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Energy International Risk Assessment

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OPEN FORUM

Letter From The Editor

This month we are celebrating the first year of our internationally distributed, independent monthly newsletter *Energy International Risk Assessment*. For this we thank the energy experts who share with us their most valuable knowledge and experience.

Watching our predictions materialise does not put us at ease. We are determined to continue working even harder to further develop our product and provide you with the highest quality of information and analyses.

Operating as a risk assessment - early warning tool in a continuously shifting energy landscape, we invite our readers to scrutinize our assessments and predictions. We welcome your criticism, analysis or opinion pieces on energy developments related to the MENA, Balkan, East Mediterranean, Caspian Sea, Black Sea and African regions.

We are also available to send through past EIRA issues upon your request.

George Hatziioannou
Editor

East Africa Oil And Gas: Exaggerated Game-Changer

The undeniable miracle of the enormous hydrocarbon reserve finds in East Africa, a true blessing for this poverty-ridden and social problems-overloaded region, has raised both expectation and apprehensions. The oil and natural gas discoveries off the coast of Kenya, Tanzania and Mozambique, as well as onshore oil deposits disclosed in Uganda have elevated East Africa on par with the more advanced hydrocarbon provinces in Western and Northern parts of the continent. In theory.

Moreover, the overtly optimistic local forecasters (who would blame them for sweet anticipation of mineral riches' cornucopia?) claim East Africa will overshadow the energy boom in Nigeria. They trump up the region as the most promising mineral Eldorado which emerged in the twenty-first century. This claim is often backed by similar prediction by outside observers who strongly believe too that the region is doomed to become the next oil and gas export hub by 2020.

Despite manifold entropic factors which have so far prevented a stable and sustainable development of the region (average annual incomes are less than US$600 while life expectancy barely reaches 60 years), the lure of energy bonanza already placed East Africa on the radar of energy majors like British-Dutch Shell, Swedish Statoil, French Total, American ExxonMobil, and Chinese CNOOC.

If we look at Kenya, for instance, the recent new onshore discoveries in the middle of January boosted the credibility of its 'founding father', the Tullow Oil company from the UK which already has a firm footprint in Africa. The added reserves on the 10BB Block, according to preliminary estimates, are believed to bring the total to 600 million barrels (mmbo). Actually, Tullow Oil had originally placed bets on unplugging at least one billion barrels accumulated in this underground treasury.

The Kenyan strategists should be credited with a visionary approach to long-term development. This conclusion is supported by the slow yet steady implementation of the Lamu Port Southern Sudan-Ethiopia Transport (LAPSSET) Corridor project (aka The Lamu corridor) with a price tag of some $29.24 billion.

This second transport corridor project envisages the construction, among other strategic infrastructure facilities, of an oil pipeline (at a cost of $4 billion). It will run from the sea port of Lamu to South Sudan and Addis Ababa, the Ethiopian capital. Additionally, an oil refinery in Lamu, costing another $2.5 billion, will be put on stream to process 120,000 barrels of oil a day.

When completed, the Lamu corridor project in its totality, meaning with all the transportation and production facilities properly functioning plus railway lines, three airports, seashore and lane shore resort cities, is expected to make a weighty contribution pushing up by 3% Kenya's GDP by 2020.

In order to propel ambitious economic endeavors Kenya needs to match it with adequate political reforms already underway. In 2010, a new sophisticated constitution was phrased and approved by a majority vote. One of the key tools to invigorate the nation born in the anti-colonial struggle for independence from Britain was devolution. Local authorities (county level) were empowered to supervise and manage a wide array of activities in the spirit of self-government.

At the same time, within the framework of the "checks and balances" concept, the supreme power was transferred from parliament to president. However, the parliament was granted the supreme right to balance and approve the national budget while taking responsibility for all the possible miscalculations. All in all, the reform-minded political class in Kenya has embarked on a rewarding yet bumpy road of change. The country goes through a transition which, provided there are no setbacks, would accelerate growth in all dimensions of life.

In Tanzania, the volume of discovered gas reserves was upped fivefold. By official count, the nation can capitalize on its wealth of some 43.1 trillion cubic feet (tcf) of recoverable natural gas.

By June 2014, in the time span of one year, 17 new wells at a cost of $700 million will be drilled. The expectations are understandably high. Some experts in the field pin hopes of making new discoveries which might increase the overall gas reserves of Tanzania to a staggering 200 tcf.

In any case, the International Oil companies (IOC) display keen interest in pushing forward exploration in this country in anticipation of new gigantic finds. Noteworthy, China, rightfully considered as the main driver of global gas consumption in the coming decades if not the whole century, is a powerful player in this market as well. Beijing supports the creation of a mega-port at Bagamoyo with a view of a possible LNG terminal to take gas out of Tanzania.

This year, Tanzania would probably put together, approve and enact a new legislation governing the management of hydrocarbons-related industries.

Uganda is yet another powerful new attraction for international investors. Its oil reserves are estimated at roughly 3.5 billion barrels. These barrels appeal to the appetite of energy majors fully committed to untap the African mineral resources, such as Total of France, Tullow Oil of UK, and CNOOC of China.

The inflows of foreign capital are impressive, by local standards. The cash-stripped government of this land-locked country (one of the consolations is that it borders Lake Victoria) was careful not to scare off these investments. Kampala is motivated by the promise of about $2 billion per year in revenues. As a matter of comparison: $2 billion equal almost half of the national budget of Uganda.

It is worth reminding that British Prime Minister, Winston Churchill, held Uganda in high repute and considered it to be the "power of Africa" for the simple reason that anywhere you go, you will find water flowing and things growing, leaving the populace not too much to worry about. Today, Uganda could be placed within the context of an emerging world-class hydrocarbon province with a fair chance of generating huge revenues and profits for all stakeholders.

To sum it up, Kenya, Tanzania and Uganda (we shall leave Mozambique out of the equation for the moment) have all the makings of becoming the next success story to be written down in textbooks as showcase of 'rag to riches' ascension of the formerly destitute, impoverished, unfairly treated, no-go peripheral rogue-states.

This is a most likely scenario but not the only one. Each of the three nations faces tremendous challenges along this "shining path' to wealth and glory.

In Kenya, uncertainty thickens over the need of a resolute yet flexible implementation of the new energy bill and community lands bill. The outcome of the energy boom will also depend on the ability of the central government to balance its interests with the interests of the county authorities in terms of oil revenues' sharing. If this is not a sensitive issue, what is?

