, or ‘insiders’, with an incentive to use the legal system creatively (2006:50). As a result, enforcement occurs selectively, and is based not on formal written rules, but on practices developed ‘outside the legal domain’: on ‘unwritten rules’ or informal norms, like a bribe, a long-standing personal relationship, or the extending of favours (2006:175). Therefore, ironically enough, it becomes more important to comply with unwritten rules than with the formal regulations (2006:13).

Who exactly are the officials or politicians who can use selective enforcement practices in order to achieve their informal objectives? Ledeneva distinguishes between insiders and outsiders, arguing that actors ‘outside’ the informal decision-making process have limited access to the formal decision-making process, and subsequently are those confronted with

punishment as a result of selective enforcement.¹⁸ Actors with access to the informal decision-making process on the other hand benefit from selective enforcement, predominantly by achieving their personal interests. Consequently, formal regulations become ammunition for ‘insiders’ to punish ‘outsiders’ (Ledeneva 2008:330). A similar distinction has been made by Hendley, who argues that there are two standards in Russia – one for the ordinary citizen and another for the privileged elite (Hendley 1999:137). Examples of selective enforcement are that criminal cases can be opened or closed, tax evasion charges can be pursued – or forgotten –, enforcement officials can continue an investigation – or abandon it –, or inspections conducted by regulatory agencies can be used to impede and intimidate (Ledeneva 2006:174). The list of possibilities is limited only by the creativity of the officials.

Rather than highlighting shortcomings in the legal system as Ledeneva does, Vladimir Pastukhov (2002) argues that selective enforcement is a result of Russia’s extensive bureaucracy. Pastukhov’s (2002:73) focus is on the overdevelopment of control mechanisms, with enforcement officials, for example, being forced to fill in innumerable forms, instead of working selectively. This is a different perspective from the enforcement styles often prevalent in the Western world, where the focus is on selecting a group of potentially known deviants rather than all potential offenders. An example of the latter is Cohen’s (1999:22) model of monitoring and enforcement, where the main focus of the enforcer is on companies who have violated the rules previously. A further example is provided by Eckert (2004:233). Eckert developed a model where the regulator uses the company’s violation history to classify it as ‘good’ or ‘bad’ and then sets inspection probabilities and fines for the two groups, where the bad group will face stricter enforcement.

Pastukhov argues that the widespread violations of the rules and corrupt authorities are too simple a characterization of formal processes in Russia. He does not reject the prevalence of both in Russian society, but emphasizes that there is widespread violation of regulations because the law ‘does not work’ (Pastukhov 2002:66). He then introduces the term ‘sleeping law’ to explain the difference between law and practice in post-Soviet Russia defining sleeping laws as ‘the insignificant difference between what is happening in Russia now and what is

¹⁸ Lauth defines the formal decision making process as ‘the course of events according to procedural rules laid down in laws and standing orders of legislative and executive organs of state (Lauth 2000:31).

usually meant by legal arbitrariness’ (Pastukhov 2002:66). Law does exist, he says, but it does not regulate the real relations of those subject to the law.

According to Pastukhov (2002:72), the law in Russia is constructed in such a way that economic actors must prove their innocence even before their rights are realized. Such a perspective is rational only if regulatory agencies can create an administrative sieve where everyone is accused – or can be accused – of breaking the rules *a priori* (Pastukhov 2002:70). This is in line with Ledeneva’s concept of ‘suspended punishment’ and the ubiquitous character of the law in Russia.

Thus not only does the enforcement of regulations based on selectivity serve unwritten rules, it is also inefficient. As a clear example of the inefficiency of regulatory agencies in Russia, Pastukhov (2002:68) cites the gap between ‘the volume of formal requirements imposed by the system on the citizen’, such as certificates, approvals, expert opinions, conclusions and permissions, versus the insufficient capacity of the administrative system for coping with these requirements (to issue the certificates approvals, expert opinions, conclusions, permissions and other papers on time). Moreover, North (cited in Ledeneva 2006:22) argues that when people perceive the structure of the rules of the system to be fair and just, transaction costs are low and enforcement costs are negligible. By contrast, when the system is perceived as unjust, transaction costs arise.

3.6 Conclusion

Table 1 shows the differences between selective enforcement as presented by Ledeneva and more impartial enforcement of formal regulations according to Hawkins, Macrory and Cohen.

| | Impartial enforcement | Selective enforcement |
|---------------------------|--|------------------------------|
| Regulator: | Regulatory agencies | Regulatory agencies |
| Target group: | Offenders of formal rules | Offenders of unwritten rules |
| General objective: | Compliance with law or punishing offenders | Informal objectives |

Table 1: Main characteristics of impartial enforcement and selective enforcement.

This chapter has presented two opposing enforcement strategies. First, enforcement strategies based on the assumption that law enforcement secures compliance with the law (cooperation

style) or punishment of the offender (penalty style). Second, the framework of selective enforcement introduced by Ledeneva and discussed in section 3.5. Table 2 presents the main differences and similarities of both strategies in addition to Pastukhov’s framework of bureaucratic behaviour. Pastukhov’s framework combines elements of the bureaucratic behaviour strategy and Ledeneva’s framework of selective enforcement.

| | Enforcement strategy | Enforcement style |
|--|--|---|
| Ledeneva (2006) | Selective enforcement | Compliance with the regulations is practically impossible. The result is selective enforcement based on the violation of unwritten rules. |
| Pastukhov (2002) | Bureaucratic behaviour / selective enforcement | Bureaucratic system resulting in a time-consuming and inefficient enforcement style. The law exists but does not work properly (sleeping laws). |
| Macrory (2008), Hawkins (1984), Cohen (1999) | Maximising social welfare /maximising compliance | Compliance/penalty style |

Table 2: Differences and similarities between strategies and styles of law enforcement.

In this chapter we have seen how Russian bureaucrats and citizens are expected to deal with selective enforcement practices in their country. How Western actors such as NGOs and the media understand and interpret these informal practices is discussed in the following chapters where I also inquire whether Western actors understand enforcement practices in the same way as Ledeneva would expect Russian actors to interpret them.

As shown in this chapter, the legal system in Russia is characterized by complexity involved in attempting to comply with the rules, widespread violation of the regulations and selective enforcement by regulatory agencies. These characteristics are all interconnected (see Figure 3). The often impossible task of complying with the extremely complicated legal framework, results in a process where the regulations are violated, sometimes not even deliberately, as people may not be aware of such ‘sleeping laws’ (Pastukhov 2002:66). As a result, laws can be used against anybody, and enforcement of these regulations is often based on interests outside the legal domain. Hence, selective enforcement has objectives other than enforcing the requirements prescribed in the formal law (see Table 2). The informal practices discussed in this chapter, such as selective enforcement, are closely related to economic and political

developments in Russia and occur not only between Russian and foreign actors, as shown in the cases outlined in the next chapters, but also among Russians themselves.

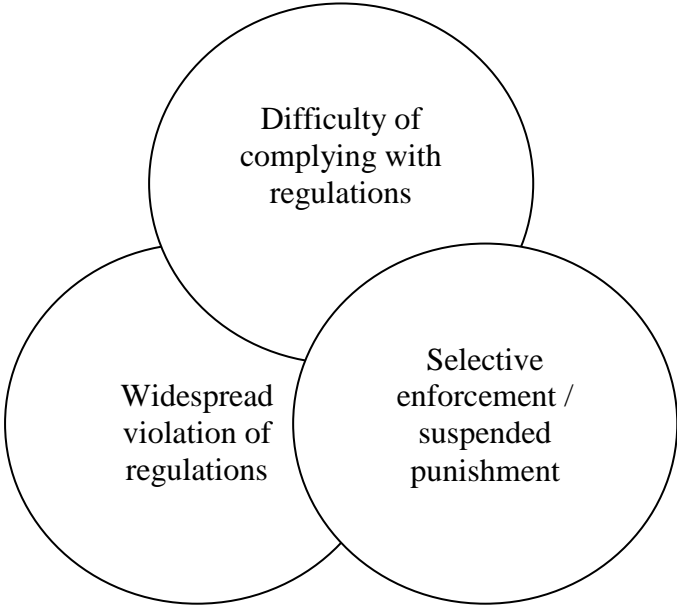


Figure 3: The difficulty of complying with regulations resulting in their frequent violation provides the basis for selective enforcement of formal rules.

Thus, it was possible for Russian enforcement agencies to enforce the rules selectively, and to serve informal ends, such as strengthening state control in the petroleum sector by reducing the influence of foreign oil companies in Russia. The conflicts between Shell/BP and the enforcement agencies were outlined briefly in the first chapter. The next two chapters examine these disputes in greater detail.

4. Sakhalin II: Putin goes green?

The conflicts between BP/Shell on the one hand and the Russian state on the other hand illustrated the relationship between IOCs and the Russian state in the petroleum sector, at a time when oil prices were increasing (see Figure 2 in Chapter 1). We now turn to the course of events and decision-making processes in the conflict between Shell, which had a controlling stake in Sakhalin Energy, and the Russian authorities over the development of the Sakhalin II oil and gas field. This chapter focuses on the complexities associated with the enforcement of formal regulations and business opportunities in contemporary Russia. Chapter 5 addresses the conflict between BP and the Russian state, and between Russian and British shareholders with the TNK-BP board.

Shell involved the public in the company's conflict with the Russian state. This can shed light on what would normally have been a closed negotiation process between oil company and state over the development of oil and gas projects. We recall the reluctance of oil company representatives to comment on the research questions presented in Chapter 1. The relationship between the oil company and the state, for example in terms of negotiations, becomes less transparent when Shell and the Russian state agree upon the terms for the further development of Sakhalin II. A similar pattern occurred in the conflict with BP, to be outlined in Chapter 5. How both IOCs understand regulatory pressure and enforcement practices in Russia, by determining the strategies of Shell and BP in order to respond to such mechanisms, will be taken up in Chapter 9. And finally, Chapter 10 discusses whether Shell and BP have understood regulatory and enforcement practices the same way as Ledeneva has argued that Russian actors would interpret them.

4.1 The Sakhalin II project

Some of the events discussed below have also been described in a recent study by Bradshaw (2010:330–359). However, rather than explaining how the Russian state gained control over the petroleum sector on Sakhalin, I wish to examine how Shell and BP understood law enforcement practices and regulatory pressure in Russia.

In 1991, the then former Soviet government invited IOCs to tender for the right to conduct a feasibility study for the development of licence blocks of the Piltun-Astokhskoye field (primarily an oil field with associated gas) and the Luns koye field (predominantly a gas field with associated condensate). Both fields had been discovered in the mid-1980s. A consortium represented by Marathon, McDermott and Mitsui won the tender for developing these fields, and signed an agreement with the newly established government of the Russian Federation in 1993. The project became known as Sakhalin II. Sakhalin is a remote, little developed region in the Russian Far East (see Figure 4) exposed to severe weather conditions with winter temperatures dropping to -70 C.¹⁹ Sakhalin is not unfamiliar to the oil industry. Neftegorsk was the centre of the onshore oil industry in the mid-1990s, with Exxon Neftegas Ltd as the operator. In late 1992, Shell and Mitsubishi joined the consortium and established Sakhalin Energy Company Ltd, henceforth Sakhalin Energy. Following an asset swap with Marathon, Shell became a major shareholder and project operator in 2000.²⁰



Figure 4: Sakhalin Island in the Russian Far East²¹

In 1994, Sakhalin Energy signed the first Production Sharing Agreement (PSA) in Russia. The Russian government was represented by the Ministry of Industry and Energy and the

¹⁹ Winter on Sakhalin runs from October to April.

²⁰ An asset swap is a financial agreement in which two counterparties agree to exchange one stream of cash flow against another stream.

²¹ Available at: <http://enviro-map.com/sakhalin> (accessed September 2012).

Administration of Sakhalin Oblast, which supervises project implementation and development. Sakhalin I was also based on a PSA.

According to this agreement, Sakhalin Energy is to invest the financial resources needed to develop the fields and pay taxes during project development, including royalties to the government of six per cent on gross revenues throughout the lifetime of the project (Sakhalin Energy Review 2002:6). Moreover, the Russian Federation is to receive a 32 per cent profit tax on all oil and gas produced at Sakhalin II (Sakhalin Energy Review 2006:16). Production revenues are to be shared between the Russian Federation, Sakhalin Oblast and Sakhalin Energy, after capital investment is repaid (Wilson Rowe 2008:58). Effect royalty and tax payments stood for approximately 10 per cent of the Sakhalin Oblast budget in 2008, in addition to the multiplier effect.²² Parts of the revenues have been transferred to the Sakhalin Development Fund, and much of this fund has been used to improve public services on the island including the construction of a children's clinic, a hospital and three schools.²³ Furthermore, several projects have been initiated for improving infrastructure including the Kholmsk fishing port, the airport at Nogliki and an upgrade of railway connections between the northern and southern parts of the island (Sakhalin Energy Review 2002:12).

Hence, the deal implies that the Russian government is to receive an increasing proportion of revenues as the project progresses. Furthermore, Sakhalin Energy must use 'its best efforts to achieve a 70 per cent target' of using Russian labour and materials, measured in man-hours worked and volume or weight of materials/supplies over the lifetime of the project (Sakhalin Energy Annual Review 2003:18). Bradshaw (2010:338) and Krysiak (2007:22) argue that the PSA concerning Sakhalin I should be seen as a better deal for the Russian side than the Sakhalin II PSA, although the exact terms of the PSAs are not publicly available.

The Sakhalin II PSA governs the license for the exploration, development and exploitation of the two fields, Piltun-Astokhskoye and Lunskeye. The project started in 1994 with the construction of offshore platforms to produce oil and gas, a system of oil and gas pipelines, a

²² The 'multiplier effect' is commonly described as the creation of new jobs, higher salaries, growing retail trade, better social programmes and higher tax payments due to oil and gas projects on a particular location.

²³ According to *Sakhalin II Phase 2 Environmental and Social Executive Summary* 100 million USD have been contributed to the Sakhalin Development Fund (Sakhalin Energy Investment Company 2005:9).

Liquefied Natural Gas (LNG) plant and export facilities for oil and LNG.²⁴ The aim is to develop and produce oil and gas from these offshore fields for delivery to the Asia-Pacific market and North America. Until the end of 2006, the company's shareholders were Shell Sakhalin Holdings B.V (55 per cent), Mitsui Sakhalin Holdings B.V. (25 per cent) and Diamond Gas Sakhalin–Mitsubishi (20 per cent).

From the outset, the Sakhalin II project met resistance from environmental organizations due to concerns as to its impact on whales and fish species, as well as fears of oil spills.²⁵ The main issue with Western grey whales is that the oil and gas deposits are located under the feeding grounds of these endangered species. The population of grey whales was classified as a 'critically endangered population' by the World Conservation Union in 2000. In 2006, the population was estimated to be around 122 individuals, excluding calves (WGWAP 2006:3). In order to discuss and suggest improvements for minimizing the impact on these whales, a scientific panel consisting of independent scientists was established in 2004, funded by the operator of the Sakhalin II field (Sakhalin Energy Annual Review 2005:29).

4.2 Company structure of Sakhalin Energy

Figure 5 shows the governance structure of Sakhalin Energy. As explained, the project has been established according to a PSA whereby the government of the Russian Federation approves and makes strategic decisions.

The most important strategies are developed by the supervisory board, where the shareholders are equally represented; Russian members of the board are appointed by governmental decree. The committee of executive directors implements decisions made by the supervisory board and the shareholders' meeting, and is also in charge of daily operational management of the company.

²⁴ LNG is liquid natural gas cooled to -160 C, making possible transport of large quantities by tanker ship.

²⁵ See 'Analysis of the Sakhalin II oil and gas project's compliance with the Equator Principles', written by Platform 2004:7–8.

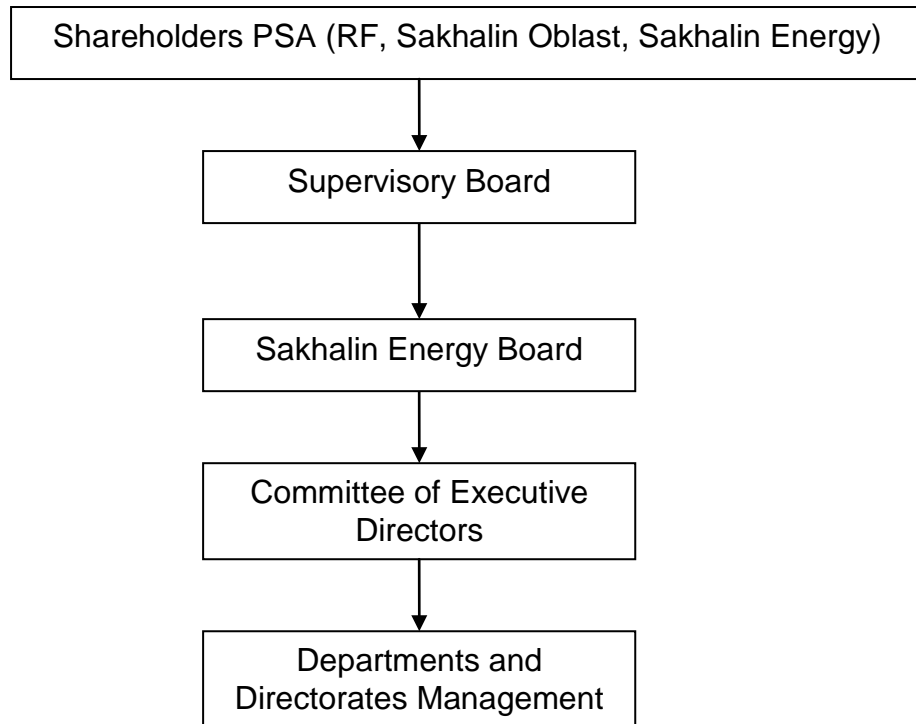


Figure 5: Sakhalin II governance structure

4.3 The project's two phases

Because of the scale of the project, the investment required and its technical complexity due to harsh climate conditions, the project was divided into two phases, each with several sub-phases. Phase 1 consisted of a construction phase for the period 2002–2008. The second phase involves the long-term employment operations starting from 2006, to last until decommissioning after the project has been completed.

Together the Piltun-Astokhskoye- and Lunskoye fields are estimated to contain in-place reserves of 600 million tonnes (4.6 billion barrels) of crude oil and over 700 billion m³ (24 trillion cubic feet) of natural gas (Sakhalin Energy Review 2002:6). This resource base will supply approximately 9.6 million tonnes of LNG for at least 25 years (Sakhalin Energy Review 2002:6). At its peak between 2004 and 2006, the construction of project facilities required approximately 17,000 workers, engaged in building two offshore platforms (Sakhalin Energy Investment Company 2005:9).

Phase 1 started in 1996 with the development of the Piltun-Astokhskoye field, discovered in 1986. The field was selected as the starting point for production of oil from the Vityaz

production complex, which is built around the Molikpaq platform (PA-A platform), a former ice-class drilling rig in the Beaufort Sea, located 16km offshore from northeast Sakhalin Island. At the time of its construction, the Molikpaq platform was the first offshore oil platform in the Russian Federation. The Piltun-Astokhskoye field is believed to hold recoverable oil reserves of more than 110 million tonnes, with a peak production of 90,000 barrels of oil and 14,826 m³ of gas per day (Sakhalin Energy Review 2002:9). Oil drilled from the Molikpaq platform is transferred through offshore pipelines to a floating storage and offloading unit located two kilometres from the production complex for delivery to the market, or to be used as fuel for operational activities. Initially, the production of crude oil took place from May to early December, and was suspended during the remaining period, when winter sea ice prevented tankers from reaching the terminal.

The second phase of the project, begun in 2001, provides for further development of the Piltun-Astokhskoye and Lunskeye fields, located 15km offshore where oil and gas are produced simultaneously. The newly established infrastructure in Phase 2 and an upgrade of the Piltun-Astokhskoye field made year-round oil production possible in 2008. Phase 2 includes the installation of offshore platforms on the Piltun-Astokhskoye and Lunskeye fields, an onshore processing facility and an oil export terminal (Sakhalin Energy Investment Company 2005:6–7). Peak crude oil/condensate production capacity from the three offshore platforms was then expected to be about 180,000 barrels per day (Sakhalin Energy Investment Company 2005:7).

The gas and condensate from the Lunskeye platform is transported to the onshore processing facility before being transferred through an 800km onshore pipeline to Progorodnoye in the South of Sakhalin. Here it will be converted into LNG and exported to customers in the Asia-Pacific region from the oil export terminal (see Figure 6). All these facilities were completed in 2008, and in December 2008 the first delivery from the new oil export terminal took place.

The necessary documents to obtain governmental permission for the construction of phase II were submitted in July 2002, including environmental protection books for each project facility that provided an assessment of the environmental impact and proposed maximum permitted discharge and emission levels (Independent Environmental Consultant Final Report 2007:26).²⁶ A positive conclusion that included several further recommendations and

²⁶ Henceforth referred to as 'Environmental Report'.

conditions was issued in 2003. Subsequently the State Environmental Expertise Review (SEER), with reference number 600 issued in July 2003, concluded that the environmental impact would be acceptable, but be subject to the approval of the relevant regulatory agencies (Environmental Report 2007:26). An additional ‘positive conclusion’ regarding the alternative route for the offshore pipeline construction was issued in 2005. The decision to reroute the offshore pipeline construction was taken as a result of studies indicating that the original construction could disturb the critically endangered whales (Sakhalin Energy Review 2004:35).

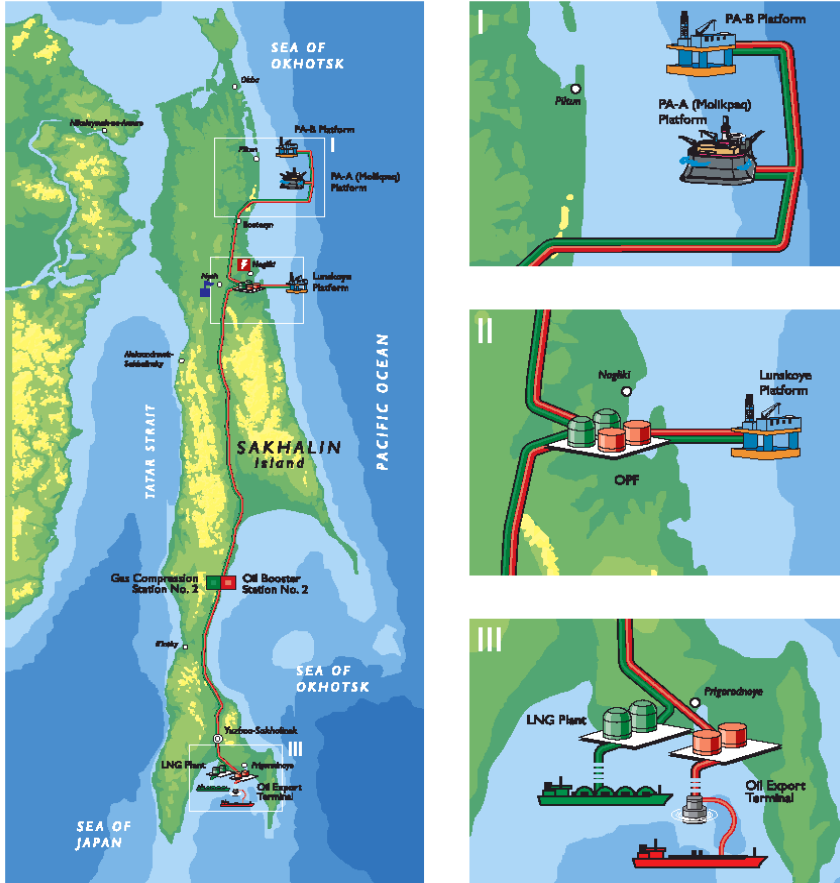


Figure 6: Overview of the Sakhalin II Project²⁷

4.4 Financing Sakhalin II: the EBRD’s helping hand

Project financing is common in the global oil and gas industry for the construction of the necessary infrastructure. Debt repayment comes from the cash flow generated by the exploitation of hydrocarbon resources. Besides the operational costs, the lack of basic infrastructure at Sakhalin made investments in infrastructure and health-care systems necessary.

²⁷ Sakhalin II Phase 2 Environmental and Social Executive Summary, November 2005:8.

The financial agreement for running Phase 1, involving a total of USD 116 million, was signed in 1998 by three main lenders: the Japan Bank for International Cooperation (JBIC), the European Bank for Reconstruction and Development (EBRD) and Overseas Private Investment Cooperation (OPIC) (Sakhalin Energy Annual Review 2006:49). In June 2008, Sakhalin Energy, the JBIC and an international consortium of commercial banks signed a USD 5.3 billion agreement on financing Phase 2 of the Sakhalin II project. This agreement was necessary to complete the final construction stage and start-up costs involved in Phase 2, such as the construction of a new pipeline.

With the EBRD as part-financer of Phase I and potential financer of Phase II of the Sakhalin II project, Sakhalin Energy needed to comply with the environmental guidelines issued by the EBRD. Increasing demands for good environmental behaviour have been forcing international financial institutions such as the EBRD and the World Bank to become norm-promoting actors that exercise pressure on companies and governments to comply with environmental norms and reduce the impact of industrial activities on the environment. As discussed in the theory of ecological modernization (Mol 2001) and in Goldenman (1999), financial institutions that do not adequately address environmental issues in investment decisions may find themselves targeted by green NGOs. And indeed, the EBRD was criticized by NGOs for financing the Sakhalin II project because of the negative environmental side-effects of Sakhalin Energy operations.

4.5 From owner to technical advisor

After the signing of a protocol on 21 December 2006, Gazprom became the major stakeholder of Sakhalin Energy. Shell sold half of its shares to Gazprom, which thereby acquired a 50 per cent plus one share in the company. Gazprom paid Shell in total USD 7.45 billion for their shares (Sakhalin Energy Review 2007:9). After this agreement, Shell came to control a 27.5 per cent stake, with Mitsui and Mitsubishi controlling 12.5 per cent and 10 per cent stakes respectively. The role of Shell has shifted, from leading stakeholder to ‘Sakhalin Energy’s lead technical advisor’ (Sakhalin Energy Review 2007:9). The next section describes the developments that lead up to the above-mentioned protocol.

4.6 The shell opens up

The conflict between Sakhalin Energy and the Russian governmental authorities, represented mainly by the Ministry of Natural Resources and its environmental inspectorate Rosprirodnadzor, started in 2005 when Shell raised the development costs for the Sakhalin II project. In July 2005, a revised cost estimate for Phase II of the order of USD 20 billion had been officially announced, implying a cost increase of USD 10 billion compared to the original budget of USD 12 billion.²⁸ Furthermore, LNG deliveries had been delayed, and were not scheduled to start before the summer of 2008.

These cost overruns are also documented in Shell's Sustainability Report 2005:

The venture remains economically attractive, despite the higher cost estimates (20 billion USD instead of 10 billion USD for phase 2) and delays to the first LNG deliveries announced in 2005. The higher costs reflect higher energy and raw materials, and wage inflation in Russia. They also reflect the complexity and the frontier nature of the project, which were originally underestimated (Shell Sustainability Report 2005:24).

According to Sakhalin Energy, the costs rises were caused by higher oil prices resulting in increased demand for oilfield services and commodities, by underestimation of the complexity of the project, and the instability of the Russian rouble. In addition to rising energy prices and inflation in Russia, Sakhalin Energy claimed that recommendations from Russian technical expert bodies and changes in the design of the infrastructure had negatively impacted operational costs negatively; examples here were additional seismic analysis, additional requirements for Sakhalin Energy's offshore facilities and rerouting the offshore pipeline construction to avoid the feeding grounds of the grey whales (Sakhalin Energy Annual Review 2006:49).

Furthermore, seven days before Shell officially announced the cost increases and project delays on 14 July 2005, Gazprom signed a memorandum of understanding with Shell. The deal

²⁸ *Shell announces Sakhalin II project schedule and cost update*, Shell Press release, 14 July 2005. Available at: http://www.lexdon.com/article/shell_announces_sakhalin_ii_project/128928.html (accessed September 2011).

provided Gazprom with a 25 per cent stake in the Sakhalin II project and Shell with a 50 per cent interest in the Zapolyarnoye Neocomian field.²⁹ As noted by Op Het Veld (2009:17), Gazprom was ‘completely surprised’ at the cost overruns and expected Shell to make concessions in the negotiations on future development of the Sakhalin II field.

Cost overruns must be approved by the Russian government. Like most governments, the Russian government is annoyed when there are cost overruns, since they prolong the time before the state will receive a share of the profits.³⁰ That is why project delays and additional operational costs need approval from the Russian side. In theory, PSAs can normally be renegotiated or cancelled when certain deadlines are not met. However, because the content of the PSA over Sakhalin II is not publicly available, it is impossible to say whether such terms are included in the agreement.

During the first years of post-Soviet transition in the 1990s, the oil industry found itself in a crisis caused by mismanagement, lack of clear ownership rights, poor infrastructure, lack of technical innovations and falling oil prices. The terms of the deal were negotiated in the early 1990s when oil prices were low, and Russia’s weaker bargaining position forced the acceptance of what many Russians today regard as humiliating terms. The political circumstances changed after Vladimir Putin became president in 2000, according to the following respondent:

During the 1990s under Yeltsin, Shell got extremely lucrative terms for the development of Sakhalin II. That was a different time. Energy sources are owned by the state and everywhere in the world states are pulling profits to themselves. The oil and gas resources in the Middle East are also nationalized. After the collapse of the Soviet Union, things were not managed properly in the 1990s. Nowadays, they try to restore this by use of available instruments, although the way the Russians operated doesn’t give them the first prize in a beauty contest (Representative of federal governmental organization, interview with author in The Hague, September 2010).

²⁹ *Gazprom and Shell sign Memorandum of Understanding to swap shares in Zapolyarnoye Neocomian and Sakhalin-2 projects*, Shell Press release, 7 July 2005. Available at:

<http://www.rustocks.com/index.phtml/Pressreleases/SVER/5/7789> (accessed September 2011).

³⁰ According to a report published by the World Wildlife Fund (WWF), Shell will recoup not just their costs but a 17.5 per cent return on their investment before the Russian state gets its share (WWF 2006:4).

Op Het Veld (2009:10–11) recalls a conversation between Vladimir Putin and Shell’s Chief Executive Officer (CEO) Jeroen Van der Veer that took place in November 2005 at the official residence of the chairman of the county council in Amsterdam.³¹ Putin’s stay in Amsterdam was part of his state visit to the Netherlands, and during this informal meeting Putin made it clear to Van der Veer that the Russian state would not accept a cost increase of USD 8 billion. Putin also demanded that Gazprom should control the majority of the shares in the Sakhalin II project.

Further, Op Het Veld argues that there is old sore between Shell and Gazprom due to a conflict in the late 1990s. In 1997, Shell and Gazprom established a strategic alliance which provided Shell access to the Zapolyarnoye Necomian field in Siberia in exchange for an investment of USD 1 billion. However, due to political instability at the time and Gazprom’s difficult financial situation, Shell’s management decided to pull out, leaving the Russians frustrated (Op Het Veld 2009:13–14). Although, Shell later gained access to Sakhalin II after the deal with Marathon, Op Het Veld argues that Gazprom felt itself bypassed (2009:13–14).

However, the Russian government refused to approve the cost updates announced by Shell, and negotiations between Shell and Gazprom were fruitless.³² Subsequently, inspections by Rosprirodnadzor were conducted in the second half of 2006. As a result, Sakhalin Energy – and indirectly Shell, as the major stakeholder – were accused of violating environmental requirements in the construction of the pipeline. This marked the beginning of a ‘public fight’ between Shell and the Rosprirodnadzor, represented by Oleg Mitvol, deputy head of the Russian federal environmental inspectorate.

Shell opted for a strategy to publicly pressure the Russian government, assuming that the latter would bend and finally give in to the company’ demands. With this, the ‘shell’ opened up and the public gained access to a conflict in what could normally be a closed negotiation process between company and state. The fact that the conflict received a great deal of media attention was, according to the interviewee quoted below, of greater interest than whether the

³¹ The WWF confirmed this meeting between Putin and Van der Veer in November 2005 (WWF 2006:2)

³² According to Op Het Veld, negotiations were unsuccessful since Shell stuck to a 25 per cent share for Gazprom instead of the larger share demanded by the Russian government.

Rosprirodnadzor inspections had been motivated by something beyond enforcement of environmental regulations. In 2003, Mikhail Khodorkovsky opted for a similar strategy, in putting pressure on President Putin by threatening to sell Yukos shares to the US oil company ChevronTexaco.

Shell deliberately selected a strategy of making noise. They hired in the press and attacked the Russians for their behaviour. As a consequence, the Russians started to do the same. BP selected the same strategy. Look for example at ExxonMobil, they deal with the same issues but this case is hardly visible in the media. Shell's strategy, hoping that the Russians would move closer, failed completely (Representative of NOC, interview with author in February 2010).

Allegations against Shell and the Russian government were made public by representatives of both actors. The Deputy Head of Rosprirodnadzor Oleg Mitvol, arriving on Sakhalin in September 2006 along with journalists and representatives of NGOs, accused Shell of poor environmental management and threatened the company with fines.³³ Shell, in turn, attempted to soften these accusations by emphasizing that the violations were minor, and invited press and NGO representatives to tour the island.

I can hardly imagine that Shell wanted to avoid a public debate when you arrange an information day for NGOs and fly Western journalists into Sakhalin – where I was one of them. The same counts for politicians expressing concerns on behalf of Shell. You have to be aware that as the only company in the Netherlands, Shell has a direct connection with high-level politicians, which in turn, accused the Russian government of being unreliable (Dutch journalist, interview with author in Amsterdam, February 2010).

When the governmental inspectorate opened its investigation case against Sakhalin Energy, Russian state television portrayed the pipeline stretch as an environmental disaster zone.³⁴ Not only did Rosprirodnadzor accuse Sakhalin Energy of violating environmental regulations, also

³³ See for instance 'Probe into Shell's Sakhalin-2 is extended', *Financial Times*, 26 October 2006, p. 20 (London 1st edition).

³⁴ 'Shell fixes most Sakhalin violations', *St. Petersburg Times*, 16 October 2006. Available at: http://www.sptimes.ru/index.php?action_id=2&story_id=19152 (accessed September 2011).

environmental organizations like WWF – already sceptical to the project because oil activities would harm the unique natural environment of Sakhalin – reported that Sakhalin Energy had not followed its own environmental guidelines and local regulations.³⁵ Failures in technical equipment, working methods or safety requirements could have serious impact on rivers, streams and disturb the habitat of salmon. The pipeline construction crosses 1,100 rivers, streams and other water courses, some 180 of which have been classified as ecologically sensitive (Environmental Report 2007:52).

The independent environmental audit conducted by the environmental consultancy firm AEA in September 2007, aimed at ascertaining the status of compliance for potential lenders such as the EBRD, noted that during the summer of 2006 three governmental inspections were undertaken: one in July by Rosprirodnadzor in the Dolinsk region and two in August, in the Makarov and the Nogliki regions (Environmental Report 2007:271, Appendix I). In focus in these audits were the location and design of spoil tips, design of the pipeline in landslide/mudslide risk areas, culvert/bridges designs, riverbank protection and drainage controls on access roads (Environmental Report 2007:271, Appendix I). In addition, inspections were undertaken in October and November 2006, the latter by Rosprirodnadzor's prosecutors, a higher governmental level than Rosprirodnadzor itself. Furthermore, on 5 December 2006, the Amur Water Basin Authority (AWBA) issued a letter notifying subcontractor Starstroi that several water use licences had been suspended due to violations of licence requirements identified in the course of Rosprirodnadzor's audits of the pipeline construction. The violations included instances of water culverts changing the hydrological regime of the water courses, spoilage in water protection zones, insufficient bank reinstatement, ineffective silt fences, felling trees in river beds, bridges changing the hydrological regime of the rivers, non-simultaneous crossings of the oil and gas pipelines, and releases of sediment to the water column during the construction of crossings (Environmental Report 2007:271, Appendix I).

³⁵ For more information see '*Risky Business – the new Shell, Shell's failure to apply its Environmental Impact Assessment Guidelines to Sakhalin II*' (WWF-UK 2005:3).

4.7 Motivations for the crackdown

Was Rosprirodnadzor's conduct motivated by other interests than enforcement of formal rules? Most respondents regarded the enforcement of formal environmental regulations conducted by Russian regulatory agencies as subject to 'informal interests', meaning that enforcement was based on other criteria than those related to the actual dispute. Here, the law is seen as being used manipulatively against political adversaries or business opponents. As a representative of a gas company and business partner with Gazprom pointed out:

The action has nothing to do with protecting the environment. Companies operating on the island [Sakhalin] with similar kinds of projects are damaging the environment too. It is not a matter of whether it is politically motivated or not. Of course it is. The interesting question is how you respond to this. I rather see it as a challenge (Representative of NOC, interview with author in February 2010).

This argument is backed up by a respondent working at a federal governmental organization:

The act was politically motivated. The Russians were furious after Shell increased the costs. In my view, Shell didn't realize what they actually did (Representative of federal governmental organization, interview with author in The Hague, September 2010).

Other respondents acknowledged that Rosprirodnadzor's eagerness to enforce the environmental rules was not motivated by genuine concern for the environment. However, these respondents also emphasize the environmental damage resulting from oil and gas exploration activities on Sakhalin, such as the following journalist:

No it [the dispute between Shell and the Russian authorities] had little to do with protecting the environment, although the environmental damage on the Island is extensive. Using environmental regulations to pressure Shell was therefore an easy and achievable solution. Sakhalin Environmental Watch and other environmental organizations have always protested against the activities because of the protection of the whales, salmon and river crossings. For NGOs it's also easier, or perhaps safer

to accuse a Western company like Shell than Rosneft or Gazprom (Dutch journalist, interview with author in Amsterdam, February 2010).

A Russian source, however, denies that environmental legislation was employed as a tool to punish Shell. This interviewee emphasizes the economic impacts of the conflict for the Russian state, rather than discussing the violation of environmental rules.

I would not consider the use of formal regulations as a mechanism to punish IOCs for other reasons than the protection of the environment. This is a wrong formulation, I'm sorry to say. There are different perspectives on the things that happened. We saw the violations, which later gave the opportunity to buy shares from Shell and to improve everything. We understand that all looks like pretext, yes as a pretext, and maybe it is not correct. But one should be more understanding. One should master the legislation and the methods of business (Russian oil and gas industry expert, interview with author in Murmansk, December 2009).

Sometimes Sakhalin Energy was supported by some environmental NGOs, like as the International Fund for Animal Welfare, which also noted that environmental damage in the order of USD 50 billion – of which the company was accused – was unrealistic considering that the standard fines for environmental harm are relatively low in Russia.³⁶ Mostly, however, NGOs accused Sakhalin Energy of violating environmental norms, as the following representative of a Russian-based NGO points out:

Sakhalin Energy has problems with NGOs. We wrote an application to the prosecutor's office regarding the grey whales because Sakhalin Energy is hard to talk to and difficult to reach an agreement with. Therefore we had to use the power of the court and the Prosecutor's office. After being accused of violating environmental regulations, Sakhalin Energy said that these violations were committed by contractors and subcontractors working there. Of course they recognized their responsibility, but argued that they had not violated the law, it was them [referring to the sub-

³⁶ 'Shelling out for the environment', *St. Petersburg Times*, 29 September 2006. Available at: http://www.sptimes.ru/index.php?action_id=2&story_id=18987&highlight=or (accessed September 2011).

contractors] (Representative of NGO, interview with author in Murmansk, December 2010).

The dispute between the Russian authorities and Sakhalin Energy was clearly more than a conflict over the violation of environmental rules. The oil company was accused of breaking the agreement with the Russian government when Shell announced that cost estimates for project would rise to USD 20 billion. These accusations came not from the Russian government itself but from an agency that supervises the use of government finances. The agency has no enforcement powers but can forward its conclusions to governmental officials for further investigation by prosecutors.

Sakhalin Energy issued action plans that identified the environmental violations and measurements for rectifying the alleged ecological damage. However, Rosprirodnadzor deemed these efforts insufficient and continued its investigations, which in early December 2006 resulted in the suspension of crucial licences for one of Sakhalin Energy's main contractors, the Russian-Italian joint venture Starstroi by the Water Resources Agency for violations of environmental rules.³⁷ That would prevent the operator from completing pipelines connecting gas fields in the north with the LNG plant in the southern part of the island. Earlier in October 2006, construction of two on-shore pipelines had been suspended by the Ministry of Natural Resources.³⁸

In October 2006, then Dutch Minister of Economic Affairs Joop Wijn, heading a trade mission to Russia, conveyed Shell's message to the Russian authorities that Shell was prepared to provide Gazprom a 50 per cent plus one share interest in Sakhalin II. The formal role of the Dutch government was to re-establish contact between Shell and the Russian government after the conflict escalated in the media.

Shell wanted to talk. The Dutch government's' job was to provide a forum where both partners could meet. As a governmental organization we cannot interfere in private

³⁷ Water-use licences were suspended by the Amur Water Basin Committee for a 3-week period during December 2006 (5 to 28 December) following identification of licence violations (Environmental Report 2007:95).

