BP in Russia

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**Executive Summary**

Many factors play an important role in directing relationships between companies from two different countries or regions and trust is one of those factors. However trust takes time to build and building trust is affected by economic and political factors. In the case under consideration, economic factors have been the most important ones along with the political factors. The results can occur in form of cooperation or conflict. In this case, there has been huge conflicts between parties and that has resulted in a change in partner for BP.

BP in RUSSIA

# ***Introduction***

There has been a considerable amount of academic research on causes of conflict between European and Russian partners when energy sector is considered. Major question in this regard pertains to whether Russia wants to exert political pressure or maximize profit through its oil and gas resources. One important aspect that is not considered in either political or economic front is trust among companies. Trust had a notable influence on the relationship between companies and individuals when European and Russian companies signed contracts. Trust decreased suspicion from the minds of both the parties. The conflicts of interest were easily handled when trust was present between companies. Development of trust was affected by the history and already existing political and economic conditions. There is a variation in level of trust between West European companies and politicians when Russia is considered. There are many non-state actors affecting success or failure of energy partnerships. There was a British-Russian joint venture formed in 2004. This case shows clear issues related to trust and consequences of breach of trust between companies (M.Ozawa, 2014).

# ***Trust and International energy trade***

Parties involved in a joint venture see trust as an important factor affecting success or failure of any project. The issue of trust is important because environments in which exploration is made are becoming more and more challenging. There is an explanation related to trust when British Russian and German Russian partnerships are compared. There is no single authority that controls the energy trade between countries unlike other consumer goods whose trade is controlled by the WTO. Most countries consider energy trade as a security issue because natural resources play a vital part in economic and military aspects. Supplier countries may also become heavily dependent on the exports from natural resources. There are certain differences in factors affecting decision making in various regions and trust allows to cover these differences (RT, 2011).

# ***Academic Research on trust***

There is a disagreement between scholars regarding working or practical definition of trust. There is a considerable agreement on the existence of risk concerning trade of natural resources. There is an agreement on the conditions which are necessary for the development and existence of trust. Risk is an important factor in psychological, social and economic aspects. Trust has been considered an opposite to risk by many economists. Parties assume that all others will adjust their policies according to each other’s preferences. There are commercial as well as political interests associated with energy deals. Each country has its own profile related to industry and supply which affect domestic and global market features. Global market of the specific commodity also affects trade relations. Institutional frameworks and geopolitics also affect the trade of commodities and level of trust between decision makers (Tornudd, 1968).

There has been a considerable disagreement between trust discussion among various disciplines including management sciences and international relations. There have been conflicts which are inherent or built-in between parties. Economists are off the view that trust can either be calculative or institutional. Psychologists describe trust in terms of attributes of trustors and trustees based on internal cognitions that come out of some personal; characteristics. The most appropriate explanation of trust for this case has been provided by international relations and economics. This is because negotiations are an integral part of any agreement made or joint venture formed in the energy sector. Various firms have different levels of association to their states and these associations affect their perception of the agreements. International institutions also play a part in this scenario either directly or indirectly. Most energy contracts take place bilaterally between companies which are tied to different objectives of their states to be fulfilled from these deals (Gowa, 1986).

Majority of literature has come from management sciences disciplines because trust becomes an important issue when inter firm alliances are considered. Management science focus on firm behavior by drawing analytical tools from various social science disciplines. Statistics, experimental analysis and other conceptual frameworks have been used to assess the relationships. There is no clear definition or meaning of trust on organizational basis. There is a continuous debate regarding best definition of trust in all disciplines but there has been no consensus (Ayios, 2004).

# ***Working Definition of trust***

A working definition of trust must fulfil three conditions to be useful in this context. Analytical precision means that there should be an indicator of trust that is based on the given data and information. Insight is the second important aspect related to trust which considers that trust has been defined differently under different contexts. There are different interests with different value for parties in an agreement and trust will depend upon these differences. An example from the case can be given, if BP has high level of interests in Russia, it will find it difficult to trust other parties. There are different processes to build trust both across industries and cultures. There must be some generalized aspects of these conditions so that it can be stated when and how much firms will trust each other (Booth & Wheeler, 2007).

After this preliminary discussion, we will assess the BP Rosneft scenario in light of three stages namely contract formation, dispute of breach of breach of contract and contract fulfilment. The case focuses on statements and views of various actors which showed confidence, expectations and beliefs that both parties will play their relevant role in the cooperating process. These aspects are important as long as parties do not show their trust in each other and specify some actions to trust in each other. There have been some actions from either parties which initiate questions on their respective trustworthiness.