Tanzania, at least at first glance, seems to be an oasis of stability. As East Africa's second biggest economy, it can offer a certified degree of predictability. Still, it is exactly this solid proof characteristic which may be the source of trouble. Since Beijing has focused on the mega-port at Bagamoyo as a strategic asset of its access to African hydrocarbons, it automatically drags Tanzania into the silent war for resources which is gearing up between the United States and China.

As for Uganda, the darling of WC (Winston Churchill), the internal rifts and drifts has never allowed a smooth transition of power for the entire half a century that this country enjoys independence. No peaceful and orderly handing over of power from one president to another ever happened. A poor record with inertia.

The political and business class of Uganda is only accommodating the recently introduced new rules of the game emanating from devolution and community land bill. Now, if local elites feel unjustifiably by-passed or even tricked by central government and central elites, tension would brew and conflict would break up. As a matter of comparison: the recently patched-up quarrel between the Kurdish Regional

Government and the central government in Baghdad, which took many years to effectuate, can be regarded as a welcoming sign, but no one can guarantee that this hammered out compromise would last forever.

Then again, the space allocated in Uganda for oil exploration in the Turkana region amounts to 65,000 square kilometers. The scale of investments must match the acreage. What if the finds turn out to be discouraging, meaning there would be no commercial rationale for proceeding to the production stage?

In East Africa, Time (with a capital T), timing and money remain key elements of uncertainty as well as the still shaky foundations of local brands of democracy. The level of political, security and commercial risks seems to be within acceptable limits, yet the fluid situation of the emerging proto-markets breeds caution. For the moment, the regional oil and gas bonanza does not look like a game-changer for the global industry. It still demands more scrutiny and less euphoria.

Obama Seeks Cohesion With The House Of Saud

The blitz-visit by US President Barak Obama to Saudi Arabia in late March looked like a perfect crisis-management exercise aimed at easing the strained dialogue between the formidable and formally secular democracy and the world's ultra-conservative theocratic monarchy. The visit was long-overdue given the dismal state of bi-lateral relations poisoned by ever more diverging views on the reshaping of the Middle East and re-shifting of the regional balance of powers.

In fact, the entrenched enmity dates back to post 9/11 accusations of Riyadh of being the birthplace of some of the terrorist hijackers who collapsed the Twin Towers, and being allegedly the patron of some of these extremists. In a fit of indignity, the desert kingdom withdrew some $200 billion of portfolio investments from the New York stock exchange, replicating the favorite American foreign policy model: hit 'em where it hits hardest, their wallet.

The aftertaste of that verbal shootout still persists. What is more troubling for both parties, is the current long list of controversies which embraces the agonizing frustration of the House of Saud at the gradual rapprochement between Washington's democratic visionaries and Iranian card-bearing ayatollahs who skillfully substituted hard-line rhetoric with soft-spoken overtures to the West.

The positive engagement tactics tacitly employed by the U.S. is worrying Riyadh beyond measure. Saudi Arabia acts as one of the main pillars and powerhouses of the Sunni alliance, while locked in a protracted struggle for mastery with Iran, the bulwark of the Shia or Shia-leaning states (Iraq, Lebanon, and Syria).

The underlying logic of the Saudis' apprehensions is crystal clear: If Washington and Tehran come to re-establish the kind of *entente* which existed at the times of the late shah Mohammad Rezā Shāh Pahlavī, an unalloyed pro-Washington creation, the balance of power would tilt in favor of the Shiites, leading to tectonic shifts in the distribution of influence and, consequently, wealth in the region.

Another discord was triggered off by the sudden US retreat in August 2013 from the almost inevitable military incursion into Syria. The Saudis counted on a full-scale US intervention for the sake of regime change. The US involvement looked all set and imminent, taking into account the precedents in Afghanistan, Iraq, and Libya. Surprisingly, America backed off.

As Obama explained to King Abdullah during his visit, the real *casus belli* were the chemical weapons at the disposal of Bashar Assad — the (in)famous "red line" drawn by Washington, but since this arsenal was placed under international supervision and marked for obliteration, there was no point in going to war.

The sudden reluctance of America to go to war in the Middle East could also be interpreted as a sign of "imperial overstretch". The one and only superpower is perilously encumbered by the deadweight of its imperial military commitments. This retreat from the role of policing the Middle

East region worries Saudi Arabia in the context of the original unsigned *concordat* with the United States based on a sort of barter deal: uninterrupted flow of oil in return for security guarantees.

A lot of oil has flown across the Atlantic since then. Presently, the conflict of interests is deeply-rooted and hard to resolve. The petrol-rich kingdom is watching closely the enthusiastic US drive towards energy self-sufficiency, propped up by a booming shale oil production accompanied by a shale gas revolution. If America achieves energy independence from the Middle East purveyors, the Saudis might see prices fall sending them into a whirlwind of economic and social uncertainties.

Even more explosive is the difference of the "war on terror" proclaimed by the former US President and inherited by the incumbent. Without saying it out loud, the U.S. is accusing Saudi Arabia of sponsoring terrorists. According to a classified document, dated December 2009 and signed by US Secretary of State Hillary Clinton, Saudi Arabia is one of the primary financial donors for the jihadists of the Salafist branch in Islam, and other militant extremist organizations, such as al-Qaeda, Taliban in Afghanistan, and Lashkar-e-Taiba in South Asia.

All these disturbing factors come on top of muted criticism for a poor human rights record of Saudi Arabia. Here women are forbidden to drive, critical remarks on Twitter might cause a sudden visit by national security agents and, according to some estimates, the actual number of political prisoners is close to 30 thousand.

Actually, on the eve of Obama's visit a letter reached the President with the following statement: "Saudi Arabian authorities have harassed, intimidated, and imprisoned almost all the country's leading independent human rights activists". The letter was signed by a peculiar alliance of congressmen and congresswomen belonging to two different camps, orthodox Christian Republicans and dyed-in-the-wool liberal Democrats. Both want the monarchy to decriminalize liberal dissent.

Yet, the issue of human rights did not quite fit into Obama's agenda which focused on whatever unites and not disunites the two countries which are worlds apart. The question of what specifically unites the U.S. and Saudi Arabia was left unanswered since there was no final communiqué or statement. It leaves plenty of room for justifiable hunches: what could constitute the hidden agenda of the visit?

It makes sense to link the behind-the-scenes conversations held between Obama and King Abdullah with the current surge of Cold war pitting the West against Russia in the context of the Ukrainian crisis. The history textbooks tell us the story of the masterly employment of oil by the United States as an omnipotent geopolitical weapon against USSR back in the 1980s.