³⁸ Press release by Ministry of Natural Resources regarding the administrative inspection of Sakhalin II. Available at: <http://www.mnr.gov.ru/part/?act=more&id=2826&pid=11> (accessed January 2012).

conflicts so there was nothing more we could or wanted to do (Representative of federal governmental organization, interview with author in The Hague, September 2010).

4.8 The shell closes

On 21 December 2006, the shareholders of Sakhalin Energy and the Ministry of Industry and Energy reached an agreement including the amended budget and cost recovery. According to a press release issued by Shell, the PSA for the project would continue and the parties had agreed to jointly resolve all outstanding issues.³⁹ Gazprom joined the project, becoming the major stakeholder in Sakhalin Energy and the operator – and licence holder – of the Sakhalin II project. The protocol confirming Gazprom's entry into Sakhalin, was formally signed on 25 April 2007. The price Gazprom paid was USD 7.45 billion (Shell Sustainability Report 2006:34).⁴⁰ Shell's new role was described as 'technical advisor'; the operating agreement Sakhalin Energy used before the ownership change – with all its environmental and social requirements – continued to apply and all existing LNG contracts remained in force (Sakhalin Energy Annual Review 2006:9–10).

After the protocol-signing ceremony, the Sakhalin Energy shareholders met with President Vladimir Putin in the Kremlin. The Russian leader welcomed the agreement with Gazprom and assured the shareholders that the government would fully support the project. He expressed full satisfaction:

I am extremely pleased that Russia's environmental agencies and our investors have agreed upon the procedure to address the identified problems...In principle, the issue

³⁹ 'Sakhalin II shareholders reached agreement with the Ministry of Energy and Industry of the Russian Federation', Shell press release, 21 December 2006.

http://www.sakhalinenergy.ru/en/media2.asp?p=media_page&itmID=199 (accessed March 2012).

⁴⁰ According to Royal Dutch Shell's Five-year fact book 2005–2009, the price was USD 4.1 billion. Furthermore, the main impact on the Consolidated Balance Sheet was a decrease of USD 15.7 billion in property, plant and equipment and USD 6.7 billion in minority interests and an increase in equity accounted investments of USD 3.7 billion (Five-year fact book: Royal Dutch Shell plc Financial and Operational Information 2005–2009:55).

may be considered closed, and the approaches to problem resolutions agreed on (quoted in Sakhalin Energy Review 2006:71).

Subsequently, revised versions of the environmental action plan were submitted to Russian federal authorities in March and October 2007. On 26 October 2007, the then-CEO of Sakhalin Energy Ian Craig, reported on the state of affairs to former Russian Minister of Natural Resources Yuri Trutnev. Russian Ministers of Industry and Energy (Viktor Khristenko) and Natural Resources (Yuri Trutnev) expressed their satisfaction with the improvements the operator had made (Sakhalin Energy Review 2007:27). Moreover, Yuri Trutnev inspected the trans-Sakhalin pipelines and concluded:

Within the period of two years...Sakhalin II has in fact become an example for similar projects. It has remedied virtually all the non-compliances and is utilising the best available world technologies in terms of water resource protection, slope stabilisation and seismic design. The Minister rated the job done as excellent (Sakhalin Energy Review 2008:10).

In the annual reports published by Sakhalin Energy, Gazprom's entry is seen in a rather positive light:

An important factor in the Project's progress is the agreement with the Russian Party on the Amended Development Budget, reached in December 2006. The entry of Gazprom, the world's largest gas producer and exporter, as a leading shareholder will also be of great value to the Project (...) The signing of the 21 December 2006 protocol to bring Gazprom into the Sakhalin Energy Investment Company Ltd as a leading shareholder was a landmark event (Sakhalin Energy Review 2006: 3, 9).

I think all the parties have won from the deal – the Russian Federation, LNG buyers in Japan, Korea and other Asia Pacific markets and, of course, the project investors (former Shell Chief Executive Jeroen Van der Veer quoted in Sakhalin Energy Review 2006:10).

The support of the Russian government was considered essential for successful completion of the project:

The greatest news is that we have stabilised the situation with the project and all the partners can now work together to get Sakhalin II up and running (former Shell Chief Executive Jeroen Van der Veer quoted in Sakhalin Energy Review 2006:10).

We, Mitsui, are confident that Gazprom's entry, coupled with the project's cooperation with the Russian Government and the Sakhalin Oblast, will not only give more strength to the project, but will also contribute to further development of Russia–Japan relations (Former president and CEO of Mitsui Shoei Utsada, Sakhalin Energy Review 2006:10).

We are also happy that the shareholders have finally succeeded in reaching mutual understanding and agreement with the Ministry of Industry and Energy on the outstanding issues connected with the project (President and CEO of Mitsubishi Yorihiro Kojima, Sakhalin Energy Review 2006:11).

From the Russian side, both President Vladimir Putin and Head of the Ministry of Industry and Energy, Viktor Khristenko are quoted in the 2006 report. Putin's comments clearly indicate that the violation of environmental regulations and the following pressure from the Russian federal authorities were now to be seen as issues from the past.

After financing phase I of the Sakhalin II project, pressure was put on the EBRD by several environmental NGOs who emphasized the impact of the project on the environment, and on grey whales in particular.⁴¹ In January 2007, the EBRD decided to withdraw from negotiations on a USD 600 million investment in the Sakhalin II project after Gazprom took control:

Following significant changes in the ownership of Sakhalin Energy it [the Bank] would no longer consider the financing package for the project, even if the new group of shareholders were to request it in the future (Environmental Report 2007:xii).

⁴¹ Letter to EBRD, JBIC, US Ex -Im, and ECGD on Sakhalin II ESHIA. Available at: http://wwf.panda.org/what_we_do/where_we_work/black_sea_basin/caucasus/publications/?21131/Letter-to-potential-lenders-from-NGO-coalition-May-2005 (accessed March 2011).

The decision by the EBRD to stop financing the second phase of the Sakhalin II project due to the ownership shift is also noted in Shell's 2006 Sustainability Report:

Gazprom's entry and the change of shareholders may alter the way the project is financed. As a result, the EBRD ended its review of the current funding proposal in early 2007 (Shell Sustainability Report 2006:35).

Today, the platforms and pipelines are complete, and Sakhalin Energy exported its first cargo of LNG in April 2009. In 2008, Sakhalin Energy even won the Russian Ministry of Resources Environmental Project of the Year award (Shell Sustainability Report 2008:19). In a radio interview in 2008, Shell's former CEO Jeroen Van der Veer said that the lesson learned was that in order to conduct business in Russia, governmental support or the involvement of strong Russian state actors is essential.⁴²

4.9 Conclusion

This chapter has shown the chain of events in the dispute between Shell on behalf of its operator Sakhalin Energy and the Russian authorities over violation of environmental regulations during the development of the Sakhalin II project. The strategies used by Shell in responding to respond to regulatory pressures and the outcome of these strategies will be presented in Chapter 9, which also takes up the subsidiary research question of how Shell interpreted enforcement practices in Russia. Whether Shell understood such practices the same way as Ledeneva holds that Russian actors would interpret them is the general topic of Chapter 10. The next chapter discusses the conflict between BP and the Russian State, and within TNK-BP's management board between the Russian and British shareholders.

⁴² Former Shell CEO Jeroen Van der Veer in a radio interview on 5 January 2008. <http://nos.nl/audio/26552-interview-met-shelltopman-Van-der-veer.html> (accessed April 2010).

5. Two commanders on one ship: Mission impossible Kovykta

The second case presented in this chapter is the conflict between BP and the Russian state over the development of the Kovykta field and later within the management of BP's joint venture with the Russian oil company TNK. Conflicts between BP and state actors had occurred before in the history of the British oil major. Around 1980, BP had to leave Nigeria and Iran after conflicts with the federal governments (Ryggvik 2009:209). The establishment of the joint venture TNK-BP is outlined in section 5.1, while the conflict over the Kovykta field is discussed in 5.2 and 5.3. The internal conflict between TNK-BP's Russian and British shareholders, where also state actors were involved, is subsequently presented in 5.4. The final sub-section discusses the aftermath of this conflict.

5.1 TNK-BP: The creation of an Anglo-Russian joint venture

On 1 September 2003, British BP and the Russian financial-industrial conglomerates Alfa, Access and Renova (AAR) announced the establishment of a new Anglo-Russian oil company for developing oil and gas assets in Russia and the Ukraine.⁴³ BP (until 1954 the Anglo-Iranian Oil Company) had initially been a state-owned company until the state sold the majority of its interests in 1987. Since 2001, BP officially no longer stands for British Petroleum: the company adopted the tagline 'Beyond Petroleum'.

TNK-BP International Ltd became Russia's third largest integrated oil company. BP and AAR each acquired a 50 per cent interest. BP paid USD 6.8 billion for these shares (BP Annual Review 2003:6). At the time of its creation, TNK-BP was the largest privately owned company in Russia ('This is TNK-BP', 2004:12). The deal provided BP with coveted access to Russia's large oil and gas reserves (BP Annual Review 2003:26). BP representatives also argued that Russia's investment climate had been improved, thanks to the political changes that took place after Putin became president, and that the country no longer was associated with instability and a lack of transparency.⁴⁴ Initially, TNK-BP's Board of Directors consisted

⁴³ BP entered Russia already in 1997, by paying USD 471 million for a 10 per cent stake in Sidanco.

⁴⁴ During the 1990s, BP accused the Russian authorities and oil company TNK of illegal bankruptcy procedures after the takeover of Sidanco by TNK. Sidanco was established in 1994, its management was led by BP while the company was majority-owned by AAR ('This is TNK-BP', 2004:20). For a study of the conflict between BP and TNK see Janssen (2004:21-26).

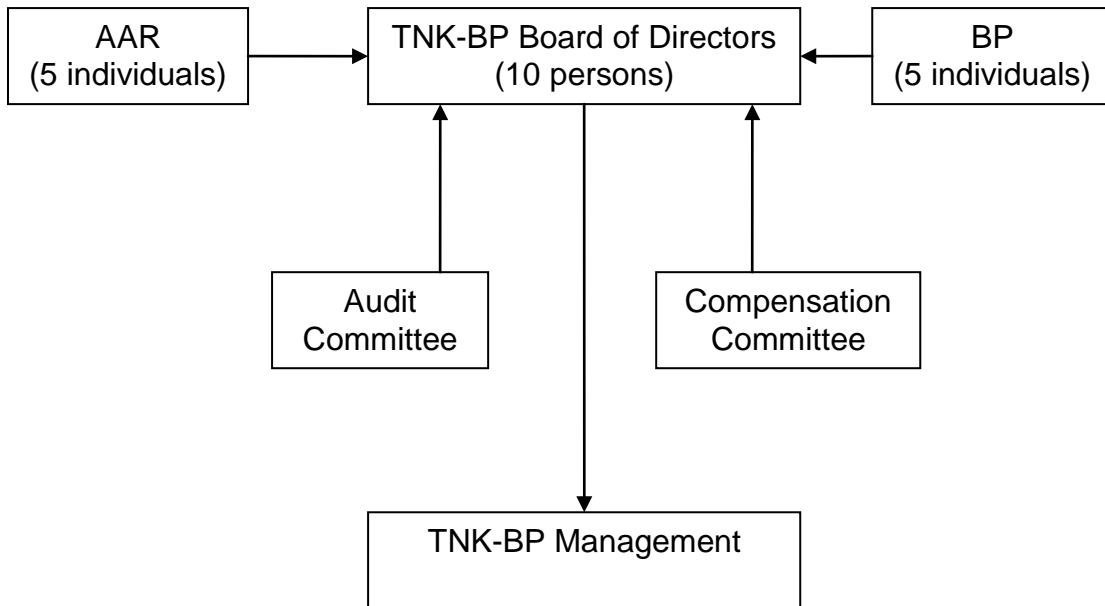
of ten people, five of whom were appointed by BP with and the other five by AAR. Figure 7 presents the company's governance structures before and after the restructuring processes in 2006. TNK-BP's main assets include all crude oil production and oil reserves held by the TBH Group. The TBH Group, officially OAO TNK-BP Holding, is registered in Russia's Tyumen region. The holding was formed in 2004/2005 through a restructuring process of the three holding companies – TNK, Sidanco, and ONACO – and their respective subsidiaries in order to simplify the complex TNK-BP legacy structure.

TNK-BP controls 95 per cent of TNK-BP Holding, with the remaining 5 per cent owned by minority shareholders. TNK-BP is headquartered in Moscow and, as a privately-owned company is unlisted, although TNK-BP Holding is quoted on the Russian Trading System Stock Exchange. Day-to-day management of the TNK-BP Holding is delegated to the management of TNK-BP. The Board of Directors of the TNK-BP Holding group consists of nine individuals.⁴⁵

In 2006 and in 2007 the Holding group produced the equivalent of 1.5 million and 1.6 million barrels of oil per day, respectively (TNK-BP Holding Annual Report 2007:5). Total liquids production volume in 2007 was 70.4 million tonnes, and total gas sales amounted to 8.9 billion m³ (TNK-BP Holding Annual Report 2007:5). In 2009 production amounted to the equivalent of 1.69 million barrels of oil per day, the highest in the history (TNK-BP Annual Report 2009:4).

⁴⁵ As of 2007, the Board of Directors was composed of four representatives from TNK and five from BP.

Governance structure TNK-BP 2004



Corporate structure TNK-BP Holding 2006

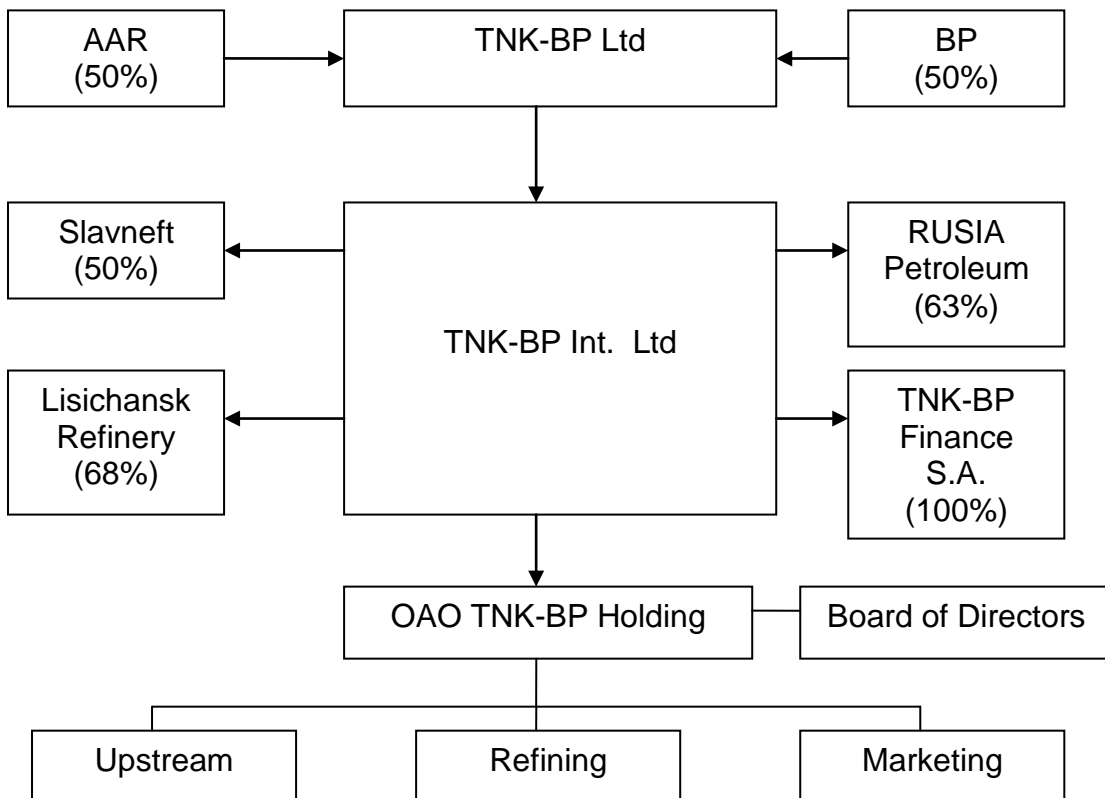


Figure 7: TNK-BP governance structure in 2004 and corporate structure of TNK-BP Holding in 2006

The TNK-BP Holding, managed by TNK-BP, held its first annual meeting of shareholders in 2006. The company combined existing reserve bases with new developments, such as Kovykta and Uvat, which were commercially proven. In 2007 total proven reserves of TNK-BP Holding were the equivalent of 8.2 billion barrels of oil (U.S. Securities and Exchange Commission on a life-of-field basis) and 10 billion barrels of oil equivalent, according to the Petroleum Reserves Management System, and the ratio for reserves replacement was 179 per cent (SEC-LOF) (TNK-BP Holding Annual Report 2007:5).

The company's main upstream operations are located in Khanty-Mansiysk, in the Yamal-Nenets Districts and Tyumen Region in western part of Siberia. Although initially established as an oil company, its heightened focus on gas transformed TNK-BP into a major oil and gas company. It is beyond the scope of this chapter to present all TNK-BP Holding's subsidiaries, acquisitions and takeovers. Suffice it here to note TNK-BP's 62.9 per cent ownership of RUSIA Petroleum, which was the license operator at the Kovykta gas field until the company went bankrupt in 2010. The other interests in RUSIA Petroleum were controlled by Interros, a privately-owned Russian investment holding, and the Irkutsk regional government, with 26 per cent and 11 per cent respectively (Insight TNK-BP, autumn 2006:8).

5.2 The Kovykta natural gas field

A major part of TNK-BP's market value was based on the oil and gas reserves in the Kovykta gas condensate field. This field differs from those previously described in the Sakhalin II project. First of all, the project was not based on a PSA between the Russian authorities and private companies. Second, the Kovykta field is purely a gas field.

As noted in the previous chapter, the gas sector in Russia is dominated by state giant Gazprom, which controls the infrastructure and is the only actor authorized to export gas (Moe 2010:283).⁴⁶ Therefore, RUSIA Petroleum on behalf of TNK-BP had to rely on Gazprom to build pipelines between Kovykta and potential foreign customers, in order to maximize profits. This dependency is a factor important for understanding the problems BP faced in developing the Kovykta field.

⁴⁶ Sakhalin II by contrast, has a large oil component – and the oil sector is a more competitive industry in which private capital still dominates.

The Kovykta gas condensate field, discovered in 1987, is located in southeastern Russia, 450km from Irkutsk (Figure 8).

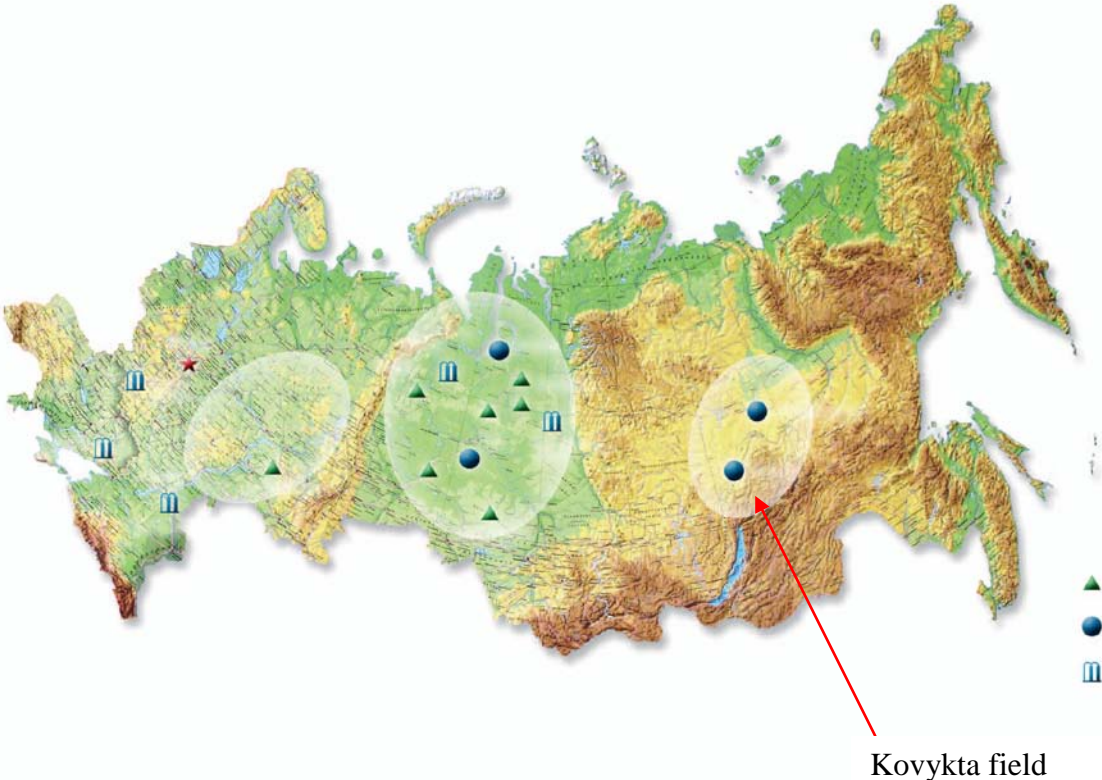


Figure 8: The Kovykta gas condensate field in south-east Russia (TNK-BP Today, 2007:35)

The 5,000 km² central field area will require about 400 to 500 wells, each approximately 3,000 meters deep, along with infrastructure to support full field development (Insight TNK-BP 2003:6). Estimates of gas reserves in this field have varied. According to the International Feasibility Study conducted in 2003, the Kovykta field includes between 1.4 trillion and 1.9 trillion m³ of gas (Insight TNK-BP 2003:6). Estimated annual production in the long term was estimated at 40 billion m³ (Insight TNK-BP 2003:10). According to Blagov (2008:4–5), however, the field contains 1.9 trillion m³ of gas combined with reserves of over 2 trillion m³, and will account for up to 20 per cent of BP’s operations in Russia in volume terms (peak output). Total costs of developing the Kovykta project were in 2006 estimated at USD 1.2 billion (Insight TNK-BP, spring 2006:11). Initially, South Korea’s Hambo Group was the project’s largest shareholder, gaining a 46.1 per cent stake in 1996. However, the Hambo Group went bankrupt already the year after, and sold the majority of its shares to BP (Ahn and

Jones 2008:116). Subsequently, Sidanco and BP established a strategic alliance for developing the Kovykta field. Sidanco was established in 1994. Management of the company was led by BP, whereas the company was majority-owned by AAR ('This is TNK-BP', 2004:20). Later on, TNK gained control of Sidanco and acquired the Kovykta field.

In order to complete the downstream part of the project, the OAO East Siberia Gas Company (ESGC), a joint venture between TNK-BP and the Irkutsk administration was established in 2004. Due to the complexity and scale of the project, construction of the infrastructure and pipelines was divided into two stages. The first stage – construction of 112km of pipeline from Kovykta to Zhigalovo securing the supply of gas to the city – was completed in 2006 (TNK-BP Information Sheet 2006:29). The second phase included the construction of pipeline from the Kovykta field to Irkutsk through the cities of Sayansk, Usolye-Sibirsk and Angarsk, which are the largest consumers of gas in the Irkutsk region. Supplies of gas to the Zhigalovo District began in late 2006, and to Sayansk in Irkutsk in late 2007 (TNK-BP Today 2007:43). Initially, ESGC was the owner and operator of the pipeline construction. In April 2011, however, Gazprom gained ownership of this pipeline. Gas consumption from the Kovykta field in the region was in 2007 estimated at 2 million m³ (Insight TNK-BP, autumn 2006:8).

However, large-scale development of the project, with TNK-BP supplying gas to China and Korea, never occurred, due to several uncertainties explained below. According to the licence obligations, TNK-BP was obliged to produce 9 billion m³ of natural gas annually (Ahn and Jones 2008:120). To comply with the production rates established in the licence agreements as well as the environmental safety requirements of the licence permit, the company introduced a new technological approach for drilling in the field (Insight TNK-BP, autumn 2006:8). This upgrade, completed in 2006, was necessary to ensure, at least technically, the export of natural gas to China and South Korea where TNK-BP could sell for a better price than it could get domestically, thus maximizing the profitability of the Kovykta field.

By November 2003, TNK-BP and RUSIA Petroleum had even signed an agreement with China National Petroleum Corporation (CNPC) and the Korean GAS Corporation (KOGAS) for the annual export of 10 billion m³ of natural gas from the Kovykta field to China and South Korea. Based on this agreement, the International Feasibility Study concluded that the project was technically viable and economically feasible (Insight TNK-BP 2003:6). The

feasibility study was submitted to the Russian, Chinese and Korean governments for approval, since the export of natural gas is Gazprom's exclusive legal right. However, in 2004 Gazprom declared that it would not approve the export of Kovykta gas to international markets, arguing that the gas should be sold on the Russian domestic market instead (Ahn and Jones 2008:119).

5.3 The battle over Kovykta

Hence, TNK-BP was not authorized to export natural gas to Korea or China without the participation of Gazprom or any other state actor in the Kovykta project. When BP acquired the field through its joint venture with the Russian actors in 2003, the company hoped to gain approval for the export of gas to the Asian market. However, an amendment to a federal law on Russia's subsoil blocked that option by prohibiting foreign ownership of 50 per cent plus one share for strategic resources, such as the Kovykta gas field (Ahn and Jones 2008:134). The draft law defined 'strategic' as deposits from any oil field containing over one billion barrels or any gas field containing over one trillion cubic meters of gas, or any reserves close to military bases (Ahn and Jones 2008:134).⁴⁷

Moreover, the law on foreign investment adopted in April 2008 prescribed that oil and gas projects on the continental shelf were to be reserved for Russian state companies (Gazprom and Rosneft) and that private companies must gain approval before acquiring more than a 50 per cent stake in a strategic company (Moe 2010:288; Moe and Rowe 2008:10). Both the law on Russia's subsoil and the law on foreign investment limited the possibilities for IOCs to participate in developing oil and gas projects (Moe 2010:288). As one Russian interviewee explained:

A year ago the Duma passed the law on mineral resources. This law closed the development opportunities for foreign actors. According to the law only state companies with a 50 per cent plus one share now have the right to work on a project (Russian oil and gas industry expert, interview with author in Murmansk, December 2009).

⁴⁷ According to federal law, the owner of the pipeline construction is also the exclusive actor for the export of gas, which effectively bans privately-owned producers from exporting gas ('biznes, tri intrigi TNK-BP', *Gazeta.ru*, 19 March 2008). Available at: <http://www.gazeta.ru/business/2008/03/19/2672225.shtml> (accessed September 2011).

Export to Asian markets would provide TNK-BP with more profit than selling on the low-priced, subsidized domestic market in Russia. Again, according to the licence agreements, TNK-BP was obliged to produce 9 billion m³ of natural gas a year, whereas annual gas consumption in the region was estimated at only 2 billion m³ annually (Insight TNK-BP, autumn 2006:8). Clearly, local population would not be able to consume the amount of gas that this field could produce (Ahn and Jones 2008:109). Inevitably, then, without other customers or export rights, TNK-BP would be unlikely to be able to produce the amount of gas stipulated by the licence permit.

Hence, Gazprom's approval was essential for successful, large-scale development of the Kovykta field – and not only because Gazprom holds the legal monopoly on the export of gas (Ahrend and Tompson 2005:801; Ahn and Jones 2008:132). Decisions concerning the construction, investment and development of the infrastructure also require Gazprom approval, even in fields where it has no direct involvement in the production process (Ahrend and Tompson 2005:813–814). Gazprom's monopoly on onshore infrastructural decisions affects the level of development of gas fields and paves the way for potential conflicts of interest between Gazprom and other producers, like BP's joint venture with TNK. This is especially the case in projects where Gazprom lacks a stake, as it did in the development of the Kovykta field.

The fact that RUSIA Petroleum was not able to produce the target volumes specified in the licence provided legal grounds for the Russian authorities to charge the licence operator with failing to fulfil the production quotas. In early 2007, Rospirodnadzor emphasized TNK-BP's failure to meet production targets (Ahn and Jones 2008:120). Furthermore, in January 2007, the agency announced that it would investigate TNK-BP for violating environmental regulations at the Kovykta field. (Noriss 2007:6). Subsequently, in May 2007, RUSIA Petroleum went to court to have its licence obligations clarified. The Russian court, however, ruled that it had no authority to review the licence terms for a gas field.⁴⁸

⁴⁸ 'Some you win, some you lose', *The Economist* print edition, May 31, 2007. Available at: <http://www.economist.com/node/9257851> (accessed September 2011).

The drastic step of revoking RUSIA Petroleum's licence was never taken. Instead, the Russian authorities seemed to be waiting for Gazprom and the owners of TNK-BP to reach an agreement on Gazprom's share in the Kovykta project. Gazprom's participation in the project was considered necessary in order to ensure profitable business, and perhaps also hoping that the official attacks on the project would stop. The situation could even be regarded as worse than Shell's dispute with the governmental authorities on Sakhalin II, as Sakhalin Energy was less dependent on cooperation from Gazprom to export LNG to foreign markets. However, both BP and the Russian shareholders obviously preferred having Gazprom enter the project on fair commercial terms (Ahn and Jones 2008:120).

In June 2007 TNK-BP and Gazprom agreed on a memorandum of understanding to cede TNK-BP's control in the Kovykta gas field to Gazprom by selling their stake in RUSIA Petroleum for a price between USD 700 million and USD 900 million (TNK-BP Information Sheet 2007:45). The deal included an option for TNK-BP to re-enter the project in the future at blocking state level, under certain conditions (TNK-BP Information Sheet 2007:75). The deal provided Gazprom with a 63 per cent stake in Kovykt; later the company formally gained ownership of the field after RUSIA Petroleum went bankrupt in March 2011. What remained to be solved was whether the 'British' (BP) or the 'Russian' (TNK) shares needed to be sold – and at what price?

From June 2007, the Russian authorities expressed concerns at the delay in negotiations between TNK-BP's Russian and British shareholders and again brought the possibility of sanctions since RUSIA Petroleum still was breaking the licence terms.⁴⁹ The exact reasons for the delay in negotiations were unclear. Further pressure on the Anglo–Russian joint venture was applied in late 2007 when Gazprom claimed that the Kovykta field contained large quantities of helium, used in aviation, space and nuclear technology and considered a protected, strategic element in Russia.⁵⁰ Chapter 9 goes into further detail on some of these issues.

⁴⁹ 'Gazprom: Budushee Kovykty ostaetsja nejasnym', *RosBusinessConsulting*, 4 April 2008. Available at: <http://top.rbc.ru/economics/23/04/2008/159834.shtml> (accessed September 2011).

⁵⁰ 'Official: Helium likely to delay Kovykta work', *St. Petersburg Times*, 11 April 2006. Available at: http://www.sptimes.ru/index.php?action_id=2&story_id=17282 (accessed March 2011)

5.4 Conflicts within TNK-BP

The conflict between TNK-BP and the Russian authorities over the Kovykta gas field was part of (or perhaps the cause of) a broader conflict within TNK-BP between its British (on behalf of BP) and Russian (on behalf of TNK) shareholders. TNK-BP was until October 2012 for 50 per cent owned by BP and 50 per cent by the Russian financial-industrial conglomerate AAR – owned by the four Russian oligarchs: German Kahn and Mikhail Fridman (Alfa Group), Viktor Vekselberg (Renova) and Leonard Blavatnik (Access Industries). BP and AAR both sold their assets to Rosneft in October 2012.⁵¹ Somewhere down the road, conflicts erupted between the Russian and British shareholders within TNK-BP. Perhaps they were due to financial disagreements after the forced sale of Kovykta at a price far below the market as outlined above – or because the parties were not able to agree whether TNK's or BP's shares would have to be sold to Gazprom and at what price.⁵² Both the Russian and the British shareholders were obviously interested in getting Gazprom on board to ensure successful development of the Kovykta project. At stake in these conflicts was not only the Kovykta field but the entire development of TNK-BP.

In March 2008 an employee of TNK-BP and his brother were arrested and charged with industrial espionage, and the oil major found itself facing pressure from trade unions (Øverland 2011:143) Furthermore, BP had staff stationed at TNK-BP. The latter compensated BP financially for hiring these employees.⁵³ However, after a court case initiated by ZAO Tetlis (a minority shareholder in TNK-BP), visa irregularities forced TNK-BP in March 2008 to recall 150 employees because the governmental officials denied them entry to the country.⁵⁴ Tetlis sued the Anglo–Russian joint venture for reduced dividends caused by

⁵¹ According to the agreement, Rosneft is to pay BP USD 17.1bn in cash as well as shares representing 12.84 per cent of Rosneft. BP will purchase a further 5.66 per cent of Rosneft from the Russian government and will acquire 20 per cent of the Russian state giant including its existing 1.25 per cent stake, 'Rosneft to pay \$55bn move tightens Kremlin grip on oil', *The Financial Times* (London UK), 23 October 2012. BP's Russian partners will sell their 50 per cent stake for USD 28bn, 'TNK-BP', *The Financial Times* (London UK), 23 October 2012.

⁵² The four Russian oligarchs who own 50 per cent of TNK-BP had a legal option to sell their interests at the end of 2007, an option they declined to use until they sold their assets to Rosneft in October 2012.

⁵³ Almost 2,000 BP employees were transferred to TNK-BP (BP Sustainability Report 2003:16).

⁵⁴ 'Another inspector calls' *The Economist* print edition, 27 March 2008. Available at: <http://www.economist.com/node/10925679> (accessed September 2011).

employing expensive foreign specialists.⁵⁵ The company demanded that the agreement be cancelled and ordered BP to return payments from TNK-BP – a clear example of private actors gaining access to the formal decision-making process, using state actors to secure personal interests. The role of minority shareholders in Russia is often dubious. In the press, for example, ZAO Tetlis was accused of having ‘connections’ with the Alfa concern.⁵⁶ Similar accusations have been made against a minority shareholder that sued Norway’s Telenor in a court case in 2009. However, such accusations are almost impossible to verify.

Perhaps the Russian shareholders themselves decided that the involvement of a strong Russian state actor could benefit the development of TNK-BP and so they used their contacts in the Kremlin to try to force British shareholders to sell their interests. As a result, BP became sandwiched by internal pressure from Russian shareholders and external pressure from the Russian governmental authorities.

TNK-BP’s CEO Bob Dudley came under pressure when Russian shareholders accused BP of mismanagement and of acting in the interest of BP alone by regarding TNK-BP as a subsidiary, rather than an independent company.⁵⁷ The Russian shareholders based their arguments on the agreement between TNK-BP and BP concerning payment of BP staff and contractors.⁵⁸ Furthermore, the Russian partners retained a desire to expand TNK-BP’s business to foreign countries and accused BP of blocking this process for fear that this would interfere with BP’s own international business.⁵⁹ As a result of all these issues, formal meetings between the British and Russian shareholders were cancelled or delayed.⁶⁰

⁵⁵ ‘Russia speeds up TNK-BP work permits’, *St. Petersburg Times*, 4 July 2008. Available at: http://www.sptimes.ru/index.php?action_id=100&story_id=26443 (accessed October 2011).

⁵⁶ ‘Russia speeds up TNK-BP work permits’, *St. Petersburg Times*, 4 July 2008. Available at: http://www.sptimes.ru/index.php?action_id=100&story_id=26443 (accessed October 2011).

⁵⁷ ‘Crude tactics’, *The Economist* print edition, 5 June 2008. Available at: <http://www.economist.com/node/11502165> (accessed September 2011).

⁵⁸ ‘Crude tactics’, *The Economist* print edition, 5 June 2008. Available at: <http://www.economist.com/node/11502165> (accessed September 2011).

⁵⁹ ‘Vopreki vole rossijskih akcionerov TNK-BP izbral sovet direktorov’, *RosBusinessConsulting*, 27 June 2008. Available at: <http://top.rbc.ru/economics/26/06/2008/190879.shtml> (accessed September 2011).

⁶⁰ ‘Crude tactics’, *The Economist* print edition, 5 June 5 2008. Available at: <http://www.economist.com/node/11502165> (accessed September 2011).

The conflict escalated in July 2008 when the Russian shareholders demanded an independent CEO and called for the resignation of Bob Dudley. For reasons to be explored in Chapter 9, Dudley's visa was not extended, so he was forced to leave Russia to manage the company from abroad.⁶¹ In September 2008, TNK-BP's shareholders agreed that Dudley should step down as CEO and that the TNK-BP Holding's Board of Directors would be expanded from nine to 11 directors, four from each side and three independents.⁶² We return to the question of how a conflict over the Kovykta gas field ended up in a conflict between BP and TNK over the business strategy of the joint venture in Chapter 9, where we also discuss whether the actions of the Russian government and Russian shareholders were coordinated.

5.5 Will the ship sink? The aftermath of the conflict

Gazprom agreed to buy RUSIA Petroleum from TNK-BP in 2007 for an estimated price of USD 1 billion, but the deal was never finalized. Instead, both companies signed a memorandum of understanding as part of a strategic alliance whereby TNK-BP agreed to sell to Gazprom its stake in RUSIA Petroleum in June 2007 (BP Sustainability Report 2007:2). According to the agreement, the final price would be negotiated within 90 days after the memorandum was signed. This deadline was repeatedly shifted due to disagreement on the final price. The conflicts between TNK and BP, and the global financial crisis in 2008 obviously contributed to the delays in the negotiation process which continued until RUSIA Petroleum filed for bankruptcy in June 2010. The operator went bankrupt because the company was unable to repay the loans provided for the development of the Kovykta gas field. TNK-BP attempted to recover some of its investments in RUSIA Petroleum, but without success. Instead, Gazprom purchased the assets of RUSIA Petroleum at an auction in March 2011, at a price estimated to be around USD 770 million.⁶³ The deal included field development infrastructure, infield pipelines, wells, power lines and other support

⁶¹ 'Crude tactics', *The Economist* print edition, 5 June 2008. Available at: <http://www.economist.com/node/11502165> (accessed September 2011).

⁶² An independent director of the Board of Directors resigned in June 2008, citing a lack of cooperation between the Russian and BP shareholders.

⁶³ The official price is unknown, but a price of USD 770 million is frequently mentioned in the media.

infrastructure. Gazprom acquired the production and exploration licence of the Kovykta field in October 2011.⁶⁴

In order to help Gazprom enter European downstream markets, BP and Gazprom agreed to form a strategic alliance by swapping assets as part of the Kovykta deal. However, the details of this agreement are not known at the time of this writing. For the time being Mikhail Fridman, head of the Alfa Group and one of the Russian shareholders of TNK-BP, has been appointed as the interim CEO, until the Board of Directors finds and agrees upon a new candidate. The current management team will remain in place.⁶⁵ The time line for the Kovykta field to be operational has been put forward to 2017.

Shell and TNK-BP were not the only IOCs to be confronted with regulatory pressure from the Russian authorities during 2006/2007. Total and Statoil's Kharyaga project in the Nenets region of north-western Russia was also targeted for contract and environmental regulations (Domjan and Stone 2010:47; Bradshaw 2006:6), as was Lundin's project in the Caspian Sea.⁶⁶ In both cases, enforcement agencies accused IOCs of violating formal regulations during the exploration of oil and gas fields. However, at the time of writing, no concrete sanctions have been issued by the Russian authorities. Krysiak argues that the Putin administration's indecision over a regional development strategy for the Barents region has prevented it from manipulating the project's management or ownership structure of the Kharyaga project (Krysiak 2007:10).

5.6 Conclusion

The material presented in the last two chapters has provided an overview of the course of events behind the conflicts between the Russian authorities on the one hand and Shell and BP on the other hand. The conflict between Shell and the Russian authorities was documented in Chapter 4, while this chapter has presented the issues BP faced regarding the development of

⁶⁴ *Gazprom experts inspect Kovyktinskoye and Chikanskoye fields*, Gazprom Press release, 6 December 2011. <http://gazprom.com/press/news/2011/December/article124994> (accessed February 2012).

⁶⁵ BP has the right to nominate TNK-BP's new CEO, although their decision must be approved by the TNK-BP Board of Directors.

⁶⁶ *Lundin Petroleum and Gazprom in Lagansky deal*, 16 July 2007. Available at: http://www.lundin-petroleum.com/Press/pr_russia_16-07-07_e.html (accessed March 2011).

their joint venture with TNK in general and the Kovykta field in particular. By analysing the strategies of both IOCs for responding to respond to enforcement practices, I aim to show how Shell and BP interpreted regulatory practices in Russia. In Chapter 6 we turn to the content of annual reports published by Shell/Sakhalin Energy and TNK-BP, and also ask whether the Russian authorities' application of enforcement practices was justified and whether formal laws were indeed broken.

6 Content analysis of official reports published by Shell and BP

6.1 Introduction

In this chapter I carry out a content analysis of official documents including annual reports and other publications, like newsletters and company magazines, by TNK-BP, Sakhalin Energy and Shell. Annual reports are a suitable indicator for examining the interpretations of actors in different fields of interest. Examining the content in these publications is a way to answer one of the subsidiary research questions in Chapter 1: how do IOCs understand regulatory pressure and enforcement practices in Russia? Combined with the narration of the course of events presented in the previous chapters, the findings in this chapter provide an overview of the strategies IOCs used in the conflicts outlined, and finally, provides an answer the research question as discussed in Chapter 10.

