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**ENERGY CHARTER SECRETARIAT**  
**СЕКРЕТАРИАТ ЭНЕРГЕТИЧЕСКОЙ ХАРТИИ**

**"ENERGETIKA XXI: ECONOMY, POLICY, ECOLOGY"**

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Mr President, Ladies and Gentlemen,

Please allow me to begin by expressing my gratitude to the University of Saint Petersburg. It is a joy to find myself once again in this magnificent city and I am very proud to speak in this prestigious setting at your university.

Ladies and Gentlemen, it is a truism to say that energy is a subject of worldwide importance. In this world market, however, local reality carries its own weight, especially where coal and gas are concerned. I would even go so far as to say that on the Eurasian continent, local reality outweighs global considerations. Energy products are moved around national territories using fixed infrastructures. This creates, as we will see, important issues in terms of transport and transit.

Energy is also, thus, an area where international trade plays an important role for producers and consumers. Inevitably, therefore, energy relationships heavily influence state's foreign policy. Energy and the energy world are highly political.

However, energy is a complex topic which cannot be analysed globally. Oil and coal are very different. Gas is a commodity unto itself where distinctions are made between liquefied natural gas (LNG), shale gas, pipeline gas, etc. Though electricity is also a form of energy, its production and transport are very different from the others.

Today I will limit myself to energy related problems on the Eurasian continent, which happens to correspond to the Energy Charter constituency.

On the Eurasian continent, Russia and the European Union are the major players. Of course, the EU has other suppliers, such as Norway and Algeria today, Iraq tomorrow and perhaps Iran in the future if the political situation changes. Russia, of course, also has other export markets than the EU, such as China, Turkey and others.

On the Eurasian continent, the key issue relates to gas. The oil market is much more liquid and most transport takes place by ship, generally on international seas, although difficulties sometimes arise from bottlenecks such as the Straits of Hormuz, Istanbul or Gibraltar or the Suez and Panama canals.

Coal is a separate case, as international trade in coal is relatively limited.

Having set the stage, I would like to briefly discuss the significance of gas within the context of the Russia-EU relationship.

First, Russia is not only a gas exporter. It uses two thirds of its production for its own needs. Similarly, the EU is not only an importer given that half of its needs are covered by its domestic or quasi-domestic (Norwegian) production.

Nevertheless, Gazprom earns most of its profits on the EU market and the EU could not survive without Russian gas supplies.

The EU and Russia are thus largely complementary. This synergy is long-standing, stable and profoundly beneficial on both economic and political levels, as it creates common interests and practices. It contributes to mutual trust in an area which is literally vital for both sides. The gas market, however, like others, is an evolving market. Without going into detail, I will point out, for example, that on the EU side, domestic production is in rapid decline, which is boosting the need for imports.

On the Russian side, easily accessible gas is also in decline, as a result of which large-scale and long-term investment is becoming urgent. This need will not be easy to meet, for several reasons. It is easy to understand that companies such as Gazprom, prior to investing colossal amounts in new production fields, must be certain that the gas will be purchased. This is security of demand. This question is more important than previously, among other reasons because it is more difficult to resolve. Until recently (say two years ago), security of demand seemed to be taken for granted. We could count on stable demand of large consumer markets, the EU among others. The gas consumers, whether industrial or domestic, were known and their gas needs were considered stable. Of course

they changed over time, but slowly and continuously. The suppliers were also known, as was their capacity and their market share. On the supply side, too, sudden changes seemed unlikely. Moreover, as a result of high energy prices, suppliers received a comfortable income often enabling them to finance their projects alone. If needed, finance from banks and other financial institutions was virtually guaranteed. We thought we were living in a comfortable world which would last forever. We were wrong.

We were wrong for several reasons. But today, I will discuss only the two most important, namely the economic and financial crisis and the arrival of shale gas in the US.

The economic crisis has had a significant impact on demand for energy. The slow-down of industry has reduced energy demand in all sectors: construction, the car industry, services, etc. In this respect it is noteworthy that for the first time since the end of the Second World War, electricity consumption (and therefore demand) has fallen. The economic crisis has thus shown that security of demand can also fluctuate depending on the circumstances. The financial crisis, a corollary of the economic crisis, has also had its effects. Investors have become more prudent, money is tight and major projects are being reconsidered in the light of these new circumstances. To complicate matters even further, we have seen the spectacular price crash, with a significant effect on corporate cash flow.

The second phenomenon, which is probably even more significant, is the arrival in force of shale gas in the US. A technological breakthrough now allows the exploitation of this gas whose existence has been known for a long time, but which could not be used owing to lack of suitable technology. This gas is now being exploited in the US, thus making the North American market self-sufficient. De facto, LNG imports, which were developed by large LNG producers, are now excluded from the market for which they were destined.

We therefore now have available, on the world market, large quantities of LNG, formerly destined for the American market, which is now closed to imports. This, together with the fall in demand, explains the surplus of gas, at any rate on the European market.

Moreover, to understand the difficulties of the present situation we need to consider movements of gas prices.

Until recently, the gas exported by Russia and others to the EU was pipeline gas. Supply contracts were for a long term (25-30 years). Their essential elements were not the price but the volume and the price determination mechanism, which was generally linked to oil prices. From everyone's viewpoint, this ensured security of demand and of supply. There was no credible alternative to gas pipelines at the local level.

