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"ENERGY TECTONICS: THE PLATES ARE SHIFTING"
ENERGY PRACTICES DRIVEN BY EVENTS, NOT BY POLICY

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Address by Ambassador Urban Rusnák
Secretary General of the Energy Charter Secretariat

Monsieur de Montbrial,
Ambassador Ramsey,
Ladies and Gentlemen,

I am very pleased and honoured to have been asked to make this opening address at the 2012 Annual Conference of the Centre for Energy at IFRI. I am particularly pleased to share this podium with the very distinguished Monsieur Thierry de Montbrial, the President of IFRI. As many of you know, I took up office as Secretary General of the Energy Charter Secretariat on 1 January. In fact, this is the first public event that I have spoken at in Brussels in my new capacity. It is therefore a particularly important meeting for me. Moreover it provides me with an excellent opportunity to share some thoughts with this audience on current energy issues, what you have termed "energy tectonics". I would, of course, also like to discuss the Energy Charter itself, and perhaps to consider its significance with regard to the changes taking place in the energy world.

I am struck by the appropriateness of the conference title which refers to "energy tectonics" and moreover to the fact that "the plates are shifting". Part of the reason for that may be my own training as an oil and gas geologist. Using that background and approaching matters from the perspective of my new role, I have asked myself what are the "tectonic plates" on which today's energy world rests. Broadly I see these "plates" as political, economic and technological. It can be said of all of them, that they are indeed shifting.

But it is the second part of the title, "energy practices driven by events, not by policy" which is of particular concern to me in my new role as Secretary General of the Energy Charter Secretariat.

The difficulty in giving this address is the very proximity of events to which I will refer, particularly those classified as geopolitical and economic. It is still really too early to be able to present an accurate analysis of how these events might impact the energy world, and international supply and demand for energy. The political and economic situation is not at all yet settled, these particular "plates" are far from settled. Perhaps this is also an evidence of the fact that tectonic plates are by nature in permanent motion.

Without doubt, the geopolitical events that have unfolded over the course of the past year and which are still unfolding as I speak, are of great significance to the energy sector. The events that I refer to include the so-called "Arab Spring", and now in particular the Syrian crisis, the Iranian nuclear programme and the West's response to it. Moreover, 2012 is a year which will see significant presidential elections: in the United States, the Russian Federation and of course in France. There are also leadership changes anticipated in China.

The economic events in question are particularly relevant to Europe. I am thinking of the on-going crisis surrounding the Euro and perhaps even the European project itself. The economic crisis has had a significant impact on energy. The slowdown of industry has reduced energy demand in all sectors: construction, the car industry, services etc. Investors have become more cautious, credit is tight, and major projects are being reconsidered in the light of these new circumstances.

The technological events include the immense changes that are taking place in the technology available to exploit energy resources. High energy prices are driving this factor. As a direct result, in recent years we have seen a rise in unconventional gas production, which is frequently described as a "game changer". Now, thanks to a technological breakthrough, shale gas is produced in the US, thus making this country's important gas market self-sufficient. Remarkably as a consequence, large LNG volumes are now excluded from the very market for which they were intended.

When we focus on the energy sector, the current political turmoil is indeed causing much uncertainty. In turn it is creating demand for more flexibility in energy markets. One has to recall that, for precisely the same reason of political instability and perceived hostility, Europe switched in the 1970s as much as was possible from the Middle East in the direction of the former Soviet Union which was perceived as stable and reliable. I should add that even if the Soviet Union may not have been as stable as anticipated, it has proved to be a reliable partner even at the height of the Cold War, and during the collapse of the communist bloc.

In Asia of course the tragic event in Fukushima is today in everyone's mind. It will certainly influence the energy mix in Japan and neighbouring countries in favour of gas. To what extent, no one can definitely predict. Nevertheless, it is already the case that Japan imports almost all of its natural gas, all in the form of LNG, and that imports have much increased recently.

