

Oil and gas regulation in Cyprus: overview

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DOMESTIC SECTOR

1. Describe the domestic sector for oil and gas, including liquefied natural gas (LNG).

Cyprus's total consumption of petroleum products for 2010, the latest year for which figures are available, was 35.2 billion kWh. This represented less than:

- 0.5% of European consumption.
- 0.1% of global consumption.

Consumption was satisfied by imports of refined products, which typically account for approximately 20% of all imports by value.

However, the announcement of the discovery of substantial gas deposits in Cyprus's Exclusive Economic Zone (EEZ) in December 2011 marks a transition for Cyprus from a relatively small importer of hydrocarbons, to a significant potential producer and exporter. Since the discovery was announced a second licensing round has commenced and negotiations are in progress for a further three blocks (see *Question 6*).

At this stage, a number of options are under consideration for exploitation and export, and it is likely to be at least five years before the necessary facilities are in place and exports start on a commercial scale.

2. What percentage of domestic energy needs is met by oil and gas?

Oil and gas meets more than 95% of domestic energy need, with the balance representing solar and wind energy. Fuel oil accounts for around 60% of total energy imports, with the remaining 40% made up of gasoline and other refined products.

Domestic policy

3. What is the domestic policy on oil and gas?

As a member of the EU, Cyprus has aligned its energy policy with the *acquis communautaire* (cumulative body of EU laws) and transposed all relevant EU Directives into national law. The Hydrocarbons (Prospection, Exploration and Production) Law 4(I) 2007 (Hydrocarbons Law) transposes Directive 94/22/EC on the conditions for using authorisations for the prospection, exploration and production of hydrocarbons, into national law.

A law has also been passed to implement Directive 2003/55/EC concerning common rules for the internal market in natural gas (Gas Directive), to regulate the natural gas market and the storage, transmission, supply and distribution of natural gas within Cyprus. However, the regulation is currently suspended and there is a state monopoly on natural gas supply (see *Questions 16 and 20*).

REGULATION

The regulatory regime

4. Describe the regulatory regime that applies to oil and gas exploration and production, including the key legislation and features of the regime.

See *Question 3*.

Regulatory bodies

5. Who regulates the extraction of oil and gas?

The exploration and exploitation process is the responsibility of the Energy Service of the Ministry of Commerce, Industry and Tourism (MCIT).

See box, *The regulatory authorities*.

RIGHTS TO OIL AND GAS

Ownership

6. How are rights to oil and gas held and who holds those rights?

The Immovable Property (Tenure, Registration and Valuation) Law provides that private ownership of land does not extend to minerals, including oil and natural gas. The Hydrocarbons Law and the Hydrocarbons (Prospection, Exploration and Production) Regulations (Hydrocarbons Regulations) together set out the licensing framework for the prospecting, exploration and extraction of hydrocarbons in Cyprus's territory including its EEZ (see *Question 7, Licences*).

Currently the oil and gas exploration area covers approximately 51,000 square kilometres offshore Cyprus, to the south and south-west of Cyprus. It has been divided into 13 exploration blocks.



An exploration licence for Block 12, which has an area of approximately 4,600 square kilometres, was granted to Noble Energy International in the first licensing round.

Negotiations are presently in progress to finalise licences for blocks 2, 3, 9 and 11, accounting for a further 16,000 square kilometres.

A state-owned company, the Cyprus Hydrocarbons Company (KRETYK) has recently been established. This company will manage the country's hydrocarbons assets and revenues and will represent Cyprus in the production-sharing contracts and in dealings with prospective investors concerning the construction of a natural gas liquefaction and export facility.

Nature of oil and gas rights

7. What are the key features of the leases, licences or concessions which are issued under the regulatory regime? Can these rights be leased by the right-holder?

Licences

The Hydrocarbons Law and Hydrocarbons Regulations provide for three types of licence:

- **Prospecting licences.** These are valid for up to one year. They do not permit drilling but allow evaluation of potential by identifying geological structures by means of gravity, magnetic and seismic surveys.
- **Exploration licences.** These are initially valid for three years and allow the holder to undertake gravity, magnetic and seismic surveys and exploratory drilling. They are renewable for two further periods of two years. On each renewal, 25% of the initial licence area is relinquished. In the event of a discovery the licensee has the right to be granted an exploitation licence for the discovery.
- **Exploitation licences.** These are granted for an initial period of up to 25 years with the option of one renewal of up to 10 years.

