INTERVIEW

The Hard Times Are Not Over for the French and European Refining Industry,

Jean-Louis Schilansky, President of the French Oil Industry Association (**UFIP**), tells **AOG**

- In addition to the well-known problems of our industry, we now face **competition from American refineries**.
- Degree of **refining overcapacity in Europe** is estimated to be at least 10%.
- **Shale gas in France**: the subject is not closed and we are going to take our full place in the national debate.
- **Peak oil** is moving further into the distance as a result of the development of technology and prices

(Following is the text of an interview with Mr. Jean-Louis Schilansky, President of the French Oil Industry Association – **UFIP**. See following page for his biography. AOG last published an interview with Mr. Schilansky on 16 February 2012).

AOG: ***France*** *now has only 10 refineries in operation, following the closure of several plants over the years. How many will there be tomorrow or the day after?*

■ **Jean-Louis Schilansky**: The refining industry in France and Europe remains in a very difficult situation. In Europe, oil consumption is declining by 1% to 2% a year, which is to say by roughly 200,000 barrels a day per annum. This trend, which has been going on for many years, has resulted in capacity reductions, and France has given a lot in this respect. And unfortunately, for the European and French refining industry, the hard times are not over yet.

In addition to the well-known problems of our industry a new element emerged recently, which is the **competition of American refineries**. They have the benefit of, on the one hand, cheaper crude oil supplies, with a price differential that can reach around twenty dollars a barrel in relation to **Brent**, and, on the other hand, lower operating costs thanks to the supply of shale gas at a competitive price. The United States can thus export refined products to the European market at a profit, which complicates things further.

AOG: *In France, two refineries are awaiting to learn their fate, one of which was previously operated by* ***Petroplus*** [Editor's note: This interview is being published a few days before the mid-

April deadline fixed by the Rouen commercial court for the possible takeover of the **Petit-Couronne** refinery] *and the other by **LyondellBasell**. If both these refineries were to close, would the French market's overcapacity problem be at end?*

J.-L. S.: On the assumption you make, that both these plants are closed, France would then find itself short of capacity, since there is an overall balance between supply and demand at the moment. But this situation conceals imbalances on some products. We would remain a gasoline-exporting country and would continue to import large volumes of gas oil.

AOG: ***French oil demand** amounted to **75.3 million tons** in 2012, which brings us back to the level of ... 1985. Furthermore, the consumption of motor fuels fell by 1.6% over the 12 months from March 2012 to February 2013 relative to the previous year. Have we touched bottom?*

J.-L. S.: Consumption remains on a downward trend and is so for numerous reasons: France's energy efficiency goals; the spectacular improvement in the efficiency of motor vehicles, which is having a negative effect on fuel consumption; the continued drop in the demand for domestic heating oil on a climate equivalence basis, due in particular to the substitution of natural gas for this fuel; the continued decline in the consumption of heavy fuel oil due to environmental regulations; and the decrease in the consumption of motor fuels because of the rise in their prices, with gas oil demand having leveled off and gasoline demand declining by 6% to 7% a year. In this environment, only the consumption of jet fuel is continuing to grow, but that cannot offset the general decline.

AOG: *UFIP thinks there is still **surplus refining capacity in Europe** (OECD Europe) and that the adjustment process is thus going to continue. Can you quantify the amount of overcapacity?*

J.-L. S.: There are around a hundred refineries in Europe today and the margin of overcapacity is estimated to be at least 10%, while the demand for oil is continuing to decline.

WHO'S WHO

> Jean-Louis Schilansky

President of the French Oil Industry Association (UFIP) since June 2008

After occupying the post of Executive Director of the French Oil Industry Association (**Union Française des Industries Pétrolières** - UFIP) between 2001 and June 2008, Jean-Louis Schilansky was appointed President of UFIP on 18 June 2008. In this role, he has continued to be the official spokesman of this organization, which has around 30 member companies. UFIP is a trade association that represents companies operating in France in one of the three main segments of the oil industry: oil and natural gas exploration and production, refining, and distribution.

Jean-Louis Schilansky started his career in the information technology department of **Mobil**. He then took charge of the company's diversification activities and subsequently became Regional Director of the **Mobil France** network, Managing Director of **Mobil Cyprus**, Planning Analyst in New York, Planning and Supply Director in London, Refining and Marketing Director France, and Vice-President of **Mobil Europe** in London. In 1998 he was appointed President of Mobil Europe in London, and then in 2000 Regional Director for Europe of **ExxonMobil**, based in Brussels.

