What is a promising result for Russians in energy cooperation with Northeast Asia?  
Case study of Japan-Russia bargaining process in Vladivostok LNG Plant Project

Naoya HASE  
Sugiyama Jyogakuen University

Introduction

Russians strategically promotes the economic development of the Far East and East Siberia area through strengthening of energy cooperation with the countries in Northeast Asia. They expect to lay down gas transport infrastructures in the Far East and East Siberia area with expansion of the gas export to the countries in Northeast Asia as the driving force, and to build the basement of economic development through fostering resource-processing industries. This strategy has been shown in "the Eastern Gas Program" which the Russia government and Gazprom created together.

In Northeast Asia, there are two important markets for Russia. Japan is the world's largest LNG importing country, and China has huge energy demand. In expanding energy cooperation with Japan, the Vladivostok LNG plant project will diversify the gas export method of Russia, and contributes to the industrial prosperity in the Far East and East Siberia. It has argued by the latest Japan-Russia economic negotiation. Although the scale of the export to China is large, it does not link with the fostering of industries in the Far East and an east Siberia area because Russia and China agree on carrying Russian gas to China by pipeline. Moreover, while gas export price for China can be susceptible to the price from Central Asia, the LNG purchase price of Japan is maintaining the high level. In this view, expanding cooperation with Japan serves as counterbalance to Chinese influence.
**Eastern vector is way to Economic Development**

Since Vladimir Putin was inaugurated as president in 2000, The Russian government restructured national energy policies and governance. Under Putin’s presidency, the Russian administration tightened control over energy companies and strengthened federal power to centralize management of mineral resources. Likewise, Putin displayed strong initiative for development of energy industrial sector and infrastructure in East Siberia and the Far East\(^1\). This agenda was recognized as integral to achieve aims of long-term national energy strategy. In July 2002, the Russian administration ordered the Ministry of Energy and Gazprom to establish “the state-run Development Program for an integrated gas production, transportation and supply system in Eastern Siberia and the Far East, taking into account potential gas exports to China and other Asia-Pacific countries”, which was the so-called “Eastern Gas Program”\(^2\).

In the mid of 2007, the Russian administration approved the “Eastern Gas Program”. Its priorities are assigned to expand gas supply for East Siberia and the Far East, and to develop gas-processing industry in this region. The “Eastern Gas Program” recommends carrying out a scenario “Vostok-50”. As this scenario plans to export 50bcm/Y of gas from Sakhalin and the Chayandaskoe field in the Sakha Republic to China (38bcm/Y) and South Korea (12bcm/Y) through SKV (Sakhalin – Khabarovsk – Vladivostok) gas pipeline, it requires securing gas produced in Sakhalin, Krasnoyarsk krai and Irkutsk oblast for processing LNG and other domestic demands. These contents of the “Eastern Gas Program” was reflected in the “Energy Strategy of Russia for the period up to 2030”, which was adopted in 2009. Similarly, concepts of the “Eastern Gas Program” are incorporated into other regional development programs such as the “Strategy for Socio-Economic Development in the Far East and Baikal region for the period up to 2025” and the “Strategy for Development of Fuel-Energy Industry in East Siberia and the Far East for the period up to 2030”.

Former deputy chairman of Gazprom Alexandr Ananenkov, who was head coordinator of the “Eastern Gas Program”, mentioned that the program was not

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\(^1\) Стенограмма совещание по проблемам социально-экономического развития Дальневосточного

\(^2\) **Программа создания в Восточной Сибири и на Дальнем Востоке единой системы добычи, транспортировки газа и газоснабжения с учетом возможного экспорта газа на рынки Китая и других стран АТР**, Приказ Минпромэнерго России, 3 сентября 2007, N 340.
business strategy of the company but state policy. Gazprom acts as a governmental agency to achieve the political goal in the “Eastern Gas Program”. For example, the “Eastern Gas Program” forecasted that the total amount of gas production by 2020 was about 150bcm/Y: 41bcm/Y for regional household and industrial demand (including 14bcm/Y for gas chemical industry), 21bcm/Y for LNG export, 50bcm/Y for pipeline export and 35bcm/Y for supply to western Russia. These expectations are analyses calculated by experts as well as political numerical targets. In July 2009, Putin took part in the ceremony for starting construction of SKV gas pipeline and declared that gas production in East Siberia and the Far East would reach to about 150bcm/Y by 2020.

