interfax
Natural Gas Daily

Natural gas news, analysis and intelligence
Volume 4 Issue 107
Thursday, 5 June 2014

Interfax Information Services Group
www.interfaxenergy.com

Kuwait shakes up Persian Gulf with LNG deals

Kuwait's Mina al-Ahmadi LNG terminal. The country will receive 32 cargoes this year. (KPC)

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Middle East contributor

KUWAIT has made a brisk start to its LNG buying season. After deals with BP and Shell in April and May, Kuwait Petroleum Corp. (KPC) signed a politically significant eight-cargo deal with Qatargas on 29 May – the first direct agreement between the two companies.

These deals confirm the Kuwaiti government's ambition to increase its gas supply through imports rather than challenge established interests by developing the Jurassic gas fields in the north of the country.

Under these deals, Kuwait will receive 32 shipments of LNG this year. Each will carry 80,000 tons, with Shell supplying 18 cargoes (nearly 60% of the total), Qatargas eight and BP six (about 20% each). Doha delivered the first cargo in April and two further cargoes have been delivered since then.

Although the Qatargas supplies will only extend the agreement beyond 2014 under certain conditions – unlike the BP and Shell increments, which will carry on for another six years – the deal is pivotal for Kuwait's gas plans by paving the way for deeper energy and commercial relations between the two Gulf states.

The LNG cargo price is understood to be lower than the export price Qatar has previously sought with international buyers, with indications Qatargas agreed a sales price with KPC of $6-7/MMBtu.

The Qatari cargoes represent a form of commercial payback for Kuwait in light of its ongoing mediation efforts between Qatar and its Gulf neighbours Saudi Arabia, the United Arab Emirates and Bahrain.

The latter countries withdrew their ambassadors from Doha in March, following a bitter diplomatic rift related to alleged Qatari sponsorship of the Muslim Brotherhood. Kuwaiti officials carefully negotiated between the states, helping to find an amicable resolution to the spat by mid-April.

"Kuwait was rewarded for its role in mediating the political disagreement between Qatar and the three Gulf states. It played a central role in bringing the sides together after Qatar was effectively excommunicated," said Justin Dargin, a Gulf energy analyst at the University of Oxford.

The supply commitments for up to 2.4 mtpa of LNG until 2020 make Kuwait a serious gas importer, as it prepares to build permanent import

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infrastructure that will eventually supersede the floating facility at Mina al-Ahmadi port.

Although the country's domestic demand is rising, Kuwait's government has the financial resources to pay for the LNG, with local estimates of the Shell deal's value placed at $12 billion, and that of the BP supply contract at $3 billion. Kuwait has little obvious alternative, given the significant challenges it has encountered in developing the 991 billion cubic metre Jurassic fields.

These are ultra-deep, high-pressure reservoirs, making recovery especially difficult for KPC subsidiary Kuwait Oil Company (KOC), which has limited technological expertise in this area.

Shell also signed an $800 million enhanced and technical service agreement (ETSA) with KOC in February 2010, covering the development of the Jurassic fields.

Lifting costs at these fields are high – they are estimated to be in the $6-8/MMBtu range, while wells are 4,000-5,000 metres deep. The sulphur content is high, and drilling is considered more difficult than on conventional fields because the Jurassic fields are not homogeneous.

Production plateau

Output from the fields has plateaued at an estimated 4.25 million cubic metres per day (MMcm/d), which makes KOC's ambition of producing 28 MMcm/d of gas by 2016-2017 look highly ambitious, not least as political disputes are stymieing development plans for the technically complex acreage.

MPs in Kuwait's parliament have been accused of having vested interests and obstructing the entry of IOCs into oil and gas fields. Shell's ETSA was referred to the public prosecutor in 2012, following a report by a special probe panel formed to investigate the contract, instigated by a former oil minister.

A parliamentary panel also investigated the deal after MPs had raised questions that the contract was awarded to Shell without competition.

More than any other Gulf state, Kuwait's political structure has obstructed national energy policy priorities.

"LNG is a walk in the park compared with wading through that minefield," said Jim Krane, energy fellow at Rice University's Baker Institute, referring to the political objections to the Jurassic project. "KPC is politically immobilised at the moment. Combine that with the Jurassic project's technical issues and it becomes hard to see how the Kuwaitis can bring the field into production."

If LNG imports, which started in 2009, were intended as a means to buy the authorities time to develop Jurassic fields, their purpose has now changed. Kuwait has been set up as a significant LNG buyer for the long term.

Although the cost of building LNG facilities and paying the market price for cargoes is substantial, the upfront expenditure would offset the opportunity cost involved in Kuwait continuing to burn substantial volumes of crude, diesel and heavy fuel-oil in its power generation plants. Converting power generation plants to run on gas would free up 250,000-300,000 barrels per day of crude oil for export.

Plans to create a permanent LNG infrastructure have gathered pace this year. In early March, Kuwait National Petroleum Co. (KNPC) awarded the design contract for a new onshore LNG terminal at Al-Zour to Foster Wheeler.

The thinking is that, by the time the KNPC terminal is finished, Kuwait will be in a position to tap more competitively priced gas as global supply expands.

Talk of increasing LNG volumes from later this decade sits well with the evolution of Kuwait's long-term energy strategy. "There's a lot more extra gas that is going to be out there, so having that terminal isn't a bad option," said Krane.

Transforming itself into an LNG importer does not mean Kuwait is about to give up on its Jurassic ambitions. According to Dargin, the Kuwaiti strategy is to have gas production at commercial levels towards the end of the decade, "not filling the gap entirely, but at least supplementing it".

While LNG has hitherto been viewed by Gulf states as a stop-gap measure until domestic output is up and running, that view may be shifting – with Kuwait in the vanguard of change.

"Kuwait has shown that LNG is going to be a vital part of the overall energy mix, and that represents a structural change in the acceptance of some Gulf states that they will become year-round LNG importers," said Dargin. ■

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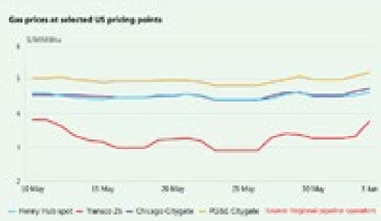

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