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THE RISK LANDSCAPE IN THE EASTERN MEDITERRANEAN:

OLD DEMONS DIE HARD

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Analysis

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Geopolitical risk is back on the forefront, or so it is frequently claimed, particularly since Russia invaded Ukraine causing turmoil in energy markets. In the Eastern Mediterranean, however, the risk landscape, including political and geopolitical risks, has always been a key concern for investors, even as regional policymakers tried to brush them off as an outdated threat whose impact can be contained. Despite a promising energy potential, the following snapshot of the current landscape in the Eastern Mediterranean could discourage any investor if the risks are allowed to grow unchecked.

GAZA WAR

The latest round of fighting between Israel and the Palestinians is the most brutal and intense in years. Its first impact on offshore activities was felt within hours of Hamas' surprise attack on October 7. Its full effect cannot be measured yet, amid the uncertainty over how the conflict is going to evolve and whether it is going to spread beyond its original theater.

On October 9, Israel suspended production from the Tamar platform, located 25 km from the shore. The 13 trillion cubic feet (tcf) gas field is the second largest in Israel and the main source of supply to the local economy, providing around 68% of domestic needs in 2022. Last year, it produced 10.2 billion cubic meters (bcm) of natural gas – about 47% of local production – of which 1.56 bcm were exported to Jordan and Egypt. The following day, Chevron announced that it was suspending gas exports to Egypt via the East Mediterranean Gas (EMG) pipeline – which connects Ashkelon in Israel to El-Arish in Egypt – and would reroute supplies through Jordan via the FAJR pipeline, more commonly known as the Arab Gas Pipeline. Neither infrastructure has been targeted yet, but they are within range of rockets fired from Gaza and were taken offline for over a month as a precautionary measure.

Other projects currently being developed in Israel have also been impacted by the war and will have to be delayed. This includes work on the offshore pipeline link between Ashdod and Ashkelon, which will enable the export of additional volumes to Egypt, that has been suspended, as well as the installation of the second oil train on Energean's Floating Production Storage and Offloading (FPSO) unit that will not take place until the security situation allows it.

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These developments are the latest reminder of the vulnerability of critical energy infrastructure in this conflict-ridden region, making their security a constant concern for stakeholders. The Tamar platform itself was shut down in previous rounds of hostilities, in May 2019 and May 2021. Only last year, Israel downed several unarmed drones launched by Hezbollah before they reached Energean's FPSO above Karish. While Tamar was offline, Israel's two other operating reservoirs, Leviathan and Karish, covered the bulk of the needs of the domestic market. But suspending production from Tamar and exports through the EMG pipeline has disrupted gas flows to neighboring countries. If Jordan kept receiving steady volumes from Israel, Egypt has seen a sharp decrease in supplies.

This came at an inopportune time for Egypt, which was hoping to restart LNG exports this fall. The country is struggling to keep up with its own demand at times amid declining production and has recently been counting on Israeli supplies to support its exports. But even that was not enough to meet the steep rise in domestic demand this summer, forcing Cairo to impose power cuts and halt LNG exports. As the heatwaves eased, Egypt exported, in early October, its first LNG cargo since July, but dwindling Israeli flows put a break on Cairo's plans to boost exports. With the resumption of Israeli supplies, Egypt exported another cargo on 21 November, but the country will not be able to match its 2022 export numbers this year.

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In case of an escalation of the conflict in Gaza, renewed outages or the shutdown of other critical energy infrastructure could have more serious consequences, not only for Israel's energy security but also for the attractiveness of its gas sector for investors. It could also lead to more severe restrictions on exports, which could negatively impact Egypt and Jordan. In Egypt, further disruptions of Israeli gas flows, if not compensated by an increase in local production, will translate into more frequent power cuts, a curtailed industrial activity and a steeper reduction in LNG exports that bring in much needed foreign currency. In Jordan, there might be a need to replace lost Israeli natural gas volumes with more expensive LNG. In both countries, such disruptions would ultimately hit people's pockets and could stoke social unrest as energy prices are among the key sources of domestic discontent. Creating overlapping interests with neighboring countries is among the reasons why Israel prioritized gas exports to Egypt and Jordan over other export options in the first place.

UPSURGE IN POLITICAL RISK

But even before the Gaza war broke out, companies operating in the Eastern Mediterranean were experiencing an upsurge in political risk.

This past summer in **Israel** was marked by a struggle between companies and the authorities over the gas export policy and quotas imposed on exports. The issue has been at the center of a tussle between them for over a decade and is the subject of periodic governmental examinations, which adds to the list of uncertainties companies operating in the country must deal with. While partners in the Tamar reservoir were granted an expansion of their export quota to Egypt by 38.7 bcm over 11 years, the Leviathan partners' request to obtain an extra 7 bcm/year of exports is unlikely to be approved in full. The latest debate came at a time when the Leviathan partners are considering a major expansion project. Restricted access to foreign markets, however, could discourage investments.

In **Lebanon**, it was thought that the mere resolution of the maritime border dispute with Israel would boost the sector's attractiveness. Yet that ignores the country's chronic instability, unprecedented economic and financial crisis and frequent political deadlocks.

A case in point is the second licensing round, which closed in October 2023, failing to attract new companies. It received only two bids from the same consortium already operating in Lebanon, despite easing the terms of the tender and pushing back the closing date six times since it was launched in 2019. This was not a one off, as it took over four years to close the previous licensing round as well, due to an incomplete legal framework and long periods of power vacuums.