Gazprom has to expand gas production and develop gas transportation infrastructure and gas-processing industry in East Siberia and the Far East for achieving targets of the “Eastern Gas Program”. While Gazprom was made in accordance with governmental policies, it steadily prepared to enter the potential Asia-Pacific market. Gazprom began to negotiate on gas export to China, made an equity participation in Sakhalin-2 Project, and received the exploitation license for the Kirinskoe gas field in Sakhalin-3 and the Chayandaskoe gas field. Natural gas production in East Siberia and the Far East reached 23bcm/Y in 2010 (without 8bcm/Y in Sakhalin-1) and this result was much the same as expectation (27bcm/Y) in the “Eastern Gas Program”.

**Diversification of Japan – Russian Energy Cooperation**

In 2006, a tension occurred in Japan – Russia energy cooperation because of Gazprom’s decision to acquire equity participation in Sakhalin-2 project. Japanese Press criticized harshly against a rise of Russian resources nationalism and the Japanese government made immediate representations to Russian counterparts. As a result of reconciling differences, Sakhalin Energy agreed Gazprom purchased 50%+1 of the consortium’s shares in the end of 2006. Mitsui Corporation and Mitsubishi Corporation – minor shareholders of Sakhalin Energy deemed positively about the result. They expected to be secured stability of business, because Gazprom’s participation would bring strong commitment of the Russian government to Sakhalin-2 project. Therefore, this problem did not obstruct enlargement of Japan – Russia energy cooperation.

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3 “Интервью”, Коммерсантъ, 2 марта 2004.
4 Zaikai, No.1381, 27 March 2007, p.31.
In February 2007, the Meeting of the Co-chairs of the Japan - Russia Intergovernmental Committee on Trade and Economic issues was held in Tokyo. The Co-chairs - then Japanese Foreign Minister Taro Aso and then Russian Industry and Energy Minister Viktor Khristenko confirmed the fulfillment of the contract for LNG export from Sakhalin-2 to Japan. In June 2007, Prime Minister Shinzo Abe proposed the “Initiative for the Strengthening Japan-Russia Cooperation in the Far East Russia and Eastern Siberia” in the meeting with Putin on the sidelines of the G8 summit in Heiligendamm, Germany.

Putin’s presidential message in 2006 showed the importance of technological innovation in Russian energy sector and his message in 2007 pointed out that Russian energy processing industries had to modernize for promoting efficient use of energy resources. From Russian point of view, deepening Japan-Russia energy cooperation is closely related in development of gas-processing industry in East Siberia and the Far East, because Japan is the largest LNG buyer in the world. Japan is potential buyer of Russian gas as well as promising investor for gas plant projects in East Siberia and the Far East. In November 2005, Japan and Russia signed two documents: “the Basic Directions of Long-Term Energy Cooperation between the Japanese government and the Russian government” and “Details of Specific Issues in Energy Cooperation”. The former document defines long-term goals in the exploitation of mineral resources deposits, promotion of energy saving policies, cooperation in energy transportation and processing project, introduction of leading energy technologies. The latter document describes details of promising cooperation in energy saving and efficient use of gas.

**Vladivostok LNG Project**

In May 2009, Gazprom, the Japanese Agency of Natural Resources and Energy, Itochu Corporation and JAPEX signed MOU on Pre-Feasibility Study for construction of LNG and CNG processing plant in Vladivostok area. In June 2008, Gazprom has examined the possibility about construction of LNG and gas chemical

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7 “The agreements in visit of the President Russian Federation Vladimir Putin”, MOFA Japan, 21 November 2011.
plant in Primorskoе krai and gas transportation route such as SKV and YKV (Yakutia – Khabarovsk – Vladivostok) gas pipeline\(^8\). One month after, Gazprom Board of Directors has decided to start building SKV pipeline that would supply gas to plant in Vladivostok. Around same time, it is assumed that corporate level negotiations were beginning.