Successful applicants for a licence must enter into an exploration and production sharing contract (EPSC), in the form published by the MCIT. Any holder of a licence who wishes to transfer it or assign any rights under it to another entity must submit a written application to the Minister for consideration.

Fees

The EPSC provides for annual surface fees of:

- EUR25 per square kilometre during the exploration period.
- EUR30 per square kilometre during the first renewal period.
- EUR35 per square kilometre during the second renewal period.

An additional EUR500 per year per square kilometre is payable during the exploitation period.

The EPSC also provides for a lump-sum payment on signature and production bonuses once certain production thresholds are attained.

Liability

Under the EPSC the contractor must indemnify any person, including the Republic of Cyprus, for any damage or loss which results from operations under the contract and to have appropriate insurance in place. If any operations are subcontracted, the subcontractor must have appropriate insurance. Entities which are subsidiaries of others may be required to provide parent company guarantees.

Restrictions

The contractor must set up a management committee to control and supervise operations, and ensure compliance with contractual work programmes and development and production plans. The Cyprus government can appoint representatives to act as observers on the management committee, and the contractor must provide them with all the information provided to members of the committee.

8. How are such leases, licences or concessions awarded?

The licensing round is initiated by the MCIT inviting applications for licences in relation to defined blocks within Cyprus's EEZ, in accordance with Directive 94/22/EC. Applications are assessed by the MCIT on the basis of specified criteria to determine a preferred bidder for each block. For the second round the following criteria were assessed:

- The technical and financial ability of the applicants.
- The ways in which the applicant intends to carry out the activities that are specified in the licence.
- The financial consideration that the applicant is offering in order to obtain the licence.
- Any lack of efficiency and responsibility demonstrated by the applicant under any previous licence or authorisation of any form in any country in the world.

Negotiations are then carried out with preferred bidders to conclude an EPSC.

9. What payments, such as taxes or royalties, are payable by oil and gas interest holders to the government? Does the government derive any other economic benefits from oil and gas exploration and production?

The EPSC provides for a lump-sum payment by the contractor on signature, followed by annual surface fees and production bonuses once certain production thresholds are attained (see *Question 7*).

In addition, the government is entitled to the proceeds of sale of its share of "profit hydrocarbons" as defined in the EPSC. The contractor is required to provide free sales and marketing assistance for the sale of the Republic of Cyprus's share of profit hydrocarbons or to purchase all or part of the Republic of Cyprus's share on the basis set out in the EPSC.

Transfer of rights

10. How are oil and gas rights transferred? Are there any restrictions on the disposal of interests?

Authorisations can be transferred with the consent of the Council of Ministers (cabinet) (*section 27, Hydrocarbons Law*). Consent will be granted only if the proposed transfer does not endanger national security and the Council of Ministers is satisfied that the proposed assignee has sufficient technical knowledge, experience and financial resources to secure the proper exercise of the activities of prospecting, exploring for and exploiting hydrocarbons. The proposed assignee may be required to agree to comply with other conditions and requirements that the Council of Ministers may impose in order to secure approval.

The transfer of any rights will not affect any liability of the transferor or assignor incurred before the transfer date or, unless the transfer specifically provides, release the transferor or assignor from liability for the accurate performance by the transferee or assignee of the obligations undertaken by them at the time the contract was entered into.

TRANSPORTATION BY PIPELINE

11. What regulatory requirements apply to the construction and operation of pipelines?

There is currently no comprehensive EU legislation on pipeline safety as the Seveso II Directive excludes pipelines from its scope, and as an isolated market Cyprus has no pipelines or legislation applying specifically to them. The Hydrocarbons Regulations merely require offshore works and installations, including pipelines, to be constructed and maintained in accordance with international petroleum industry practice and applicable legislation and regulations. Several alternative options are currently being considered regarding pipelines to and from Cyprus and detailed regulations will need to be put in place before a pipeline is constructed.

12. Is there a system of third party access to pipelines and other infrastructure?

The issue of third party access to pipelines and other infrastructure is still under consideration.

HEALTH, SAFETY AND THE ENVIRONMENT

Health and safety

13. Describe the health and safety regime that applies to oil and gas exploration and extraction, and transportation by pipeline.

Under the Hydrocarbons Regulations, hydrocarbons operations must be undertaken in a proper, safe and workmanlike manner, and in accordance with good oilfield practices. Every holder of an authorisation must comply with the Hydrocarbons Regulations

and with any other legislation regulating work practices, employers' obligations, safety and health at work, and the rights of employees.

