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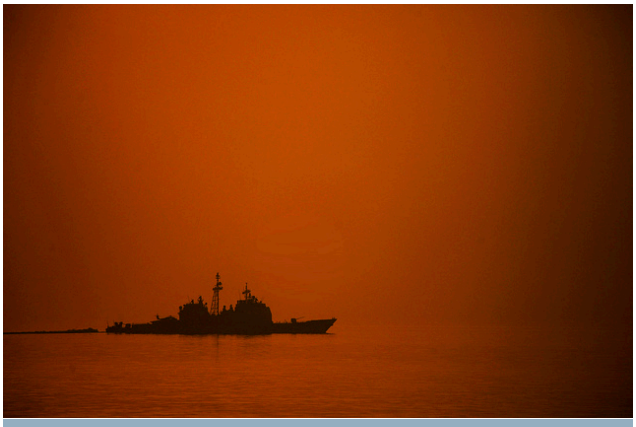
# Energy International Risk Assessment

An Independent Monthly Review



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## OPEN FORUM



## Letter From The Editor

Dear friends,

While approaching our third year of free circulation, in 2015 we expect a further deterioration of the political and economic situation in the hydrocarbon producing countries of MENA and beyond, that are already suffering hard from external invasions and/or internal conflicts.

Thus we consider it our duty to increase our efforts in making our predictions about tomorrow's energy developments as accurate as possible and for that we have created EIRANEWS.COM to supplement our Energy International Risk Assessment (EIRA) monthly newsletter sent to you via email.

We wish all our readers and especially our faithful and well informed friends worldwide who provide us with top level estimates about the future developments of the world of hydrocarbons, to have a very Happy New Year. We need your editorial contributions to expand and develop our product.

Yours Sincerely,

George Hatziioannou
Editor

## Libya: The Forgotten War

Two important oil terminals in Libya become war zones. The biggest one, Es Sider, and the second, Ras Lanuf, are now a battlefield for rival factions of local militants.

The terminals are controlled by Ibrahim Jedran's forces, the Petroleum Protection Guard. As the leader of armed guards of those terminals, Mr Jedran went into opposition to the government this summer. The dispute was about oil money. Now he supports the federalists who want Libya to become a federal state and is an ally of General Khalifa Haftar (occasionally spelled Hiftar) (see Libya: Second Civil War Three Years After Gaddafi, EIRA, Volume 2, Issue 6, June 2014), who's forces are fighting the jihadists and are propping up the internationally recognized government seated in Tobruk, at the border with Egypt.

Mr Jedran's forces are now under attack by Fajr Libya (Libya Down), a coalition of Islamists now in control of the capital city, Tripoli, and the Misurata brigade coming from the famous city which mounted a fierce resistance to Khadafy's troops during that stage of the civil war. They have launched the Operation "Shoroog" ("Sunrise") in an attempt to establish control over these terminals, the key element of Libyan oil export and main source of revenues.

The hostilities are of small proportions, compatible with the not so densely populated country; anyway, it is not a skirmish but a full-blown battle with heavy weapons, dead and wounded, destructions and a strong impact on the oil business. Basically, it is the struggle for international recognition: those who control oil production and delivery facilities could demand to be treated with respect.

That is not the only war news from Libya. In the Western part of the country, located not far from the Tunisian border, Fajr Libya is challenged by a local tribal coalition. It is composed of brigades from Zintan and the Wershefanas tribe, considered to be a Khadafy-loyal unit. Shoot-outs are taking place not far from an important gas facility, Mellitah. During one of the clashes near Ras Jedir border crossing point, Fajr Libya forces were defeated and groups of former Libyan military personnel, who were hiding in Tunisia, passed the border line and came back to Libya thus strengthening the anti-Tripoli camp.

Simultaneously, the Zwara tribe is considering to block the zone around the Millitah facility from which natural gas goes to Italy, and even the gas pipeline running from the production fields in Southern Libya to the export-bound pipeline. In that way they would like to counter the bombardments of Tripoli-Misurata forces by the government in Tobruk. If this gas transportation system is blocked, gas flow to Italy would be halted.

In the opposite part of the country, which is supposed to be under the control of the government in Tobruk, its opponents control big lumps of territory. In Bengasi, the second largest city in Libya, loyalists are battling with Islamists linked to Ansar al-Sharia jihadist group. In the South, fighting between local tribes and supposed Islamic radicals, maybe from the Aqmi movement, are taking place. But the flash point of Islamic radicals is the city of Derna with approximately 150,000 inhabitants. Ansar al-Sharia (now on the UN list of terrorist organizations) has organized a military training camp in that area, using the mountainous hence difficult to access relief.

US military claim they are training some 200 Libyan militants. Other sources report that Ansar al-Sharia is rallying also foreign fighters. Local jihadists bended the knee to the Islamic State, a movement which controls a part of the Sunni areas in Iraq and Syria. So did Jound al-Khalifa in Algeria and Ansar Beit al-Maqdis in Egypt. Fighters from Derna are also trying to impose their law on local tribes which are supporting General Haftar. Some reports indicate that fighting in that zone keeps going from October 2014 and those jihadists sent an ultimatum to local tribes to abandon the pro-governmental militias or their families and themselves will be killed.

So far, the situation in Libya turns more and more chaotic and nobody is willing to contribute

to the restoration of at least 'some kind of order' in that country. Egypt, UAE and Saudi Arabia are backing Tobruk against Tripoli but in a limited way. The US after the famous "leading from behind" tactics in overthrowing Khadafy regime and after having lost their ambassador, killed by local radicals, now have turned a blind eye on Libya and are concentrated on their own other battlefields. European countries after having bombed Khadafy's forces without any international mandate and in this way contributing to a regime change in Libya, now are at a loss viewing the controversial results of the Libyan version of the Arab Spring. They are witnessing the 'somalization' of Libya but prefer not to intervene.

The former colonial power in Libya, Italy, the most exposed to the dangerous development in its 'deep south', has no intention to act either. The Italians were training some military personnel from Libya but there is now no authority to find new recruits, so the project was cancelled.

"We exclude the option of sending troops if there is no international mandated issued by the UN, said in a recent interview to Corriere della Sera newspaper the Italian Defense Minister, Roberta Pinotta. I do not think that such a mandate can come from NATO."

