

5. Surgutneftegas: quiet conservative

Surgutneftegas's response to changing times has been to resist change as much as possible through a strategy of tight control. Of all the heads of the Soviet oil enterprises, only Surgutneftegas Director Vladimir Bogdanov and Vagit Alekperov of LUKOIL have succeeded in defeating the oligarchs and retaining control of the companies (see the chapter on LUKOIL in this book).

Surgutneftegas is considered to be Russia's most conservative, least transparent and perhaps most financially stable oil company. It has always paid its taxes promptly, even when tax evasion was rife in the country. *Forbes* magazine stated that 'as a competent and honest industrial tycoon, Bogdanov stands out in Russia' (Forbes 2001). Surgutneftegas has also supported other domestic industries, kept politics and foreigners at arm's length and demonstrated solid organic growth (Poussenkova 2004). Bogdanov has remained a loyal and respected citizen of Khanty-Mansi Autonomous District, where most of the company's exploration and production has been concentrated, although the company faces protests from some of the indigenous peoples displaced by Surgutneftegas activities.

Surgutneftegas has proved to be resilient to the challenges presented by low oil prices, financial crises and Western sanctions. It is one of the few oil companies in Russia that can produce hard-to-recover reserves using its own technology and expertise without international partners. While the company does not make grand statements on climate change, it has employed some relatively climate-friendly, efficient technologies, and its level of utilization of associated petroleum gas (APG) has consistently been the highest in Russia. Shvarts et al. (2015), Shvarts et al. (2016) and Shvarts et al. (2018) rate Surgutneftegas as the most environmentally responsible Russian oil company.

With oil production of 61 million tonnes in 2018, Surgutneftegas is the fourth-largest Russian oil company after Rosneft, LUKOIL and Gazprom Neft. Unlike most of the Russian oil companies, it is headquartered near its main assets, in the town of Surgut in Western Siberia. The company is wholly privately owned, although its precise shareholder structure remains unknown.

The company's exploration and production operations are concentrated in Western Siberia, Eastern Siberia and Timan-Pechora. Surgutneftegas owns the Kirishinefteorgsyntez (KINEF) refinery, located in Leningrad region near Saint Petersburg, and five petroleum product distributors in the same region: Kaliningradnefteproduct, Kirishiavtoservis, Novgorodnefteproduct,

Pskovnefteproduct and Tvernefteproduct (295 fuel stations in total) as well as the Surgut gas-processing plant and two R&D institutes (SurgutNIPIneft, based in Surgut with a branch in Tyumen) and Lengiproneftekhim (Saint Petersburg).

CORPORATE HISTORY

The predecessor of the present-day company, Surgutneftegas Production Association, was established in 1977. This was a decision-making body with oversight over several state oil-producing enterprises. Vladimir Bogdanov, aged 33, was appointed General Director of Surgutneftegas Production Association in 1984, becoming the youngest director ever of the largest West Siberian production association.

The 1990s: Unchanging Surgutneftegas in a Changing Russia

Along with LUKOIL, YUKOS and Rosneft, Surgutneftegas was established by Presidential Decree 1403 of 19 November 1992 (Kremlin 1992), which enabled the creation of vertically integrated oil companies by merging existing state-owned companies and assets. In 1992, Vladimir Bogdanov enjoyed the strong support of the Russian government and was able to handpick the assets he wanted to incorporate into Surgutneftegas, including the KINEF refinery. Analysts observed that among the oil companies that appeared in the 1990s, Surgutneftegas had the tightest fit between its subsidiaries and the most streamlined corporate structure. The open joint stock company (OJSC) Surgutneftegas Oil Company was established by the Russian government's order 271 of 19 March 1993, 'On the Establishment of the OJSC Surgutneftegas Oil Company'.

Surgutneftegas was one of the first vertically integrated oil companies in Russia to be privatized. Vladimir Bogdanov was determined from the outset to establish firm control over the company, and he accomplished this goal. In 1993, 8% of Surgutneftegas shares were sold by the federal government at a closed auction. Surgutneftegas purchased another 7% of its own shares for vouchers. At this time, 45% of the shares remained in the hands of the federal government. In June 1994, Khanty-Mansi Autonomous District sold 40% of Surgutneftegas shares via a tender to the company Neft-Invest, which was controlled by Surgutneftegas (Nefte.ru 2019).

Bogdanov decided to arrange a loans-for-shares auction for Surgutneftegas along the lines of other loans-for-shares auctions that took place in the early 1990s. He managed to limit access to the auction: Rosneft, for instance, was excluded on a technicality (Gustafson 2012). At that time, Bogdanov had a powerful ally in Moscow, Vladimir Potanin, founder of ONEXIM Bank and

a key player in the wider loans-for-shares scheme. Thus, in November 1995, 40.12% of the Surgutneftegas shares that were still being held by the state were sold at the loans-for-shares auction. The Surgutneftegas Pension Fund, established by the company's management, received this stake in trust by pledging to pay the government the tax debt of Surgutneftegas Oil Company (amounting to USD 216 million) and provide the state with a loan worth USD 84 million. Potanin agreed that ONEXIM Bank would act as a guarantor of the Surgutneftegas Pension Fund at the auction. In return, Surgutneftegas kept its accounts in ONEXIM Bank for several years (Forbes 2004). Surgutneftegas also bought a 16% share in ONEXIM Bank, partly as a good investment and partly to keep an eye on its partner.

When the stake was resold in 1997, the relevant obligations included a provision of financing for Surgutneftegas production programmes (RUB 1.1 trillion for three years) as well as local social and economic development programmes (RUB 100 billion for one year). The stake was won by Surgutfondinvest, a previously unknown pension fund manager, which turned out to be a member of the Surgutneftegas family (The Moscow Times 1997). The Surgutneftegas privatization was complete.

In the mid-1990s, Bogdanov also focused on tightening his control over the exports of Surgutneftegas oil. He found a trading partner in the company Nafta-Moscow, the former Soviet Soyuznefteexport, and bought 15% of its shares in 1997, thus ensuring a stable channel for exports of its oil. In 2001, when Nafta began to lose its market position, Bogdanov sold the shares again.