Contractors must ensure that all materials, supplies, machinery, plant, equipment and installations used by them, or their subcontractors:

- Comply with generally accepted standards in the international petroleum industry.
- Are of proper construction.
- Are kept in good working order.

Contractors must use the natural resources of the licensed area as productively as practicable to:

- Prevent damage to producing formations.
- Ensure that hydrocarbons discovered, mud or any other fluids or substances do not escape.
- Prevent damage to hydrocarbon and water bearing strata that are adjacent to a producing formation.

Contractors must store hydrocarbons in appropriate receptacles and observe the provisions of the Solid and Hazardous Waste Law 215(I) 2002 (Hazardous Waste Law) as regards hydrocarbon waste.

Flares and vents

14. Are flare and vent regulations in place?

Detailed operational regulations have not yet been drafted.

Environmental impact assessments (EIAs)

15. Is an EIA required before extracting or processing oil and gas?

A strategic environmental assessment (SEA) was undertaken before the first licensing round under the Assessment of the Effects on the Environment of Certain Plans and/or Programmes Law 102(I) 2005, which transposed Directive 2001/42/EC on the assessment of the effects of certain plans and programmes on the environment (Strategic Environmental Assessment Directive) into national legislation. Licensees must comply with the standards stipulated in the SEA and with the opinion of the environmental authority on the SEA.

Licensees must conduct a preliminary EIA study before beginning any exploration work and a full EIA study before beginning any exploitation work. These studies must comply with the:

- Assessment of Environmental Impact (EIA) from Certain Projects Law 140(I) 2005 (EIA Law).
- Recommendations set out in the SEA.
- Opinion of the environmental authority.
- Relevant provisions of Directive 85/337/EEC on the assessment of the effects of certain public and private projects on the environment (EIA Directive).



16. What are the different stages of the EIA?

The EIA process will typically include the following stages:

- Scoping (the process of determining the content and extent of matters to be covered by the EIA and the environmental statement).
- Identifying issues.
- Technical assessment.
- Preparing a draft EIA.
- Initial review.
- Requiring further information (if relevant).
- Finalisation.
- Review and evaluation.

The EIA must cover the areas prescribed in the EIA Law and EIA Directive and include:

- A description of the project comprising information on the site, and the design and size of the project.
- A description of the measures envisaged to avoid, reduce and, if possible, remedy significant adverse effects.
- The data required to identify and assess the main effects which the project is likely to have on the environment.
- A non-technical summary of the above information.

The time required to complete an EIA will vary according to the complexity of the proposed project. Completion of the first EIA, which related to exploratory drilling in Block 12, took around seven months.

Environmental permits

17. Is there a permit regime for environmental damage or emissions produced during the extraction or processing of oil and gas?

Under the EPSC, the contractor must submit a detailed operating plan for the following year, no later than 45 days before the end of each calendar year, including the development and production operations with respect to each exploitation area. This is subject to agreement with the MCIT.

The issue of environmental damage and emissions is an element of the detailed annual operating plan required under the EPSC. There is no permit regime.

Waste

18. What are the regulations on the disposal of waste products resulting from oil or gas extraction or processing?

The Hydrocarbons Regulations require operators to apply the provisions of the Hazardous Waste Law as regards waste. Operators must also comply with:

- The International Convention for the Prevention of Pollution from Ships (MARPOL 73/78), which is the main international convention covering prevention of pollution of the marine environment by ships from operational or accidental causes.
- The Convention for the Protection of the Marine Environment and the Coastal Region of the Mediterranean (Barcelona Convention 1995).

Operators may not discharge waste into the Mediterranean Sea and must have waste management and contingency plans to deal with accidental spillages.

Decommissioning

19. What are the decommissioning obligations and liabilities that arise?

Under the EPSC, the contractor is entirely responsible for proper decommissioning. The contractor must submit a decommissioning plan to the MCIT no later than six years prior to the anticipated date of decommissioning. The MCIT may request amendments to the plan with a view to arriving at a mutually agreed final plan in accordance with best international petroleum industry practice. To secure the implementation of the decommissioning plan, the contractor must establish a reserve fund, and deposit it in an escrow account in a bank acceptable to the MCIT. If the actual decommissioning costs exceed the reserve fund, the shortfall is to be borne by the contractor. If the actual decommissioning costs are less than the reserve fund, the surplus is payable to the Republic of Cyprus.