Companies in Lebanon do not only have to deal with deteriorating business conditions, but also find themselves operating in an increasingly adverse environment. There is little dissociation between companies and the policies pursued by their countries of origin in Lebanon, which are often viewed in a negative light. At times, this has represented an added challenge for the companies, which must manage the country risks associated with the country where they are operating and those of their home country too.

Moreover, this sector in particular fuels conspiracy theories and caters to the widely held view that Lebanon is a pawn in a larger geopolitical game. Companies have been the target of rumors and false allegations going as far as accusing them of falsifying drilling results as part of a bigger plot to prevent Lebanon from exploiting its resources, as Total (now known as Total Energies) faced after drilling in Block 4 and Block 9.

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In **Cyprus**, the Energy Ministry and Chevron, the operator of Aphrodite, are at loggerheads over modifications submitted by the U.S. company in May 2023 to the field development plan agreed in 2019 with former operator Noble Energy. To slash development costs by around USD 1 billion, the updated plan scrapped a floating production unit (FPU) over the gas field and reduced the number of wells, which Nicosia fears would affect Aphrodite's overall output and revenues. The revisions involve a tie-back to Shell's underutilized facilities at the West Delta Deep Marine (WDDM) in offshore Egypt. The output would then either feed the domestic market in Egypt or be reexported as LNG via the Idku terminal. This is another cause of concern for Cyprus, which prefers to reexport the gas, rather than direct it to the Egyptian market where prices are much less attractive.

While Nicosia's concerns about the modifications are fair, they are at least partly dismissed by Chevron, which maintains that it can manage the reservoir equally well via tie-back to WDDM facilities. For Giorgos Papanastasiou, the Cypriot Energy Minister, scrapping the FPU means "control over the field is no longer in Cyprus." But perfect is the enemy of progress, as they say, and the dispute threatens to delay the development of the 3.5 tcf gas field discovered 12 years ago.

Papanastasiou's gambit is a bet; he will either be remembered as the minister who was able to assert Cyprus' interests and control over its resources, or as the one who delayed Aphrodite's development for an undetermined period of time. His brawl with the Electricity Authority of Cyprus, public handling of the "photovoltaics for all" plan and promotion of a new gas strategy for the Island suggest that companies are dealing with a dynamic but somewhat brash minister who is intent on leaving his mark. The ongoing negotiations between the Energy Ministry and the U.S. major will be decisive for the future of Aphrodite. The two parties will either reach an agreement that would pave the way for development or an impasse that could lead to further delays or, potentially, legal action. While Nicosia announced a breakthrough on the first of December without providing further information, the devil is in the details. ENI, which is also considering developing its gas finds in Block 6 via tie-back to its installations in Egypt, will be closely following how the dispute between Chevron and the Ministry will unfold.

This latest disagreement with Chevron is not the only challenge that has hampered the development of Aphrodite since its discovery in 2011. A small part of the gas field extends into the Israeli Exclusive Economic Zone. After years of negotiations, Cyprus and Israel have yet to conclude a unitization agreement and companies on both sides of the reservoir to agree on profit distribution. Absent that, the field cannot be developed.

While **Egypt** emerged as the most practical option to monetize the region's offshore gas resources owing to its central location, its large market and existing infrastructure, its stability is also a cause of concern for its neighbors. Cairo is grappling with a dire economic crisis, soaring inflation and a rising debt. A shortage in foreign reserves is putting pressure on the national currency and has led to a series of devaluation measures. The resulting growth in public discontent is stoking fears of a potential relapse of instability.

In the early 2010s, the prevailing instability had a devastating effect on the petroleum sector. A pipeline exporting gas to Israel was the target of over a dozen attacks. Cairo accumulated billions of dollars in arrears to foreign oil and gas companies. Low investments in the sector, which preceded the upheavals, constrained domestic production, while demand continued to grow. The gas crunch led Egypt to divert supplies away from exports to the domestic market, much to the dismay of the operators of the country's two LNG terminals. It turned Egypt into an LNG importer between 2015 and 2018.

Egypt has come a long way since then. But the security of energy infrastructure, diversions of gas volumes from export plants to the local market when local production fails to keep up with demand, and a long history of delays in paying dues to oil companies in times of crisis are a constant concern for Egypt's partners. They partly explain why Cyprus insist on installing an FPU over Aphrodite and is uncomfortable with tying the gas field's fate solely to Egypt.

CONCLUSION

The war in Gaza might have revealed the immediate effects of a conflict on the sector, such as threatening and shutting down critical energy infrastructure, disrupting gas flows, readapting the energy mix, and incurring financial losses. Depending on the extent and duration of the conflict, the situation could impact regional energy cooperation, which is crucial for unlocking the full potential of the region's offshore gas wealth. It is also likely to hamper the investment climate, which could delay certain projects, acquisitions, and final investment decisions.

But the range of political risks impacting the sector is not limited to the ongoing war. The conflict is just the latest reminder that certain problems in the region are of a recurring nature. Other issues include Egypt's hardships and their impact on the sector in neighboring countries; Israel's conflicting relations with some of its neighbors and constant security concerns; Lebanon's political instability and dysfunctional governance; Cyprus' multi-faceted dispute with Turkey and its impact on upstream activities off the Island's coast. This comes over and above challenges in managing the sector at a national level – which is common to all countries in the region with varying degrees – and which has led, in many cases, to complicating the process of monetization of deepwater gas resources.

When certain problems reemerge persistently after a period of dormancy, they draw attention to their cyclical nature and serve as a reminder to investors that political risk in the region remains high.

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