The approach is quite clear, in conformity with the expectations. What is basically not clear, is why the troubles in Libya, an important OPEC member country, are not having any impact on world oil prices? Geopolitical troubles (Islamic State's expansion in the Middle East, tensions linked to Ukraine and Russia, etc.) does not affect oil markets which defy this type of risks and seem to be governed by other factors. Imagine this: fire in an oil reservoir in Es Sider during a fierce battle in the vicinity has led to the barrel of WTI surging in Asia by 28 cents, and of Brent, by 13 cents. It happened on the 26th of December!

One might conclude that geopolitics is no longer a driver for world oil pricing.

## Oil Prices In 2015 - Watch For QE And USD

What will the price of oil be in 2015? The person who gets the correct answer, to be confirmed during the year, for sure, would be the richest in the world. Unfortunately, nobody can make predictions and experts throughout the world are proposing different scenarios and explications for the coming months.

There is a different reasoning trying to explain that trend. They are basically linked to the demand and production side with variations built on some conspyrological considerations.

The supply and demand side is definitively a reality of the actual oil market. The production is growing. OPEC countries for years are keeping the same level, 30 million barrels/day. They are maintaining this level and do not want to go below it, inviting non-OPEC countries to limit their own production and promise not to reunite to discuss the issue until the next ministerial meeting due in June 2015.

That attitude is dictated by the Gulf petro-monarchies providing 17.5 million b/d of OPEC's total output, in particular, by the biggest producer, Saudi Arabia. Their goal is to assure the present share on the oil market, not to lose it to competitors. Seated on comfortable gold and currency reserves ($741 billion for Saudi Arabia only) they can afford a long period of low prices. That's not the case of some other OPEC member states, from Venezuela to Iran and Algeria. They rely on oil revenues to balance budgets. For that purpose oil prices should be double the present benchmark or more in order to meet the social needs of these countries: they do not have any serious financial safety net.

For how long would OPEC be able to follow that line? A recent Bank of America analysis claims that with $50 per barrel OPEC could be considered as dissolved.

Gulf monarchies are sending strong messages to the market. Even with the price of barrel at $20 they will not cut their production. It is not in the interest of OPEC producers to cut the

production whatever the price, said Saudi Oil Minister, Ali bin Ibrahim Al-Naimi. "Whether it goes down to $20 a barrel, $40, $50, $60, it is irrelevant," he said in an interview with the Middle East Economic Survey (MEES).

Simultaneously, Saudi Arabia has prepared the budget for 2015 calculated on the basis of oil price at $80 per barrel, so it could be interpreted as a sign that Riyadh is betting on a reverse of the price trend. But it should be noted that the country may afford to pass through 2015 with a lower oil price.

The main reason explaining that attitude is not only the determination to keep the share of the oil market. Saudi Arabia and other Gulf monarchies, reportedly, would like to put pressure on US shale oil producers who are the major source of increasing world oil production. That production is more expensive than the traditional one, especially in the Middle East and may need prices higher than $40-60 per barrel. The rumor has it that 15% of US shale producers are already losing money. The Saudi logic believes that low prices will squeeze some of the American producers from the market and, in a broader perspective, will make tight oil projects more risky for the future.

That approach may be correct. However technological progress could limit the extent of the success.

First, fracking technologies used for shale oil production are becoming more and more sophisticated, costs are going down and the break-even point could go down even further.

Second, the time of restarting of the suspended production is now much shorter than before, meaning that in a comfortable pricing environment extraction of oil may resume in the nick of time. Old technologies requested longer periods to resume withdrawal.

Thereby, on the production side there are some reasons for price decreases but they seem not to be critical for that trend. One more confirmation is that events and declarations which usually have an impact on oil prices do not have any significant influence. Russian Energy Minister, Mr Novak, assumed that Russian oil export may drop by 2% in 2015, but that was not reflected in price quotations. Islamic State progress in Syria and Iraq as well did not push prices up, neither did the Libyan bloody attacks on oil terminals (see in this issue **Libya: The Forgotten War**).

On the demand side, the influence on pricing is similar. Slowdown of Chinese economies, the previous driver for energy demand growth, stagnation in the EU and Japan, disruptions in other developing economies, all of these factors are contributing to lowering prices. One additional factor is the growth of energy efficiency in the developed countries. Oil price cuts may generate additional GDP in consumer countries, but they are also increasing risks of deflation, especially in EU, and of financial troubles in oil producing countries with bad consequences for new projects, including shale oil and oil sands production in Argentina, Canada, etc. Anyway, on the demand side troubles are not ready to disappear, the consequences could be much unexpected. The impact of demand factors on oil prices trends is comparable to the impact of production factor.

Maybe, geopolitics is playing the leading role? Some suspect a Saudi plot. The main target is considered to be Iran, the Shiite arch-rival of the Sunni petro-monarchies, with Saudi Arabia at the front. They are at odds with each other over Syria. Iran is suspected to be the hidden driver of popular unrest in Yemen and Bahrain. The Iraqi Government run by the Shiites is no more trusted by them. Riyadh is also concerned by the possibility of a full and formal normalization of the US-Iran relations and also by the lifting of American sanctions against Teheran. In the context of the millenarian regional rivalry, the lowering of oil could be a tool in undermining Iran's positions. Iran needs $130 per barrel in order to balance its budget.

To some extent, Gulf countries have already reached a higher degree of understanding and managed to overcome some contradictions. In December 2014, members of the Gulf Cooperation Council (GCC) agreed to create a regional police service, a common military

command. It is professed that Qatar will eventually abandon its support of the Muslim Brotherhood, the main cause of its controversy and confrontation with Saudi Arabia.

In Russia some experts suspect a US plot aiming to hit the Russian economy through low oil prices maintained due to Saudi Arabia's stance allegedly targeting American shale oil companies. This theory looks a bit too complicated. In any case, the present situation is not the repetition of the 1980s when the Soviet Union was not able to survive very low oil prices, arranged by Saudi Arabia, for a long time.

All these factors, however, contribute to low oil prices. But they are not setting the trend. The main factor here seems to be a financial one.

