



AZERBAIJAN

THE GREAT GAME COMES TO BAKU

Who will tap—and transport—the Caspian's sea of oil?

Oil and the venerable Caucasian town of Baku have had a long and profitable association. In 1900, Baku, then a Russian outpost, was a cradle of the fledgling oil industry on a par with Oil City, Pa., and East Texas. At about that time, Russian writer Maxim Gorky described booming Baku's clutter of wooden derricks and huts as "a dark hell painted by an artist of genius."

Now Baku, the capital of recently independent Azerbaijan, is poised to open a dramatic new chapter. Foreign companies are ready to plunk down tens of billions of dollars to help open the Caspian's riches. Azerbaijan and neighbors Kazakhstan and Turkmenistan could have well over 100 billion barrels of oil, making them comparable to Iraq or Kuwait and potentially bigger than Alaska's Prudhoe Bay or the North Sea. **OFFSHORE PUMPS.** Baku, a city of 1.5 million with an old world, Middle Eastern flavor, stretches back from a crescent-shaped harbor on the blue Caspian. Baku's oil industry is now moribund because of a lack of capital, but it is gearing up to be the major staging area for the coming oil bonanza. Over the past three years, oil companies have been busy setting up shop, drawing in West-

ern-style services, including a new Hyatt Regency hotel that opened in late May. "We think the potential of the whole region is between 100 billion and 200 billion barrels. That is why there's such enormous interest by the industry," says Thomas M. Hamilton, president of Pennzoil Exploration & Production Co., which is in on two big Caspian projects.

Leading the pack in Azerbaijan is a 12-member consortium headed by British Petroleum Co. and Amoco. Pennzoil, Exxon, the Russian giant Lukoil, and Socar, the Azeri national oil company, are also partners in the Azerbaijan Independent Operating Co. The AIOC hopes to start pumping crude from an offshore platform planted in about 125 meters of water about 190 kilometers east of Baku.

The first flows will be modest, about 80,000 barrels a day. As more platforms are erected in the Chirag and its sister Azeri and Gunashli fields, they will increase to about 700,000 barrels a day, roughly one-third as much as Britain's production from the North Sea. As the

CHERNOMYRDIN, AN OLD ENERGY HAND, WILL PUSH MOSCOW'S CLAIMS IN AZERBAIJAN HARD



deal is structured, Azerbaijan will keep 80% of the revenues, meaning the nation of 8 million will receive an incredible windfall of about \$80 billion over the 30-year life of the project.

Western oil executives so far like what they have seen in Baku, especially the technical prowess of Azeri engineers. For years, it was the center for Soviet petroleum engineering, not just for the Caspian but for far-flung oil fields

stretching from the Russian Far East to frozen Western Siberia.

Before the Azeris get into high gear again there are huge uncertainties to overcome. The big drawback about the Caspian is that it is landlocked: Oil must be piped through other countries to seaports and on to world markets. There is no easy way to do this because the surrounding region is one of the most politically turbulent and contentious on earth. Proposed pipeline routes go through unstable Georgia, devastated Chechnya, or Armenia, which has been at war with Azerbaijan since 1988.

What's more, all the region's big players—Iran, Turkey, and especially Russia—all want to influence the Caspian republics and would like a slice of the oil revenues. Often through oil companies but sometimes by other means the competing powers are playing out a latter-day version of the 19th century Great Game in which Britain and Czarist Russia fought and intrigued for influence in this area.

Russian meddling has already contributed mightily to the instability that has plagued Azerbaijan since independence in 1991. There have been two coups and four presidents. Moscow has been putting the screws to Azerbaijan by covertly supporting the Armenian side in the war over the breakaway enclave of Nagorno-Karabakh. "The Russians want to keep Azerbaijan in the Russian fold. There will be no exports from that region without the Russians sanctioning them," says Julia Nánay, an analyst at Petroleum Finance Co.

RIGHTFUL PLACE? A new factor in Russia is the ascendancy of Prime Minister Viktor S. Chernomyrdin, a former gas industry chief who is a master at the international energy game. He has made Boris Yeltsin's government aware of the strategic importance of oil and has been working with his associates at Russia's oil companies to extract profit from the region's resources. Chernomyrdin has been pushing long-stalled foreign oil projects in Russia. Exxon and Japan's Sodeco in late June signed a \$12.7 billion contract for a huge oil and gas project

on Sakhalin island in Russia's Far East. The Russians feel they have a rightful place in the Caspian, having helped develop the region's oil fields when it was part of the former Soviet Union. Also, they don't want Caspian oil and gas to compete with their own hydrocarbon exports in the world market.

The Western oil companies and the Azeris have been encouraged by Chernomyrdin's new prominence. While he's no pushover, they feel Chernomyrdin is

"You're going to have at least 1 million barrels a day of oil coming out of [there] before long"

a reasonable man with whom they can do business. They have cut Lukoil, which is close to Chernomyrdin, in on 10% of the AIOC and 34% of another project with Pennzoil. The thinking is that if Chernomyrdin and his oil and gas crowd prevail, a way will be found to get the oil out. If hard-liners regain the upper hand in Russia, all bets are off. Chernomyrdin's camp recently won a big victory when they defeated a no-confidence vote in Parliament and Yeltsin ousted several Kremlin hard-liners.

