Energy and natural resources

Nothing is permanent but change

J Jay Park
Macleod Dixon LLP
Calgary

The last two years have seen big changes in the energy business, and this has been mirrored by the changes in the practice of energy law.

Changes in circumstances

Price changes
The price of crude oil has more that doubled in the past two years. Skyrocketing prices have also been felt in global natural gas markets. This energy price double whammy has impacted on the energy budgets of consumers. In earlier times, this portended recession; so it is intriguing that current price changes seem to be having only minimal impact on world economic growth.

Supply volatility
As Thomas Pynchon said repeatedly in his novel *V*, “the international situation was desperate, as usual”. We can all agree that the oil market has always had to deal with perceptions of instability, but it is unusual that matters as insignificant as a single hurricane in the Gulf of Mexico, or the action of a handful of terrorists in remote regions of Nigeria, can have double-digit percentage impacts on the global price of oil and gas.

Many have suggested that this is a sign that we are approaching *peak oil*, which is that point in time when global production of oil has hit its peak rate, and will inevitably start to decline. While the theory of peak oil has been proved within individual nations, whether it is also a valid theory for global production, and whether we are at or near the peak, has yet to be shown. There is no doubt, however, that there is less global spare capacity of oil and gas production than ever.

Impact of change on energy law

The obsolescing bargain
The news has been full of the words and actions of some of the world’s leaders, as they have dealt with the impact of price changes on their domestic economies. It is interesting that the loudest changes have occurred in some of the countries that are producers and exporters of oil and gas, and host to international oil companies who conduct exploration activities there. Both Bolivia and Venezuela have taken precipitous actions to alter the arrangements between the state and the oil and gas investor, through expropriation or heavy-handed negotiation. However, many other states have been busy either making similar changes, or talking about them, with much less fanfare. The underlying fact is that, when commodity prices swing wildly, the bargain between the state and the investor appears obsolete, and states often take steps to change it in their favour. This attitude pervades most of the relationships between states and investors. Oil companies might be finding it increasingly difficult to find oil, but finding sympathy is even harder in the current price environment. To deal with these challenges, new financial arrangements are emerging in many states that better address an appropriate sharing of economic rent between the state and investor across a variety of price and profitability environments.

State oil companies: controlling and competing
The last two years have seen the emergence of state oil companies as bigger players both in their own domestic energy markets, and in the competition for international oil and gas opportunities. Increasingly, state oil companies are denying investors the opportunity to search for oil and gas in their home states, preferring to keep these opportunities for themselves. State oil companies now account for 90% of the world’s conventional oil reserves and, as some international oil companies see their reserves-

Energy and natural resources

life index drop into the low teens, it becomes more clear that the balance of power in the oil industry is shifting to the state oil companies.

A second challenge to international oil companies is the emergence of state oil companies on the international scene. Led by Chinese and Indian state oil companies, recent transactions in the energy business have often seen these *international national* oil companies pick up prime production assets and companies. The same is occurring in the exploration area, as state oil companies are benefiting from state-to-state awards of exploration blocks, often involving trade and aid arrangements that are impossible for private investors to match.

Non-conventional and remote supplies
This has led the international oil companies to fall back on their strongest suits: technology, personnel and access to capital. Non-conventional oil and gas opportunities are now being developed at a pace never before seen, using advanced technology that often requires large personnel and capital investments. The oil sands production facilities in Canada are now being pursued at a pace never before seen or imagined, as $80 billion is committed for expenditure over the next few years. The oil sands of Venezuela and Trinidad might be next, and oil shale projects are once again being seriously assessed. Coalbed methane deposits across the world, and multibillion-dollar pipelines to gas fields in the Arctic and oil fields in landlocked states such as Kazakhstan are seeking to bring on-stream oil and gas from the remotest parts of the world.

The LNG factor
Once neglected, natural gas is now the growing energy giant. New and better LNG technology and rising energy prices now make economic the production of gas that is distant from large markets. This area has seen large investments, and increasingly the marketplace is changing to match it. Gas is becoming a globally-priced commodity, as was seen when Hurricane Katrina caused a planet-wide change in gas prices.

The energy business is in an up-cycle in every category. Energy lawyers are kept busy keeping up with its implications.