The US dollar and oil are wedded: if one goes up, the other goes down. It's due to the fact that both are considered by the market as better hedging instruments against financial risks. In the previous period, oil prices were oriented upward, because large volumes of oil could be bought and later resold with a secure margin. The guarantee of the gains was the Federal Reserve and its program of Quantitative Easing (QE). US dollars were abundant, affordable and easy to get. When some months ago QE was curtailed, it wiped out the guarantees of cheap dollars. Buying and reselling oil lost its attractiveness. Instead, buying US bonds became again an interesting hedging instrument: they ensure secure revenues, higher than inflation rate.

This is why oil was replaced by the US dollar as a main hedging instrument: oil went down and the dollar went up. Enormous amounts of money were displaced by hedge funds and other financial institutions looking for stable revenues, from oil market to dollar market and that movement was the main factor explaining the changes of the oil market.

Could the trend be inverted without FED going back to QE program? As long as US dollar will be more attractive than oil for financial markets, the trend will be maintained. Other factors, supply and demand, geopolitics, etc., could have an impact and even overrun the financial considerations. For example, if the oil production will be underinvested, it could have an upward impact on prices. The possibility of a kind of QE program by Japan and the European Central Bank could also contribute to it, but it will cover, under certain estimations, some 35% of the global stimulus lost as the FED stopped its QE program.

## Algeria Needs $130 Per Barrel To Survive

The President of Algeria, Abdelaziz Bouteflika, 77, at the end of December spent some days at a clinic in Grenoble (French Alps). The visit was attempted to be made in secret, to no avail: the news leaked out.

After the President's health troubles and his reelection for a 4th mandate, to last until 2019, his condition is the main subject of rumours and speculations in the country. Will he be able to stay in power? Who, if not he? Bouteflika or chaos? Is there any alternative to the clan in power? Is an alternative desirable? What will be the consequences for the energy market, Algeria being the biggest natural gas producer in Africa and still extracting 1.2 million barrels of oil per day?

So far, nobody has answers but everybody is preparing for the fearful 'day after'.

The state of affairs looks like this. At the top there is the Head of State. He has all the powers. Algerian TV shows him receiving foreign guests and Algerians. French Foreign Minister, Laurent Fabuis, recently saw him and commented to journalists that he found the President in a clear mind although with some difficulty with articulation. Apparently, Mr Bouteflika is more concerned now with his health than with governance.

The presidential younger brother, Said, holds the real power. At the beginning, he was not perceived as the true ruler but he was able to impose himself and to develop strategic views and skills. Could he be made the official heir? It is a million-dollar question. In Algiers, some

believe that with years his chances to become Number One might also grow. If the President does not last long, the real decision-makers may opt for a transitional figure: the Prime Minister, Abdelmalek Selial, Interior Minister, Tayeb Belaiz or the former Prime Minister, Ahmed Ouyahia. Such a leader would have to maintain a status quo with no major changes in the political and social areas. The decisions will be taken by the two most powerful institutions in Algeria, the army and the security service, DRS. Their respective chiefs, General Ahmed Gaid Salah and General Mohamed Mediene, are considered to be rivals but in a critical situation they would find common ground and name the successor.

The present political immobility looks, for many, as the best option against the consequences of the Arab Spring in neighbouring countries, especially Libya. Under the cover of stability even the Algerian opposition is moving on and reorganizing. Different forces, from Islamists to secularists unite their electorate potentials.

In June 2014, an impossible coalition, the National Coalition for Freedom and Democratic Transition (CNLTD) was created. Former foes became allies. Even some strange characters from the banned Islamic Salvation Front (FIS) have joined them, as well as some former Prime Ministers, namely Ahmed Benbitour and Ali Benflis. The promoters of CNLTD explain that they would like to create a credible alternative to the present 'autopilote' regime in case of a fast deterioration of the situation. Before starting to implement their agenda, they plan to create a mechanism of democratic power transfer.

The extreme elements of the Algerian politics are also on the move. Radical Islam was contained so far by resolute army's actions and heavy social subsidies to the populace thanks to oil and gas revenues. Nevertheless, jihadists are trying to expand their footprint in Algeria. In September 2014, radical fighters from Jund al-Khilafa group have abducted and then beheaded a French mountain guide, Herve Gourdel. At the end of the year the Army announced that in October it had killed one of the five criminals, and was still searching for others.

More alarming could be the information about the stay in the country of a singular personality called Mohamed Haydar Zammar. He is considered one of the masterminds of the 9/11 attack who recruited in Hamburg the executors of that abominable crime. He was caught in Morocco, transferred to Syria (he is a Syrian national), condemned to death but in 2013 he was released by Bashar Assad's regime in a framework of a deal with Islamists. Mr Zammar turned a close ally of Abu Bakr al-Baghdadi, the leader of the Islamic State (IS) movement. He dispatched him recently to enroll jihadist movements in other parts of the Arab world on the IS band wagon. He succeeded in Sinai (Egypt), where Ansar Bayt al-Maqqdis movement submitted himself to IS. He reached the same in Libyan Derna (see in the issue **Libya: The Forgotten War**). Then Mr Zammar arrived in Algeria where he contacted Jund al-Khilafa. The killing of the French guide was supposed to be an act of allegiance to IS. But the main target of Mr Zammar is the leader of Al-Qaeda of Islamic Maghreb, the terrible Mokhtar Belmokhtar who is operating almost everywhere in the region. His most spectacular operation was an attack on an Algerian gas production facility in January 2013 when jihadists killed more than 40 foreigners. There is no information if the two have met and what was the outcome of the possible meeting. However, that jihadists' activity demonstrates that Algeria could also be a target of choice for them.

This fragile political construction and the social stability is placed on the sick President Bouteflika's shoulders and rely on hydrocarbon revenues which make up 95% of Algerian export and are generating 60% of the state budget revenues.

The current downfall of oil prices is severely hitting the financial system. The government has announced the freeze on recruiting new civil servants as well as the salaries of the already employed. Many non-vital projects are to be postponed until better times. But the investment program of $262 billion for 2015-19 will be maintained. However, it is not clear how it can be implemented with the current level of oil prices. In 2011, a sharp hike of salaries and different subsidies allowed Algeria to avoid the

fate of Tunisia, where the Arab Spring convulsions had started.