The U.S. brilliantly conspired with Saudi Arabia, the linchpin of OPEC, to dramatically increase crude oil production and dump it on the world markets. The result was a dramatic price drop. Between 1981 and 1988, inflation-adjusted oil prices fell 69% which turned into a devastating curse and scourge for the Soviet Union heavily dependent on oil revenues to balance its budget. Cheap oil squeezed the finances out of USSR, and eventually brought about its final downfall.

There is a fair likelihood that on his visit to Riyadh Obama had exactly this successful strategy in mind, hoping to lure the Saudis into another crusade against Russia to punish it for supporting the regime of Bashar Assad in Syria. It looks convincing on paper, but the historical circumstances have changed. At the moment, Saudi Arabia has largely lost its "strategic depth" as the number one oil supplier to the world. In simple terms, the Saudis can no longer afford cheap oil. In order to break even and balance the budget, they cannot go lower than $85 per barrel.

Yet there is a probability that Riyadh has succumbed to the call of Washington and for a limited span of time will play hardball in global politics. It might soon start to manipulate the price of oil, but without going to the extremes. In the months to come, we might witness a strange volatility in the oil markets.

Nevertheless, it is hardly possible to duplicate the oil price shock of the 1980s. The global crisis has not yet expired, and oil revenues remain for many OPEC countries the main if not the sole source of revenues and well-being. Saudi Arabia may go it alone, but the impact would be a pale shade of the previous punitive onslaught.

Saudis vs Qataris: Premier League Cold War

The grand vision of the US messianic strategists, who called for a reformatted Big Middle East, seems to have materialized, at least partially. In the wake of the Arab Spring convulsions, which reverberated throughout a wider area, the number of regional conflicts multiplied, the degree of mutual animosity involving formal long-term allies has upped, and time-honored rivalries resurfaced compromising local alliances of convenience and enhancing uncertainties on the energy market.

The complexity of controversies was explicitly manifested by the Arab League annual summit which took place on March 25-26 in Kuwait whose emir, Sabah al-Ahmed al-Sabah once again, given a rather remarkable track record of mediation, attempted to act as the regional pacifier and peace-maker. It was a nice try only.

Sheikh Sabah did his best to highlight the challenges to regional solidarity, although not mentioning anyone by name. Sheikh Sabah simply called on the 22 member states to resolve disputes polarizing the region. "The dangers around us are enormous and we will not move towards joint Arab action without our unity and without casting aside our difference," Sheikh Sabah desperately appealed.

Yet, the course of official discourse and behind-the-scenes exchange of views, the details of which were eventually leaked out to the media, showed that "casting aside our difference" was a mammoth task that hardly anyone present was apt to. Similar to a daring endeavor of cruising up a mountainous creek without a paddle.

Jaw-jaw and no war-war over Syria

The major apple of discord within the Middle East has been the historical schism between the two main branches of Islam projected into the on-going proxy wars, both cold and hot, between the Sunnis and the Shiites. It is worth to remind that the Sunni Muslims have their power base in the Gulf monarchies, and the Shia Muslims are represented on state level by Iran, Iraq, and to a certain extent by Lebanon, influenced by the Shiite-born Hezbollah movement, and Syria where the Shiite-linked Alawite minority is the foundation of the regime.

At the Kuwait-hosted summit, the Syrian militant opposition lobbied for a significant increase of armament's hardware deliveries for the paramilitary formations to invigorate the fight to topple Bashar Assad. Despite a strong backing by Qatar, the main sponsor of the anti-Assad guerillas with a fundamentalist leaning, this appeal, surprisingly, fell flat, being reduced to nothingness.

The reasons for such a dramatic change in approach to the "mother of all battles" against the Shiites in Syria can be traced in at least three recent developments.

First, the hopes of luring the United States into yet another overseas military intervention in the region were buried after Barak Obama accepted the proposal to destroy Syrian chemical weapons under international supervision. Moreover, these hopes were in total tatters when in autumn last year the US President made game-changing overtures to Iran hinting at a possibility to patch up the old quarrel and establish a workable *modus vivendi* with the Shia ayatollahs.

Second, in Syria the al-Qaeda-linked jihadists, largely sponsored by Qatar, took the upper hand and resorted to annihilation of their ideological foes within the patchy alliance of anti-Assad and anti-Alawite forces. This shift in the balance of power within the opposition indicated the likelihood of the Islamic fundamentalists and not the Islamic moderates replacing the Assad regime, which would invariably turn Syria into a

formidable enemy of the West and moderate Arab states.

Third, the Arab League counts several allies of Syria, that is Iraq, Algeria and Lebanon opposed to the prolongation of war and favouring a diplomatic settlement.

The summit heard the opinion of the U.N. and Arab peace envoy for Syria, Lakhdar Brahimi, who called for an end to the flow of arms to combatants in the war which has killed over 150,000 people and displaced millions. "The whole region is in danger" of being dragged into the conflict, Brahimi said in a speech delivered on behalf of U.N. Secretary-General Ban Ki-moon. The U.N. is pushing forward the idea of a settlement through negotiations, placing bets on the fresh restart of the peace process after Geneva-2 talks in February dismally failed.

All factors must have contributed to the final communiqué which amounts to a major shift in the approach to the civil war in Syria, now in its fourth year. The summit of the Arab League called for a "political solution" in Syria based on the declaration at Geneva-1 talks. This is basically an admission that the conflict has no military solution which precludes supplies of military hardware to opposition. Winston Churchill's formula "Better jaw-jaw than war-war" seems to have been embraced by the League, although this is not yet carved in stone.

The multi-million-dollar question is whether Qatar and Saudi Arabia will interpret the wording of the communiqué as an imperative or as a non-binding appeal. It is even more intriguing since the two power houses of the Gulf support conflicting parties within the anti-Assad alliance of guerillas. So will there be a subtle retreat?

Egyptian night befalls Cairo-Doha relations

The second and ever more belligerent difference between Riyadh and Doha is focused on the plight of the ousted Muslim Brotherhood in Egypt and its leader Mohamed Morsi who was the darling of Qatar. Egypt's interim president, Adly Mansour called for the extradition of wanted individuals, apparently referring to the activists of Brotherhood. Mansour vehemently demanded "rejection of providing them with shelter and support in any form" which was clearly an overt warning message to the Qataris.

The demand must have fallen on deaf ears. Qatar's emir, Sheikh Tamim bin Hamad al-Thani called on the new authorities in Egypt to initiate a "comprehensive political and social dialogue", an evident suggestion to re-engage Muslim Brotherhood. But this would hardly soften the military-backed Egyptian government which passed a decree banning the "Brothers" altogether without any chance of appeal, at least in the near future.