In June 2009, deputy chairman of Gazprom Ananenkov and vice president of Itochu Corporation Uichiro Niwa discussed Pre-Feasibility Study for construction of LNG plant in Vladivostok\(^9\). After the completion of Pre-Feasibility Study, Gazprom and the Japanese Agency of Natural Resources and Energy agreed they would carry out joint FS on gas transportation and marketing in early 2011. And Itochu Corporation established the consortium “Japan Far East Gas Co.” that agreed with Gazprom on the completion of joint FS by the end of the year\(^10\).

**Deadlock in Sakhalin-1**

To realize Vladivostok LNG project, both of Japanese and Russian side examined the possibility to gain gas from Sakhalin-1. In September 2011, the construction of SKV pipeline finished and the operation started. There are no gas fields around Vladivostok area; therefore, SKV pipeline was the only transportation infrastructure realizing to supply gas from Sakhalin to Primorskoе krai. Although Shareholders of the consortium “Japan Far East Gas Co., Ltd.” and SODECO which has 30% shares of Sakhalin-1 partly overlap: Itochu Corporation, Marubeni Corporation, JAPEX, these factors don’t work favorably because of the over 2000km distance from Sakhalin-1 to Vladivostok. While “Japan Far East Gas Co., Ltd.” expects to purchase gas from Sakhalin-1, SODECO is unwilling to pay the transportation tariff. It is rational for SODECO to sell gas in Sakhalin. Furthermore, Gazprom keeps confronting against Exxon Mobil that is main operator of Sakhalin-1.

After the completion of Komsomolysk na Amure – Khabarovsk gas pipeline (a part of SKV pipeline), Sakhalin-1 provides 2-3bcm/Y of gas for power stations in Khabarovsk krai. The remaining 5-6bcm/Y of gas made reinjection in the ground. Since 2004, Exxon Mobil negotiated with CNPC in order to export all of gas to North Eastern

\(^8\) “Газпром» рассматривает возможность строительства завода СПГ в Приморье”, РИА Новости, 24 июня 2008.

\(^9\) “Газпром» встретился с Itochu”, Ведомости, 30 июня 2009.

\(^10\) Itochu News release, 26 April 2011.
China. In October 2006, Exxon Mobil and CNPC signed temporary agreement on exporting gas to China. If the negotiation was settled, Exxon Mobil was ready to construct pipeline that would supply 8bcm/Y of gas to China. Gazprom was concerned about the result of negotiation between Exxon Mobil and CNPC. Then, Gazprom strongly opposed to export gas produced in Sakhalin-1 to China, because it planned to use gas from Sakhalin-1 for gasification in the Far East and to export gas to China through SKV pipeline. The Ministry of Industry and Energy became afraid of that gas pipelines for export to China would be competing. Russian federal organs, which supervise the operation in Sakhalin-1, condemned the plan of Exxon Mobil.

Though Exxon Mobil made a contract with CNPC in July 2008, they decided to make a compromise proposal. Because Gazprom monopolizes the right of gas export, it is possible for Gazprom to force Exxon Mobil to sell gas at an unreasonably low price. In 2010, Exxon Mobil sent a compromise proposal to deputy CEO of Gazprom Valery Golubev who is in charge of domestic market and also deputy CEO of Gazprom Alexandr Medvedev who is in charge of gas export. However they failed to adjust differences of opinion in Gazprom. Medvedev answered, “It isn’t my role, because the issue is a problem of domestic gas market. After this, you should talk with Mr. Golubev”. The Russian government ordered the related organs to resolve the issue of Sakhalin-1 gas by the end of 2011. Although the Ministry of Energy recommended Exxon Mobil to sell all of gas in Sakhalin-1, the situation didn’t change. Power of Gazprom in Sakhalin-1 is limited, as the gas field is under the influence of Rosneft.

**Factionalism in Gazprom**

Kirinskoe gas field of Sakhalin-3 was an option for Vladivostok LNG project. But factionalism in Gazprom made it difficult to choose. Kirinskoe gas field in Sakhalin-3 is a part of SKV pipeline project to achieve goals of “Eastern Gas Program” that former deputy chairman of Gazprom Ananenkov is in charge. In February 2007, Ananenkov established the subsidiary company “Gazprom Invest Vostok” for process management of “Eastern Gas Program”. Since the beginning of 2012, CEO of “Gazprom Invest

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12 “Уполномоченный по СРП", Ведомости, 5 июня 2008.
13 Интерфакс, 13 июня 2011.