Further: did Sakhalin Energy and TNK-BP indeed violate environmental regulations and/or licence agreements? The answer to this question will help to elucidate whether the companies were victims of selective enforcement of formal rules, as discussed in section 3.5, or whether they had indeed violated formal rules and the state – as enforcer of the law – punished them for this, a possibility discussed in section 3.3. The key question here is whether the two IOCs were in fact in a position to comply with the formal regulations.

Annual reports are analysed to examine how Shell and BP deal publicly with their conflict with the Russian authorities. Although it is unlikely that such public documents outline such issues in detail, any study that aims to examine how IOCs interpret enforcement practices in Russia, but excludes public reports, is likely to be incomplete. In addition, these reports are important in view of the fact that both IOCs have refused to comment directly on their conflict with the Russian authorities or the relationship between them and the Russian authorities in general. On the whole as the analysis in the following sections will illustrate, official documents published by IOCs provide a clear example of the interpretation generated by the company on enforcement practices in Russia, and can help us to understand how the companies have interpreted these practices.

The annual reports analysed in this chapter along with other documents were all published within the research period, January 2000 until October 2008, and deal with regulatory practices between 2005 and 2008. Prior to 2005, there was no reporting on enforcement practices or regulatory pressure in the publications examined.

Like most IOCs, Shell and BP publish an annual sustainability report, accounting for the environmental and social performance of their activities. These reports are good indicators of the environmental statement of the companies – although there is disagreement as to whether environmental reporting – or any kind of reporting by companies, is sufficient for assessing their environmental impact (Mol 2001:203). This is partly due to the fact that the numbers and figures associated with the broad activities of companies of the size of Shell and BP and their sub-contractors are complicated. However, Shell and BP are considered to be the pioneers in environmental reporting, and their annual environmental reports are subjected to external review by a committee of independent experts/external assurance reports.⁶⁷

6.2 Annual and company reports published by Shell

The analysis here includes annual environmental reports as well as operational and financial reports published by Shell and Sakhalin Energy. From 2005, Shell has titled their annual report on environmental and social issues the *Shell Sustainability Report*. Prior to that, reports with a broadly similar content were published as *The Shell Report*. The reports are dated in accordance with the current production year, although *The Shell Report 2001* covers operations from 2000.

In order to explore how IOCs understand regulatory pressure and enforcement practices exerted by the Russian authorities we also need to examine whether formal regulations were actually broken by Shell during the development of Sakhalin II, as well as whether compliance with the formal regulations is indeed possible. The difficulty of complying with the formal rules is a main feature of Ledeneva's framework of selective enforcement outlined in Chapter 3. Further: were the threats interpreted as a strategy to provide Gazprom with

⁶⁷ In *The Shell Report 2003*, for example, an external assurance was conducted by KPMG and Pricewaterhouse–Coopers LLP (The Shell Report 2003:16–17).

access to the project, or as a reminder that Shell needed to comply with Russian environmental regulations?

Prior to 2005, no information regarding enforcement practices has been recorded in official documents published by Shell. In fact, most annual reports focused on the achievements, investments and profits regarding their operations on Sakhalin.

With the development of Sakhalin II, however, came a range of environmental and social challenges. The protests initiated by NGOs and the regulatory pressure exerted by the Russian authorities were outlined in Chapter 4. In its 2003 report, which covers operations from 2002, Shell acknowledged the environmental and social issues connected with the project:

(...) decided to invest in the multi-billion dollar second phase of a major oil and gas development on Russia's Sakhalin Island. (...) continued our efforts to respond to worries about the project's social benefits and environmental impacts (The Shell Report 2003:4).

During the initial phase of the project, environmental concerns centred on the endangered whale population around Sakhalin Island. According to the 2004 Shell Report:

Sakhalin Energy has delayed construction of the offshore pipeline and changed the route in response to concerns about the whales (The Shell report 2004:6).

Furthermore, in 2004 the company convened an independent panel of whale experts under the auspices of the World Conservation Union, tasked with determining the impact of oil and gas exploration on the whale populations.⁶⁸

The panel's report, published in mid-February 2005, indicated that all oil and gas activity carries risks for the whale population. It highlighted the need to actively

⁶⁸ Sakhalin Energy provided financial support and agreed to the World Conservation Union's terms that selection of the panel should be completely independent, according to the chairman of the Scientific Review Panel (The Shell Report 2004:9). The panel was established in 2004 and completed its work in early 2005. In 2006, a long term western grey whale advisory panel was established, to study whale habitats and project impact during the final phase of construction and operation.

manage and reduce these risks, which include noise, oil spills, collisions with ships and physical disturbance. (...) The panel advocated a more cautious approach by SEIC [Sakhalin Energy] and other developers in the region to compensate for the known risks and uncertainties surrounding potential environmental effects of oil and gas development (The Shell Report 2004:19).

Subsequently, Shell decided to move the pipeline away from the whales' feeding areas, 20km south of the original route. Beside the environmental impact, the annual report acknowledges the social impact of company activities on the local population of Sakhalin Island. However:

In addition, some residents of the town of Korsakov, 13 kilometres from Sakhalin Energy's LNG plant, maintain that the negative impacts on the community outweigh the benefits of employment and infrastructure improvements (The Shell Report 2004:19).

In the next year's report, conflicts between Shell/Sakhalin Energy and the local population are acknowledged and documented:

But the focus of Sakhalin Energy's engagement had been too narrow. In 2005, a wider group of indigenous people protested against oil and gas development. In response, the joint venture began working with the new Sakhalin Indigenous Minorities Council, formed in the wake of the protests (Shell Sustainability Report 2005:25).⁶⁹

Although the violations of the Russian environmental regulations were not mentioned specifically, analysis of the content in Shell's annual reports makes clear the legal and environmental challenges the company faced in developing the Sakhalin II field. In its 2005 Sustainability Report Shell, on behalf of the operator Sakhalin Energy, acknowledged that during the construction of the onshore pipeline that crossed more than 1000 rivers and streams, violations of their own environmental strategy had taken place:

⁶⁹ The chairman of the Sakhalin Indigenous Minorities Council stressed that the protests were directed at oil and gas development on the island in general, rather than Sakhalin Energy in particular. He is quoted as saying 'Sakhalin Energy was the only company to respond and take responsibility for their impacts....although we have not yet reached compromise on all issues, I am confident that we will' (Shell Sustainability Report 2005:25).

Contractors did not always comply with the strategy during the winter of 2004/5. Sakhalin Energy stopped the winter work programme when it learned of this (Shell Sustainability Report 2005:25).

The term 'strategy' seems to refer to Shell's own environmental action plan. Sakhalin Energy goes on to outline the efforts made to avoid any future non-compliance with their environmental strategy:

Contractors were retrained and contracts redrawn to include incentives and penalties based on their compliance with the strategy. Independent and technically-qualified external observers were invited to watch how each sensitive river crossing was made (Shell Sustainability Report 2005:25).

Similar issues are noted in the 2006 Sustainability Report. For the first time, an official publication by Shell refers to the involvement of Russian governmental agencies:

Sakhalin Energy requires contractors to use low-impact techniques for these crossings, including working in winter when the rivers are frozen or at low flow. When some contractors failed to do so during the winter of 2004/05, Sakhalin Energy stopped work, improved its controls and sought help from outside experts. Independent observers and environment agency representatives were invited to monitor, first-hand, how each sensitive crossing was made during the winters of 2005/06 and 2006/07 (Shell Sustainability Report 2006:34).

So far, it was mainly Sakhalin Energy's efforts to minimize the impact on the environment that were emphasized in official publications, and not for instance, the violation of federal rules. From 2006 however, the charges by regulatory agencies are recorded. The company acknowledges the violations of formal environmental regulations, but concludes that they are minor and repairable:

In October 2006, the Russian environment agency threatened to suspend crucial licences, citing violations of environmental permits. These alleged violations would not have caused long-term environmental damage. Sakhalin Energy developed an

Environmental Action Plan which, after further refinement, was submitted to the authorities in March 2007 for further review (Shell Sustainability Report 2006:35).

An marine biologist confirms the violations, but states they were committed by sub-contractors working for Sakhalin Energy:

In my opinion, Sakhalin Energy has taken the challenge of getting its contractors to comply with standards seriously. Compliance has steadily improved, reducing environmental impacts (Shell Sustainability Report 2006:35).

Sakhalin Energy's violations of environmental standards were acknowledged by the consultants of AEA Technology after an environmental audit published in November 2007. The audit was conducted on behalf of potential project lenders like the EBRD. The content of this report will be examined in detail in the next sub-section. According to Shell's Sustainability Report 2007, the consultants concluded that:

Sakhalin Energy's...plans fully meet a large majority of the requirements against which the project has been assessed and there are examples of laudable best practice. Where non-conformances with requirements have been identified in the documentation, these are either minor in nature or else Sakhalin Energy has plans in place for their resolution (Shell Sustainability Report 2007:33).

This is the first reference to the charges made by the Russian authorities in the second part of 2006 where Sakhalin Energy admitted that 'non-conformances with requirements have been identified'. Unfortunately, the 2007 Sustainability Report does not provide information on the environmental action plan that was submitted by Shell after the first inspections and subsequently rejected by the Russian environmental watchdog, Rosprirodnadzor.⁷⁰ Perhaps this was no longer seen as urgent, since the conflict with the Russian state had been solved in December 2006.

⁷⁰ Oleg Mitvol, head of Rosprirodnadzor, stated that the environmental action plan was 'not a remedy plan, but a collection of jokes'. In 'In Russia, control justifies the means', *Financial Times*, 12 December 2006, p. 19 (London 1st edition).

A common problem associated with environmental reporting appeared in the 2007 Shell Sustainability Report: the extent to which IOCs report operations conducted by sub-contractors or subsidiaries. As a result of the deal with Gazprom, Shell no longer owned the majority of Sakhalin Energy, and, thus had no control over the project. As stated in Shell's 2007 Sustainability Report:

In April 2007, control of the JV building the project, Sakhalin Energy Investment Company Ltd (Sakhalin Energy), passed from Shell to Gazprom. The agreement saw Shell's share in Sakhalin Energy drop from 55 per cent to 27.5 per cent. This changed our role in the project (Shell Sustainability Report 2007:33).

One consequence of the shift in ownership was narrower coverage of the project's impact on the environmental and social performance in the sustainability reports covering 2007 and 2008. As a result of the transaction, Sakhalin Energy was described as an associated company, rather than a subsidiary (Royal Dutch Shell Five-year fact book: 2005–2009:55).

So far, in respect of the environmental violations, I may conclude that the violations have been briefly addressed and acknowledged by Shell/Sakhalin Energy. However, the company refers to these violations as 'minor' or blames them on the sub-contractors. The conflict between Shell and Rosprirodnadzor did not receive much attention in the annual reports. Shell's Financial and Operational Information reports 2001–2005 and 2004–2008 provided no relevant information for the research criteria selected.

6.3 Annual and company reports published by Sakhalin Energy

The operator of the Sakhalin II project, Sakhalin Energy, has published annual review reports since 2002. In order to assess what they say about the enforcement of formal rules and regulatory practices in Russia, these annual reports were analysed for relevant text, headings or statements. In line with Shell's sustainability reports, most of the text is directed towards Sakhalin Energy's efforts to improve social conditions on the island and, minimize the environmental impact of operations, and to describe the project activities. Prior to 2005, before the announced cost overruns and the ensuing battle with the Russian authorities, the main message of the annual reports was that Sakhalin II was a successful project that would secure Russia's position as global energy supplier. Sakhalin Energy was even able to comply

with the disputed requirements concerning the methods for river crossing, which became subject of discussion later on, as shown in the next sub-section.

River crossing timing and constructing methods for each river and stream is approved by the relevant Russian Federation regulatory agencies, including local fish inspectorates, the regional fishery regulatory agency Sakhrybvod, and the Federal level agency Tsuren (Sakhalin Energy Review 2005:26).

Annual environmental reports like Sakhalin Energy's annual reviews are often labelled as little more than 'window dressing' by NGOs. An example of such 'window dressing' is seen in Sakhalin Energy's annual report from 2003, which describes how the company uses 'high technology horizontal directional drilling to install pipelines underneath rivers with very high importance for salmon' (Sakhalin Energy Annual Review 2003:24). The report fails to mention whether similar techniques have been used in other river crossings. An independent audit (Environmental Report 2007) conducted later on concluded that only a few river crossings had used this method.

All the same, the annual reports published by Sakhalin Energy are more detailed than Shell's sustainability reports. For example, they mention the challenges Sakhalin Energy faced in navigating through the complex formal regulatory framework in Russia. Already the first Sakhalin Energy Annual Review notes the difficulties of operating in Russia:

The transition to democracy and a market-oriented economy has been a complex one that is still evolving. The legal and regulatory framework continues to be difficult for companies developing large-scale projects in Russia. (...) Russia remains a challenging place to do business. It can take a great deal of time and resources to conduct business transactions that would be more straightforward in other parts of the world. For example, more than one thousand official permits and licences were required to develop the Phase 1 project alone (Sakhalin Energy Review 2002:4).

The report goes on to claim that over 1000 separate approvals and licences were necessary in order to start production at the Piltun-Astokhskoye field. The lack of development in terms of Russia's regulations was a recurrent theme in Sakhalin Energy's annual reports.

Phase 1 was the first offshore development in Russia and as such a regulatory framework specific to offshore development did not exist. As such Russian regulators for onshore development or vessels were adapted and applied to the project (Sakhalin Energy Review 2002:11).

Similar comments concerning the enforcement of formal regulations were also made:

In recent years, the Russian Federation government has adopted a set of environmental standards and regulations that are amongst the most stringent in the world. The framework to monitor and regulate compliance with these standards is still evolving. The company's experience shows that the Russian authorities check everything we do with care and a healthy degree of investigation (Sakhalin Energy Review 2002:29).

The 2002 report also states that the political, economic and social transformation of Russia following the collapse of the Soviet Union resulted in an overall and gradual improvement in corporate governance, as outlined below.

Russia's political, economic, legal and social systems have all been transformed since reforms began. Economic growth has resumed after the slump of the early 1990s, and the financial crisis of 1998. Legislation has been developed; including production sharing legislation in 1995, and corporate governance is improving (Sakhalin Energy Review 2002:4).

The investment in the Sakhalin II project is even considered a sign of growing confidence in the Russian economy:

Direct foreign investment in Russia delivers many direct benefits, including growing international confidence in Russia as a place for foreign investment, growth in the goods and services, industries, and other multiplier benefits (Sakhalin Energy Review 2002:7).

The content in Sakhalin Energy's annual reports for 2002, 2003 and 2004 does not provide relevant text, comments or indicators regarding enforcement practices against IOCs in Russia.

In September and October 2006, the Russian government put pressure on Sakhalin Energy after the violation of environmental regulations and licence agreements. The previous subsection concluded that Shell's annual reports reported on the violations made by the company or sub-contractors working on behalf of the company. This makes it interesting to examine Sakhalin Energy's annual report covering its operations in 2006 in more detail. Not surprisingly however, the governmental inspections are dismissed as a minor issue, as Sakhalin Energy's former CEO writes in the 2006 annual report:

When the project was criticised by Russian regulators, we took this as a challenge to improve our environmental performance, find new solutions and strengthen controls and management of our contractors. (...) The shareholders now look forward to implementing the project in line with the current schedule, including obtaining all necessary permits and approvals granted in accordance with applicable Russian legislation and the PSA (Sakhalin Energy Annual Review 2006: 3, 9).

Further on in the 2006 report, these inspections are described in greater detail:

Sakhalin Energy, being committed to minimising all harmful environmental impacts from construction works, has undertaken a whole range of actions to ensure that the unique natural environment of Sakhalin Island is preserved to the maximum extent. However, those actions proved not to be completely sufficient: in 2006 the environmental authorities demanded that Sakhalin Energy should pay more attention to the Project's environment safety. In the second half of 2006 Rosprirodnadzor held a number of inspections to check the environmental compliance of Phase 2 construction, especially the onshore pipelines (Sakhalin Energy Annual Review 2006:70).

The 2006 report summed up the efforts undertaken by Sakhalin Energy to ensure compliance with the environmental regulations:

Stringent compliance with environmental requirements will be achieved by way of strengthened control over the construction techniques and the contractors' quality of work on the Company's sites (Sakhalin Energy Annual Review 2006:70).

Hence, in line with the content in Shell's sustainability reports, Sakhalin Energy recognized that environmental regulations were violated throughout 2006.

In the winters of 2005–2006 and 2006–2007 several groups of independent observers were engaged to ensure compliance during river crossing construction. They informed us of every noncompliance with the winter river crossings strategy. Information received from independent observers helped the company eliminate the non-compliances and prevent their occurrence in subsequent river crossings (Sakhalin Energy Annual Review 2006:70).

Sakhalin Energy acknowledged the findings of environmental compliance inspections in 2006 and used them to develop and implement respective corrective plans (Sakhalin Energy Annual Review 2007:27).

The content in Sakhalin Energy's 2007 annual report does not provide any relevant text. The conclusions of the independent environmental audit, however, are included:

The AEA report states that 'there is a high level of compliance for most of the project's facilities/assets', and that 'there are examples of laudable best practices'. 'Where non-conformances with requirements have been identified in the documentation these are either minor in nature or else Sakhalin Energy has plans in place for their correction (Sakhalin Energy Annual Review 2007:28).

This audit was carried out by AEA in its capacity as an independent consultant. The audit provides excellent insight into the issues Shell/Sakhalin Energy faced in their efforts to comply with the formal regulations in Russia. It also confirms that environmental rules had been violated and shows the complexity of complying with the formal framework in contemporary Russia.

6.4 Could Sakhalin Energy have complied with the rules?

From an examination of the annual reports published by Shell and Sakhalin Energy I conclude that Shell did indeed violate environmental regulations, even though this was given considerably less attention in the sustainability reports than might have been expected. It is

hard to determine whether Shell violated licence agreements, due to, for example, delays in the delivery of LNG, since the licence agreements regarding Sakhalin II are not publicly available.

One of the main conclusions in sub-section 3.5 above – where Ledeneva’s framework of selective enforcement in Russia was presented – was that enforcement of formal rules in Russia is selective and biased. Chapter 3 also emphasized that enforcement practices are partly related to the difficulties of actually complying with the complex and sometimes contradictory regulations in the country, which may mean that rules are violated *a priori*.

In order to understand whether enforcement targeted at Shell was conducted selectively, we also need to examine the extent to which Shell has been able to comply with the formal environmental rules of the Russian Federation during the development of Sakhalin II. For this, we return to the audit conducted by the consultants of AEA Technology (referred to as Environmental Report 2007 in this study).

In September 2007 AEA, an independent environmental consultancy firm, conducted an audit to examine the environmental and social impact of Phase 2 of the Sakhalin II project. In order to deal with these impacts already at an early stage, Sakhalin Energy initiated a Health, Social, Environmental and Safety Action Plan (HSESAP), outlining the environmental management system, including internal requirements, that the company should comply with.

Here we will see that Sakhalin Energy did indeed violate environmental regulations at the time when Rosprirodnadzor conducted inspections during the second half of 2006. Moreover, the audit shows that achieving full compliance with the law in Russia is difficult – a point in line Ledeneva’s conclusions, and providing an explicit opportunity for the selective enforcement of formal rules and regulations. The information provided by the audit is essential in order to better understand the pressure the Russian authorities exerted on Shell and moreover, to examine the strategy or strategies of Shell in their interaction with the Russian authorities, discussed in Chapter 9.

The main purpose of the audit was to outline the status of implementation and compliance with HSESAP requirements and formal regulations of the Russian Federation. Sakhalin Energy has a responsibility to the agency lenders and potential lenders, so the audit was

conducted on behalf of banks that would potentially provide financial support to the project, such as the EBRD (Environmental Report 2007:1). The action plan aims to minimize the environmental impacts. However, all requirements documented in the HSESAP need to be fully met and proper contractor management is essential to prevent law-breaking behaviour. The summary in the audit, referring to good contractor management, concluded:

This [contractor management] has proven to be challenging for Sakhalin Energy for the onshore pipeline contract, and has been the underlying cause of many of the issues surrounding the construction of the onshore pipeline system (Environmental Report 2007:xvi).

In order to proceed with the construction of phase II of the project, Sakhalin Energy would need at least to comply with the formal regulations and the licence terms specified in the PSA. In addition, the company would have to comply with the requirements of their action plan which is based on industry practices, Sakhalin Energy's own environmental standards, guidelines and safeguard policy requirements of shareholders such as financial institutions, and requirements of international agreements (Environmental Report 2007:25). My analysis here will focus on the rules required by the Russian Federation since these provide the basis for regulatory pressure and/or sanctions from the authorities. It is important to distinguish violations in terms of Sakhalin Energy's own action plan – for example the failure to fully implement the independent recommendations of the scientists – from violations of established laws, like using unapproved methods for river crossings.

The audit provides an overview of the Russian Federation's legislative system, pointing out: *'The RF (Russian Federation) legislative system is complex and rigorous'* (Environmental Report 2007:25).

The Sakhalin Oblast has its own regional environmental rules. These regulations do not cover procedures or requirements for Environmental Impact Assessments (EIA), which are specified in federal regulations. Furthermore, in order to conduct major industrial construction in Russia, a Technical and Economic Substantiation Construction (TEOC) document must be produced and submitted to the authorities. This is a highly bureaucratic and complex process that includes several governmental organizations across various levels. The TEOC incorporates the results of key surveys, design work and associated documentation and is

subject to approval by the Industrial Safety expert review, GosGorTechNadzor, a state expert review by GlavGosExpertisa, a state ecological expert review by the Ministry of Natural Resources, a review by the Ministry of Emergencies and finally a review by the Employment Department. Approval by these authorities can result in a ‘positive conclusion’, based on a number of ‘conditions’, including environmental requirements or the submission of additional drawings or documents (Environmental Report 2007:26). A ‘positive conclusion’ is necessary in order to obtain the final land acquisition and the water-usage licences (Environmental Report 2007:26). The final approval issued by the Ministry of Natural Resources included:

...numerous recommendations, suggestions and requests for additional documentation that Sakhalin Energy should address (...) the recommendations and suggestions (including both environmental and technical considerations) are sometimes vague and thus open to interpretation. It is not possible to confirm compliance with all these recommendations because of the ambiguous nature of some of the requirements, although we can confirm that Sakhalin Energy appears to have addressed/be addressing all material environmental requirements set forth in the State Environmental expertise Review (Environmental Report 2007:26–27).

After obtaining the State Environmental Expertise Review, construction work cannot start until the company in question (here: Sakhalin Energy) reaches agreement with the local authorities regarding necessary permits such as maximum permissible concentrations for emissions and discharges, and sanitary protection zones.⁷¹ The following excerpt from the audit makes clear the complexity of this process:

The methodology for undertaking these calculations is set by regulation and is both conservative and complicated. Particular difficulties can arise when a maximum permissible concentration for a particular pollutant is set at a concentration below the background levels of that substance in the locality. The constraints set by the maximum permissible concentration/sanitary protection zones-process can require variations to the siting of a facility and can involve the imposition of maximum

⁷¹ ‘Sanitary protection zones’ are minimum zones around facilities and pipelines where certain activities are prohibited in order to protect towns and other residential areas (Environmental Report 2007:27).

permissible emissions that are technically impossible to achieve (Environmental Report 2007:28).

The approval process for the maximum permissible water discharge was similar to the one outlined above. However, in addition to the previous process, approvals are required from central and local fisheries committees, the local committee for sanitation and epidemiology and the local committee for natural resources.

Finally, even after approval of TEOC and ‘in principle’ of the conceptual monitoring programme, discussions will be held with the local authorities to discuss the detail of the monitoring programme (Environmental Report 2007:29).

Water-use licences issued by the RF Ecological Expert Examination are required, and approval of the TEOC is necessary for this. Once approval has been granted by the Ecological Expert Examination, the TEOC will be formally approved by the Russian Ministry of Natural Resources.

The complexity of the Russian regulations is also exemplified by Conform IT, Sakhalin’s database containing information on relevant regulations.

Conform IT is considered as the industry standard database, but as with all other databases it does have information gaps due to the enormity of Russian legal materials. In 2005, we noted that it did not provide automatic legal updates and there was no mechanism in Russia to subscribe directly with federal/local legislators. In the absence of a mechanism to provide automatic updates and to guarantee 100 per cent coverage of relevant Health, Safety and Environmental and Social legislation, updates depend upon working relationships with appropriate authorities (Environmental Report 2007:31).

The above-mentioned analysis makes evident the complexity and bureaucracy that surrounds the approval of industrial activities in Russia. Regulations are not only complex, but sometimes insufficient or even absent. Bodies of water, for example, are classified according to their environmental sensitivity, depending on whether the water course supports endangered or protected species or provides spawning grounds for fish, prohibiting certain

activities on and near classified bodies of water. As of the end of 2007, however, no bodies of water in or around Sakhalin Island had been classified. In the absence of such classification, they were all temporarily placed in Group 2, the medium sensitivity classification.

The independent audit also identified the violations of formal rules by Sakhalin Energy – or its sub-contractors operating on its behalf. One of the major violations committed by Sakhalin Energy was the use of a prohibited technique in the construction of pipelines across rivers. For several river crossings ‘dry cut techniques’ have been used, rather than the prescribed ‘wet cut construction methods’.⁷² It should be noted that only rivers where the volume of river flow is low enough that the water flow can be controlled with the help of flumes are suitable for ‘dry cut’ techniques.⁷³ The audit makes the following observations:

In May 2005 it became apparent that the use of dry cut techniques might not be permitted by the local Russian fishing authority (SakhRybvod), and this was finally confirmed in September 2005. This, together with concerns about ongoing river construction works identified during field visits by Agency Lenders and AEA in late 2004 and early 2005, highlighted the necessity for amendment and improvement to Sakhalin Energy’s approach to river crossings (Environmental Report 2007:89).

Dry cut technique is regarded as best environmental practice (BEP). The OSPAR Convention defines BEP as ‘the application of the most appropriate combination of environmental control measures and strategies’. Best available technique (BAT), on the other hand, is generally considered to be a technique based on the latest stage of development, state of the art, and the best option for minimizing environmental damage. The BAT regarding river crossings is termed ‘horizontal directional drilling’, but is expensive and not (yet) required by Russian law. The dry cut technique is generally considered best practice by the industry and governmental authorities around the world for constructing pipelines across rivers while minimizing the amount of sediment released into the rivers. However, the dry cut technique was in fact prohibited by Russian law until early 2006 (Environmental Report 2007:88). Interestingly, the requirements in Sakhalin Energy’s own HSESAP prescribe the ‘dry cut

⁷² ‘Dry cut’ is a technique where the watercourse is temporarily diverted around the work area and the work area is made water free. ‘Wet construction’ methods involve excavating the pipeline trench across the river while the water is still flowing.

⁷³ Flume pipe crossing methods are most suitable for narrow rivers with flow rates of less than 4 m³/s.

techniques’ as the best technique for river crossings as being more environmentally friendly, if conducted properly, than ‘wet cut construction methods’.

Thus, prior to early 2006 the use of ‘dry cut techniques’ was a violation of Russian law. But *not* implementing this method would be a violation of Sakhalin Energy’s own environmental action plan. In January 2006, Sakhyrbvod and Sakhalin Energy agreed upon the use of ‘dry cut techniques’ for rivers with a width of less than 1.5 m. Since few of the rivers in question fell into this category, most river crossings were made with ‘wet cut techniques’, thereby again violating Sakhalin Energy’s own requirements as set out in the HSESAP.

Several rivers crossed in the winter 2004/2005 that, under the final river crossing strategy, should have been dry cut were in fact crossed using wet cuts. The extent to which such rivers could have been dry cut in reality is a moot point as the RF authorities made their objection to dry cut techniques later in 2005 (Environmental Report 2007:92).

The use of a prohibited technique resulted in fines and the suspension of work, as the Environmental Report comments:⁷⁴

During December 2005 flume crossings were undertaken at a number of rivers to generally good effect. However, in January 2006 the local RF authorities determined that the use of flumes was outside the permit conditions and fines were imposed in a number of cases where such construction methods had been employed (Environmental Report 2007:94).

Moreover, in order to minimize the environmental impact of construction activities the law prescribes ‘simultaneous’ crossing of both oil and gas pipelines. However, in terms of practical feasibility, the report concludes:

SakhyRybvod requires ‘simultaneous’ crossing of both the oil and gas pipelines. Although actual simultaneous crossings of rivers is unrealistic on technical grounds,

⁷⁴ Water-use licences were suspended by the Amur Water Basin Committee from 5 to 28 December 2006 following identification of licence violations (Environmental Report 2007:95).

the intent of the requirement is to minimise the duration of impact and thus it is reasonable to assume crossings in individual rivers should be performed as near to back-to-back as possible' (...) During the initial stages of river crossing construction (e.g. winter 2004/2005) conformance with the requirement for back-to-back installation of the oil and gas pipeline was low (...) This issue was formally raised with Sakhalin Energy by SakhRybvod (Environmental Report 2007:91–92).

Other violations noted in the audit report are non-compliance with regard to water protection zones: multi-season crossings: the location, design and approval of spoil tips; and temporary bridges with centre supports (contrary to permit conditions) or bank supports encroaching into the river (Environmental Report 2007:105–135). Permits prescribe that temporary bridges must be single-span because centre supports disturb the river flow. Further:

Under Article 24 of the Federal law No 52-FZ on wildlife' April 1995, activities that cause death, reduction in population or disturb the natural habitats of rare or endangered species, which includes taimen, are prohibited (Environmental Report 2007:116–117).

Obviously, such a requirement means practical problems for the construction of infrastructure or any kind of production activities, not only for Sakhalin Energy's project at Sakhalin, but for the construction of roads and factories as well. However, according to Sakhalin Energy, habitat disturbance was considered unlikely if the river-crossing strategy could be fully implemented (Environmental Report 2007:117). Here the audit comments:

AEA has sought Sakhalin Energy's position on this issue during the early stages of construction. At that time, the risks of death, reduction in population or disturbance to habitats of rare or endangered species was considered unlikely provided the river crossing strategy was fully implemented. AEA has continued to monitor this issue and following significant non-compliance of the HSESAP commitments pertaining to river crossings and soil erosion control, we now consider this to be a potential risk (Environmental Report 2007:117).

Thus, besides violations of both environmental regulations as well as the requirements set out Sakhalin Energy's own HSESAP, the general conclusion of the audit is that:

Sakhalin Energy's written assessments and plans fully meet the large majority of the individual requirements against which the project has been assessed. Moreover, the project provides examples of laudable best practice. Where non-conformances with requirements have been identified in the documentation these are either minor in nature or Sakhalin Energy has plans in place for their resolution, details of which are provided in this report (Environmental Report 2007:xiv).

We have now seen the complexity of regulations in Russia and the difficulty of complying with formal regulations. The AEA audit surveyed, for example, the complexity of the bureaucracy associated with gaining permission for industrial activities. The report also confirmed that Sakhalin Energy had violated environmental regulations during the implementation of the Sakhalin II project, as when the company opted for other river-crossing methods than those prescribed by the law. These violations have also been noted by the company in their annual reports, as mentioned in the previous sub-section.

So far, these findings are in line with Ledeneva's framework of selective enforcement of formal rules, stressing the difficulty of complying with formal regulations in Russia. Furthermore, Ledeneva argues that rule enforcement is based on informal means, such as unwritten rules rather than the letter of the law. The cost overruns announced by Shell in July 2005 could be regarded as a violation of such an unwritten rule, and subsequently provided the incentive for enforcing the formal rules, in this case environmental regulations. Unfortunately, such informal practices are not dealt with in annual reports or any other official publication from the IOC in question, as confirmed by the analysis thus far.

However, in an attempt to emphasize Shell/Sakhalin Energy's efforts to reduce its environmental impact, the annual reports do send out a message that the violation of environmental regulations is a minor and 'reparable' issue. By referring these violations as 'minor', the company, at least publicly, seems to regard the environmental conflict with the Russian authorities as a financial disagreement over cost overruns, rather than an environmental issue and openly discusses the enforcement practices of the authorities involved. The next sub-section analyses the annual reports of TNK-BP and BP, in an attempt to see how BP understood enforcement practices and regulatory pressure in Russia.

6.5 Annual and company reports published by TNK-BP

Similarly to Shell and Sakhalin Energy, BP's joint venture with TNK published annual reports and sustainability reports during period studied here (2000–2008). The content of these reports is examined in order to show how BP responded to the pressure exerted by the Russian authorities in connection with the licence agreements for developing the Kovykta natural gas field. BP might have regarded these moves as an attempt to provide Gazprom with access to the Kovykta project, or as a reminder to comply with licence agreements by increasing the amount of production. As BP refused to answer direct questions on this subject, I have used the annual reports and other publications published by TNK-BP as a proxy for gauging how regulatory pressure exerted by the Russian authorities was interpreted.

The analysis of environmental legislation in Chapter 5 concluded that compliance with the formal rules in Russia is complicated due to incoherency in regulations and state bureaucracy. This applies also with regard to TNK-BP's licence agreements. Although RUSIA Petroleum was formally the operator of the Kovykta field, the company was controlled by TNK-BP, which was therefore regarded as the owner. The joint venture between Russian TNK and British BP was not established until January 2003, so BP's annual reports and sustainability reports covering 2000–2002 have been excluded from the material presented here.

In the early stages, the joint venture was seen as a challenge for BP to maintain its overall level of corporate governance and sustainability. As noted in the 2003 Sustainability Report noted:

Our joint venture, TNK-BP, faces a challenge in bringing health, safety and environmental performance up to international standards. Many of TNK-BP's assets date from the Soviet era and transforming these operations will take time with regard to transparency and governance (BP Sustainability Report 2003:3).

The 2006 Annual Review outlined BP's approach towards conducting business in Russia and their 'cooperation' with Gazprom.

Our experience in working with the Russian Federation is to act with caution, respect and genuine reciprocity. The agreement we concluded with Gazprom during the year

to provide liquefied natural gas (LNG) cargoes indicates the scope for co-operation to build new supply chains in the international marketplace (BP Annual Review 2006:5).

Generally, TNK-BP data are not included in BP's annual reports. However, during the period under study, TNK-BP issued several other publications, such as annual reports, newsletters and information sheets, like the quarterly publication *TNK-BP insight*, which first appeared in winter 2003. The Company publications during 2004 take account of the fact that the joint venture between TNK and BP was established in late 2003, and emphasize the confidence of the international business community in Russia's future ('This is TNK-BP', 2004:2). Corporate governance is seen to be improving and Russia is seen as a major supplier of hydrocarbon resources. In his foreword to a publication from 2004, TNK-BP's President and CEO underscores the attractiveness of the newly established joint venture: *People from all our business heritages want to be part of this new type of company in Russia* ('This is TNK-BP', 2004:3).

Moreover, the report stresses that the implementation of standards of corporate governance and management transparency will in time be 'among the most stringent in Russia' ('This is TNK-BP', 2004:5). However, TNK-BP's information sheets refer to 'a number of uncertainties' regarding the early phase of development of the Kovykta field, without further explanation, similarly to TNK-BP's information sheet published in 2006 (TNK-BP Information Sheet, August 2006:29).

Throughout 2006–2007 TNK-BP faced pressure from the Russian authorities who accused the oil company of violating licence agreements. TNK-BP's 2007 annual report which includes a message from President and CEO Bob Dudley, identifying some of these issues:

In Russia we also saw a record taxation burden and rising cost inflation in our sector. The Russian industry also witnessed further state involvement and scrutiny by authorities (TNK-BP Holding Annual Report 2007:2).

Without referring to the issues between the Russian authorities and TNK-BP specifically, TNK-BP Today published in 2007, mentioned Gazprom's monopoly and the resultant constraints faced by private gas producers in Russia:

However, constraints imposed by the existing regulatory framework and limited access to Gazprom's transportation, storage, and processing capacities often mean that independent producers encounter difficulties monetizing these reserves. Further evolution of Russia's gas industry will depend upon the pace of liberalization of the sector and opening access to Gazprom's transportation facilities (TNK-BP Today 2007:5).

Annual reports and other publications like brochures and magazines detailing BP's operation activities in Russia were published less frequently than in the case of Shell/Sakhalin Energy for the period under study here. From the analysis of the content in BP and TNK-BP's official documents, the main official line after the establishment of the joint venture so far is that there are certain risks associated with conducting business in Russia, but that, given the profit margins, these risks are worth taking. However, in a speech delivered at the Eight Russian Economic Forum in London, Bob Dudley, at the time TNK-BP's CEO, discussed the latest trends in Russia's investment climate. The full text of the speech is published in Insight TNK-BP, April 2005. Unfortunately, this document has not been available on the internet since January 2011, although some parts – such as Gazprom's monopoly – are also discussed in TNK-BP Today, 2007. Speaking at the forum, Bob Dudley stated that:

Russia today presents a mixed picture for the investor. On the one hand, the macroeconomic environment is favourable. Economic growth is strong, driven not only by high commodity prices, but also by recovering domestic demand. Foreign reserves are rising; the trade and current account balances are strongly positive, and the state of government finances could rightfully make some OECD governments envious. Nevertheless, despite these impressive macroeconomic indicators, foreign investment has not poured into Russia and indeed there are reliable reports we are again witnessing significant net capital flight from Russia. And it has long been known that FDI remains lower per head than in other countries of its peer group. Investor confidence remains uncertain – and not only among foreign investors (Insight TNK-BP, April 2005:6).

The causes of this trend, he said, were related to the changes in Russia's investment climate since February 2003 – without reference to specific cases. Dudley emphasized the increasing role of state companies, and the selectivity in the application of the law.

I believe we have seen some changes in Russia's investment climate since February 2003. And I suspect not all these changes have been positively received by the investment community. It is my contention that Russia is inadvertently becoming more difficult to navigate for well-intentioned investors – Russians and foreign alike. (...) Over the past two years, a new configuration has emerged in the Russian economy: The state has progressively asserted its influence over the commanding heights of the economy, and state-owned companies have begun to play an increasingly prominent role. This trend is particularly evident in the oil and gas sector. This in itself is not necessarily a negative development. This configuration can be effective, and both state-owned and private companies can work together to deliver economic growth. However, experience shows that for this model to be successful, a clear set of fair and transparent rules must be established (...) Finally, the industry continues to face an increasing government take in the form of growing tax pressures (...) These are important considerations for all investors and in combination these factors tend to impede investment, both domestic and foreign, and slow down economic growth (Insight TNK-BP, April 2005:6).

As a concrete example of the sort of indicators affecting the investment climate in Russia, Dudley mentioned Russia's subsoil law from 2008 and regulations on work permits for non-Russians:

The current drafts all agree that companies with foreign affiliation will be excluded from bidding for 'strategic fields' (...). Investors will need these rules to clarify what constitutes 'strategic fields' and to also clearly spell out just what are the levels of international participation that Russia is concerned about (...) In addition, new regulations on work permits for expatriates have become progressively more restrictive. At the time when Russia's economy is in need of knowledge and management skills, it is becoming increasingly difficult to bring in managers and executives who would not only provide unique experience, but also pass on their skills to a new generation of Russian managers and experts (Insight TNK-BP, April 2005:7).

Ironically enough, Bob Dudley was at that time unaware that work permit regulations would force him to step back in the summer of 2008. Furthermore, Dudley feared that unclear regulations and a lack of transparency could lead to selective enforcement:

An abundance of unclear regulation continues to be problematic. Most commentators and participants alike believe this leaves too much room for discretionary decision-making and selective enforcement (Insight TNK-BP, April 2005:6).

Finally, Dudley commented on the lavish praise and initial targets that had surrounded the establishment of TNK-BP in the autumn of 2003, and proffered his own opinion:

Russia has consistently professed a desire to attract what should be its rightful share of annual global investment. The agreement between the Russian groups of Alfa, Access and Renova and BP to establish TNK-BP was reached in February 2003 and was immediately heralded by some as 'breakthrough' investment; one which would lead the way for many more to come in our sector. In fact, some have followed but I suggest fewer and smaller than were hoped at that time (Insight TNK-BP, April 2005:6).

Bob Dudley's speech can be interpreted as a clear signal towards Russian and Western actors regarding the investment climate in Russia, and more specifically the selectivity of enforcement practices, referring to the back-tax claim the Russian authorities imposed on TNK-BP in November 2004. The content in official documents shows that constraints between TNK-BP and the Russian authorities and/or Gazprom have occurred. Apart from a few concrete examples, however, it is uncertain whether these issues could be related to the problems regarding the development of the Kovykta field or within the management of TNK-BP itself. Whether the conclusions outlined above can help to answer the research question is discussed in Chapters 9 and 10.

6.6 Conclusion

This chapter has examined the content of annual and company reports, seeking to identify how BP and Shell understood law enforcement and regulatory pressure in their conflicts with the Russian authorities during the period under study here (2000–08). This, in combination

with Chapters 4 and 5, has shown some of the strategies followed by the two IOCs in their interactions with the Russian authorities, and the dispute over formal rules in particular. This chapter has also provided insights useful for understanding the pressure the Russian authorities exerted on Shell and BP, for example by examining whether these IOCs did indeed violate formal regulations, and whether it would have been possible to comply with the formal law. Whether both IOCs acknowledged that they violated the law, or whether they saw themselves as victims of selective enforcement aimed at increasing state control in Russia's energy sector, is discussed in more detail in Chapter 9.

