Choking on fumes

The rocketing and seemingly unstoppable price of oil is forcing the energy sector to look at new markets they can tap, new customers they can sign agreements with, and politicians they can get on side to fight their corner. Neil Hodge investigates

Perhaps, unsurprisingly, oil industry eyes are focused firmly on Iraq and the chance to help improve on its current oil output of 2.5 million barrels per day. Despite the US-led invasion five years ago, the country's oil and gas reserves are still free of foreign hands – a situation that western firms believe has lasted too long. But plans are taking shape to redress this. At the beginning of July the Iraqi oil ministry invited foreign companies to bid for contracts to develop eight oil and gas fields, starting a process that could return international oil companies to Iraq for the first time in three decades.

The Iraqi oil ministry believes that the country is in dire need of expertise from international oil companies to achieve its target of three million barrels per day by the end of 2008. Iraq has been relying on a Saddam Hussein-era natural resources law until the country's parliament approves a new oil law to regulate the international oil companies' work and share Iraq's oil resources among the country's Shiites, Sunni Arabs and Kurds – a delay that has left western oil companies chomping at the bit. More than 70 international firms met the ministry's deadline of 18 February to compete for tenders to help develop Iraq's oil reserves, seen as vital to providing the funds to rebuild the shattered country, but the process has continued to drag on, with no firm timetable in sight for the work to actually begin.

Talking in tongues

Frustrations are coming to the fore in the Caspian region, with Russia's new president Dmitry Medvedev embarking on a charm offensive at the beginning of July to Azerbaijan and Turkmenistan to help cement good relations and tie up natural gas for the Russian market, to the detriment of the EU.

Gazprom, the Russian natural gas giant, has already offered to import gas from Azerbaijan and is battling to find a compromise with Turkmenistan on future gas trading terms. Its progress is watched closely by Europe, which has struggled to secure enough Caspian gas to fill the planned Nabucco pipeline across the Caucasus to Europe – the cornerstone of its strategy to reduce dependence on Russian gas.

Analysts believe that Azerbaijan, already a crucial non-Russian pipeline route for Caspian oil exports to the west, would hesitate to undermine its strong relationship with the US by agreeing to sell gas to Russia. But the Russian offer could be tempting, providing a more immediate outlet for Azerbaijani gas than Nabucco.

Rock the Caspian

But Gazprom's most pressing concern is to lock in future gas supplies from Turkmenistan, the biggest and most internationally sought-after source of gas in the Caspian. The country claims that a new gas pipeline it is building to China will be finished next year, ending Russia's stranglehold over its gas export routes. Furthermore, Turkmenistan has signed an energy co-operation pact with the EU, raising hopes in Brussels that a commercial agreement to supply gas to Nabucco may eventually be reached. The country has increased gas export prices twice this year and informed Gazprom it will raise prices to European rates in 2009.

Analysts say that the importance of Turkmenistan in terms of an untapped energy market should not be undervalued. "Turkmenistan holds all the gas cards in the Caspian," says Julia Nanay, Senior Director at PFC Energy, an energy consulting company. "It is critical to Russia, critical to China and critical to European plans to diversify supplies away from Russia."

Cut-throat competition is not the only issue on the agenda of Europe's energy firms. Some are lobbying EU governments to push energy concerns as a tenet of their foreign policies to help secure contracts, secure resources, and keep prices profitable and affordable. In July Antonio Brufau, Executive Chairman at Repsol, Spain's biggest energy company, lambasted European politicians' inability to formulate a unified energy policy, saying that Europe needed to consider energy as an integral part of its foreign policy. Mr Brufau criticised Europe's lack of cohesion when dealing with oil and gas producers such as Russia and Algeria and took a swipe at the EU's biofuels targets, which he called "misguided". He also questioned Europe's failure to develop a cross-border gas and electricity network.

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"In terms of energy, Europe is not advancing in the right direction," Mr Brufau said. "We have to have one single voice, one single policy, one single market."

The lingua franca

Although individual companies still had to negotiate their own supply contracts, Mr Brufau believes that a common energy policy among European states would help set the framework for these negotiations. "If Europe spoke with one voice, then there would be more equilibrium between it and the producer

countries." He added that this lack of unity was reflected in EU directives on alternative energy sources, which often failed to draw on the experience of Member States. Efforts by the EU to increase production of bioethanol, for example, were misguided, as it replaces gasoline, which is in surplus, but fails to tackle the shortage of diesel fuel, he said. The Repsol head also questioned how much technical analysis had gone into Europe's 20/20/20 target, which calls for 20 percent of energy to come from renewable sources, and a 20 percent improvement in efficiency by 2020.

But increased competition, rising prices and the threat of oil reaching €150 a barrel are creating opportunities elsewhere in parts of the energy market which had previously been thought to be moribund, such as coal. Fresh signs of the resurgence of Britain's coal mining industry emerged in July when Scottish Coal, the UK's second largest coal mining group, won a bid to supply €880m of coal over five years to Scottish Power.

Scottish Coal has agreed to sell about two million tonnes of coal a year – half its current output – to Scottish Power to feed its two coal-fired power stations, Longannet in Fife and Cockenzie in East Lothian. The coal will be sold at an undisclosed fixed price, which Scottish Coal said gave both parties the certainty they needed to invest in new mines and power generation equipment.

Exporting value

While coal prices have risen sharply this year, it is still cheaper for energy companies to burn coal than gas, the price of which is linked to oil. Furthermore, coal supplies are more secure than gas. Whereas gas reserves are concentrated in only a few countries, including Russia and Iran, coal is found in several and interest has moved to mineral-rich Indonesia, the world's largest thermal coal exporter.

Indonesian coal producer Bayan Resources has highlighted the interest investors are taking in the country when it announced plans to raise up to €442m by floating 25 percent of its shares on the country's stock exchange in August. With countries including China looking for alternatives to oil, global demand for Indonesia's largely low-grade thermal coal, used mostly in power stations, is surging, helped by the fact that suppliers, including Australia and South Africa, can no longer meet demand. And the figures speak for themselves: the price of thermal coal has climbed more than 160 percent in the last 12 months and power station coal prices at Australia's Newcastle port – a benchmark for Asia – jumped to a record €109.6 a metric tonne in the week ended 27 June.

On the back of the rise in prices and demand Bumi Resources, Indonesia's largest coal miner, has seen its share price climb 922 percent in the last 18 months. Indonesia's big four listed miners now comprise some 15 percent of the country's stock exchange's €127bn market cap and 20 percent of its daily turnover.

Dozens of foreign companies have bought stakes in Indonesian mines in the last two years. India's Tata Power, for example, last year paid €0.8bn for stakes in both of Bumi's mines and 10m tonnes of coal. Dozens more companies have started green field projects in the last year.

Indonesia's government is mostly supportive of the expansion, but it is also savvy enough to know when to put the brakes on production to keep demand high. Simon Sembiring, the director-general at the energy ministry responsible for mining, has said that foreigners will not be allowed to mine and export at will. "If we met all the demands from China, India, Japan and Korea, all the coal would be gone in a few years," he says. "It's not just about chasing the money. We have to make sure we still have coal for the next 20 years." ■