Another export-trading partner of Surgutneftegas was Kineks, owned, among others, by Gennadiy Timchenko. This alliance had long-term strategic implications for both partners. Kineks was established in the mid-1990s and began to flourish in the late 1990s when it was already exporting 60% of Surgutneftegas's petroleum products and had begun to tighten its grip on exports of its crude, gradually displacing Nafta-Moscow. In 2003, Timchenko broke up with his partners in Kineks and established the oil-trading company Surguteks, where he had managed to capture 51% of Kineks's business (Vedomosti 2012a). Another oil-trading company, Gunvor, was established by Timchenko in 1997, and also became an important trader of Surgutneftegas's oil and petroleum products.

Surgutneftegas's leaders – in effect, mainly engineers by background – showed considerable sophistication in financial matters. Thus, in early 1995, Surgutneftegas was the first Russian company to make an additional issue of shares. It also issued first-level American depository receipts (ADRs) in 1997, becoming the fourth Russian oil company after LUKOIL, Chernogorneft and Tatneft to enter Western stock markets.

Surgutneftegas differed from other vertically integrated Russian oil companies in that it never used tax-optimization schemes. It was always one

of the most punctual taxpayers in Khanty-Mansi Autonomous District and had the firm support of the local authorities (Kommersant 2000). Moreover, Surgutneftegas has never had wage arrears, while its salaries are higher than those paid by many other oil companies.

Probably because of this fiscal discipline, Surgutneftegas successfully lobbied for its interests with the federal government and often obtained more benefits than its competitors. For instance, in 1996, the government permitted the company to export an additional 10 million tonnes of oil for two years to finance the construction of an export terminal in Batareynaya Bay in the Gulf of Finland; Surgutneftegas was allowed to pump the whole allocated volume while the export schedules of its rivals were curtailed.

During the 1990s, there was an avalanche of new joint ventures between foreign companies and Russia's oil majors (Overland et al. 2013). Yet during this time, Surgutneftegas was the only major that did not establish joint ventures with foreigners. According to Bogdanov, 'oil produced by most joint ventures could be produced by domestic enterprises using our technology and would cost the Russian side much less' (Russian Petroleum Investor 1997). There may have been another reason why other Russian oil companies opted for joint ventures while Surgutneftegas avoided them. They often regarded them as vehicles for increasing export volumes; however, Surgutneftegas was already exporting more crude oil than its Russian peers.

Although his power has been challenged in different ways, Vladimir Bogdanov has suffered surprisingly few defeats over the decades. One such challenge came from the indigenous Khanty people living close to the Tyanskii reserves in Khanty-Mansi Autonomous District, who feared that oil development threatened their reindeer herding and sacred sites. In March 1991, the Khanty of Russkinskii village held a referendum and voted unanimously against oil extraction in their local area. The project received a negative review from the state ecological experts; however, this decision was overturned by the federal government, which resulted in so many local protests that the district government was forced to announce a moratorium on the oil developments until 1996. In fact, Surgutneftegas resumed work on the Tyanskii field in 1994, but the deal that came out of this conflict established a precedent for engagement between indigenous peoples and oil companies in the Russian North, including the negotiation of company-community agreements.

Bogdanov's most significant failure during the 1990s was probably his unsuccessful attempt at controlling the petroleum products distribution in Saint Petersburg, which resulted in a major fuel shortage in the city in December 1994 and the restructuring of Surgutneftegas as a business. Following Bogdanov's efforts in 1994 to control distribution through strong-arm tactics and share swaps, the Saint Petersburg authorities set up a competing company, and Surgutneftegas eventually lost control over its distribution network. The

situation was compounded when a local gang boss took control of the local market. In 1998, Surgutneftegas sold off the last of Surgutneftegas's distribution and retail assets in Saint Petersburg, although it retained some distributors in the wider Leningrad region (Gustafson 2012).

The 2000s

While Putin's Russia differed radically from Yeltsin's Russia, Surgutneftegas stuck to the strategy and management principles it had developed during the 1990s. Strengthening a grip over the company was still one of the key objectives of its leadership. Surgutneftegas has maintained good relations with the political elite throughout the Putin era, although it has resisted getting more involved than necessary. Bogdanov was Putin's close ally in the 2000 elections, but he subsequently declined an offer to become the Minister of Energy.

In the 2000s, support for domestic industry remained one of the top priorities for Surgutneftegas. The company formulated a strategic objective to replace 50% of imported technologies and materials with Russian analogues. In particular, it cooperated with the former defence enterprises to convert them to manufacturing of oilfield equipment (Burneft.ru 2017). In 2003, Surgutneftegas placed orders for 106 types of equipment and spare parts at 22 Russian enterprises. Given Surgutneftegas's large outlays for high-tech gear, it meant significant private investments in Russia's domestic R&D potential.

Surgutneftegas also demonstrated efforts towards more responsible oil development. In 2000, it became one of the few oil companies that gave up the practice of dumping wastewater into natural reservoirs, instead channelling them back into the oil and gas fields in order to maintain reservoir pressure.

In the new millennium, Surgutneftegas has managed to achieve considerable success in its E&P despite the limitations of the ageing reserve base (see the section on production strategy below). However, its track record of downstream operations is less impressive. In June 2002, Surgutneftegas, Rosneft and the government of Leningrad region signed an agreement on building a refinery and a sea terminal in Primorsk at the cost of USD 1.3 billion to process 8–10 million tonnes per annum. However, in 2004, Rosneft withdrew from the project, and in 2006, Surgutneftegas also gave up its plans, with Bogdanov stating that the shortage of electricity and water had made the construction commercially unfeasible (Vedomosti 2006). Also, in 2013, Surgutneftegas terminated the construction of the oil-loading terminal at Batareynaya Bay, a project it had been half-heartedly implementing since the late 1990s (NIAR 2014).