Even without the falling oil prices the Algerian hydrocarbon industry is in a bad shape. Depleting oil and gas fields accompanied by the growth of internal consumption is creating problems for exports. The country has passed its peak gas export in 2005 with 65 billion cubic meters (bcm) compared to present 47 bcm. In 2013, hydrocarbon export generated $63.8 billion earnings compared to $70 billion in 2012. In 2015, there could be bad surprises if the current oil prices trend is maintained. For a balanced budget Algeria should have an oil price of $130 per barrel. Still the country has a very low public debt and at the end of 2013 had a comfortable gold and currency reserve of $194 billion. But Algeria has to act quickly and resolutely to improve the situation, to diversify the economy pending on a potentially troubling internal social and political context.

The Algerian national Sonatrach energy company is losing its share of the European gas market (90% of Algerian gas export) but is thinking of focusing on a more lucrative Asian market. "Asian market, its dimensions and diversity are offering better opportunities", said Director for studies and markets at Sonatrach, Ahmed Mazighi, at a recent Northern African Oil and Gas Summit.

The company is planning to invest in LNG production earmarked for Asian destinations in order to increase revenues and not to be over dependent on the unattractive European market. There are also plans to produce some shale gas although it is not given that they would find enough water for the use in the fracking technologies. It would be even more difficult to upgrade the investment climate and make various projects more attractive for foreign energy majors. Previously, all the attempts to achieve this goal were an epic fail.

## Israel - Gaza. Specter Of ISIS Round The Corner

The ISIS contamination of the terrain seems to be spreading outside the terrorist organization's current zone of occupation in Iraq and Syria.

An alleged ISIS duplicate in the Gaza region, called "Wilayat Gaza", has upped its profile by issuing a warning to local women to strictly observe the Islamic dress codes. In an another message this avatar of ISIS almost condemned 18 writers and artists to death, calling them apostates for what it considered to be sacrilegious behavior characterized by promiscuity and disrespect of Islam.

The promotional self-advertising of "Wilayat Gaza" came on the back of other disquieting events. In the time span of three months, two bomb attacks were carried out in the courtyard of the French cultural centre. Remarkably, the explosion took place when the building was empty, so no one was injured. The responsibility for the first attack was claimed by a group calling itself Islamic State in Gaza, while no one admitted committing the second terrorist act.

Those attacks were evidently masterminded just for the sake of creating an atmosphere of fear. Was it an explicit signal to Hamas by radicalized Islamists within Gaza or by 'outsiders'? Could be either of the two options, yet, the first option is more likely. In this case the statement of the Hamas authorities seem to be credible. Eyad al-Bazm, a spokesman for the interior ministry, dismissed assumptions of hostile infiltration: "There is no Islamic State in Gaza", adding that "the people who wrote this letter are troublemakers."

Even if taken at face value, this explanation is hardly comforting. There are "troublemakers" of different grade of fanatic devotion to violence. Besides, the emergence of radicals who position themselves to the right of Hamas in the political spectrum in Gaza is in itself indicative of the failure in governance.

Basically, it illustrates the cumulative effect of the interaction of external factors, such as the gradual advance and institutionalization of ISIS in the vicinity, the decision of Ansar Bait al-Maqdis, a militant group in the neighbouring Sinai peninsula, to pledge allegiance to ISIA, with the overall break-down of political stability in the wider region, and the mounting internal and cross-border troubles.

The border clashes on Christmas Eve activated the use of Israeli military planes and tanks, followed later by punitive air strikes on Gaza provoked by a rocket launched from Gaza in the direction of Israel. Actually, this was the first instance when the cease-fire brokered four months ago was violated.

Looking back, the hostilities this year could be viewed as the third war between Israel and Gaza after Tel Aviv withdrew its military forces from this strip of land in 2005, followed by a surprise win by Hamas of local elections.

It is worth revisiting the chronology of events. Since June 2014, three Israeli youngsters were kidnapped with their bodies found three weeks later. The government of Benjamin Netanyahu accused Hamas of the atrocity. In a fit of vengeance, Jewish extremists have burned alive a Palestinian young man. In response, Hamas and Islamic Jihad resumed rocket attacks on Israel. On 8 July, the Israeli army launched a full-scale military operation in Gaza, employing ground troops and warplanes, in order to weaken Hamas and, in particular, to destroy the 32 tunnels used for smuggling weapons from Egypt. On 26 August, through the mediation of Egypt a cease-fire agreement was reached, renounced by Gaza hard-liners who, anyway, celebrated it as their victory although they gained nothing.

The cease-fire as shown by the Christmas shoot-out remains shaky. Prime Minister Benjamin Netanyahu and his cabinet are determined to maintain pressure on Hamas by prolonging the blockade of Gaza. But time is running out. The next elections, scheduled for March 2015, will be a crucial test for the right-wing political parties in Israel. They have to deliver on their traditional promises of impregnable national security for the Jewish State amid a hostile environment.

This task is almost mission impossible given the developments in 2014, namely, the rise to prominence of ISIS and its declaration of a revived Caliphate, the radicalization of previously moderate Islamist formations, the stop-and-go flirtation of the United States with the Islamic State of Iran, etc.

What's more, Israel must have watched with bewilderment how the changing world public opinion is becoming more sympathetic than ever of the plight of the Palestinian people. This year, Sweden, in a largely symbolic move, has officially recognized the State of Palestine, and baroness Warsi picked up the tune by suggesting that the UK must recognize Palestine. On top of it, Hamas was removed from the list of terrorist movements by the EU court.

The last news could be a sign of the world warming to Hamas, not necessarily accepting it as a *bona fide* partner. Hamas could be in raptures on hearing the news were it not for the multiplying problems at home threatening to discredit the legitimacy of its hold on power.

In the past year and a half, the smuggling tunnels leading to Egypt and used for trade in goods were forcibly blocked and even destroyed by the new authorities in Cairo. The flow of cash dried up. The loss of this source of revenues was hurting. Cash-strapped Hamas administration was not able to provide timely pay to its civil servants, including the security units. It narrows the circle of loyals. If things keep deteriorating, Hamas might lose credibility and face a challenge from various groups capable of playing the populist card to its advantage. It could well be some ISIS-affiliated groups relying on financial, logistical, and even military support.

Noteworthy, Hamas has already mounted a classical defense shield by sending out the message to the people of Gaza: if you keep pressuring us, then you will have to deal with ISIS which is eager to step into our shoes if we show weakness. Then, be warned, Gaza will be turned into a battlefield like Iraq or Syria. Will this ultimate argument deter the doubtful silent majority or not, remains to be seen. In any case,

it is worrisome, since the new saying goes: Mention ISIS and it is sure to appear.

