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## **Emerging Markets: BP, AAR, and TNK-BP (also see Emerging Markets 7.1)**

TNK-BP is a joint venture (JV) company that is 50% owned by BP and 50% owned by the AAR consortium, which represents three major Russian business groups: Alfa, Access, and Renova. Founded in 2003, TNK-BP is a major oil company in its own right. It is Russia's third largest oil producer and among the ten largest private oil companies in the world. Producing about 1.9 million barrels of oil per day, TNK-BP provides about 25% of BP's oil production and 40% of its reserves. It pays about \$2 billion dividends each year to BP. Such a cash cow with huge reserves would seem to be—in the words of Bloomberg Businessweek—a “godsend.” Unfortunately, TNK-BP has turned out to be an unending saga of headaches, conflicts, and intrigue between BP and its three Russian oligarch partners: Mikhail Fridman (founder of Alfa Group and chairman of the board of TNK-BP), Len Blavatnik (founder of Access Industries), and Viktor Vekselberg (founder of Renova Group). Two episodes stand out.

### **Episode I**

In 2008, the Russian partners publicly aired two grievances. First, TNK-BP relied on too many BP's expatriate (expat) consultants, whose fees were a “rip off”—extra dividends to BP but excessive costs to TNK-BP. Second, and more importantly, the Russians wanted TNK-BP to pursue opportunities outside of Russia and Ukraine, but BP insisted on fencing TNK-BP within Russia and Ukraine to prevent TNK-BP from becoming a global competitor. A memo from the American CEO of TNK-BP at that time, Bob Dudley, barred managers from entertaining deals in countries blacklisted by the US State Department, such as Cuba, Iran, and Syria. “TNK-BP is an independent Russian company,” noted Fridman, “and should be subject to Russian laws,” which would bless deals in these countries. In fact, given its Russian background, TNK-BP might be particularly well-suited to exploit opportunities in these “rogue” countries labeled by the US government. The board room dispute quickly spilled out to grab media headlines. The Russian partners claimed that TNK-BP should be free to grow into an independent, global oil company (at least the JV agreement did not ban this).

Rapid-fire developments took place in 2008. In January, the visas of BP's 148 expats working at TNK-BP were declared invalid. In March, the Moscow offices of both BP and TNK-BP were raided by police. Shortly after, a TNK-BP manager was arrested for alleged espionage. In April, a little-known minority shareholder filed a court case blocking BP's expats from working at TNK-BP. In June, the high drama on who was in charge in this 50/50 JV reached a bizarre climax. In a Moscow hearing with Russian immigration officials regarding the proper number of visas for TNK-BP's foreign workers, two delegations showed up, both claiming to represent TNK-BP (!). Tim Summers, TNK-BP's chief operating officer and a BP representative, claimed that visas for 150 foreign workers would be needed. But Vekselberg, a director and 12.5% shareholder of TNK-BP, said that only 71 visas would be necessary. Officials supported Vekselberg's case and thus forced some expat employees to leave Russia almost immediately for good.

BP framed the dispute as oligarchs' time-honored practice to grab control of companies by political pressures and argued that the outcome would be a test of the rule of law in Russia. BP also implied that the Russian government might be behind the oligarchs' aggressive moves. In an article published in Financial Times on July 7, 2008, Fridman dismissed political motivations and characterized the dispute as "a traditional, commercial dispute about different ambitions of the strategic development of the business" (see Emerging Markets 7.1). Accusing BP of being opportunistic, Fridman wrote that BP treated TNK-BP as if it had been a wholly owned subsidiary instead of a JV. BP allegedly treated Russians as "subjects," as opposed to shareholders of equal rights. The article noted that BP cared more about its oil reserves than costs or profits. The punch line? Dudley's ouster as TNK-BP's CEO. Under such tremendous pressures, Dudley had to quickly flee the country. A Russian court even barred him from performing his job for two years for allegedly violating local labor laws. In September 2008, Fridman, in addition to his position as chairman of the board, became interim CEO of TNK-BP.