The 2000s were a time for further tightening of Bogdanov's grip on Surgutneftegas. In the year 2000, Bogdanov consolidated his holding in an unusual manner. Shares of JSC Surgutneftegas, the oil-producing subsidiary,

were swapped for shares of the parent company, Surgutneftegas Oil Company, and the refinery and petroleum product subsidiaries. Initially, many small-scale shareholders viewed this consolidation negatively, fearing the dilution of their stock. However, the share swap ratios proposed by the company seemed acceptable to everybody, and consolidation was achieved without scandals or lawsuits (Newsruss.ru 2019).

In 2003, Bogdanov further consolidated his control over the company. After the TNK-BP alliance and failure of the YUKOS-Sibneft deal, everybody was expecting new mergers and acquisitions (M&A) in the sector and considered Surgutneftegas to be the prime candidate for a hostile takeover by Sibneft or TNK. In spring 2003, there were indications that the Sovlink brokerage firm acting for TNK was actively purchasing the stock of Surgutneftegas. In a counteroffensive, Surgutneftegas, without much regard for price, aggressively bought a block of its own stock sufficient to ensure a controlling interest for Bogdanov. As a precautionary measure, Surgutneftegas Oil Company, the key subsidiary that held the most significant block of Surgutneftegas shares (36.7% of authorized capital and 42% of voting stock), was renamed Leasing Production Ltd and was transformed from an OJSC into a limited liability company, making it even less transparent (Neft i kapital 2004).

In late 2006, Surgutneftegas sold the structure called Leasing Production. Analysts estimated the value of the deal at USD 20 billion, one of the biggest transactions carried out in Russia to that date. However, it was unclear who bought this stake (external buyers or Surgutneftegas entities) and why Surgutneftegas initiated this deal (probably as a precautionary measure against a hostile takeover) (Kompromat 2007). Subsequently, in early 2007, information was leaked indicating that the Surgutneftegas Pension Fund had become the owner of Leasing Production (Vedomosti 2007b).

The same year, that is, 2007, analysts inferred that 72% of Surgutneftegas shares (85% of voting stock) might belong to 23 non-commercial partnerships that kept them under the heading of long-term financial investments in their accounts. These partnerships were either established by Surgutneftegas or controlled by its top managers, including Bogdanov (Vedomosti 2007b); however, the ownership of these partnerships was later transferred to ordinary employees of Surgutneftegas.

In the new millennium, Surgutneftegas has continued to maintain its reputation as an investor-unfriendly company – a reputation originally established through its practice of limiting investor access to share auctions and engaging in share-swapping to consolidate control over the company. Minority shareholders have frequently expressed dissatisfaction about Bogdanov's dividend policy. In 2001, the international investment fund Russian Prosperity sued Surgutneftegas for its practice of calculating the profit that allegedly led to the under-statement of dividends on preferred shares but lost the case.

A further disagreement in 2004 was connected with a lawsuit by Harvard University Pension Fund, which held 3 million ADRs on preferred shares. The Fund claimed that over six years, Surgutneftegas had intentionally declared dividends far below the amount mandated by the company's charter; it had managed to do so by using an artificially under-stated net profit figure by deducting from revenues not only operational expenses and taxes but also investments. Since management controls the bulk of Surgutneftegas's common shares, the plaintiff argued that Surgutneftegas's retention of virtually all the company's earnings benefited its executives at the expense of holders of preferred shares. The Harvard University Pension Fund estimated its 2003 losses at USD 3.7 million (Ria Novosti 2004).

In 2004 and 2005, William Browder, Head of the Hermitage Capital hedge fund, initiated a lawsuit against Surgutneftegas, demanding redemption of its treasury stock (the common stock owned by Surgutneftegas itself) but lost the case (Gazeta.ru 2013). Browder has referred to Bogdanov as 'the Saddam Hussein of Russian business' (Bloomberg 2015). In 2005, Browder's Russian visa was annulled.

Surgutneftegas continued to be one of the most closed and least transparent Russian oil companies. In fact, information about the key shareholders remains one of the best kept secrets in the Russian oil industry. There were many rumours about the owners, one being that Gennady Timchenko held some 25% of the company. However, Timchenko denied that he owned a large stake in Surgutneftegas, and his representative told the *Financial Times* in 2013 that he held less than 0.01% of the company's stock (BBC 2013).

During the 2000s, there were also unconfirmed rumours that Vladimir Putin owned 37% of Surgutneftegas, although the Kremlin vehemently denied it (Ino TV 2014). Given these rumours, it is unsurprising that Surgutneftegas managed to avoid being acquired by other Russian oil companies, although the market was regularly kept on edge by speculations about a potential purchase of Surgutneftegas by Gazprom or Rosneft.

However, one important characteristic of Surgutneftegas did change during the 2000s: the formerly apolitical company was gradually drawn into the political agenda of the new Russian leadership. Vladimir Putin and Igor Sechin likely became acquainted with Bogdanov in the early 1990s when they both worked in Saint Petersburg mayor's office (Znak 2015). It is noteworthy that the title of Igor Sechin's PhD (kandidatskaya) thesis, which he defended at Saint Petersburg Mining University in 1998, was 'The economic valuation of investment projects of oil and petroleum products transit: the case of the Kirishi-Batareynaya petroleum product pipeline' (Lenta.ru 2019). This pipeline is owned by Surgutneftegas.

Throughout the 2000s, Surgutneftegas was increasingly associated with the *siloviki*¹ group (politicians from the military or security services) in

the Russian establishment, and especially with Igor Sechin, who was then the Deputy Head of the Presidential Administration, and it seems that the company was sometimes asked to perform certain services for the Kremlin. For instance, during the 2004 auctioning of a former key asset of YUKOS, Yuganskneftegaz, Baikal Finance Group appeared out of nowhere and submitted the winning bid. Baikal Finance Group was represented at the auction by two managers from Surgutneftegas, Igor Minibayev, Head of the Department of Organizational Structures, and Valentina Komarova, First Deputy Head of the Financial Department (Vedomosti 2014).