In 2005, enforcement practices were mentioned for the first time in official documents published by BP's joint venture with Russian TNK. Especially after Bob Dudley's speech in London in April 2005, the content in the reports came to focus more on the stressful relationship between the company and the Russian state. Selective enforcement of formal rules was a concrete example, apart from unclear regulations, increased state control and a lack of transparency. However, this speech, which should be interpreted as an attempt to influence the decision-making process on Russian side, is one of the few instances where representatives of TNK-BP publicly announced their grievances in relation to the ongoing situation with the Russian authorities. In the reports analysed above, neither TNK-BP nor BP made specific reference to the allegations and/or pressure exerted by the Russian authorities over the violation of licence agreements regarding the development of the Kovykta field. Issues concerning TNK-BP's investments in Russia are often mentioned in general terms, and the question of whether TNK-BP had the possibility to comply with the formal regulations could not be answered on the basis of the information provided in annual reports. However, one of the main conclusions of Chapter 5 was that TNK-BP could not have complied with the licence agreements of the Kovykta natural gas field, if the objective was to monetize the reserves of this field.

Regarding Sakhalin Energy's project, the independent audit clearly illustrated the enormous bureaucracy and complexity of formal regulations in Russia. The analysis showed that full compliance with environmental regulations is practically impossible, such as when a maximum permissible concentration for a particular pollutant is set against a concentration below the background levels. The difficulty of complying with formal rules is one of the conclusions of Ledeneva's framework, where she argues that such compliance is difficult in Russia and that unwritten rules, ironically enough, serve as the trigger for the enforcement of

written ones. Shell and Sakhalin Energy acknowledged the violations of formal rules. However, the argument in the company publications examined here is that this non-conformance with Russian legal requirements was either minor in nature or that Sakhalin Energy had plans in place for correcting them, leaving room for discussion as to whether these instances of non-conformance legitimized the enforcement practices exerted by the Russian authorities.

The main objective of this dissertation, as formulated in Chapter 1, is to answer the research question of how Western actors understand and deal with regulatory and law enforcement practices in the Russian petroleum sector. This main research question is operationalized through three subsidiary questions where the first one, how IOCs understand law enforcement practices, was partly taken up in this chapter. The second research question is how the media interpret law enforcement and regulatory pressure against IOCs in Russia. As the following chapters will illustrate, the dominant storyline in Western media indicates that the enforcement of formal regulations in Russia is subject to political interests rather than exerting impartial enforcement of formal rules for purposes related to the dispute as such, for example, protection of the environment.

7. Shell and BP in British newspapers

In the previous chapter, I discussed how Shell (Sakhalin Energy) and BP understood enforcement practices and regulatory pressure in Russia, on the basis of annual reports and other company publications. Both companies faced regulatory pressure from the Russian authorities in connection with the development of their oil and gas fields. The question in this chapter and the next is how the Western media have interpreted law enforcement practices and regulatory pressure against IOCs in Russia. A discourse analysis was carried out of newspaper articles from four leading newspapers published in two countries, the United Kingdom and the Netherlands. I will identify the dominant storyline in the British newspapers here, and turn to the two Dutch newspapers in the next chapter.

The material that follows presents the data related to the media coverage of the two British newspapers in detail, starting with the coverage of the *Financial Times* – its London 1st, 2nd and 3rd editions, the Europe 1st edition and the Surveys edition. The London edition appeared until February 2003 and was later converted into the London 1st, 2nd and 3rd editions. *The Guardian* is examined in the second part of this chapter.

7.1 Coverage of IOCs in the *Financial Times*

The *Financial Times* is a UK-based daily with editions throughout the world, including an Asian edition and a US edition (not represented in this analysis). These last two editions are not included in this analysis. Apart from Sakhalin II and the Kovykta natural gas field, several other oil and gas projects in Russia are controlled by IOCs, as is the case with ExxonMobil's Sakhalin I PSA. In total 80 per cent of this project's stock is in foreign hands.⁷⁵ Like Sakhalin II, Sakhalin I is based on a PSA agreement. Furthermore, ExxonMobil announced that the total costs of its project increased from USD 12.8 billion to USD 17 billion (Bradshaw 2006:7). However, coverage of Sakhalin I in the *Financial Times*, in terms of the number of articles published, was significantly less intensive than the number of articles covering

⁷⁵ Exxon Neftegaz, the operator on the field, consists of ExxonMobil controlling 30 per cent, the Japanese consortium SODECO controlling 30 per cent, the Indian state -owned company ONGC Videsh Ltd. controlling 20 per cent and Rosneft controlling 20 per cent.

Sakhalin II and Kovykta. A search in the digital database of the *Financial Times* yielded the results shown in Figure 9.

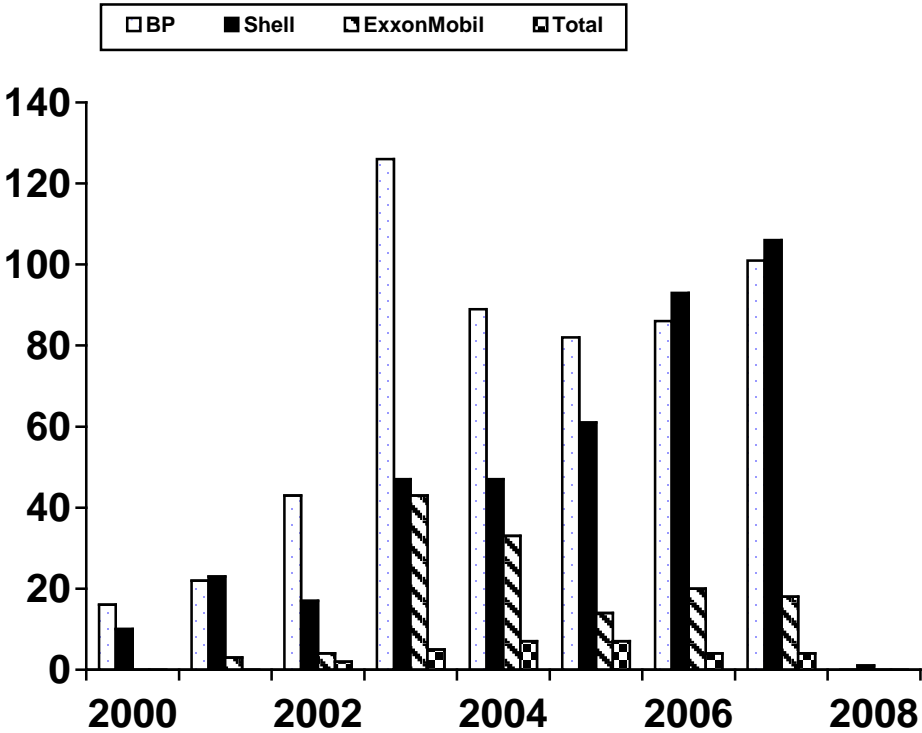


Figure 9: *Financial Times*: number of articles covering various IOC operations in Russia 2000–2008.

A search in the digital database of the *Financial Times* revealed an even lower number of articles reporting on Total’s operations at the relatively small Kharyaga oil field.⁷⁶ Hence, its coverage of Shell’s and BP’s operations shows a significantly higher number of newspaper articles published than regarding other IOCs.

Two separate searches in the digital archive of the *Financial Times*, using the terms ‘Shell AND Russia’ and ‘BP AND Russia’, resulted in a total of 970 articles. A broad search was conducted in order to avoid missing relevant articles excluded from the search results. Subsequently, articles considered irrelevant were excluded, such as those discussing the attack on Yukos that had no reference to the impact on Shell’s operations at the Sakhalin II field.

⁷⁶ Together with Norwegian Statoil, Total is the owner of the 1999 PSA for the Kharyaga oil field in northwestern Russia. The operator Total controls 40 per cent, Statoil 30 per cent, and the remaining interests are controlled by Zarubezhneft (20 per cent) and the Nenets Oil Company (10 per cent).

The analysis of newspaper articles employs a system of packages outlined in Chapter 2. A ‘package’ consists of a selection of newspaper articles focusing on a particular subject with similar content or meaning – for example, environmental protests against oil and gas activities on Sakhalin II. Gamson and Modigliani define packages as ‘a set of interpretive packages that give meaning to an issue’ (1989:3). Packages construct meaning by incorporating news events into their interpretive frames and compete over which interpretation will prevail.

The packages illustrated in this chapter consist of quote materials from newspaper articles. I began by classifying all articles according to their main message and then grouped those with similar messages into packages. Over time, the prevailing package came to contain the dominant storyline, defined by Hajer (1995:62) as ‘narratives on social reality through which elements from many domains are combined and that provide actors with a set of symbolic references that suggest a common understanding’.

7.2 Storylines on enforcement practices and regulatory pressure

This section shows a discourse analysis from the *Financial Times* from September 2006 to December 2007. The first article concerning regulatory pressure against Shell was published on 18 September 2006 with the headline ‘*Dollars 20bn Shell project faces Russian snag*’. This article focused on the regulatory pressure exerted by the Russian authorities against Shell’s project at Sakhalin II. Tensions between the Russian authorities and TNK-BP over the development of the Kovykta natural gas field had already been reported by the *Financial Times* in September 2004.⁷⁷ However, no sanction or regulatory pressure was exerted against these IOCs until September 2006, when Shell was accused of violating formal environmental regulations. Again, ‘regulatory pressure’ is here defined as the threat to impose sanctions, whereas the enforcement of formal regulations – in line with Macrory and Hawkins as discussed in Chapter 3 – is defined as imposing sanctions on an offender.

In total, 139 *Financial Times* articles were examined in detail. The first was published on 18 September 2006, the last on 17 December 2007. The content of these articles allowed the identification of four different packages, each representing its own discourse. In one package, the argument might be, for instance, that ‘The enforcement of formal regulations in Russia is

⁷⁷ ‘Chilly wind across the Atlantic cool’, *Financial Times*. 17 September 2004, p. 32 (London 1st edition).

subject to informal interests’ or ‘Shell and BP violate environmental regulations in Russia’. Each package consists of a group of articles with similar content. The dominant package is the package that has the greatest number of newspaper articles; it represents the storyline in the *Financial Times* during the period under study.

The results of the analysis of these packages are shown in Figure 10. An overview of each article and its corresponding package can be found in Appendix II.

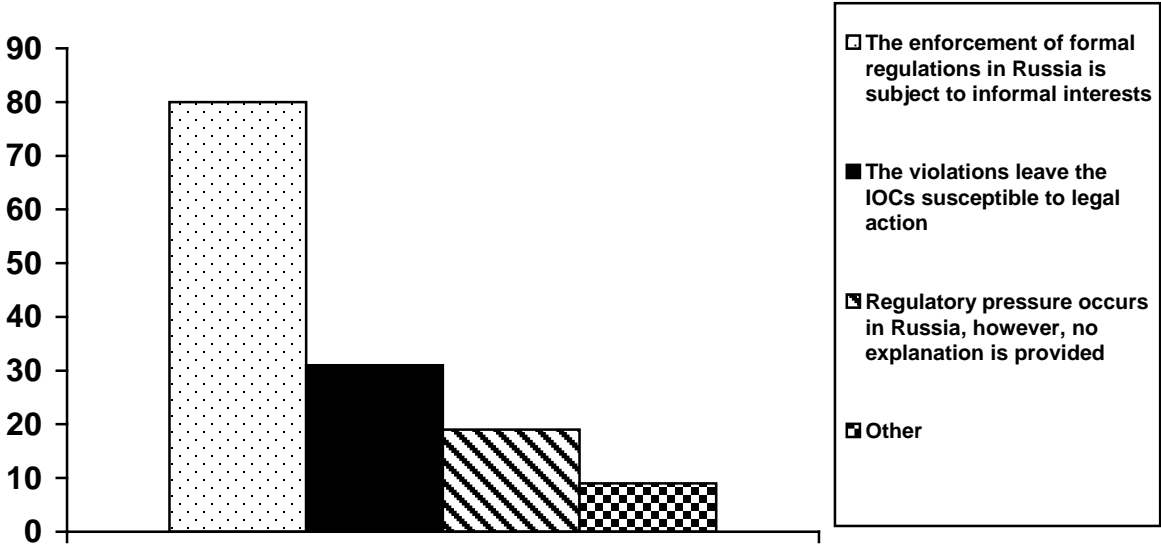


Figure 10: Analysis of articles published in the *Financial Times* 2006–2008 divided into four packages (total number of articles: 139).

The packages described in Figure 10 are explained below, with concrete examples derived from newspaper articles. A group of newspaper articles was considered insufficient to form a package when there were fewer than three articles.

7.2.1 ‘The enforcement of formal regulations in Russia is subject to informal interests’

The majority of the articles (80 out of 139) published in the *Financial Times* between 2006 and 2008 make up the package presenting the argument that the enforcement of formal regulations in Russia is subject to informal interests. Newspaper articles construct this package based on their actual content (meaning), or headlines. This package showed that enforcement practices against IOCs in Russia have other motivations than (impartial) enforcement strategies where for instance protection of the environment is the main objective for enforcing formal environmental regulations (see Chapter 3). The articles in this package

state that the Russian authorities have a political objective, which is to gain control over the oil and gas sector, or to strengthen their grip on the oil and gas industry rather than enforcing environmental regulations. The argument in this package sees enforcement practices against Shell and BP as selective, part of a more general strategy aimed at providing the Russian government with better control over the energy sector. The emphasis in this package is on selective enforcement rather than on discussing the violations of formal rules by both IOCs. The offences are not mentioned, or only in passing. Articles that emphasize the violations and their impact for the Russian economy or ecology have been framed in the package ‘The violations leave the IOCs susceptible to legal action’.

Note that not all these articles refer specifically to enforcement or regulatory practices in Russia. They often use terms such as ‘pressure’ or that IOCs were ‘forced’ to sell their interests in oil and gas projects. However, the meaning is clear: the Russian authorities are employing power, in terms of enforcement or regulatory practices, to secure other interests. Therefore, articles using these or similar terms follow the perspective offered in this package.

Most articles in this package construct the enforcement of formal regulations against IOCs in Russia as being subject to informal interests because they interpret the objective of the Russian authorities as being to ensure state control over oil and gas assets, rather than to enforce environmental regulations or licence agreements. Examples can be found in ‘*Russia’s stance on Shell sends a chilling message*’ and ‘*BP under pressure over Kovykta*’.⁷⁸ The article ‘*BP submits to Kremlin pressure and hands Kovykta to Gazprom*’ indicates a broader strategy as regards the Russian government pressuring Western companies in general, as is clear from the following excerpt:⁷⁹

BP yesterday became the last Western oil company to fall victim to the Kremlin’s campaign to claw back control of Russia’s natural resources. TNK-BP, the company’s Russian joint venture, bowed to pressure and agreed to cede its controlling 62.9 per cent stake in the vast Siberian Kovykta gas field to Gazprom, for Dollars 700m–Dollars 900m. In giving way to Gazprom, BP has followed Royal Dutch Shell which

⁷⁸ ‘Russia’s stance on Shell sends a chilling message’, *Financial Times*, 19 September 2006, p. 20 (London 1st edition) and ‘BP under pressure over Kovykta’, *Financial Times*, 28 February 2007, p. 20 (London 1st edition).

⁷⁹ *Financial Times*, 23 June 2007, p. 1 (London 1st edition).

last year also forced to concede a majority stake in its Sakhalin 2 gas and oil project to Russia's state controlled gas company.

Rather than one single conflict between state and company, the *Financial Times* indicates that these conflicts are part of a wider campaign to provide Gazprom with access to oil and gas projects. Here I can note, '*Moscow turns up heat on Sakhalin investors*' states:⁸⁰

Moscow has stepped up pressure on the Exxon-led Sakhalin I consortium to abandon plans to export future natural gas production to China and instead sell all supplies to Gazprom, the Russian state natural gas monopoly. Sakhalin I, the last big foreign oil and gas project in Russia, began producing oil in 2005 from a field off Sakhalin Island, but the consortium has delayed the massive gas reserves discovered in the area until an acceptable market has been found. Mr. Medvedev said Sakhalin I had a choice to sell gas direct to Gazprom or to Sakhalin Energy, the group running the neighbouring Sakhalin II project. Gazprom took a 50 plus 1 per cent share in Sakhalin II last year, wresting control over Russia's first big liquefied natural gas project from a Shell-led group (...) Earlier this year, Gazprom ousted TNK-BP, the Russian-British oil major, from Kovykta, an extensive gas field in eastern Siberia.

A similar perspective is provided in '*Russia cancels Shell's permit for Sakhalin-2*'⁸¹

Russian authorities cancelled a key environmental permit for a Dollars 20 billion (pounds 10.7bn) energy project led by Royal Dutch Shell, in a move that could halt work on one of the world's biggest oil and gas ventures. The cancellation by the natural resources ministry followed pressure on three of the largest foreign investments in Russian energy – the Shell-led Sakhalin-2 – and projects by ExxonMobil of the US and France's Total – as the Kremlin seeks to bring strategic assets back under control.

Terms such as 'law enforcement' or 'violation of regulations' are not always explicitly mentioned in the text, but are signified in terms such as 'claw back' and 'pressure'. This

⁸⁰ *Financial Times*, 3 August 2007, p. 3 (Europe edition).

⁸¹ *Financial Times*, 19 September 2006, p. 1 (London 1st edition).

supports the view of rule enforcement as a rather successful strategy for forcing IOCs to make certain concessions.

The following examples show how articles in the package ‘the enforcement of formal regulations in Russia is subject to informal interests’ discuss the reasons behind enforcement practices in Russia, rather than emphasizing the violations held to have been committed.

Next, those policies have been implemented in untransparent ways that have done nothing to restore respect for the law – and have instead created a chilling fear of officialdom. Also, the resurgence of the bureaucracy has been matched by growing corruption. For foreign investors these are rich but dangerous waters. Even large groups are not immune from arbitrary actions, as Royal Dutch Shell found when it was pressed to sell control of the Sakhalin-2 scheme to Gazprom. Even companies not involved in strategic sectors may be hurt in the cross-fire, as the forum organisers have learnt. Investors who think they can avoid political risk are fooling themselves. In Russia almost everything is political and almost everything potentially carries political risk (‘Russian revenge’).⁸²

TNK-BP, the Anglo–Russian oil joint venture, is bracing itself for a full investigation within weeks into its licence agreement for a giant Siberian gas field as the Kremlin tightens its grip on the country’s energy resources. Russia has used environmental audits and regulatory threats to restore dominance over oil and gas supplies. This week saw Gazprom take a controlling stake in Royal Dutch Shell’s Sakhalin-2 project after months of pressure (...) Russian authorities have already stepped up pressure on TNK-BP, accusing it of breaking a licence agreement on production levels. The prospect of losing the licence for Kovykta is likely to soften TNK-BP’s negotiation position. The authorities have decided to investigate the Kovykta licence because of TNK-BP’s alleged failure to meet its conditions (‘BP under pressure on Kovykta’s venture threatened with loss of Russian licence’).⁸³

⁸² *Financial Times*, 23 April 2007, p. 10 (London 1st edition).

⁸³ *Financial Times*, 23 December 2006, p. 15 (London 1st edition).

Several articles in the *Financial Times* report on the complexities for TNK-BP to comply with the licence obligations. Three examples are outlined below:

*Under the terms of its Kovykta licence signed in 1992, TNK-BP was due to produce 9 billion cubic meters of gas this year. It will actually produce about 1.5 billion, rising to perhaps 2.5 billion by the end of the decade. TNK-BP says producing that much would mean it would have to flare off most of the gas because there is not enough local demand to make use of it ('Russia tightens grip on BP gas venture').*⁸⁴

*Russia raised pressure over the issue last month by declaring TNK-BP to be in violation of its licence to develop Kovykta. The Russian Natural Resources Ministry has given TNK-BP until April to start producing 9 billion cubic meters of gas as the licence stipulates or face having its licence revoked, a task TNK-BP says is impossible ('Gazprom tests ground for joint venture with BP').*⁸⁵

*The development of TNK-BP's vast east Siberian Kovykta field, which contains 2,000 billion cubic meters in gas reserves, has been stalled for years because Gazprom has blocked access to its main export pipeline. TNK-BP argues it has been unable to produce the 9 billion cubic meters of gas stipulated in its licence agreement without access to export markets. Local demand amounts to no more than 2.5bcm, it says ('Russia postpones TNK-BP licence decision').*⁸⁶

From the articles described above, I may conclude that the content in this package interprets the enforcement of formal regulations against IOCs in Russia as selective, and as serving other (political) interests than those intended by the law. Media articles arguing that compliance with the formal rules in Russia is impossible underscore the selectivity and sometimes absurdness of the Russian legal system, as '*TNK-BP and Rosneft*' shows:⁸⁷

⁸⁴ *Financial Times*, 10 February 2007, p. 15 (London 1st edition).

⁸⁵ *Financial Times*, 2 March 2007, p. 22 (London 1st edition).

⁸⁶ *Financial Times*, 2 June 2007, p. 19 (London 1st edition).

⁸⁷ *Financial Times*, 24 March 2007, p. 14 (London 1st edition).

As with Moscow's professed environmental concerns over Royal Dutch Shell's project in Sakhalin, its current indignance regarding TNK-BP's giant Kovykta gas field has more than a hint of the absurd about it.

7.2.2 'The violations leave the IOCs susceptible to legal action'

A second perspective appearing in the coverage of the *Financial Times*, although less frequently, is that the violations committed by Shell and BP provide the Russian authorities with an opportunity to enforce formal regulations. As distinct from the previous package, articles classified in this package stress the impact of the violations on the economy and/or ecology of Russia. However, in some articles it is argued that the sanctions imposed, such as the suspension of essential licences (which basically means that the whole project must be suspended), are not in accordance with what are seen as (minor) violations. As '*Cynical in Sakhalin; Russia must not re-negotiate oil contracts by the back door*' states:⁸⁸

Russia should address environmental concerns. But shutting down large foreign investors is not the way to do it. Environmental worries about Sakhalin-2 are real: both Western and Russian non-governmental organizations have been vocal opponents. But Russia's natural resources ministry has also argued that Sakhalin-2, and similar agreements signed with ExxonMobil and Total in the mid-1990s, are too generous to the Western oil companies (...) If the withdrawal of Shell's permit is politically motivated, it will undermine the rule of contract and the wider rule of law in Russia. Foreign investors, despite their lust for Russia's mineral wealth will be deterred (...) Foreign investment should not be at the expense of the environment and, if Shell has broken the rules, it should be fined or told to make good the damage. But the rules must be applied consistently and with due process: suddenly withdrawing permits is no way to treat a corner shop, let alone a Dollars 2 billion investor.

Or take '*Long on resources but short on clear rules*':⁸⁹

⁸⁸ *Financial Times*, 30 September 2006, p. 18 (London 1st edition).

⁸⁹ *Financial Times*, 10 October 2006, p. 3 (London 1st edition).

The Ministry of Natural Resources has accused Royal Dutch Shell, which owns a 55 per cent stake in Sakhalin 2, of causing enormous environmental damage and threatened to suspend an environmental permit issued three years ago. But the real reason for the attack on Shell, Russian politicians admit, has more to do with the rising costs of the project which is being developed under a production-sharing agreement. Shell announces a doubling of the costs of the project to Dollars 20 billion, which would delay the moment Russia starts receiving money from the project. Russia refuses to agree the cost rise and, says Shell, has instead changed the terms of the production-sharing agreement. Most observers say Russia has a legitimate cause for complaint, but using environmental issues as a pretext undermines its credibility.

Hence, the articles grouped in this package describe the enforcement practices conducted by Russian authorities as subject to informal interests – but these articles do not obscure the violations committed by IOCs or, as in the example above, avoid addressing the impact of budget overruns on Russia’s economy. Moreover, the articles in this package all attempt to view the issue both from both standpoints – the Russian one, and that of the IOC. The article ‘*Out on a limb*’ is a clear example.⁹⁰ This article identifies three grounds for regulatory pressure against Shell: cost overruns, resource nationalism and violations of environmental regulations:

Yet senior ministers readily concede that the crackdown on Sakhalin Energy – the holding company that is 55 per cent owned by Shell – was ‘detonated’ by matters that had little to do with the environment. German Gref, minister of trade and economic development, has described the main factor as rising costs. Last year Sakhalin Energy announced that these would be double the Dollars 10 billion it estimated in 2001. President Vladimir Putin is said to have been enraged: not only did Russia give Shell an advantageous deal but now it had to bear the burden of the price increase. Even worse was the timing of the announcement. Shell had just agreed to swap assets with Gazprom, giving Russia’s gas giant a 25 per cent stake in Sakhalin-2 in return for 50 per cent of Gazprom’s Siberian field. Gazprom felt tricked by the cost announcement and called the deal off last year. Analysts say the government had a point and Shell should have anticipated trouble.

⁹⁰ *Financial Times*, 23 November 2006, p. 15 (London 1st edition).

The article goes on to emphasize the operator's violations of environmental norms, and the difficulties the oil company faced in complying with Russian regulations:

The company was forced to spend Dollars 300m rerouting its offshore pipeline in order to avoid a feeding ground of the world's only population of grey whales. Ironically, the Russian government was against the change of the route. 'Regarding whales, we always had more problems with the ministry of natural resources than with the company itself', says Dmitry Lisitsyn of Sakhalin Watch, the main independent environmental group on the Island. The Kremlin has always treated environmental campaigners such as Mr. Lisitsyn as at best a nuisance, at worst a front for foreign intelligence services. The sudden change of heart coincided with the crackdown on Shell. Armed with photographs by Sakhalin Watch and flanked by reputable environmentalists and diplomats, Mr. Mitvol chartered a jet and flew to Sakhalin to show the extent of the damage. Stumbling on a dead fish at one of the rivers, Mr. Mitvol rejoiced at finding an evidence of Shell's 'barbaric' behaviour. One environmentalist accompanying him, who tried to explain that the fish's dead was a result of its natural two-year cycle, says the official took him aside and urged him to keep quiet. In fact, the salmon catch in Sakhalin this year was higher than expected. But the dead fish has become a regular feature of state television broadcast about Sakhalin-2. (...) The company (Sakhalin Energy) admits that not all its river crossings were perfect and admits to cutting down more trees on some steep hills than it was permitted. 'You can find violations – temporary spoil heaps, encroachments, some river crossings – but those are fixable problems', says Mr. Craig. Mr. Craig argues that building a pipeline under the sea would have been easier.

The impact of Shell's cost increases for the Russian economy is reported in several articles, among them 'BP/Shell/Russia':⁹¹

Russia's tightening of the screws on Shell's Sakhalin-2 project may be partly motivated by pride. Sakhalin-2 is operated under a long-standing production sharing agreement (PSA), typically used to shield foreign operators in less-stable regimes.

⁹¹ *Financial Times*, 19 September 2006, p. 18 (London 1st edition).

That seems anachronistic to Russia's politicians now that it has recovered from the humiliation of its 1998 debt crisis. Cost overruns at Sakhalin-2 have dented Shell's case, since PSA-terms allow for recovery of costs before the government sees a cent.

The article '*Shell learns cold reality of Russian deals*' even speaks of justice:⁹²

From the Russian point of view, by taking control over Sakhalin-2 the Kremlin was 'restoring justice' rather than expropriating assets, according to one senior Russian official. 'The problem is that in Russian psyche justice and law are not the same thing' the official said. During the past few weeks, Gazprom has been aggressively pushing down the evaluation of Sakhalin-2 project, arguing it should be set off against the cost increase and environmental damage it has caused.

In addition to Shell's conflict with the Russian authorities over the development of Sakhalin II, this package provides several examples of BP's dispute concerning the development of the Kovykta field, such as '*Blair to quiz Putin about BP and Shell*':⁹³

Russia has threatened TNK-BP with the loss of its licence for Kovykta, an important prospect for the company's long-term growth. In an interview text released yesterday, Mr. Putin signalled that TNK-BP had run out of time over Kovykta, demanding 'if the members of the consortium are doing nothing to meet licence obligations, how much longer do we have to tolerate this'. Under the terms of its licence, TNK-BP is supposed to produce 9 billion cubic meters of gas a year from Kovykta, but is producing less. Mr. Putin also brushed aside TNK-BP's argument that there would be no point producing more gas as it could not be either used locally or transported elsewhere. 'They know about it when they bid for the licence. They knew about these problems and possible restrictions. And they nevertheless bought the licence.

⁹² *Financial Times*, 22 December 2006, p. 19 (London 1st edition).

⁹³ *Financial Times*, 5 June 2007, p. 23 (London 1st edition).

7.2.3 ‘Regulatory pressure occurs in Russia, however, no explanation is provided’

The articles in this package report on the conflicts between both IOCs and the Russian authorities. However, the articles classified in this package provide no argument or explanation in the text that illuminates whether regulatory pressure or the enforcement of formal rules in Russia serves other interests than those intended by the law. The package consists of articles briefly referring to the conflicts between IOCs and the Russian authorities using terms such as ‘to force’, ‘to block’ and ‘to cede’, indicating that an enforcement strategy was used in order to achieve a particular objective. However, since these articles do not explain or address the motivations behind these strategies, they therefore cannot be classified as part of the package ‘the enforcement of formal regulations in Russia is subject to informal interests’. Therefore, these articles became their own package, stipulating that regulatory pressure against IOCs occur in Russia, without discussing or explaining the motivations behind these regulatory practices. The package in question often includes articles containing a few sentences that refer to the disputes between Shell, BP and the Russian authorities. An example is ‘*Litvinenko probe sours UK ties, says Russia*’ stating:⁹⁴

But a decision that could have soured relations between Russia and the UK further – removal of TNK-BP’s licence for the massive Kovykta gas field in Siberia because of alleged violations – failed to materialise yesterday after a regulator postponed talks on the topic for up to two weeks.

Further examples of articles constructing this package are ‘*EU invitation to Putin ‘diplomatic blunder*’, ‘*Oil group engineer shot dead in Siberia*’ and ‘*A new era of nationalism*’.⁹⁵

7.2.4 Other

Finally, a fourth package consists of all articles referring to Shell/BP’s operations at the Kovykta and Sakhalin II fields. However, as these articles lack references to enforcement

⁹⁴ *Financial Times*, 2 June 2007, p. 5 (London 2nd edition).

⁹⁵ ‘EU invitation to Putin “diplomatic blunder”’, *Financial Times*, 16 October 2006, p. 6 (London 1st edition), ‘Oil group engineer shot dead in Siberia’. *Financial Times*, 4 October 2006, p. 20 (London 1st edition) and ‘A new era of nationalism’, *Financial Times*, 19 June 2007, p. 2 (Survey edition).

practices, they could not be classified within any of the packages described above. Articles here often discuss developments in the oil and gas industry in Russia in more general terms. Also in this case, a group of articles with similar content and meaning was considered insufficient to form a separate package if there were fewer than three articles.

7.3 Shell and BP in *The Guardian*

Using the same methodology, the second part of this chapter examines the British newspaper *The Guardian* in order to assess the dominant storyline in relation to enforcement practices and regulatory pressure in Russia in connection with the conflicts between Shell/BP and the Russian authorities. The analysis of coverage in the *Financial Times* concluded that no newspaper articles reporting on enforcement practice or regulatory pressure were published before the summer of 2006. This applies to coverage in *The Guardian* as well.

7.4 The coverage of IOCs in *The Guardian*

Claims by Russian authorities against Shell and BP were not mentioned in *The Guardian* until the summer of 2006 with the publication of the article ‘*Moscow puts legal pressure on Shell to halt pipeline*’, on 4 August 2006. The results of a search in the section ‘business’ in *The Guardian*’s digital archive with the terms ‘Shell AND Russia’, ‘BP AND Russia’, ‘Total AND Russia’ and ‘Exxon AND Russia’ are shown in Figure 11. A broad selection strategy was employed in order to avoid omitting relevant articles from the search results. Articles considered irrelevant were excluded, such as those reporting stock exchange results or articles where the word ‘shell’ was used in other senses. Also excluded were articles reporting on Shell’s other operations, such as those in Nigeria and Shell’s investment in the Salym oil fields in the Khanty-Mansiysk region in Russia, or articles reporting on rumours of a merger between Shell and BP. Because BP’s dispute regarding the development of the Kovykta natural gas field is part of a broader conflict between the Russian authorities and the shareholders within BP’s joint venture with TNK, articles on issues concerning TNK-BP’s operations in Russia in general have been included. However, in order to be selected, articles had to refer to Shell’s operations at Sakhalin or TNK-BP’s operations in Russia specifically. Not all articles include page numbers, as several were published on the internet on Sunday’s.

As concluded in Chapter 5, not only Shell and BP, but also ExxonMobil and Total faced pressure from the Russian authorities.⁹⁶ However, as with the results of the analysis of the *Financial Times*, the number of articles published in *The Guardian* reporting on Shell and BP was significantly higher than the number of articles reporting on Total and ExxonMobil's operations in Russia during the period under study. One explanation might be that Shell and BP deliberately used the media as a medium to express their concerns regarding their relationship with Russian authorities – i.e. the investment climate in Russia and the use of regulatory practices against private oil companies. This explanation accords with the results of the interviews presented in Chapter 4 and 5, and will be explained in more detail in Chapter 9.

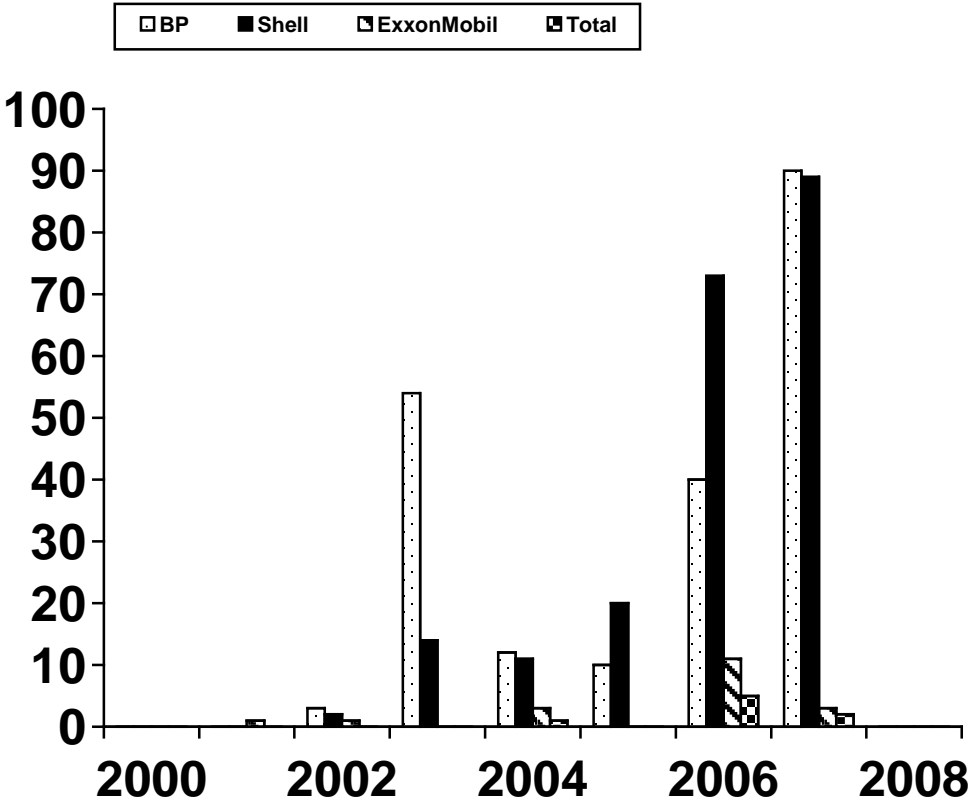


Figure 11: *The Guardian*: number of articles covering various IOC operations in Russia 2000–2008.

⁹⁶ Krysiak argues that the strength, competence and composition of the Sakhalin I consortium in addition to the unsolved questions surrounding the project's future gas exports explain the reluctance of the Russian authorities to alter the project's management or ownership structure (Krysiak 2007:18).

7.5 Storylines on enforcement practices and regulatory pressure

In total 51 articles were selected in order to examine the storyline in the period 2006–2008. The content of the articles was grouped into five packages, as shown in Figure 12. Each package represents a group of articles with a similar meaning or content. The first article was published on the 4 August 2006, the last article on the 21 October 2007. The articles report on the regulatory pressure exerted by the Russian authorities, represented by environmental watchdog Rospirodnadzor and/or the Kremlin against BP's joint venture with TNK and Sakhalin Energy, where Shell was the major shareholder until December 2006.

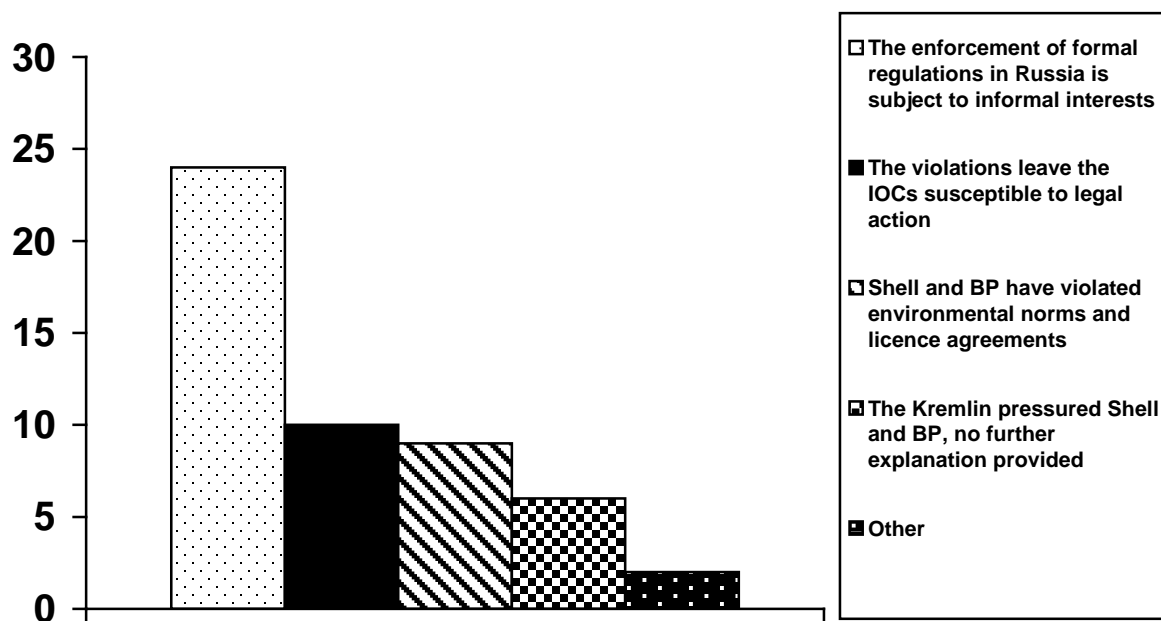


Figure 12: Analysis of articles published in *The Guardian* 2006–2008 divided into five packages (total number of articles: 51).

In the following, the packages are explained individually and illustrated with examples. Appendix III gives an overview of all articles analysed.

7.5.1 ‘The enforcement of formal regulations in Russia is subject to informal interests’

The greatest number (24 out of 51) of relevant articles published in *The Guardian* during the period under study describe enforcement practices against IOCs in Russia as subject to informal interests rather than presenting a deeper interpretive package where the enforcement of formal rules is exerted objectively. The content and meaning of the articles in this package argues that enforcement of regulations is exerted in order to ensure state control over the energy sector. Moreover, articles in this package refer to a wider campaign by the Kremlin, linking regulatory pressure against for instance Shell with enforcement campaigns against other foreign companies, such as Peter Hambro, BP and ExxonMobil, and political developments such as the Ukraine/Russia gas disputes in March 2005 and October 2007.

What the articles in this package have in common is that they indicate that the political objective of the Russian authorities is to take control over the energy supply or strengthen their grip on the oil and gas industry. Environmental breaches or the violations of licence agreements by IOCs are not mentioned or noted only in passing. The packages ‘the enforcement of formal regulations in Russia is subject to informal interests’ and ‘The violations leave the IOCs susceptible to legal action’ are distinct: an article could theoretically report that the enforcement of regulations is selective without even referring to the environmental record of the ‘offender’ involved. Instead, the focus is to ascertain the motivations and objectives behind the enforcement of formal rules. Together, both packages outweigh the other packages of relevant articles published in *The Guardian* during the period under study.