In the end, while the Russians needed BP's expertise, BP also needed to access TNK-BP's crude in Siberia, which was far easier and safer to get at than the complicated and

unsafe deep water drilling in places such as the Gulf of Mexico. In April 2010, the devastating oil spill took place. In July 2010, Dudley—although disgraced in Russia—was promoted to become the new BP CEO. As the new CEO, Dudley quickly flew to Moscow and became more accommodating to the Russian partners. With a changed attitude, BP now agreed that TNK-BP could expand abroad. In October 2010, BP sold assets worth \$1.8 billion in Venezuela and Vietnam to TNK-BP—a milestone for TNK-BP that finally broke out of Russia and Ukraine. As a Russian company, TNK-BP might indeed be better positioned to do well in “tricky” countries such as Venezuela and Vietnam. To BP, these sales raised immediate cash to help defray the cleanup and compensation costs in the Gulf of Mexico, and it did not have to sell to competitors. Overall, Episode I seemed to have a (relatively) happy ending.

## Episode II

Only a couple of months after the ending of Episode I, Episode II began. In January 2011, BP announced a new \$16 billion strategic alliance with Russia’s state-owned Rosneft. Creating the first cross-shareholding alliance between international and Russian oil companies, the deal would enable BP to own 9.5% of Rosneft’s shares and Rosneft to own 5% of BP’s shares. Both sides would jointly explore a new offshore oil field on the Russian Arctic continental shelf in the Kara Sea. Rosneft is Russia’s second largest oil company, which produces 2.4 million barrels of oil a day (behind Gazprom but ahead of TNK-BP). This new alliance had the full support of the Russian government—after all, Rosneft’s chairman of the board Igor Sechin was the sitting Deputy Prime Minister. All seemed well . . . but here was the catch: The Russian partners at TNK-BP jumped out and sought to block the deal. Their argument was that per the TNK-BP JV agreement, BP could only pursue further business in Russia through the JV. In other words, AAR’s rights of first refusal were violated. In simple terms, “if you want to marry a new wife,” a furious Fridman argued, “you have to divorce the old one first.” The Russian government was mad about BP too. “I met with BP’s head and he did not say a word about it,” said (then) Prime Minister Vladimir Putin. Basically, BP had lied to Rosneft that it had no third-party obligations. According to the Economist,

At the least, it seems a woeful misjudgment on BP's part. The company says it had no idea that its deal with Rosneft would result in such a legal tussle, so it felt no need to mention the terms of its shareholder agreement with TNK-BP to its new Russian partners. Perhaps Mr. Dudley gambled that getting into bed with Rosneft would silence TNK-BP.

Such a gamble backfired badly. AAR initiated legal challenges by initiating arbitration proceedings to block BP's deal with Rosneft.\* In March 2011 a Swedish arbitration tribunal supported AAR and dealt a blow to the Rosneft deal, which became known as "Ros-nyet." In May 2011, BP admitted failure and reaffirmed that it remained fully committed to TNK-BP as its "primary business vehicle in Russia"—which, in human marriage terms, sounded like acknowledging AAR as its legally married spouse after being caught for indulging in an extramarital affair.

However, BP's headache did not end. In September 2011, its frustrated other partner Rosneft struck a new strategic alliance deal with Exxon Mobil. They would jointly explore the same icy blocks of the Arctic Kara Sea that slipped from BP's hand. Things then got worse. The very next day, BP's Moscow offices were raided by police again. Having managed to alienate both the Russian government and Rosneft—just imagine Kremlin's fury after the collapse of the deal—on the one hand and AAR on the other hand, "BP appears to have little protection against being pushed around in Russia," noted the Economist. In October 2011, a severely weakened BP agreed to let Fridman to formally serve as CEO, thus enabling him and AAR partners to essentially run the show at TNK-BP.

Despite the ordeals, challenges, and hard feelings, both BP and AAR remained committed to the success of TNK-BP. One has to be totally naïve to believe that they would live "happily ever after." So stay tuned for Episode III...

Sources: Based on (1) BusinessWeek, 2008, BP: Roughed up in Russia, June 16: 69; (2) Bloomberg Businessweek, 2010, How BP learned to dance with the Russian bear, September 27: 19–20; (3) BP, 2010, BP to sell Venezuela and Vietnam businesses to TNK-BP, October 18, [www.bp.com](http://www.bp.com); (4) BP, 2011, BP and AAR agree on new management structure for TNK-BP, October 21, [www.bp.com](http://www.bp.com); (5) BP, 2011, BP and

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