Similarly, in 2005, Surgutneftegas bought 35% of the Ren TV channel from Severstal for between USD 60 and 100 million, according to different estimates. This was surprising as Surgutneftegas had previously avoided the acquisition of non-core assets. In fact, this was one of the steps taken by the state to tighten its control over the mass media by bringing key media organizations under the control of loyal companies. According to newspaper reports, it may have been Sechin who proposed the idea of selling a stake in Ren TV to Surgutneftegas (Vedomosti 2005a). Continuing this trend, in March 2009, Surgutneftegas raised its stake in National Media Group from 12.3% to 24%. The group owns 51% of National Telecommunications, 100% of Ren TV, 72% of the Petersburg Channel 5 and 51% of *Izvestiya* newspaper (Kommersant 2009).

This close association with politics poses a certain risk to Surgutneftegas in that it could be asked to do even more serious favours for the Kremlin. For instance, when a 19.5% stake of Rosneft was to be sold off in the second round of its privatization, speculation was rife that Surgutneftegas would be the buyer and that its funds would be used to cover USD 23.5 billion of Rosneft's debt, although this was never confirmed (Ihodl.com 2015).

Post-2010

In 2012, Surgutneftegas changed its ownership structure: 13 of the 23 non-commercial partnerships mentioned above ceased to exist and were merged with other partnerships. Their owners remained practically the same; however, there was a significant decrease in the total financial investments of the new non-commercial partnerships. This reorganization, which further complicated the already very complex ownership structure, might have been connected with Surgutneftegas's pending publication of its financial statements under international accounting standards (IAS) for the first time in ten years as a way for Surgutneftegas to avoid disclosing information about its owners (Kommersant 2012a) (see the section on transparency below).

Surgutneftegas continued to have only the one refinery that it obtained during privatization. KINEF is located in Leningrad region and produces over

80 different petroleum products. Surgutneftegas has continued to upgrade KINEF over the years.

Surgutneftegas still was able to obtain significant benefits from the government through its alliances with politically influential partners. Thus, in 2012, the Russian oil companies found themselves unable to upgrade their refineries in time to comply with the terms established by the government in October 2011 and asked the ministry to extend the deadline. However, at that time, only Surgutneftegas managed to reach an agreement with the officials concerning such an extension. The company was allowed to postpone the commissioning of isomerization and catalytic reforming installations from 2015 to 2016, hydrocracking from 2012 to 2013 and hydro-purification from 2014 to 2015 (Kommersant 2012b).

In June 2017, Vladimir Putin signed a Decree on State Awards. In recognition of Surgutneftegas's contribution to Russia's innovation potential, Bogdanov and his deputies Yuri Baturin and Anatoliy Nuryaev received science and technology awards for creating a sustainable system of development for the petroleum fields of Western Siberia (Kommersant 2017).

COMPANY PROFILE

This section covers key aspects of Surgutneftegas's operations, which help set out the company's corporate profile. These include the company's production strategy, involvement in the Arctic and in offshore oil and gas developments, internationalization strategy, operational transparency and corporate social responsibility.

Production Strategy

The production strategy developed by Surgutneftegas during the 1990s was quite unusual for Russia. The company aimed at stabilizing output based on its existing assets rather than through acquisitions. It targeted exploration drilling to ensure adequate reserve replacement and was the only oil company in Russia to establish an exploration division in 1995. It brought on stream several new fields (for example, Tyanskoye and Konitlorskoye with reserves of 300 million tonnes in 1994). One analyst observed in 1996 that Surgutneftegas was 'one of the few companies thinking about the future' while its competitors 'were living off the fields discovered in the Soviet times with state funds when no one counted the money being invested in the sector's development' (Russian Petroleum Investor 1997, p. 70). As a result of this strategy, Surgutneftegas's production decline from 1994 to 1995 (2.4% per annum) was much lower than the sector average (8–10% per annum). It is also noteworthy that

Surgutneftegas's oil output had already begun to grow in 1996 while Russia's other vertically integrated oil companies posted growth only in 2000.

However, Surgutneftegas's rates of growth began to decline in the mid-2000s: in 2003, production grew by 11.7%, and 7.11% and 2.65% in 2005 and 2006, respectively. Some analysts believed that this slowdown happened because of the heavier financial burden on the sector, which was not being compensated for by the rising oil prices. Others thought that it resulted from the natural depletion of Surgutneftegas's West Siberian fields with no major new acquisitions to offset the decline. Some drew on horizontal drilling to explain this phenomenon, which the company mastered in 2001 and 2002, and argued that Surgutneftegas leadership relied excessively on these aggressive methods of field development (Vedomosti 2007a).

From 2007 onwards, Surgutneftegas's production declined for five consecutive years, and only in 2011 did it increase again by 2.1% due to the commissioning of new fields – Talakansk and Alinsk – in the Republic of Sakha (Yakutiya) (see below). In addition, the company gradually managed to bring the mature fields' rates of decline under control: in 2006, the rate was 6.2% and 2.8% and 1.8% in 2010 and in 2011, respectively. This was accomplished by intensifying its drilling programme (Kommersant 2012c).

Surgutneftegas has always focused on increasing its oil recovery ratio, which at 0.43 is one of the highest among Russian oil companies (Neft i kapital 2012). Annually, it undertakes over 9000 operations to enhance oil recovery. The company has also always had the lowest number of idle wells in the total well count among Russian oil companies. The company's APG utilization has also consistently been the highest in Russia – 99.56% in 2018 (Surgutneftegas 2018) (see the section on climate change below).

Surgutneftegas's E&P activities have always been concentrated primarily in Khanty-Mansi Autonomous District, and the company stayed away from the 'asset-grabbing fever' in Russia in the mid-1990s, avoiding growth for the sake of growth. However, by the mid-2000s, as the limitations of the ageing West Siberian fields became increasingly visible, Bogdanov changed his approach. In 2003, Surgutneftegas shed its reputation of a Khanty-Mansi recluse by gaining the rights to the Talakansk field, with 124 million tonnes of reserves in the Republic of Sakha (Yakutiya). Initially, Sakhaneftgaz, controlled by YUKOS, had won the licence for Talakan in 2001. The results were subsequently annulled because Sakhaneftgaz was unable to pay the required bonus of USD 501 million. Another investment contest was planned; however, in 2002, Surgutneftegas, as the bidder that offered the second-largest bonus (USD 61 million), asked the arbitration court of Sakha to recognize it as the winner. In late 2003, it was decided that the licence be granted to Surgutneftegas, and in April 2004, Surgutneftegas and the Sakha Republic signed an agreement for the development of the field. Surgutneftegas's growing oil production in

Eastern Siberia reached 9.1 million tonnes in 2018, with the region accounting for 15% of the total output of the company (Surgutneftegas 2018).

