



The Chair,  
CDM Executive Board  
UNFCCC Secretariat  
[CDMinfo@unfccc.int](mailto:CDMinfo@unfccc.int)  
March 6<sup>th</sup>, 2009

Dear Chair,  
CDM Executive Board

**Subject: Request for review of the request for registration for the CDM project activity “Dead Sea Works Ltd. Small Scale Fuel Switch Project” (UNFCCC Ref. no. 2263)**

SGS has been informed that the request for registration for the CDM project activity “Dead Sea Works Ltd. Small Scale

Fuel Switch Project” (UNFCCC Ref. no. 2263) is under consideration for review because three requests for review have been received from members of the Board.

The requests for review are based on the reasons outlined below. SGS would like to provide a response to the issue raised by the request for review:

***Request for clarification to the DOE/PP:***

**Request for Review issues 1-4 Issue 1:**

*The DOE is requested to further substantiate the barrier analysis. The PP/DOE are reminded that if the barriers cannot be sufficiently substantiated, they have an option to establish baseline and additionality through financial analysis.*

**SGS Response to Issue 1:**

Historically natural gas has not been widely available for use in the energy and industrial sectors in Israel. With the discovery of a small natural gas reserve off of Israel's southern coast in 1999, the Israeli government launched a regulatory and infrastructure process designed to bring about a conversion to natural gas on a national level.

However, 10 years later several significant barriers remain and few facilities have converted to natural gas. The vast majority of facilities, and all private-sector industrial facilities with the exception of one CDM project, have opted instead to avoid the significant risks entailed by the great uncertainty in the fuel supply and the obstacles posed by a lack of host country experience with natural gas.

**Uncertainty of Fuel Supply Barrier – Sole Supplier**

The primary barrier faced by industrial users interested in converting to natural gas is the fact that there is no secure supply of natural gas for Israel in the long term. At the time of the Global Stakeholders Process (GSP) in January 2008, Yam Tetis (also termed as Tethys), which owns the license to develop the Israeli natural gas reserves discovered in 1999, was the sole supplier of natural gas to the Israeli market.

The PP has presented the DOE with the 2007 financial reports of Delek Group, a publicly-traded company and one of the four primary partners in the Yam Tetis project, which state that proven Yam Tetis reserves prior to the natural gas extraction amounted to only 32 billion cubic meters (BCM). By the end of 2007, just prior to the GSP, these proven reserves had dwindled to a total of 24 BCM (Annex 1, pg. A-208). Furthermore, some 70% of the reserves had already been contracted to the four Israeli facilities that had

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already converted to natural gas at the time – three companies that were either government-owned or had enjoyed significant government backing, and one CDM project. When compared to an expected annual Israeli demand that could be as high as 15.627 million metric tons, or approximately 12 BCM, by 2015 (Annex 2), it is clear to the DOE that this reserve cannot meet the needs of the Israeli industry beyond the short term. In fact, according to information provided by the Ministry of National Infrastructures' 2008 budget summary (Annex 3), the Yam Tethys reserves "are running out."

As such, when Dead Sea Works (DSW) finally did sign a gas purchase agreement with Yam Tetis in March 2008, this agreement only secured a natural gas supply for the plant for the short term. Excerpts of this contract were provided to the DOE, which uploaded them to the UNFCCC Web site along with the request for registration. As can be seen by the Delek Group financial reports, this contract is limited in time to five years after the running in period, but no later than 2015 (Annex 1, pg. A-236). From the perspective of an industrial plant, switching fuels is a strategic decision with significant long-term implications. In this context, the DOE is convinced that securing a fuel supply for five years does not reduce the uncertainty of fuel supply barrier faced by the DSW plant.