## Israel - Jordan. Ticking Islamist Bomb Next Door

By the end of December the painstakingly hammered out framework of a gas deal between the Kingdom of Jordan and the State of Israel became the target of blatant and vicious attacks. The apparently lucrative agreement was pushed on the brink of an abyss mainly by the Jordanian Islamists who were correct to assume that this pipeline link would serve as a strong bond locking Tel Aviv and Amman into a strategic alliance of economic convenience.

The apple of discord is simply a letter of intent signed in September by the US-registered Noble Energy, the operator of the Israeli Leviathan reservoir, and the Jordanian National Electric Power Company (NEPCO). The document stipulated the steady flow of natural gas to Jordan from the gigantic Leviathan offshore field. The Kingdom would receive in total 45.4 billion cubic meters with the duration of the contract set for over 15 years (maybe 20 years). Sources within the industry estimate the worth of the deal to be close to 11.4 billion euros or $15 billion.

Jordan has all the reasons to rejoice at this achievement since it has been sent to the ropes and cornered by the deplorable, to put it mildly, turn of events in 2011. An explosion on the export-bound gas pipeline from Egypt, running across the unruly Sinai Peninsula with local tribes in business for themselves, have cut short the contracted supplies to Jordan. Never to be resumed. The logical search for an alternative gas provider was quite vigorous ever since then, with few options on the table, but luckily culminated in the handshake with the Israeli purveyors.

However, the final approval by the Jordanian government was still missing when on 20 December the Islamic Action Front (IAF) stepped into the ring. The IAF is the political wing of the Jordanian branch of the Muslim Brotherhood and the main opposition force. IAF issued an adamant warning to the authorities. In a statement of objections placed on the Front's website the Islamists made it clear that they "strongly reject the deal in question, no matter what the pretext, political or economic, and will prosecute all those who agree to or sign such an agreement."

The warning by IAF can hardly be ignored since almost half of the population of Jordan is of Palestinian origin which resent any deals with the country labeled the "occupying force", and on top of all the peace treaty between Jordan and Israel which has amazingly withstood all the turbulences in the region. Yet, the scrupulously preserved peace, propped up by dynamic trade and economic ties between the neighbours, remains highly unpopular.

This is a powder keg easy to detonate if something goes wrong in the continuous interaction between Jordan and Israel, no matter what or who triggers off the malfunctioning of this time-honored bilateral marriage of expediency.

The debates in the Jordanian parliament bore witness to the deep ideological divide in the society. Here is a sample of passions running at pitch high levels. Jamal Qamwa, who heads the parliament's energy commission, in an interview with AFP, was aggressively eloquent: "Gas supply is part of national security, so how can we link it to an enemy who does not respect its commitments?.. We are bound to Israel by a peace treaty, but it does not respect it... It is also attacking our people (Palestinians) in the West Bank and in the Gaza Strip." And here is the final argument: "This whole issue is not about importing gas or about prices. Buying from Israel will make us hostage to the Zionist enemy."

The Energy Minister Mohamed Hamed did his bit by promoting the deal with neighbours, explicitly stating that purchasing natural gas, so much needed for domestic consumption, from Israel "does not threaten the future of Jordan nor does it leave Jordan's economy hostage in the hands of any country." The call of reason fell on deaf ears. A total of 79 lawmakers in the 150-

seat house signed a motion calling for the gas deal with the "arch-enemy" to be dumped.

The battle for the gas deal with Israel is not over yet. What are the arguments, put forward by the government (Jordan covers imports 97% of energy demand by imports) in favor of the deal, which seem to miss the target audience?

First, the Leviathan-produced gas arriving to Jordan will help avert such dreadful happenings as daily power cuts and prevent further hikes in the electricity bills for the households. Second, it would cut losses incurred by NEPCO which were expected to hit the ceiling at $1.8bn by the end of 2014.

Third, the deal, if it pulls through, will save $1.5 billion a year since Israeli gas is twice cheaper than the present alternatives, including the renewables. Jordan tested the waters by looking for suppliers in Gaza and Cyprus but the Israeli offer was unrivaled. Senator Jawad Annani, an economist by training, made his point: "We have to be logical and not emotional when examining this."

Fourth, the long-term deal will optimize costs and alleviate the present financial burden. *Nota bene*, the rising energy costs have largely contributed to the Jordanian sovereign external debt soaring to $23 billion. (To avoid the impression that it is an act of charity for Israel: the Jordanians will pay higher prices than offered on the Israeli domestic market). Finally, it is a piece of cake on the technical side: the only missing link to start pumping Israeli gas to Jordan is an on-shore pipeline just a few kilometers long.

In response to these factual expostulations, the detractors of the energy concordat repudiate by applying not arguments grounded in business sense but emotion-laden vindictive language, like "Zionist enemy" and "killing of our people" from the parliament's rostrum. The Arab Street is even more vociferous. Local protesters used to exhibit their placards with lambasting wording: "Jordanians refuse to fund Israeli weapons" and "Hell is better than Israeli gas."

In other words, politics overshadowed the economic expediency. It was not the natural want for natural gas that provoked the clash of opinions but the domineering and overarching issue of the shelved Middle East settlement with the ill-fated and still unborn Palestinian state at the core of it.

In essence, the controversy within the parliament and the society in general reflects the intervention of politics, and geopolitics in a wider context, in the rational mode of conducting business in the best of national interests. The Kingdom of Jordan has evidently become a hostage of the regional fundamental controversies.

## Israel. Will Leviathan Submerge Without Surfacing

The pre-Christmas warning shot by the Israeli Antitrust Commissioner David Gilo announcing plans to review the property rights of the Texas-based Noble Energy and Israel-registered Delek Group, linked in partnership to operate Tamar and develop Leviathan natural gas fields, came as a nasty surprise for the energy peers, investors, and potential customers, though not domestic but overseas.

Commissioner Gilo has sided with the left-wing activists who accuse the oil and gas oligarchs of reaping disproportionate gains from the hydrocarbon riches. These three-fisted fighters for social justice originally demanded upping the taxes, but lately shifted the emphasis on increasing the domestic consumption quota.