Surgutneftegas has consistently been one of the leaders in exploration and development drilling in Russia. In 2018, it accounted for 20% of Russia's total exploration drilling and 18% of development drilling. By the end of 2018, it had a total of 24 457 active wells, while the proportion of idle wells had fallen to 8%, the lowest in the sector (Surgutneftegas 2018).

Since the company rarely makes presentations for analysts, the main source of information about its production strategy is Bogdanov's speeches. At the 2012 annual general meeting (AGM) of shareholders, Bogdanov told journalists that Surgutneftegas did not plan to buy any assets: 'I do not need to buy anything. We have everything!' He also stated that the company's production strategy remained the same: 'to drill, drill, drill and develop what we [already] possess' (Bogdanov, cited in Vedomosti 2012b). At the 2013 AGM, Bogdanov repeated that the company would not change its strategy: it would develop in Russia and continue to accumulate money in bank deposits. He stated that Surgutneftegas had stabilized production at the 2012 level of 61.4 million tonnes, and crude output would grow again in the coming years mainly due to new projects, the largest among them being the Severo-Rogozhinskoye field in Western Siberia where production would begin in 2015, six years ahead of the deadline established in the licence (Kommersant 2013a). Indeed, by 2018, the Rogozhnikskaya group of five fields reached the planned production level of some 4 million tonnes of oil per annum (Surgutneftegas 2018).

Analysts have frequently said that one of the key problems for Surgutneftegas is its insufficient reserve increment (replacement of production with new reserves), which was much lower than that of LUKOIL or Rosneft. However, in December 2012, Surgutneftegas began to spend some of its financial reserves. In an intense competition with Rosneft, Gazprom Neft and Gazprombank, it bought for RUB 46 billion a production licence for the Schpielman field in Khanty-Mansi Autonomous District, containing 146 million tonnes of oil. It was Surgutneftegas's most significant purchase in recent years and the most expensive licence in Russia until then (Kommersant 2012d).

In 2016, Surgutneftegas began to develop a new area, the Uvat cluster in Tyumen region, by commissioning the Yuzhno-Nyurymyskoye field with recoverable reserves of 8.5 million tonnes. In 2018, oil production at the Uvat cluster with two fields under development reached 935 000 tonnes. Within a five-year time horizon, Surgutneftegas was planning to commission 21 new fields, ensuring that production stayed at 61 million tonnes per annum.

In 2016, oil production by Surgutneftegas grew by 0.4% to 61.8 million tonnes, with East Siberian fields providing the bulk of the growth. In 2017, Surgutneftegas was to reduce its oil production to 61.1 million tonnes to contribute to the fulfilment of the requirements of the OPEC+ agreement of

November 2017, where OPEC and non-OPEC producers agreed to extend oil production cuts to the end of 2018. In 2018, production declined further to 61 million tonnes. At the same time, gas production continued to decline from 12.3 billion cubic metres in 2012 to 9.7 billion cubic metres in 2016 and remained at this level in 2018 (Surgutneftegas 2018, p. 8). The commissioning of new gas fields in the Republic of Sakha did not offset declines at the depleting fields in Western Siberia. Since there is neither a market nor an infrastructure for gas in the Republic of Sakha, Surgutneftegas had to re-inject gas, increasing the level of APG utilization in Sakha to 96.7% in 2014 (Territory neftegas 2015).

The Arctic and Offshore Development

With current operations in Western and Eastern Siberia and Timan-Pechora and a long history of activity in Khanty-Mansi Autonomous District, Surgutneftegas has ample experience of operating onshore fields in the Arctic and sub-Arctic conditions. Yet the company has never demonstrated any serious ambition to work offshore in the Arctic. In 2005, there were reports that it was negotiating the possible joint development of offshore oil and gas fields in Russia with the Norwegian oil company Statoil (later renamed Equinor) (Vedomosti 2005b). However, these plans never materialized.

In 2008, amendments were made to the Law on the Continental Shelf, restricting offshore development to projects led by Gazprom and Rosneft. Bogdanov stated that it was now only possible to undertake offshore development as a minority partner of one of the two major state companies,

and we are not ready to work under such conditions ... We are also a decent Russian company. Our principle is the following: We fully implement the project by ourselves from the beginning to the end; we do not join partnerships; we have enough money and potential, both technological and human. (Vedomosti 2012b)

Internationalization

Over the years, Surgutneftegas made only two serious attempts to operate outside Russia. In 2008, it reluctantly joined the National Oil Consortium in Venezuela, which also included Rosneft, LUKOIL, TNK-BP and Gazprom Neft, and was established on Igor Sechin's initiative to develop the Junin-6 field. In 2012, when Sechin left his position as Deputy Prime Minister, Surgutneftegas quickly withdrew from the consortium, and Rosneft bought its stake for RUB 6 billion (Kommersant 2012e).

Another unsuccessful attempt to operate overseas was made in April 2009 when Surgutneftegas bought 21.2% of the Hungarian company MOL for EUR 1.4 billion from the Austrian company OMV. MOL considered this

acquisition a hostile takeover and, as a precautionary measure, introduced amendments to its charter, significantly expanding the authority of its board of directors whereby it could limit the shareholders' rights if they did not provide information about the company's owners (or if there were reasons to doubt this information). Thus, in effect, MOL could demand to know the identity of the ultimate beneficiaries of Surgutneftegas, which refused to provide such information. Consequently, MOL did not even include Surgutneftegas in the register of its shareholders, precluding Surgutneftegas's participation in the AGM, which approved the above-mentioned amendments (Vedomosti 2009a).