At the time of the GSP, there were two other potential fuel suppliers in the region, neither of which supplied natural gas to the Israeli market at the time. The first, British Gas, has the license to develop a natural gas field with proven reserves of only 1 tcf (approximately 30 BCM) off the coast of the Gaza Strip (Annex 4). Given its small size, and when compared to the forecasted Israeli demand of up to 12 BCM annually by 2015, it is clear to the DOE that this reserve too cannot provide the Israeli market with natural gas in the long term. In addition, as the reserve belongs to the Palestinian Authority it faces a more immediate problem, due to the ongoing conflict between Israel and the Palestinians in general and the Gaza Strip's Hamas leadership in particular. In fact, in 2005 the Israeli government decided not to permit Israeli consumers to purchase natural gas from the reserve, due to concerns that the funds would reach Hamas (Annex 5). As a result, British Gas froze plans to develop the reserve. Even had British Gas begun to develop the reserve in early 2008, at the time of the GSP, this gas would not have been available prior to 2011 (Annex 6). This was the estimate in 2007, before British Gas withdrew from negotiations with the Israeli government in December of that year and in January 2008 closed its offices in Israel (Annex 4). Therefore, British Gas was not available for DSW as a supplier at the time the plant decided to undertake the project activity. Furthermore, any progress on bringing the natural gas to the Israeli market is dependant on improved ties between Israel and the Gaza Strip, and even then - due to the limited gas reserves - British Gas will be unable to meet the Israeli market's demand for natural gas in the long term.

The second potential natural gas supplier, which also was not supplying the Israeli market at the time of the GSP, is Eastern Mediterranean Gas (EMG). EMG has the license to develop significant natural gas reserves in Egypt, and as such the DOE is convinced that at the time the DSW plant decided to implement the fuel switch it was the sole potential supplier of natural gas to the Israeli market beyond the short term.

The complete dependence on a single supplier of natural gas is problematic in any part of the world, as evidenced by the recent natural gas crisis in Europe. In January 2009, Russian gas giant Gazprom cut off supplies to Europe via the Ukrainian pipeline, leaving many European countries dependant on Russian gas without adequate energy supplies (Annex 7). In the context of the Middle East conflict, however, for Israeli industries the dependence on an Egyptian gas is far riskier, as it means that the fuel supply is constantly subject to Arab-Israeli geopolitical tensions. The DOE has validated that at the time of the GSP, the Israeli government had signed an agreement with Egypt for EMG to supply natural gas to the IEC, but the supply had yet to commence. Fierce calls were being heard in the Egyptian opposition to cancel the supply of natural gas to Israel (Annex 8).

The availability of natural gas from Egypt to Israel, the sole source of natural gas for Israeli industry beyond the short term, is not only subject to geopolitical risks, but also to risks associated with the limited capacity of the natural gas transmission system. The system, both within Israel itself and from Egypt, was designed based on earlier forecasts for Israeli consumption. The DOE has validated that by the time of the GSP, however, updated demand forecasts showed that the pipes used in constructing the transmission system were too narrow, and would not be able to provide the Israeli market with the quantity of gas demanded.

According to the Israeli Ministry of National Infrastructures the pipeline from Egypt is capable of transporting only 7 BCM annually (Annex 9). This pipeline therefore does not have enough capacity to meet the forecasted demand of up to 12 BCM per year by 2015. As previously mentioned, the Yam Tethys reserves are expected to be exhausted in the coming years. The British Gas reserves too are limited, and even with

the significant political progress needed for Israel to purchase this gas, it will take several years to develop the reserves. As such, in the absence of a new source of gas, or an expansion of the transmission system – which would entail replacing the existing pipeline, or installing an additional pipeline alongside it – the DOE is convinced that Israeli private sector may be left without adequate access to natural gas (Annexes 10, 15). Hence it was verified by the DOE that at the time PP decided to implement the fuel switch project the DSW plant faced a significant uncertainty of supply barrier.

### **Uncertainty of Fuel Supply Barrier – Lack of Host Country Experience**

The risk that the pipeline will not have the capacity needed to meet Israel's demand for natural gas, which directly impacts the availability of the fuel to the Israeli private sector, is indicative of the barriers posed by the lack of host country experience in dealing with natural gas infrastructure.

In 2002, as the existence of potential natural gas reserves became apparent, the Israeli parliament (Knesset) passed the Natural Gas Sector Law (Annex 11), enacting strict requirements for industrial use of natural gas and establishing the Natural Gas Authority (NGA) as the regulatory agency. In 2003, a government company, Israel Natural Gas Lines (INGL), was established as the sole company responsible for constructing the transmission system and transporting the gas, which it received the license to do in 2004.