Asia is today the main and rapidly growing client for natural gas, both LNG and pipeline gas. Japan, South Korea and China are in first place, as they seek energy for their booming economies, particularly for power generation. However, the information on China's gas-to-power demand is somewhat unclear, figures vary from 9% to 50% of total gas imports.

China, of course, is an immense country. The distances between gas sources, for instance in Siberia or Central Asia, and its rapidly developing economic regions are enormous. Such distances make the construction of pipelines costly and difficult in so many ways, compared to the so far preferred LNG option. Japan is also far from the centres of gas production, but it is the fact that it is located in such a seismically active part of the world that leaves the country no choice but to rely on LNG for its gas supply (recently even more so, with the need to compensate for the loss of nuclear power capacity resulting from the Fukushima accident).

If we look at India, a similar situation can be observed: insufficient national energy resources, but easy access to the sea. Like China, India might also envisage being supplied by pipelines from Central Asia. But there again the distances are enormous and there is the additional engineering challenge of crossing some of the world's largest mountain ranges. The political and security problems are numerous and extremely difficult. One only has to think about the difficulties of a pipeline from Central Asia through Afghanistan and Pakistan. Therefore the practical solution, if perhaps for the short term, is LNG.

My point therefore is that the shifting of these particular "tectonic plates" seems to be favouring the expansion of the market in LNG. This can be noticed in every region of the

globe. However, the bulk of LNG trade and investment is already, and will increasingly be, in Asia. In Europe, pipeline gas will remain the primary choice, but not exclusively. This shift will make global energy systems more flexible, with less dependence on specific suppliers or consumers. But it will increase the need for a generally applicable set of basic rules of conduct.

I would now like to focus on the Energy Charter, the Energy Charter Treaty, and what has come to be known as the Energy Charter Process.

I will do so by returning to our initial analogy, the shifting tectonic plates. It is well known that the shifting of tectonic plates cannot be prevented, and it is even impossible to predict exactly when the seismic movement will happen. Therefore, like a building that rests on such plates, the energy world needs a robust structure or framework, a system that helps to bring some predictability and security to markets with so many variables. Let us refer to it as a set of basic rules of conduct. We must do our best to ensure that energy practices are driven not solely by events – as mentioned in the title of this conference.

That is precisely what I argue the Energy Charter Treaty helps to do. The Treaty was developed on the basis of the 1991 Energy Charter. Whereas the latter document was drawn up as a declaration of political intent to promote energy cooperation, the Energy Charter Treaty is a legally-binding multilateral instrument and part of international law. But the important point is that the Energy Charter Process can only function effectively when the political will is there to use it, and to make it pertinent.

The fundamental aim of the Energy Charter Treaty is to strengthen the rule of law on energy issues, by creating rules for a level playing field to be observed by all participating governments, thereby mitigating risks associated with energy-related investment and trade. Some states including important energy producing and exporting countries, such as Australia, Norway and notably the Russian Federation, have not ratified the Treaty yet, while still actively participating in the Process. The organisation's governing and decision-making body the Energy Charter Conference brings these diverse states together to discuss energy issues at its meetings, or through its subsidiary bodies.

In addition, the Charter promotes energy efficiency policies consistent with sustainable development on the legal basis of the Protocol on Energy Efficiency and Related Environmental Aspects. Just yesterday, I returned from Chieti in Italy, where we launched a joint project sponsored by the European Commission to improve energy efficiency at a local level. Under the initiative of "Covenant of Mayors going East" we are targeting four partner cities and districts in Azerbaijan, Belarus, Kazakhstan and Tajikistan.

I would like now to focus on three particular issues where I believe that the multilateral approach – as embodied in the Energy Charter Treaty – can make a vital contribution to a more predictable energy policy and legal certainty, investment protection, secure and reliable transit, and building confidence and promoting cooperation through dialogue.

