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Crimean oil and gas deposits: the energy component of the Russian policy for Ukraine

Abstract

Russia's annexation of Crimea is considered to be the most significant geopolitical shift in Europe, following the dissolution of Former Yugoslavia in the 1990s. A key issue at stake is the demarcation of the Black Sea and the subsequent ownership of the subsea deposits, located offshore Crimea.

1. Introduction

Although it is common knowledge that Russia, throughout its history, has always considered Crimea as indigenous Russian territory and the port of Sevastopol a strategic point for the Russian Black Sea Fleet, yet it becomes clear that there was another key factor that made Crimea's annexation urgent to Russia: its hydrocarbons potential. There are three major provinces in Ukraine holding significant hydrocarbons reserves: a) the Eastern region- Dniprovsko- Donetska compression and Northwestern Donbass, b) the Western region- Volyno- Podilska Plate, Fore-Carpathians, Folded- Carpathians and Trans- Carpathians and c) the Southern region- Crimea and the EEZ of Black Sea and Azov Sea¹.

2. The main oil-fields

Four major oil and gas offshore deposits are located in the Black Sea, in the western and eastern continental shelf of the Crimean peninsula, bound to contain significant reserves: the Skifska block, which lies to the southwest of Crimea in the Black Sea, the Subbotina block off the eastern coast and the Pry Kerch blocks, where several oil and gas prospects have been identified.



¹ "Overview of the Ukrainian oil and gas and shale gas market opportunities" by Lyubomyr Goncharuk, Canada- Ukraine oil and gas opportunities workshop, Kiev, 25-26 February 2013

Skifska² is located on the western part of the Black Sea, along the territorial waters of Ukraine with Romania, where ExxonMobil and OMV are already jointly exploring offshore gas fields. It is estimated to hold 200- 250 bcm of natural gas and condensate. On this base, Skifska should produce 5 bcm/year during the 50 years of the PSA (Production Sharing Agreement). In September 2013, a consortium of ExxonMobil, Shell, OMV Petrom and Nadra Ukrainy signed a PSA for Skifska, pledging to invest \$400 million in the initial exploration phase together with a signature bonus of \$325 million in a deal worth more than \$12 billion. In November 2013, Ukraine signed an offshore oil and gas PSA with Italy's ENI and France's EDF, for a 540-square-mile western Crimean Black Sea offshore block³. The deal included the Subbotina oil license and the Pry Kerch block, where several oil and gas prospects have been identified and where Chornomornaftogaz produced 80,400 barrels per day.⁴

The PSAs were part of Ukraine's effort to diversify its energy supply and production sources from Russia. However, Shell pulled out in January 2014, while ExxonMobil said in early March 2014 it was putting its involvement in the project Skifska "on hold due to current circumstances"⁵. The project is now stalled, with the companies stating that they remain interested, but they will not get involved in the dispute between Russia and Ukraine. The big question now is whether Skifska remains under Ukrainian jurisdiction or if Russia could simply declare it a Crimean (i.e. Russian) asset. One year after the violent annexation of Crimea to Russia, no progress has been done whatsoever by the Russian side with respect to field development in Crimea. When Ukraine lost control of its Crimean offshore deposits, the local authorities transferred the Crimean energy company Chornomornaftogaz assets to Gazprom, thus leading to Ukraine losing out approximately 117 million barrels equivalent of gas production over the next seven years, as 50 offshore wells would have been drilled and completed, had Chornomornaftogaz's Crimean offshore PSA production not been halted⁶.

In 28/07/2014, Ukraine's Energy and Coal Industry Minister Yuriy Prodan remarked that Russia's unilateral annexation of Crimea has caused massive energy asset losses to Ukraine. "*Taking into account all the energy facilities in Crimea, we are talking about the loss to Ukraine of billions of dollars in the energy sector. We estimated about \$300 billion*". According to the Ukrainian energy minister, the Black Sea shelf contains about 2.3 million tons of oil equivalent, which translates to 2 tcm of natural gas, adding that when Chornomornaftogaz was seized by Russian authorities, "*we immediately lost 2 bcm of gas in storage.*" Exploiting the afore mentioned hydrocarbons assets could, in the future, help reduce Ukraine's dependence on

² Skifska: square- 16.698 km, depth- 10.000 m, PSA granted to EXXONMOBIL, permit duration- 50 years with extension.

³ Interfax- Ukraine, "*Ukraine signs PSA with ENI, EDF for Black Sea blocks*", 27 November 2013, Kyiv Post, <http://www.kyivpost.com/content/ukraine/ukraine-signs-psa-with-eni-edf-for-black-sea-blocks-332525.html>

⁴ *GEOExPro*, Vol. 11, No. 3, May 2014.

