Energy & Natural Resources - Israel

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Electricity sector
Natural gas sector
IPP regulation
Renewable energy regulation

Israel has an installed electricity capacity of 12,000 megawatts, which is based almost exclusively on fossil fuels. Until the discovery of natural gas offshore, all fuels were imported. The introduction of natural gas into Israel's fuel basket is dramatically changing the energy landscape, allowing for the introduction of independent power producers (IPPs) and modernisation of the market. Renewable energy is also slowly penetrating the market, predominantly in the photovoltaic sector.

Electricity sector

The electricity market is dominated by Israel Electric Corporation Ltd (IEC), a government-owned, integrated monopoly which is responsible for generating approximately 95% of Israel's electricity. IEC is also responsible for the transmission, distribution and supply of electricity to consumers.

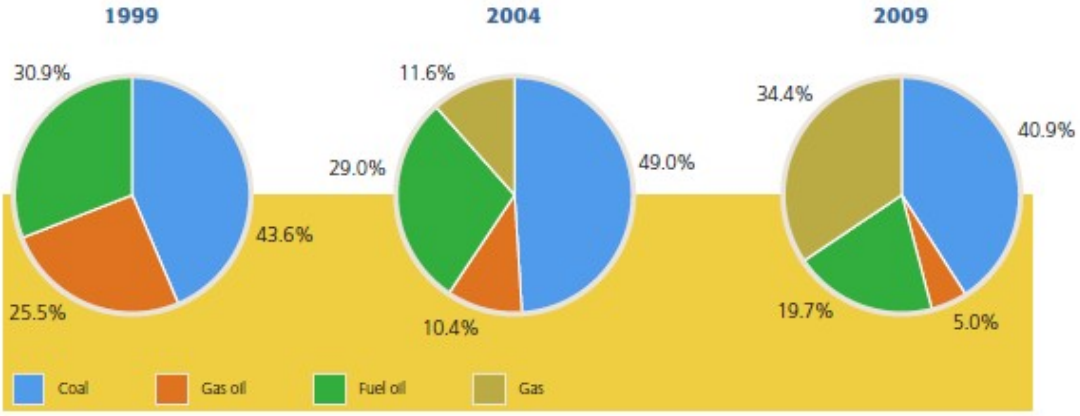
The Electricity Sector Law 1996 introduced a licensing regime whereby IPPs can enter the market by obtaining generation licences for conventional, co-generation and renewable energy power stations, and supply licences for the electricity that they produce.

According to the Electricity Law, an 'essential services provider' (as defined in the Electricity Law; at present, only IEC qualifies as such) is obliged to purchase electricity from a licensed IPP. An essential services provider is also obliged to provide electricity transmission services and a back-up electricity supply to the customers of a licensed IPP, in exchange for a tariff.

Amendments to the Electricity Law over the last five years have sought to implement structural reform in the electricity sector by separating the links of the electricity supply chain and splitting up IEC into generation, transmission, distribution and supply companies, and forming a separate system management company. The structural reform has not yet been implemented; however, ongoing discussions between the government, IEC and the IEC trade union should result in structural change to some extent.

The introduction of natural gas into Israel's fuel basket has greatly influenced the electricity market. In 2010 almost 35% of Israel's electricity was generated from natural gas. IEC has served as anchor buyer for both of Israel's gas suppliers, purchasing more than 90% of the gas supplied. However, the introduction of natural gas is slowly enabling the entrance of IPPs and heavy industries into the electricity generation market.

Fuels used in electricity generation (figures from IEC's 2009 Annual Report)



Natural gas sector

Gas supplies
The first significant natural gas discovery in Israel was made a decade ago by a consortium in which US oil and gas company Noble Energy Inc holds a 47% stake and the Israeli Delek group of companies holds a 53% stake. Delivery of gas from the group's offshore Mari B field began in 2004 and is expected to continue until 2013.

Egyptian company East Mediterranean Gas SAE delivers gas from the Egyptian gas system, through a marine pipeline from El-Arish to the southern Israeli coast.

In 2010 East Mediterranean Gas and the Noble-Delek group delivered approximately 5 billion cubic metres (BCM) to Israeli customers.