Articles grouped in the first package often refer to the assumption that the objective of the Kremlin is to strengthen control over the energy sector. To mark this point, articles often refer to the opinions of analysts and observers, in addition to featuring stirring and sensational headlines, like ‘*Russia tries to rein in foreign oil firms*’ or ‘*Investors fear economic cold war as Kremlin eyes Western asset*’.⁹⁷ These and similar titles leave no doubt that the enforcement of formal rules, was not the Kremlin’s main objective: otherwise, the focus would have been

⁹⁷ ‘Russia tries to rein in foreign oil firms’, *The Guardian*, 19 September 2006, p. 22 and ‘Investors fear economic cold war as Kremlin eyes Western asset’, *The Guardian*, 20 September 2006, p. 25.

more on the environmental performance of the IOC, as seen in *'Shell hailed troubled project as world model'* or *'Fears over Sakhalin-2 in Shell emails'*, discussed later on.⁹⁸

One example of the view that enforcement of environmental regulations was not the objective of Russian authorities is found in *'Shell profits beat expectations and fuel City's hopes of recovery'*:⁹⁹

Some analysts have suggested Russia could be using environmental issues to pressure Shell and its partners into amending Sakhalin's original development plan, which offers the country relatively little money until the developers have covered their costs. There have also been reports that Russia could be trying to pressure Shell to provide better terms in an asset swap that would see state-controlled Gazprom take a stake in Sakhalin in exchange for Shell acquiring a holding in a Siberian field.

Furthermore, in *'\$20bn gas project seized by Russia'* I find:¹⁰⁰

Shell is being forced by the Russian government to hand over its controlling stake in the world's biggest liquefied gas project, provoking fresh fears about the Kremlin's willingness to use the country's growing strength in natural resources as a political weapon...But other senior politicians in Moscow had no doubt Shell was being harassed into reducing its 55 per cent stake in Sakhalin-2 to something close to 25 per cent through relentless pressure from ministries. But even non-governmental organizations have expressed surprise at the way the Russian authorities have taken up environmental issues since the summer after taking little interest before.

Another example indicating that enforcement practices in Russia are subject to informal interests can be found in *'Russia gives out mixed messages'*,¹⁰¹ where Kremlin pressure directed against Shell is seen as part of a wider campaign against foreign oil companies:

⁹⁸ *'Shell hailed troubled project as world model'*, *The Guardian*, 27 September 2006, p. 25 and *'Fears over Sakhalin-2 in Shell emails'*, *The Guardian*, 6 November 2006, p. 23.

⁹⁹ *The Guardian*, 27 October 2006, published on the internet (accessed January 2011).

¹⁰⁰ *The Guardian*, 12 December 2006, p. 1.

¹⁰¹ *The Guardian*, 26 September 2006, p. 26.

Some interpret the permit issue as the latest attempt by Moscow to wrest back control of oil and gas assets held in the private sector while Gazprom acts as a political arm of the Kremlin. There have also been local reports that ExxonMobil's Sakhalin-1 oil project could face a similar fate.

A similar perspective is suggested in 'Kremlin may force BP to share oil venture':¹⁰²

The problems have been interpreted by many in the West as the latest turn of the screw on foreign and privately owned local oil companies which began with the effective liquidation of Yukos and continued with the squeezing of Shell to cede part of the Sakhalin-2 gas project to Gazprom.

Moreover, according to 'Investors fear economic cold war as Kremlin eyes Western assets' the objective of the Kremlin is to ensure state control, rather than the punishment of 'offenders' for violating formal regulations.¹⁰³ The article comments:

In recent years, he [referring to President Vladimir Putin], has wrestled back into state control much of Russia's reserves, which were sold off cheaply in the flawed privatisation process that created the oligarchs of the Yeltsin presidency. He has already targeted some of the super-rich oligarchs who benefited from the sell-offs. Now the deals with foreign companies signed in the mid-1990s, when oil prices were low, appear to be under attack.

Similar arguments are made two articles published in autumn 2006 'Shell beats forecasts' and 'Russian threat to sue Shell for billions over Sakhalin'.¹⁰⁴

BP and Shell are reluctant to give direct comments in the media on the subject of their alleged violations of formal regulations. Statements are typically restrained, as shown by the

¹⁰² *The Guardian*, 20 March 2007, p. 26.

¹⁰³ *The Guardian*, 20 September 2006, p. 25.

¹⁰⁴ 'Shell beats forecasts'. *The Guardian*, 26 October 2006, published on the internet (accessed January 2011) and 'Russian threat to sue Shell for billions over Sakhalin'. *The Guardian*, 11 November 2006, p. 38.

following comment by a Shell spokesperson on the revoking of its environmental permit in October 2006:¹⁰⁵

Although there have been various environmental challenges on this project, these have been tackled and largely overcome... We are confident there are no valid grounds to revoke the order 600 (environmental permit).

However, when the deals are closed – in other words, once Gazprom has entered the project and acquired a significant share – company representatives gladly report statements such as the following by TNK-BP CEO, Bob Dudley, in ‘BP retreats from Russia with £400m’:¹⁰⁶

Yesterday, Bob Dudley described the deal as ‘an important development’. He added: ‘We look forward to broadening our working relationship with Gazprom and BP and further developing our Russian asset base as well as securing access to material additional opportunities.’

7.5.2 ‘The violations leave the IOCs susceptible to legal action’

A total of 10 out of 51 articles published in *The Guardian* during the period under study (2006–2008) indicate that enforcement practices are subject to informal interests without, however, omitting mention of the alleged violations of formal regulations. The articles in this package should be distinguished from those in the package mentioned above. Articles in this cluster stress, for instance, Shell’s poor environmental record at Sakhalin II, or the impact of budget overruns for the Russian economy. A clear example of this perspective is provided in ‘Rouble trouble’:¹⁰⁷

Another week, another attack by the Kremlin on Shell and TNK, the Russian oil business half-owned by BP. The British companies are accused with increasing regularity of mishandling their lucrative oil and gas holdings in Russia. Some of the

¹⁰⁵ *The Guardian*, 19 September 2006, p. 22.

¹⁰⁶ *The Guardian*, 23 June 2007, p. 34.

¹⁰⁷ *The Guardian*, 5 November 2006 published on the internet (accessed January 2011).

criticism might even be justified, but most observers believe that Moscow's real agenda is simply to remind the foreigners who is the boss.

'Moscow puts legal pressure on Shell to halt pipeline,' describes NGO criticisms of the environmental impact of Shell's project, but also a wider Russian campaign designed to strengthen the Kremlin's grip on the energy sector:¹⁰⁸

Shell has suffered a doubling of costs on Sakhalin 2, which provides for Russia's first liquefied natural gas (LNG) export plant at the southern end of Sakhalin Island, off the east of the country. The pipeline is needed to bring gas from offshore fields further north. The route has already been changed to placate environmentalists angry that it goes near breeding grounds of endangered western grey whales. The move helped to double the costs of Sakhalin 2 but did little to halt the wave of criticism from green activists. Yesterday Friends of the Earth (FoE) attacked the Royal Bank of Scotland, which it says will today report huge profits on the back of supporting projects such a Sakhalin 2. Some industry experts were surprised at the statements from the natural resources ministry saying the pipeline had been approved by the Russian government. They wondered whether the move could be part of a wider negotiating ploy by the Russian state whose Gazprom company is trying to persuade Shell to sell its 25 per cent of Sakhalin in return for a 50 per cent holding in its Siberian Zapolyarnoye field.

The majority of the articles grouped in this package refer to Shell's operations at Sakhalin II, rather than BP's dispute over the Kovykta natural gas field. Comments from Shell in the media are rare: however, in *'Kremlin warns of charges in Sakhalin gas inquiry'* the company comments remarks on the investigations initiated by the Russian authorities over environmental violations:¹⁰⁹

Sakhalin Energy, which is responsible for the scheme, the world's biggest liquefied natural gas project, said it was determined to resolve all the issues raised by the latest environmental inspection and to ensure that the transparency and accountability

¹⁰⁸ *The Guardian*, 4 August 2006, p. 24.

¹⁰⁹ *The Guardian*, 26 October 2006, published on the internet (accessed January 2011).

demonstrated by Sakhalin-2 can be seen as a benchmark for future energy developments in Russia.

7.5.3 ‘Shell and BP have violated environmental norms and licence agreements’

During the period under study a total of 9 out of 51 articles in *The Guardian* present the perspective that Shell and BP violated environmental norms and licence agreements. Articles in this package emphasize the (environmental) violations of both IOCs, rather than focusing on the political interests or objectives behind enforcement practices in Russia. This package can be distinguished from the previous packages in that there are no references that could impute selective enforcement practices on the part of the Russian authorities. ‘*Fears over Sakhalin-2 revealed in Shell emails*’ is a clear example of the content in this package:¹¹⁰

Shell was warned more than four years ago by one of its own senior officials that he had major reservations about safety issues inside the troubled Sakhalin-2 development in eastern Russia. Internal Shell emails sent to the then technical director of the Shell-led Sakhalin Energy company raise fears about the size of wells, drilling in an earthquake area, and an unforgiving schedule.

‘*New fears of state takeover of BP gas field*’, provides an example of a similar argument concerning BP’s dispute over development of the Kovykta field:¹¹¹

Vladimir Putin turned up the pressure on Britain’s biggest company yesterday saying it was intolerable that BP and its local partners were ‘doing nothing’ to meet their obligations by fully developing Kovykta, a huge gas field in Siberia. BP has come under increasing pressure over Kovykta with allegations that the operating company it controls is not meeting the levels of gas supplies it promised.

¹¹⁰ *The Guardian*, 6 November 2006, p. 23.

¹¹¹ *The Guardian*, 5 June 2007, p. 26.

7.5.4 ‘The Kremlin pressured Shell and BP, no further explanation provided’

In total, 5 out of 51 articles are classified in *The Guardian* selected for analysis here are classified in the package ‘The Kremlin pressured Shell and BP, no further explanation provided’. The content and meaning of these articles refer to the disputes between the IOCs and the Russian authorities, but without seeking to explain whether the *pressure* or *force* was the result of a manipulative game behind the scenes, or of poor environmental performance or failure to comply with licence agreements. There may be a few sentences referring to the dispute(s), in an article generally focusing on other issues, like the problems faced by IOCs in acquiring new oil reserves. The following quote is taken from ‘*Big oil may have to get even bigger to survive*’:¹¹²

The Russian government felt happy to sign production-sharing agreements with multinationals in the mid-Nineties (allowing them revenues from projects until their costs are paid off, when income is split) when the oil price was low and the national coffers empty, but it is now unhappy with the deals and is exerting pressure on a number of projects – to the detriment of Shell, Exxon and Total.

7.5.5 Other

Finally, articles employing a perspective that falls outside the other packages outlined above have been placed in the package ‘other’. Here and elsewhere throughout this study, a group of newspaper articles was considered insufficient to form a package when there were fewer than three articles.

7.6 Conclusion

This chapter has presented the coverage in the *Financial Times* and *The Guardian* during the period under study (2006–2008). The main objective has been to answer the second subsidiary research question, on how the Western media have interpreted enforcement practices and regulatory pressure against IOCs in Russia, as outlined in Chapter 1. In the

¹¹² *The Guardian*, 29 October 2006, published on the internet (January 2011).

Financial Times, we saw that the dominant storyline was of the enforcement of formal regulations in Russia being subject to informal interests. The majority of the articles published here (111 out of 139, including the package presenting IOC violations as rendering the companies susceptible to legal action) interpret enforcement practices and regulatory pressure in Russia as subject to informal interests. Consequently, the motivation for enforcing formal regulations is presented as being to serve personal or political interests, rather than to punish offenders for violating formal rules, or to secure compliance with formal regulations.

The majority of the articles published in *The Guardian* involved the perspective that the enforcement of formal regulations in Russia against both IOCs is subject to informal interests, rather than aimed at securing compliance with environmental norms or licence agreements. Articles tended to deal with Shell's problems at Sakhalin, with less coverage of BP's failure to comply with licence agreements at the Kovykta gas field. Only a few articles interpreted the practices of the Russian authorities as being impartial, objective enforcement where the authorities punish offenders for violating formal rules.

Moreover, the results presented in Figures 9 and 11 (differences in media coverage between Shell, BP and other IOCs operating in Russia) showed that attention to Shell's and BP's operations in Russia, in terms of the number of articles published, was significantly higher compared to those of other IOCs such as Total and ExxonMobil. Here we should recall the conclusions of the interviews presented in Chapters 4 and 5: that Shell and BP after being accused of violating formal regulations, deliberately launched a public debate aimed at pressuring the Russian authorities.

However, the results presented in Figures 9 (*Financial Times*) and 11 (*The Guardian*) are insufficient to conclude whether the media coverage in these British newspapers was been directly influenced by Shell and BP. Therefore, in Chapter 9 I examine the media coverage of this chapter in combination with the strategies selected by Shell (Sakhalin Energy) and BP in more detail. Now, in Chapter 8, we turn to the dominant storylines in the two Dutch newspapers *Financieel Dagblad* and *De Volkskrant*, employing the same approach as with the British papers.

8. Shell and BP in Dutch Newspapers

This chapter examines the media coverage of two leading Dutch newspapers: *Financieel Dagblad* and *De Volkskrant*. The coverage of *Financieel Dagblad* is outlined in sections 8.1 and 8.2, and *De Volkskrant* in sections 8.3–8.5. Conclusions follow in section 8.6.

8.1 Coverage of IOCs in *Financieel Dagblad*

The period covered here is from September 2006 until January 2008, as the first article in *Financieel Dagblad* that mentioned conflicts between Shell/BP and the Russian authorities was published on 19 September 2006.¹¹³ The last article referring to these conflicts was published on 3 November 2007. The results of a search in the digital archive of *Financieel Dagblad* with the terms ‘Shell AND Russia’, ‘BP AND Russia’, ‘Total AND Russia’ and ‘Exxon AND Russia’ are presented in Figure 13. This figure shows that the majority of the articles were published during 2006–2007. Furthermore, the coverage of Shell and to a certain degree BP, in terms of the number of articles analysed exceeds the number of articles reporting on the operations of Total and ExxonMobil’s in Russia.

8.2 Storylines on enforcement practices and regulatory pressure

In total 56 relevant articles from *Financieel Dagblad* were examined in detail. They report on enforcement practices and regulatory pressure exerted by the Russian authorities against BP’s joint venture with TNK and Shell’s project on Sakhalin. Each article, usually on the basis of the headline but sometimes of the meaning, allowed the creation of different packages, each representing its specific discourse. The meaning or headline of the article creates and shapes a certain perspective. As throughout this study, each perspective is represented in a single package, consisting of a group of articles with a similar content/headline.

¹¹³ ‘Russia shuts down Shell-project’ (Rusland legt Shell-project stil), *Financieel Dagblad*, 19 September 2006, p. 1.

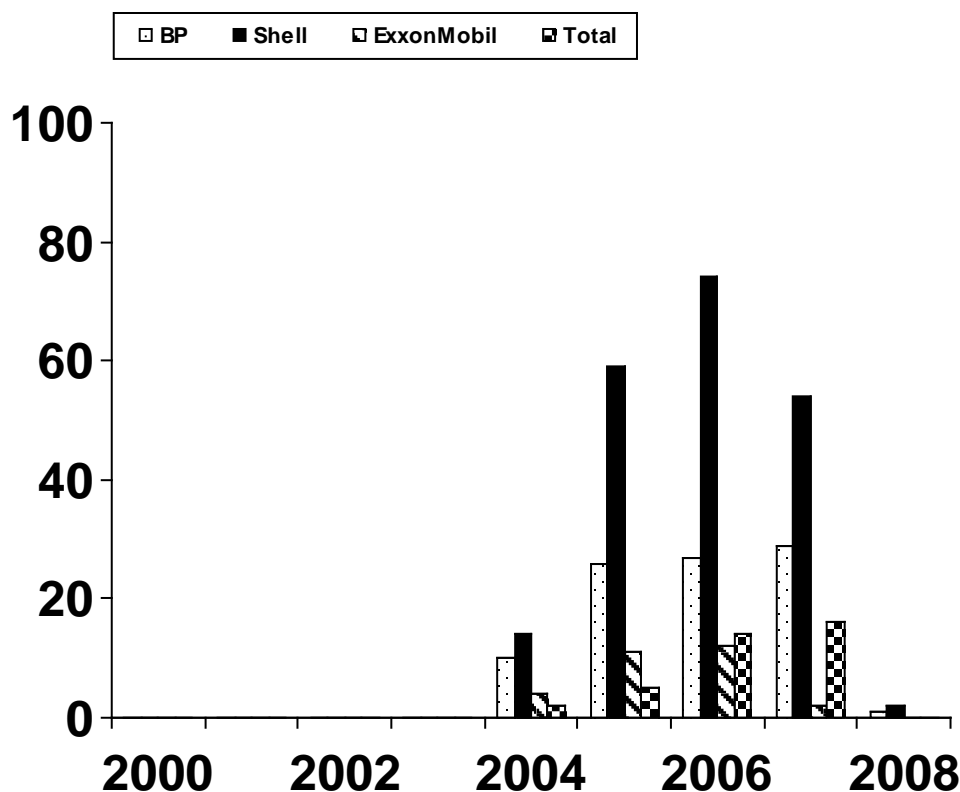


Figure 13: *Financieel Dagblad*: number of articles covering various IOC operations in Russia 2000–2008.¹¹⁴

The package ‘other’ consists of articles framing an argument that is insufficiently supported by other articles, so that the number is not enough to construct a separate package. The result is shown in Figure 14. Appendix IV provides an overview of all selected articles. The packages presented in Figure 14 are explained in detail below, with examples. The original Dutch headlines of each article can be found in the corresponding footnote. All translations of excerpts from Dutch articles presented here and throughout this study were done by the present author.

¹¹⁴ The databank of *Financieel Dagblad* provides access only to newspaper articles from 1 September 2004, so articles published between January 2000 and September 2004 are excluded in this figure.

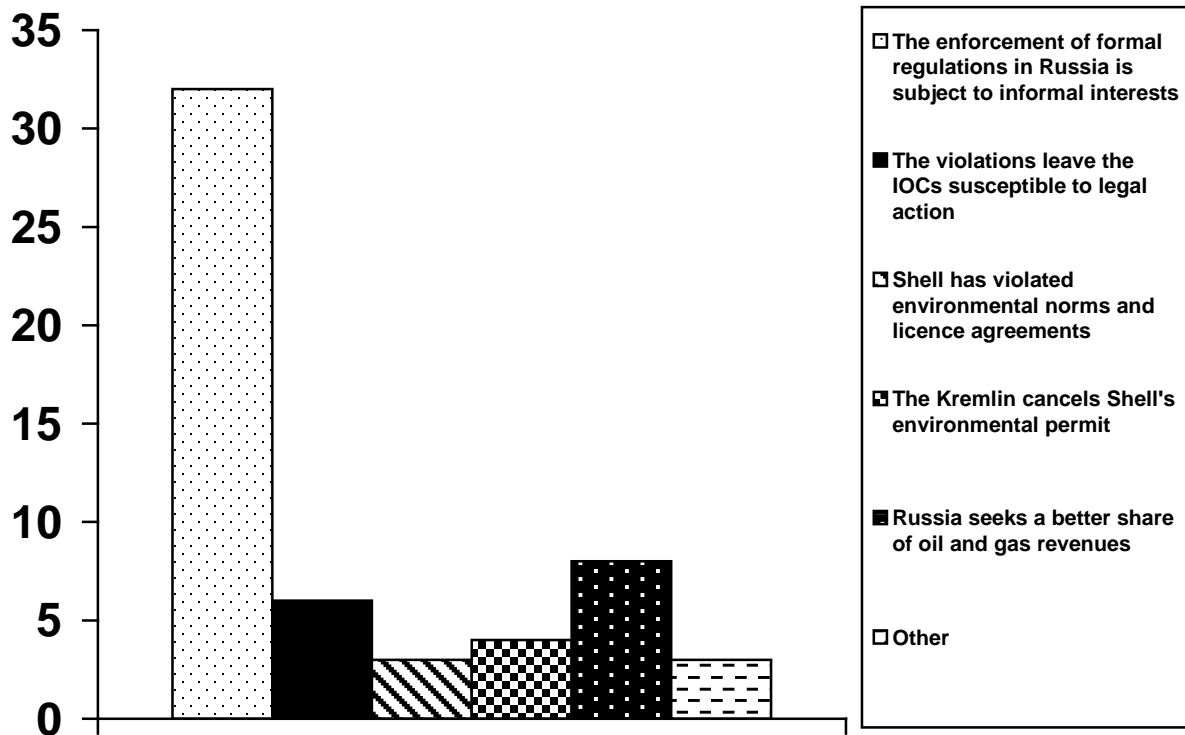


Figure 14: Analysis of articles published in *Financieel Dagblad* 2006–2008 divided into four packages (total number of articles: 56).

8.2.1 ‘The enforcement of formal regulations in Russia is subject to informal interests’

The majority of the articles published in *Financieel Dagblad* during the period under study have the perspective that the enforcement of formal regulations in Russia is subject to informal interests. The content in these articles rarely deals with the violations held to have been committed by the IOCs, or the impact of these violations on the environment or for the Russian state budget. Rather, over half (32 out of 56) of the articles in this package suggest that other motives lay behind the enforcement of formal regulations or regulatory pressure (threatening to enforce these rules) – such as regaining control over the energy sector, providing Gazprom with access to oil and gas projects, or obtaining better fiscal terms in a negotiation process between the Kremlin and IOCs. There are frequent references to comments made by observers and experts, as in ‘*Criticism of stopping Shell project in Russia*’:¹¹⁵

¹¹⁵ ‘Criticism of stopping Shell project in Russia’ (Kritiek op dwarsbomen Shell-project in Rusland), *Financieel Dagblad*, 29 September 2006, p. 13.

Observers argue that with this step, Moscow is putting pressure on Shell in order to enforce better terms in relation to the exploitation of natural gas. The terms in the PSA between Shell and the Russian state were agreed during a time when oil prices were low. Since there is no legal basis to terminate the contract, the Kremlin – stimulated by increasing energy prices – would use environmental grounds to force Shell to make concessions.

According to this perspective, the enforcement of formal regulations has little to do with protecting the environment. Instead, there are other, political, motives, as captured by ‘*Europe can resist Russia*’:¹¹⁶

The truth is that Russian regulators couldn’t care less for the environment and the health or welfare of Russians. They demand that energy companies shift from the use of gas to the use of more expensive coal. The combustion of coal affects the environment and human beings. In this way, the Russian government seeks to ensure that Gazprom complies with international agreements at the cost of its own people. As for Sakhalin, Gazprom assisted by blackmail procedures by the Russian authorities, demands the ‘exchange of assets’ to gain a blocking majority in Sakhalin II, in addition to major interests in Shell’s North American terminals for liquid gas.

‘*Shell’s gas exploitation in trouble*’ also indicates that environmental grounds were a strategic move, rather than one aimed at protecting the environment:¹¹⁷

A positive effect for Shell is that the environmental issues on Sakhalin are moving to the background. ‘The fundamental problems of the project’, as Putin said on Thursday evening, ‘should be considered resolved’. He implicitly indicated that the environmental claims that pressured Shell were part of a negotiation strategy.

¹¹⁶ ‘Europe can resist Russia’ (Europa kan Rusland weerstaan), *Financieel Dagblad*, 30 September 2006, p. 7.

¹¹⁷ ‘Shell’s gas exploitation in trouble’ (Gaswinning Shell in de knel), *Financieel Dagblad*, 23 December 2006, p. 1.

A second group of articles in this package link the selective enforcement of formal regulations against Shell to Russia's foreign energy policy, as '*Sakhalin catalyst for energy dialogue*':¹¹⁸

Sakhalin fits in a process where Moscow is strengthening its grip on the gas sector and using energy as a political weapon in its foreign policy more frequently. Russia shows many faces. On the one side there is a great need for foreign investment. On the other side, investments in Russia are risky as a result of non-transparency in the legal system and political instability. Russia is a country where 240 billion dollars' worth of bribes are paid annually: just as much as the entire Russian state budget.

Most of the articles published in *Financieel Dagblad* deal with Shell's problems concerning the development of Sakhalin II. Only four articles – all of them in the package that sees the enforcement of formal regulations in Russia as subject to informal interests – report on BP's dispute with the Russian authorities over the Kovykta natural gas field. In '*BP in irksome hug of Russian bear*', for example, the newspaper comments:¹¹⁹

The Ministry of Mining Resources is seeking to revoke the permit because TNK-BP could not comply with the production demand of 9 billion m³ [of gas]: The company responds that, despite all efforts, no more than 2 billion m³ can be sold on the consumer market. It is rather cold comfort that not only BP is facing these kind of conflicts. Shell lost control over Sakhalin II to Gazprom and provided the [Russian] state with a fixed profit after legal pressure due to the violation of environmental laws. In the neighbouring Sakhalin I, ExxonMobil is struggling with alleged violations of environmental laws and the rights for exploitation of new reserves.

Several Shell representatives are quoted in *Financieel Dagblad*. The article '*Shell needs to take a look at it*' includes a comment by Shell on the cancellation of its environmental permit:¹²⁰

¹¹⁸ '*Sakhalin catalyst for energy dialogue*' (Sachelin Katalysator voor energiedialoog), *Financieel Dagblad*, 14 November 2006, p. 9.

¹¹⁹ '*BP in irksome hug of Russian bear*' (BP in knellende omhelzing van Russische beer), *Financieel Dagblad*, 2 June 2007, p. 11.

¹²⁰ '*Shell needs to take a look at it*' (Shell moet er nog eens goed naar kijken), *Financieel Dagblad*, 20 September 2006, p. 13.

Surprise and indignation must be great at Shell. After a so-called State Environmental Expert Review, sixty recommendations have been followed up in order to solve the environmental problems on the island. ‘The majority of the recommendations have been implemented and the rest is in progress’, says a Shell representative. ‘Therefore, every ground for the cancellation of the environmental permit disappears.’

I note that Shell does not acknowledge the alleged violation of environmental regulations. Moreover, the exact motivations behind these accusations remain unclear to the then-CEO Jeroen van der Veer, according to the same article:

When the Russian Academy of Natural Sciences in the end of May reported on delays and cost overruns, the alarm bells started to ring at van der Veer’s head quarters in The Hague. Not only Shell but also the joint ventures of US ExxonMobil and French Total felt uncomfortable as a result of the following statement: ‘The academy requests an increase in the quota of Russian enterprises in these ventures to 51 per cent, as one of the efforts to increase the efficiency of the total production contracts’. Since then, the Ministry of Natural Resources has expanded its pressure on Shell. The Kremlin, however, blows hot and cold. ‘Russia respects her contracts’, says the Russian Minister of Energy Victor Khristenko. That message was a relief for van der Veer. ‘Most people understood this as an indirect reference to the publication of the Academy of Natural Sciences. As I did.

8.2.2 ‘The violations leave the IOCs susceptible to legal action’

In total six articles argue that Shell and BP’s behaviour by violating formal regulations, justified the enforcement of those rules by the Russian authorities while at the same time giving them the opportunity to secure other interests than those intended by the law. These articles can be distinguished from those in the previous package because articles in this package do not omit mention of the violations committed by both IOCs. For instance, they explicitly take up the environmental impact of Shell’s operations, or poor financial

management. ‘*Shell pushed aside in Russia*’ provides an example of this perspective.¹²¹ The article focuses on Shell’s internal problems, in terms of project and financial management.

The schedules for the delivery of LNG and the budget became hard to realize. This occurred at a bad moment for Shell. Shell’s production growth was under pressure during 2002 and 2003. The intended expansion was not realized and Shell needed new oil fields. Meanwhile, the problems at Sakhalin were recognized too late. After the reserves’ scandal in 2004, which shook Shell to its foundations, a clean sweep was made, also for the Sakhalin II project. The management was replaced and all budgets were evaluated. The latter is a process for the long term.

After focusing on Shell’s internal operations in the first part, the article goes on to comment the company’s cost overruns:

July was not even over when Shell presented the results of the evaluation of the Sakhalin II budget. The project would cost USD 10 billion and not 20 billion. Furthermore, the oil and gas would not be delivered from 2007 but from 2008. The result was that the deal [before Shell announced the cost overruns, Shell and Gazprom had agreed upon an asset swap providing Shell a 50 per cent share in the Zapolyarnye oil field and Gazprom a 25 per cent share in Sakhalin II] was at stake. Since then, the Kremlin has refused to approve the revised budget. According to the PSA, the budget excesses are chargeable to the Russian state, and Gazprom (the state) is reluctant to give Shell a 50 per cent stake in the valuable Zapolyarnye field. Exhausting negotiations followed. The environmental permit at Sakhalin II was under pressure and billion dollar claims targeted Shell. The result: Gazprom is to take control of the consortium.

8.2.3 ‘Shell has violated environmental norms and licence agreements’

The third package consists of a small group of articles reporting on the violations of environmental rules and licence agreements. Here it is noted that Shell has violated environmental norms and licence agreements, rather than framing Shell as the victim of

¹²¹ ‘Shell pushed aside in Russia’ (Shell aan de kant geschoven in Rusland), *Financieel Dagblad*, 22 December 2006, p. 17.

selective enforcement practices. Only three articles in *Financieel Dagblad* offer this perspective, and there are no references or perspectives discussing the motivations behind enforcement practices. An example is found in ‘*Shell wants grip on oil sand in Canada*’, which states:¹²²

Russian authorities blame Shell for violating environmental laws in the so-called Sakhalin II project. Furthermore, President Putin of Russia thinks that Shell deliberately increased the costs of the project.

Articles in this package often devote only a few sentences or brief mentions of the disputes around Sakhalin II. No articles discuss BP operations in Russia.

8.2.4 ‘The Kremlin cancels Shell’s environmental permit’

Four out of 56 articles provide no interpretation whether enforcement practices in Russia are subject to informal interests or whether Shell or BP violated the rules. The texts of these articles simply report that Shell’s environmental permit for Sakhalin II has been annulled, perhaps with a few sentences on the situation on Sakhalin in the aftermath of the dispute. Examples can be found in the article ‘*Shell’s activities on Sakhalin continue*’.¹²³

8.2.5 ‘Russia seeks a better share of oil and gas revenues’

Unlike the coverage in the *Financial Times* and *The Guardian*, coverage in *Financieel Dagblad* includes a perspective that President Putin presumably operating on behalf of the Russian government, is seeking a better share of oil and gas revenues. This is to be achieved either through financial compensation or through involving Russian state actors in oil and gas projects like Sakhalin II. The articles in this package do not emphasize the selectivity concerning the enforcement of formal rules, mentioning it at most only in passing. The conflict between Shell and the Russian authorities is portrayed as a negotiation process aiming at securing Russian participation and increasing state revenues from Sakhalin II. No articles in

¹²² ‘Shell wants grip on oil sand in Canada’ (Shell wil grip op teerzand in Canada), *Financieel Dagblad*, 24 October 2006, p. 15.

¹²³ ‘Shell’s activities on Sakhalin continue’ (Werkzaamheden Shell op Sachalin gaan door), *Financieel Dagblad*, 26 September 2006, p. 11.

this package address BP's conflict. 'Wine' provides an excellent example of this perspective:¹²⁴

President Putin of Russia is threatening to withdraw Shell's environmental permit if the Kremlin is not able to obtain more profits from the enormous oil and gas project that Shell is overseeing on the island of Sakhalin. At least, that's the perspective that has been framed in the West in recent days. How would Putin think? He is proud of the renewed power that Russia has gained thanks to a strong energy sector. During the turbulent 1990s, Yeltsin gave several foreign oil companies carte blanche in the energy sector. As a result, Shell, ExxonMobil and Total achieved lucrative contracts. Yeltsin was otherwise afraid that Russia would not be able to attract foreign capital (and expertise). Putin is horrified at this heritage. In the meantime, Gazprom is becoming a world player on the energy market. The state energy company, controlled by the Kremlin, wants to be involved in projects such as Sakhalin. Therefore, Putin is unhappy with Shell's lucrative terms. A disproportionate share of the profits goes to The Hague and Tokyo, and too little ends up in Yuzhno Sakhalinsk and Moscow. Putin aims to establish a new deal with Shell, a development common in other oil- and gas-producing states according to an interview with Jeroen van der Veer at the previous article. Putin demands that Russia and Shell divide the profits of the project equally. The high energy prices and the high level of expertise in Russian companies justify a new agreement, claims Putin. Moreover, Gazprom should play a prominent role in the consortium, and the project should get a national character. Participation of Gazprom [in the Sakhalin II project] is in the national interest. Then the cost overruns: According to Putin, profits from the Sakhalin II project for Russia were already low. According to the current agreement, a 10 billion USD cost overrun means that state revenues for Russia from the project will decrease by a similar amount. Putin will make it clear that the cost overruns are the result of poor project management, for which Shell is responsible. Putin will claim that a solution should be found which is acceptable for both parties: a solution that justifies Russia's ambitions and Shell's investments.

¹²⁴ 'Wine' (Wijn), *Financieel Dagblad*, 21 September 2006, p. 15.

8.2.6 Other

As elsewhere in this study, the package ‘other’ consists of articles framing a perspective that is not supported by enough other articles to constitute a separate package.

8.3 Shell and BP in *De Volkskrant*

The following sections present the media coverage from the second Dutch newspaper *De Volkskrant*. The objective is to examine how this newspaper interprets enforcement practices against IOCs by assessing the dominant storyline during the period under study. This period starts with the publication of an article dealing with regulatory pressure exerted by the Russian authorities against Shell published on 6 September 2006.¹²⁵

8.4 Coverage of IOCs in *De Volkskrant*

The results of a search in the digital archive of *De Volkskrant* with the terms ‘Shell AND Russia’, ‘BP AND Russia’, ‘Total AND Russia’ and ‘Exxon AND Russia’ are presented in Figure 15. This figure shows that the number of publications reporting on Shell and to a certain degree BP exceeds the number of articles reporting on Total and ExxonMobil’s operations in Russia, as was also the case with the other newspapers analysed.

¹²⁵ ‘Russia nags Shell on Sakhalin’ (Rusland zit Shell dwars op Sachalin), *De Volkskrant*, 6 September 2006, p. 7.

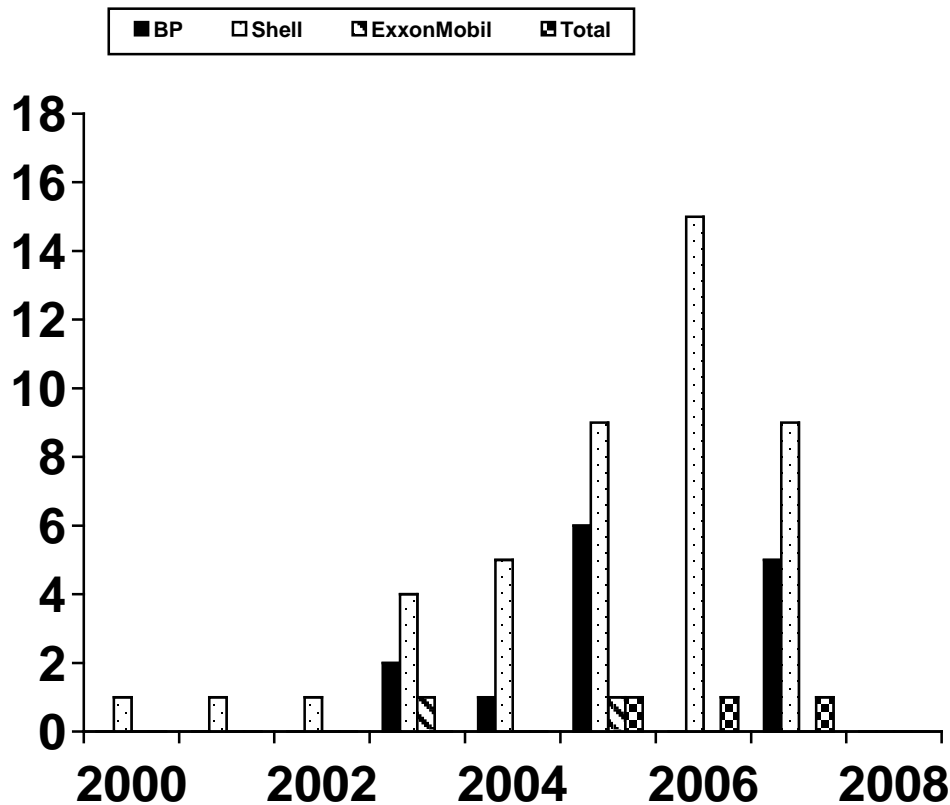


Figure 15: *De Volkskrant*: number of articles covering various IOC operations in Russia 2000–2008

8.5 Storylines on enforcement practices and regulatory pressure

In total, 46 relevant articles were examined and subsequently clustered into four packages. Seven articles report on BP’s dispute with the Russian authorities and Russian shareholders in their joint venture with TNK over the development of the Kovykta field, whereas 39 articles report on Shells dispute over Sakhalin. The interpretive packages are presented in Figure 16. Appendix V provides an overview of all the articles analysed, together with the perspective the article in question represents. In the following, the packages are explained, with sample extracts. The original Dutch headlines can be found in the corresponding footnotes. Several articles lack page numbers as they were published online only.

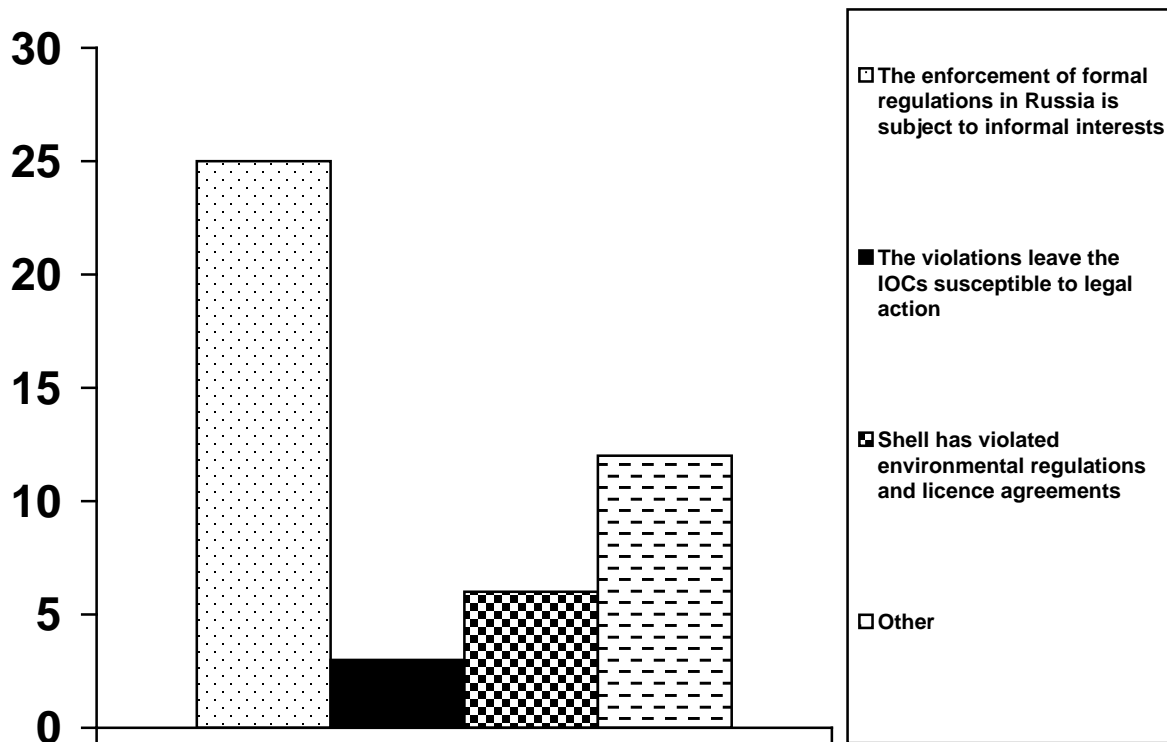


Figure 16: Analysis of articles published in *De Volkskrant* 2006–2008 divided into four packages (total number of articles: 46).

8.5.1 ‘The enforcement of formal regulations in Russia is subject to informal interests’

This dominant perspective (presented in 25 out of 46 articles analysed here) considers the enforcement of formal regulations against Shell and BP in Russia to be subject to informal interests. Other interests are seen to lie behind Russia’s enforcement strategies, varying from strengthening the grip on the petroleum sector to a wider campaign to reduce the opportunities for foreign companies. Overlap between these interests occurs, and articles often identify a combination of these motivations. However, the environmental breaches by Shell or the violations of licence agreements by both Shell and BP are not taken up; or, if they are mentioned, this is only as a minor point. Although not all articles refer specifically to enforcement practices, they describe a negotiation process based on unequal grounds where one part (the Russian government) puts legal pressure to bear on the other (the IOCs). An energy analyst refers to this process in ‘*Russia obstructs Shell on Sakhalin*’:¹²⁶

¹²⁶ ‘Russia obstructs Shell on Sakhalin’ (Rusland zit Shell dwars op Sachalin), *De Volkskrant*, 6 September 2006, p. 7.

As the Russian government is now hitting Shell constantly, one may conclude that this is being done in order to decrease the value of the project.

However, most articles in this package refer to the Kremlin's primary objective of strengthening its grip on the development of natural resources as one way to interpret the enforcement of formal rules against IOCs. For examples:

With the decision [to postpone granting of the environmental permit] the Russian government seems to increase the pressure on foreign companies. The Kremlin seeking to increase its grip on natural resources ('Shell permit postponed').¹²⁷

Apparently, the Anglo-Dutch oil company ignored environmental laws. Experts regarded the move last week by Russian authorities as an attempt to strengthen the grip on their own oil and gas reserves ('Balkenende discusses Sakhalin energy project with Putin').¹²⁸

The case resulted in diplomatic tensions since Russia threatened to shut down the activities, widely regarded as an attempt to secure grip on the oil and gas reserves ('Shell violated many environmental regulations').¹²⁹

A similar perspective is framed in *'Also Shell meets Putin's hard hand'*:¹³⁰

The recent problems Shell faced at Sakhalin II, the world's biggest oil and gas project, raise questions in Europe regarding the investment climate in Russia. However, they fit perfectly in President Putin's ambition to control the energy sector in the country. Even environmentalists regard the withdrawal of the environmental permit as a politically motivated step implemented by the Kremlin.

