

Ukraine's agreement with Shell on shale gas extraction

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On 24 January in Davos, the Ukrainian Minister of Energy, Eduard Stavitsky, and the director of the Dutch-British company Shell, Peter Vozer, signed a 50-year Production Sharing Agreement (PSA) concerning a project for the production of shale gas from the Yuzivska field (in the Kharkiv and Donetsk regions). Shell will explore the deposit in partnership with the Nadra-Yuzivska company (90% of whose shares belong to the state-owned holding company Nadra Ukrainy, and 10% to the SPK-Geoservis company, which most likely represents the interests of the 'family', that is, the political and business groups centred around the president's son, Oleksandr Yanukovych). The state's participation in the extraction will amount to between 31% and 60% (depending on the production costs). The investor has received tax reductions and exemptions which are unprecedented in Ukrainian terms. The signing of the PSA with Shell represents the next stage in the project to extract gas from the Yuzivska deposit, which is estimated to be the richest in the country. According to optimistic Ukrainian estimates, it may contain up to 4 trillion m³ of gas. If this is confirmed, industrial-level exploitation is expected to start within the next few years. According to the government, capital expenditure for the operation could reach US\$10 billion, and could result in annual gas production of several billion m³ in the initial period, rising to over 10 bcm by 2023.

Commentary

- The Ukrainian government has stepped up its efforts to diversify energy sources, in connection with the failure of the attempts it has made since 2010 to revise the unfavourable conditions for importing gas from Russia. The most advanced of the projects relates to increasing domestic gas production, including starting the extraction of shale gas. In 2012, the foreign investors who would undertake the exploration of Ukraine's energy resources were selected, including Shell (the Yuzivska deposit), Chevron (the Oleska deposit) and a consortium dominated by Exxon Mobil and Shell (the Skifska deposit on the Black Sea shelf).
- At present, it is too early to assess the feasibility of the optimistic Ukrainian forecasts for either the timing or the volume of gas production from the new projects, not to mention the deposits themselves. Only the clear results from the exploration and test drilling, which will take several years, will make this possible.

- The Ukrainian government has been using the development of domestic production, including that of shale gas (as in the case of the LNG terminal project and gas imports from the West) as an asset in its gas negotiations with Russia. Kyiv wishes to demonstrate that it has an alternative to the traditional form of co-operation based on importing expensive Russian gas.
- The Ukrainian government's determination to implement the shale gas extraction project also stems from the 'family's involvement in it. The Energy Minister Eduard Stavitsky, one of the proponents of developing shale gas extraction in Ukraine, is seen as their representative. In the current situation, the 'family's direct involvement in the project is the best guarantee of doing business safely in Ukraine. On the other hand, working with a major international corporation which has capital and modern technology at its disposal creates a good environment for the project, in which the interests of the most expansive political and business group are consistent with the interest of the Ukrainian state, which is to reduce its dependence on Russian gas.