

Novatek is taking over Shell's assets in Sakhalin

Filip Rudnik

On 11 April, Russia's prime minister Mikhail Mishustin signed a decree authorising the sale of a nearly 27.5% stake in the state-owned company Sakhalinskaya Energiya, which is operating the Sakhalin-2 oil and gas project in the Far East, to the Russian company Novatek for 94.8 billion roubles (around \$1,6 billion). The stake previously belonged to the Western giant Shell, which announced its withdrawal from Russia in March 2022 in response to the Russian attack on Ukraine, but was unable to sell its assets due to the ban imposed by the Russian government. The situation changed this April, when the Russian media reported that President Vladimir Putin had agreed to pay 94.8 billion roubles to Shell as compensation for the assets it had left behind in Russia. Shell was also allowed to convert these funds into Western currencies and to transfer them out of Russia. The parties concerned, Novatek and Shell, have not commented on the transaction as yet.

The Sakhalin-2 oil and gas project is being carried out under the Production Sharing Agreement (PSA) which was signed in 1994 and was intended as the Russian government's guarantee to investors that the operating conditions would not change. Russia's first gas liquefaction plant was built as part of the project. The plant currently has two trains with a total annual production capacity of approximately 11 million tonnes of LNG. In 2022, Sakhalin-2 produced 11.5 million tons of LNG and 3.9 million tons of crude oil. Its product is mainly sold to Asian customers, including China, Japan and South Korea.

The project was originally operated by its majority shareholder, Royal Dutch Shell. In 2007, Gazprom took control of Sakhalin-2 due to pressure from the Russian government, which resulted in a change in the project's shareholding structure. Until 2022, the project was managed by the Sakhalin Energy Investment Company Ltd. (registered in Bermuda), whose shareholders were Gazprom (50% plus 1 share) along with three foreign partners: Japan's Mitsui (12.5%) and Mitsubishi (10%), and Shell (27.5% minus 1 share). The Kremlin took over all its assets of Sakhalin Energy and appointed Sakhalinskaya Energiya, a limited liability company registered in Russia, as the project's operator on 30 June 2022 by a presidential decree. The shareholders were offered the opportunity to take over the same proportion of shares in the new structure as they had had in the old one. Gazprom and Japan's Mitsui and Mitsubishi accepted the offer, while Shell confirmed its intention to exit the investment and sell its shares. However, Moscow blocked the transaction; pursuant to Putin's decree of 8 September 2022, the sale of Russian assets by entities from "countries unfriendly to the Russian Federation" is subject to government approval.

Commentary

- The decision to pay Shell nearly 94.8 billion roubles for its stake in the Sakhalin-2 project is unprecedented, given the policy of unfair takeovers of assets from Western companies which have decided to leave Russia (see [‘The silence of the lambs’. Russian big business in wartime](#)). Most probably, the Kremlin is trying to use this deal to minimise the risk of the EU imposing further restrictions on the gas sector, especially the LNG branch. The Kremlin sees continued gas exports to the EU not only as a source of income but also as an potential instrument of pressure, because it can threaten to unilaterally cut off supplies to the West. If Novatek takes over the shares in Sakhalin-2 for next to nothing, that could trigger further sanctions, and possibly result in an embargo on LNG imports. This would further complicate the company’s relations with its foreign partners (mainly France’s TotalEnergies, as well as Chinese and Japanese companies). It should be emphasised that until now the liquefied gas industry in Russia has been developed in close cooperation with international companies, and with the use of Western technologies.
- Novatek’s acquisition of the shares in the Sakhalin-2 project will strengthen its position in the Russian gas sector and confirm its dominance in the LNG industry. For several years now, the company has benefited from the Kremlin’s policy of increasing the production of liquefied gas. For example, the Yamal LNG project implemented by Novatek was exempted from the extraction tax and export duties for 12 years (see [‘Expansion at the state’s expense: Novatek as a driving engine of the Russian LNG sector’](#)). In addition, LNG has become more important for the Kremlin due to Gazprom’s gradual reduction of gas supplies to Europe via pipelines. In 2022, the Russian Federation exported around 46 bcm of LNG (approximately 33 million tonnes, an 8.6% increase y/y), of which 19.2 bcm went to EU consumers (compared to around 62 bcm supplied to the EU by Gazprom via gas pipelines). According to the government’s plans, LNG production in Russia is to increase in the coming years, mainly thanks to Novatek’s investments (including the Arctic LNG 2 project). However the sanctions, together with the country’s isolation from the Western technologies used in the production of liquefied gas and its transport, may become a serious obstacle to fulfilling these plans. Russia’s technological solutions (for example, Arctic Cascade) are still much less efficient than those from abroad.
- The decision to transfer the shares in the Sakhalin-2 project to Novatek is a demonstration of how economic policy is being subordinated to the elite’s interests. The Kremlin sees the acquisitions of assets from Western corporations withdrawing from Russia by people from Putin’s inner circle as a way to partially compensate them for the losses domestic big business incurred due to the war and the sanctions, and to maintain the loyalty of its representatives. Novatek is favoured because its owners maintain social and business contacts with Putin. One of the company’s main shareholders is Gennady Timchenko, who owes his fortune to his close ties to the president of the Russian Federation. In March 2022, Timchenko resigned from the supervisory board of Novatek, as he had been subjected to EU sanctions, but he still holds about 23% of shares through the Volga Group holding. The largest shareholder of Novatek is Leonid Mikhelson, who is Timchenko’s close associate (24.76% of shares); the remaining shares belong to France’s TotalEnergies (19.4%), Gazprom (9.99%) and petty shareholders. Nevertheless, since March 2022, the French company has been gradually withdrawing from its Russian assets (for example, it does not include shares in Novatek in its accounting records) due

to the Russian aggression against Ukraine and the threat of sanctions.