

The Israel-Jordan Natural Gas Deal:

Pumping Revenue into Israel's Coffers



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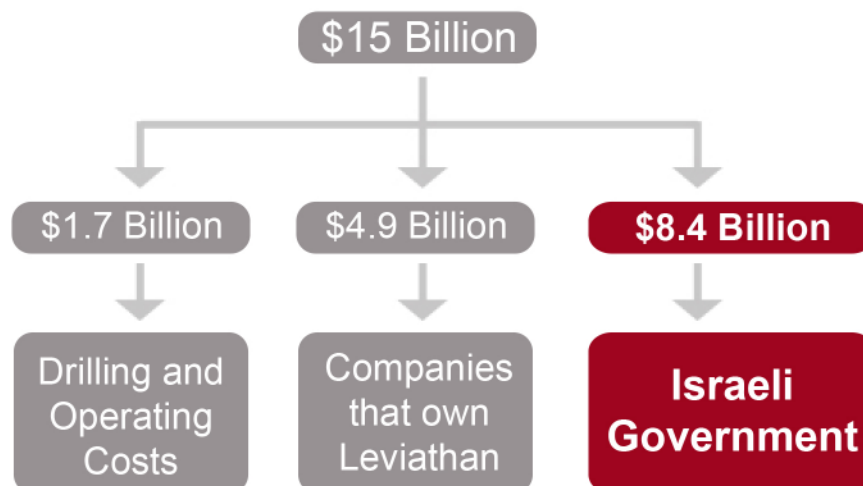
Executive Summary

The Jordanian National Electric Power Company (NEPCO) has signed a preliminary agreement to import large quantities of gas from Israeli-controlled East Mediterranean waters. The proposed \$15 billion deal would see NEPCO purchase 300 million cubic feet of gas per day over 15 years from the Leviathan field. (*1)

This report models revenue flows and calculates the contribution that Jordan will make to Israeli budgets.



Out of the \$15 billion total, Jordan will pay 56% to the Israeli state in royalties, windfall tax levy and corporation taxes. Over 15 years, \$1.7 billion will cover drilling and operating costs, \$4.9 billion will go to the companies that own Leviathan and \$8.4 billion to the Israeli government. Of the amount that will go to the companies that own Leviathan, \$1.93 billion will go to the US company Noble Energy, and \$2.93 billion will go to the Israeli companies in the consortium. The amount that will go to the Israeli government corresponds to an annual payment of \$559 million.



(*1) <http://investors.nobleenergyinc.com/releasedetail.cfm?ReleaseID=868812>

Jordan and the Gas of Leviathan

In September 2014, the Jordanian National Electric Power Company (NEPCO) signed a letter of intent with Noble Energy to import large quantities of gas from Israeli-controlled East Mediterranean waters. The proposed \$15 billion deal would see NEPCO purchase 300 million cubic feet of gas per day over 15 years from the Leviathan field. (*2)

This briefing explores the likely revenue streams that underlie the proposed deal.

- What will the payment transfers from Jordan to the Leviathan consortium look like?
- How much revenue will be paid to the Israeli state? How will the \$15 billion be split?

Gas discoveries in the Eastern Mediterranean have reshaped energy power relations in the region. Discovered in 2010, the Leviathan field was the world's largest offshore gas find in the last decade. (*3) It is operated by US company Noble Energy (39.66%), and co-owned with Israeli companies Delek Drilling (22.67%), Avner Oil Exploration (22.67%) and Ratio Oil Exploration (15%). The companies claim that the field contains an estimated 22 trillion cubic feet of gas – although it is only technically feasible to extract a portion of this.

In late September the consortium submitted a \$6.5 billion “development plan” that aims to extract 16 billion cubic metres a year starting from 2018. The gas will be pumped from the floating production storage and offloading unit through pipelines. (*4)

The Israeli government decided to allow the export of 40% of the gas reserves that it controls, as a means to influence relations with nearby states, along with commercial interests. The agreement between NEPCO and Noble Energy followed a \$500 million gas sale agreement to Arab Potash and the Jordan Bromine Company and a \$1.2 billion contract with the Palestine Power Generation Company. (*5) But the new deal with Jordan is far larger. With a projected start date in 2018, Jordanian imports from this deal are set to total 1.64 trillion cubic feet of natural gas by 2033. This amount makes up almost 20% of the total extraction from the first phase of the Leviathan field. According to the terms of this agreement, Jordan will be importing 300 million cubic feet out of the 1.6 billion cubic feet to be extracted from Leviathan every day. (*6)

The proposed terms for Jordan's gas imports have not been published, and negotiations over the price are only expected to be finalised by mid-November 2014. (*7) However, by combining provisional data about the quantity of gas Jordan plans to purchase with the terms of the 2011 Israeli Petroleum Profit Taxation Law, we can calculate the revenue flows to the Israeli state.

