

**COMMUNICATION FROM THE INDUSTRY ADVISORY PANEL
TO THE ENERGY CHARTER CONFERENCE**

24 November 2010

1. Introduction

Mandate, Membership and Working Method of the IAP

The objective of the IAP is to support cooperation and dialogue between the energy industry and the Contracting Parties and to promote the use of the ECT. The number of IAP members now stands at 30 from around 20 Contracting Parties and covers the full scope of energy supply, distribution and financing activities.

The IAP seeks to advise the Energy Charter Conference on the basis of expert input from members (both private and state-owned companies) and through examination from a business perspective of the relevant work of the Secretariat.

Date of Formation and Number of Meetings to Date

Since its inception in late 2004, the IAP has held 17 meetings, mainly in Brussels at the premises of the Secretariat, but also during the last three years in Baku, Athens, Milan, Amman and Stavanger, at the invitation of members and other interested parties. The meetings outside Brussels have provided outstanding opportunities to engage with industry operators and to understand and comment on important regional energy perspectives.

Meetings in 2010

The IAP held three meetings in 2010. In addition to two meetings in Brussels, a meeting in Stavanger at the kind invitation of Statoil provided valuable insights into the development of the Norwegian oil and gas sector, the challenges of Arctic natural resource development and the role of the Extractive Industries Transparency Initiative based in Oslo.

Working Method

The IAP continues to work on the dual basis of:

- case studies provided by its members with subsequent comment on the issues raised
- review of expert work presented by the Secretariat or other invited authorities

It is rewarding to note that meetings continue to be well attended and members show great willingness to present case studies based on their relevant company or trade association experience. The expert input of the Secretariat is also greatly appreciated.

2. Main Issues Considered and Observations for 2010

Energy Resource Availability

Presentation of the BP Statistical Review for 2009 emphasised that hydrocarbon reserves are sufficient for decades to come and the world is not hydrocarbon resource constrained.

However, major investments are required in all parts of the energy supply and distribution chain to ensure future continuity of supply. The principle risks to primary energy supply remain ‘above the ground’ in terms of access, investment and political factors and not ‘below the ground’ in terms of reserves or technology.

Coal will remain an important primary energy source for electricity power generation, most notably in China and the US and this has environmental implications.

Natural gas fired power generation emits around half the CO₂ emissions of coal and has other competitive advantages in the form of:

- plentiful regional and global reserves
- rapid and capital efficient construction
- considerable operational flexibility (including in combination with intermittent renewables supply)

There is a good case for natural gas to be regarded as a fuel of choice for power generation and industrial use wherever it is competitively available.

Renewable energy is making a growing global contribution but still provides only a small proportion of total global energy requirements. Energy efficiency continues to offer considerable room for progress in all locations.

International Coal Markets

Global coal demand has increased steadily over the last decade, most notably in the BRIC economies. Global coal trade has increased substantially along with demand, with China (for example) becoming a major coal importer in 2009. Coal is likely to remain the primary fuel for global power generation for several decades to come. The growth of the international coal trade means that coal is now priced as a global commodity and the international legal framework provided by the Energy Charter may be of increasing relevance to the coal sector.

Global and regional coal reserves are plentiful and global reserves currently stand at 160 years of global consumption. Consumption is influenced by the regulation and pricing of emissions and is relatively less important in the EU than in other regions. Future developments in CO₂ markets and pricing will impact investment and consumption but may also incentivise technology options such as carbon capture and storage (CCS), if supported by clear national and regional energy policies.

Copenhagen Summit

The Copenhagen summit agreed that the increase in global average temperatures should be kept below 2°C and set out a framework for monitoring, reporting and verification of GHG emissions (MRV); fast track financing; and regional/national pledges to cut GHG emission by 2020. However, it is acknowledged that, even with achievement of the highest levels of ambition set out in the Copenhagen framework, there is a gap between the undertakings given and the outcomes needed to stabilise the climate. The extent to which regional and national authorities follow through on these commitments will be critical in determining future outcomes.

