

Israel's Zero Gas Option: Take II

Written by Gal Luft

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Last August [I floated in this Journal](#) the highly unlikely scenario that due to bureaucratic paralysis and inability to instill confidence among international oil and gas firms Israel might blow its chance to become a major player in the global natural gas landscape. This week the scenario took a major leap toward materialization when the Australian energy giant Woodside Petroleum which had previously agreed to buy a 30% stake in Israel's Leviathan gas field withdrew from the deal's signing ceremony at the last minute due to disagreements with the Israeli Tax Authority. What was likened to a bride escaping from her wedding prior to the "I do" moment, came as a shock to Israel's energy sector. The \$2.5 billion deal was the biggest in the sector's history, and the investment is considered key to the development of the Leviathan. Woodside demanded a high depletion allowance, tax deferrals and exemptions on its future investments in the project to the tune of hundreds of millions of dollars from the Israeli government. And while the Tax Authority went to great lengths to accommodate the Australians it was too little and too late. Woodside has not closed the door yet. In a statement to the Australian stock exchange it stated "Discussions continue with the parties and the Israeli government with a view to resolving the remaining issues and executing definitive agreements." I wouldn't bet that the gaps can be closed, at least not in the foreseeable future as the sides are still far apart on fundamental issues, and the political climate in Israel is not conducive to reducing the prospective tax take on so called energy tycoons. It is time to begin to think about the day after Woodside in case the Aussies decide after all to stay down under.

The implications of the failure of the Woodside deal are profound. First, Woodside brings to the table unique expertise in natural gas liquefaction (LNG) and shipment. A Woodside departure from the deal would essentially put an end to the LNG option. This would leave Israel with only two major export destinations: Turkey and Egypt. Both options would be considerably cheaper than the LNG pathway yet both are politically challenging. At a time when Europe is struggling to reduce its dependence on Russian gas Turkey seems to be the most attractive of the two despite the likely victory of Turkish Prime Minister Erdogan in the upcoming elections. This will put more pressure on the Netanyahu government to expedite the reconciliation with Turkey. There are signs of this happening anyway. Turkish Foreign Minister Ahmet Davutoglu said this week that Turkey is interested in bringing the 2010 Mavi Marmara crisis to an end, and that "The gap between the expectations of the two sides is closing." Simultaneously, Israeli unions announced the end of the boycott of Turkish vacations which means that rivers of Israeli tourists will soon return to the coasts of Anatolia, providing a shot in the arm to the struggling Turkish economy. The cost of constructing a pipeline to Turkey is estimated at \$3 billion, significantly cheaper than an LNG terminal.

Second, a Woodside departure would postpone the arrival of gas from Leviathan and its smaller sister fields Tanin and Karish. Under the best case scenario this gas was scheduled to arrive to the Israeli market by the end of 2017 and to the Asian market via a floating LNG terminal no earlier than 2020. However, if the deal collapses the schedule will certainly change. In fact, there is no guarantee that the fields will be developed at all. One thing is certain: the current owners – Noble Energy, Delek, and Ratio - will have to seek new partners or borrow billions to secure the \$5 billion necessary for the development of Leviathan.

Third, the collapse of the deal will be a crippling blow to Israel's reputation as an investment destination for independent oil and gas producers. Those have been monitoring the situation in the Eastern Mediterranean from the sidelines for a while, and their impression so far has been: "stay away." The implications of Israel's undesirability for the independents is that Israel will be more prone to investment by National Oil Companies – Russian, Chinese, Indian – that are

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motivated not only by commercial considerations but also by their governments' geopolitical agenda. Such investments always come at a price.

Without Woodside a new chapter will open in Israel's gas saga, one that is more modest and grounded in reality and devoid of [hallucinatory and reckless talk](#) about Israel becoming an energy superpower. The Leviathan partnership will be at a much weaker bargaining position vis-à-vis Erdogan and General Sisi of Egypt and will have to be more open to embracing domestic use of natural gas in the transportation and petrochemical sectors as well as to less grandiose export destinations. Energy starved Jordan is one such market and while Jordan is a relatively small market, the geopolitical gains of connecting Israel and Jordan with an energy bridge and the relative ease of building a trans-Jordan pipeline would make this option more compelling than ever.

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