Jean-Louis Schilansky holds a diploma from the **Ecole Nationale Supérieure des Mines** and has been a member of France's **Economic, Social and Environmental Council** since 2004. In September 2008 he was appointed Vice-President and Treasurer of the French industry federation, the **Mouvement des Entreprises de France** (Medef). He is also President of **Medef Paris**.

Source : UFIP.

That said, one has to make the connection with **refining margins**. In 2012 we enjoyed something of a "breather", with better margins than in previous years. But if they were to narrow again in the near future, further refinery closures in Europe would very probably be inevitable.

AOG: *Despite this very gloomy landscape, some **non-European companies** are eyeing the European market. How can their interest be explained?*

J.-L. S.: The market remains attractive in some respects, especially for large producers of gas oil. But it is more a case of new outlets for refined products in this market than new industrial entrants.

AOG: *You referred just now to the question of **refining margins** in Europe. 2012 was an extremely good year, with gross margins of **34 euros per ton**, as against 14 euros/ton in 2011, 21 euros/ton in 2010 and 15 euros/ton in 2009. More interesting still, the average over the period from 1995 to 2012 was 22 euros/ton. Doesn't the industry have something to be pleased about?*

J.-L. S.: 2012 was unquestionably a better year than the previous ones. Things have to be put into proportion, however. This was not an excellent result. Today, a gross margin of around 30 euros/ton enables refiners to cover all their costs, which is to say their fixed costs, variable costs and depreciation. That enables them to replenish their financial reserves but these are not "super profits".

In fact, you have to look closely at the factors that explain the level of margins last year. This was mainly the consequence of refinery closures: permanent closures in the case of some of the plants operated by **Petroplus**; and temporary closures in the case of those of **Esso** and **Total**, which carried out major technical shutdowns at their refineries. In addition, there was the reduction in the processing capacity of the **Gonfreville** refinery operated by Total, trimming it from 16 million tons/year to 12 million tons/year. The satisfactory level of margins in 2012 can hardly be regarded as a lasting fait accompli.

The satisfactory level of margins in 2012 cannot be regarded as a lasting fait accompli

AOG: ***Gas oil demand** in France exceeded **37 million tons** in 2012 and French refineries' output of this product has varied **from 20 to 25 million tons/year** since around 1995. Why is it that the industry has not used this time to increase its production of gas oil, when the growth in the demand for this product is not a new phenomenon, quite the contrary?*

J.-L. S.: It is true that French gas oil production is more or less stable, but that does not mean that refiners have not done anything. They have offset the negative impact of refinery closures through their investments, which is not negligible. And that has been done in a context of delicate profitability. The **spreads between gas oil and gasoline prices on the Rotterdam market** are narrow, which does not encourage refiners to undertake costly investments in distillation facilities. In addition to that you have to take account of the difficult context in which French refiners operate and the very great **variability of refining margins**. Moreover, the leading western oil companies give precedence to exploration-production in allocating their investment budgets: **upstream activities are effectively far more profitable than downstream ones**.

AOG: *The French government recently indicated that it ought to shift progressively towards a* ***rebalancing of the tax rates on gas oil and gasoline*** *in order to give the former less of an advantage. If these remarks were put into effect, would that be very good news for the French refining industry?*

J.-L. S.: The key parameter remains the gross refining margin. If it is low, the rebalancing of taxes on motor fuels, which would be a very good thing in itself, would not be enough to save refineries in difficulty. If margins were to stabilize within a range of 25 to 30 euros a ton, that would provide real support. If gasoline prices were to fall on international markets, such a development could have a very negative impact.

AOG: *We are still in the realm of hypotheses, but the point you have just made is not at all improbable, given the strengthened competitiveness of the refining industry in the United States, to which you referred just now. In addition, UFIP has been concerned about this scenario for some years, since it would exacerbate the situation of French refineries, which export gasoline, in particular towards this market where diesel oil use is very low.*

J.-L. S.: That is effectively a sword of Damocles hanging over French refiners. Up to now, the United States market has remained open, since gasoline demand is holding up quite well and there have also been refinery closures on that side of the Atlantic.

