Revealed: Egypt negotiates purchasing Israeli gas through Cyprus

MEMO
MIDDLE EAST MONITOR

MIDDLE EAST MONITOR

The Middle East Monitor is a not-for-profit policy research institute that provides research, information and analyses of primarily the Palestine-Israel conflict. It also provides briefings on other Middle East issues. Its outputs are made available for use by journalists, academics and politicians with an interest in the Middle East and North Africa region.

MEMO aims to influence policy and the public agenda from the perspective of social justice, human rights and international law. This is essential to obtain equality, security and social justice across the region, especially in Palestine.

Title: Revealed: *Egypt negotiates purchasing Israeli gas through Cyprus*
First Published: November 2013

This report is available to download free of charge on the Middle East Monitor Website: www.middleeastmonitor.com

SPECIAL REPORT

Revealed: Egypt negotiates purchasing Israeli gas through Cyprus

Revealed: Egypt negotiates purchasing Israeli gas through Cyprus

"Cyprus must do everything possible to secure use of Israeli gas at a planned LNG terminal on the island, or else risk jeopardising the whole project," Charles Ellinas, national gas company head in Cyprus told Cyprus Gas News on Saturday. Ellinas argued that the estimated 5 trillion cubic feet in Cyprus' exclusive economic zone (EEZ) was simply not enough to justify the construction of a costly liquefaction plant at Vassilikos.

This project is a plan by the eastern Mediterranean country to tap into the Asian market, known to be more lucrative than Europe's, by collaborating with Israel on their already existing reserves. In return, Israel will have easier access to the European market and will not have to invest in LNG facilities, which Cyprus is in the process of constructing.

If Israel and Cyprus want to become exporters of gas, they will have to work together. A special proposed arrangement between the two countries, first reported last year, was confirmed by Cypriot energy minister Giorgos Lakkotrypis in October. Under the proposal, he said that Israeli gas – from the Leviathan prospect – would be diverted to Cyprus for exports. The minister said Nicosia and Tel Aviv are engaged in a dialogue on two fronts: using a mooted Cyprus-based LNG plant pooling the two countries' gas resources for exports and importing gas from Israeli offshore fields to generate electricity for Cyprus' needs. Converting natural gas to liquefied form makes it possible to export by ship, rather than requiring the construction of new pipelines, which ultimately means it will go further and reach more potential customers.

Cyprus hopes to begin work on the LNG terminal in 2016. It announced earlier in November an agreement with Total, the French oil giant, to develop an LNG plant. It will not start exporting its own natural gas before 2020 in contrast to Israel which has already started and ready to export gas.

It was clear that there would be diplomatic and political consequences when a discovery of a huge reserve of natural gas offshore of Israel and Cyprus was made last year. The Leviathan gas field is the world's most strategically located and politically sensitive. The fields – deep below the seabed in waters 2000 metres deep and more than 100 kilometres from the coast of either country – give both Israel and Cyprus the potential to become energy exporters.

Not only does this shift have the power to transform the economies of each country, it could have serious implications for alliances and power balances in the region.

The alliance has threatened Israel's relationship with Turkey, which is already tense since the 2010 Gaza flotilla incident. The Turkish government has said that the Israeli-Cypriot agreement may hinder development of a proposed natural gas pipeline between Israel and Turkey. There is also ongoing tension with Lebanon, which claims that the maritime borders agreed by Israel and Cyprus infringe on its territory.

Given the complexity of maritime law and existing regional tensions, these disagreements should come as no surprise. But could the exporting agreement between Israel and Cyprus also open the door to unexpected deals and new alliances?

Noble Energy had confirmed that it planned to target nearby markets like Egypt and Jordan rather than shipping the gas further afield

Numerous reports have suggested that Egypt may purchase gas from Israel. In October, Israel's minister for energy and water, Silvan Shalom, told IDF radio: "Egypt, which is currently experiencing a shortage of gas, is showing interest in buying gas from Israel. If it turns out that they do want gas and that these things are real, I see no reason not to sell it."

The Israeli newspaper Haaretz reported this week that Noble Energy, the US company leading the development of the giant Leviathan offshore gas field, had confirmed that it planned to target nearby markets like Egypt and Jordan rather than shipping the gas further afield.

If these rumours prove to be true, it would be an almost exact role reversal. Until early 2012, Israel imported much of its natural gas from Egypt. Around 45% of Israel's gas consumption came from Egypt. The deal, made under President Hosni Mubarak, went through a pipeline between El Arish and Ashkelon. It was unpopular with many Egyptians, due to the population's broadly anti-Israel views, and the deal was terminated after Mubarak was overthrown in 2011. The new Egyptian government cited a "business dispute."

Since the 2011 revolution, the pipeline has been attacked more than a dozen times, demonstrating the extent of anti-Israel feeling in Egypt, as well as increasing lawlessness in the Sinai Peninsula, where many of the attacks took place. In April 2012, Egypt terminated the agreement by which gas was exported to Israel. (Although the then head of EGAS insisted that the "decision we took was economic and not politically motivated".)