1. Investment Protection

If the full energy potential of energy producing countries is to be achieved, large-scale foreign investment will be required. Experience shows that in relatively opaque investment markets, where the issue of rule of law is far from determined, and where there are real risks of expropriation, foreign investors are reluctant to invest.

One way to improve the climate for investment is to reduce the level of risk. This is exactly what the Energy Charter Treaty does through its investment promotion and protection provisions, including the legally binding commitment made by parties to the Treaty to abide by international investor-state arbitration in cases of dispute.

Beyond the immediate resolution of particular disputes, these provisions have the secondary effect of helping to strengthen the rule of law and transparency, thereby contributing to an improvement in the general investment climate.

2. Secure and Reliable Transit

Transit is a major issue. It is so for China and the EU as energy consuming regions. But is particularly so for the Caspian, an energy producing region.

The Energy Charter Treaty already contains important provisions in the area of transit. However it is not a secret that the negotiations on a Transit Protocol to the Treaty have had great difficulties. For the moment there is a form of deadlock in these negotiations and consideration is been given to a re-set, or even a return to the beginning. Now is the right time to make every effort to pursue such a Protocol that would go a long way to addressing transit challenges. The fact that the Caspian countries are land-locked means that the transit arrangements of the region are vital not just to them but also to the consumer nations of Europe and Asia.

I believe that the Charter has taken the correct approach in balancing the interests of producer, consumer and transit states under a single legal framework. This experience will remain valid in the case of the most prominent transit country, Ukraine. If a reliable common framework were in place at this stage, there would be no need for expensive bypass pipelines. I should also emphasise that the Energy Charter is available as a multilateral framework to address emergency situations with regard to energy supply.

3. Building Confidence and Promoting Cooperation through Dialogue

The third issue where a multilateral approach can make a contribution to addressing the current energy challenges is the provision of a forum for states to discuss issues of mutual interest and concern. Experience shows that dialogue around critical energy issues can do much to promote better understanding, transparency, and exchange of information and, in these ways, contribute to building confidence.

The constituency of the Energy Charter is located mostly on the Eurasian continent, at least at this point in time. Here, the Russian Federation and the European Union are the major players. There is an important synergy between the EU and Russia, which is longstanding, stable and profoundly beneficial on both economic and political levels. The European Union has other gas suppliers, such as Norway and Algeria, maybe Iraq in the future. Russia also has other export markets than Europe, such as China and the North-East Asia region. It must be said however that none of those markets are mature enough to absorb significant volumes comparable to those of the European Union.

Russia has clearly indicated its desire to modernise the existing Energy Charter. In December 2010 the Russian delegation presented a “Draft Convention on Ensuring International Energy Security”. This Russian proposal was carefully analysed and enabled us to be clearer as to what Russia has in mind by way of change, though it remains to be seen how it will be

achieved. The suggestions were consistent with the intention of other ECT member states to recognise the changes, which had come about in the energy sector, reflected just a month earlier in the Road Map for Modernisation as adopted by the Energy Charter Conference. Furthermore, the member states agreed that the Energy Charter was the appropriate tool with which to make progress on this issue. As for myself, I will do all that I can to facilitate this.

Modernisation is the most important endeavour of the Energy Charter for the immediate future. The Treaty signatories now have an excellent opportunity to discuss the substance of the modernisation process and its implementation. Moreover I believe that this process should be open for observer countries that qualify having signed the initial political declaration of the Energy Charter. We have a clear road map for the way forward, and we have an important role to fulfil. I am convinced that active participation of our constituency will result in a positive outcome from this exercise. The ECT would thus become attractive to an even greater number of countries. This would be our part of the public service that the Energy Charter Secretariat can provide to strengthen our common energy policy building on moving "tectonic plates" worldwide.

I, as Secretary General of the Charter's Secretariat, therefore look forward with optimism. I believe that we are capable of successfully dealing with the challenges that may arise.

On that note may I now thank you for your kind attention. I hope that my reflections will be useful in your further discussions and help to address in more detail the very interesting question that this conference poses.