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Where next for Shell after Sakhalin-2 seizure debacle?

By James Moore | Saturday 23 December 2006 01:00 |

For Shell, the cup runneth over when it comes to cash - but the glass is looking half empty when it comes to energy reserves.

The upshot of the Sakhalin-2 affair, which saw Shell and its Japanese partners giving up control of Russia's largest energy project to Gazprom for £3.8bn in cash, is a big hole in the company's reserves.

The cash Shell does not need, the vast pool of liquefied natural gas it desperately does. The estimated loss could be 5-6 per cent of proven reserves, because losing its majority stake means Shell can no longer consolidate the project in its figures.

Not that Shell had much choice - the Russian authorities had become terribly concerned about breaches of environmental regulations at the project, not something they have ever bothered much about in the past.

President Vladimir Putin was, in effect, holding a gun to Shell's head. Shell had no choice but to surrender in an increasingly hostile political

climate.

The Sakhalin agreement with Gazprom has the effect of ripping up an asset-swap deal that offered Shell a new opportunity in a half share of Zapolyarnoye, another Siberian gas field, that was negotiated last year.

It comes at a time of continuing instability in the Niger Delta, Nigeria, where Shell's facilities have come under attack from militants in a dispute over money.

The question now facing the company is where next? Shell badly needs to find new and profitable sources of oil and gas after years of under-investment in reserves replacement, culminating in the reserving scandal of 2004 when it emerged that the company had mis-stated its proven reserves by a fifth.

When the scandal broke it was revealed that the company had just 10 years of proven reserves left, the lowest of any oil major.

Dinnur Galikhanov, analyst at Panmure Gordon, said Shell is faced with a dilemma common to all energy companies. Easily extractable oil and gas tends to be located in unstable places. Where the politics are friendlier, such as in the Gulf of Mexico, it is hugely expensive to get at the energy.

"Shell will just have to strike the right balance," he says. "The Gulf of Mexico is still very prospective. If you have a good system in place to manage your relationship with a local government, that could give you a better outcome."

He does not rule out future opportunities for Shell in Russia, although the era of big stakes in super projects such as Sakhalin-2 is probably over.

Nathan Piper, analyst at Bridgewater Securities, said: "At least Shell has resolved the situation. Getting money rather than reserves is disappointing but it does allow them to access future opportunities."

Jeroen van der Veer, Shell's chief executive, has said the company would "consider all opportunities" including in Russia. But any future opportunities will be on Mr Putin's and Gazprom's terms.

There is, at least, one crumb of comfort for Shell. For years it had been unfavourably compared to BP. That is no longer the case. While Shell has many problems, its rival looks to be in a complete mess as its young Turks battle each other to succeed the once sainted Lord Browne.

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