Noteworthy, at the end of the day, it was Egypt's foreign minister Nabil Fahmy who was proved correct in his early predictions that reconciliation was hardly feasible. "I do not expect we will leave from the Kuwait summit with all parties convinced that all things are resolved…The wound is deep."

Since Egypt is the most populous Arab country, despite its current fragile state and the diminishment of its role in regional Middle East affairs, the land of pharaohs will someday bounce back. And then someone will have to pay for the Egyptian night that had befallen the Cairo-Doha relations due to meddling from the outside.

Oh, Brother!

Could Muslim Brotherhood be considered a terrorist organization? This assumption would need to be supported by hardcore facts. Could the jihadists fighting against Assad in Syria be termed terrorists? Probably, yes if their links with al-Qaeda are established without a shadow of doubt. Deliberating these issues is no pure theorizing since it has direct impact on the already complicated relationship within the Arab League nations.

To expose the radicalism of either Muslim Brotherhood or Syrian jihadists is a delicate and even dangerous exercise since it immediately

fuels enmity and animosity. Yet, it did not deter the Crown Prince of Saudi Arabia, the Emir of Kuwait and the current interim President of Egypt who on the first day of the summit called on other members of the League to unequivocally condemn terrorism which, in their words, posed "an imminent danger" to regional security.

The divisions in the assessment of the evolution of Egypt reflect a wider concern of a number of nations over the political role of Islamists in the region. This dispute pits Qatar which favours and supports political Islam against Saudi Arabia, United Arab Emirates and Bahrain which consider Muslim Brotherhood as a potent hostile political force. In early March, in an unprecedented show of displeasure these three countries recalled their ambassadors from Qatar which was a proof of how sensitive the divergences have become since 2011, the start of the Arab Spring.

The three-strong alliance accuses Qatar of offering patronage to Islamists who preach and practice a republican agenda, and this amounts to a direct threat to the very existence of the monarchies. Doha rejects charges that it breeds contenders and remains unrepentant, swearing to proceed with the same foreign policy as before. If so, the seeds of discord and rivalry in the Gulf area will keep on growing. The Arab Spring has acquired a new dimension and a new meaning: the Premier League cold war pitting Saudis versus Qataris is in full bloom.

Was US faith in Qatar misplaced?

The United States with hardly any reservations endorsed the forceful "reformatting" of power in the Arab countries, which happened almost in full conformity with the Republican neocon guru Frederick Kagan's doctrine of "regime change". The major driver of the Arab Spring was the Sunni fundamentalist petro monarchy in Qatar. This does not seem to be a sheer coincidence. To be put on record: Qatar is home to one of the largest American military bases abroad.

Now that the tide of popular disenchantment swept away the Muslim Brotherhood rule in Egypt, and a wide assortment of social groups have opted for a more familiar mode of governance, an autocratic regime somewhat similar to Hosni Mubarak's model of rule, the Qataris are being blamed for all the mishaps.

The "guilt" of Qatar, at first glance, must be blatant disregard of the heterogeneous composition of the Arab nations which require, if not demand, a strong charismatic (if any) leader at the top with a nanny-state attitude to his humble subjects. There has also been disregard of the paternalistic mentality of the population. People in the Muslim World rally around a strongman (or strongwoman if we think of Benazir Bhutto in Pakistan) and/or a traditionalist idea, not necessarily bent on the fundamentalist dogmas of the Quran and shariah law.

At a certain moment, there was wishful thinking belief in the efficiency of political Islam, with Turkey under Tayyip Erdoğan serving as a model, but the doubtful governance of Islamists in Tunisia and especially the gross dilettantism of Brothers in Egypt revealed the true worth of religion-based rule.

The Arab League summit in Kuwait not only exposed the deep divisions within the region but cast doubt on the ideological drive of Qatar to reformat the Middle East with the silent yet apparent consent of the United States. Now that things have turned sour, will Washington turn its back on Doha for the epic fail of the Arab Spring?

In any case, the conflict of political interests among Gulf -Persian Gulf to be exact- countries may well spill over to economic interests, rupturing the uncharted rule that, no matter what the nation-state differences are, when it comes to energy outbound supplies it is always "business as usual" and no mixing of politics with money-making practices. Today, this never challenged *modus operandi* can be undermined by the invigorated rivalry between petro and gas monarchies.

Libya remains KOed

Paolo Scaroni, CEO of Italian oil and gas major Eni, visited Libya some time ago and made some overtly optimistic declarations. He expressed satisfaction with the fact that the country is back for gas deliveries and welcomed the new Prime minister, Abdullah Al Thani.

"Our production (in Libya) is going well, however we need some years before the situation is stabilized," Scaroni said. In his mind, Italy, despite "post-Qaddafi convulsions", may rely on Libya in a situation of crisis in Ukraine which may have repercussions for energy flows to Europe.

Mr. Scaroni might sound prone to euphoria on the Libyan post-revolution evolution. Last month events showed that the state of affairs is grimmer than simply "post-Qaddafi convulsions". Basically, the country is balancing between another civil war and fragmentation, with the situation exacerbated by a power vacuum, insecurity and lack of consensus on how to share hydrocarbon revenues.

The recent conflict, at a certain point, was so violent that only mediation of tribal chieftains managed to stop the fighting. The conflict took place in the city of Ajdabiya, the historical limitation line between Tripolitania and Cyrenaica. Clashes started between forces loyal to the government in Tripoli under the command of Colonel Bechir Abou Dhafira and local strongmen who seized some oil export facilities, the Ali Hassen Jabeur unit under the command of Colonel Abou Ghafir. Finally, Sheikh Salah Attiouch, the head of the major tribe in that region, Al Magharba, and others from Barga arrived to conduct negotiations. It was agreed that a commission to control the blocked oil terminals will be created and military units will go back to the barracks. The ghost of a possible full-scale armed civil conflict evaporated. For how long?

Those events were preceded by a truly James Bond story. A tanker, Morning Glory, under North Korean flag, was loaded with 234,000 tons of oil. That volume was sold in one of the occupied oil terminals, Al Sidera. The other ports are Zueitan and Ras Lanouf (export capacity 600,000 tons per day for the three). They are under the control of rebels, former port guards, who demand their overdue payment and a more honest, from their point of view, sharing model of oil revenues. The conflict started last summer but it was the first time when Libyan fuel was sold through non-official channels. The tanker was intercepted. Libyan military authorities were ready to use force. But, amazingly, the vessel managed to escape. The "block-posts" were composed of small fishing boats with anti-aircraft guns on board. Some days later, the tanker was seized by the US Navy Seals unit near Cyprus, and returned back to Libyan authorities. The crew will be subject to interrogation.