In response, in June 2009, Surgutneftegas filed a lawsuit against MOL in the Court of Budapest demanding that Surgutneftegas be included in the register. It lost two court cases against MOL, which continued to deny Surgutneftegas's access to its register and shareholders' meetings. Igor Sechin, who was considered the 'main curator' of the deal, tried to help Surgutneftegas but in vain (Kommersant 2011a). Ultimately, in May 2011, Surgutneftegas sold its stake to the government of Hungary for EUR 1.88 billion, earning some EUR 500 million. Still, most Russian analysts believed that cash-rich Surgutneftegas did not need this money and that it had been requested by the Kremlin to buy a stake in MOL on behalf of one of the state companies (Kommersant 2011b).

These two failed attempts to go international reinforced Surgutneftegas's preference for operating within Russia. Indeed, in 2012, Bogdanov explained that Surgutneftegas was not interested in overseas production assets: 'Their oil is the same as ours' (Vedomosti 2012b). He reiterated this statement at Surgutneftegas's AGM in 2013: 'We believe that it is more efficient to work in Russia despite the high taxes, problems with tariffs of natural monopolies and unstable legislation ... I have not seen any information showing that other companies that work abroad earned profits that could ensure a return on investments' (Vedomosti 2013a).

Innovation

As noted above, Surgutneftegas was the only Russian oil major that decided not to establish joint ventures with foreign companies in the 1990s. Yet despite its cautious attitude towards foreigners, Surgutneftegas has been a pioneer among Russian oil companies in using Western production technologies and state-of-the-art equipment. In the mid-1990s, it was the first to implement the 'enterprise resource management' software from the leading German provider SAP to monitor and control costs. Bogdanov's approach to the new technology was cautious. However, once he had made up his mind, he sent his best people abroad by the hundreds to be trained (Gustafson 2012, p. 226). By the mid-1990s, investment analysts declared that Surgutneftegas was Russia's leader in the use of modern crude extraction technologies and one of the few

Russian oil companies capable of horizontal drilling and fracking, which it performed using in-house resources rather than drawing on the services of foreign service companies.

This focus on 'localization' was also manifested in Surgutneftegas's approach to its own scientific resources. The research institute SurgutNIPIneft initially started to use Schlumberger technology to create geological models for eight fields; however, it gradually shifted to domestic methods of digital geological and hydrodynamic modelling.

Transparency

Surgutneftegas is considered to be Russia's least transparent major oil company. This strategy has helped Bogdanov maintain control over the company. As noted above, the lack of transparency around share ownership, for example, may have reduced the risk of hostile takeovers, although it led to difficulties when attempting to acquire overseas assets.

Surgutneftegas's 2013 IAS reconfirmed the company's lack of consideration for investors. Surgutneftegas had not provided financial statements under the IAS since 2002 when it issued its 2001 IAS Report, causing a scandal. The 2001 Report stated that the treasury stock of the company accounted for 40.5% of its authorized capital or 46.6% of voting stock. The largest minority shareholders sued Surgutneftegas, demanding it not to vote for this stock. Since then, Surgutneftegas has provided statements only under Russian accounting standards. However, in 2013, it was forced to publish IAS statements under a new order by the Ministry of Finance applicable to public companies and banks (Vedomosti 2013b).

The IAS 2012 statements did not advance our knowledge of Surgutneftegas; its treasury stock and beneficial ownership remained in the dark (Vedomosti 2013c). Analysts stated that during the investor day organized on the occasion of the publication of IAS statements, Surgutneftegas confirmed its reputation as the most closed company in the sector. One analyst stated thus: 'They do not need anything. Surgutneftegas is a state within a state. The company owns practically everything in its region, and the average salary is RUB 60 000, which is much higher than regular Russian wages; they are satisfied with everything' (Kommersant 2013b).

At the same time, the IAS statements demonstrated that Surgutneftegas remained one of the main contributors of capital to the Russian banking system. In late 2012, its bank deposits exceeded the combined bank deposits of the Ministry of Finance and the regions of the Russian Federation. Surgutneftegas mainly kept its money in dollars (USD 24.3 billion) and euros (EUR 3.4 billion) in Sberbank, Gazprombank, VTB and Unicredit-Bank and earned about USD 1 billion per annum in interest (Kommersant 2013b).

Surgutneftegas publishes an annual report, which covers production, research and technology, corporate governance and securities, financial statements and key risks to business; it also reports on environmental and social issues, including expenditure in these areas and the energy resources utilized by the company. Its key performance indicators include, among others, production figures, investments, existing and new wells and gas stations, number of personnel, revenue, net profit and dividends per share. In the section on corporate responsibility, it analyses environmental safety, human resources policy, spending on social activities, charity and sponsorship. It reports on the following areas relating to environmental protection: enhancing environmental safety and prevention of accidents; atmospheric air protection; protection, rational use and re-cultivation of land; protection, rational use and restoration of water resources; waste treatment; and monitoring of the environment and production facilities (Surgutneftegas 2016a, pp. 68–70). Since 2004, Surgutneftegas has been producing an annual *Environmental Report*, which elaborates all aspects of its environmental protection activities and engagement with local and indigenous communities (Surgutneftegas 2019b).

The company's website also provides some information relating to all aspects of the company's activities, including E&P; financial reports for investors and shareholders; information for the public, including reports on environmental conflicts and community grievances; company policy concerning its relations with indigenous peoples; and information relating to protected areas, including reports and videos on Numto Nature Park.

Surgutneftegas is also listed on several foreign stock exchanges, including the London Stock Exchange. Participation in international stock exchanges obliges Surgutneftegas to adhere to minimum transparency standards.

CSR

Like other Russian vertically integrated oil companies, Surgutneftegas continues to sign and implement cooperation agreements with the administrations of the regions where it operates and enters into direct agreements with indigenous peoples (Neftegaz.ru 2008). The agreements with indigenous peoples often relate to the provision of vehicles, chainsaws, fuel, diesel generators, construction materials and so on. The company pays the transportation expenses of indigenous families, reimburses expenditure for medical treatment and care and supports children's education (Neftyaniki 2015). These arrangements have occasionally come under criticism as commitments are not always followed through, while Surgutneftegas has limited the eligibility of families to receive this kind of support, excluding households who receive income through state employment. Unlike LUKOIL, which frequently offers ad hoc assistance to

indigenous peoples outside of formal agreements, Surgutneftegas is reported to have a policy that restricts assistance to formal agreements.