(*2) <http://investors.nobleenergyinc.com/releasedetail.cfm?ReleaseID=868812>

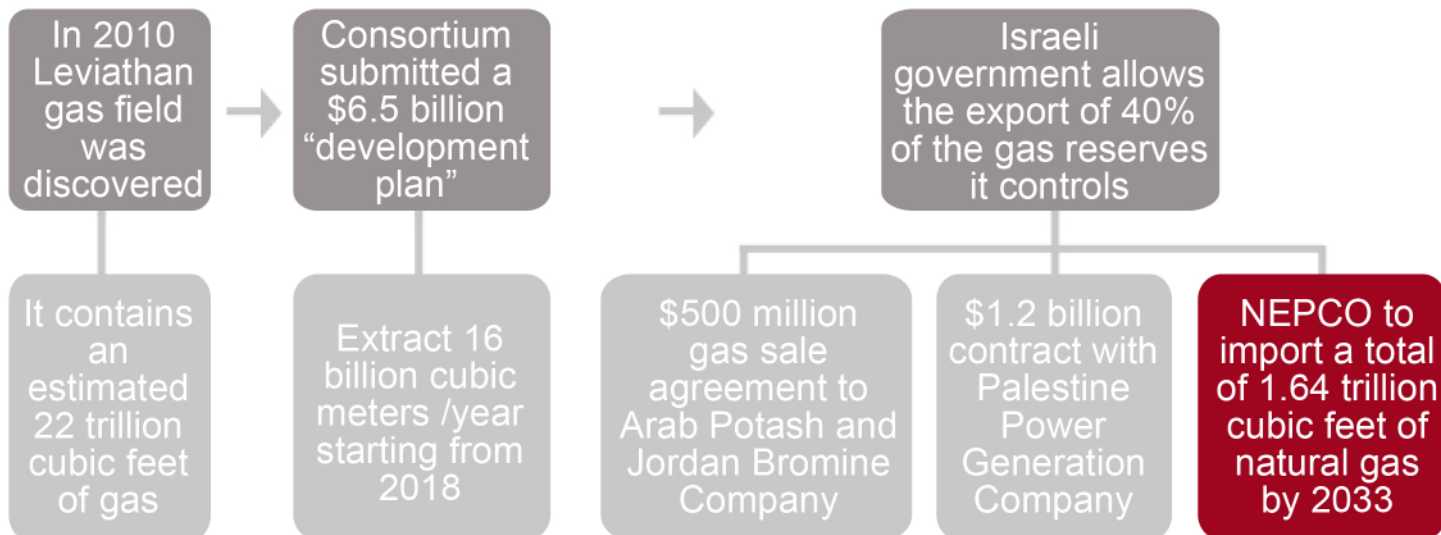
(*3) <http://investors.nobleenergyinc.com/releasedetail.cfm?ReleaseID=868812>

(*4) <http://www.reuters.com/article/2014/09/30/natgas-leviathan-idUSL6N0RV1VO20140930>

(*5) <http://www.naturalgaseurope.com/leviathan-partners-palestinian-authority-gas-deal>

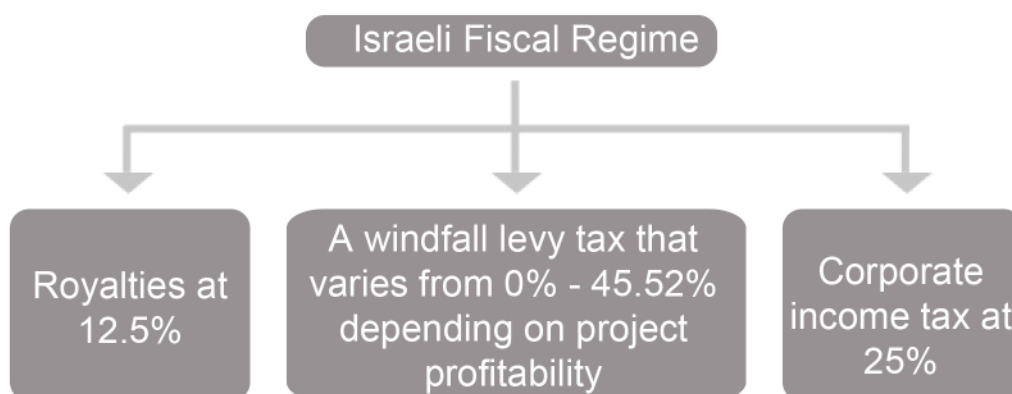
(*6) <http://investors.nobleenergyinc.com/releasedetail.cfm?ReleaseID=868812>

(*7) <http://www.reuters.com/article/2014/10/24/us-mideast-investment-jordan-energy-idUSKCN0ID0YM20141024>



Israeli Fiscal Regime

The Israeli fiscal regime for oil and gas is relatively simple and corporate-friendly. It consists of three key elements:



Royalties

Royalties are a fixed 12.5% percentage share of production that goes to the host state. In calculating revenues, royalties take precedence, before any assessment of costs. In the Israeli case, there is only one royalty rate, regardless of extraction or profitability increases.

