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CEE bankwatch network

Proposed Lukoil EBRD loan – for whose benefit?

Despite the Russian invasion in Ukraine leading to EU and US sanctions against Moscow and major Russian energy companies, public banks supported by EU countries are gearing up to offer almost a billion dollars in financial support to Russian company Lukoil for gas extraction in Azerbaijan.

Half a billion dollars from the European Bank for Reconstruction and Development (EBRD) and another USD 450 million from the Asian Development Bank (ADB) are to be invested in Lukoil's 10 percent share in the Shah Deniz offshore gas field in Azerbaijan (a final decision by the EBRD is expected in early 2015).

The Shah Deniz oil and gas field is envisaged to be the main provider for one of Europe's major energy projects, the Southern Gas Corridor, a set of planned pipelines meant to bring gas into Europe from the Caspian region. The transportation infrastructure included in the Southern Corridor includes three major pipelines -- South Caucasus, Trans Anatolian and Trans Adriatic – which, combined, is expected to require a total investment of more than EUR 35 billion (USD 45 billion).

The two banks plan to finance two bridge-linked offshore gas platforms, 26 subsea wells, 500 km of subsea pipelines, the expansion of the gas plant at Sangachal Terminal and the South Caucasus Gas Pipeline expansion.

However, as well as the irony of financing a Russian company to decrease energy dependence on Russia, there are plenty more reasons to be concerned about EBRD and ADB financing for Shah Deniz II. A small selection of them are laid out below:

Impacts on supply/transit countries

Azerbaijan is in no way a more secure country of supply than Ukraine or Russia. The unresolved conflict between Azerbaijan and Armenia over Nagorno Karabakh, Russia-backed separatist regions like Abkhazia and South Ossetia claiming independence from Georgia, the threat of Maidan-style social unrest provoked by increasingly oppressive and corrupt elites in the region all pose a threat to the stability of Azerbaijan and neighbouring countries on the route of pipelines.

The EBRD justifies its loans by claiming it has a positive „transition impact" on the countries where the projects are located. Yet gas infrastructure is rarely a guarantee of peace and security as the example of Ukraine shows very well. On the contrary, energy politics undoubtedly contributed to the civil war in the country which delivered the final blow to Ukraine's unstable economy.

Deepening Azerbaijan's hydrocarbon dependency and conserving the political status quo

Over the years, the EBRD has maintained that Azerbaijan needs to diversify its economy away from reliance on hydrocarbons. With oil production reaching a plateau, the IMF forecasts a decline in the economic growth of Azerbaijan to 3.5 percent in 2015. To make up for the shrinking budget revenues, the government appears to be seeking to reposition itself as a major gas exporter. The proposed financing for Shah Deniz would support this unsustainable trajectory by perpetuating the country's heavy dependence on a single commodity and extending the rule of the Azeri governing elites. The EBRD should rather step up its efforts to assist smaller companies in different sectors which are more independent from the government.

The human rights situation has got noticeably worse in Azerbaijan in the last year or so, with a serious crackdown on independent critics of the Ilham Aliyev dictatorship. Oil and gas revenues and overtures from the EU help the country's elite to feel that it has nothing to fear from tightening its repression. On Friday 5 December yet another person was arrested due to her political activities - Khadiaj Ismayilova - an investigative journalist who has done more than any other to link corruption directly to Aliyev.

Weathering sanctions over Russia - what is not prohibited is allowed?

Lukoil was one of the Russian energy companies sanctioned by EU and US in early September. Although the sanctions prohibit Lukoil from accessing Western technology used for hydrocarbon exploration and production in Russia, they do not prevent it from raising debt financing on the international markets. Any foreign financial support given to Lukoil for development of its operations overseas will in the end benefit the company and the Russian state budget. Taking into account that the sanctions were aimed at increasing Russia's political isolation and economic costs, the US and EU constituencies on the EBRD Board should take this into consideration when deciding on voting positions, in order to avoid double standards.

Lukoil's environmental record

As a matter of fact, Lukoil is a long term client of the EBRD. The company has already received five EBRD loans since 2000, amounting to USD 840, of which 310 million went for the Shah Deniz field development in Azerbaijan. The currently proposed half a billion loan follows an earlier investment of USD 200 million for Shah Deniz stage 1 extension of field development, which was approved by the EBRD in January 2014. At the time, the EBRD stated that *'this project has a high level of transparency and is adhering to strict international and national standards'*.

The EBRD claims that its experience with the Shah Deniz development is positive, but if Lukoil's practices at home in Russia are anything to go by, then we have only reasons for concern. In 2007, **the EBRD invested USD 300 million in Lukoil's strategic environmental programme in Russia** which included, among others environmental remediation investments, pollution clean-up, pipeline replacement and gas flaring reduction.

At the end of 2013, **shortly before the latest EBRD loan to Lukoil was approved, Lukoil was fined 614 million rubles (USD 18.5 million) for nine oil spills since 2011** in Russia's northern republic of Komi. Reportedly Lukoil-Komi spent 15 million rubles on recultivating the polluted land, but the court ruled it to be an insufficient measure.

Greenpeace Russia has produced a shocking video and reported accounts of indigenous Komi people who failed to note the *'environmental benefits'* that the EBRD financed, but instead complained about lack of consultation on well construction in their backyard and **a cover-up attempt of a leaking oil pipeline**. In April the municipal council of Izhma district supported claims of local community and voted to stop oil company Lukoil operations in the area. A rally on Sunday, Nov. 16 2014 was only the latest in a series of protests by indigenous people from Komi against the damage from Lukoil operations.

Lukoil's poor environmental and safety record, in Russia and abroad should be enough reason for the EBRD to halt loans to it. Even more so, because since the Ukrainian crisis, support for Russian energy companies from European public finance is hardly excusable. The deal is being justified by energy security needs of Europe, though Azerbaijan is far from a secure country of supply and Europe's energy security would be much better ensured through domestic renewables and energy efficiency than through large pipelines bringing fossil fuels from countries with authoritarian regimes.

Do we even need that much gas?

The EU's plans for large new gas import pipelines and LNG terminals to Europe, outlined in the European Commission's October 2013 list of priority energy projects as well as in the May 2014 blueprint for energy security, are not only counter to the EU's long-term climate goals but also unjustified according to the EC's own demand forecast. Projects aimed at increasing EU gas imports included in the European Commission's Projects of Common Interest (PCI) would surpass the five scenarios of the EC's own Energy Roadmap 2050 which all foresee an overall decrease in gas imports, even taking into account that imports from Norway are expected to dry up in the coming decades.

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