AOG: ***Crude oil prices*** *set a new record in annual average terms in 2012, and 2013 has started under favorable auspices in this respect despite the sovereign debt crisis that has dealt a hard blow to the European Union, the world's second largest market after the United States. What is the outlook for crude oil prices in 2013?*

The strength of crude prices since the beginning of 2013 is surprising

J.-L. S.: I am surprised by the strength of crude oil prices at this early stage of the year despite the European crisis, the slowdown in world economic growth, the increase in the United States' oil production thanks to shale oil, and the absence of political tensions. The main factors that explain the continued high level of prices are probably Asia's economic growth and its rising oil demand, an economic climate in the United States that is looking a little more positive than expected, the persistence of geopolitical tensions in the Middle East and Iran, and the feeling that Saudi Arabia will not allow prices to slide substantially and lastingly below the $100/barrel level that it regards as the optimal level in the current circumstances.

AOG: *When one talks of oil in relation to France, one is talking above all about the downstream sector. For some time, however, UFIP has also stressed the* ***upstream*** *sector due to the country's potential in the area of* ***source rock hydrocarbons****, more commonly called shale oil and shale gas, as well as to the* *oil discovery made off **French Guyana**. On this last subject, UFIP recently indicated that this could result in a fivefold increase in French oil production, which is currently running at about 800,000 tons/year. Can you explain this forecast?*

J.-L. S.: We have drawn a parallel with the **Jubilee** field discovered by **Tullow Oil** off Ghana. Jubilee is producing around 100,000 barrels/day of oil, which is to say 5 million tons/year. This only gives a rough idea, of course. At the moment we do not have the information needed to enable us to predict the future output of the field discovered off Guyana. We will have to wait for the continuing appraisal work being carried out by **Shell** before being able to advance reserve and production estimates.

AOG: *The future of exploration-production in France also, and perhaps above all, lies in **shale gas** and, possibly, **shale oil**. What is UFIP's position on this very controversial subject?*

J.-L. S.: On this issue, we are engaged in an intensely emotional and political, indeed ideological, debate. There is thus a lot of explaining to be done. We have to try and take the emotion out of the debate, remove the ideological connotation, and place objective elements in the public domain. In view of the importance of this issue, we consider it to be one of UFIP's essential missions today.

AOG: *Who are you mainly targeting? The authorities, the media, public opinion?*

J.-L. S.: Our primary objective is to act on public opinion. In democratic countries governments pay attention first and foremost to shifts in public opinion.

AOG: *You think this subject should have its place in the debates taking place in France on **energy transition**.*

J.-L. S.: This should be part of the debate. The oil industry supports the idea of energy transition, but this transition has to take a realistic path. What is at stake is important for our industry and our country. We must not forget that France imports 99% of the oil and 98% of the gas it consumes.

AOG: *Are you optimistic about getting your views on this issue taken into consideration?*

J.-L. S.: The issue is a delicate one, and in France the pragmatic path of progress is not necessarily the rule. To simplify matters, in the United States on a subject like this, the question is how to do a certain number of things, whereas in France we look for all the arguments to justify doing nothing.

The oil industry supports the idea of energy transition, but it has to take a realistic path

This attitude weighs heavily on our energy choices. That is the reason why we are suggesting that the authorities agree to an experimental approach to shale oil and gas. That is a way of breaking the deadlock.

We have noticed some tentative moves on this issue recently, such as the Senate's decision to ask the **Parliamentary Office for the Evaluation of Scientific and Technological Choices** (OPECST) to look into it, the National Assembly's creation of a study group on shale gas, and the interest shown by the general public in the national debate on energy transition. The subject is not closed, therefore, and we are going to take our place in it.

AOG: *Apart from shale gas, there is also the question of* ***coal-bed methane*** *in France. What do you think about that? UFIP seems to have some reservations about it.*

J.-L. S.: We are looking closely at this issue. **European Gas Limited** (EGL), a company that is carrying out drilling operations in the Lorraine region, is a member of UFIP. There is a necessary phase of learning and getting a grasp on this particular area of the gas industry. But we hope the results will be positive. In France, however, the potential of coal-bed methane will probably be more limited than that of shale gas.

AOG: *In a recent contribution to the debate on energy transition, UFIP maintained that the* ***world's crude oil reserves*** *could have a productive life of more than a century. Can you expand on this argument?*

J.-L. S.: The key message is that "**peak oil**" is moving further into the distance as a result of the development of technology and prices. Until very recently, hydrocarbon exploration and exploitation were concentrated on major reservoirs into which oil and gas had migrated. With unconventional hydrocarbons, we are interested in **disseminated hydrocarbons** as well, and techniques, or combinations of techniques, have been developed that enable them to be extracted, which opens up considerable potential. That represents a real paradigm shift, a "game changer". The world's oil and gas potential remains enormous, therefore, and probably far greater than was thought only 10 years ago.