Windfall Levy Tax

The 2011 Israeli Petroleum Profit Taxation Law created a special incremental profits levy in addition to regular corporate tax.

The levy will be imposed only after the capital investments in exploration, drilling and construction are fully returned plus a 50% yield. Levy rates vary according to the project's profitability, measured by an R factor, which equals net cumulative revenues divided by exploration and development expenses. Net cumulative revenues are "cumulative revenues less cumulative current expenses and payment of cumulative royalties and levy."

The windfall levy starts at 20%, then rising incrementally to 35% and then 45.52% after a return of 230% on investment.

Payback on investment	R factor	Windfall Levy
<150%	0 – 1.5	0%
150 - 200%	1 – 1.5	20%
200 - 230%	2 – 2.3	35%
>230%	>2.3	45.52%

Corporate Income Tax

The general Israeli corporate income tax rate of 25% applies to the oil & gas sector. Future changes to income tax rates won't affect existing oil projects, as the windfall tax rate will be amended correspondingly.

As well as corporate income tax, the Israeli tax system imposes a 30% withholding tax on dividends paid to shareholders holding >10% of the company, and 25% on shareholders holding <10%. However, this withholding tax rate is often lower, dependent on international tax treaties. So Delek Drilling, Avner Oil and Ratio Oil will pay a 30% withholding tax on dividends, as a US company, Noble is only liable for 15%. (*8)

Our Model

Platform has created a fiscal model to assess the split in revenues between the companies and government. Our calculations calculate the overall revenue breakdown for the first phase of Leviathan development over 15 years, and then extract the portion related to Jordan exports.

The Jordan-Israel deal is reported as being worth \$15 billion, for a total of 1.6 trillion cubic feet – 300 million cubic feet a day. By this measure, the first phase of Leviathan is worth \$76 billion, given a total of 8.34 trillion cubic feet over 15 years (based on the envisaged 16 billion cubic metres per year).

Initial investment costs are likely to be \$6.5 billion, according to Noble Energy's Leviathan development plan submitted in September. (*9) Operating costs have been estimated at \$0.30 per thousand cubic feet (mcf) – totalling \$2.5 billion over the 15 years. (*10)

(*8) <http://embassies.gov.il/nicosia/NewsAndEvents/Documents/Doing%20Business%20with%20Israel%20%28Tieger%29.pdf>

(*9) <http://www.reuters.com/article/2014/09/30/natgas-leviathan-idUSL6N0RV1VO20140930>

(*10) <http://www.reuters.com/article/2014/09/30/natgas-leviathan-idUSL6N0RV1VO20140930>

Our model works from annual extraction rates, to calculate royalty payments, the windfall tax levy and corporation tax transferred to the Israeli state. As the project's profitability increases, so does the rate of the windfall levy. Using the available information, we can assess the total state revenues, net corporate profits, and final (post-tax) corporate revenues derived from the Leviathan field every year. From this, we can work out the portion of revenues paid by Jordan to the companies and the Israeli state.

$$\text{State Revenues} = \text{Royalty} + \text{Windfall Tax Levy} + \text{Corporation Tax}$$

