



Weekly Briefing

**Romania economy briefing:
Potential exploitation of Black Sea gas fields under threaten
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Potential exploitation of Black Sea gas fields under threaten

Investments in the exploitation of Black Sea gas have been put on standby in the last two years due to several reckless legislative changes. While there are important gas fields in the Black Sea, the opportunities for being exploited are reducing unless measures are taken. On one hand, huge investments are needed, which are not possible if the legislation does not improve. The two companies which took the perimeter into concession already announced potential withdrawal from the project. On the other hand, in the European Union's (EU) energy strategy, gas only plays a role in the transition to renewable energy, therefore European financing for gas production capacities is under discussion. The amended Offshore Law could enter into force in a few months, but it depends on the new configuration of the Parliament, which will be established after the elections.

The Natural Gas Forum which took place recently brought back to attention the amendment of the Offshore Law, envisaged for several months already. Due to previously reckless legislative changes, investments in the exploitation of Black Sea gas have been put on standby for the most part, according to the representatives of the Government, but starting the extraction is an important goal. The commencement of natural gas exploitation in the Neptune deep perimeter of the Black Sea depends on the amendment of the Offshore Law. The provisions of the law, especially the fiscal ones, were considered unacceptable by Exxon Mobil and OMV Petrom, the companies which are equal partners in the Neptune project, which is intended to explore the deep-sea field in the Black Sea.

Last year, Exxon announced its intention to withdraw from Romania due to the costs imposed by the regulations and because it has discovered much larger and more valuable deposits than those in the Black Sea, while OMV Petrom representatives have repeatedly argued that gas extraction from the Neptune deep perimeter will become uncertain if the Offshore Law is not amended. Since last year, when Exxon Mobil announced its intention to withdraw from the project, the prices on the gas market have first fallen, then collapsed with the eruption of the coronavirus pandemic. Romania is the second largest natural gas producer in the EU. However, in the context in which the EU gas production fell by 19% in the first half of this year, the quantity extracted in Romania also diminished by 10%, according to a report by the European Commission's Directorate-General for Energy. The final investment decision in the

operation of Neptun has not been taken yet, as Exxon Mobil has announced to sell its stake, while the Romanian State is interested in buying the share through the Romgaz company. The reserves of the deep-sea Neptune field are estimated at 42 - 84 billion cubic meters of gas, which represents 4 to 8 times more than the current annual production of Romania.

Another major problem for the Black Sea exploitation is due to the new EU regulations. At the EU level, new gas projects will no longer be funded if they block financial resources in assets that delay the transition to renewable energy solutions. In the context of Green Deal, Romania is interested in obtaining European financing for initiating the transition from coal energy production to natural gas produced energy. At present, coal energy provides over 20% of Romania's electricity consumption.

In the actual context, natural gas generates half of CO₂ emissions as compared to coal, but its production is associated with methane gas leaks, a strong greenhouse gas. Moreover, environmental activists consider that the new natural gas power plants could run for decades, jeopardizing the EU's goal of reducing CO₂ emissions by 2050. Under these circumstances, financial resources needed for the transition to renewable energy sources could be blocked, on the long term, in natural gas assets which will not lead to the EU environmental objective to reduce pollution. Due to this fact, EU Member States decided to recommend excluding nuclear and gas investment projects from Fair Transition funding. Several other countries in Central and Eastern Europe, among which Poland, Bulgaria and Hungary, are in a similar situation and requested European Commission not to exclude natural gas projects from future funding. At present, the Council and the European Parliament are working on an agreement on the various budgetary instruments of the Multiannual Financial Framework, which would provide solutions related to financing gas-related investments. Therefore, according to experts, the window of opportunity has narrowed considerably for the exploitation of Black Sea gas, and efforts are quickly needed for harnessing what could be exploited.

At the European Council in October, President Iohannis stated that Romania could accept, under certain conditions, the European Commission's proposal to reduce greenhouse gas emissions, as long as the energy mix remains a national competence. Romania's position is that the reduction of greenhouse gas emissions by 2030 is an ambitious project, which could be accepted under certain conditions. Therefore, the achievement of the EU target will depend on the establishment of support mechanisms and flexibilities adapted to the needs and specifics of the Member States. In addition, previous efforts in this direction should be taken into account, as well as the differences between Member States.

Since mid-2019, President Iohannis announced the intention to make changes to the Offshore Law and to the provisions of the Government Ordinance 114/2018 which affected investors in the Black Sea. At the beginning of 2020, the Government Emergency Ordinance 1/2020 repealed a part of the provisions of the Emergency Ordinance 114 which added new investment costs at that time. However, oil companies' representatives considered that the provisions of the ordinance were not enough without amending the Offshore Law. Oil companies still reclaim that several stipulations of the law raise problems, such as the obligation that at least half of the extracted gases to be sold on a Romanian stock exchange; the threshold for deducting investments from taxes reaches a maximum of 30% of the total tax on additional offshore income, which is considered restrictive; the obligation that 25% of the average annual number of employees used to carry out the agreements to be of Romanian citizenship and to have the fiscal residence in Romania. Now, they persuade the Government to enhance the change of the legislation, given the new framework of conditions emerged under the EU's environmental pact.

At the beginning of October, a draft for amending the Offshore oil exploitation law was drawn by the Minister of Economy, Energy and Business Environment, based on the discussions with the investors in the Black Sea region. The draft law will be launched in public debate before the elections at the beginning of December, but it will have to be approved by the next Parliament by early March 2021. In the meantime, a clear schedule of discussions will be launched. The main target is to bring balance between the interests of the state regarding the capitalization of reserves for financing the budget and the need to stimulate investors. A representative of the Minister of Economy said the Romanian Government intends that gas extraction from the Neptun deep offshore field to begin by 2025. However, the fact that the officials of the Minister do not rule out the delay of starting the operation until 2025 denotes the difficulties of rebuilding the consortium of concessionaires, given that the natural gas markets are going through a difficult period that could be prolonged.

While there is a large exploitation potential in the Black Sea, a high fee on the exploited gas will reduce the competitiveness of these gases, both in the domestic market and in the single European energy market. The investments made so far in the Black Sea are about 3.5 billion dollars, only in exploration. To exploit these resources and reach a peak of over 10 billion cubic meters per year, investments of at least 6-7 billion dollars are needed, therefore investors should be encouraged to participate. The key for such investments is low taxation, according to the representatives of the Ministry.

In addition, there is another problem, since the Financial Supervision Authority has not yet issued the necessary approval to the Romanian Commodity Exchange to mediate derivative contracts on the natural gas market and to become a financial counterparty in all transactions, as stipulated in the actual Offshore Law. It is intended that the Romanian Commodity Exchange to provide both the functions of electronic trading platform and post-trading, being a financial counterparty in all registered transactions. The request of the Romanian Commodity Exchange is still under analysis.

Therefore, the purpose of the actual legislative proposal is to remove a number of obstacles that are blocking investment in the Black Sea as soon as possible. The new draft law intends to create a framework for investors who exploit gas to have business continuity and to multiply the effects of their investments in the economy. This will lead to an accentuated development of the gas market, to the transparency of the transactions and to the stimulation of the competition.