Their arguments rooted in the solid ground of populism claimed that the discovered offshore gas deposits, estimated to total 1.1 trillion cubic meters, if consumed domestically, meaning solely inside Israel, would last for some 130 years and drastically reduce energy bills for the households.

The appeal of this simple reasoning could not be easily dismissed. Yet, the final decision was as balanced as Solomon's verdicts, making relatively happy both the electorate and the producers who knew all too well that they would get more profits from selling gas abroad. The share of offshore

gas due to be consumed at home was fixed at 60% while 40% were earmarked for exports.

The 60:40 arrangement strands and covers, so far, the sales of gas extracted from the Tamar field which had started in 2013. The Leviathan field still remains "a pie in the sky" since the much awaited FID has been delayed and expected to be completed, as the best case scenario, by mid-2015.

However, the internal debates within the Israeli government around the apportioning of the offshore gas prolonged the negotiations with Woodside, an Australian company specializing in LNG, and broke the camels' back. The Australians seemed to have lost patience and quit. The ensuing antitrust probe which targeted this time the tandem of Noble Energy and Delek had thickened the uncertainties about the future of Israel's gas bonanza even further.

By the end of December, Noble Energy and Delek Group were waiting on pins and needles for the decision by the Antitrust Tribunal on the status of the partnership with focus on their alleged dominant market position and, in particular, on the justification of the price they intend to charge. The tandem swears to God it would not sell gas at a price higher than USD 6.5 per MBtu, significantly less than prices on European and Asian markets, with the exception of the Henry Hub in the US.

Whether the pledge to maintain such a comfortable benchmark will survive the clash with the market realities, is another story. In any case, local industry is currently paying USD 25 per MBtu buying boiler oil and gasoline, and would be more than happy to reduce the energy bills at least threefold to a level of USD 8-9 per MBtu, Israel's *Maariv* newspaper reported. Nevertheless, the opposition is pinning the "monopoly" down with pre-emptive accusations of overcharge for the Tamar field's gas and unfair, in their opinion, distribution of revenues.

The anti-oligarch's opposition looks like putting more steam into the anti-monopolistic campaign. The *Haaretz* newspaper in its 22 December 22 Editorial indicted the government for turning a blind eye to the enrichment of the Tamar and Leviathan field's owners. It revealed the existence of a confidential report submitted to the office of the prime minister which highlights "the absence of oversight on the prices charged by the gas monopoly" leading to "a 5-percent rise in electricity prices, which can be expected to continue rising steadily."

Since Noble Energy and Delek Group are targeted for inappropriate market behaviour, it definitely sends a discouraging signal to potential international investors. With the Woodside retreat at the back of their mind, foreign business will view the investment climate in Israel with more apprehension and make reservations about making financial commitments.

The tide of negative perceptions of the rip-off oil and gas barons could be reversed if the lawyers, representing Noble Energy and Delek, manage to prove beyond any reasonable doubt at the a hearing in January that the two companies did not conspire to form a cartel and never had the intention to manipulate prices.

Yet, it would be an uphill battle given the pre-determination of Commissioner Gilo to prove his point spelled out as early as November 2012. It was then that Mr Gilo first labeled the tandem "a monopoly" implying it was setting exorbitant prices and restricting fair competition.

It should not be overlooked that Commissioner Gilo has if not powerful yet vociferous allies in the parliament. Labour MP Avishay Braverman made public his distress because the Israel Electric Corporation was paying for natural gas from Tamar field about USD 5.6 per MBtu which, in his opinion, was far too much. Mr Braverman believed that a fair price should hang around USD 3.0 and USD 3.50 per MBtu, later correcting the benchmark upwards to USD 4.0 per MBtu.

This stance is hardly acceptable for Noble Energy and Delek, and they would certainly dispute the rationale of this suppressed price. Not to mention the ideology behind Mr Braverman's logic when he emphasized to *The Jerusalem Post* "the importance of engaging in benevolent capitalism." Benevolence has never been applied to underpin neither FID, nor foreign investors' commitments.

## *Rondo Alla Turca* Or Turkey Is Back In The Game

Following the halt to the implementation of the South Stream project, the contours of the suggested substitute are slowly showing through the still vague rhetoric.

Addressing the Bosphorus Energy Club's third meeting in Istanbul, Taner Yıldız, Minister of Energy and Natural Resources, sounded quite upbeat about the prospect of bringing Russian gas to the northwestern Thrace region and setting up a gas hub on the Turkish-Greek border. "Turkey will not merely be a transit country for the new natural gas pipeline project from Russia through the Black Sea, but it could have a compact facility including an LNG terminal", Taner Yildiz unveiled the final stance taken by Ankara after a certain pause (see "Turkey poised to become regional energy hub", EIRA, Volume 2, Issue 11, November 2014).

Noteworthy, Mr Yildiz, an indisputable heavyweight in the current cabinet, called the proposed pipeline 'Turkish Stream', thus fully legitimizing the project.

Turkey expectedly welcomed the volte-face of the defunct South Stream in the long run, while other parties originally engaged in the undertaking showed a wider range of opinions. Anger, bewilderment, and hope were all on display.

The Italian Prime Minister, Matteo Renzi dismissed speculations that the sudden abortion of South Stream incurred damage for his country. Speaking to the MPs at the Chamber of Deputies, the PM explicitly explained that the project, with ENI as the member of the consortium to build to the off-shore part the of pipeline, was "not decisive" for Italy's future. The government neither "celebrated nor contested" the cancellation of the all too complicated project, Mr Renzi revealed.

For Italy, priority is focused on bringing to fruition the implementation of the Trans-Adriatic Pipeline (TAP). The PM made it crystal clear that, despite its modest size, TAP is perfectly right for Italy, and, on top of all, it is in no way controversial and has the full support of the European Commission.

Sources in the industry passed the rumour that the Italian energy major, ENI was actually relieved to get its hands free of its commitment to proceed with South Stream. ENI was quite fidgety due to the erosion of financial hedging, which in turn was the result of the continuous pressure of the sanctions regime on Russia. The uncertainties of the European energy markets contributed to the hesitant mood at ENI headquarters no less than the pressure of the US-based stakeholders.

The contingency planning at the EU level in the wake of a meeting of the representatives of Bulgaria, Romania and Greece placed emphasis on speeding up the project of a 'Vertical gas corridor' linking Northern and Southern nations. The supply infrastructure would embrace TAP and the Greek Revithoussa LNG Terminal, operated by DEPA and capable of processing 2 bcm per annum.