With its headquarters in Surgut, Surgutneftegas is one of the two vertically integrated oil companies (the other being Tatneft) that has its headquarters in a production region rather than in Moscow or Saint Petersburg. As a result, it pays considerable attention to the city, which is one of the best funded and managed in Russia. Unlike many other Russian oil companies, Surgutneftegas did not abandon the social infrastructure that it maintained during the Soviet era by transferring it to municipalities, which was a fashionable thing for oil companies to do in the 1990s. Contrary to the advice of Western consultants, the company continued to sponsor education in target areas; it also provided its staff with accommodation, medical insurance and a generous non-state lifetime pension scheme with established guaranteed payments (Ugra.mk.ru 2012).

Some of Surgutneftegas's oil production facilities are located within or in the vicinity of nature reserves and/or areas sacred to indigenous peoples, such as Numto Nature Park and the sacred Imlor Lake in Yugra (Surgutneftegas 2016a, p. 83; Vestnik 2013). Despite protests from the residents living around Imlor Lake in 2010, Surgutneftegas managed to reach an agreement with the Governor of Khanty-Mansi Autonomous District, and today all but one indigenous household have left the Imlor Lake area in tandem with advances in oil development. Greenpeace Russia has campaigned on both the Lake Imlor and Numto cases. In the case of Numto in 2015, more than 36 000 letters were sent to regional and federal officials urging them to reject proposals to open up the wetlands of Numto Nature Park to oil drilling. Public hearings were held; however, in October 2016, the Ministry of Natural Resources and Environment decided to change the zoning regulations in the park to allow oil drilling in the wetlands (Greenpeace 2017).

In 2018, Surgutneftegas spent RUB 17 billion on environmental protection – according to its own account (Surgutneftegas 2019c). As a result of the measures aimed at reducing air pollution, the emission of pollutants decreased by 42% between 2006 and 2016 (Surgutneftegas 2016a, pp. 68 and 70). Surgutneftegas has consistently been ranked high in WWF Russia and CREON reports (2014, 2015, 2016) on the environmental responsibility of Russian oil companies. In 2014 and 2015, Surgutneftegas was rated first but dropped to third place in 2016 after Sakhalin Energy and Gazprom. In 2018, it was ranked number one in terms of environmental management.

COPING WITH CHANGE

Surgutneftegas is assumed to be one of the most conservative and least adaptable of the Russian oil majors. However, while many of its strategic principles

have remained unchanged throughout its history, the company has more than once demonstrated its ability to respond to new challenges. In some cases, the response strategy has precisely involved sticking to the old ways of doing things.

Responding to Low Oil Prices, Crises and Sanctions

Throughout its history, Surgutneftegas has been able to cope successfully with financial and economic crises by adhering to its long-term strategy. Russia's economic meltdown in 1998 was an acid test for most Russian vertically integrated oil companies. Compared to its peers, the crisis had little impact on Surgutneftegas apart from lowering the value of its shares. The company's focus on self-reliance turned out to be a winning strategy in times of trouble. Since it did not have debts in foreign currencies, it has weathered both low oil prices and the dramatic depreciation of the rouble (NFGR 2006).

When the 2008 financial crisis began, the value of Surgutneftegas's short-term financial investments, cash and other current assets rose by 50% to RUB 383 billion. One manager explained that the company had accumulated financial reserves in the past 'in case of a possible crisis. You do not remember the times when there was no money to pay salaries' (Vedomosti 2008). Similarly, at the AGM in June 2009, Vladimir Bogdanov commented: 'We were always accused of channelling a lot of money to our investment reserve. Today we can see how justified this strategy was' (Vedomosti 2009b). Surgutneftegas was also the only vertically integrated oil company in Russia to recruit new people during the 2008 crisis. From mid-2008 to mid-2009, its headcount increased by 2% to 94 502 employees (although the company cut average salaries in 2009 compared to 2008) (Vedomosti 2009c).

Surgutneftegas recognizes oil price volatility as one of the key financial risks for the company. The *2016 Annual Report* notes that the company takes into account possible changes of oil and petroleum product prices using scenario planning for the development of investment projects and budgets, implements cost reduction programmes and re-evaluates the existing business plans (Surgutneftegas 2016a, p. 24).

Recognizing the impact of global oil price variations on its business, at the 2017 AGM, Bogdanov stated that 2016 had been unstable because of declining oil prices and currency fluctuations. Surgutneftegas then had some USD 34 billion in hard currency deposits, and because of the appreciation of the rouble, the company reported a loss of RUB 105 billion – its first in many years (Znak 2017). However, by October 2017, it had already increased its currency deposits to USD 37 billion.

Regarding Surgutneftegas savings kept on currency deposits (and again highlighting the risks associated with oil price volatility), Bogdanov said

in 2013 that ‘these funds are an insurance mechanism; nobody knows what will happen with the oil prices. We need this money so that the company can continue existing without problems. If the situation of 1998 is repeated, what would we do then?’ (Kommersant 2013b).

Despite the losses that the company sustained in 2016, Surgutneftegas did not intend to revise its strategy. According to Bogdanov, ‘it does not make sense to change financial policy trying to guess where the rouble rate of exchange or oil price would go. We are focused on our goals: ensuring production efficiency, cost reduction and introduction of technologies’ (Znak 2016). However, Surgutneftegas is oriented towards an average oil price of USD 40–50 per barrel for the near future.

Interestingly, despite its investor-unfriendly reputation, according to Bloomberg, Surgutneftegas was the company with the highest dividend yield in the world in 2016. It was the only public oil company that ensured a positive return to investors after the November 2016 decision of OPEC and non-OPEC producers to reduce oil output. In 2015, the dividend yield of its shares was 18.5%, significantly higher than that of Shell (5.6%), for example. Analysts attributed these impressive results to its large dollar reserves. Also, since June 2014, when oil prices began to fall, Surgutneftegas was a leader in Russia both in a dividend yield of its preferred stock (37.8%) and total shareholder return (TSR) (96%) (Vedomosti 2016).

