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Influence of Unconventional Gas on Global Politics and Economics and Long-Term Outlook for Unconventional Gas

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I would like first of all to thank the Conference for the kind invitation to me as Secretary General of the Energy Charter Secretariat to speak on this important topic, and to consider with you the effect of unconventional gas on global politics and economics. Together we will attempt to define how big a role unconventional gas will play globally in the long term.

Before I address the specific discussion points of this afternoon's session, I will briefly explain the role of the Energy Charter. I will then deal with the discussion points in that context.

The energy world is highly political. Energy is an area of great importance for both producers and consumers in the context of international trade. In essence, the role of the Energy Charter is to define the rules of this international trade. Members of the Energy Charter have all subscribed to certain core principles: national sovereignty over energy resources, respect for contract and property; stable and open frameworks for flows of energy, capital, technology and investment.

The Energy Charter, which was a political declaration, was signed in December 1991 by more than 50 states including what are now the 27 EU member states (together with the EU itself), the states of the former Soviet Union, as well as Japan, Turkey, Australia and others.

The Energy Charter Treaty was developed on the basis of the 1991 Energy Charter. Whereas this initial document was drawn up as a declaration of political intent to promote energy cooperation, the Energy Charter Treaty is a legally binding multilateral instrument. It is international law. It contains a comprehensive system for settling disputes on all matters covered by the Treaty. These include disputes between the members of the Treaty, disputes between investors and host governments, transit disputes, trade disputes, and disputes on competition and environmental issues.

Moreover the Treaty offers a highly developed regime of investment protection which is designed to encourage international investment and cross-border trade and transit across the Energy Charter constituency. This of course fully applies to trade and transit in unconventional gas.

The emergence of unconventional gas as a force on the US market, in particular shale gas, has shaken certain assumptions held until recently. Prior to the current economic difficulties, security of demand was taken for granted, particularly from large consumer markets such as the EU.

The consumers of gas were known, whether industrial or domestic. Their gas needs were considered stable, they were only expected to change slowly and continuously over time. The suppliers were also known, as was their production capacity and market share. Likewise, on the supply side sudden changes seemed unlikely.

Furthermore, high energy prices ensured that these suppliers received a comfortable income which often enabled them to finance their projects independently. Now however, some analysts suggest that as much as half of natural gas production in the US could come from unconventional sources by 2020. Already the US market is largely self sufficient. Globally there is a lot of interest in potential gas shales in Canada, Europe, Asia and Australia.

Large quantities of LNG, previously destined for the US, are now available on the world market. There is therefore a surplus of conventional gas, at least when it comes to Europe. This is due to the shale gas factor, as well as the overall fall in energy demand which has resulted from the global economic crisis.

Having made these general points, I will now attempt to address the specific questions of this afternoon.

Let's begin with the topic that is on a lot of people's minds lately. Is unconventional gas the "silver bullet"? Can it fix the concerns over European and global energy security? Of course, we cannot answer this question without looking into how much unconventional gas can be developed in reality, and where we will use it. Therefore, I propose to take these two questions together.

I believe that when we speak of unconventional gas we mainly have in mind shale gas, though of course unconventional gas is more than that. As we know, shale gas is very important today on the US market. However it is my view that there are big differences between the situation in the US and that of Europe. There are two major reasons for that: one legal, the other environmental.

The legal aspect is that under US law, what is below the surface, is the property of the land owner. That is generally not the case in Europe. By contrast, in Europe any resources underneath the surface are the property of the state. The consequence of this is that whereas in the US the land owner has a very direct interest in exploiting these resources, the European situation is rather more complex.

Exploitation may be viewed by the European land owner as troublesome and intrusive, rather than as profitable and beneficial.

As for the environmental factor, the greater population density in Europe compared to the US has certain implications. It means that acceptance of the exploitation of shale gas cannot be taken for granted.

People have concerns about the potential increase in local traffic, particularly heavy commercial traffic, the noise caused by drilling, and the general disruption to their habitual life rhythm. Moreover, there are also concerns about the long-term impact of drilling on underground water. It may be assumed, of course, that technology will in time evolve to make such exploitation more acceptable. But this is not the case for now.

There are also other hurdles of a technological nature. In the US, the capacity of the gas pipeline infrastructure is higher. It is also more accessible. In Europe access to pipelines is difficult and highly depends on the conditions of long-term contracts. This makes the situation in Europe less flexible.