Since TAP is planned to go online only around 2019, and LNG providers shy away from Europe being attracted by higher prices in Asia, the more viable element in the new infrastructure would be the interconnector between Slovakia and Hungary which is due to be put on stream in January-February 2015. Yet, for the moment the only gas to be pumped into the interconnector would still be Russian by origin.

The other alternatives mentioned in the aftermath of the Brussels' deliberations amounted to drilling for off-shore gas in the Mediterranean and Black Seas, and luring LNG purveyors to the European markets. Despite cautious optimism, sources close to the European Commission unveiled a strain of sceptic mood there.

Remarkably enough, in mid-December the Bulgarian government announced its readiness to issue all the necessary permits for the entry of South Stream pipeline into its territory after crossing the Black Sea. After a round of consultation in Brussels, Prime Minister Boiko Borisov declared that Sofia was keen to proceed with the implementation of the project, and thus

avoid paying penalties for non-compliance with the inter-governmental agreement.

Bulgaria must have believed (or pretended it did) that after such a positive signal sent to Moscow the ball was on the side of Gazprom. At that very moment, the vessel *Castoro Sei*, specially designed for laying pipelines on the seabed, was still waiting for instructions in the Bulgarian port of Varna. There was no response.

Probably, Sofia was simply overtaken by events. On 10 December, the Turks and the Russians sat down to discuss preliminary details of the alternative route to deliver gas to Europe with emphasis on turning the Thrace region into a regional gas hub. The basic concept, to put it in a nutshell, is that the EU member states in the future would have to purchase gas on the Turkey-Greece border.

What happens next, after gas arrives to the gas distribution center in Turkey? With no solid facts at disposal, it leaves plenty of room for all type of hypnosis. For instance, the Macedonian newspaper *Dnevnik* fancied in detail the yet imaginary network of pipelines heading westward. The pipeline would run into Greece and enter Macedonia, turning this miniscule Balkan country into a transit country and filling state coffers with transit fees. Then, gas will pour into Serbia, Hungary and end up in Austria, as it was agreed in the third revised version of South Stream.

There is a high probability, as the Macedonian expert assumed in *Dnevnik*, that the new pipeline would also branch out southward, intertwined with TAP, not physically but in content. Meaning, it would blend gas molecules of different origin, Caspian and Siberian. A bit far-fetched, isn't it?

Supposedly this is exactly how the Turkish-Russian duo would like to proceed from here. The new reshaped energy landscape would not offer much comfort for Southern Europe. In December, the European Parliament's Industry and Energy Committee debated the Energy Security Strategy and the change of partners, the substitution of Bulgaria by Turkey. Energy Commissioner Miguel Arias Cañete sounded confident when saying that South Stream would not have increased the security of supply to Europe. In his own words, "it would have diversified routes of supply, but not the suppliers", and adding that Europe has to combat "supply monopolies" (implicitly pointing at Gazprom).

However, if the "Turkish Stream" does not follow the path to a dead-end as Nabucco did, then there would be a new set of challenges. The members of the committee openly doubted that Turkey was a better option than Ukraine. In the words of MEP Benedek Jávor (Greens, Hungary), "...if we connect Europe to other unreliable partners that won't solve the problem."

Faced with a somewhat dubiously trustworthy transit-country, Southern Europe is no less concerned with the construction of the missing interconnectors to link the "Turkish Stream" with the end-consumers. So far, it remains unclear whether regional and international investors, and above all the European Commission would find enough finances to make the Southern Corridor operational. Despite a strong commercial rationale, the political overtones sound rather alarming.

In any case, Turkey is back in the game after the collapse of the Nabucco project (Verdi might be distressed). To draw another musical parallel, Turkey's buoyant disposition and anticipation of its elevated status sounds like Mozart's "Rondo Alla Turca", i.e. political leadership in Ankara with Neo-Ottoman vision of its role in the surrounding areas (former provinces of the Osman Empire) is nurturing enhanced ambitions to become a formidable energy hub in the region.

# Open Forum

## A View On South Stream Cancellation

Immediately after the anouncement by Russian president Vladimir Putin on 1 December 2014 of the abandonment of the South Stream project and its redirection to Turkey, RIA Novosti news agency asked George Hatziioannou, editor of EIRA monthly newsletter and eiranews.com, to comment on this important development.

Q and A — RIA Novosti

**RN: What could be the economic importance for Greece of the new Russian/Turkish pipeline project announced by Putin?**

EIRANEWS.COM: If the re-formatted South Stream project and the idea of a gas hub on the Turkish-Greek border are realized, Greece will be elevated to the status of a key energy transit country and, probably, of a local distribution center. Greece as the EU member state would be the gateway to a united Europe for part of the Russian gas exports.

**RN: What are the prospects of building a hub in the Turkish/Greek border?**

EIRANEWS.COM: There is strong economic and commercial rationale behind the idea of a hub on the Turkish-Greek border. Since it is a complicated enterprise affecting the energy security of many regional players, the success could be ensured only through multilateral negotiations to balance the interests of all parties concerned. I believe Greece would benefit from the emergence of the hub provided all the delicate issues are handled and settled in good faith with due regard to equitably spread benefits.

**RN: Will the European Union/ Commission give its permission for this new Russian/Turkish pipeline to be connected with Europe through Greece?**

EIRANEWS.COM: The question is a good one. It would be more appropriate to place the question on the threshold of the European Commission.

**RN: What will happen with TAP? TAP is antagonistic to Blue Stream. The European Commission is not giving permission to SOCAR to acquire DESFA. Is the Azeri gas cheaper or more expensive that the gas of Gazprom?**

EIRANEWS.COM: I do not see TAP as antagonistic to Blue Stream. Russian gas going through Blue Stream is earmarked exclusively for the internal market of Turkey while TAP is designed to deliver Azeri gas to Greece, Albania, and Southern Italy. The two pipeline systems have different destinations and different markets; hence, they do not compete with each other.

The obstacles to legitimizing the acquisition of DESFA, by Azeri gas major SOCAR, derive from the Third Energy package prerequisite of unbundling: producers cannot own transport infrastructure. Let us wait for the final decision. Pricing in gas industry is a commercially sensitive issue; I would not like to comment on it.