Who actually bought that oil? It is still unclear. The owner of Morning Glory was an Egyptian company which has the right to fly the North Korea flag. North Korea denied involvement and cancelled that permission. Some suggest that the buyers were some Qaddafi loyalists, trying to destabilize the incumbent government in Tripoli.

Meanwhile, the Prime Minister of Libya, Ali Zeidane, was dismissed by the General National Congress, the interim parliament. He was weakened by his incapacity to solve the country's enormous problems, to engage in state-building, to disarm militias and to create a credible army and police force. Zeidane became even more vulnerable some months ago when he was briefly kidnapped. Ali Zeidane preferred to rapidly leave the country on a private jet. He stopped at Malta and then left for a European country, probably for Germany (he also has a German passport). Zeidane was exiled to Europe during the Qaddafi rule when he opposed the Colonel. But his liberal approach did not go well with the new Libyan leadership and the new realities on the ground.

The interim Prime Minister is Abdallah Al Thani, who was Minister of Defense in the previous government. The clashes in Ajdabiya occurred under his rule. Apparently the worst is did not happen. Libyan life is back to normality (or abnormality): recently, an Italian engineer

was kidnapped, and a Tunisian official murdered. Oil production is still at a mere 250,000 barrels a day (1.5 million barrels were produced under Qaddafi). The conflict between warring militias around the oil terminals' zone is estimated to cost $10 billion a year for the Libyan budget. The government is at pains to pay the bills.

Libya, despite hope against all hope, is still not back to the energy market.

Algeria Postpones Making Hard Choices. For How Long?

On 17 April Algerians will vote for their president. The result is more or less predictable. Abdelaziz Bouteflika will have this job for the 4th time in a row, his health allowing.

Algeria, third major natural gas supplier to Europe, is in a very delicate position. The country has not succumbed to romantic illusions of the Arab Spring, which started in 2009. At some time, in the middle of the popular uprisings in the Arab world there was an impression that Algeria is destined to become the next target. Yet, local elites managed to avoid this threat. The system combining tough control of the society by security forces, corruption and distribution of hydrocarbon revenues survived. Algeria did not fall into Islamist hands.

At the same time, Algeria is undergoing a challenging generational change. The old guard, dating back to the times of the struggle for independence, is turning really old, and it has to pass the power to new people. President Bouteflika, 76, is in bad shape. He had a stroke in April 2013, spent some months in a military hospital in the Parisian suburbs. Upon his return home, he practically disappeared from the public, having chaired only two Government meetings. Bouteflika has welcomed few foreign guests. He has not made a public speech since May 2012: in Sétif he spoke about the need to transfer power to a new political generation!

Until the last moment, Bouteflika, was not sure whether to run for a 4th mandate or not. Some cynics in Algeria are sarcastic: the president wants to have a national funeral for himself as a statesman who passed away while in power. More seriously, the country faces the problem of the "heritage" of the regime. The issue is not evident so far, so the best choice seems to be avoiding any change.

Different groups within the elite are preparing themselves for the final countdown. To put it simply, strongmen are the Chief of staff of the Algerian army, General Ahmed Gaïd-Salah, and Mohamed Lamine Médiène Alias Tewfik, Head of the Intelligence and Security Department (Département du renseignement et de la sécurité, DRS). At some point in February, their rivalry turned public through influent proxy attacks.

Neither of them have the prerequisites to position themselves as pretenders to the throne. The first of them is 74 years old, the second is 75; they belong to the President's generation. Nevertheless, both would like to hold the grip on power for the sake of their clans and to have guarantees of impunity for the whole old generation. In that stalemate situation and with the persisting risk of a second wave of uprisings, the best choice seemed to be keeping the political stage unchanged. Former Prime Minister, Ahmed Ouyahia, is also back (currently holds the post of presidential chief of staff), and he is perceived to be the person symbolizing the temporary compromise and balance of power.

Very illustrative is the story about the local business association deciding to support Buteflika's nomination. The Forum of business leaders (Forum des chefs d'entreprise, FCE), the main entrepreneur's organization in the country, officially forwarded the proposal of a new mandate for the incumbent Head of State. That was done with some violations of FCE's Charter, even with no secret vote. One member openly refused to do it; many left the assembly and did not vote. The adopted document was a soft worded one. It mentioned the dire international context and the need to support Government's strategy.

Nevertheless, the problem of the future political shape of Algeria did not evaporate; the final decision was simply postponed. The Big fight is now being prepared in the shadows.

If there are lessons to be drawn from the catastrophic Arab Spring, we must conclude: any brutal change in favour of the Islamic leaning in that part of the world results in a profound social and political destabilization of the country. That scenario was avoided in Algeria due to its important role as an oil and especially gas provider to the market (remember January 2013, when Islamists attacked an important gas production facility in Amenas in Algeria).

However, Algeria can no longer afford its present economic model, based on subsidizing the population from oil and gas revenues, in order to preserve social stability. The reason that this model has expired is that the country is no more able to generate the same amount of gas revenues as in the past. Production is declining, no new fields are being discovered.

There are a number of signs underlining this decline. Professor Abderrahmane Mebtoul recently announced that natural gas reserves in Algeria are less important than originally believed. He estimates them to be 2.0-3.0 tcm of gas instead of the official data, 4.5 tcm. The latter figure was made public in 2003, but no new estimates were published since then! Exported and internally consumed volumes are not replaced by new discoveries. Energy production in Algeria is based on gas fired plants; the demand for power is growing dramatically. Professor Mebtoul concludes that internal gas consumption in 2017 will more than double and reach 70 bcm, and most of the produced gas will be consumed on the Algerian domestic market and not be bound for export.

True, internal gas demand is now growing by 12% y-on-y.

A similar development will cut export revenues while undermining the social policy of the government. Algerian gas export is already declining, having dropped from 13% to a 9% share in the European market. A new political course is needed for Algeria, but it should be adopted without convulsions and violence. Otherwise, markets, especially in Southern Europe, will experience problems with natural gas supplies from that country. How much time is left to prepare for it?

Too many things now depend on President Bouteflika's health. But time is running out, and the real hard choice is better to be made sooner rather than later.

Croatian Oil Industry Doomed For Stagnation

One of the first victims of the EU's disenchantment with Russia which has expanded into Crimea could be the Croatian oil company INA. The government in Zagreb for months worked hard to bring the Russians on board as a big stakeholder in the largest industrial unit of the country, replacing Hungarian MOL. When everything seemed to be ready for the transaction, the developments in Ukraine and Crimea made this deal impossible, at least for some time.

Obviously, there were no official announcements, but the course of events could be interpreted in that framework.