¹²⁷ 'Shell Permit postponed' (Vergunning Shell opgeschort), *De Volkskrant*, 19 September 2006, p. 7.

¹²⁸ 'Balkenende discusses Sakhalin energy project with Putin' (Balkenende spreekt Poetin over energieproject Sachalin), *De Volkskrant*, 22 September 2006, published on the internet (accessed March 2010).

¹²⁹ 'Shell violated many environmental regulations' (Shell overtrad veel milieu-regels), *De Volkskrant*, 6 December 2006, p. 7.

¹³⁰ 'Also Shell meets Putin's hard hand' (Ook Shell maakt kennis met harde hand van Poetin), *Volkskrant*, 20 September 2006 p. 9.

When TNK-BP was facing regulatory pressure over development of the Kovykta field, the following article in the *De Volkskrant* suggested a link with Shell's conflict in late 2006:

*Like with Shell's project, the objective of the Russian side here is to provide Gazprom a controlling stake in the project. Therefore, TNK-BP has been harassed for months with juridical and environmental technically related troubles, where the only solution for the company is to come to terms with the Kremlin ('The Kremlin seems to harass BP as well').*¹³¹

As outlined earlier, violations of environmental regulations were interpreted as an excuse for the Kremlin to gain control over the energy sector because Shell is conducting its operations carefully, according to this perspective, so as to avoid environmental damage, as shown in 'Shell tackled by environmental regulations'.¹³²

The major environmental damage, however, hardly exists (...) The three fish tunnels (established by Sakhalin Energy in order to minimize the impact of pipeline constructions on the salmon) are not used, according to Hansen [then Sakhalin Energy's environmental expert] in December 2005, long before the Russian authorities made mention of 'serious environmental pollution' at Shell's billion dollar project at Sakhalin. (...) The fish tunnels on Sakhalin, north of Japan, are a symbol of Sakhalin Energy's excessive efforts to protect the environment. (...) With the construction of an 800km pipeline to the ice-free LNG port in the southern part of the island, no stone has been left unturned in order to prevent environmental damage.

The article underscores the efforts initiated by Sakhalin Energy/Shell to prevent or minimize the environmental footprint as a result of its oil and gas operations. Further on, however, the article comments on the violation of environmental regulations – blaming the Russian subcontractors for non-compliance, and not the multinational company.

¹³¹ 'The Kremlin seems to harass BP as well' (Het Kremlin lijkt nu ook BP weg te pesten), *De Volkskrant*, 30 May 2007, p. 9.

¹³² 'Shell tackled by environmental regulations' (Shell pootje gelicht door milieuwetten), *De Volkskrant*, 22 December 2006, p. 7.

During the grant of the environmental permit, Shell and the Russian authorities agreed that 70 per cent of the project should be conducted by Russian employees. Since only Western companies have the know-how to build a pipeline offshore, an onshore option was selected, hereby creating a job for Russian employees. However, it is the local subcontractors, that the Russian state was so eager to help, who are responsible for the environmental violations.

The last sentence of this article has its background in one of the requirements specified in the PSA: 70 per cent of the personnel and material used should be ‘Russian’. Although the PSA text is not publicly available, other sources refer to this requirement.¹³³

Finally, comments from representatives of Shell and BP were frequently published in the *De Volkskrant* during the period under study. As early as September 2006, after the first accusations against BP appeared in the newspaper, TNK-BP CEO Bob Dudley was quoted in his response to the question of whether TNK-BP was afraid of receiving the same kind of treatment as Shell had recently experienced.¹³⁴

As president of one of the largest foreign investors in the energy sector in Russia, Dudley runs the gauntlet. ‘We did everything we could in order to meet the terms’, says Dudley. ‘We have all the necessary permits’. Is Dudley not afraid of facing ‘administrative pressure’ from Russian authorities as Shell did last week in the Sakhalin project? ‘The world is watching us, and I do not believe there is an intention to destroy that. Obviously, there is consolidation in the industry, but that doesn’t necessarily have to be a bad thing, as long as there is space for different models: state companies in addition to private companies with foreign owners. That drives efficiency.

¹³³ Sakhalin Energy must use ‘its best efforts to achieve a 70 per cent target’ for using Russian labour and materials, measured in man-hours worked and volume or weight of materials/supplies over the life of the project (*Sakhalin Energy Annual Review 2003:18*).

¹³⁴ ‘Rich Russians queuing up for establishment management school’ (Rijke Russen in het gelid bij oprichten managementschool), *De Volkskrant*, 25 September 2006, p. 6.

In September 2006 during the early stages of the conflict over Sakhalin II, Ian Craig, then CEO of Sakhalin Energy, was not afraid of the impact of the Kremlin's pressure – at least according to his statement quoted *De Volkskrant*:¹³⁵

Ian Craig, the highest placed person responsible for the project is, like Lavrov [then Russia's Minister of Foreign Affairs] confident that the affair will blow over. 'It seems unlikely to me that our permit will be revoked', he said in the corridors of the conference. He admitted that the opposing signals by the Russian government are 'not useful', neither were six environmental inspections in two months.

Similarly with Shell's CEO, Jeroen van der Veer in 'Shell top executive optimistic over the outcome of Sakhalin':¹³⁶

Although the project has significant challenges in terms of environmental protection, we are convinced that these (challenges) are fully taken care of.

8.5.2 'The violations leave the IOCs susceptible to legal action'

The content and meaning of the articles in this package acknowledge that political interests are part of the Kremlin's enforcement strategy, but they also emphasize the violation of formal rules by both IOCs, such as environmental regulations and licence agreements. Articles in this package specifically take up the violations and their impact on Russian ecology and/or economy (like reductions in state revenues as a result of cost overruns and project delays). This perspective can be found in only three articles. The following extract from 'Shell yields to Kremlin pressure' describes Russia's main objective as being to regain a grip on the energy sector, although environmental violations are also stressed.¹³⁷

¹³⁵ 'Chaos complete at Sakhalin: Minister soothes, officials pour oil on the flames' (Chaos compleet op Sacahlin: minister sust, ambtenaren gooien olie op vuur), *De Volkskrant*, 28 September 2006, published on the internet (accessed March 2011).

¹³⁶ 'Shell top executive optimistic over the outcome of Sakhalin' (Shell-topman optimistisch over afloop Sachalin), *De Volkskrant*, 17 October 2006, p. 7.

¹³⁷ 'Shell yields to Kremlin pressure' (Shell zwicht voor druk uit het Kremlin), *De Volkskrant*, 12 December 2006, p. 7.

The negotiations were hampered after Shell declared that project costs would increase from 10 to 20 billion dollars. The project was suspended when the Russian government started to worry about environmental permits. Officially, the Russian government accuses Shell of violating environmental laws, such as polluting rivers which in turn could harm the local salmon population. The problems, however, are not proportional to the pressure exerted on Shell. The true reason, one may suppose, is that the Russian state is seeking to provide a favourable negotiating position for Gazprom. Under President Putin, Russia is regaining its grip on the oil industry. The private oil company Yukos has already fallen victim to this policy. Shell made favourable agreements during Yeltsin's term as president, and as a result the company today is paying relatively low taxes.

8.5.3 'Shell has violated environmental regulations and licence agreements'

Articles in this package see Shell as violating environmental regulations and licence agreements. The package portrays Shell as an offender of formal regulations, rather than emphasizing the shortcomings of regulatory practices in Russia. Take, for example, this excerpt from the article '*Putin threatens Georgia with war*':¹³⁸

The Russian president said that Moscow decided to freeze the permit in order to force Shell to comply with environmental demands. In addition, he complained that Shell deliberately increased the costs of the project so that the Russian state had no prospect of any kind of profit from the Sakhalin project. According to Putin, the costs were doubled as a result of 'additional incomes' for foreign staff. Furthermore, Shell would not comply with the agreement that a major part of the staff would be recruited from Russia. 'They wanted to double the costs of the project', said Putin.

8.5.4 Other

The package 'other' consists of articles framing other kinds of perspectives that are not shown in Figure 16 because there were fewer than three articles involving a similar interpretation.

¹³⁸ 'Putin threatens Georgia with war' (Poetin dreigt Georgië met oorlog), *De Volkskrant*, 21 October 2006, p. 5.

Such articles often consist of a few sentences reporting on rumours concerning take-overs or Shell's operations in Russia in general.

8.6 Conclusion

This chapter has examined how two major Dutch newspapers interpreted enforcement practices and regulatory pressure against Shell and BP. Sections 8.1 and 8.2 identified the dominant storyline in the *Financieel Dagblad*. The different interpretive packages of the newspaper are shown in Figure 14. The number of publications in *Financieel Dagblad* reporting on Shell and BP exceeded the number of articles on ExxonMobil and Total's operations, as shown in Figure 13. The majority of the *Financieel Dagblad* articles analysed, 32 out of 56, displayed the perspective that the enforcement of formal regulations in Russia against IOCs is subject to informal interests. The content in these articles did not emphasize the violations of environmental rules, norms or licence agreements, but focused on the 'real' motivations behind the enforcement practices. Most of the *Financieel Dagblad* articles reported on Shell's operations at Sakhalin: only four articles focused on TNK-BP's operations in Russia.

In the other Dutch newspaper studied here, *De Volkskrant*, a total of 46 articles dealt with the conflict between Shell and BP on one hand, and the Russian authorities on the other hand. There were significantly more articles on Shell's operations than on the conflict between BP and the Russian state, as was also the case with *Financieel Dagblad*. As shown in Figure 15, the number of articles reporting on Shell and BP exceeded the number of articles reporting on other IOCs operating in Russia, such as Total and ExxonMobil. The analysis has shown that the dominant storyline in *De Volkskrant* during 2006–2008 was that the enforcement of formal regulations in Russia is subject to informal interests. In this perspective, the main objective of the Russian authorities in their conflicts with Shell and TNK-BP was not to protect the environment or avoid environmental pollution, but to strengthen their grip on the exploitation of natural resources and/or to provide Gazprom with a major interest in oil and gas projects on favourable terms. This perspective was displayed in the majority of the articles analysed.

The main objective of this dissertation, as formulated in Chapter 1, has been to answer the research question of how Western actors understand and deal with regulatory and

enforcement practices in the Russian petroleum sector. This main research question has been operationalized through three subsidiary questions, where the second one – how the media interpret enforcement practices and regulatory pressure against IOCs in Russia – has been discussed in this chapter. From analyses of relevant articles in four leading newspapers in the UK and in the Netherlands, we have seen how the Western media interpret law enforcement and regulatory pressure against IOCs in Russia as being subject to *informal* interests, rather than guided primarily by environmental concerns.

The first subsidiary research question, how IOCs understood law enforcement practices, was discussed briefly in Chapter 6, by analysing the content of annual reports and company publications. That chapter concluded that Sakhalin Energy, on behalf of Shell, and BP had indeed violated formal regulations in the course of their operations in Russia, as the Russian authorities had accused them of doing. Chapter 6 also showed that complying with the formal regulations in Russia proved extremely complicated for Shell and BP. Along with the selectivity of enforcement practices, I identified the three main elements in Ledeneva's selective enforcement framework presented in Chapter 3: the complexity of complying with formal regulations, in turn resulting in these rules being violated, and finally leading to enforcement practices guided by purposes outside the legal domain.

Chapter 9 provides a broader discussion of the third subsidiary research question: Do Western actors understand regulatory practices and law enforcement in the same way as Ledeneva stipulates that Russian actors would interpret them? To answer this question, I identify the strategies employed by Shell and BP in their interactions with the Russian authorities and discuss these findings in relation to the afore-mentioned framework of Ledeneva.

9. Discussion of the findings

9.1 Introduction

This dissertation has focused on the following research question: how have Western actors understood and dealt with enforcement practices in the Russian petroleum sector? As outlined in Chapter 1, this main research question has been operationalized through three subsidiary research questions. Here I start with a broader discussion of how the Western media have interpreted enforcement practices and regulatory pressure against IOCs in Russia, followed by an analysis of how IOCs have understood these practices (sections 9.5 and 9.6). Section 9.7 discusses whether Western actors have understood regulatory practices in the same way as Ledeneva (2006) holds that Russian actors would interpret them.

The analysis in this chapter is based on qualitative interviews, the chain of events as outlined in Chapters 4 and 5, annual reports, official publications of the companies and other relevant material such as the audit conducted on behalf of the EBRD, discussed in Chapter 6. By identifying the strategies of the IOCs in their interaction with the Russian authorities and by offering a broad discussion of the dominant storylines in the Western media, this chapter aims to answer the third and final subsidiary research question: have Western actors understood regulatory practices in the same way as Ledeneva expects Russian actors to interpret them?

I start by examining how the Western media have interpreted enforcement practices and regulatory pressure against IOCs in Russia. Empirical data on this question was provided in the previous chapters where four newspapers from the home countries of BP and Shell were analysed. At some point, a particular understanding of the problems gains dominance while others do not (Hajer 1995:44). To this I now turn.

9.2 Comparing the interpretations of British and Dutch newspapers

The second subsidiary research question outlined in Chapter 1 concerned how the Western media, in the form of selected newspapers, have interpreted enforcement practices and regulatory pressure against IOCs in Russia. To this end, I analysed the dominant storylines in four major newspapers from two relevant countries. Newspaper articles construct meaning

(Gamson and Modigliani 1989:10). This meaning, including the title, is essential for identifying the dominant storyline. Media coverage – as distinct from archival documents – is useful for shedding light on the informal objectives behind enforcement practices. Such informal practices are usually not the subject of written archival documents like the annual reports, analysed in Chapter 6.

Thus, the objective was to identify the dominant storyline in the four newspapers (see Hajer 1995:62 and Hønneland 2003:10 for a definition of ‘storyline’). The dominant storyline of a particular newspaper was identified after a selection of the main packages during a specific period. ‘Packages’ are a collection of interpretive newspaper articles that give meaning to an issue (Gamson and Modigliani 1989:3). Table 3 presents the dominant storylines in the newspapers based on the analysis conducted. Perhaps not surprisingly, all four newspapers emerge with a similar storyline. Furthermore, the analysis shows that several packages from the newspapers do not consist of two opposite positions where enforcement practices are either described as politically motivated or not (Gamson and Modigliani 1989:36). Instead, the analysis shows several interpretive packages – for instance, portraying the violations committed by IOCs as a pretext for a legal action.

Coverage in the British daily newspapers *Financial Times* and *The Guardian* was analysed for perspectives on enforcement practices and regulatory pressure in relation to the cases outlined in Chapters 4 and 5. From the Netherlands, *Financieel Dagblad* and *De Volkskrant* were studied. Issues from August/September 2006 until January 2008 were examined: from the period when these papers started to publish articles on regulatory pressure against Shell (Sakhalin Energy) and BP. This explains the difference between the period under study for analysis of media coverage (2006–2008), and the longer period covered by the research as such (2000–2008).

Table 3 shows that the number of newspaper articles in the *Financial Times* exceeds the number of articles of the other newspapers. However, these figures are not conclusive, because I would first need to know the total number of articles on similar topics published in each newspaper and subsequently exclude sports, culture and other news topics that may be accorded differing levels of attention in the newspapers analysed. Sports, for example, receive more coverage in *The Guardian* than in the *Financial Times*. Further, most of the relevant articles published in the two Dutch newspapers report on Shell’s oil project at Sakhalin, and

not on BP’s conflict with Russian authorities and the Russian shareholders in their joint venture with TNK.

| Newspaper | Number of newspaper articles examined | Dominant storyline 2006–2008 |
|---------------------------|---------------------------------------|--|
| <i>Financial Times</i> | 139 | The enforcement of formal regulations in Russia is subject to informal interests |
| <i>Financieel Dagblad</i> | 56 | The enforcement of formal regulations in Russia is subject to informal interests |
| <i>The Guardian</i> | 51 | The enforcement of formal regulations in Russia is subject to informal interests |
| <i>De Volkskrant</i> | 46 | The enforcement of formal regulations in Russia is subject to informal interests |

Table 3: The storyline in four Western newspapers’ reporting on enforcement practices in Russia from August/September 2006 to January 2008.

There is consensus in the dominant storylines among all four newspapers: enforcement practices and regulatory pressure against Shell (Sakhalin Energy) and later BP in the period 2006–2008 were subject to informal interests, rather than being a matter of unbiased enforcement of formal regulations. This is interesting in itself since those who break environmental norms are usually roundly condemned by the media (as with, for example, the deep sea disposal of the Brent Spar and BP’s Deepwater Horizon oil spill in the Gulf of Mexico in 2010).¹³⁹ However, the storyline in the four newspapers examined did not focus on environmental issues, but on the selectivity and arbitrariness of Russian enforcement practices. Underscored was Russia’s energy policy aimed at strengthening the country’s grip on the development of natural resources. Apart from the broad attention given to Shell’s activities and the limited interest in BP’s activities, the coverage in the two Dutch newspapers was not so very different from the coverage in the *Financial Times* and *The Guardian*.

The Guardian was the first newspaper to report on regulatory pressure exerted by the Russian authorities against Shell, on 4 August 2006. The other newspapers all made reference to the

¹³⁹ For a review of the dispute regarding disposal of the floating oil storage facility ‘Brent Spar’ see Grolin 1998.

conflict one month later, starting with *De Volkskrant* on 6 September 2006, and followed by the *Financial Times* and *Financieel Dagblad* on 18 and 19 September 2006 respectively.

Besides interpreting the enforcement of formal regulations in Russia against IOCs as subject to informal interests, a second perspective acknowledged that the enforcement of formal regulations is subject to political interests – without, however, obscuring the violations of environmental rules and/or licence agreements. In fact, such violations were described as offering an opportunity for the Russian authorities to pressure IOCs to renegotiate PSAs or to provide the state giant Gazprom with access to lucrative oil and gas projects. Many newspaper articles in *The Guardian* displayed this package, presenting a more nuanced perspective of the issue. The same argument was prevalent in the other newspapers examined, but less frequently than in *The Guardian*. This development, where positions and arguments are diversified in the media discourse rather than being presented as a simplified dichotomy of two opposite positions, resonates with the findings of the study outlined by Gamson and Modigliani (1989:36). Furthermore, the dominant storylines of the four Western newspapers are in line with an essential characteristic of Ledeneva's framework of selective enforcement (2006:18): the incentives for exerting regulatory pressure or imposing sanctions against IOCs served purposes other than the claimed purposes of the inspections, like the protection of the environment. However, another important characteristic – the difficulty of complying with regulations resulting in the widespread violation of these regulations, whether deliberately or not (presented in figure 3) – received considerably less attention in the Western media during the period under study. As I have noted, the difficulties involved in complying with Russian regulations due to the complexity and incoherency of the various formal institutions make it impossible to punish *all* possible offenders – which in turn creates a situation where enforcement of formal rules is not based on the logic of the law.

9.3 Has the storyline in the Western media been influenced by Shell and BP?

Figures 9, 11, 13 and 15 in Chapters 7 and 8 showed that the number of articles reporting on the Russia-based operations of Shell and of BP by far exceeded the number of articles on the operations of other IOCs in Russia, such as Total or ExxonMobil. Is this greater focus on Shell and BP the result of a carefully selected strategy to involve the media or the public? An explanation for this strategy can be found in the study by Gamson and Modigliani (1989:7), who argue that actors promote their interests through the media. These actors, defined as

sponsors, are often professional specialists employed by organizations whose main job it is to get in touch with journalists. In the present study, however, the information presented in these figures is insufficient to conclude that the storylines in the media were influenced by any conscious decision on the part of BP or Shell to involve the media and the public in their conflict with the Russian authorities. Newspapers sell a product, and their success depends on being able to present articles of interest to their readers. Consequently, British companies receive more coverage in British newspapers than for example a French company like Total; similarly, Dutch newspapers are most interested in Shell, which is widely regarded as a (partially) Dutch company.¹⁴⁰ This point was confirmed by the analysis of the Dutch newspapers in the previous chapter.

The interviews conducted in the initial phase of the research concluded that Shell and BP publicly pressured the Russian authorities to influence their decision-making process. Recall the following remarks by an individual familiar with the case (presented in Chapter 4):

Shell deliberately selected a strategy of making noise. They hired in the press and attacked the Russians for their behaviour. As a consequence, the Russians started to do the same. BP selected the same strategy. Look for example at ExxonMobil, they deal with the same issues but this case is hardly visible in the media. Shell's strategy, hoping that the Russians would move closer, failed completely (Representative of NOC, interview with author, February 2010).

Moreover, it seems unlikely that a multinational would invite journalists and NGO representatives to the remote island of Sakhalin with the objective of explaining or demonstrating Shell's environmental policy, *if* the company at the same time was seeking to avoid broad media coverage of their conflict with the Russian authorities. Similarly, TNK-BP CEO Bob Dudley's speech to an economic forum in London, published later in TNK's periodic reports and referred to in several articles, should be understood as a strategy carefully selected in order to engage the public in the company's conflict with the Russian authorities.

¹⁴⁰ Shell's headquarters are located in The Hague, and the company's CEO for the period 2004–2009 was Dutch national Jeroen van der Veer. Furthermore, Royal Dutch Shell was established as one company with a single capital structure at the end of 2004, through a dual capital structure between Shell Transporting and Trading Company Ltd and the Royal Dutch Petroleum Company.

See http://www.shell.com/home/content/aboutshell/who_we_are/our_history/ (accessed September 2011).

PR divisions and communication experts employed by internationally operating multinationals like BP and Shell carefully select their strategies for communicating with the outside world, for example through annual reports – so Dudley’s remarks can hardly be dismissed as ‘a slip of the tongue’. The following company report, published in 2007, provides an example of some of the issues taken up by Dudley already in 2005:

However, constraints imposed by the existing regulatory framework and limited access to Gazprom’s transportation, storage, and processing capacities often mean that independent producers encounter difficulties monetizing these reserves. Further evolution of Russia’s gas industry will depend upon the pace of liberalization of the sector and opening access to Gazprom’s transportation facilities (TNK-BP Today 2007:5).

Thus, companies can ‘involve the public’ – but that does not necessarily mean that they contact journalists directly to influence the coverage of a particular newspaper, or that storylines in the media are a direct result of this decision. A speech at a forum where businessmen, researchers and journalists are represented will serve equally as well – as will inviting journalists and NGOs to Sakhalin to demonstrate the company’s environmental policy.

9.4 What motivations were imputed?

In section 9.2 I concluded that the storyline in the Western media examined for this study was that enforcement of formal regulations in Russia is subject to informal interests – meaning that the real reasons for the enforcement of formal rules have to do with other interests than those intended by the law. With BP, unlike the case of Shell, the company faced no cost overruns in the development of the Kovykta project, which was not based on a PSA. Therefore, a more general desire on the Russian side to renegotiate oil deals so as to increase state revenues from oil and gas explorations seems to have played a significant role. The analysis of the media coverage and the conclusions of the interviews separately have shown that cost overruns in combination with a strong wish to renegotiate the PSAs agreed on in the 1990s were the major reason for the Russian authorities to impose sanctions against Shell and BP. In the process, those who were reluctant to renegotiate oil deals which the Russian

authorities saw as outdated were accused of violating unwritten rules – in this case refusal to renegotiate oil deals.

In Chapter 1, I concluded that agreements between oil companies and the state are often subject to renegotiations, due mainly to rising oil prices (see Bremmer and Johnston 2009:155; Domjan and Stone 2010:35). Moreover, the obsolescing bargain (Vernon 1971:46) and the cyclical nature of resource nationalism (Stevens 2008:5) refer to a situation where oil-producing states, often developing countries, succeed in wresting control from IOCs in the petroleum sector either by establishing NOCs or by securing more favourable terms for the host country. In such cases, negotiations take place sheltered from the gaze of the media and the outside world, in a closed process described as *the closed shell*, where state and company agree on (new) terms for the development of oil and gas projects. Therefore, any attempt to describe how IOCs such as ExxonMobil, ENI or Total understand these negotiations must remain speculation. However, precisely because both Shell and BP publicly took up some of their issues with the Russian authorities, I can identify how they have understood enforcement practices and regulatory pressure in the petroleum sector in Russia. This, the first subsidiary research question, is discussed in detail in the following sections.

9.5 How did Shell interpret enforcement and regulatory pressure in Russia?

The analysis presented in this section is no summing up of the facts and events as in Chapter 4, but rather an attempt to identify how Shell understood law enforcement practices and regulatory pressure in Russia during the period under study. The conclusions in this section build on examination of the company's actions and selected strategies during their conflict with the Russian authorities over the development of the Sakhalin II project.

The Anglo–Dutch oil major Shell acquired a majority stake (55 per cent) in the Sakhalin II oil field in the early 1990s during a period of relatively low hydrocarbon prices and economic transition, while the Japanese investors Mitsui and Mitsubishi acquired 25 per cent and 20 per cent respectively. Shell became the operator on the field although, formally, Sakhalin Energy was responsible for the achievement of production targets and compliance with formal regulations. In July 2005, Shell reached an agreement with Gazprom providing the latter a 25 per cent stake in Sakhalin II. Gazprom's interest in the project should be seen in the context of

Russia's energy strategy aimed at involving the state in the development of major LNG projects in the country, as documented in the Energy Strategy of Russia for the Period up to 2020 (Øverland 2008:45). In return, Shell would gain a 50 per cent interest in the Zapolyarnye oil fields. However, just after the agreement, made public in a press release by Shell on 7 July 2005, Shell announced cost overruns in the development of the Sakhalin II project: Phase II of the project involved a cost increase of USD 8 billion to a total of USD 20 billion.

According to the terms of the PSA, Sakhalin Energy was allowed to recoup its initial investments before sharing their profits with the Russian state. The content of Sakhalin II's PSA is not publicly available, but has often been the subject of discussion in the public debate in the media, as discussed in Chapters 7 and 8. Moreover, oil prices increased from less than USD 30 a barrel in the late 1990s, when Russia was in a difficult economic situation, to more than USD 100 a barrel by 2008 (see Figure 2). Add this to the Russian wish to renegotiate oil deals from the 1990s, deals that 15 years later were seen by many as outdated, and the seeds of a potential conflict of interest were sown. This development was not a matter of Russian exceptionalism, but should be seen in terms of 'the obsolescing bargain' and the cyclical nature of resource nationalism, as explained by Vernon (1971:46) and Stevens (2008:5). 'A poor deal today is a renegotiation of unilateral change tomorrow' (Stevens 2008:27). The result was a process where Shell was put under pressure by the Russian authorities to renegotiate the PSA, for instance by providing Gazprom access to the Sakhalin II project on more favourable terms. In other words, now it was Shell that would have to pay for the cost increase, and not the Russian state.

Here the 'problem' for the Russian authorities was how to renegotiate a deal with Shell – by providing Gazprom direct access to the project, or re-negotiating the terms of the PSA – without unnerving foreign investors more than necessary. Generally, a PSA does not allow one part, like the authorities, to increase state revenues unilaterally, for example through a new tax system. Other options would have to be explored in order to obtain the objective (renegotiation of the PSA) legally.

In May 2006, a report published by the Russian Academy of Natural Sciences called for renegotiations of PSAs in the petroleum sector. The outcome of this report, reported briefly in the *Financial Times* and *Financieel Dagblad*, could be seen as a first step in a process that gradually increased the pressure on IOCs in Russia. Furthermore, inspections from regulatory

agencies during the second half of 2006 resulted in allegations against Sakhalin Energy (Shell) for violations of environmental regulations during the development of Sakhalin II, further stepping up the regulatory pressure on the oil company.

Shell's official reports and an independent audit conducted on behalf of the EBRD did not report on any environmental inspections prior to May 2006, although the audit concluded that environmental regulations had been broken already during early stages of the project, for example in connection with construction activities in 2005. Inspections started in July and August (two inspections on different locations), and October and November 2006 (Environmental Report 2007:271). In September 2006, Rosprirodnadzor claimed that Sakhalin Energy should pay for the environmental damage that, it maintained, amounted to more than USD 50 billion, without explaining this figure in any detail.¹⁴¹ The inspection undertaken in November 2006 did not result in any fines or statutory notices – the latter being a written statement elaborated by the regulator where the offender is ordered to undertake certain measures (Macrory 2008:101–102). So after the announcement of cost overruns in July 2005, and the ensuing discussion between Putin and Van der Veer in Amsterdam in November 2005 (see Chapter 4.6), inspections by regulatory agencies were initiated. Informally, the objective was to renegotiate the PSA with Shell and to punish the company for the cost overruns whereas formally, the objective was to ensure that the oil major would comply with the environmental regulations. The dominant storyline in the media, describing the enforcement of formal rules in Russia as subject to informal interests, suggested that informal interests lay behind these inspections, which is in line with my conclusions from the interviews referred to in Chapters 4 and 5. Table 4 provides an overview of the gradually increasing pressure Shell faced between May and October 2006.

¹⁴¹ 'Shelling out for the environment' *St. Petersburg Times*, 29 September 2006.

http://www.sptimes.ru/index.php?action_id=2&story_id=18987&highlight=or (accessed September 2011).

| Date | Type of pressure | Pressure exerted by |
|-----------------------------------|---|---|
| May 2006 | Report calling for renegotiations of PSAs in Russia | Academy of Natural Sciences |
| July 2006 | Inspection | Rosprirodnadzor |
| Aug. 2006 | Two inspections in different locations | Rosprirodnadzor |
| Aug. 2006 – Sep. 2006 (Chs. 7–9) | Accusations through the media | Rosprirodnadzor, various governmental officials |
| Oct. 2006 | Inspection and suspension of construction activities hampering the development of Sakhalin II | Rosprirodnadzor/Ministry of Natural Resources |

Table 4: Gradually increasing pressure on Shell/Sakhalin Energy (May 2006–December 2006).

Here we recall that a process whereby formal regulations are utilized in order to achieve personal or political interests is one of the main characteristics of Ledeneva’s framework for understanding enforcement practices in Russia (Ledeneva 2006:18). Her framework, as outlined in Chapter 3, provides an explanation for the inspections during the second half of 2006. By emphasizing the selectivity and arbitrariness of enforcement practices, Ledeneva argues that objectives other than enforcement of the written rules serve as the trigger for enforcing the law in Russia. Hence, we can see the inspections during the second half of 2006 and the ensuing allegations as part of a strategy aimed at securing other objectives than the enforcement of the environmental regulations – such as punishing Shell for the cost overruns, and/or gaining increased state revenues from oil and gas projects. It is hard to say whether the informal objective was to renegotiate an ‘outdated’ PSA or to provide Gazprom with a majority stake in the project: a combination of these objectives seems most likely.

It might be argued as in several newspaper articles examined in previous chapters, that environmental regulations were a logical option for putting pressure on Shell, since the company had already been accused by NGOs of violating environmental norms, for example regarding the protection of endangered whales. I can only speculate whether this played a role in the decision-making process on the Russian side. What is less relevant here is whether a decision to revoke or suspend the company’s environmental permit, thereby effectively holding back the whole project, can be regarded as legitimate on the basis of violations of what were actually minor environmental regulations.

Complying with the formal environmental regulations in Russia is complicated, due to bureaucracy and shortcomings in the legislation (Pastukhov 2002:74; Ledeneva 2006:13). A concrete example is Article 24 of the Federal Law on Wildlife: ‘activities that cause death, reduction in population or disturb the natural habitats of rare or endangered species are prohibited’ (Environmental Report 2007:116–117). This was exactly what happened with Shell’s project at Sakhalin. Already in 2005, the local fishing authorities had objected to dry cut techniques for crossing rivers (Environmental Report 2007:89). Chapter 6 showed that Sakhalin Energy used both dry and wet cut methods for river crossings, although the dry cut method was prohibited. However, no licences were suspended before October 2006.

Moreover, the dry cut method for implementing river crossings is regarded as ‘Best Environmental Practice’ (BEP), meaning that this technique is considered to be less harmful to the environment than other river-crossing techniques such as wet cut techniques. The OSPAR Convention requires contracting parties to apply BEP in their efforts to prevent and eliminate marine pollution. In order to achieve this, various recommendations and decisions for various industrial techniques are developed, of which BEP is one of them. If Shell were to use wet cut methods on all river crossings – thus complying with the formal regulations in Russia – the company would be violating BEP as well as their own environmental action plan, which requires all river crossings to be conducted according to BEP. The result would inevitably be that Shell provided NGOs with more ammunition for criticizing the oil company for violating international agreements, or worse, using outdated methods with a worse impact on the environment. That made it a better option to violate Russian law hoping, or perhaps feeling sure, that the Russian inspectors were unlikely to obstruct the development of such a major project. This approach obviously failed: Shell came in conflict with the Russian authorities after announcing cost overruns that would result in the loss of revenue for the Russian state. Here again we see how the inconsistency of formal regulations and the widespread violation of these rules can enable the authorities to accuse almost anybody of violating the formal rules (Ledeneva 2006:13; Pastukhov 2002:73).

After concluding that Shell indeed violated environmental regulations and that Ledeneva’s framework of selective enforcement can be applied to this case, I now turn to the next step in the analysis. How did Shell understand enforcement practices and regulatory pressure, and how did the company respond to the pressure exerted by the Russian authorities?

In order to examine whether Shell’s strategies changed throughout the conflict, including the period covered by the research, I have divided this part of the analysis into four time periods. Table 5 provides an overview of the strategies selected by Shell during the various stages of its conflict with the Russian authorities. The results are based on the content and context of the annual reports in the research period and qualitative interviews. It was difficult to identify Shell’s strategy between November 2005 and August 2006. Strategies were considered to be unsuccessful when no agreement for the solution had been achieved – either in terms of a new agreement between the owners of Sakhalin II and the Russian state, or when the Russian authorities gave in to Shell and halted the regulatory pressure against the oil company (Table 4).

| Period | Incident | Shell’s strategy | Strategy successful? |
|---|--|--|-----------------------------|
| 1 st period (July 2005 – Nov. 2005) | Announcement cost overruns Sakhalin II project | Establish negotiations with the Russian authorities | No |
| 2 nd period (Nov. 2005 – Aug. 2006) | Inspections by Russian officials increase the pressure on Shell | Unknown | No |
| 3 rd period (Aug. 2006 – Oct. 2006) | Broad coverage in the media of a conflict between Shell and the Russian authorities | Shell involves the public to defend its environmental policy and influence the decision-making process on Russian side | No |
| 4 th period (Oct. 2006 – Dec. 2006) | Contact between Shell and the Russian authorities re-established: a new agreement is signed, providing Gazprom with a majority share in the Sakhalin project | Negotiations with the Russian authorities | Yes |

Table 5: Shell’s strategies during different stages in the conflict with the Russian authorities (July 2005–December 2006).

1st period (July 2005 – November 2005)

The first period started with Shell's announcement of cost overruns in relation to Sakhalin II. No inspections by federal Russian officials were conducted during this period, even though the environmental audit showed that Shell was in violation of environmental regulations (Environmental Report 2007:89). During this period Shell was apparently not violating any unwritten rule by crossing anyone's informal interests. Instead, the company and the Russian authorities were in some sort of negotiation process where the message to Shell was not to be misunderstood: the company would have to pay for the cost overruns and/or provide Gazprom with a major share in the project. There was no enforcement of formal regulations during this stage. As Ledeneva argues, the actual punishment is 'suspended' but can be enforced at any time (Ledeneva 2006:13). Meanwhile, the Russian authorities cancelled the deal that gave Gazprom 25 per cent of the project. Negotiations during this period were hardly conducted in public or referred to in articles or annual reports. Thus, during the first period, Shell recognized the conflict as a financial rather than an environmental issue. Then the inspections conducted by the Russian regulatory agencies forced the company to change its approach in the next period.

2nd period (November 2005 – August 2006)

Table 4 showed that during this period the pressure against Shell increased gradually, starting with the publication of a report by the Russian Academy of Natural Sciences calling for the renegotiation of PSAs in the petroleum sector. The report could be seen as a first modest sign, although the message was clear: the Russian authorities were not satisfied with the progress in negotiations during the first period, and now intended to step up the pressure on Shell. The assumption is that this period started in November 2005 after Putin's visit to Amsterdam, where, according to Op het Veld and WWF, no agreement was reached between Putin and Shell CEO Van der Veer. (Op Het Veld 2009:10–11; WWF 2006:2).

Shell's strategy between November 2005 and August 2006 is difficult to identify. Prior to the meeting in Amsterdam, it is likely that the oil major attempted to negotiate a new deal with the Russians. Apparently, the latter were not satisfied with the results and decided to switch from regulatory pressure, in other words the *threat* of enforcing the law, to *actively* enforcing the formal regulations by suspending construction activities in October 2006.

3rd period (August 2006 – October 2006)

In general, environmental conflicts are rarely acted out in public or end up as court cases, since companies are reluctant to get involved in a ‘painful process on the public stage’ (Hawkins 1984:8). Instead, both parties tend to agree upon a solution before adjudication. Unlike most environmental conflicts, the third period in this case is characterized by the fact that the conflict had now moved into the public sphere – which might indicate that environmental regulations were not at the core of the conflict between the Russian authorities and Shell. Note that the negotiations between both actors already started in July 2005. During this period, however, the dialogue between Shell and the Russian authorities was postponed, continuing in newspapers rather than in meeting rooms.

Thus far, the regulatory pressure exerted by the Russian authorities had proven insufficient to break Shell, and so the Ministry of Natural Resources suspended construction activities in October 2006. Again, I note that Shell had been violating formal regulations concerning for instance river crossings, ever since 2005. But from September 2006, the company violated an *unwritten* rule by openly crossing the interests of the Russian government.

Figure 9 in Chapter 7 showed the number of relevant articles published in the *Financial Times* in August and September 2006. That the conflict got so much attention from the media, experts and politicians was the result of a carefully selected strategy on the part of Shell. Immediately after the first publications about regulatory pressure against Shell appeared in the media, Dutch, British and EU politicians publicly expressed their worries in the media.¹⁴² Moreover, journalists and NGOs participated at an oil and gas conference arranged in Yuzhno-Sakhalinsk on 22 September 2006.

Shell decided to involve the public (represented by the media, politicians and NGOs) for two reasons. First the oil company wanted to demonstrate its environmental performance, thereby indirectly responding to allegations from representatives of the Russian regulatory agencies. Secondly, the company wanted to influence the decision-making process on the Russian side,

¹⁴² See for example: ‘Balkenende calls Putin about Sakhalin’ (*Financieel Dagblad*, 23 September 2006), ‘Brussels wants explanation from Russia after revoking Shell’s permit’ (*De Volkskrant*, 19 September 2006), ‘Balkenende expresses concern against Putin’ (*De Volkskrant*, 23 September 2006), ‘Bot wants explanation regarding the revoking of Shell’s permit’ (*De Volkskrant*, 20 September 2006) and ‘Blair wades in to Russia oil crisis’ (*The Guardian*, 24 September 2006).

for example to secure favourable terms in future negotiations. Therefore, the idea was to launch a public debate framing law enforcement in Russia as selective and manipulative and thus indirectly or even directly emphasizing the instability of the investment climate in the country.

As concluded in the Chapters 7 and 8 the dominant storyline in the analysed newspapers interpreted enforcement practices in Russia as subject to personal or political interests, rather than criticising Shell for violating the environmental regulations. It is obvious that the image framing the enforcement of formal regulations as selective and manipulative is not positive for a country in need of foreign investors for the development of its oil and gas reserves. So far Shell's strategy was quite successful because this perspective was established in the dominant storyline in the newspapers. However, the storylines in the Western media did not impress the Russian authorities. On the contrary, the conflict escalated and Shell faced public damage. The question whether it were the Russian authorities or Shell who decided to involve the public first is not possible to answer because the data presented so far provides insufficient information.

When the financial conflict – starting with the announcement of cost overruns in July 2005 – turned into a media circus, the oil major faced pressure not only from the Russian authorities, but also from environmental NGOs and, indirectly, the EBRD. Shell has a primary listing on the London Stock Exchange and is a constituent of the FTSE 100 index, as well as having secondary listings on Euronext Amsterdam and the New York Stock Exchange. Exchange-listed companies are sensitive to criticism and pressure by environmentalists and international financial institutions. Even before 2006, environmentalists had been criticizing both Shell and the EBRD, as the financier of Phase I of the project, for the environmental impacts of Sakhalin II but media attention was moderate (see Figure 9). Sakhalin Energy needed a loan from the EBRD to complete Phase II of the Sakhalin II project. That meant that the company was vulnerable to pressure from the EBRD and found itself forced to respond to the public allegations made by Russian officials. Moreover, Shell seemed to remember the lessons learnt from similar pressure from governments and NGOs over the disposal of the Brent Spar platform in 1995.

Pressuring the Russian authorities publicly, whether by defending the company's environmental policy or publicly discussing the stability of Russia's investment climate to

secure better terms for the oil company could bring success, forcing the Russian authorities to step back – or it could make things worse. When the financial conflict turned into an environmental conflict, however, Shell had no other options than to defend its environmental performance.