The situation has certainly changed. As I have said, producers of LNG are seeking new markets. LNG is abundant and its international price is unrelated to oil prices. As a result, LNG, which is plentiful and 30% cheaper, has become a serious competitor. This explains the desire on the part of large companies to renegotiate, to the extent possible, their long-term contracts.

Does this mean that the situation of European suppliers is permanently weakened, or in other words that LNG will generally replace pipeline gas?

I think not.

I believe that the current weakness of demand will not last and that sooner or later the world economy will take off, even if not as rapidly as predicted.

Moreover, the exhaustion of domestic EU gas supplies will create a need for increased imports. In my opinion, these imports will come primarily from pipeline gas and primarily from Russia. Pipeline gas provides guarantees of stability, of supply and of cost. It also offers unbeatable environmental security.

I also think that, so far as gas is concerned, the reliability of Russia and the extent of its reserves guarantee Russia a primary role in the long term. There are additional and even more important factors, such as geography, history and similar outlooks.

Generally speaking, therefore, even if the current situation is not dramatically different, it is nonetheless new. It requires all players to review their positions and probably to consider new policy orientations.

The EU, for its part, is permanently and regularly engaged in this exercise. This is no easy task, given that in practice foreign relations fall within the competence, not of the European institutions, but of their member states or their large companies. To simplify, one can say that European energy foreign policy is dominated by bilateralism. It cannot be denied that in the field of energy the EU does not speak with one voice; this is probably because many member states do not want this. One may hope that this will happen one day, but for the time being it is not the case.

This being said, I need to open a parenthesis because, indeed, there has been a well coordinated and successful cooperation among EU member states during the last 2009 crisis. But that was inside the EU, it was not a foreign affair.

For its part, Russia is faced with the usual challenges of a supplier: which investments to make, whether to develop an LNG industry, to what extent, which new markets it could develop, etc.

More generally, the events of the last two to three years prove once again that history constantly changes and that nothing is definitive. This is equally true for energy. The strong positions of yesterday are weaker today. I am thinking of the EU, which for a long time produced significant quantities of gas domestically. I am also thinking of Russia, which for a long time had, if not a monopolistic, at least a preponderant position as a gas supplier. But these are not the only examples.

Allow me, for instance, to mention the transit issue. Here too, for a long time, Ukraine also enjoyed a quasi-monopolistic position in transiting Russian gas towards the EU.

Here, too, the situation is changing. Once its construction is completed, Northstream will allow the transport, without transit, of 55 bcm, or approximately half the volume currently transited by Ukraine.

This example illustrates that the various crises which we have known are leading states to seek solutions which avoid transit as far as possible. Northstream is a perfect illustration of this tendency. In Europe, therefore, we have – if not a new – a deeply changed situation.

This is the more so given that neither Europe nor the energy world can escape globalisation. I have spoken at length of LNG which, carried by tanker in international seas, is global by definition. But other players, such as India and China, have become very active. To tell the truth, their influence on the European market – I am speaking of an area running from Lisbon to Vladivostok – is mainly indirect. But this gives Russia new possibilities for its exports and Qatar potential alternative markets. By becoming self-sufficient, North America has forced LNG to find new directions. Obviously given its size and its wealth energy suppliers must take an interest in the large European market.

In my opinion, globalisation will continue and become even more pronounced. Globalisation has risks and dangers. It also has many potential benefits. To reduce the risks and obtain the benefits, globalisation must be contained. Rules of the game must be defined, accepted and known by most players. Very generally, this is the aim of the WTO. More specifically, in the energy context, this is the aim of the Energy Charter. The Charter, negotiated between the USSR and the EU, now involves 51 states, in other words, all of the member states of EU and CIS, together with Japan, Turkey, Australia, etc.

It should be noted that Australia, Belarus, Iceland, Norway and Russia have not yet ratified the Treaty, although they have signed it.

Broadly, the Treaty organises investment protection and security of transit. It also provides dispute resolution mechanisms, including international arbitration. As of today, the Energy Charter is the only international treaty creating the rules of the game which I spoke of earlier. Although Russia has not ratified this

Treaty, it has proposed to modernise the existing Energy Charter Treaty. Let us look together at Russia's arguments and at the reaction to its proposals.

The first argument, which in effect includes all the others, is that the world has changed. The EU has grown considerably and today includes 27 member states. Russia has found new stability and a path towards the future. Moreover, the energy sector now has a new look. Finally, globalisation gives the issues a new dimension. From this, President Medvedev deduces a need to review the existing texts, not necessarily to change them, but to adapt, complete and enlarge them.

For my part, I can only agree with this viewpoint. This is also the view of our member states as expressed at the Energy Charter Annual Conference in Rome in December 2009.

The Rome Declaration, however, is only a first step, which although important must be followed by others if President Medvedev's initiative is to bear fruit.

In order to launch negotiations of this significance, it is important to set out the aims point by point, to inform participants, to establish a timetable, etc...I believe in the need to modernise the Energy Charter Process and I think that the general approach suggested by President Medvedev is correct. At the latest meeting of our Strategy Group in Brussels, not later than this Monday, 11<sup>th</sup> October, the Russian representatives made an excellent presentation on the draft Convention on Ensuring International Energy Security, which Russia is planning to distribute in the near future. This is excellent news; it means that soon after the State Party Conference end of November we shall be in a position to start concrete work on Modernization. This is what we wanted; this is also what is needed today by the energy sector worldwide.

I want to leave you on this optimistic note and I thank you all for your attention.