Recognizing the lack of skilled and properly trained personnel in Israel, the Israeli government appointed a team to pursue cooperation with countries and natural gas suppliers that have experience in the field (Annex 12). Moreover, the DOE has validated that INGL required local subcontractors charged with constructing the natural gas pipeline to partner with experienced subcontractors from Annex I states (Annex 13). The tender was awarded to a joint venture of Solel Boneh, an Israeli company, and the Italian company Ghizzoni S.p.A, a well-established firm with over 50 years experience in pipeline construction.

The construction of the transmission system nonetheless suffered several delays. The first part of the overland transmission system, near the southern cities of Ashkelon and Ashdod, was expected to be in place by the end of 2006; in reality, the IEC power plant in the area had to wait until May 2008 before being connected to the gas lines. The second part of the transmission system, which will bring gas to DSW and other plants in the Dead Sea area, was expected to be completed by January 2008; to date, it is still incomplete, and is now expected to be finalized sometime in mid-2009. An updated letter from the Natural Gas Authority's chief economist Miki Korner was provided in order to confirm these delays (Annex 14).

According to the Manufacturing Association of Israel's Energy Committee Director Oren Harambam, these delays were due primarily to "problems with acquiring the necessary statutory permits and authorizations. Due to the lack of experience in Israel with natural gas, a dangerous substance that requires strict safety and operational precautions, the state required that the national transmission system be approved by a wide range of entities.

The construction was also delayed due to the late delivery of several major types of equipment, including Pressure Reducing and Metering Stations (PRMS) and valves, as well as delays on the part of project subcontractors due to financial disputes." (Annex 15)

At the time of the GSP, in January 2008, the transmission system to the DSW plant was still incomplete and continuing to suffer delays. This uncertainty in the availability of the gas added to the risks faced by DSW in deciding to undertake the project. In fact, the Delek Group 2007 financial reports define "uncertainties regarding construction of the national gas pipeline" as a risk of "major effect" (Annex 1, pgs. A-241, A-245). It is worth noting that still, over one year later, the natural gas transmission system to DSW has not been completed – further demonstrating that the uncertainty faced by DSW was real and concrete (Annex 14). The DOE is therefore concluded that the uncertainty regarding the completion of the transmission system constitutes an additional uncertainty of supply barrier faced by DSW in implementing the project.

### **Technological Barriers – Lack of Host Country Experience**

The PP has demonstrated that the lack of experience in working with natural gas has meant that the process of converting to the fuel, in accordance with the new Israeli regulations, is both long and arduous.

In the years that followed the passage of the Natural Gas Industry Law, the National Infrastructures Ministry and NGA elaborated on this regulatory framework by approving a series of new regulations regarding industrial use of natural gas. In order to receive the natural gas through the INGL transmission system, DSW must comply with a number of laws and regulations, including:

**1. Natural Gas Sector Law 2002** (Annex 11): This law is intended to

- a) Create the conditions necessary for the development of a competitive natural gas market;
- b) Regulate the market in a way that ensures investment and services at a high level of quality, reliability, and availability in an efficient manner;
- c) Ensure safe use of the natural gas.

Among other things, the law requires DSW to undergo an extensive and thorough licensing process for the entire natural gas infrastructure installed at the plant.

**2. Building and Planning Regulations (Low Pressure Natural Gas Facilities) 2006:** This regulation describes the detailed criteria which must be met by new natural gas facilities constructed by industrial users, including with regards to safety, environment, transportation, building materials, and landscaping.

**3. Natural Gas Market Regulations (Work Plan for Distribution Network) 2006:** This regulation describes the process for submitting blueprints of the natural gas infrastructure in industrial facilities, and what information must be included in each submission.

These regulations require any industrial plant switching to natural gas to contract external companies from Annex 1 countries to approve both the fuel switch plans and the actual installation of the natural gas equipment, down to the last detail. External companies must also be brought in to implement new safety systems (Annex 15). Therefore, DSW contracted with Afcon, a subsidiary of the German company Wega, to approve the plant's engineering plans. Bureau Veritas, from Belgium, was hired to perform third-party inspection of all the project equipment and construction at the plant to ensure that all components meet new Israeli Standard 5664 for natural gas systems meeting, which is based on the Dutch standard NEN 3650: 2003. The contracts with both Afcon and Bureau Veritas were presented to the DOE during the validation. The DOE has therefore validated that the need to contract Annex I companies for their technical expertise constitutes a technological barrier faced by DSW in implementing the fuel switch project.