4th period (October 2006 – December 2006)

A Moscow visit by the Dutch Minister of Economic Affairs Joop Wijn on October 6 resulted in a breakthrough in the conflict. At an earlier stage, Shell had requested the Dutch government to establish contact with the Russian authorities so that negotiations could be resumed between representatives of Shell and the Russian government. Several meetings were held between President Putin and Shell's CEO Jeroen Van der Veer to negotiate the terms of the final agreement. This was presented in December 2006 and formally signed in April 2007. And, once the final agreement had been reached, environmental allegations moved to the background (see Chapter 4.8).

In sum: Shell knew in advance that it would be hard to avoid renegotiation of the PSA. When other strategies proved insufficient, the company, in a last-ditch attempt, decided to put pressure to bear on the Russian authorities and their decision-making, by involving the public. This strategy was combined with a public campaign highlighting Shell's commitment to environmental management. The strategy of publicly defending its environmental policy, and thereby directly and indirectly responding to the allegations made by Russian officials, makes sense from Shell's perspective because of the company's vulnerability to attacks by NGOs as a stock-listed company and because Sakhalin Energy needed a loan from the EBRD to finance Phase II of the project. The EBRD in turn is vulnerable to pressure from environmental NGOs, as noted in the theory of ecological modernization (Mol 2001; Goldenman 1999).

'Ecological modernization' theory refers to the transformation of ecological interests, ideas and considerations involved in social practices and institutional developments, in turn resulting in the constant ecological restructuring of modern societies (Mol 2001:59). Theorists of ecological modernization argue that although processes of modernization and globalization often result in environmental degradation, they can also encourage policies designed to improve the quality of the environment, for instance through an absolute decline in the use of natural resources or emissions discharge. These theories use the term 'global environmentalism' (Mol 2001:216) to describe the transformation processes of environmental

reform through a worldwide harmonization of the ethics and principles of good environmental behaviour – such as BEP and the possibility of monitoring and reacting to environmental mismanagement of international operating oil companies like Shell. Globalization processes have established the harmonization of international environmental regimes and standards, transforming the relationship between states and consumer markets and transnational enterprises. The widespread emergence of environmental management systems is a clear example of such a development (Roberts 1998), besides the change in state–market relations in environmental issues. NGOs, producers, consumers, (international) financial institutions, insurance companies and business associations all become important actors in framing and shaping ecological restructuring and environmental reform. The criticisms that Shell received from NGOs directly and the EBRD indirectly, should be seen in light of this development.

Thus, Russian officials claiming violations of the environmental regulations ensured that NGOs, the EBRD and later on Shell would respond. An inevitable result of the fact that the conflict had received broad media coverage was that Shell no longer could regard the matter as a financial disagreement (renegotiation of the PSA): it had become a disagreement that was both financial *and* environmental. There was pressure by NGOs and the EBRD even though the dominant storyline in the newspapers focused on the shortcomings of enforcement practices in Russia (see Chapters 7 and 8). Moreover, these storylines failed to impress the Russian authorities. The conflict escalated, negotiations were postponed and Shell faced damage to its public reputation.

9.6 How did BP interpret enforcement and regulatory pressure in Russia?

In this section I return to the struggle over the Kovykta natural gas field and within BP's joint venture with the Russian oil company TNK. How did BP understand regulatory practices in Russia? As with the conflict between Shell and the Russian authorities, the answer to this question must build on the oil company's actions and strategies during its conflict with the Russian authorities. Apart from broad coverage in the media (see e.g. Figure 11), the issue was mentioned less frequently in annual reports than the dispute over Sakhalin II. However, company reports published by TNK-BP and especially a speech by TNK-BP's CEO Bob Dudley at an economic conference in London in April 2005, proved valuable for drawing up a

picture of the chain of events and BP's strategy for dealing with Russian enforcement practices.

First, it is important to note the similarities and differences between the conflict over Sakhalin II on the one hand, and on the other, the development of TNK-BP in general and the Kovykta gas field specifically. In both cases, privately owned IOCs found themselves in conflict with the Russian authorities over the development of oil and gas fields. In both cases, the Russian regulatory agencies used formal mechanisms to pressure and punish the oil companies. Finally, both Shell and BP decided to involve the public in an attempt to influence the decision-making process on the Russian side.

However, unlike Sakhalin II, the Kovykta field is not subject to a PSA dating from the late 1990s. The agreement between the owners of the licence on Sakhalin II and the Russian state had been signed at a time when the country was in a difficult economic situation. By contrast, the joint venture between TNK and BP was signed in early 2003, when the oil price was significantly higher than in the 1990s (see Figure 2). Moreover, the Kovykta field is an onshore field, primarily containing natural gas, whereas the offshore Sakhalin II fields contain a combination of oil and gas – the Piltun-Astokhskoye field is primarily an oil field, with associated gas; and the Lunskeye field is predominantly a gas field with associated condensate.

The oil sector in today's Russia is dominated by five vertically-integrated oil companies: Rosneft, Lukoil, Surgusneftegaz, TNK-BP and Gazprom Neft, which together produce 75 per cent of the country's oil (Moe 2010:283). The infrastructure for the transport of oil in Russia is owned by state company Transneft. Unlike the oil industry, most of Russia's gas industry has not been privatized, but has remained mainly under state control, being a more stable contributor to the state coffers than oil. Since 2004 the Russian state has retained a 50.002 per cent controlling stake in OAO Gazprom (Gazprom Sustainability Report 2008/2009:10). In 2009, Gazprom accounted for around 80 per cent of production in Russia (Gazprom Annual Report 2009:1). Gazprom controls the up- and downstream sectors, 55.1 per cent of Russia's proven reserves, pipeline infrastructure, and has 'blocking stakes' in many gas distribution organizations. Russian legislation requires shareholder majorities of at least 75 per cent for certain decisions. Consequently, shares of 25 per cent are sufficient in order to veto management decisions (Ahrend and Tompson 2005:802). In addition, Gazprom controls

several operators of oil and gas projects, such as Sakhalin Energy (after December 2006) and Shtokman Development AG.

Moreover, by law, Gazprom is the only organization legally authorized to export gas from Russia to non-CIS (Commonwealth of Independent States) countries, even in cases where Gazprom is not the owner of the licence permit or operator. Due to the gap between domestic gas prices and international gas prices, export is often the only profitable option for companies operating in the Russian gas sector. However, Gazprom's ownership of the infrastructure in terms of transportation, gas storage facilities and the existing regulatory framework means that independent gas producers face difficulties in developing their gas reserves unless they have some kind of cooperation with Gazprom. Hence, Gazprom controls the gas sector by a combination of commercial and regulatory functions.¹⁴³ Ahrend and Tompson even introduce the term 'quasi-ministry' to describe Gazprom's domestic position (2005:803).

Gazprom holds an export monopoly, and decisions concerning the pipeline system require permission from Gazprom. Moreover, the laws on Russia's subsoil and foreign investment have reduced – or in the case of the continental shelf even closed – the development opportunities for private companies like TNK-BP. This is because the law states that only state companies with a 50 per cent plus one share are allowed to work on onshore projects of 'strategic importance'. In addition, private companies need approval from the government before acquiring 50 per cent of companies operating in strategic sectors. TNK-BP owned 66 per cent of the operator of the Kovykta field, considered to be of 'strategic importance' due to the number of gas reserves included. All this provided the foundation upon which a conflict of interest was bound to occur, even before a single cubic meter of gas was produced – although BP obviously hoped to avoid such problems expecting to be seen as 'insiders' through the joint venture with TNK.

Another difference between the two conflicts is that, formally, the subject of discussion over Sakhalin II was the violation of environmental regulations, whereas licence agreements, visa irregularities, draft laws and the outcome of court cases were used as ammunition for regulatory pressure in the conflict over the development of TNK-BP in general, and the

¹⁴³ In addition, Gazprom controls holdings in sectors like banking, insurance and a TV channel.

Kovykta gas field specifically. On the other hand, in both cases formal rules (environmental and immigration regulations, licence agreements etc.) were used to achieve an informal objective (renegotiation, re-nationalization, getting rid of members of the board etc.). This double-edged relationship to market and democracy, by supporting the formal framework through the application of formal regulations while on the other hand manipulating these rules to achieve informal interests, is a main characteristic of selective enforcement (Ledeneva 2006:3). Whether this informal objective is legitimate is a subjective question and therefore less relevant here. What matters is that formal regulations are utilized for purposes different from the claimed purposes of the inspections (Ledeneva 2006:18). Moreover, in both cases the pressure exerted by the Russian authorities increased gradually as long as they were not satisfied with the result, as shown in Table 4.

Finally, BP faced less pressure from NGOs than Shell. However, the company decided already at an early stage of the conflict – or perhaps ‘negotiation’ is a better term to describe the interaction at that point – to involve the public by openly discussing the issues in relation to Russia’s business climate, at a forum in April 2005. Again, the decision to mention these issues was a carefully selected strategy for involving the public in the debate regarding the stability of the investment climate in Russia. In the conflict over Sakhalin II, Shell invited journalists and NGOs to the production site to underscore or defend the company’s environmental policy, and disputed the allegations made by Russian regulatory agencies. The arena where TNK-BP’s CEO decided to discuss Russia’s investment climate was not at one of the production sites, but a public meeting in London. A decision to involve the public does not necessarily mean that representatives of oil companies directly contact journalists, in order to influence the storylines in the media – but touching on issues in a public speech to an audience of businesspeople, researchers and journalists could produce the same result: public debate about the stability of Russia’s investment climate.

Let us briefly recall the main developments outlined in Chapter 5. On 1 September 2003 BP and Russian oil company TNK established a joint venture, TNK-BP. TNK was owned by the Russian financial conglomerates Alfa, Access and Renova. BP and the Russian partners received a 50 per cent share each. The agreement was important for BP because TNK had major oil reserves and BP was, like most IOCs, searching for oil and gas reserves in a world characterized by rising oil prices and declining oil and gas reserves among IOCs. TNK-BP’s flagship was the Kovykta gas field, with RUSIA Petroleum as the operator. The licence

agreements stipulated that TNK-BP was to produce 9 billion m³ of gas annually. As explained, Gazprom has a monopoly position regarding the export of gas and the development of pipeline infrastructure in Russia. Compliance with the licence agreements was complicated since the region around the production field could consume only around 2 billion m³ gas annually, so profitable exploitation of the Kovykta field without Gazprom's approval to export gas was impossible. Furthermore, according to the 2005 federal law on Russia's subsoil and the 2008 law on foreign investment, 'strategic' onshore gas fields, such as the Kovykta field, are to be controlled by a Russian state company; private companies need permission from the authorities before acquiring more than a 50 per cent stake in a 'strategic' company.

Soon conflicts of interest occurred between the Russian authorities and TNK-BP because the oil company could not comply with the licence agreements. As noted, the difficulty of complying with formal rules – although in this case hardly the result of shortcomings in the legal system – ensures that everyone at some point can be accused of breaking Russian law (Pastukhov 2002:73). Although renegotiations of oil deals are a recurrent phenomenon (Vernon 1971:46; Stevens 2008:5), disagreements over licence agreements can accelerate these negotiations.

Table 6 shows the regulatory pressure exerted by the Russian authorities to pressure TNK-BP, formally, for the violation of licence agreements, but with the informal objective of securing for Gazprom a share in the lucrative project or re-negotiating a better deal for the Russian state. It could also be argued that pressure had begun when tax inspectors attempted to claim unpaid taxes in relation to BP's takeover of Sidanco in the late 1990s. TNK-BP acknowledged the charge and paid USD 1.44 billion of backdated tax to settle the case in 2006.¹⁴⁴ However, this move is not included in Table 6 because the tax claim had no direct impact on the development of the Kovykta field. In the end, TNK-BP gave in to the regulatory pressure over the licence agreements, acknowledged Gazprom's existing monopoly on export and pipeline infrastructure and subsequently signed a memorandum of understanding with Gazprom in June 2007. Negotiations between TNK-BP and Gazprom concerning the final price went on until RUSIA Petroleum filed for bankruptcy in June 2010; Gazprom purchased the assets in an auction in March 2011 at a price far below the market value of the Kovykta project.

¹⁴⁴ 'TNK-BP settles its back taxes in Russia' *Financial Times*, 11 November 2006, p. 15 (London 3rd edition).

| Date | Kind of pressure | Pressure exerted by |
|-----------------------|-------------------------|----------------------------|
| January 2007 | Inspection | Rosprirodnadzor |
| February – March 2007 | Inspection | Rosprirodnadzor |

Table 6: Pressure on RUSIA Petroleum, TNK-BP's operator at the Kovykta gas field (first half of 2007).

Again, TNK-BP was already violating the licence agreements when it acquired the Kovykta field after the joint venture with TNK in 2003. Why then were these agreements not enforced until the first half of 2007? In contrast to the conflict over Sakhalin II, here it is difficult to say exactly when and how many inspections Russian regulatory agencies conducted between 2003 and 2007, as this is not documented in independent reports, audits or company publications. A simple explanation could be that the Russian authorities wanted to give TNK-BP the opportunity to comply with the licence agreements. However, compliance was impossible, not only because the licence agreements stipulated a production of 9 billion m³ of gas annually, but also because the local market could not absorb such volumes and the authorities withheld approval of the necessary infrastructure and permission allowing TNK-BP the export of gas. Thus, 'suspended punishment', as outlined in Chapter 3.5, is here a better explanation (Ledeneva 2006:13). Punishment for violating the formal regulations is suspended, but can be enforced at any time – in this case, during the first part of 2007.

From the available documentation, it is unclear if the attack on Kovykta was the result of a coordinated action between the Russian authorities and the Russian shareholders in BP's joint venture with TNK (Øverland 2011:152). This seems unlikely, because such an attack was not in the latter's interest. A better explanation is that the Russian authorities were passive and provided the British and Russian shareholders with the opportunity to negotiate the financial terms until Gazprom inevitably would take over their shares, knowing that exploitation of the gas field in the meantime was impossible due to legal obstructions. When, according to the Russian authorities, these negotiations took too much time, the authorities started to pressure the operator of the Kovykta field for violation of licence agreements and environmental regulations during the first half of 2007.

Moreover, after Gazprom signed a memorandum of understanding with TNK-BP over the sale of the Kovykta field in June 2007, conflicts occurred between the British and the Russian shareholders of the oil company. The Kovykta gas field had been TNK-BP's flagship. When

the memorandum of understanding was signed and Gazprom acquired control over the Kovykta natural gas field for a price that would need to be negotiated in a later stage, Russian and British shareholders lost their assets for a price far below the market value. It is possible that conflicts emerged about who was to blame for the loss of these assets – the British or the Russian shareholders? Poussenkova (2008:50), on the other hand, argues that Gazprom was interested in a stake in TNK-BP itself, rather than simply taking over the Kovykta project.

The result in both cases was the same: an internal conflict within BP’s joint venture with Russian TNK as to which part would have to sell their shares to Gazprom, and for what price. It seems likely that the regulatory pressure and enforcement practices against TNK-BP’s (non-Russian) staff over visa irregularities were a coordinated action in which the Russian shareholders used regulatory agencies in order to pressure British shareholders. In Ledeneva’s terms, the Russian shareholders were insiders who were entitled to manipulate legal enforcement mechanisms to secure personal interests (Ledeneva 2006:3).

Again, with the shortcomings of Russia’s legal system as described in Chapter 3 as the helping hand, formal regulations (in this case immigration laws) were used to achieve an informal objective: to reduce the influence of foreign staff within TNK-BP. Table 7 presents the pressures that finally forced CEO Bob Dudley to step down in September 2008.

| Date | Kind of pressure | Pressure exerted by |
|-------------|--|-------------------------------|
| March 2008 | Employee charged with industrial espionage | Government security officials |
| March 2008 | Visa irregularities | Governmental officials |
| July 2008 | Visa irregularities | Governmental officials |

Table 7: Gradually increasing pressure on TNK-BP’s British shareholders (March 2008 – July 2008).

After analysing the dispute over the licence terms of the Kovykta field and the conflict within the board of TNK-BP, we now need to identify how BP has interpreted law enforcement practices and regulatory pressure in interactions with the Russian authorities. What kind of strategy did the company use for responding to the pressure exerted by the Russian authorities? Table 8 gives an overview of the strategies used by TNK-BP. The strategies were considered to be successful, from TNK-BP’s point of view, when an agreement to solve the problem had been achieved, whether in terms of new licence agreements or allowing the company to export gas. The conflict is divided into time periods, each with its own strategy.

| Period | Incident | TNK-BP's strategy | Strategy successful? |
|------------------------|--|--|-----------------------------|
| Nov. 2004 – Jan. 2007 | Tax claim and the lock-down of Kovykta | TNK-BP publicly mentions issues concerning Russia's investment climate | No |
| Jan. 2007 – June 2007 | Memorandum of Understanding secure Gazprom the purchase of the Kovykta field | Court case and publicly addressing issues concerning Russia's investment climate | No |
| Mar. 2008 – Sept. 2008 | Accusations of visa irregularities; pressure from trade unions | No general strategy (conflict within the board of TNK-BP) | No |

Table 8: Strategies of TNK-BP during different stages in the conflict with the Russian authorities and within the Board of Directors of TNK-BP (November 2004–September 2008).

1st period (November 2004 – January 2007)

This period started when TNK-BP was hit by a back-tax claim in the second part of 2004 subsequently settled in November 2004.¹⁴⁵ This, in combination with the lock-down of the Kovykta project provided the opportunity for TNK-BP CEO Bob Dudley to speak openly about the business climate in Russia at an economic forum in London in April 2005. The objective seemed to be to pressure the Russian authorities by publicly discussing the constraints of Russia's investment climate. As explained, the lock-down of the Kovykta field was the result of Gazprom's monopoly on infrastructure and the export of gas, in addition to later federal laws allowing only Russian state actors to own majority shares in 'strategic' oil and gas projects.

2nd period (January 2007 – June 2007)

As mentioned, the objective of Bob Dudley's speech in April 2005 seemed to be to launch a public debate over the stability of Russia's investment climate, hoping that such a debate would have an impact on the decision-making process on the Russian side, and perhaps unlock Kovykta. As a result, a debate about Russia's investment climate appeared in several

¹⁴⁵ 'TNK-BP faces Dollars 87m back-tax bill Russia', *Financial Times*, 12 November 2004, p. 16 (Europe 1st edition).

newspapers.¹⁴⁶ Chapters 7 and 8 presented the dominant storyline in the Western media including the above-mentioned period, arguing that the enforcement of formal regulations in Russia is subject to informal interests. This storyline certainly also drew on Shell's experience in the conflict on Sakhalin. However, TNK-BP's strategy of involving the public is here considered to be unsuccessful because Russian policy-makers were not sufficiently affected by Dudley's speech in London or by storylines in the Western media and kept up the pressure on Kovykta during the first half of 2007. The company made an attempt to clarify the licence agreements in a court case in May 2007, but the Russian court ruled that it had no authority to review the licence terms of a gas field. I can only speculate whether Ledeneva's (2008:324) concept of 'telephone justice' can be applied to this court case.

3rd period (March 2008 – September 2008)

During this period the conflict moved from a dispute between TNK-BP and the Russian authorities to a conflict within the Board of Directors of TNK-BP between the Russian and the British shareholders. A united strategy for TNK-BP can therefore not be identified. Moreover, after trying to publicly pressure the Russian authorities in the 1st period and initiating a court case in the 2nd period, the already disunited Board of Directors had few options available. In the end, visa irregularities related to the CEO's residence permit were the final blow, forcing Bob Dudley to step down as CEO in September 2008.

Already at an early stage, TNK-BP saw the problems, such as the lock-down of Kovykta, as a general problem related to Russia's business climate rather than stemming from the violation of licence agreements for a particular gas field. TNK-BP's Waterloo was not NGOs, forcing the company to defend its social policy, but internal problems within its Board of Directors between Russian and British shareholders. From a battle between TNK-BP and Russian authorities over the Kovykta field, it became a battle within TNK-BP, where the Russian shareholders used their privileged access to Russian security organs to put ostensibly legally-based pressure on BP, now driven more narrowly by private interests rather than those of Gazprom or the Russian state.

¹⁴⁶ Examples are the following newspaper articles published in the *Financial Times*: 'TNK-BP chief attacks Russia's uncertain investment climate', 13 April 2005, p. 8; 'Another Yukos?' 13 April 2005, p. 18 (London 2nd edition) and 'With his eye on keeping control, Putin misses a moment for economic reform', 15 April 2005, p. 17 (London 3rd edition).

9.7 Do Western actors understand regulatory practices the same way as Ledeneva?

In Chapter 3, I explained how Ledeneva argues that the enforcement of regulations in Russia is manipulative and subject to other interests than the logic of the law. The result is that formal regulations are replaced by rules introduced and negotiated outside the formal institutions (Ledeneva 2006:13). Her framework has been written from a Russian perspective, assuming that these are established games in which Russians understand the interplay between the informal and formal component of Russian society. Consequently, Russians deal with legal sanctions at the informal level, rather than complying with the formal rules. The inevitable result, according to Ledeneva, is that the violation of unwritten rules can result in the enforcement of written ones – which makes it more important to comply with the unwritten rules than the written ones. Here, however, I wish to see whether Western actors – in this dissertation, two major IOCs and four leading newspapers – interpret enforcement practices the same way as Ledeneva stipulates that Russian actors would interpret them. Again, law enforcement practices are in this dissertation defined as sanctions imposed by regulatory agencies for breaking formal regulations, for example fines or licence suspension (Macrory 2008:35–180), whereas regulatory pressure is defined as the *threat* to impose such sanctions. The Russian authorities have frequently applied both regulatory pressure and enforcement practices in their conflict with Shell and BP during the period studied here.

The analysis has shown that the dominant storyline in the Western media was that the enforcement of formal regulations and regulatory pressure against Shell and BP was subject to informal interests, thus emphasizing that the core of the conflict was *not* the violations of formal rules that both IOCs had been accused of committing. This storyline follows one of the main findings of Ledeneva's study of enforcement practices in Russia: that the incentives to exert regulatory pressure or impose sanctions against offenders serve other interests than the claimed purposes of these sanctions. According to the dominant storyline formal rules in Russia, such as environmental regulations and licence terms, were used in order to increase state control over the development of oil and gas projects. Other important aspects of the rule of law in Russia – like the difficulty of complying with written rules, resulting in the widespread violation of these regulations, consciously or unconsciously (as presented in Figure 3, Chapter 3) – received considerably less attention in the Western media studied. The same can be said for the conflict between the British and the Russian shareholders. The media did

not focus on the practice whereby insiders (in this case the Russian shareholders) use their contacts in state agencies in order to secure personal interests at the cost of outsiders who do not have access to the decision-making process (in this case TNK-BP's British shareholders). This perspective did not appear in the prevailing storyline of the newspapers, or in less dominant packages either.

Both Shell and BP appeared to understand Russian society as Ledeneva stipulates that it works, as a system of interconnected formal and informal levels in which the informal level is dominant. By opting for strategies like publicly pressuring the Russian authorities to stand off, both IOCs attempted to deal with the informally driven pressures. Rather than seeking to comply with the formal rules Shell and BP attempted to challenge the informal component. Compliance with the formal regulations was impossible due to their complexity and/or shortcomings. For example, it is obvious that setting a maximum permissible concentration for a particular pollutant to a value that is actually below the background level, will mean difficulties for a large-scale industrial project as Sakhalin II, if such a rule is enforced. Similarly, profitable development of the Kovykta gas field was impossible without governmental approval to export gas.

The fact that both IOCs could not comply with the formal rules is, as explained in Chapter 3, an essential part of the concept of informal practices in Russia. Anything except giving in to the informal interest that resulted in the enforcement of formal rules is considered to be useless and will inevitably result in further legal pressure. The complexity of complying with formal regulations is part of the basis for the manipulation of the legal system, and usually succeeds in making resistance futile for outsiders without direct state power or the willingness to play outside the formal rules.

Again, the fact that both Shell and BP opted for various strategies during their conflict with the Russian authorities indicates that both IOCs attempted to deal with the informally driven pressures, rather than seeking to comply with the formal regulations. Recall, for instance, that BP was aware of Gazprom's monopoly on gas export before it purchased the Kovykta field. The oil major most likely hoped to circumvent such formal barriers by gaining access to the decision-making process by acquiring a strong Russian partner.

Hence this study indicates that, unlike Russians, Western actors find it hard to fully understand the entire system of selective law enforcement as described by Ledeneva, even if they may partially understand it. Perhaps influenced by widespread reports of corruption, Western actors can understand that enforcement practices in Russia are manipulated and subject to processes outside the legal domain; that behind the enforcement of a formal law there may lie informal factors, such as a bribe or political interests.

However, BP and Shell's strategy of challenging the Russian authorities within this system by publicly pressuring them indicates that they either failed to fully understand the system, or misread the policy shift towards the petroleum sector. A third possibility is that both IOCs overestimated their own strength, or underestimated the determination and discipline of the Russian authorities. By failing to grasp the shift in enforcement style from a cooperation style towards a penalty-oriented style, both IOCs not only misunderstood enforcement practices in Russia, but also underestimated the determination of Russia's regulatory agencies. It was probably a combination of these errors that landed both oil companies in protracted conflict.

Finally, Shell and BP seemed to forget the important lesson from the literature, that the oil-producing *states* are in the drivers' seat and have a dominant position in relation to IOCs. Trying to counter-pressure the Russian authorities publicly may have been counter-productive, serving instead to agitate and further irritate the Russian actors involved.

9.8 Conclusions

This chapter has surveyed how the Western media and IOCs interpreted enforcement practices and regulatory pressure in Russia in the specific case of two major oil companies, Shell and BP. We have seen the storylines in the four newspapers studied here did not consist of two opposite positions where enforcement practices were interpreted as being either politically motivated or not. Instead, the analysis revealed several interpretive packages, each displaying its own argument. *The Guardian*, for example, had the perspective that the violations were seen as an opportunity for the Russian authorities to punish Shell and BP. There was consensus in the dominant storylines that enforcement practices and regulatory pressure against Shell (Sakhalin Energy) and later against BP's joint venture with TNK were subject to informal interests. By bringing forward the argument that the incentives to impose sanctions against these IOCs served purposes other than the claimed purposes, the dominant storylines displayed

one of the essential characteristics of system of selective enforcement described by Ledeneva. However, two other important characteristics – the difficulty of complying with regulations and the widespread violation of regulations – received considerably less attention in the media during the period under study.

Although my research has shown that involvement of the public was a strategy actively chosen by Shell and BP, it remains uncertain in what ways these IOCs directly influenced the storylines in the media in general and the analysed newspapers in particular. We have also seen that cost overruns, in combination with a strong wish to renegotiate the PSA signed in the 1990s, served as the trigger for the Russian authorities to impose sanctions on Shell. Conflicts of interest between the Russian authorities and TNK-BP occurred because TNK-BP did not, and could not, comply with the licence agreements and cost overruns. Although the literature (Vernon 1971:46; Stevens 2008:5) shows that renegotiations of oil deals are recurring events, disagreements over licence agreements can accelerate these negotiations. The conflict over the Kovykta field is a clear excellent example of ‘suspended punishment’: the rules are violated *a priori*, and, as a result, punishment is ‘suspended’ but can be enforced at any time.

10. Main findings of the study

The central objective of this study was to explain how Western actors interpret and deal with regulatory and enforcement practices in the Russian petroleum sector. This main research question was operationalized through three subsidiary research questions.

1. *How do IOCs understand regulatory pressure and law enforcement practices in Russia?*
2. *How does the Western media interpret regulatory pressure and law enforcement practices against IOCs in Russia?*
3. *Do Western actors understand regulatory practices and law enforcement the same way as Ledeneva stipulates that Russian actors would interpret them; in what ways do their understandings differ?*

These three subsidiary questions as formulated in Chapter 1 were answered in the previous chapter and comprise the core of this dissertation. This concluding chapter discusses the findings of my research more broadly.

Two similar conflicts between the two oil majors and the Russian state provided the background for this analysis. In both cases, the Russian authorities – operating on behalf of the state – accused the IOCs in question of violating formal regulations. Besides the examination of dominant storylines in four major newspapers, this research has shed light on the strategies pursued by Royal Dutch Shell and by BP's joint venture with TNK in response to regulatory pressures exerted by the Russian authorities, and has shown the challenges both companies faced when operating in Russia during the first decade of the 21st century.

Unfortunately it was difficult to get interviews with representatives of Shell, Sakhalin Energy and/or TNK-BP. One Russian respondent, who wished to remain anonymous, explained during a seminar in Rovaniemi, Finland, in November 2011 that oil companies are reluctant to discuss such issues because they often use informal practices to satisfy political or personal interests as part of their interaction process with particular state actors. (Examples of this could be certain payments that fall outside the formal framework such as bribes). It is to a certain degree also understandable that stock-listed companies are reluctant to discuss state–industry relations,

especially when they may have used informal practices and their home-states might have different ethical views when it comes to business strategies abroad. This is exemplified by the political sensitivity surrounding the theme of this dissertation. Instead of personal interviews with oil company executives, I therefore analysed the annual reports and company publications of Shell, Sakhalin Energy, BP and TNK-BP in order to identify the strategies selected by BP and Shell in their interaction with the Russian authorities.

Both cases stand as clear examples in the petroleum sector of Ledeneva's concept of selective enforcement, for several reasons. Firstly, the real motivations behind enforcement practices against the IOCs in question were personal or political interests, and hence became subject of discussion, in the Western media as well as in public documents published by the oil companies and other non-state actors. Secondly, both conflicts underscored the difficulties for IOCs of complying with formal regulations in Russia by stressing shortcomings in the Russian legal system – such as the incoherency of environmental rules on different governmental levels, complicated bureaucratic procedures and unclear immigration regulations. The result is a situation where the law can be invoked and used against anybody at any time ('suspended punishment', in Ledeneva's terminology). These characteristics are all essential parts of Ledeneva's framework. Crossing the personal or political interests of the Russian authorities, or private actors who have access to the formal decision-making process ensures that these complicated laws will be used against the offender, as has been documented here.

It seems likely that the violation of an unwritten rule, personal interest – or the establishment of a new informal demand which the IOCs needed to comply with – changed the relationship between state and IOC from one based on cooperation to a potential conflict between the oil companies and the authorities. The result of violating these unwritten rules was that the enforcement style transformed from a compliance style into a penalty style, with punishment of the offender as the main objective. The penalty style is characterized by the idea that the law must be upheld. Violation of the rules will inevitably result in sanctions, regardless of the excuses for violations, be it incoherency of the legislation or the benefits of a particular project for society in general. This transformation in the interaction process is important for a better understanding the state–IOC relationship. However, rather than seeking to explain the complexities of the system itself, the aim of this dissertation has been to understand how Western actors have interpreted and dealt with the peculiarities of Russia's legal system. The conclusions of this dissertation can be distinguished in several areas. Each area involves

different themes related to the objective of understanding how Western actors deal with regulatory practices in the Russian petroleum sector when they find themselves in conflict with the Russian authorities.

I. IOCs operating in Russia can have a two-level relationship with the authorities: a formal one between the state as regulator and enforcer of formal rules and the IOC as part of regulated community; and a more informal one where the state is in the driver's seat and the company has to accept the terms of the state.

Relationship between oil-producing states and private oil companies are characterized by periods of cooperation or conflict, depending on the oil price, among other things. As noted in the first chapter, the renegotiation of 'outdated' oil deals and re-nationalization of the oil industry is a recurring event throughout the world, and not a uniquely Russian phenomenon. Throughout history, a number of states have participated actively in the petroleum industry (Yergin 1991). These developments have occurred in most places where natural resources are to be found, also in the Netherlands and the United Kingdom, the home countries of the two oil majors studied here.

IOCs can have a double-edged relationship with the authorities of the country in which they operate. First there is a formal relationship where the state has the role of regulator and enforcer of formal institutions and the oil company in question is one of many actors within the regulated community. Violations of formal rules can trigger processes where these rules are enforced by the regulatory authorities, operating on behalf of the state, with the objective of punishing the offender, to ensure compliance with the formal rules, or – as in the cases covered in this thesis – to secure personal or political interests. Second, more informal relationships between IOCs and the oil-producing state are often subject to political developments which in turn are often influenced by the oil price. These developments, described as 'resource nationalism' (Stevens 2008; Bremmer and Johnston 2009) and the 'obsolescing bargain' (Vernon 1971), refer to conflicts of interest between oil-producing states and foreign companies. This phenomenon is typical for natural-resource rich countries, due to the strategic and economic importance of revenues from the extraction of natural resources. Conflicts between oil-producing states and IOCs are hardly unique to the Russian petroleum sector but have occurred and still occur in many other resource rich countries, such as Iran, Nigeria, Saudi Arabia and Venezuela. In all these conflicts IOCs are pressured by the oil-producing

states to accept less favourable terms for the development of existing or new oil and gas fields. Whether such pressure occurs in the form of the renegotiations of oil deals deemed outdated or re-nationalization of the petroleum sector is not decisive in this context.

As Øverland has argued (2011:154), ‘the difference lies not so much in what Russia has done, but how it has done it’. This dissertation has shown how Shell and BP gave in, after a period of heavy, coordinated pressure that effectively secured the informal demands from Russian state and business actors. The Russian authorities effectively pressured Shell and to a lesser degree TNK-BP to accept their terms. The pressure to agree upon new terms could be regarded as an informal demand or unwritten rule that IOCs must comply with. These rules are informal because they are not established in formal institutions. We recall the Russian state actor’s interest in participating in Sakhalin II and the Kovykta field, as involving informal rules that the IOCs were expected to comply with. As a result, the two oil majors in focus in this dissertation faced regulatory pressure because they failed – or refused – to comply with these informal rules, and indirectly, did not accept what was in fact the stronger position of Russia as the oil-producing state, as outlined in the ‘obsolescing bargain’ (Vernon 1971) and the literature on resource nationalism (Bremmer and Johnston 2009; Domjan and Stone 2010; Stevens 2008).

II. Shell and BP involved the public in their conflict with the Russian authorities, in unsuccessful attempts to put pressure on decision-makers in Russia.

From the available information, this research concludes that BP and Shell faced two challenges. The first challenge was to identify the interests or unwritten rules that apparently had been violated. Secondly, the companies needed to decide whether they were willing to accept processes driven by such informal factors. The strategies the two IOCs chose for dealing with this new burden made up the core of this dissertation. We saw that they used different kind of efforts – and subsequently faced different constraints – in seeking to identify and successfully comply with demands from the informal level.

Both BP and Shell were aware that at the core of their conflict was not the violation of licence terms for a particular gas field or environmental regulations, both of which are formal written frameworks. Tables throughout the dissertation have shown how environmental regulations were part of a broader conflict between Shell and the Russian authorities. The dispute over

Shell's violation of environmental regulations appeared only at a later stage of the conflict, when negotiations over new terms had been going on for a year already. Similarly, TNK-BP's failure to meet the licence terms, resulting in the take-over of the Kovykta field by Gazprom, was most likely the trigger for an internal conflict which in turn provided Russian business actors the opportunity to use their contacts in state agencies to enforce immigration regulations and thereby effectively reduce BP's influence in the joint venture.

When other efforts, such as negotiations behind the scenes, proved ineffective from Shell's point of view, the company sought to involve the public, such as journalists and business community, in a rather unsuccessful attempt to influence the Russian decision-makers. By contrast, TNK-BP decided to publicly address issues concerning Russia's investment climate already at an early stage of the interaction process with the authorities. For both companies, the objective was to pressure the Russian authorities by launching a public debate on the stability of Russia's investment climate and possible impacts on foreign direct investment in the country, thereby apparently hoping to influence the decision-making process in Moscow. This strategy is not unlike the game of 'chicken' where two vehicles – one driven by the IOCs, the other by the authorities – approach each other from opposite directions. The inevitable result will be a bad crash, unless one of the drivers yields and swerves aside. However, the storylines in the Western media failed to impress Russian decision-makers, probably also because these were published in Western newspapers less accessible to Russians than the Russian media, and – according to Ledeneva – Russians take more or less for granted that the enforcement of formal rules can be manipulated in order to achieve informal interests.

What happened was that the strategy of involving the public exacerbated Shell's predicament instead. From a financial dispute between company and the Russian authorities, the matter became an environmental issue where regulatory agencies accused Shell of violating environmental regulations. Moreover, Shell's move provided NGOs with additional ammunition for pressuring the company directly and indirectly through the EBRD for violation of environmental regulations and norms – which in turn forced Shell, as a stock-exchange listed company, to respond to these allegations in public. Shell was particularly vulnerable to pressure from NGOs because the company needed a loan from the EBRD in order to finance Phase II of the Sakhalin project.

The shortcomings of Russia's legal system, such as the complexity of complying with the formal rules, were hardly a surprise for the two oil majors. At an earlier stage, Shell was confronted with the incoherency of environmental legislation in Russia and the complex bureaucratic procedures involved in obtaining the necessary permits. Later on, the oil major ended up in a situation where environmental rules were used against it, at a juncture that can hardly be described as a coincidental. Because compliance with the environmental regulations was almost impossible, as Chapter 6 showed, the punishment was suspended, only to be enforced at a time considered appropriate by the Russian authorities – which proved to be after Shell had announced major cost overruns.

Similarly, BP knew in advance that exports from the Kovykta natural gas field would be subject to approval by the Russian authorities, and that the Kovykta field could be profitable only if most of its output could be exported to China and/or South Korea. Hence, the terms to ensure the maximum profitability of the project needed to be negotiated at a later stage. In the hunt for oil reserves, the British oil major most likely decided to postpone the negotiations over the development and profitability of the gas field, and first secured ownership of the field by gaining access to the Russian market through a joint venture with TNK. Perhaps BP assumed that this joint venture with a Russian partner would help secure the acquiescence of Gazprom and the Russian authorities, making BP in Ledeneva's terms, an 'insider' rather than an 'outsider'. However, the conflict with the Russian authorities and the internal dispute with the Russian shareholders showed that this strategy failed. The oil major remained an outsider because it had no access to the formal decision-making process and therefore was unable to manipulate formal regulations, unlike its adversaries.

III. The Western media interpreted enforcement against IOCs in Russia as driven by ulterior, informal motives.

In order to see how the Western media interpreted enforcement and regulatory practices against IOCs, four leading newspapers were examined and their dominant storylines identified. Chapters 7 and 8 analysed the storylines in four newspapers in the home countries of the two IOCs. Perhaps not surprisingly, the dominant storyline in all four newspapers was that the enforcement of formal regulations in Russia was motivated by personal interests or other informal drivers, and not by concern for the letter of the law. We saw that this dominant storyline did not consist of two opposite positions where enforcement practices were

interpreted as politically motivated or not. Instead, the analysis showed several interpretive packages, each with its own argument. Moreover, this analysis provided an interesting perspective on how enforcement and regulatory practices in Russia was covered and interpreted in Western media, in contrast to for example BP's oil spill in the Gulf of Mexico and Shell's policy regarding the disposal of the Brent Spar.

IV. Foreign companies operating in Russia should understand that the violation of formal regulations can be used against them for purposes not necessarily related to the violation of the formal rules for which they are being accused of – but as part of a broader conflict between Russian actors and the foreign companies in question.

This dissertation has shown some of the challenges involved in dealing with Russia, both on formal and on informal levels, where the informal level is dominant. In Russia, formal and informal levels are interconnected, and are part of a system where the enforcement of formal rules is not necessarily motivated by the logic of the law. Disputes over formal regulations can be part of a broader conflict between the Russian authorities – or, as this dissertation shows, private actors who have access to the decision-making process – and the victim. One should not be surprised if a dispute with Russia over the release of a person suspected of espionage suddenly turns into a ban on the import of, say, your apples because the Russian authorities argue that the apples contain contaminants that are a danger to the public health (after having the same quality for over 12 years). The victim can be an oil company, as studied here, or state actors, or universities or a whole range of other actors etc. Their challenge – and the key to the solution – lies not in dealing with the formal component, but in identifying the informal interest behind it, and dealing with that.

Note that far from all enforcement actions in Russia are selective and not all formal regulations are subject to manipulative enforcement mechanisms. But in spheres that are of strategic or economic importance for the Russian state, like the petroleum sector, the risk of becoming involved in selective enforcement practices or being the victim of a manipulative utilization of the formal rules may be assumed to be higher. This makes it important to distinguish two categories of formal regulations in Russia: a first category and a second one. Rules ranked in the first category are considered to be widely recognized and understood by everyone, such as the prohibition against driving through a red light, stealing, or theft. Enforcement of these rules is often straightforward and not subject to manipulation. Formal rules in the second category,

however, are less visible regulations, not widely understood by the people who are subject to these rules and are often enforced selectively for purposes unrelated to the dispute. Pastukhov refers to these often extremely complicated rules as ‘sleeping laws’ (2002:66). Examples of such laws are rules concerning the registration of inhabitants in living apartments, tax regulations and visa requirements. The enforcement style of the rules in the second category switches from a style focusing on cooperation and compliance during a time when the sanctions are suspended, to a penalty style with the objective to punish the offender when the sanction in question is imposed because some personal or political interests (at the informal level) have been violated. Back-tax claims and visa irregularities in business conflicts are examples documented in this dissertation. It would also be possible to use the terms ‘hard’ and ‘soft rules’, although that is inconsistent with the existing literature.