Like in a classic drama, we have some key actors: Croatian ex-Prime Minister, Ivo Sanader, he was in high office from 2003 to 2009, and CEO of MOL, Zoltán Hernádi. In March, a court in Zagreb condemned the former Croatian strongmen to 9 years in jail and to a fine of 2 million euro. He was found guilty of corruption. In 2012, he was declared guilty by a court of first appearance. The main accusation against him was to have received money from MOL in exchange for selling 49.9% of INA's stake to the Hungarians. The conditions were later found unfavorable for the Croatians. MOL promised to invest in INA but never complied, reducing the agreed volumes of investment.

A conflict between the two Governments erupted. The deal, designed to pull Croatia and Hungary closer, turned into a local tug of war (see "Croatia and Hungary: Neighbourhood Watch", EIRA Volume 1 Issue 7, 2013). Ivo Sanader was subjected to investigation, and we know the results. Croatians attacked Zoltán

Hernádi, putting him on an international wanted list. Budapest protected its top manager. The conflict ended in a stalemate. In fact, INA didn't get the expected investments, its market value went down; MOL didn't have the money for huge investment; meanwhile the refinery in Sisak was not modernized.

A mutually acceptable solution was found: MOL must sell its stake in INA to a more powerful bidder. The Croatians looked for an investor in Russia, which has interests in the energy sector in the Balkans and has money to back it. A rather big Russian market player, Gazprom Neft, has proved its worth in Serbia: some years ago it acquired a local company, NIS which by now has been turned into one of the most dynamic oil companies in the region, boasting of a finely modernized refinery. There were rumors that Gazprom was interested in INA. But finally the deal was closed with its Russian competitor, Rosneft. According to some reports, Hungarian Prime Minister, Victor Orbán, negotiated during a recent visit to Moscow the selling of MOL's stake in INA to Rosneft. The Croatian Government was happy, local media were in raptures, waiting for huge investments.

But the European Commission and the U.S. were not happy with that perspective. Brussels decided that its antitrust DG had to scrutinize the deal and have the final word. The crisis in Ukraine gave an additional argument to the opponents of the Russian acquisition of INA. Budapest and Zagreb were reportedly warned that the moment is not opportune for the transaction. The U.S. State Department sent to Zagreb a special envoy, Deputy Assistant Secretary for Energy Diplomacy Amos J. Hohstein, to suggest that an Americans company would replace Russians as co-owners of the Croatian company.

Zoltán Hernádi is no more wanted, MOL started negotiations with the Croatian Government and makes pacifying gestures. Croatian Prime Minister, Zoran Milanović, is talking about the strategic role of INA for the country, the need for it to be profitable and to reinvest its gains in the country. At the same time, the Government took a decision to regulate internal gas prices and to sell locally produced gas at fixed prices. The company expects that for the next three years it will lose up to 46 million euros in revenues.

Sanader's sentence is also seen as a part of that game. Some observers in Zagreb suppose that the Court decision opens the way to declare illegal the sale of INA's stake to the Hungarians and to restart the process from zero ground.

One question doesn't still have an answer: where to find money for investment in the Croatian oil industry? So far, no alternatives were found. As a result, INA's facilities are forfeiting its remaining competitiveness. It's not surprising that Croatian Minister of economy, Ivan Vrdoljak is still saying that he's ready to cooperate with anyone keen to develop INA. Moreover, the minister doesn't comment on allegation that Brussels has forbidden the deal with Rosneft.

Meanwhile, the economic situation in Croatia is far from comfortable. This EU country has the highest unemployment growth rate: 2.9% in Q4, 2013, the Croatian National Bank (HNB) revealed. The overall unemployment rate is 21%. The GDP growth is still negative (-1% in 2013), public debt is going up, having reached 29 billion euro (67% of GDP in 2013, 11 percent points up in a year).

The EU calls on Zagreb to continue its restrictive budget policy to achieve positive macroeconomic results. But there is no apparent driver for economic growth in Croatia. Hopes were placed on the energy sector, but without large investments it will not take off. The Russians are gone, and there is no money anywhere on the horizon. There seems to be only one modest consolation: the EU is considering the development of the local railway network, pushing forward its full-scale modernization. The European Union might finance the project to the tune of 1 billion euro a year, up to 2020.

Old Ways Are Challenged In Greece

It has been exactly one year since we reported in our very first issue of EIRA that successive Greek governments have been holding onto and mishandling all research data necessary to develop Greece's energy sector. This data has proved integral towards the current steps being taken in Western Greece and the Ionian sea - where agreements with certain companies, that were later nullified, had taken place 15 years ago- and even in the waters south of the island of Crete. It was approximately 15 years ago that this data was deliberately concealed by the then Greek socialist government to serve the interests of oligarchs.

Without warning, in 1997 the Greek state official responsible for these explorations, Imperial University geology graduate Ms. Tereza Fokianou, was expelled from her position and even received life threats while her entire department, the state controlled *Public Oil Corporation - Research and Production of Hydrocarbons,* was scrapped altogether. Every effort to explore and exploit hydrocarbons was suddenly stopped, causing the energy sector in Greece to continue being exploited by middlemen that have up to date been supported through scandalous 'favours' performed by corrupt politicians.

Today, the old programmes of Ms. Fokianou have been reactivated by the same socialists that participate in the Greek coalition government. However, they have been subjected to excrutiatingly slow and bureaucratic procedures, indicating clear traces of corruption. The new winning bidder, Mr. Mathios Rigas, President of Energean Oil and Gas is an independent and dynamic young Greek businessman who champions exemplary values of the necessary modernization of the business environment in Greece.

At a time when Greece is plagued by debt, poverty, unemployment and the unmasking of a business class that hastily transfers its capital overseas, Ms. Fokianou and her close associate Mr. Elias Konofagos from Flow Energy S.A. can feel proud to watch their dreams materialize and Mr. Mathios Rigas be praised for his stubbornness to do business in his home country.

Mr. Rigas is the only Greek businessman who is investing money in the exploration and exploitation of Greek hydrocarbons today and has created the necessary infrastructure to host foreign companies that carry the 'know-how' to develop major Greek hydrocarbon reserves in the future.

However, the main and common characteristic of the afore-mentioned pioneers developing the Greek energy sector, is their friendly attitude towards local communities and the struggle for the abolition of the country's notorious bureaucracy.

Speaking at a recent conference in Athens, Mr. Rigas revealed that during the 6-year operation at his Prinos site in Northern Greece, his company paid more than €80 million in salaries and other services to local communities, while the taxes paid to the Greek State came up to €40 million. He added that besides the €180 million already invested at the Prinos site, he plans to invest €160 million more by the end of 2015, plus €32 million at the site in Ioannina and €15 million at the Katakolon site in Western Greece.