One of the optimists is Natick A. Aliyev, head of the Azeri company Socar. He holds court in a waterfront mansion on the Caspian—once owned by a pre-

Soviet oil millionaire. Aliyev says that over the next 30 months, he and his partners want to finish seismic studies to determine the extent of three fields' reserves—an essential point to secure financing. That will clear the way for an offshore platform called Chirag I to begin pumping about 80,000 barrels a day of so-called "early oil" by late 1996. "The point of early oil is to show that the consortium works," Aliyev says.

CHEVRON STRUGGLE. By September, the consortium will choose a route for early oil that won't require huge new pipelines. The three most likely contenders go through Georgia to the Black Sea ports of Batumi or Poti, or through Chechnya and the Russian port of Novorossiysk, also on the Black Sea. The cost of upgrading pipeline routes runs from \$150 million to \$300 million. "The selection will be economically driven. If Russia puts on too many restraints, it will drive us away," says Terry D. Adams, a British Petroleum official who is the AIOC's president.

The biggest decision of all comes later: the selection of a new pipeline that could cost \$1.5 billion and would handle a much larger volume. That choice means everything to the success of the AIOC project, others like it, and the political and economic future of Azerbaijan.

The AIOC doesn't want to get into a mess similar to the Chevron Corp. ordeal in Kazakhstan. Since the late 1980s, Chevron has been struggling to get its \$20 billion project off the ground. After much turmoil, it signed a production

GASPIAN PIPELINES

Companies and countries are fighting for the enormous energy riches of the troubled region. But wars and geopolitics are holding the projects up.



The pipeline scuffle is drawing in some of the world's most brazen entrepreneurs

deal with the Kazakhs in 1993. But expansion is limited because of Russia's inadequate transport system.

Three years ago, a new group called the Caspian Pipeline Consortium (CPC) was put together to build a \$1.5 billion pipeline capable of handling the 700,000 barrels a day that Chevron's Tenghiz field could eventually produce. The CPC, which includes Kazakhstan, Russia, and maverick Oman Oil Co., picked a route that runs along the northern shore of the Caspian and across southern Russia to the port of Novorossiysk.

RISKS. But the project has gone nowhere. The chief reason, sources say, is that John Deuss, an independent operator who is head of Oman Oil, wants others to put up most of the money while giving his outfit a 25% share. Feuding with Deuss, Chevron has stubbornly refused to participate in the CPC on Deuss's terms. Chevron proposes that it and Oman Oil each put up 50% of the financing in return for 25% stakes. Meanwhile, Russia and the Kazakhs would get 25% each for putting up existing assets, says Tom Burns, general manager of Chevron Overseas Petroleum Inc. So far, no one has been able to break the impasse, though Deuss now says Oman will guarantee funding for a \$300 million first phase. And Chevron has not been able to get rid of Deuss—reputedly because of his ties to Chernomyrdin and other key Russians.

Bickering over pipeline routes has also slowed the Azeri consortium. Moscow wants the pipeline to terminate at its Black Sea port of Novorossiysk, with oil then being shipped through Turkey's Bosphorus Straits. But Turkey balks at a plan that would deprive it of transport revenues and expose the city of Istanbul to the risks of tanker spills and explosions in the narrow Bosphorus. The Turks are stumping for a terminus at their southern port of Ceyhan.

The pipeline game is drawing in some of the world's most brazen entrepreneurs. One is Roger Tamraz, a Cairo-born U.S. citizen who is a veteran oil wheeler-dealer. Tamraz, head of New York-based Oil Capital Inc., on June 6

announced a new plan to build a large, \$2 billion pipeline through Armenia. One \$500 million phase of the pipeline will be financed by a consortium of Austria's Steyer and the Austrian subsidiary of Siemens. Tamraz says he has a commitment for an additional \$1.5 billion from the engineering arm of China's National Petroleum Corp.

spring. The companies could have pressured Russia by negotiating for a route through Iran or by swapping their oil with the Iranians for oil at the Iranian export terminals on the Persian Gulf. But by forcing the Azeri consortium to rescind the 5% share that it had given the Iranians and by ruling out a pipeline route through Iran, the White



Says Tamraz: "The fact of the matter is that you need several pipelines. You're going to have at least 1 million barrels a day of oil coming out of the region before long, and there's no way all that oil can go through the Bosphorus."

VALUABLE WEAPON. Washington, too, is fast becoming entangled in the complicated web of Caspian oil politics. With a powerful and growing constituency including such oil heavyweights as Amoco, Mobil, Exxon, McDermott, Brown & Root, Bechtel, and Chevron, the Clinton Administration is increasingly being pushed to alter its pro-Russia policy and to start backing the republics. Officials at the Energy Dept. are now saying that the Russians should not be allowed to dictate in the Caspian.

But in the view of some analysts, Washington threw away a valuable weapon against Russia when it launched a campaign against Iran this

PRAYING IN BAKU: THE CITY HAS AN OLD-WORLD, MIDEAST FLAVOR

House drove the one regional power with resources to match Russia's closer to the Kremlin.

In riposte, angry Iranian officials are supporting Russia's attempts to hold each Caspian country to a 65-kilometer territorial limit—which would give Iran and Russia a stronger say in mineral development there. Tehran also could close its borders with Azerbaijan to slow the import of crucial oil equipment. Russia has done likewise from time to time—using its war in Chechnya as an excuse to seal its Azerbaijani border and keep out supplies.

That's why the outcome of the battles in the Kremlin is being watched so closely in Baku and elsewhere. The key to the future of this potentially huge energy source probably lies there.

By Peter Galuszka in Baku, with John Rossant in Rome, Julie Flynn in London, Gary McWilliams in Houston, and Stanley Reed in New York