More important is that it seems likely that particular laws apply to particular people. In this dissertation, it is the ‘insiders’ (such as Russian business actors) with access to the decision-making process who ensure that these ‘sleeping’ laws are applied, in contrast to outsiders (Sakhalin Energy executives and Bob Dudley). Ledeneva argues that manipulation of the legal system is only authorized by ‘insiders’ at the cost of ‘outsiders’. Unfortunately, Ledeneva does not identify the position or characteristics of insiders and outsiders but explains that actors who are punished, for example by courts, for manipulation of the legal system are examples of actors unauthorized to conduct these informal practices, and hence considered to be outsiders. An example is the court case that TNK-BP initiated to clarify the licence agreements (Table 8). The court ruled that it had no authority to review the licence terms of a gas field, thereby saying that it regarded TNK-BP as an outsider. In other words: the company had no direct access to the decision-making process.

The conclusions of my research do not necessarily mean instability for IOCs or other foreign investors in Russia. Ironically, the alleged instability resulting from the selective enforcement of regulations may even provide a kind of stability for foreign investors because such selective enforcement establishes relatively clear rules of the game. The rules in this case – although on a more informal level rather than on the formal level as usual – are the participation of Russian state actors in the exploitation of major oil and gas projects, preferably as the majority shareholder. The development of the Shtokman field in the Barents Sea so far is one example of how these rules can play out. Laws are formal institutions of societies that prescribe the rules of the game. In today’s Russia, it is less relevant whether these regulations are in written

or unwritten: what is more important is that the rules of the game are understood by those subject to these rules. And as we have seen, learning to comply with these unwritten rules is necessary for oil international majors such as Shell and BP, if they are to participate in the exploitation of Russia's hydrocarbon resources.

11. Appendix

Appendix I: List of interviews and interview questions

A) List of interviews

| Organization: | Position: | Location: | Date: |
|---|---|------------------|----------------|
| NGO | Project coordinator oil and gas projects | Murmansk | December 2009 |
| Association of suppliers for oil and gas industry | Editor magazine | Murmansk | December 2009 |
| Association of suppliers for oil and gas industry | Deputy Director | Murmansk | December 2009 |
| Association of suppliers for oil and gas industry | Director General | Murmansk | December 2009 |
| NOC | Deputy Director | Murmansk | December 2009 |
| IOC | Researcher, Environment & Climate | Tromsø | June 2010 |
| IOC | Director, Communications | Tromsø | January 2008 |
| IOC | Chairman | Oslo | May 2009 |
| European company operating in Russia | General Director | The Hague | September 2010 |
| NGO | Advisor, Russian Department | Oslo | October 2010 |
| NOC | Head Public Affairs | Groningen | February 2010 |
| Research institute | Deputy Director | Oslo | October 2010 |
| Media | Journalist, newspaper | Amsterdam | February 2009 |
| European company operating in Russia | General Manager, Russia Environment & Agriculture | Arkhangelsk | November 2011 |
| Russian company | Director | Arkhangelsk | November 2011 |
| European company operating in Russia | Lawyer | Arkhangelsk | November 2011 |
| Research institute | Project leader | Tromsø | January 2012 |
| European company operating in Russia | Director | Arkhangelsk | November 2011 |
| IOC | Director operations in Russia | Tromsø | January 2008 |
| Research institute | Researcher | The Hague | July 2010 |
| Research institute | Researcher | The Hague | July 2010 |
| Research institute | Researcher | Oslo | July 2008 |
| Research Institute | Researcher | Oslo | July 2008 |
| University centre from a European university | Director | St. Petersburg | December 2007 |
| Russian state organization | Head, local department | Arkhangelsk | November 2011 |
| State governmental organization | Representative | The Hague | September 2010 |
| Research institute | Researcher | Oslo | July 2008 |
| Research institute | Researcher | Tromsø | March 2009 |

B) Interview questions

- Do you think that the conflict over Sakhalin II between Shell/Sakhalin Energy and the Russian authorities was a conflict over the violation of environmental rules, a more classical business conflict over the development of oil and gas projects, or both?
- What has been the role of the EBRD in Shell's dispute over Sakhalin II?
- What do you think has been the cause – or causes – of the conflict between TNK-BP and the Russian authorities over the development of the Kovykta field?
- Do you think that the dispute over Kovykta and the problems within the Board of Directors of TNK-BP are related to each other?
- Do you think that other IOCs faced similar problems in Russia, and if so, why do they receive less attention, for example, in the Western media than Shell and BP's dispute?
- There has been a huge number of publications in the media from both conflicts (for example in the Financial Times). Do you think that involvement of the public was a carefully selected strategy on the part of both oil companies?
- Are there similarities between Shell's dispute with the Russian authorities over the development of Sakhalin II and between TNK-BP and the Russian authorities over the development of the Kovykta field in particular and TNK-BP in general?
- Do you think that new conflicts could arise between IOCs operating in Russia and the Russian authorities, for example with regard to the Shtokman field?

Appendix II: Articles on BP and Shell’s operations in Russia in the *Financial Times*, September 2006 – December 2007 (total of 139 newspaper articles).

| Headline of newspaper article | Date of publication | The enforcement of formal regulations in Russia is subject to informal interests | The violations leave the IOCs susceptible to legal action | Regulatory pressure occurs in Russia, however, no explanation is provided | Other |
|--|---|--|---|---|-------|
| ‘Dollars 20bn Shell project faces Russian snag’ | 18 Sept. 18. 2006, p. 25 (London 1 st edition) | | X | | |
| ‘Russia’s stance on Shell sends a chilling message’ | 19 Sept. 2006, p. 20 (London 1 st edition) | X | | | |
| ‘Russia cancels Shell’s permit for Sakhalin II’ | 19 Sept. 2006, p. 1 (London 1 st edition) | X | | | |
| ‘BP/Shell/Russia’ | 19 Sept. 2006, p. 18 (London 1 st edition) | | X | | |
| ‘Moscow faced with global oil backlash’ | 20 Sept. 2006, p. 1 (London 1 st edition) | X | | | |
| ‘Moscow denies political move for cancelling gas permit’ | 20 Sept. 2006, p. 8 (London 1 st edition) | | X | | |
| ‘Cynical in Sakhalin; Russia must not re-negotiate oil contracts by the back door’ | 20 Sept. 2006, p. 18 (London 1 st edition) | | X | | |
| ‘Putin makes Shell’s ‘big ears’ flap’ | 21 Sept. 2006, p. 18 (London 1 st edition) | X | | | |
| ‘Prosecutors put TNK-BP Russia licence at risk’ | 21 Sept. 2006, p. 22 (London 1 st edition) | X | | | |
| ‘Hail to risk managers’ | 21 Sept. 2006, p. 22 (London 1 st edition) | X | | | |
| ‘Threat to Sakhalin-2 shakes confidence’ | 23 Sept. 2006, p. 8 (London 1 st edition) | X | | | |
| ‘Moscow reassures Shell over Sakhalin’ | 26 Sept. 2006, p. 11 (London 1 st edition) | | | X | |
| ‘Emerging markets short of bargains’ | 28 Sept. 2006, p. 44 (London 1 st edition) | | | | X |
| ‘Gazprom approach puts pressure on TNK-BP’ | 29 Sept. 2006, p. 28 (London 1 st edition) | X | | | |
| ‘Sakhalin-2 fell afoul of zealous official’ | 29 Sept. 2006, p. 12 (London 1 st edition) | | X | | |
| ‘Oil group engineer shot dead in Siberia’ | 3 Oct. 2006, p. 10 (London 1 st edition) | | | X | |
| ‘Death puts Russian spotlight on BP’ | 4 Oct. 2006, p. 20 (London 1 st edition) | X | | | |
| ‘Small oil operating ‘below the radar’ | 4 Oct. 2006, p. 20 (London 1 st edition) | X | | | |
| ‘Algiers turns up nationalistic heat in oil and gas industry’ | 6 Oct. 2006, p. 6 (London 1 st edition) | X | | | |

| | | | | | |
|--|--|---|---|---|---|
| 'Long on resources but short on clear rules' | 10 Oct. 2006, p. 3 (London 1 st edition) | | X | | |
| 'US shrugs off setback over gas supplies' | 11 Oct. 2006, p. 8 (London 1 st edition) | | X | | |
| 'EU invitation to Putin 'diplomatic blunder' | 16 Oct. 2006, p. 6 (London 1 st edition) | | | X | |
| 'Putin dinner 'risks' exposing EU splits' | 18 Oct. 2006, p. 2 (Europe 1 st edition) | X | | | |
| 'Russia threatens to revoke 19 Lukoil oilfield licences' | 26 Oct. 2006, p. 6 (London 1 st edition) | | X | | |
| 'Probe into Shell's Sakhalin-2 is extended' | 26 Oct. 2006, p. 20 (London 1 st edition) | | X | | |
| 'Shell optimistic on Sakhalin' | 27 Oct. 2006, p. 19 (London 1 st edition) | | X | | |
| 'TNK-BP settles its back taxes in Russia' | 11 Nov. 2006, p. 15 (London 3 rd edition) | | | X | |
| 'Out on a limb' | 23 Nov. 2006, p. 15 (London 1 st edition) | | X | | |
| 'BP and Rosneft sign Dollars 700m Sakhalin deal' | 23 Nov. 2006, p. 20 (London 1 st edition) | | | | X |
| 'Hambro Mining hit as Russia warns on licences' | 30 Nov. 2006, p. 17 (London 1 st edition) | X | | | |
| 'Gazprom holds the keys to the kingdom' | 5 Dec. 2006, p. 4 (Surveys edition) | | | X | |
| 'World prepares for a transformed industry' | 5 Dec. 2006, p. 5 (London 1 st edition) | | | X | |
| 'Sakhalin-2 water permits withdrawn' | 8 Dec. 2006, p. 20 (London 1 st edition) | X | | | |
| 'Why Shell's compromise is no solution for Russia' | 12 Dec. 2006, p. 23 (London 1 st edition) | | X | | |
| 'Who might be next?' | 12 Dec. 2006, p. 19 (London 1 st edition) | | X | | |
| 'The 'elephant project' still on thin ice' | 12 Dec. 2006, p. 19 (London 1 st edition) | | | | X |
| 'Shell offers Gazprom control of Sakhalin-2' | 12 Dec. 2006, p. 1 (London 1 st edition) | | X | | |
| 'In Russia, control justifies the means procuring Gazprom a substantial stake in Sakhalin-2 was the Russian government's real purpose' | 12 Dec. 2006, p. 19 (London 1 st edition) | | X | | |
| 'Gazprom's gas grab' | 12 Dec. 2006, p. 14 (London 1 st edition) | | X | | |
| 'Hazards of doing business in Russia' | 12 Dec. 2006, p. 19 (London 1 st edition) | X | | | |
| 'Peter Hambro in damage limitation move after reports about its Russian licences' | 13 Dec. 2006, p. 19 (London 1 st edition) | X | | | |
| 'Gazprom close to deal with Shell on Sakhalin-2' | 13 Dec. 2006, p. 19 (London 1 st edition) | | | X | |
| 'Peter Hambro Mining gains Russian relief' | 15 Dec. 2006, p. 18 (London 1 st edition) | X | | | |
| 'Minister refuses to give official warning to environmental watchdog' | 15 Dec. 2006, p. 18 (London 1 st edition) | X | | | |
| 'Living in the long shadow of a resurgent Russia' | 15 Dec. 2006, p. 4 (Surveys edition) | X | | | |
| 'Shell nears deal with Gazprom' | 18 Dec. 2006, p. 22 (London 1 st edition) | | X | | |
| 'Nyet effect' | 19 Dec. 2006, p. 20 (London 1 st edition) | X | | | |
| 'Accident-prone BP' | 19 Dec. 2006, p. 18 (London 2 nd edition) | | | | X |
| 'Timing remains the key to BP's succession plans' | 21 Dec. 2006, p. 19 (London 1 st edition) | X | | | |
| 'Russia's gas champion reaches out to with the European consumer' | 21 Dec. 2006, p. 6 (London 1 st edition) | X | | | |

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|--|--|---|---|---|---|
| 'Shell learns cold reality of Russian deals' | 22 Dec. 2006, p. 19 (London 1 st edition) | | X | | |
| 'Gazprom to pay Dollars 7,45bn to control Sakhalin-2' | 22 Dec. 2006, p. 1 (London 1 st edition) | X | | | |
| 'Shell/Sakhalin' | 23 Dec. 2006, p. 14 (London 1 st edition) | | X | | |
| 'BP under pressure on Kovykta's venture threatened with loss of Russian licence' | 23 Dec. 2006, p. 15 (London 1 st edition) | X | | | |
| 'Sharing down the barrel of a new year for many chief executives' | 27 Dec. 2006, p. 16 (London 1 st edition) | | | X | |
| 'There are times when you cannot be sure of Shell' | 29 Dec. 2006, p. 16 (London 1 st edition) | | | X | |
| 'Russians hit Shell with extra bill over Sakhalin' | 29 Dec. 2006, p. 1 (London 1 st edition) | | | X | |
| 'Amvescap advances on bid rumours' | 30 Dec. 2006, p. 32 (London 1 st edition) | | | X | |
| 'Momentum of Russian rally will overcome most obstacles' | 4 Jan. 2007, p. 36 (London 1 st edition) | X | | | |
| 'Frosty Congress on collision course with Moscow' | 10 Jan. 2007, p. 10 (London edition) | X | | | |
| 'EBRD drops work on loan for Sakhalin-2' | 12 Jan. 2007, p. 8 (London 1 st edition) | X | | | |
| 'Ministry to probe licence of TNK-BP' | 19 Jan. 2007, p. 18 (London edition) | X | | | |
| 'Moscow plans to reserve new oilfields for state giants' | Jan 23, 2007, p. 7 (London 1 st edition) | X | | | |
| 'Shell increases Canadian offer' | Jan 24, 2007, p. 20 (London 1 st edition) | | | X | |
| 'Record profit may mark apex at Shell' | Jan 29, 2007, p. 21 (London 1 st edition) | | | | X |
| 'Russia tightens grip on BP gas venture' | 10 Feb. 2007, p. 15 (London 1 st edition) | X | | | |
| 'Cash handouts hit investment' | 22 Feb. 2007, p. 19 (London 1 st edition) | X | | | |
| 'BP under pressure over Kovykta field' | 28 Feb. 2007, p. 20 (London 1 st edition) | X | | | |
| 'Gazprom test ground for joint venture with BP' | 2 Mar. 2007, p. 22 (London 1 st edition) | X | | | |
| 'Doubling of oil reserves lifts imperial by 40%' | 7 Mar. 2007, p. 19 (London 1 st edition) | X | | | |
| 'The new seven sisters' | 12 Mar. 2007, p. 15 (London 1 st edition) | X | | | |
| 'Russia gives TNK-BP ultimatum on Kovykta' | 17 Mar. 2007, p. 14 (London 2 nd edition) | X | | | |
| 'TNK-BP and Rosneft' | 24 Mar. 2007, p. 14 (London 1 st edition) | X | | | |
| 'Shrewd move puts BP in winning position even if it fails on Rosneft' | 24 Mar. 2007, p. 16 (London 1 st edition) | X | | | |
| 'Kremlin throws the door open on Yukos' | 26 Mar. 2007, p. 24 (London 1 st edition) | X | | | |
| 'Analysts sceptical as BP quits Yukos auction at first stage' | 28 Mar. 2007, p. 1 (London 3 rd edition) | | | X | |
| 'Moscow rules' | 29 Mar. 2007, p. 14 (London 1 st edition) | X | | | |
| 'Russia M&A activity hits records Dollars 71bn' | 2 Apr. 2007, p. 8 (London 1 st edition) | | | X | |
| 'Shell pounds 3.8 buyout of Canada unit' | 3 Apr. 2007, p. 20 (London 1 st edition) | | | X | |
| 'Russian bargain that comes at price' | 5 Apr. 2007, p. 24 | X | | | |
| 'Approach that is globally acceptable but better suited to home' | 20 Apr. 2007, p. 6 (Surveys edition) | | X | | |
| 'The state's unsated appetite' | 20 Apr. 2007, p. 4 (Surveys edition) | X | | | |

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|---|--|---|---|---|--|
| 'Russian revenge' | 23 Apr. 2007, p. 10 (London 1 st edition) | X | | | |
| 'Disciplined Finn finding his voice' | 25 Apr. 2007, p. 21 (London 1 st edition) | | X | | |
| 'Urals Energy joints Russian targets' | 16 May 2007, p. 22 (London 1 st edition) | X | | | |
| 'Foreign investors' | 18 May 2007, p. 4 (Surveys edition) | X | | | |
| 'Industrial giant tap into frozen wealth' | 18 May 2007, p. 1 (Surveys edition) | X | | | |
| 'Moscow ready to revoke licence for BP Russian venture in 'days' | 22 May 2007, p. 1 (London 1 st edition) | X | | | |
| 'TNK-BP faces loss of licence' | 29 May 2007, p. 19 (London 1 st edition) | X | | | |
| 'Russian power reform' | 31 May 2007, p. 20 (London 1 st edition) | X | | | |
| 'Alarm at Russia's BP threat' | 1 June 2007, p. 28 (London 1 st edition) | X | | | |
| 'Oil groups can still gain from a new era in Russia' | 1 June 2007, p. 17 (London 1 st edition) | X | | | |
| 'Russia postpones TNK-BP licence decision' | 2 June 2007, p. 19 (London 1 st edition) | X | | | |
| 'Litvinenko probe source UK ties, says Russia' | 2 June 2007, p. 5 (London 2 nd edition) | | | X | |
| 'Seizure later' | 2 June 2007, p. 12 (London 1 st edition) | | X | | |
| 'Blair to quiz Putin about BP and Shell' | 2 June 2007, p. 23 (London 1 st edition) | | X | | |
| 'Pipeliner all!' | 6 June 2007, p. 1 (London 1 st edition) | | X | | |
| 'UK steps up alert on investing in Russia' | 7 June 2007, p. 1 (London 1 st edition) | X | | | |
| 'Cold front why the Kremlin is making a stand over missile defence' | 8 June 2007, p. 13 (London 1 st edition) | | | X | |
| 'Business undeterred by Moscow doubts' | 11 June 2007, p. 6 (London 1 st edition) | X | | | |
| 'UK investors say Blair's stance with Putin could harm business' | 12 June 2007, p. 1 (London 1 st edition) | | X | | |
| 'TNK-BP edges toward an accord with Gazprom' | 16 June 2007, p. 21 (London 1 st edition) | X | | | |
| 'Big four making their mark on power business' | 19 June 2007, p. 8 (London 1 st edition) | X | | | |
| 'Laid low by scandal' | 19 June 2007, p. 3 (London 1 st edition) | X | | | |
| 'A new era of nationalism' | 19 June 2007, p. 2 (London 1 st edition) | | | X | |
| 'BP chief wants better access for Russia' | 19 June 2007, p. 20 (London 2 nd edition) | | | X | |
| 'A new climate of change' | Jun 19, 2007, p. 1 (Surveys edition) | X | | | |
| 'End of dispute means BP can continue to do business in Russia' | 23 June 2007, p. 15 (London 1 st edition) | X | | | |
| 'BP submits to Kremlin pressure and hands Kovykta to Gazprom' | 23 June 2007, p. 1 (London 1 st edition) | X | | | |
| 'Exxon faces tricky talks over Sakhalin gas exports' | 28 June 2007, p. 24 (London 1 st edition) | X | | | |
| 'Mileage still in energy' | 2 July 2007, p. 20 (Surveys edition) | X | | | |
| 'Shtokman offers hope of tuning tide for big oil' | 10 July 2007, p. 24 (London 1 st edition) | | X | | |
| 'Kitchen-sink diplomacy' | 17 July 2007, p. 18 (London 1 st edition) | X | | | |
| 'Business aim to limit the fallout' | 18 July 2007, p. 3 (London 1 st edition) | X | | | |
| 'BP seeks growth in joint ventures' | 24 July 2007, p. 19 (London 1 st edition) | X | | | |
| 'Oil group warned over delay to Kazakh project' | 31 July 2007, p. 4 (London 1 st edition) | | X | | |

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|--|--|---|---|--|---|
| 'Moscow turns up heat on Sakhalin investors' | 3 Aug. 2007, p. 2 (Europe edition) | X | | | |
| 'LSE should encourage the rule of law in Russia' | 4 Aug. 2007, p. 8 (London 1 st edition) | X | | | |
| 'Putin appoints Rosneft ally to Sakhalin Island' | 8 Aug. 2007, p. 6 (London 1 st edition) | X | | | |
| 'How oil majors can thrive in an age of state monopolies' | 10 Aug. 2007, p. 11 (London 1 st edition) | | X | | |
| 'WWF pursues Sakhalin judicial review' | 16 Aug. 2007, p. 2 (London 1 st edition) | | | | X |
| 'Row halts work on Kazakh oilfield' | 28 Aug. 2007, p. 5 | X | | | |
| 'A Caspian halt shows oil giants face fresh political perils' | 4 Sept. 2007, p. 11 (London 1 st edition) | X | | | |
| 'Law strengthens Kazakh hand in dispute with ENI' | 27 Sept. 2007, p. 7 | X | | | |
| 'Too good to resist' | 2 Oct. 2007, p. 1 (Surveys edition) | X | | | |
| 'Sakhalin Energy is given a green bill of health' | 9 Oct. 2007, p. 27 (London 2 nd edition) | | X | | |
| 'Politics 'no bar' to Anglo-Russian business' | 11 Oct. 2007, p. 8 | X | | | |
| 'Highland Gold wins key licence extension for Russian project' | 11 Oct. 2007, p. 22 (London 1 st edition) | X | | | |
| 'TNK-BP plans to boost output' | 26 Oct. 2007, p. 21 (London 1 st edition) | X | | | |
| 'Ten top powers to be reckoned with' | 9 Nov. 2007, p. 8 (London 1 st edition) | X | | | |
| 'State groups give majors a run for their money' | 9 Nov. 2007, p. 6 (London 1 st edition) | | X | | |
| 'Protest builds amid contamination fears' | 9 Nov. 2007, p. 6 (London 1 st edition) | | | | X |
| 'Opportunity lost as gas markets set to tighten' | 9 Nov. 2007, p. 14 (London 1 st edition) | | X | | |
| 'Moscow's tightening grip' | 9 Nov. 2007, p. 3 (London 1 st edition) | X | | | |
| 'Big shift in balance of power' | 9 Nov. 2007, p. 7 (London 1 st edition) | | | | X |
| 'Gazprom considers stake in Timan and Imperial Energy' | 13 Nov. 2007, p. 28 (London 1 st edition) | X | | | |
| 'Heir to Russia Inc mixes ruthlessness with diplomacy' | 11 Dec. 2007, p. 2 (London 1 st edition) | X | | | |
| 'EU wary as Russia puts a velvet glove on its iron fist' | 12 Dec. 2007, p. 28 (London 1 st edition) | | | | X |
| 'The year Russia flexed its diplomatic muscle' | 17 Dec. 2007, p. 4 (London 1 st edition) | X | | | |

Appendix III: Articles on BP and Shell’s operations in Russia in *The Guardian*, August 2006 – October 2007 (51 newspaper articles).

| Headline of newspaper article | Date of publication | The enforcement of formal regulations in Russia is subject to informal interests | The violations leave the IOCs susceptible to legal action | Shell and BP have violated environmental norms and licence agreements | The Kremlin pressured Shell and BP, no further explanation provided | Other |
|---|----------------------|--|---|---|---|-------|
| ‘Moscow puts legal pressure on Shell to halt pipeline’ | 4 Aug. 2006, p. 24 | | X | | | |
| ‘Russia tries to rein in foreign oil firms’ | 19 Sept. 2006, p. 22 | X | | | | |
| ‘Investors fear economic cold war as Kremlin eyes Western assets’ | 20 Sept. 2006, p. 25 | X | | | | |
| ‘Blair wades in to Russia oil crisis’ | 24 Sept. 2006 | X | | | | |
| ‘Moscow makes its power play’ | 24 Sept. 2006 | X | | | | |
| ‘Environmentalists back Putin over Shell’s energy permit’ | 25 Sept. 2006, p. 21 | | X | | | |
| ‘Russia gives out mixed messages to Shell and BP’ | 26 Sept. 2006, p. 26 | X | | | | |
| ‘Shell hailed troubled project as world model’ | 27 Sept. 2006, p. 25 | | | X | | |
| ‘Russia denies ulterior motives over Sakhalin’ | 27 Sept. 2006, p. 25 | | | X | | |
| ‘Kremlin attack dog vows to take Shell in the battle of Sakhalin’ | 4 Oct. 2006, p. 25 | | X | | | |
| ‘Oil and gas rights: the weapons of a new Cold War’ | 15 Oct. 2006 | X | | | | |
| ‘Shell’s environmental efforts fail to quell Russian threat’ | 17 Oct. 2006, p. 29 | | X | | | |
| ‘Russia investigates Shell’s Sakhalin-2 project’ | 25 Oct. 2006 | | X | | | |
| ‘Kremlin warns of charges in Sakhalin gas inquiry’ | 26 Oct. 2006, p. 26 | | X | | | |
| ‘Shell beats forecasts’ | 26 Oct. 2006 | X | | | | |
| ‘Shell profits beat expectations and fuel City’s hopes of recovery’ | 27 Oct. 2006, p. 32 | X | | | | |
| ‘Big oil may have to get even bigger to survive’ | 29 Oct. 2006 | | | | X | |

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|--|---------------------|---|---|---|---|---|
| 'Rouble trouble: the risks of Russian boards' | 5 Nov. 2006 | | X | | | |
| 'Fears over Sakhalin-2 revealed in Shell emails' | 6 Nov. 2006, p. 23 | | | X | | |
| 'Russian threat to sue Shell for billions over Sakhalin' | 11 Nov. 2006, p. 38 | X | | | | |
| 'For months, Kremlin piled on the pressure until Shell could take no more' | 12 Dec. 2006, p. 23 | X | | | | |
| 'Stepping on the gas' | 12 Dec. 2006 | X | | | | |
| '\$20bn gas project sized by Russia' | 12 Dec. 2006, p. 1 | X | | | | |
| 'Shell struggles to get a better deal as Russia closes in' | 13 Dec. 2006, p. 20 | X | | | | |
| 'Greenpeace lawyer prepares case against Shell' | 15 Dec. 2006, p. 31 | X | | | | |
| 'Sakhalin issues 'settled' as Russia takes 50% stake' | 22 Dec. 2006, p. 25 | | X | | | |
| 'BP's boss doesn't look so slick now' | 24 Dec. 2006 | | | | X | |
| 'Kremlin Inc ready to take on the West' | 7 Jan. 2007 | X | | | | |
| 'Coming in from the cold' | 10 Jan. 2007, p. 28 | | X | | | |
| 'City fears BP will be seen as 'dead money' until new king is crowned' | 16 Jan. 2007, p. 25 | | | X | | |
| 'Sakhalin blow hits Shell's reserves' | 28 Jan. 2007 | | | X | | |
| 'Exxon and Shell see profits rocket' | 1 Feb. 2007 | | | | X | |
| 'Profits up a fifth but Shell emits more CO2 than most countries' | 2 Feb. 2007, p. 28 | | | X | | |
| 'BP offers Gazprom a stake after Kremlin sets impossible target' | 16 Feb. 2007, p. 29 | X | | | | |
| 'Kremlin may force BP to share oil venture' | 20 Mar. 2007, p. 26 | X | | | | |
| 'We want to stay in Russia, BP boss tells Putin' | 24 Mar. 2007, p. 38 | | | | X | |
| 'Thin smile from Shell as it sells Sakhalin stake' | 19 Apr. 2007, p. 25 | X | | | | |
| 'BP control over Siberian gas field slipping away' | 29 May 2007, p. 24 | X | | | | |
| 'BP marks return to Libya with \$900m gas deal' | 30 May 2007, p. 21 | X | | | | |
| 'New fears of state takeover of BP gas field' | 5 June 2007, p. 26 | | | X | | |
| 'Putin's tough talk over gas may yet flare up in his face' | 10 June 2007 | X | | | | |
| 'BP retreats from Russia with £400m' | 23 June 2007, p. 34 | X | | | | |
| 'Banks warned not to fund Sakhalin-2 project' | 2 July 2007, p. 29 | | | | | X |
| 'Beware of energy nationalism, warns global agency' | 10 July 2007, p. 25 | X | | | | |
| 'Russian row puts British firms on alert' | 22 July 2007 | | | | X | |

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|--|---------------------|---|---|---|---|---|
| 'Wildlife claims stop Shell drilling in Arctic' | 24 July 2007, p. 21 | | | X | | |
| 'Gazprom seeks BP's help to break into American energy supply' | 24 Aug. 2007, p. 36 | | | | | X |
| 'UK oil firms cheating investors, says Russia' | 27 Aug. 2007, p. 21 | | X | | | |
| 'Kazakhs halt Shell oil project' | 29 Aug. 2007, p. 25 | | | X | | |
| 'Oil boss sees no answers blowing in the wind' | 31 Aug. 2007, p. 29 | | | | X | |
| 'BP drives to drill itself out of a hole' | 21 Oct. 2007 | X | | | | |

Appendix IV: Articles on BP and Shell's operations in Russia in *Financieel Dagblad*, September 2006 – November 2007 (56 newspaper articles).

| Headline of newspaper article | Date of publication | The enforcement of formal regulations in Russia is subject to informal interests | The violations leave the IOCs susceptible to legal action | Shell has violated environmental norms and licence agreements | The Kremlin cancels Shell's environmental permit | Russia seeks a better share of oil and gas revenues | Other |
|--|----------------------|--|---|---|--|---|-------|
| 'Russia shuts down Shell project' | 19 Sept. 2006, p. 1 | X | | | | | |
| 'Shell needs to take a look at it' | 20 Sept. 2006, p. 13 | X | | | | | |
| 'Criticism of stopping Shell project in Russia' | 20 Sept. 2006, p. 13 | X | | | | | |
| 'Wine' | 21 Sept. 2006, p. 15 | | | | | X | |
| 'Bot and Shell' | 22 Sept. 2006, p. 9 | | X | | | | |
| 'New reality' | 23 Sept. 2006, p. 6 | | | | | X | |
| 'Balkenende calls Putin about Sakhalin' | 23 Sept. 2006, p. 3 | | | X | | | |
| 'Shell's activities on Sakhalin continue' | 26 Sept. 2006, p. 11 | | | | X | | |
| 'Putin turns on the screws at Shell' | 28 Sept. 2006, p. 17 | X | | | | | |
| 'Russia will follow contract with Shell' | 29 Sept. 2006, p. 1 | | | | | X | |
| 'Russia retains the free market' | 29 Sept. 2006, p. 5 | | | | | X | |
| 'A lot of interest for trading delegation to Ukraine and Russia' | 29 Sept. 2006, p. 5 | | | | X | | |
| 'Europe can resist Russia' | 30 Sept. 2006, p. 7 | X | | | | | |
| 'Russia will talk with Shell about Sakhalin' | 5 Oct. 2006, p. 1 | X | | | | | |
| 'Russian Audit Authority aims arrows at Exxon' | 7 Oct. 2006, p. 5 | X | | | | | |
| 'Moscow needs to offer stability' | 13 Oct. 2006, p. 5 | X | | | | | |
| 'Rapid action against climate problem' | 20 Oct. 2006, p. 5 | X | | | | | |

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|--|---------------------|---|---|---|---|---|---|
| 'Shell receives tax claim in Russia' | 21 Oct. 2006, p. 9 | X | | | | | |
| 'Putin denounces Shell's high costs' | 21 Oct. 2006, p. 9 | | | X | | | |
| 'European leaders support top institute' | 21 Oct. 2006, p. 5 | | | | X | | |
| 'Russian state makes war against the market' | 23 Oct. 2006, p. 5 | X | | | | | |
| 'Costs Sakhalin higher than expected' | 23 Oct. 2006, p. 11 | | | | | | X |
| 'Putin plays the game tough' | 24 Oct. 2006, p. 7 | X | | | | | |
| 'Amsterdam starts financial season optimistic' | 24 Oct. 2006, p. 19 | | | | | | X |
| 'Disharmony' | 25 Oct. 2006, p. 9 | | | | | X | |
| 'Holland along with the Japanese step into the breach for Sakhalin II project' | 25 Oct. 2006, p. 5 | | | | X | | |
| 'Russia is a spot on Shell's financial results' | 27 Oct. 2006, p. 13 | X | | | | | |
| 'Europe's dealing with power' | 28 Oct. 2006, p. 7 | X | | | | | |
| 'Sakhalin catalyst for energy dialogue' | 14 Nov. 2006, p. 9 | X | | | | | |
| 'Many regulations violated at Sakhalin gas project' | 6 Dec. 2006, p. 1 | X | | | | | |
| 'Shell worried about Sakhalin project' | 9 Dec. 2006, p. 11 | X | | | | | |
| 'Shell bends for Kremlin regarding Sakhalin' | 12 Dec. 2006, p. 11 | X | | | | | |
| 'Gazprom aims half of Shell project' | 13 Dec. 2006, p. 11 | | X | | | | |
| 'New delay threatens Shell's Sakhalin project' | 14 Dec. 2006, p. 19 | | X | | | | |
| 'Shell pushed aside in Russia' | 22 Dec. 2006, p. 17 | | X | | | | |
| 'Gazprom takes over control at Sakhalin' | 22 Dec. 2006, p. 17 | | X | | | | |
| 'Shell's gas exploitation in trouble' | 23 Dec. 2006, p. 1 | X | | | | | |
| 'Energy illusions' | 28 Dec. 2006, p. 7 | | | | | X | |
| 'Russia designs costly security economy in Soviet style' | 29 Dec. 2006, p. 9 | X | | | | | |
| 'Week agenda' | 8 Jan. 2007, p. 8 | X | | | | | |
| 'BP surprises investors with low production' | 10 Jan. 2007, p. 11 | X | | | | | |
| 'Gazprom and Rosneft divide offshore fields' | 27 Jan. 2007, p. 13 | X | | | | | |
| 'Power transfers to the east' | 27 Jan. 2007, p. 13 | X | | | | | |
| 'Nigeria slows down the speed of Shell' | 2 Feb. 2007, p. 9 | X | | | | | |

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|---|------------------------|---|---|--|--|--|---|---|
| 'Sakhalin II is already sold out' | 12 Feb. 2007, p. 9 | | | | | | | X |
| 'Agenda of the week' | 12 Feb. 2007, p. 8 | X | | | | | | |
| 'Gazprom wants to sell themselves in EU' | 22 Feb. 2007, p. 7 | X | | | | | | |
| 'We need a Kalker' | 24 Feb. 2007, p. 5 | X | | | | | | |
| 'Shell changed the rules, not Russia' | 13 Mar. 2007, p. 3 | | | | | | X | |
| 'New relationship with Russia is strongly needed' | 10 Apr. 2007, p. 5 | | | | | | X | |
| 'Shell condemned to play role in the margin' | 1 June 2007, p. 6 | X | | | | | | |
| 'BP in irksome hug of Russian bear' | 2 June 2007, p. 11 | X | | | | | | |
| 'Companies kiss Putin's hand' | 11 June 2007, p. 11 | X | | | | | | |
| 'Shell chief goes away after controversial e-mail' | 22 June 2007, p. 13 | X | | | | | | |
| 'Climate provides surprising winners' | 28 June 2007, p. 5 | X | | | | | | |
| 'OPEC has many friends; Producers are pleased with high oil prices' | 3 Nov. 2007, p. 17 | | X | | | | | |

Appendix V: Articles on BP and Shell's operations in Russia in *De Volkskrant*, September 2006 – December 2007 (46 newspaper articles).

| Headline of newspaper article | Date of publication | The enforcement of informal regulations in Russia is subject to informal interests | The violations leave the IOCs susceptible to legal action | The Kremlin cancels the environmental permit for Shell at Sakhalin | Shell has violated environmental regulations and licence agreements | The investment climate in Russia is at stake | Other |
|--|---------------------|--|---|--|---|--|-------|
| 'Russia obstructs Shell on Sakhalin' | 6 Sept. 2006, p. 7 | X | | | | | |
| 'Gazprom wants to buy half of TNK-BP for 25bn dollar' | 18 Sept. 2006 | | | | | | X |
| 'Shell permit postponed' | 19 Sept. 2006, p. 7 | X | | | | | |
| 'Brussels wants explanation from Russia after revoking Shell's permit' | 19 Sept. 2006 | | | | | X | |
| 'EU and Japan angry over Russian decision' | 20 Sept. 2006, p. 9 | | | | | X | |
| 'Bot wants explanation regarding the revoking of Shell's permit' | 20 Sept. 2006 | X | | | | | |
| 'Also Shell meets Putin's hard hand' | 20 Sept. 2006, p. 9 | X | | | | | |
| 'Balkenende discusses Sakhalin energy project with Putin' | 22 Sept. 2006 | X | | | | | |
| 'Balkenende expresses concern against Putin' | 23 Sept. 2006, p. 7 | | X | | | | |
| 'Rich Russians in the line for establishment management school' | 25 Sept. 2006, p. 6 | X | | | | | |
| 'Shell's operations at Sakhalin continue' | 26 Sept. 2006 | | | X | | | |
| 'Russian minister does not meddle with Shell's Sakhalin contract' | 27 Sept. 2006 | | | | X | | |
| 'Chaos complete at Sakhalin: Minister soothes, officials pour oil on the flames' | 28 Sept. 2006 | X | | | | | |
| 'Shell negotiates with Japanese partners about Sakhalin' | 3 Oct. 2006 | | | | X | | |
| 'Russia halts Lukoil after Shell' | 14 Oct. 2006, p. 7 | | | X | | | |
| 'Shell top executive optimistic over the outcome Sakhalin' | 17 Oct. 2006, p. 7 | X | | | | | |

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|---|-------------------------|---|---|--|---|--|---|
| 'Putin threatens Georgia with war' | 21 Oct. 2006, p. 5 | | | | X | | |
| 'Shell's costs at Sakhalin increase again' | 23 Oct. 2006, p. 6 | | | | X | | |
| 'Shell grabs more oil out of the ground' | 27 Oct. 2006, p. 9 | | | | | | X |
| 'Deep searching for new oil fields' | 27 Oct. 2006, p. 9 | X | | | | | |
| 'Shell violated many environmental regulations' | 6 Dec. 2006, p. 7 | X | | | | | |
| 'Shell assigns control Sakhalin to Gazprom' | 11 Dec. 2006 | | | | X | | |
| 'Possible giant claim against Shell in Russia' | 12 Dec. 2006 | X | | | | | |
| 'Shell yields to Kremlin pressure' | 12 Dec. 2006, p. 7 | | X | | | | |
| 'Gazprom aims half at Sakhalin' | 13 Dec. 2006, p. 7 | | | | | | X |
| 'Shell optimistic over negotiations with Gazprom' | 18 Dec. 2006, p. 6 | | X | | | | |
| 'Shell tackled by environmental regulations' | 22 Dec. 2006, p. 7 | X | | | | | |
| 'Shell yields to Kremlin pressure' | 22 Dec. 2006, p. 1 | X | | | | | |
| 'Gazprom deal has bright sides as well' | 23 Dec. 2006, p. 9 | X | | | | | |
| 'Rodamco joins real estate in Moscow' | 28 Dec. 2006, p. 7 | | | | | | X |
| 'Winners, stubborn persons and an angel' | 30 Dec. 2006, p. 9 | | | | | | X |
| 'Eastern Europe bank could drop Sakhalin' | 2 Jan. 2007, | | | | | | X |
| 'BP's sun king in a fix due to several accidents' | 12 Febr. 2007, p. 15 | X | | | | | |
| 'Clean up Shell almost completed' | 4 May 2007, p. 9 | X | | | | | |
| 'The Kremlin seems to harass BP as well' | 30 May 2007, p. 9 | X | | | | | |
| 'Shell still wants to invest in Russia' | 10 June 2007 | | | | X | | |
| 'Gazprom seeks interest in BP' | 11 June 2007, p. 6 | X | | | | | |
| 'Putin: The world changes but the West doesn't' | 12 June 12, p. 9 | | | | | | X |
| 'BP hands gas field to Gazprom' | 23 June 2007, p. 9 | | | | | | X |
| 'Moscow opens the door for foreign gas partners' | 9 July 2007 | X | | | | | |
| 'Shell hugs the Kremlin' | 10 July 2007, p. 9 | X | | | | | |
| 'Shell regards half a century ahead' | 27 July 2007, p. 7 | X | | | | | |
| 'Kazakhs provoke oil project' | 28 Aug. 2007, p. 7 | X | | | | | |

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|---|-------------------------|---|--|--|--|--|--|
| 'Kazakhstan seeks to participate in exploitation of Kashagan oil field' | September 7, 2007, p. 9 | X | | | | | |
| 'Shell cooperates with Tatneft on fields in Tatarstan' | October 26, 2007, p. 7 | X | | | | | |
| 'There is plenty of oil' | December 22, 2007, p. 7 | X | | | | | |

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