Many things have changed since that deal was first signed; not only has Israel made this discovery of huge natural gas reserves, but Egypt's gas output has massively declined. The country is now facing gas shortfalls and many of its plants are being under-utilised. Wracked by political instability – the Muslim Brotherhood government that replaced Mubarak was recently ousted in a military coup – Egypt's economy is floundering. The worsening energy shortage could have serious political consequences for the country's new leaders.

Israel's new supply of gas is nearby, and would therefore be among the cheaper import options for Egypt. The pipeline already exists; all it would take would be to reverse the direction.

Yet despite Shalom's statement and Noble's plan to target Egypt, the country's leaders have denied that they will import gas from Israel. "For importing the LNG, we are working with companies, not with countries," said Taher Abdel Rahim, chairman of state-run Egyptian Natural Gas Holding Company (EGAS), in October. "Companies like BP, Shell, BG – those are the companies working on importing LNG." Specifically responding to Shalom's claim that Egypt was showing interest in Israel's gas, Rahim said: "There is no negotiation, no communication, nothing at all between us and them."

Importing LNG would cost significantly more (around $12 per million British thermal units) than pipeline deliveries from Israel, and would also require an outlay of cash to erect terminals to receive the gas. All of these are costs which Egypt, mulling an IMF bail-out, can ill afford. The reluctance to be seen to publically countenance such a deal is clearly political. A recent poll by the Brookings Institute found Egypt's public are nearly exactly split between those who would like to see Egypt maintain its peace treaty with Israel (46%) and those who would like to see it cancelled (44%).

Since the overthrow of the Mubarak regime, Egypt's domestic demand for natural gas has risen dramatically. Egypt has contractual commitments for export volumes that are difficult to meet

Moreover, the shift in power balance – from exporter to importer, and importing from a country with whom relations are characterised by mutual suspicion, at best – may be too much of a risk for the government to take, given the already unstable political context of Egypt. General Abdel Fatah al-Sisi, the head of the military who engineered the military coup which took place on 3 July, wants to be seen in the nationalist tradition of the former president Gamal Abdel Nasser. Striking up a deal to import gas from Israel – although financially expedient – would undermine this image.

A recent report by the Washington Institute looked at the possible export options for Israel and Cyprus. It noted that:

"Since the overthrow of the Mubarak regime, Egypt's domestic demand for natural gas has risen dramatically. Egypt has contractual commitments for export volumes that are difficult to meet. In August 2013, Qatar made LNG cargoes available to be delivered to Egypt's export customers. A demand for imported gas remains, though Egypt has no regasification vessel available at present. Israel therefore remains a potential supplier of gas, although such a scheme would face likely Egyptian domestic political objections. This problem might be overcome if Israel establishes itself as a gas supplier to Jordan, the Palestinian Authority in the West Bank, and to the Gaza Strip."

The report suggests that the problem might be overcome if Israel strikes up export arrangements with Jordan, the Palestinian Authority in the West Bank, and the Gaza Strip. The reasoning is that if these allies of Egypt also import gas from Israel, the decision to do so might become less politically toxic.

Despite the current Egyptian regime's insistence that they would not import Israeli gas, there are clear signs of greater cooperation. The Muslim Brotherhood government which replaced Mubarak, headed by Mohammed Morsi and ousted in July, was resistant to working with Israel at all. There was even doubt he would allow Israel to ship its Gas through the Suez Canal to sell in the Far East. The Washington Institute report states:

"Until the overthrow of the Mohamed Morsi government in Egypt in summer 2013, it seemed unlikely that a Muslim Brotherhood-dominated government in Cairo would countenance Israeli LNG cargoes transiting the Suez Canal. (Although treaty obligations guarantee free passage, politically motivated inspections of Israeli cargoes on spurious safety grounds could render the route unviable.) The military- supported regime that replaced the Morsi administration may be more open to Israeli LNG traffic through the waterway. "

One of the many export options currently being explored by Israel is the use of spare Egyptian LNG capacity. This was originally raised during Morsi's tenure, and seemed impossible due to opposition from him and his party. Under this proposal, Israel would make use of LNG plants on Egypt's Mediterranean Coast. The Washington Institute's report notes that:

"When initially mooted, the opposition of the Muslim Brotherhood-led government appeared to be a total block on such a project. Since the mid-2013 replacement of this regime by the Egyptian military, this option may be given further consideration. In August 2013, the leading Israeli gas company, Delek, informed the Tel Aviv Stock Exchange that it was in talks to pipe gas to Egypt and had proposed reversing the Ashkelon-el-Arish line, which, until 2012, brought Egyptian gas to Israel, in order to reach the LNG facilities."

All of this shows that there are clear reasons to question the EGAS head, Rahim's assertion that there has been absolutely no discussion or negotiation between Israel and Egypt on the matter of gas exports. Of course, domestic political opposition is not the only reason that Egypt may be reticent about using the existing pipeline. Egypt's lack of control over the Sinai Peninsula – which is home to militant violence and increasing lawlessness – has allowed many attacks on the pipeline to take place.