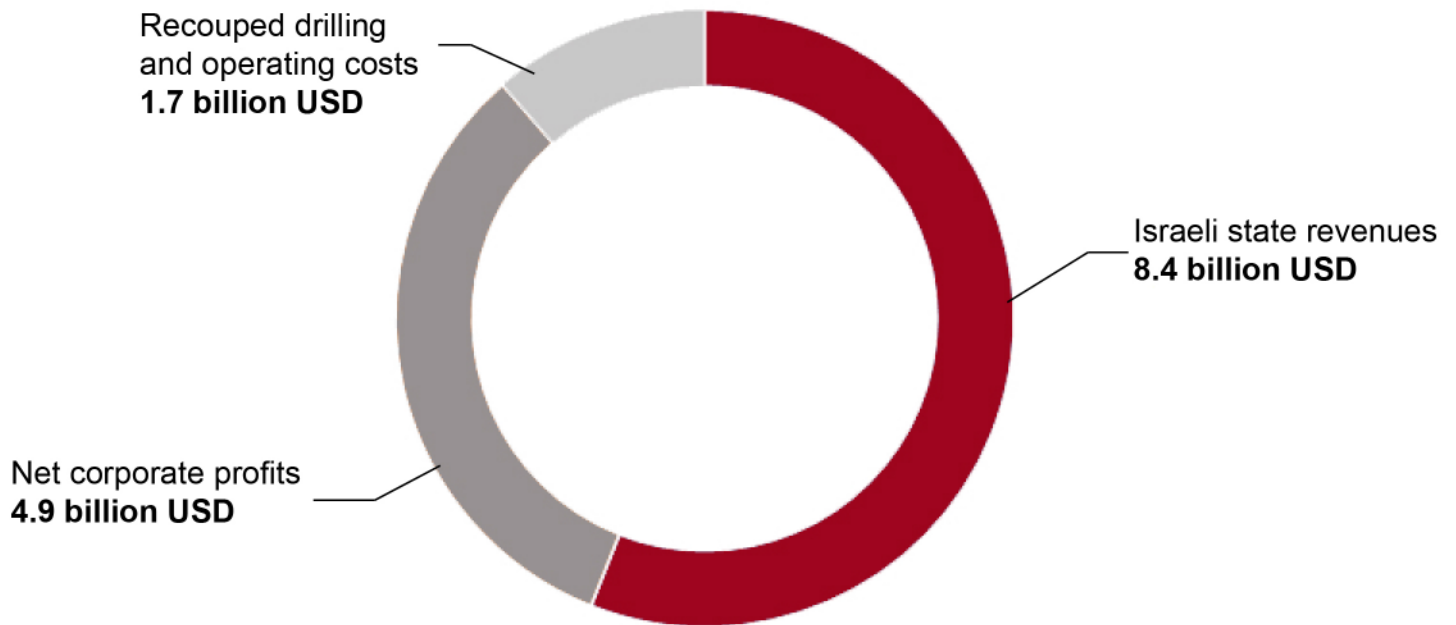
$$\text{Net Corporate Profits} = \text{Revenues} - \text{Royalty} - \text{Investment Costs} - \text{Operating Costs} - \text{Windfall Tax Levy} - \text{Corporation Tax}$$

	Israeli state revenues (USD)	Net corporate profits (USD)	Recouped costs (USD)
2018	125,000,000	0	875,000,000
2019	231,125,318	318,375,953	450,498,730
2020	556,601,875	410,548,125	32,850,000
2021	623,047,510	344,102,490	32,850,000
2022	623,047,510	344,102,490	32,850,000
2023	623,047,510	344,102,490	32,850,000
2024	623,047,510	344,102,490	32,850,000
2025	623,047,510	344,102,490	32,850,000
2026	623,047,510	344,102,490	32,850,000
2027	623,047,510	344,102,490	32,850,000
2028	623,047,510	344,102,490	32,850,000
2029	623,047,510	344,102,490	32,850,000
2030	623,047,510	344,102,490	32,850,000
2031	623,047,510	344,102,490	32,850,000
2032	623,047,510	344,102,490	32,850,000
2033	623,047,510	344,102,490	32,850,000
Totals	8,389,297,313	4,858,153,958	1,752,548,730

Note: Net corporate profit does not take into account any corporate income tax that Noble Energy may need to pay to the United States Government

Out of the \$15 billion that Jordan would pay for gas over the coming 15 years, \$8.4 billion will be paid to the Israeli state. \$1.7 billion will cover drilling and operating costs, and \$4.9 billion will go to the companies involved. That means that almost 56% of Jordanian gas payments will go to the Israeli state - \$559 million every year.

Of the money going to the companies in the consortium, \$1.93 billion will go to the US company Noble Energy, and \$2.93 billion will go to Israeli companies.



Revenue Distribution

In reality, the revenue income to the Israeli state will almost certainly be significantly higher. This calculation does not include:

- The 30% withholding tax on dividends paid to Delek Drilling, Avner and Ratio Oil shareholders or the 15% withholding tax that Noble Energy is liable for. (*11) Even if only one third of corporate profits are returned to shareholders, this would create a further \$389 million in tax revenues.
- Income tax on employees
- 25% Capital gains tax if Leviathan shareholders sell any of their holdings. (*12)
- 17% VAT rate

This means that \$8.4 billion is likely a low estimate of actual Israeli state revenues derived from gas exports to Jordan.

(*11) <http://embassies.gov.il/nicosia/NewsAndEvents/Documents/Doing%20Business%20with%20Israel%20%28Tieger%29.pdf>

(*12) [http://www.ey.com/Publication/vwLUAssets/2013_global_oil_and_gas_tax_guide/\\$FILE/EY_Oil_and_Gas_2013.pdf](http://www.ey.com/Publication/vwLUAssets/2013_global_oil_and_gas_tax_guide/$FILE/EY_Oil_and_Gas_2013.pdf)

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