In addition to meeting the new laws and regulations, the PP has demonstrated that the fuel switch required the plant to invest in an extensive training program for all employees who are involved in production, operation and maintenance and who will work with the natural gas. The plant's employees needed to be trained in working with the natural gas in accordance with the new standards and regulations, safety issues, and dealing with malfunctions. An external company, Shalhevet, was contracted to design and implement the training program. The contract with Shalhevet was provided in the initial response to the request for review, while the syllabus and actual training hours were uploaded to the UNFCCC Web site with the request for registration. The DOE believes that the need to contract an external company to design and implement such an extensive training program constitutes an additional technological barrier faced by DSW in switching to natural gas.

The implementation of such an arduous conversion process was further complicated by the fact that natural gas supply contracts are "take-or-pay", meaning that the plant must commit to purchasing a fixed quantity of gas, regardless of actual consumption (Annex 1, pgs. A-234-6). Given DSW 's lack of experience in working with natural gas, not to mention the lack of experience at other private industrial facilities in Israel, the DOE validates that committing in advance to a specific quantity of natural gas poses a significant risk. The DOE has validated that continued use of HFO and LPG, the consumption of which can be adjusted according to production needs, would not have entailed this additional risk.

In deciding to implement the project, DSW took a pioneering step despite the significant barriers and risks it faced. These barriers included uncertainty in the fuel supply – due to reliance on a sole, problematic supplier in the long term, and a lack of Host Country experience that led to repeated delays in the construction of the transmission system and severe limitations in its capacity – as well as technological barriers posed by an arduous process to convert to natural gas due to lack of Host Country experience and stringent regulations. The DOE has confirmed that as a result of these barriers, and the significant risks they entail, at the time of GSP and even to date few facilities in Israel have already converted to natural gas (Annexes 14, 15).

Of those facilities, the DOE has found that only one – American Israel Paper Mills - was a private-sector industrial plant that converted without government ownership or significant government backing, and that this fuel switch is registered CDM project activity No. 1502. The DOE has confirmed that all other conversions to

natural gas were implemented by government-owned companies or companies that enjoyed significant government incentives – the IEC, Ashdod Refineries, and IPP Delek Ashkelon.

The IEC is Israel's national electricity company, and serves as a strategic national asset that supplies Israeli private and industrial consumers with electricity. In addition to being government owned, it also enjoys crucial government support in the form of regulated electricity tariffs, which are determined according to a "cost plus" structure – meaning that whatever the cost of electricity generation, the IEC is assured a profit. As the construction of the national transmission system continued to experience delay, some IEC power plants that had already invested in a conversion to natural gas were forced to combust the far more expensive fuel diesel instead – something that was only made possible due to the "cost plus" tariff structure.

The Ashdod Refineries also converted to natural gas while still a government company in 2005, and as such the investment and risks were undertaken by the Israeli government. The final Israeli consumer of natural gas, the IPP Delek Ashkelon power plant, was constructed under a government tender with the specific intent to supply Israel's sole desalination plant, a strategic piece of national infrastructure. As such, the tender granted the IPP plant a government safety net that eliminated the risks faced by the project developer, without which the plant would not have been constructed.

As can be seen from the letters provided by both the Natural Gas Authority and the Manufacturers Association of Israel, to date these are still the only Israeli companies to have converted to natural gas. With the exception of AIPM, which took advantage of the additional revenues of CDM, all of the companies that have converted to natural gas have done so due to the fact that they received some form of government support.

CDM alleviates the barriers to natural gas use in Israel for private-sector plants in the same manner that government ownership or incentives have for strategic infrastructure facilities. In the absence of such incentives, the remaining Israeli industrial facilities continue to rely on a traditional mix of petroleum fuels for energy generation. The DOE is therefore convinced that it has been sufficiently substantiated that the barriers would have prevented DSW from switching to natural gas in the absence of CDM; the baseline scenario is therefore continued use of HFO and LPG (current practice), and the project is deemed to be additional.