Mr. Rigas underlined that Greece can become an attractive E&P investment opportunity, provided decisions are taken fast, laws are not to be changed often, the fiscal terms become attractive and there be no delays in issuing permits. He also insisted on the immediate operation of HHMC (a Greek state company that will take on responsibilities of the hydrocarbons sector). Public perception of potential oil & gas revenues also has to be managed. "It will take time to see specific results, we have to be patient. Oil & Gas is only secured through the drill bit and with high risk investment" Mr. Rigas concluded.

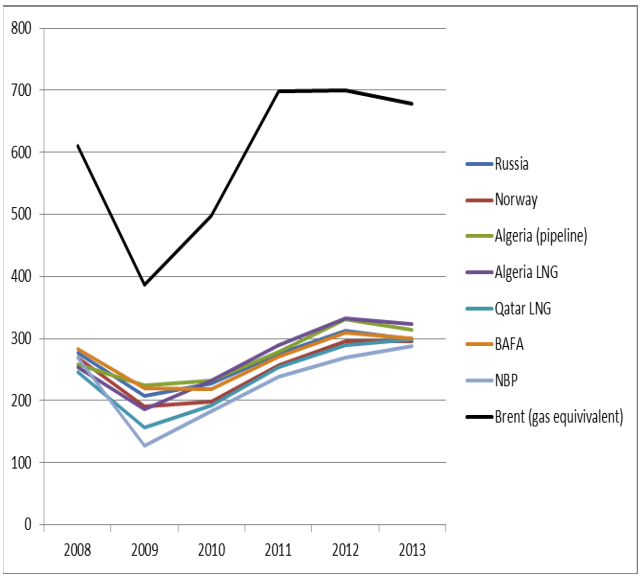
Open Forum

RES Subsidies Implications For The European Gas Market

*by Aleksei Grivach, Deputy Director of National Energy Security Fund (Moscow)

There is a lot of talk about the urgent need for Europe to abandon the 'antique' oil-linked prices in long-term gas purchasing contracts and switch to 'civilised' market relations. Is it feasible at a time when energy markets in Europe are distorted by subsidies, taxes, and over-regulation which disrupt fair competition? Actually, it breeds a multitude of controversies and misunderstandings at political, commercial, and even at expert's levels.

As a matter of fact, the subject of "oil indexation versus the spot market" is a non-issue. The dynamics of the price in the EU's main spot hub NBP differ little from the prices at which gas was supplied to united Europe by key exporters of pipeline gas and LNG (see chart).



Source: Eurostat COMEXT, Gazprom, IMF, BAFA, Norway Statbank

However, there are two fundamental problems which, at first glance, have no connection to each other. Yet, they adequately reflect the current status of gas as an unloved stepson in the European energy "family" due to absurd subsidies to the renewables and the dynamics of tax burden on gas users in the EU.

The most typical example of large-scale subsidisation of renewable energy in the EU is Germany. The German Renewable Energy Act has given electricity priority access to the energy system and has set the so-called green compensation fees (feed in tariffs) paid at the expense of other market players and end users.

Compensation amounted to €19.1 billion in 2012 and totalled almost €70 billion over five years since 2008. This compensation made it possible to generate just about 450 TWh. For comparison, in the same period Germany imported over 5,000 TWh's worth of gas for €123 billion.

Nota bene: The price of one kWh of imported gas on the border of Germany even at its peak levels is 5 to 6 times lower than the price which the energy market of the largest EU economy pays for one kWh of electricity generated from renewable energy sources.

To my mind, under the circumstances mentioned above, it is somewhat improper to claim that imported gas costs Europe too much. What's more, it is outrageous to compare gas with coal, which has become a noticeable feature in recent years. Indeed, before the crisis the difference between the cost of imported coal in Rotterdam and gas on the border of Germany was €100 per 1,000 cubic metres, but in late 2010 the spread began to increase and by the end of last year it reached €200 per 1,000 cubic metres of gas equivalent.

The conclusion is self-evident: The €100 spread between prices of gas and coal has to be reinstated, then the competitiveness of gas in the European power industry will return too. It is very tempting to accuse gas suppliers of overpricing and, consequently, losing to coal producers and sellers who actually hijacked the end-users by lower prices. In fact, gas-coal competition is much more complex.

There is hard-core evidence that gas-fired power plants, on average, are not only more efficient than coal-fired power generation (approximately 1.8 times more efficient), but also produce, on average, three times fewer emissions. But we have witnessed the collapse of the system of trade in quotas for CO2 emissions in Europe. After prices for the quotas fell from €20 per tonne of carbon dioxide emissions to €4-5, and the prices for imported coal in Rotterdam to €70 per tonne, gas can hardly compete with coal in the German market if it sells at €130 per 1,000 cubic metres. Now, coal is 2.5 times cheaper. In fact, it is even lower than the average domestic price in Russia net of the export duty and the cost of transport to the EU across Ukraine.

To sum it up, the EU regulatory policies considerably worsened competitiveness of gas-fired power generation compared with coal-fired option. Previously, gas was able to compete with coal when the difference in prices did not exceed €100 per 1,000 cubic metres of gas equivalent. And even at $130 gas will win the "competition" with coal, but lose to home-grown lignite which has tax preferences.

Let us look at internal gas pricing in the EU. Its dynamics also puts to doubt claims of imported gas expensiveness. This chart shows that the spread between the price for the average industrial user in the EU and the average price of imported gas on the border of Germany grew from €50 in 2008 to €130 in 2009. Then it decreased a little, but all the same it surpasses the level of 2008 by 60%.

Source: Eurostat

It is essential to take into consideration taxes on gas which average 25-30% for industry. The price of 1,000 cubic metres was €77 higher in 2012 in comparison with 2008. This is virtually twice as much as the growth of prices negotiated with Russian Gazprom or Norwegian Statoil during the same period.

As a result, importers were forced to lower prices, but competitiveness of gas in the market did not improve because exporters had to readjust the long-term supply contracts. Competition even weakened in some of the EU countries due to tax surge. It turned out that money "expropriated" from exporters through pressure was not used as originally intended to make gas affordable to the end-customers. The prices for end-users are still growing. The European energy market is now dependent on imported photoelectric cells from China. The energy system, regrettably, is getting less stable and less reliable. In order to reduce the financial burden on power generation, energy companies switched to cheap yet polluting fossil fuels, thus increasing their carbon emissions' footprint.