Yet another issue is that exploitation of shale gas requires the use of large volumes of water. This is a particular concern in many European countries such as Poland, where there are already water shortages.

The next block of topics on our agenda is the ultimate cost of production of unconventional gas and its impact on geopolitics. In particular, we will look at possible consequences for Russian, Qatari and Iranian gas.

The cost of production issue cannot be avoided. However, it is important to remember that today, for the first time, we are dealing with this issue in the context of gas oversupply. This would mean that the production of indigenous unconventional gas in Europe would have an impact on the gas which is now imported. In Europe, the main source of pipeline gas is Russia. The main source of LNG is Qatar. The volume of LNG imports has doubled in the last ten years. LNG is a much more flexible commodity than pipeline gas, as pipeline gas is linked to fixed infrastructure and is mainly covered by long-term contracts. My point therefore is that the emergence of unconventional gas is more likely to have an impact on LNG precisely because of its flexibility, rather than on pipeline gas, due to its more rigid arrangements.

This leads us to the next question: how well would shale gas and LNG get along? Would they compete or complement each other?

The answer to these questions very much depends on volumes. We should remember that in Europe production of conventional indigenous gas is rapidly decreasing. This is where shale gas may fill the market gap, but only if and when the obstacles that I have described earlier are overcome. This gives a certain advantage to LNG for which no legal or technological adjustments have to be made. On the other hand, if the market gap is not significant, this will have a negative impact on LNG imports. It is likely that governments would favour indigenous gas over imported gas.

Let us now discuss how we see the overall prospects of natural gas. How will consumer demand patterns affect it? Is it still the fuel of the future?

I do believe that natural gas has a promising future for power production, again because of its flexibility. It is abundant, acceptable and affordable both for industry and for domestic consumption. Indeed, for a growing urban population, it is the natural choice. This however, does not mean that natural gas will bring about the end of nuclear energy, which is essential for the production of power. Neither will it have a detrimental effect on renewable energy sources because of the political and environmental need to address climate change, and because of the energy saving aspects of this development. But in the interim, before such developments are complete, gas is a very good solution. It is noticeable that whereas there are often protests against nuclear energy, natural gas is generally acceptable.

Last but not least, there is the important issue of market interconnectedness, which we need to ensure.

We need a more uniform infrastructure for shale gas, indeed for natural gas in general. This was highlighted after the most recent gas crisis. More needs to be done to enable easy gas flow rerouting. Already there have been major developments in Europe’s infrastructure, which have greatly improved the connection between suppliers and consumers. I can refer here to the Nord Stream and the so-called Southern Corridor projects.

If I may now again briefly refer to the Energy Charter. There is another aspect which should not be neglected. Unconventional gas, whether in the form of shale gas or its other forms, requires enormous investment in order to be viably exploited. Achieving a reliable return on this investment is even more important for investors given that unconventional gas fields have a tendency to tail off more rapidly than conventional ones. In this context, the investment protection guarantees offered by the Energy Charter Treaty assume even greater importance.

As I have already mentioned, the Treaty offers guarantees against political risks affecting international investments in all aspects of the energy sector. This includes exploration, extraction, refining, production, storage and land transport of natural gas, as well as all other energy materials and products defined in the Treaty.

The investment protection guarantees offered by the Energy Charter Treaty include guarantees of fair and equitable treatment, of constant protection and security, of freedom of movement of key personnel and capital transfers, a guarantee against expropriation unless subject to specific conditions, including the payment of prompt, adequate and effective compensation. And most importantly, it guarantees access to international arbitration for investors who believe that these substantive guarantees have been violated. Such investors have the possibility of initiating arbitration with ICSID, with the Stockholm Chamber of Commerce, or an ad hoc arbitration under the rules of UNCITRAL.

The investment arbitration mechanism of the Energy Charter Treaty is hardly a “lawyer’s paradise”, but time has demonstrated that it works. So far as we are aware, the arbitration mechanism has been used on around 30 occasions since the Treaty entered into force in 1998. Of the final decisions, roughly half are in favour of investors and half in favour of governments. So I think we can say that the ECT investor-state dispute settlement procedure is a balanced mechanism, which takes into account the interest of both parties to disputes.

On that note may I now thank you for your kind attention.