

Speech of Amb. Mernier
Energy Policy of Ukraine: Unconventional Gas Focus
Kiev, 20-21 April 2011

I am very pleased to have this opportunity to take part in this important conference which in fact is the first international conference entitled "Energy Policy of Ukraine: Unconventional Gas Focus". I thank the Deputy Minister, Mr. Makukha, for his kind invitation to me to address you in my role as Secretary General of the Energy Charter.

This conference is well timed given certain global events such as the accident at Fukushima, and also the political events in the Arab world. Each of these happenings very clearly will have a particular impact on global energy markets, but also on the future of natural gas. Taken together, they allow gas to be viewed as a relatively clean, relatively cheap fuel that can help fill the world's energy needs. Gas has a promising future for power production because of its flexibility. It is also abundant, acceptable and affordable both for industry and for domestic consumption.

The focus of this conference is on Energy Policy of Ukraine. Ukraine, because of its geographic and strategic position, is of major significance in the energy relationship between the Russian Federation and the European Union.

Moreover the conference will focus on Unconventional Gas. When we speak of unconventional gas, I believe that we mainly have in mind shale gas, though of course unconventional gas is more than that.

World experience of unconventional gas today is for the most part taken from the US. Commentators indeed speak of the "Shale Gas Revolution". US President Obama recently described natural gas as part of the solution to reducing America's oil addiction. "The potential for natural gas is enormous," he said. The US is not alone, however. Many other countries, India, China and those in Eastern Europe, in particular, of course Ukraine, have very significant potential shale gas reserves too.

Even before the still unfolding events of 2011, the emergence of unconventional gas was a very significant phenomenon. The lack of suitable technology had previously prevented exploitation of this gas whose existence has been known for some time. Now thanks to a technological breakthrough shale gas is being produced in the US, thus making the North American market self sufficient. Remarkably as a consequence, LNG imports, which were developed by large LNG producers, are now excluded from the very market for which they were intended.

But when we again look at developments in the US, there are also some significant difficulties with regard to shale gas. As shale gas drilling increases it has been met by a growing environmental reaction, and by public concern. There are worries about spills. There is concern about air pollution from closely clustered wells.

However it is water that is at the centre of the environmental impact of shale gas drilling. First there are fears of water contamination from "fracking" - the hydraulic fracturing process which is used to tap shale gas reserves. There are concerns about the actual long term impact of drilling on underground water.

Then there is the fact that large volumes of water are required for the actual drilling. This is obviously of concern in countries where there are already water shortages.

The environmental problem is complex. The richest shale gas reserves are often in densely populated areas which are more used to consuming fossil fuels than producing them. This is particularly true in Europe but also in parts of the North Eastern US. People also are concerned about the increase in local traffic, particularly heavy commercial traffic, the noise caused by drilling, and the general disruption to their habitual life rhythm.

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, though technology is evolving rapidly in the US.

There are also further barriers of a technological nature. In the US, the capacity of the gas pipeline infrastructure is greater. It is also more accessible. In Europe access to pipelines is difficult and very much depends on the conditions of long term contracts. This makes the situation in Europe less flexible.

A further issue which cannot be avoided particularly in the context of Ukraine is the cost of exploitation. 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 the European Union, 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 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.

When speaking about Ukraine, I must refer to another vital issue, that of transit. For a long time, Ukraine enjoyed perhaps a quasi-monopolistic position in transiting Russian gas towards the EU. Here too the situation is changing. Once its construction is completed, Nord Stream will allow the transport, without transit, of 55 bcm, or approximately half the volume currently transited by Ukraine. Nord Stream is but one of a number of such projects e.g. Nabucco and South Stream. It must be realised that each of these projects has among its objective the need to avoid transit. Nonetheless Ukraine actually has in place the infrastructure and the long experience and expertise to manage transit effectively. Ukraine moreover has the ability and the means to continue to play the important role in transit that it has played in the past. But in order to do so the arrangements must be ever more secure and certain, and indeed, be seen to be so. Suppliers and consumers must have confidence that this

particular supply route is unquestioned and reliable. Otherwise there will only be increased justification for projects which allow for the avoidance of transit.

In essence I believe that a number of implications can be drawn from what I have said:

1. Unconventional gas will strengthen domestic production in countries with reserves, and contribute to security of supply;
2. Credible answers are however urgently required to the environmental concerns that I have outlined;
3. A new legal framework is required to facilitate the necessary investment in the development and exploitation of resources.

On my last point I have read the recent remarks of President Viktor Yanukovich when he spoke recently about Energy security being a common strategic interest for Ukraine, the European Union, and Russia. On 7 April the President stated that Ukraine should welcome European and Russian investments in the modernisation of the country's gas transportation system. In his remarks President Yanukovich made specific reference to the Energy Charter, of which of course, I am the Secretary General.

Ukraine is a very important member of the Energy Charter Treaty. As Secretary General, I am very appreciative of this long standing relationship has proved to be mutually beneficial for Ukraine, the Energy Charter as whole, and for all participants of the Energy Charter Process.

In common with all members of the Energy Charter Treaty, Ukraine has subscribed to certain core principles; national sovereignty over energy resources, respect for contract and property rights, stable and open frameworks for flows of energy, capital, technology and investment. All of this is inspired by an orientation towards market solutions, among them - non-discrimination, transparency, energy efficiency and sustainable development.

The Energy Charter now has many years of experience in promoting multilateral cooperation. The Treaty offers a balanced framework of international rules and principles already well established, effective and widely supported. The three "pillars" of the Treaty - investment protection, dispute resolution and security of transit - offer an unrivalled legally binding framework to develop mutually advantageous approaches to the challenges facing its member states. The Treaty also provides an opportunity to maintain dialogue with industry. Over fifty states are Contracting Parties to the Treaty and new observers and members continue to join.

A final but important point that I should like to mention is the modernisation of the Energy Charter Treaty. Russia has clearly indicated its desire to modernise the existing Energy Charter Treaty. Indeed last November our Russian colleagues presented a "Draft Convention on Ensuring International Energy Security" whose draft text translates into legal terms the ideas which were contained in the "Conceptual Approach published in 2009. I have welcomed this recent further Russian initiative. This draft text enables us to be quite clear as to what Russia has

in mind by way of change, though it remains to be seen how it will be achieved. The proposals are consistent with the fact that the Member States of the Energy Charter have agreed to recognise the changes in the energy sector.

Furthermore the Member States agreed that the Energy Charter is the appropriate tool with which to make progress on this issue. As for myself, I will do all that I can to facilitate this. The Energy Charter Secretariat is willing to guide and advise on the process. Already we have prepared a comparative analysis of the two texts to enable Member States to more easily appreciate the similarities and differences of the two texts. It is not of course for the Secretariat to make any value judgement with respect to any provision of either document. That is a matter for the Member States, Ukraine, of course, included.

In that context I am sure that this important conference will stimulate thoughtful discussion on how the investment climate in Ukraine can be further improved as the implications of unconventional gas make themselves felt. I very much hope that the Energy Charter will assist and contribute positively to this debate.

I wish you a fruitful discussion and look forward to learning more of the significant developments taking place in Ukraine's energy markets.