In September 2014, the United States introduced sanctions against several Russian oil companies, including Surgutneftegas. Restrictive measures forbade the US export of commodities, services and technologies to support deep-water, Arctic and shale projects of Gazprom, Gazprom Neft, LUKOIL, Rosneft and Surgutneftegas (Forbes 2014). The new US sanctions introduced in August 2017 applied to these five companies and forbade American citizens and companies from participating in their new projects both within and outside Russia (RBC 2017). However, Bogdanov commented that the sanctions would have little effect on Surgutneftegas since it did not have any debt denominated in foreign currencies, did not have any deep-water or (offshore) Arctic projects and had limited dependence on foreign technology (Neftegaz.ru 2014a).

Unconventional Reserves

Surgutneftegas is one of the few oil companies in Russia that can produce hard-to-recover reserves on its own without international partners. Since 2005, the company has been working on the Bazhenov shale oil formation in Western Siberia – the world’s largest. By 2013, it had developed schemes for testing and commercial production in 19 oilfields and was operating 87 wells within these fields. But over the years, it produced only 2.5 million tonnes of

oil, and the company insisted that the development of Bazhenov required state support (Surgutneftegas 2013).

In 2013, Surgutneftegas increased its oil production from the Bazhenov formation by 60% from the 2012 level. The company's chief geologist commented that although the company has incurred a 3 billion rouble loss, Surgutneftegas invests in the development because it is a promising direction for future operations (Neftegaz.ru 2014b). The company planned to commission 24–39 development wells annually. Surgutneftegas expected that by the end of 2018, the accumulated production from the Bazhenov formation would have reached 5.7 million tonnes (by 2014, it was about 2.5 million tonnes) (OGJ Russia 2014).

Climate Change

Since 1997, Surgutneftegas has had a policy of sustainable energy use and energy efficiency as a way to improve the company's financial performance (Surgutneftegas 2019a). The *2016 Annual Report* states that the 'rational use of energy resources, energy-saving and advanced engineering solutions in the power generation sector are among the main drivers to ensure better production performance and competitiveness of the company' (Surgutneftegas 2016a, p. 55). Thus, while the company and Bogdanov are not known for making statements about the importance of climate change, the company does pursue an efficiency-based policy which can help limit GHG emissions. Over a five-year period, the company reduced its sulphur dioxide emissions by 25% (Surgutneftegas 2019a). In the *2019 Annual Report*, Bogdanov claimed that the company directs significant funds to environmental programmes and environmental policy and that this is one of the key priorities of the company (Surgutneftegas 2019b).

Ninety-nine per cent of Surgutneftegas's natural gas is produced as APG – a by-product of oil extraction. Surgutneftegas makes a considerable contribution to climate change mitigation efforts in Russia by minimizing the flaring of APG in its fields. Surgutneftegas was the first Russian company to introduce gas utilization equipment and technology, an experience that is being emulated by its Russian peers. In the 1990s, it installed three gas-turbine power stations with a total capacity of 43.5 MW to utilize APG instead of flaring it, to meet the energy needs of the Tyanskoye and Konitlorskoye fields. As a result of this technology development, Surgutneftegas's level of APG utilization has been consistently the highest in Russia, that is, 99.56% in 2018, according to the annual report.

Surgutneftegas utilizes APG in the following main ways: processing at the Surgutneftegas gas-processing plant (some 62%) with subsequent deliveries to domestic consumers, power generation needs at the company's power

plants (over 21%) and utilization as fuel and for technological needs of Surgutneftegas (15%) (Surgutneftegas 2016b, pp. 42–3). Surgutneftegas aims to further upgrade the system of APG gathering, transportation and utilization in the current fields and by establishing such systems in new fields.

As we have not been able to find any information from publicly available sources that Surgutneftegas or Vladimir Bogdanov personally regard climate change as an important issue, it seems ironic that Surgutneftegas simultaneously makes a considerable contribution to climate change mitigation efforts in Russia by successfully minimizing the flaring of APG from its fields. In 2016, Surgutneftegas started to implement a system of GHG emissions accounting to comply with Russian legislation and international standards (Surgutneftegas 2016b, p. 34). According to the *2016 Environmental Report*, Surgutneftegas reports on GHG emissions to the Russian Ministry of Energy, the Russian Federal State Statistics Service and other regulators (Surgutneftegas 2016b, p. 34).

CONCLUSION

Surgutneftegas is the most conservative oil company in Russia. Led by Vladimir Bogdanov for over 30 years, it has been stably successful during three distinct periods in modern Russian history: Soviet socialism, the gangster capitalism of the 1990s and the authoritarian capitalism of the early part of third millennium.

It has remained an independent company despite the efforts of other players to acquire it. Being consistently loyal to its long-term strategies and principles, Surgutneftegas has successfully adapted to new realities and found a winning formula for doing business in Russia. Its good ties with the political elite have helped it achieve its goals and be protected against hostile takeovers. However, at the same time, this protection might have cost Surgutneftegas its freedom to make strategic business decisions without the Kremlin's blessing. It has also had to serve a political agenda from time to time.

The company has remained resolutely non-transparent about its operations and shareholder structure. Uniquely among Russia's oil majors, Surgutneftegas has kept foreign partners and investors at arm's length. At the same time, it has made efforts to adopt and employ the West's best technologies. The company has always paid its taxes, avoiding tax scandals affecting other companies. It has addressed the climate change imperatives by adopting efficiency measures and reporting publicly on its emissions and environmental and social performance without exaggerating its achievements.

In the current era of climate change and the rise of alternatives to oil combined with the increasing international isolation of Russia, Surgutneftegas seems to be well placed among its peers to survive, having in place appropriate

reporting systems, a culture of technology-based production efficiency and a long-standing strategy of independence from foreigners.

NOTE

1. Powerful actors with a background in the military or security services.

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