

Australian Company's Exit Reflects Israel's Natural Gas Challenges

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Brief Analysis

Woodside's decision shows how Israel will need to cement its foreign partnerships, investments, and export routes in order to take full advantage of its growing gas surplus.

On May 20, Woodside Petroleum, Australia's second biggest oil and natural gas producer, announced that it was ending its longstanding bid to acquire a stake in Israel's Leviathan offshore gas field, noting that "negotiations between the parties failed to reach a commercially acceptable outcome." The company's bland statement likely obscures price and tax disagreements that may deter other foreign investors needed to fully exploit Israel's new hydrocarbon bonanza.

When Woodside's interest in the Leviathan venture was first announced in late 2012, the putative \$2.7 billion deal was seen as the key to financing the exploitation of Israel's largest offshore gas field, as well as a potential means of opening a market for the gas in Asia, the center of the company's existing commercial operations. But Woodside's subsequent talks with the various players -- including the Israeli tax authorities, U.S. company Noble Energy (the field's operator and minority owner), and Israeli partners led by Delek Energy -- have been tough. Reports of troubled negotiations have been constant in recent months, most illuminatingly when a party to celebrate an announcement was cancelled at the last moment in March. Details of what may have gone wrong are sparse, but attempts to agree on a final price were probably complicated by upward revisions in the field's size and the emergence of pipeline routes for export, which are cheaper and more practical than conversion to liquefied natural gas, one of Woodside's special skills.

The company's official statement provides hints of such problems, citing the failure to reach a deal "that would have allowed fully-termed agreements to be executed" and noting its "commitment to making disciplined investment decisions." But Woodside has not completely shut the door to future involvement; the statement noted only that "we

will not get [to agreement] under the current proposal," while CEO Peter Coleman "acknowledged and thanked the Leviathan Joint Venture participants and the Israeli Government for working with us."

More broadly, Woodside's decision illustrates the challenges of developing Israel's offshore gas findings. The country's Tamar field came onstream a year ago, and Leviathan, almost twice the size, is planned to come onstream in 2016 or 2017. The combined reserves from these and other fields will create a surplus for export. Thus far, Israel has been working on a deal to sell gas to Jordanian industrial plants, as well as plans for a pipeline to a future West Bank power plant and undersea pipelines to Egypt and Turkey. But all of these projects remain tentative to one degree or another.

Moreover, the development of Israel's hydrocarbons still requires much investment. Along with the major gas findings, Noble Energy believes there may be oil deposits underneath the gas fields. Delek recently used a successful bond offering to raise \$2 billion for the development of Leviathan, but more funding is needed. This will likely require Israel to maintain a welcoming taxation system for foreign companies, which have their own shareholders to satisfy and alternative opportunities for investment elsewhere in the world. Given that gas revenues are only now beginning to surge, the government will need to maintain a domestic political environment in which publicly controversial energy decisions do not become so contentious that they stall outside investment.

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