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Will Shale Gas Transform Argentina's Energy Sector?

Inter-American Dialogue's Latin American Energy Advisor

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Q and A: Will Shale Gas Transform Argentina's Energy Sector?

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In December, Repsol YPF announced a 4.5 trillion cubic feet discovery of shale gas in Argentina's Neuquén Basin. According to the company, the find expands YPF's proven reserves from six years to 16 years. What is the potential to exploit shale gas resources in Argentina? How does the recovery of shale gas differ from traditional oil and gas reserves? What new regulations and rules will Argentina need to adopt as a result of the find? Will the shale gas discovery have a significant effect on the country's domestic capacity and its potential to export energy to neighboring countries?

A: John C. Ale, partner and head of the Houston office of Skadden, Arps, Slate, Meagher & Flom LLP, and Jorge H. Kamine, counsel in the firm's Washington office:

"Tapping shale gas has been a game-changer wherever its production has commenced. Due to shale development over the past several years, the United States has seen a dramatic increase in reserves, with a concomitant drop in prices, cancellation of new capacity for LNG imports and need for improved pipeline and storage infrastructure in regions not historically known as gas producers. Given the key role of gas in Argentina's energy mix, these discoveries can be expected to bolster the reliability in domestic production, thereby contributing to the nation's energy security, reducing prices and allowing domestic use to grow side-by-side with exports. Because gas-fired power generation releases far less greenhouse gases than coal-fired, this can help reduce Argentina's carbon footprint until more economic renewable sources are developed. Production of shale gas, however, is more complex and therefore more costly than conventional production, and Argentina may need to modify its existing price-control regime to take into account these differences. Recently, the composition of hydraulic fracturing fluids and the possibility of leakage have attracted more scrutiny in the United States, with some state and local authorities temporarily banning drilling until the processes can be reviewed. 'Fracking' also consumes significant quantities of water, which can be scarce in the region, and although reusing drilling water has become common in the United States, the allocation of water resources will play an important part in the success of shale gas development. Finally, the country must sort out who arranges and pays for the improvements to roads, pipelines and infrastructure that will be needed to develop and transport these resources."

A: Leni Berliner, chair of M3 Investment Group and president of Energy Farms International:

"While Argentina is highly prospective for natural gas, for several years exploration and development were not replacing reserves, and exports were disrupted to enable natural gas to be sold in the domestic market. Technological developments have made 'tight' gas deposits more economically viable to pursue than they were the last time petroleum prices were very high, and several companies have been exploring in Neuquén. Next month, Neuquén Province will attempt to issue \$260 million in debt backed by royalties paid by producers of oil and natural gas. While the 'fracking' technology used to suck natural gas out of shale deposits generally means fewer individual wells have to be operated, there is a risk of intercepting and contaminating ground water contained in the same formations. Should it proceed to develop the field, YPF will have to take great care to obtain and retain community support for its efforts. YPF is not popular, with a judge having recently suspended share trading to address claims made by workers regarding their holdings in the company; this comes on the heels of a delisting of the company's American depositary shares on the New York Stock Exchange. Repsol's priorities are to expand its LNG business and to grow sales to Asia. How far from existing gas gathering and transportation facilities are the new fields? Will it make sense for Repsol YPF to build an LNG plant in Neuquén? And if so can the Argentine energy market become a competitive destination?"

A: Rose Anne Franco, Latin America upstream research analyst at Wood Mackenzie:

"Repsol YPF's 4.5 trillion cubic feet unconventional gas discovery in Argentina's Loma La Lata area confirms the country's unconventional gas potential, but would have not been possible without an improvement in tariffs. Price caps over the last decade fueled domestic demand while stifling private investment. In response to declining gas output, the government launched the Gas Plus program in 2008, permitting operators to secure higher pricing for more difficult to produce gas fields, with some projects fetching \$4-5 per million metric British thermal units (mmbtu). However, operators must both secure a buyer willing to pay the higher rates and approval from the federal government for Gas Plus designation and thus far, this has been occurring in a piecemeal fashion. In other words, full-scale development of Argentina's unconventional gas resources will rest on long-term sales contracts at higher prices, with operators suggesting Gas Plus rates closer to \$6-6.50 per mmbtu. In comparison with conventional oil and gas, development of the unconventional gas segment entails a more aggressive drilling campaign and nimble adoption of new technology, which in North America was facilitated by the role of the independent companies. Overall, however, in addition to a more liberalized price environment, growth in Argentina's unconventional gas segment will rest on improvements on many of the variables that currently stymie conventional oil and gas—heavy government intervention and regulatory uncertainty. Only with more fundamental improvements on these fronts can Argentina reverse course in terms of gas production and once again be considered a reliable gas supplier."

The Energy Advisor welcomes responses to this Q&A. Readers can write Editor Gene Kuleta at kuleta@thedialogue.org with comments.