⁵ Roland Flamini, "*Crimea: Putin's war for oil and gas?*", World Affairs Journal, online edition, <http://www.worldaffairsjournal.org/blog/roland-flamini/crimea-war-oil-and-gas>,

⁶ John C. K. Daly, Jamestown Foundation, "*Ukraine claims energy losses for Crimean annexation reach 300\$ billion*", Eurasia Daily Monitor, vol. 11, Issue 141, 01 August 2014.

Russian gas imports⁷.

Furthermore, as stated above, ExxonMobil is already involved in the continental shelf of the Black Sea. Along with Petrom of Romania and the Austrian OMV, ExxonMobil conducts exploration works at Neptun block on the Romanian sector of the Black Sea. Neptun block lies in an area of 9. 900 square kilometers, at a depth ranging from 50 to 1. 700 meters. At the end of 2011, the drilling of the first well Domino-1 has started, and the well confirmed the presence of hydrocarbons. In 2013, the 3D seismic survey was completed at an area of 6. 000 square kilometers and the drilling platform Ocean Endeavor for the drilling of the second well Domino-2 was contracted. Based on the [preliminary estimates](#), the natural gas reserves at this block range between 42-84 bcm. It should be noted that Neptun and Skifska are located next to each other and are actually parts of the same subsea geological formation.



Meanwhile, there is also potential to explore and develop resources at the eastern continental shelf of Crimea. In November 2012, the Italian ENI announced that a 540 square mile area it had signed up to explore, located in the eastern part of the Crimean peninsula, has significant hydrocarbons potential. ENI has been made operator of the eastern Crimean offshore area with a 50% stake, while other partners included EDF (5%) and Ukrainian companies Vody Ukrainy (35%) and Chornomornaftogaz (10%).

⁷ Carol Matlack, "Losing Crimea could sink Ukraine's offshore oil and gas hopes", Bloomberg Business, 11/03/2014, <http://www.bloomberg.com/bw/articles/2014-03-11/losing-crimea-could-sink-ukraines-offshore-oil-and-gas-hopes>

3. *Developments after the annexation of Crimea by the RF*

The issue at stake here is whether, following the annexation of Crimea to Russia, there is going to be a new sea demarcation at the Black Sea between the littoral States involved, i.e. Russia, Ukraine and Romania, since, as was stated above, there are offshore fields adjacent one to the other, that lie across the sea borders of Ukraine and Romania. Following the Russian entry by force in Crimea, the Treaty on Accession of the Republic of Crimea to the Russian Federation was signed between representatives of the Republic of Crimea (including Sevastopol, with which the rest of Crimea briefly unified) and the Russian Federation on 18 March 2014 to lay out terms for the immediate admission of the Republic of Crimea and Sevastopol as federal subjects of Russia and part of the Russian Federation. In article 4, section 3 of the treaty, it is stated that international law will govern the drawing of boundaries through the adjacent Black and Azov seas⁸. Should Crimea be considered Russian territory, this would mean that the EEZ (Exclusive Economic Zone) and the territorial waters become Russian and not Ukrainian any more. Out of the six, five littoral Black Sea countries (Turkey excluded) apply the International Law of the Sea, based on the UNCLOS Convention of Montego Bay (1982).

According to UNCLOS, coastal nations can claim EEZ and extend it up to 200 nautical miles from their shores. Inside the EEZ, each coastal nation can explore, exploit, conserve and manage deep water resources, living and non-living. Should there is a new sea demarcation, it becomes clear that the economic stakes for Russia are very high, since the Crimean fields will belong to the Russian continental shelf and any hydrocarbons found offshore Crimea will end up in Russian hands. Hence also, the transfer of Chornomornaftogaz to Gazprom.

In any case, since the annexation of Crimea to Russia is not recognized by any independent State and certainly not by the United Nations, *de iure* and *de facto* so far there is no change in the demarcation of the Black Sea, leaving things as they were. Nevertheless, it becomes all the more evident that Russia is not in a hurry and does not pursue any legal or exploration activity offshore Crimea, in an attempt to create a *status quo ante* in the area, as time passes by, that would lead to the tacit approval of the new status of Crimea by the neighbouring littoral countries in the future.

Another reason for the Russian absence of activity in Crimea is the mounting economic recession, due to Western economic sanctions against Russia over the conflict in Ukraine. Reducing access to Western financing and advanced technology makes all the more difficult for Gazprom to proceed with offshore oil and gas development of the fields in Black and Azov seas, as is the case in the Barents and Kara seas as well⁹.

⁸https://en.wikipedia.org/wiki/Annexation_of_Crimea_by_the_Russian_Federation#Accession_treaty_and_immediate_aftermath

⁹ William J. Broad, “*In taking Crimea, Putin gains a sea of fuel reserves*”, New York Times, 17/05/2014, <http://www.nytimes.com/2014/05/18/world/europe/in-taking-crimea-putin-gains-a-sea-of-fuel-reserves.html>.

ANNEX