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Vostok” Vitaly Markerov took over Ananenkov’s duties and promoted deputy chairman of Gazprom. They are responsible for the completion of Vladivostok LNG project, and then attended the joint committee for coordination with Japanese Agency of Natural Resources and Energy. Director of Eastern project coordination Gazprom Viktor Tymoshirov mentioned Gazprom would not attract foreign investment to Sakhalin-3.

Immediately after the Tohoku earthquake in 11 March 2011, Putin ordered accelerate the development of Sakhalin-3. Sakhalin Energy prepared the plan for construction of Sakhalin-2 third train LNG plant. According to the original plan, the construction would complete by around 2010 and its capability of supply would be 7mln tons/Y. In May 2008, CEO of Shell Gas & Power Linda Cook said that gas processing capability in Sakhalin-2 could rise to around 18mln tons/Y (at this time, 10.8mln tons/Y) and this expansion of facilities would be supported by Gazprom, the Russian government, Mitsui Corporation and Mitsubishi Corporation14. Thus, it is assumed that Royal Dutch Shell leaded it. Although shareholders of Sakhalin Energy made effort to foster consensus since February 2009 when first train plant started to export LNG, they did not make the final decision. The reason is why the total amount of gas produced in Sakhalin-2 is not enough to supply gas into three train plants. Sakhalin Energy tried to gain additional gas from Sakhalin-1, but it could not start negotiation with the Consortium of Sakhalin-1. On the other hand, in October 2011, deputy CEO of Gazprom Medvedev mentioned Sakhalin Energy soon made a decision about third train LNG plant and implied to use gas of Sakhalin-3 for new facility of Sakhalin-2. Medvedev is CEO of the subsidiary company “Gazprom Export” that is responsible for Sakhalin-2 project. In November 2011, Director of Gazprom Tymoshirov opposed against Medvedev’s remarks and noted the gas production in Sakhalin-2 was not sufficient to meet a need of additional LNG plant.

The Chayandaskoe Gas Field

Third option is gas from the Chayandaskoe gas field in the Sakha Republic. This field has enormous gas reserves and its total amount estimates over 3tcm. However, the distance from Vladivostok is around 3000km and the gas includes much of helium. Gazprom received the exploitation license in 2008. As former deputy

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chairman of Gazprom Ananenkov made a judgment on that the development of the Chayandaskoe gas field was unprofitable, CEO of Gazprom Alexey Miller did not work the development diligently. Such situation did not change before March 2011 when then vice prime minister Igor Sechin proposed Japanese ambassador to Russia Masaharu Kono to invest the Chayandaskoe gas field and Kovyktinskoe gas field in Irkutsk by Japanese companies When Japanese nuclear energy policy was drifting since the accident in Fukushima first nuclear power station, the Russian government decided to push Russian gas sales and development of gas fields in East Siberia and the Far East. Since the completion of SKV pipeline in September 2011, Gazprom accelerated feasibility Studies and policy coordination in the Sakha Republic.

In October 2012, Gazprom CEO Miller explained Putin that Gazprom planed to construct YKV gas pipeline up to 2017\textsuperscript{15}. In December of the year, the Gazprom Board of Directors approved activities to arrange re-development of the Chayandaskoe and the Kovyktinskoe gas field. In 2013, Gazprom decided to start the operation of Vladivostok LNG Plant in 2018. They planed to gain natural gas from Chayandaskoe and Kovyktinskoe gas field, and also Sakhalin-3.

**Conclusion**

- Gas from important gas fields in the Far East concentrates Vladivostok
- Vladivostok LNG, SKV pipeline and YKV pipeline became mainstay of infrastructure in the Far East (easily transporting gas to other Asia Pacific countries)
- Vladivostok LNG project accelerates the development of new gas fields
- Vladivostok LNG is a model case for modernizing Russian energy sector

**References**


\textsuperscript{15} Новость Газпрома, 29 октября 2012

