EAST MEDITERRANEAN OIL & GAS: WHY LEBANON SHOULD KEEP AN EYE ON REGULATORY HURDLES IN ISRAEL

Since 2010, policymakers in Israel have had to repeatedly intervene in the energy sector to deal with challenges — not just opportunities — presented by the discovery of large gas fields.

In December 2014, Israel's antitrust commissioner David Gilo revoked a previous agreement that allowed US based Noble Energy and Israeli company Delek to retain ownership of Israel's biggest offshore field, Leviathan, in return for giving up two small fields, Tanin and Karish. The decision threatens the development of Leviathan, expected by 2018, and risks delaying it for an undetermined period of time.

The decision comes after the results of a report, commissioned by the Public Utilities Authority, were made public on December 18, confirming previous worries, including an ongoing increase in the price of natural gas sold by the Tamar consortium (the Noble and Delek led partners in Tamar, another large field) and anticipating an increase in electricity prices, as a result of "monopolistic contractual demands," locking Israeli consumers into artificially high and perennially rising prices. The Israel Electric Corporation (IEC) is currently paying around $5.70 per million British Thermal Units (mmBtu), perceived as a reasonable price, but the concern is about future developments and trends. The starting price for IEC's long term supply agreements was $5/mmBtu but would eventually reach $7.70/mmBtu.

The decision, which triggered a clash with the Ministry of Energy, also comes amid a mood of economic populism in Israel, relayed at the highest levels of state institutions (including by certain members of the cabinet and the Knesset), and fueled further by the March 17 national election.

Noble has threatened to freeze "additional exploration or development investments" in Israel until the resolution of this and other regulatory matters. Regulatory uncertainty is perceived as a

deterrent for foreign investments in Israel, particularly in the oil and gas sector. Gilo's decision to renege on a previous agreement is not an isolated event. Since 2010, (i.e. after the discovery of Tamar and Leviathan), Israeli authorities have repeatedly intervened to regulate the sector. First, through the Sheshinski committee — a special commission whose recommendations, including a major tax increase, were approved by the Knesset in March 2011 — and second, through the Tzemach committee and the decision in 2013 to put a cap on gas exports, upsetting companies who argue that the Israeli market is too small and exports are needed to justify huge development costs. With such regulatory uncertainty finding a potential buyer for Leviathan might prove to be challenging, although the field retains enough appeal for investors.

Unless a compromise is found — which seems to be a possibility — the Noble–Delek partners will be required to renounce one of their two major fields, Leviathan or Tamar, prompting, by the same token, a lengthy legal battle with the state. A potential compromise could include retaining Tamar and Leviathan, in exchange for selling Tanin and Karish, in addition to a requirement to sell the gas separately, thus creating competition. Another compromise might involve establishing a public company to buy the gas and sell it domestically at 'reasonable' prices, or even imposing controversial price controls. The latest plan proposed by Gilo involves breaking up the monopoly into several entities, each of which would sell the gas separately. The plan bars Noble from selling Tamar gas in the domestic market. In Leviathan, each partner would sell its share of the gas separately. In addition, the plan calls for Delek to sell its stakes in Tamar and requires Noble and Delek to sell their stakes in Karish and Tanin. The plan was reportedly rejected by the concerned parties. The Antitrust Authority — which initially said the plan was final and failure to abide by it would lead it to declare that the current ownership structure constitutes a restraint of trade, prompting unilateral action — has delayed its decision until the end of April to allow enough time to reach an agreed solution.

The debate surrounding the way the sector is being managed is so intense and widely backed by the public that a possible change in the institutional framework and the establishment of a regulatory authority cannot be ruled out.

The uncertainty over Leviathan's ownership and possible development delays might jeopardize gas supply deals currently in discussion, including:

- A letter of intent with Britain's BG, operator of an LNG plant in Idku, Egypt, to supply 7 bcm of natural gas per year over a period of 15 years. The deal is estimated to be worth around $30 billion.

- A preliminary deal with Jordan's National Electric Company to supply 45 bcm of natural gas over a period of 15 years, for approximately $15 billion.

- A $1.2 billion deal with the Palestine Power Generation Company to supply 4.75 bcm of natural gas over a period of 20 years. The PPGC already declared in early March that the deal will be canceled within 30 days unless regulatory issues are solved.

The US is a firm supporter of these deals, which it perceives as helping secure regional stability by fostering mutual interests, and has been instrumental in facilitating the negotiations. The Israeli move is therefore perceived by the Americans as an obstacle to the policies they are pursuing in the region. Special Envoy for International Energy Affairs at the Department of State Amos Hochstein, who visited Israel following Gilo's announcement that he is revoking the deal with Noble and Delek, had two main messages to convey: first, the dispute will have consequences on the investment environment in Israel, and second, gas agreements with potential regional clients are an opportunity that must not be discarded.

Stability and the ability to anticipate the regulatory framework are particularly vital for the energy sector, one that requires major investments at the initial phase with the expectation of a return on investments. Regulatory uncertainty is already affecting the attractiveness of the sector and more difficulties are to be expected if the process drags on. Italy's Edison, which prequalified for Lebanon's first licensing round, is now reconsidering its decision to acquire the two small Israeli gas fields close to the Lebanese border, Tanin and Karish. But energy is also a strategic sector. If unchallenged, a monopoly would emerge supplying energy to broad sectors, and any change in future prices would affect the entire economy.

The desire to prevent that is understandable. But adapted measures should have been taken long ago if Israel wanted smooth sailing through the extractive process. The problem is the failure to anticipate any of the developments and always being a step behind: failure to anticipate the possibility of large discoveries and develop an adequate fiscal framework; the lengthy period to make a (first) decision on Noble and Delek forming a possible monopoly; making a decision that failed to address monopoly concerns (forcing them to sell Tanin and Karish, which together hold up to 3 tcf of natural gas, compared to Tamar and Leviathan's approximately 32 tcf); and finally deciding, a year later, to retract that decision.

Recent developments in Israel are a case in point, demonstrating how important it is to set a policy as early on in the process as possible to avoid regulatory uncertainty. This is worth pondering in a country like Lebanon where de facto monopolies are tolerated.