The other collateral effect is low interest to invest in new large scale upstream projects targeting the EU market. Norway hesitates. Algeria made its choice to develop a resource base for LNG production. However, there are no LNG investors seeking LTC with European customers as a mainstream marketing strategy. All of them are looking to Asia Pacific. Finally, Gazprom is very keen to establish itself as a devoted mainstay on the Chinese market. Once the long-awaited contract for gas pipeline deliveries is concluded, investments, from my point of view, will flow to Eastern Siberia.

Against such a development, it is evident that the EU faces a huge risk of remaining hostage of an illusion that everyone is dreaming of exporting energy to the European markets. The only relative success to boost security of supply for Europe was gas infrastructure to bring gas from Azerbaijan. But, first of all, we are looking at rather limited gas volumes, and second, supply and transit risks are not mitigated in this case. It took 7 years to reach the projected production level at Shah Deniz-1 field which is far simpler on the technological side in comparison with

Shah Deniz-2. My take is that the trans-Anatolian gas transit route might unpleasantly surprise the buyers and the sellers in the future.

The current confusing signals coming from the European energy market, can serve as a timely reminder that excessive injection of politics into business and over-regulation with disregard to the core interests of market players ruin chances of success and turn everyone in the industry, and also the end-customers, that is the taxpayers, into card-bearing losers.

Reports On Israeli-Turkish Energy Relations

On April 3, only days after Turkish Prime Minister Tayyip Erdoğan's March 30 triumphant win, US global intelligence company Stratfor came out with a story entitled "Turkey and Israel may reconcile after years of tension", claiming that an energy pipeline connecting the two nations for the transport of Israeli gas to Europe could renew their partnership after years of strained relations.

Stratfor referred to a March 23 article of Israeli financial daily, Globes, stating that 10 companies had submitted bids to the tender for a proposed undersea pipeline that could export natural gas from Israel's offshore Leviathan field to southern Turkey. The statement came shortly before Turkish newspaper Zaman reported a meeting between Israeli Prime Minister Benjamin Netanyahu's personal envoy for energy and security issues, Mr. David Meidan and the chief of Turkey's National Intelligence Organization, Mr. Hakan Fidan, in which both parties reportedly agreed to work on reopening embassies and normalizing relations.

Noteworthy is the following story published by Globes on March 26, with the title "Leviathan quandary: Turkey, Egypt or expand production":

The government will restrict natural gas exports via pipeline from the Leviathan gas field, according to the license conditions published today. The license requires the partners in Leviathan to keep capacity of 8-10 billion cubic meters (BCM) of gas a year for the domestic market, which leaves it 6-8 BCM a year for exports to other countries in the region. This is an amount of gas sufficient for one anchor customer: either Egypt or Turkey, but not both.

*In their response, the partners in Leviathan -**Noble Energy Inc.** (NYSE: **NBL**), **Delek Group Ltd.** (TASE: **DLEKG**), and Ratio Oil Exploration (1992) LP (TASE:**RATI.L**) - said that the set-aside exceeded Israel's expected natural gas demand from Leviathan, at least during the gas field's first years of operation.*

The choice is between the potential loss of billions of dollars in revenue from gas sales to neighboring countries or the need to invest heavily to expand Leviathan's production infrastructure, which will greatly increase its development cost. The partners' current development plan calls for an initial investment of $4.9 billion for a floating production, storage and offloading (FPSO) ship, which can deliver 16 BCM of gas a year to a pipeline.

The Tzemach Committee on gas exports estimates Israel's gas needs from Leviathan at 2-7 BCM a year during its first ten years of operation. The Ministry of National Infrastructures insisted on keeping a surplus capacity, partly because of the lesson from the Tamar gas field's development for which insufficient capacity was approved, because the ministry did not anticipate the loss of Egyptian gas.

The Ministry of National Infrastructures believes that the reserve capacity is critical for Israel's needs, and insists that this will not prevent development of Leviathan, even if it reduces the partners' profits. The ministry agreed to soften its demand that the Petroleum Commissioner have the right to require the partners to keep gas for an emergency reserve, even if this resulted in violating commitments to foreign customers.

The Leviathan partners objected to both the capacity reserve and the government's demands for future open access to Leviathan's infrastructures to other companies' gas fields, and to a $100 million bank guarantee.

Environmental organizations slammed the Ministry of National Infrastructures' refusal to allow a public hearing on the license. "It is improper that such an important agreement with far-reaching effects and such great public interest is published in its final version without giving the public an opportunity to comment on it," said the ***Israel Union for Environmental Defense****.*

In a separate development, the ***Antitrust Authority*** *will today announce a hearing for the settlement with Noble Energy and Delek Group on their alleged cartel at Leviathan. The settlement requires the companies to sell the Tanin and Karish gas fields, and if their aggregate amount of gas is less than 70 BCM, to sell gas reserves from Leviathan to meet this threshold.*

The settlement with the Antitrust Authority, the license, and export taxes are the main issues that have delayed the signing of the agreement to sell 25% of the rights to the Leviathan licenses to Australia's ***Woodside Petroleum Ltd.*** *(ASX:* ***WPL****) for $2.71 billion. The settling of these issues allows the agreement to be signed in a ceremony in Jerusalem on Thursday.*

Woodside representatives met top ***Ministry of Finance*** *officials today to raise their reservations about its tax model for gas exports. Woodside had expected the model to set in advance the guaranteed yield for the floating liquefied natural gas (FLNG) facility that it will build to export gas from Leviathan, but the ministry prefers letting the Tax Authority have the final say in a process for each export contract.*

EIRA Issue 3, Volume 2 extensively covered the possible paths exportable Israeli gas could follow, indicating that the liquefaction solution (LNG) and the Asian markets are the most profitable for the producers.

Seeing that all indications show that the amount of Israeli gas to be exported to Europe will indeed be limited, many experts believe that the most convenient solution could be the use of the nearby Egyptian facilities, while others add a pipeline to Turkey, provided all security issues have been considered in both cases.

Cyprus' proposal for an LNG facility on its soil brings her in a collision course with Greece, which favours the construction of a pipeline connecting the Eastern Mediterranean deposits with Europe through its own territory.

CONTACT US

GEORGE HATZIIOANNOU
Editor

A former diplomat, he has served as Press and Communications Officer at the Greek Embassies of the USA, the UK, the Russian Federation and the Czech Republic.

For all enquiries contact him at eiraeditor@gmail.com

DONNA HATZIIOANNOU
Deputy Editor

A graduate of the London School of Economics, she has editorial experience from Chatham House and the European Union's External Action Service.

For all enquiries contact her at eiracomment@gmail.com