The end of 2010 could not have been more dramatic for Israel's energy sector. The Noble-Delek group, with additional partners, announced a deep-water gas find of close to 450BCM in the Leviathan field. This followed the group's Tamar field discovery, which is said to contain approximately 145BCM.

There is a third potential pipeline supplier in the vicinity, namely the British Gas group, which holds a licence offshore of Gaza for the development of a field of approximately 40BCM. This gas is yet to be contracted for.

Regulatory system for upstream sector
The Petroleum Law 1952 governs and regulates Israeli upstream activities with regard to the exploration and production of hydrocarbons, including natural gas.

The Petroleum Law sets out the rules and procedures for granting preliminary permits, licences and leases. A preliminary permit grants the right to conduct preliminary tests (eg, seismic exploration) in the permit area, but does not grant the right to drill. A petroleum licence entitles the licence holder to conduct exploratory activities. On making a commercial discovery in a licensed area, the licence will be converted into a lease which grants the exclusive right to produce hydrocarbons for the period of the lease.

Permits, licences and leases are granted by the petroleum commissioner, usually in consultation with the Petroleum Council, which is an advisory body to the commissioner. Once granted, they are recorded and published in the Petroleum Register.

Since the discovery of the Tamar field, there has been public debate over the need to update and amend certain provisions of the Petroleum Law which have remained untouched for many decades. The royalty-government take issue (the royalty take is currently 12.5%) has drawn the majority of the fire and has led to the minister of finance forming an advisory committee (the Shishinski Committee), whose findings have just been published. The findings of the committee include imposing a windfall tax on profits and cancelling certain tax breaks, while leaving royalties at their current rate.

The rules applicable to the transfer of petroleum licences are also undergoing changes. The Petroleum Law determines that the transfer of a licence is subject to the commissioner's consent. Since the discovery of the Tamar field, there has been a significant rise in the number of transactions surrounding the transfer of interests in licences. A proposal was recently published for a public hearing, under which the transfer of licences would be severely limited and the commissioner's discretion would be interpreted to apply also to the change of control of licences.

Regulatory system for downstream sector
The Natural Gas Industry Law 2002 governing the downstream sector determines a

licensing regime for the construction and operation of transmission and distribution pipelines, storage facilities and liquefied natural gas facilities.

The Natural Gas Law also sets out rules on the tariffs and service obligations of infrastructure licence holders. In addition, it includes provisions facilitating the acquisition of rights in land for downstream infrastructure.

Natural gas infrastructure and storage
The Israel Natural Gas Lines Ltd, a government-owned company, holds a licence for the construction and operation of the gas transmission system in Israel. At present, the transmission system stretches over 400 kilometres.

The Natural Gas Authority regulates the natural gas sector and is responsible for publishing gas transmission tariffs and connection rules.

Regarding distribution networks, tenders have been published and licences have been granted for distribution networks in central and southern Israel. Tenders for additional areas are being published.

At present, there are no natural gas storage facilities or liquefied natural gas facilities in Israel. Linepack in the transmission system is minimal and does not exceed a few hours.

IPP regulation

Some parts of the IPP regulation apply to all modes of generation (eg, renewable energy and conventional), including:

- the regulations determining conditions under which licences will be granted;
- the template licence provisions; and
- the project finance facilitation regulations.

However, there is also specific regulation of tariff structures and other price mechanisms and rules, which vary according to each generation sector.

Renewable energy regulation

An essential services provider is obliged to purchase electricity generated from a renewable energy IPP at a set tariff for a period of 15 to 20 years.

In 2004 the Public Utility Authority published a premium-based incentive tariff system for renewable energy generation, whereby in addition to the manufacturing component applicable to all IPPs, the renewable energy IPP would be entitled to a premium. The premium is payable based on the amount of pollutants that the renewable energy generation prevents in comparison to conventional generation.

This system applies to all forms of renewable energy generation, including wind, water and solar, unless specific alternative tariff systems have been determined (eg, the feed-in tariff system, which is determined in the solar sector and part of the wind sector).

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