#### **Request for review Issue 1-4 Issue 2:**

*The PP/DOE are requested to describe how the 'output from the dryer' has been defined in the project context and the procedure and method to measure the 'output from the dryer' and confirm that the requirements of paragraph 5 of AMS-III.B. version 12 are complied with.*

#### **SGS Response to issue 2:**

As per Paragraph 5 of AMS-III.B (version 12) states that "the emission baseline is the current emissions of the facility expressed as emissions per unit of output (e.g., kg CO<sub>2</sub>equ/kWh)." This paragraph does not require that output be defined as a unit of energy, but rather simply provides an **example** of an emission coefficient in which output is defined as a unit of energy. The DOE has therefore validated that there is no obligation for the PP to define output as a unit of energy. Also there is a clarification in Small scale methodology **F-CDM-SSCwg ver 01 SSC\_147** ([http://cdm.unfccc.int/UserManagement/FileStorage/AM\\_CLAR\\_3S1P9HTD691F90P0YYDK5E5DCZB8U1](http://cdm.unfccc.int/UserManagement/FileStorage/AM_CLAR_3S1P9HTD691F90P0YYDK5E5DCZB8U1)) explicitly states on page 2 that the methodology version 12 applies to projects in which "fuel oil is replaced with natural gas in a drying unit of an industrial facility." The DOE has therefore validated that there is no obligation for the PP to define output as a unit of energy.

An examination of registered CDM projects has found that there are three projects currently registered under AMS-III.B in which output is defined in terms of the weight of the output produced, some of which have already been issued CERs. The projects are;

1. Quimvale and Gas Natural Fuel Switch Project, No. 0828. This project was registered on 09 March 2007 under AMS-III.B version 9, and defines output as tons of CaCO<sub>3</sub>.



2. Switching of fuel from Natural Gas to Hydrogen in CCU-II at Dahej complex of GACL, No. 0940. This project was registered on 06 April 2007 under AMS-III.B version 9, and defines output as metric tons of Caustic Soda Flakes.
3. Acos Villares Natural gas fuel switch project, No. 1037. This project was registered on 19 May 2007 under AMS-III.B version 10 and defines output as both steam and tons of steel produced.

The DOE has checked that in both version 9 and version 10 of the methodology, under which the above three projects were registered, paragraph 5 contains the exact same language and defines output in the exact same manner as in version 12. The DOE has therefore accepted that the defined output for the current project activity is in accordance with the requirements of the methodology.

Furthermore, the PP has defined output as the weight of the product because it is technologically impossible to measure the amount of energy generated by the DSW plant's dryers. This is due to the fact that the dryers constitute an open system, and therefore the heat generated by the dryers either is absorbed in the product, forms steam when it comes into contact with the product, escapes through the stack, or escapes as heat losses to the surrounding environment. Monitoring the quantity of heat generated by the dryers is impossible, as no monitoring devices exist that can monitor the above four parameters in a continuous manner in order to determine the energy balance of the dryers. Therefore, the PP decided to define output as weight of product, and the DOE has validated that this is the most appropriate parameter as it can be clearly and accurately monitored and is in-line with both the methodology and previous projects approved by the EB under this methodology.

#### **Request for review Issues 1-4 Issue 3:**

*The DOE is also requested to clarify how they have ensured that all the emission reductions claimed is only due to fuel switching measure but not on account of any other measures (such as increase in efficiency, etc).*

#### **SGS Response to issue 3:**

As per the Methodology III-B, paragraph 1 "this category comprises fossil fuel switching in existing industrial, residential, commercial, institutional or electricity generation applications. **Fuel switching may change efficiency as well. If the project activity primarily aims at reducing emissions through fuel switching, it falls into this category.**"

The primary purpose of the project activity is to switch fuels, not improve energy efficiency, and in fact is not expected to impact energy efficiency at all. When ICL issued a tender for a contractor to implement the fuel switch at the DSW plant, one of the primary requirements of the tender was that contractor certify that "the performance of the present production process [remain] unchanged, including all production parameters." (Annex 16)

Furthermore, the DOE has validated an official letter from the DSW plant's Gas Conversion Project Manager Arie Farkash, confirming that the fuel switch will "not affect the efficiency of the dryers neither negatively nor positively" due to the fact that both heat input to the dryers and heat losses will remain unaffected. (Annex 17)

The DOE has therefore validated that the project will have no impact on the plant's production process, including energy efficiency, and thus all emission reductions claimed are due to the fuel-switching measure alone.