Market mechanisms can set a carbon price in accordance with policy signals and play a significant part in attracting the necessary capital flows into the energy sector. However, some degree of long term predictability in market structures is needed to support the very large scale of investment required. The implementation of the third phase of the EU Emissions Trading Scheme (ETS) will be very carefully observed in this context. In the absence of functioning market mechanisms, a trend towards regulatory and direct government intervention may be anticipated over time.

Although the recession has reduced GHG emissions in the developed economies, global GHG emissions continue to rise, driven by the rapid growth of the BRIC economies and the continued use of coal as the leading source of primary energy. In the view of IAP members and notwithstanding the current economic downturn, an understanding of climate change impact should continue to inform energy policy thinking, in a manner that allows effective long term investment choices.

In this respect, IAP members share the view that natural gas, energy efficiency and technology development (including in renewables, transport technologies, CCS and grid management) should figure prominently in energy policy development for the period to 2020 and beyond.

In the view of IAP members, a new global agreement on carbon regulation, with clear targets and transparent and non-discriminatory policy measures, is in the interests of the energy industry, not least with a view to secure future energy investments and advance low carbon technologies. The IAP therefore supports the efforts of the international community to make such an agreement possible.

Oil Market Volatility

The unpredictability caused by severe energy price volatility (as seen during 2008) has significant consequences for both energy consumers and investors. IAP members agreed that greater cooperation, to improve investment predictability and sustain acceptable levels of spare capacity, could be of long term advantage for all market participants.

Norwegian Oil and Gas Industry

Norway is effectively self-sufficient in indigenous renewable sources for electricity production as a result of its large hydro-power capacity. The great majority of Norwegian offshore oil and natural gas production is consequently available for export and makes a very important contribution to both European and global energy supply diversity and security.

Although oil production from the Norwegian continental shelf is in decline, natural gas production continues to increase and is expected to be sustainable at these levels until at least 2025. Exploration activity is increasingly moving into the northern Norwegian and Arctic waters.

The Norwegian oil and gas sector is regulated by the Norwegian Petroleum Directorate (NPD) under the Ministry of Petroleum and Energy. The state holds an economic interest in oil and gas extraction through a shareholding in Statoil, through its direct (non-operated) participation via Petoro and through royalty and tax collection.

Licences are awarded on a discretionary basis based on a range of criteria. Regulatory attention is focused on prudent resource management, safety, emergency preparedness and environmental protection. The recovery factor from the continental shelf has increased from 17% in 1974 to 55% in 2005, largely as a result of prudent management and regulatory practices, technological development and higher energy prices.

Oil and gas together account for around 22% of Norwegian GDP and 27% of Norwegian state revenues. Petroleum revenues are invested in the Government Pension Global Fund (GPGF), from which only fund returns may be used for current expenditures and the invested capital is preserved for future generations. This also helps to limit the ‘Dutch disease’ impact on the remainder of the economy.

IAP members greatly appreciated the time and expertise made available to them by Statoil and the Norwegian Petroleum Directorate. It is recognised that the success of the Norwegian economy represents an important reference point for policy makers and economic operators in other natural resource rich countries.

Challenges of Arctic Resource Development

The US Geological Survey and other authorities, estimate that a significant proportion of the world’s remaining petroleum resources will be found in offshore Arctic regions. Exploration and production operations in these regions present particular challenges related to ice formation, darkness, remote location and severe weather conditions.

Nevertheless, exploration and development activities (principally for natural gas) are proceeding in northern Norwegian waters and the recent agreement between Norway and the Russian Federation on Barents Sea delimitation is expected to stimulate activity in this region. Strict environmental provisions apply to all activity and public opinion in Norway appears broadly favourable, reflecting a degree of trust arising from the long track record of effective regulation in the Norwegian oil and gas sector.

Technology will also play a key role in successful Arctic exploration and development, with such concepts as full subsea development (no surface platforms) and long distance multiphase pipelines, assuming central importance. Liquefied natural gas (LNG) development may also be an option for remote natural gas field locations.