Price differentials are not the only factor taken into account by the buyers while concluding deals. No less important are clauses on flexibility, guarantees of uninterrupted supplies, the general reliability and credibility of purveyors, etc.

**RN: What does Putin's decision mean for Turkey? Turkey will be the seller or just the transporter of Russian gas?**

EIRANEWS.COM: It is my understanding that the actual status of Turkey, whether it becomes only the transporter or the seller as well, would be the subject of negotiations. For the moment, it looks like Turkey, eventually, will have control of the gas flows coming from Russia, Iran, Azerbaijan, and probably from Iraq. It will turn the country overnight into an almost dominant market player in regional energy affairs. In my humble opinion, this model of operations might be a bit tricky and risky. There is a fair chance that at a certain point Ankara might try to "do a Ukraine." I do not believe that Turkey is going to be an easy partner.

**RN: How much will the price of natural gas be more expensive, because of Turkeys in between role?**

EIRANEWS.COM: It is too early to comment on it.

**RN: What will happen with the Israeli, Cypriot, Greek initiative of building a pipeline from Cyprus/Israel to Greece, to Europe?**

**EIRANEWS.COM:** For the moment, the expediency of this grand project has been substantiated neither by a solid feasibility study, nor by a display of a strong political will by any of the involved and interested parties.

## EIRANEWS.COM Editor Gives Comments To Itar Tass News Agency On Putin's Decision To Cancel The New South Stream Project

**TASS**: Dear Mr Hatziioannou, we know you as an established expert in the gas and oil field and the editor of EIRANEWS.COM/Energy International Risk Assessment portal.

Russia had an intention to build a South Stream gas pipeline in order to ensure energy security of Europe by additional Russian natural gas supplies. Now, however, due to obstruction by the European Commission, Russia decided not to build the pipeline and redirect volumes, about 63 billion cubic meters per year, to other markets. What does Europe lose from the failure to build this pipeline? Will Europe be able to make up the loss of such volumes of natural gas by importing shale gas or liquefied gas or will the European consumers again suffer, especially in the south of the continent?

EIRANEWS.COM: We do not see any direct threat of a possible rupture neither of the signed agreement nor of the gas flow as a result of the abandonment of the South Stream project. It should be noted that the curve of gas demand in Europe is either flat or modestly rising. With the EU implementing the program of energy efficiency and constructing interconnectors to create a unified gas market, the forecasts on the need of additional imported hydrocarbons are put to doubt.

It should not be overlooked that the South Stream project is simply a new transportation route to deliver gas already contracted by European clients. It is not so much "new" gas but "old" gas; this gas will cease to run across Ukraine, which proved to be not a very reliable transit middleman.

**TASS**: During the recent visit of Russian President Vladimir Putin to Ankara Russian Gazprom and Turkish company Botas signed a memorandum of understanding on the construction of a gas pipeline across the Black Sea from Russia to Turkey with the capacity of 63 billion cubic meters of gas per year. 14 billion cubic meters of gas of the capacity is intended for delivery to Turkey, the rest - about 50 billion cubic meters of gas - will be delivered to the border of Turkey and Greece. One can see that the total capacity of the new pipeline is similar to the South Stream. Practically, this means that Russia changes the direction of its South Stream from Bulgaria to Turkey, having in mind that the construction of a new gas pipeline to Turkey, according to experts, will be cheaper. The offshore section of the pipeline coming to the Turkish territory will be shorter and cheaper than the same section to Bulgaria: 925 km to Bulgaria will cost 10.75 billion euros, while about 400 km to Turkey – approximately 7 billion euros. What is the significance, in your opinion, of this development for regional, European and even global energy market?

EIRANEWS.COM: The correction of South Stream offshore route across the Black Sea which amounts to the pipeline going not westward to reach Bulgaria but southwestward to end up in Turkey, has a clear rationale on the financial side. Definitely, it will be a remarkable cost-saving amendment of the original concept.

If Moscow makes a good bargain with Ankara on channeling Russian gas further on to South East Europe, it would leave the task of constructing the much needed additional pipeline infrastructure on the receiving end to the local governments and the European Commission. Gazprom will save a lot of money having scrapped its commitment to build onshore

pipelines and no longer caring about how its gas would be transported from the proposed hub on the Greek-Turkish border further on to the European customers. But not all is yet clear to me in that respect.

I can see another advantage for the Russians: apart from saving money, you will save a lot of trouble in dealing with the European Commission. It is my understanding that you might shift this headache to another head and shoulders.

**TASS**: Greece first signed an agreement with Russia to participate in the South Stream, but then Gazprom decided to change the direction of the pipeline to Serbia. However, after the exclusion of Greece from the membership in the pipeline Athens asked Gazprom to consider making an additional ramification to Greece from future South Stream. Now, with the planned change in direction of Russian gas supplies to Turkey, Greece once again becomes an important player in the regional energy scene, because Russian gas from Turkey to Europe will go through Greece. How do you assess the new opportunities that may open up in this regard to Greece? Can Greece use for new supply the infrastructure that it already has and is building additionally to deliver gas from Turkey?

EIRANEWS.COM: Greece would be happy to assume the role of a transit country when or rather if the EU and Russia come to terms with each other regarding gas export. In this case, Greece as the EU member state would be a gateway to Europe for this part of Russian gas exports. If this scenario unfolds, Greece will be elevated to the status of a key energy transit country and probably of a distribution center.

Definitely, it opens new vistas for Greece to ascertain its newly-acquired prominent place in the regional energy markets. Some of the existing pipelines could be of use but most probably there will be a need to build additional infrastructure to channel gas to other parts of South East Europe. Actually, Greece cannot do it alone, and it will require direct investments from the EU.

**TASS**: The EU and other Western countries imposed political and economic sanctions against Russia, although it would be logical if the so-called democrats of the EU imposed sanctions against the pro-Nazi regime in Kiev, which launched a war against its own people and kills civilians only for the fact that they speak Russian and do not want to obey the new authorities. But as you know, the EU sanctions are detrimental not only to Russia, but also to European countries, including Greece. What do you think about this?

EIRANEWS.COM: This is a political issue, and I do not do politics. The focus of EIRA, Energy International Risk Assessment web-portal and monthly bulletin, is the analysis of risks and opportunities, naturally, with a political lining, on the energy markets.

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