#### **Request for review Issues 1-4, Issue 4:**

*The DOE is requested to validate how the 'output' from the dryer will be measured in line with the requirements of paragraphs 5 and 9 of AMS-III.B, version 12.*

#### **SGS Response to issue 4:**

Paragraph 9 of AMS-III.B (version 12) states that "Monitoring shall involve:

- (a) Monitoring of the fuel use and output for an appropriate period (e.g., a few years, but records of fuel use may be used) prior to the fuel switch being implemented - e.g. coal use and heat output by a

district heating plant, liquid fuel oil use and electricity generated by a generating unit (records of fuel used and output can be used *in lieu* of actual monitoring);

(b) Monitoring fuel use and output after the fuel switch has been implemented - e.g. gas use and heat output"

This paragraph provides examples, in which monitored output is defined as a unit of energy, either heat or electricity, but it does not require that output be defined in this manner. The DOE has validated that the methodology therefore does not prohibit the PP from defining monitored output as the weight of the product.

The PP has not defined output as a unit of energy because it is technologically impossible to measure the amount of energy generated by the DSW plant's dryers. This is due to the fact that the dryers constitute an open system, and therefore the heat generated by the dryers either is absorbed in the product, forms steam when it comes into contact with the product, escapes through the stack, or escapes as heat losses to the surrounding environment. Monitoring the quantity of heat generated by the dryers is impossible, as no monitoring devices exist that can monitor the above four parameters in a continuous manner in order to determine the energy balance of the dryers. Therefore, the PP decided to define output as weight of product, as this can be clearly and accurately monitored and is in accordance with the methodology.

Furthermore, this is in-line with previous projects approved by the EB under this methodology. The DOE has examined all the projects that are currently registered under AMS-III.B, and confirmed that there are three projects in which output monitored is defined in terms of the weight of the product, some of which have already been issued CERs:

- Quimvale and Gas Natural Fuel Switch Project, No. 0828. This project was registered on 09 March 2007 under AMS-III.B version 9, and defines output as tons of  $\text{CaCO}_3$ .
- Switching of fuel from Natural Gas to Hydrogen in CCU-II at Dahej complex of GACL, No. 0940. This project was registered on 06 April 2007 under AMS-III.B version 9, and defines output as metric tons of Caustic Soda Flakes.
- Acos Villares Natural gas fuel switch project, No. 1037. This project was registered on 19 May 07 under AMS-III.B version 10 and defines output as both steam and tons of steel produced.

The DOE has validated that in both version 9 and version 10 of the methodology, under which the above three projects were registered, paragraph 9 contains the exact same language and defines monitored output in the exact same manner as in version 12.

The DOE has therefore validated that the PP has defined output in accordance with the requirements of the methodology, paragraph 9.

It should be noted that this definition of output is applied in a consistent manner in both the baseline and project scenarios, leading to an accurate and conservative calculation of emission reductions. The weight of the product produced in the plant is a core and central parameter in the plant's operations, and as such is measured in a continuous and accurate manner. It is the opinion of the DOE that this is therefore the most appropriate and accurate parameter to be defined as output.

We apologize if the initial validation report has been unclear and hope that this letter and the attached information address the concerns of the members of the Board.

Nikunj Agarwal (+91 98717 94661) will be the contact person for the review process and is available to address questions from the Board during the consideration of the review in case the Executive Board wishes.

Yours sincerely



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Enclosures:

Annex 1 – Delek Group 2007 Full Year Financial Report

Annex 2 – Energy Forecast

Annex 3 – Min of National Infrastructures - 2008

Annex 4 – BG Gas Reserves

Annex 5 – Knesset discussion BG

Annex 6 – BG Available in 2011

Annex 7 – Business Week - Russian Gas Crisis Seeps into Europe

Annex 8 – Egypt opposition to NG agreement with Israel

Annex 9 – RFI for NG (Piping - 7 BCM)

Annex 10 – The Marker - Pipeline Capacity

Annex 11 – The Natural Gas Sector Law

Annex 12 – Govt. Resolution No. 2920

Annex 13 – Requirement for foreign subcontractor

Annex 14 – Letter from National Gas Authority

Annex 15 – Letter from Manufacturers Association

Annex 16 – ICL Tender for Fuel Switch

Annex 17 – No Change on Efficiency

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