Transparency in the Extractive Industries

The potential for serious economic and social distortions in oil and gas rich economies is widely recognised and a significant cause of concern for governments, civil society and industry participants. Transparency of petroleum related revenue flows can do much to address this issue. The Extractive Industries Transparency Initiative (EITI) provides a framework for sovereign governments and economic operators to make such data available on an agreed basis.

Article 20 of the Energy Charter Treaty calls for transparency in the energy business and a number of Charter signatories have implemented or are considering implementation of the EITI. Over fifty of the world’s largest oil, gas and mining companies (some of them members of the IAP) are also actively participating in the EITI process.

IAP members consequently observe the work of the EITI with great interest and support the work of the Investment Group in furthering the attention given to the EITI through the Charter process.

Gulf of Mexico Accident

The significance of the Deepwater Horizon accident in the Gulf of Mexico on 20th April 2010 is fully recognised by the members of the IAP.

It is anticipated that the IAP will take the opportunity during 2011, to consider the various reports into the causes and impacts of the accident and to highlight those outcomes which it believes are of greatest significance from an industry perspective.

Attention will also be given to the response of governments, the European Commission and other international agencies to the accident and to areas of potential interaction with the Charter process.

Energy Infrastructure in the EU

The availability and interconnectivity of energy infrastructure, is widely recognised within the EU as a principal driver of important energy policy outcomes, including energy security, competitive markets and access to lower carbon energy. The revised European Commission Energy Strategy to 2020 and related legislative proposals are consequently expected to focus on energy and also CO₂ infrastructure development in Europe.

As cross border energy trade and demand for transportation capacity increases, the implementation of more transparent rules based on the principle of freedom of transit, remains an issue of central importance.

Given the close relationship between internal European market security and external energy supply, the IAP would urge the European Commission to continue to give close attention to the Energy Charter Treaty, as a key instrument for supporting the required investment in energy production, transmission and efficiency throughout the Charter area.

Investment Protection

IAP members have consistently drawn attention to the investment protection provisions of the Energy Charter Treaty, as an important and indispensable reference point for the security of international energy investment. For this reason, the IAP will continue to follow the work of the Investment Group in the area of investment protection with particular and close interest.

It is noted that the recent analysis by the Investment Group of expropriation laws in a number of selected countries within the Energy Charter constituency, supports the view that the Energy Charter Treaty provisions on expropriation are an important complement to domestic legislation, in ensuring international coherence in the protection of energy investments.

Role of the Energy Charter Treaty

The IAP has continued to underline its support for the Charter process and the principles of the ECT in the context of the current Strategic Review. From an industry perspective, the value and importance of the Energy Charter framework for the protection of energy investment and the provision of secure energy transportation and transit, remains unchanged.

Cross border transportation of energy is still widely subject to regulatory obstructions. Given that there is no other multilateral process in place for dealing with energy transit issues, the Energy Charter Treaty remains of particular relevance in this respect.

The role of the Secretariat in providing expertise and visibility for the ECT and in coordinating with other relevant international organizations is also fully recognised.

3. Work Programme for 2011

It is proposed that the IAP will meet on three occasions in 2011, with meetings currently scheduled for Brussels (hosted by the Charter Secretariat), Prague (at the invitation of CEZ) and Baku (at the invitation of SOCAR).

Proposed issues for consideration during 2011 include:

- electricity systems development including smart grids
- financing of major energy and CO₂ infrastructure developments
- energy technology and energy efficiency
- offshore oil and gas activities in the light of the Gulf of Mexico accident
- non-conventional resource technologies
- pathways to a lower carbon economy

In addition, the IAP will seek to extend its level of interaction and engagement with the European Commission and Parliament, in order to give greater visibility to its work and support for the Charter process with these important constituencies.

The IAP will continue to monitor energy industry developments and the role of the ECT in facilitating secure and competitive energy supplies in the Charter area.