The gas supply to Jordan stopped in March 2012 after 13 separate attacks on the feeder pipeline to El-Arish, since the beginning of the 2011 Egyptian revolution. Some of these attacks were carried out by Islamists, some by Bedouin complaining of economic neglect and discrimination by the Cairo government. Persistent natural gas shortages in Egypt led to the supply to Israel being halted; supply to Jordan resumed but at a rate substantially below the contracted amount. The pipeline is therefore currently in use – but it remains under threat, bringing into question how usefully it can be used.

Another option, however, would be for Egypt to import Israeli gas via Cyprus. Egypt and Cyprus have friendly relations; back in 2012, the two nations announced a new working partnership over natural gas, aimed at sharing expertise and experience.

At the same time as suggestions of a deal with Israel over gas imports were batted away, Egyptian officials confirmed that they would negotiate with Cyprus over the purchase of natural gas. The Egyptian Minister of Petroleum, Sharif Ismail, revealed a few days ago (22 November 2013) that Egypt is in serious negotiations with Cyprus over the purchase of natural gas. He hinted this would be a better option than continuing to deal with Qatar which is "inflating the price of supply to Egypt." More revealing was when he said the gas import from Cyprus will be in exchange for Cyprus using the Egyptian LNG facilities at Edco.

But Cyprus will not be ready to export its own natural gas until 2020 as a recent New York Times report explains that its own offshore natural gas reserves have yet to be developed or even fully explored. In fact, Cyprus is currently negotiating importing gas from Israeli offshore fields to generate electricity for Cyprus' needs. So any agreement for gas going from Cyprus to Egypt (or anyone else) would, in fact, come from Israel, at least in the short-term. Crucially, such agreement between Egypt and Cyprus will allow

The gas supply to Jordan stopped in March 2012 after 13 separate attacks on the feeder pipeline to El-Arish, since the beginning of the 2011 Egyptian revolution the liquefaction of Israeli gas in the Egyptian LNG facilities opening more immediate markets for Israel, particularly in Far East Asia where the demand is high with much more favourable prices in the region, or in Europe.

By this Israel will not need to wait to build its own LNG off shore facility or to wait until the facility in Cyprus starts in 2016. Timing is important to get the best prices for the Israeli gas as at present the Far Eastern markets are the most attractive in terms of price. But Australia, Mozambique, America, Canada and Russia are all planning to export gas to the Far East from 2018-2020. If there is a delay, Israel and Cyprus may lose these markets or have to sell the gas at cheaper prices, reducing profit. They will be left with the European market, whose prices are much lower. A deal with Egypt to use its LNG facility is the fastest track to sell the Israeli gas at the best deal, something that would be unthinkable if Morsi was still in power.

However, for Egypt to get Israeli gas through Egypt is substantially more expensive than gas transferred by pipelines. But it may be more politically palatable for Egypt's new regime if it is to retain a good reputation among its people. It would also avoid the problems with using the pipeline amid increasing lawlessness in Sinai.

Israel's new oil reserves will allow it to become energy independent for the first time ever. The country is also confident that its offshore gas-fields will generate windfall profits of as much as $60 billion over the next 20 years although as demonstrated by a lengthy legal battle over what proportion of gas to export, there is significant internal disagreement about the best way of managing this.

Now that it has been agreed that 40% of the gas will be exported, the profitability will depend not just on Egypt but on partnerships with other neighbours too. Israel's gas is likely to be sold to the Palestinian Territories, Jordan, and Turkey, among others. Speaking to an investor convention in Miami this weekend, Charles Davidson, CEO of Noble Energy said that although LNG would be included in the Leviathan business, the major export markets would be nearby – namely, Egypt and Jordan – and that these nations would get the gas through the pipelines. This would allow the Leviathan partners – which include Noble and Israeli company Delek – to begin exports sooner, and to do it more cheaply.

Clearly, importing Israeli gas to Egypt via Cyprus would not be the most convenient in terms of money and time, but it would attract less criticism from Egyptians unhappy with the domestic situation, who would not appreciate further collaboration with the Israeli State next door.

More direct exports from Israel's Leviathan stock to Egypt also remains a possibility. The EGAS head Rahim may have batted off the claim that there were any dealings between the two countries, but his assertion that Egypt will deal "with companies, not countries" does leave space to strike up a deal with Noble, which is, after all, an American company. The irony is that the Egyptian minister talked about negotiation with Cyprus the country and not with companies. These contradictory statements by the two Egyptian officials appear to seek to hide the true negotiations happening taking place with Israel.

Either way, contrary to their public protestations, it is clear is that post-coup Egypt is certainly interested in Israel's supply of gas.

...it has been agreed that 40% of the [Israeli] gas will be exported, the profitability will depend not just on Egypt but on partnerships with other neighbours too

MEMO
MIDDLE EAST MONITOR
Creating New Perspectives

middleeastmonitor.com