# ***Contract formation***

First stage refers to contract formation in which parties undertake a selection process. Economic analysis is undertaken along with analyzing political risk factors. The final decision will be made after careful assessment of trust and issues related to it. It all started with some informal meetings between company executives and politicians where trust influenced decisions to from a contract in case of BP and AAR. The first contracts came out as a result of three factors, there were commercial incentives attracted companies to explore the possibilities of trade and investment. The political climate of Russia had been a historical barrier to trade and it was removed. In the process of interactions among the actors, development of trust shaped the decision of companies to join hands with a particular company. In case of BP and AAR, the starting point was different as compared to many other European Russian partnerships. BP had no experience of contracting with companies in Russia. A change in political system in Russia made it possible for companies to invest here. Several economic factors also play their part in assessment. The reserves held by BP had become stagnant and investors were pressing hard on the company to grow (Bower, 2009). The CEO had decided to invest in Russia because of pressures from investors and to find new reserves of oil and gas. There was a conflict between BP and AAR in their first joint venture named Sidanco. This venture was started in the year 1994 and it was an oil and gas company holding significant resources in Russia. Initial investment made by BP in this venture was just 10% in 1997 and this stake was raised to 25% in the year 2003. BP officials did not know that there was already a dispute running between two investors of Sidanco. The major consequence of this dispute was that an investor had filed a bankruptcy case against Sedanco and his share had to be paid to him out of assets owned by BP. The locals knew that this has been a common procedure to acquire state assets but BP did not know this practice. With this background, Browne decided to make heavy investments to recover the losses incurred (Browne, 2010). In fact, the CEO was saving his face more than anything else. After a series of meetings with various politicians, decision was made to invest in TNK. This decision contradicted with some statements from Brown mentioning that the stake of BP were tried to be stolen. There were stories in various media regarding the bad practices undertaken by TNK which prompted Fridman tried to communicate with Browne. Lord Janner also asked Browne to talk to him who was a common friend and stated that Fridman was a better person as compared to those with whom he was dealing. This increased confidence of Browne in Fridman. He was also thinking about an alternative named Khodorkovsky but Putin told him that he was not a good choice. Russian side of decision making comprised of two types. First was the commercial partner to BP which was an investment group named AAR and was led by Fridman. There were huge economic incentives for AAR related to this deal because the refining and other facilities of TNK were becoming outdated. It also needed to explore Europe and Asia which were two most lucrative markets for its natural gas product. Technical expertise and financial resources were required by TNK to successfully explore these markets. AAR did not consider trust as major factor in deciding to partner with BP.AAR wanted to expand beyond Russia and at the same tine develop some trust with European companies and governments for future working. The partnership with a giant like BP will have a positive impact on TNK reputation in the west. The second consideration on the part of TNK was political in nature. Putin and his energy minister Igor Sechin were involved in the deals. BP suggested an equal stake in the joint venture rather than a controlling one. This removed all suspicions from the minds of politicians about foreign control in Russian oil and gas industry. BP also promised to undertake social goals alongside economic ones which reassured Putin that the partnership will help his country

# ***Disputes and breaches of Contract***

The second stage looks into the decisions of actors when there were disputes or breaches of contracts occurred. There are various options for parties to react to disputes and breaches including cooperate, compromise or retaliate in form of legal actions. With TNK BP, diverging interests and direct conflict between decision makers led to conflicts. BP pursued to replace AAR with some other company which was initially intended to be Gazprom. BP had not been able to change the way it operated in Russia. In 2007-2008, BP wanted to be partner with Gazprom. The lack of trust played the decisive role in BP stepping back from its desire to do business in Russia. AT TNK BP, first contract lasted for four years from 2004 to 2008. Companies were required to maintain existing management structures and were restricted not to sell their stake in this joint venture. Issues began to intensify when AAR official raised voice regarding staffing issued and CEO appointed by BP named Robert Dudley. Fridman had an opinion that BP was not paying heed to suggestions forwarded by their company in terms of staffing expatriates and starting ventures outside of Russia. Although original contract did not restrict investments outside of Russia, it did allow a veto power to both parties. Veto power was used by both parties in different scenarios (Castle, 2006).

Relationships between Robert Dudley representing BP and German Khan representing AAR began to worsen at the beginning of project. The main reason of dispute was their differing ideas on staffing issues. Dudley brought a considerable number of people from BP to this joint venture who were expatriates. Fridman and Khan had the opinion that many of these posts were an extra burden on company in terms of salary expense. There were some language barriers that resulted in least interaction between expatriate staff and local Russian staff which had a demoralizing effect on the local Russian staff. The result of this conflict was that the expatriate staff started to miss scheduled board meetings and there were problems in having effective decision making in the company. Business concerns and geographical boundaries also had negative impact on relationship. Fridman wanted to extend relationship with BP outside of Russia but top management in BP did not consider this proposal for once. Instead of communicating and resolving the issues, both parties used media and political channels to address the issues. AAR appealed the Russian ministry of Energy to pressurize BP. BP launched its own campaign to pressurize AAR. Heads of State from UK and US wrote letters to Putin on behalf of BP. The relationships between AAR and BP reached a level where BP started looking for another partner in Russia.

# ***Contract fulfillment and decision to continue or not***

BP opted for Rosneft as a partner to continue working in Russia. Technically speaking, BP and AAR had met their respective obligations in the initial contract made between these two companies and the joint venture was a profitable company despite the clashes between persons. AAR wanted that TNK BP should take part in the new partnership with Rosneft instead of BP alone. By signing a contract with Rosneft, BP violated the contract with AAR. This decision shows high level of distrust and there were two reasons of this distrust to develop. Working with state owned companies was considered a better option by BP. AAR also showed behavior that cannot be explained by the economic factors alone. Fridman refused to take an amount of $ 35 billion for selling shares in TNK BP. In case of Rosneft, BP had better relations with Kremlin which is also evident by the willingness shown by Rosneft to work with BP.

To summarize the findings, trust, economic factors and political factors jointly affect the decisions taken by companies whether to cooperate or to fight. Difference in interests resulted in a dispute between BP and AAR but things got worse when there was a breakdown of trust between parties. Parties went to court against each other and BP ended the agreement as a reaction. Various networks had been used to select a partner and build confidence with other actors. Interpersonal skills played an important role in the whole scenario and relationship between Browne and Kremlin ultimately resulted in breaking of the original agreement. Language barriers halted the relationship between expatriates and local Russians who worked with them. This decreased the trust between lower level employees and eventually became a point of contention. Relationships of BP with Kremlin resulted out of signaling interests and BP committed to fulfill economic as well as social responsibilities (Overland, et al., 2013).

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