SALE AND TRADE

20. How is trade in oil and gas usually completed?

As an isolated and an emergent market, Cyprus is allowed to derogate from substantial portions of Directive 2009/73/EC concerning common rules for the internal market in natural gas, and the gas sector will follow a fully monopolistic model for at least ten years. The Natural Gas Public Company of Cyprus (DEFA) is the sole distributor of any form of natural gas in Cyprus, and is responsible for the Cyprus internal gas market. DEFA was established and is controlled by the Cyprus government.

DEFA is currently undertaking a procurement procedure for the supply of natural gas to Cyprus to replace heavy fuel oil and gas oil for electricity generation. This will cover the interim period of approximately five years before gas from Block 12 becomes available.

21. Are oil and gas prices regulated?

Prices are not currently regulated.

TAX

22. What are the main tax issues arising on oil and gas works?

Contractors and their subcontractors must comply with the applicable taxation laws and regulations in force in Cyprus, and are entitled to the benefits of the various double taxation agreements and international conventions to which Cyprus is a party.

Under the EPSC the applicable corporate tax is deemed to be included in the Republic's share of profit oil, and the portion of available oil which the contractor is entitled to is net of corporate tax.

23. What taxes and duties apply on import and export of oil and gas?

As an EU member state, Cyprus is a member of the EU Customs Union and applies the common EU tariff.

ENFORCEMENT OF REGULATION

24. What are the regulator's enforcement powers?

The Natural Gas Law, Law 183/2004 (Natural Gas Law) transposed the provisions of the Gas Directive into domestic law, and made the Cyprus Energy Regulatory Authority (CERA) responsible for regulating the gas market. Any person engaged in the following requires a licence from CERA (*Article 8, Natural Gas Law*):

- The import, storage or gasification of natural gas.
- The construction or operation of facilities for the import, storage or gasification of natural gas.

In exercising its licensing powers CERA must ensure that natural gas undertakings can supply eligible customers through a direct line and that any eligible customer within Cyprus has access to supply through a direct line. CERA's other responsibilities include:

- Setting the rules for the management and the distribution potential of interconnection, in consultation with the appropriate authority(ies) of the member states with which there is interconnection.

THE REGULATORY AUTHORITIES

Ministry of Commerce, Industry and Tourism – Energy Service (MCIT)

Address. 13-15 Andreas Araouzos Street, 1421 Nicosia, Cyprus
T +357 2286 7100
F +357 2237 5120
E perm.sec@mcit.gov.cy
W www.mcit.gov.cy

Main responsibilities. Granting licences for prospection, exploration and exploitation of hydrocarbons and supervision of activities under them.

Cyprus Energy Regulatory Authority (CERA)

Address. PO Box 24936, 1355 Nicosia, Cyprus
T +357 2266 6363
F +357 2266 7763
E info@cera.org.cy
W www.cera.org.cy

Main responsibilities. Regulation of the natural gas market (currently suspended) and development of the sector.

- Assuring control and transparency in the market to avoid possible misuse of dominant position, particularly misuse which is to the detriment of consumers.
- Determining the measures to be put in place if an unforeseen crisis occurs in the energy field, or when the safety of people, works, installations or the integrity of the networks are threatened.
- Monitoring:
 - security of supply, and especially the balance of supply and demand in the market;
 - the level of the expected future demand;
 - the availability of supply; and
 - the level of competition in the market.
- Protecting the interests of end users.
- Resolving disputes regarding access to the upstream network.
- Determining the minimum standards of technical design and operation for connection to the network and other natural gas installations.

However, Law 199(I)/2007 amending the Law on the Regulation of the Natural Gas Market 2004 provides for most of the provisions of the Natural Gas Law to be suspended if the Council of Ministers assigns the import and supply of natural gas to Cyprus to a sole supplier, and designates one land terminal as the exclusive station for the delivery, storage and re-gasification of liquefied natural gas (LNG). It requires CERA to refrain from issuing licences to avoid jeopardising that goal. The subsequent establishment of DEFA as the monopoly supplier has effectively suspended CERA's regulatory role and powers.



25. Is there a right of appeal against the regulator's decisions?

Article 146 of the Constitution provides for a right of judicial review of decisions made by public authorities through administrative recourse to the Supreme Court of Cyprus. The Natural Gas Law also allows for the possibility of passing regulations to regulate the procedures to be followed in the event of a refusal of an application. If regulations are issued providing for a hierarchical recourse, this would not affect the applicant's right to refer any decision to the Supreme Court under Article 146. However, for the time being this is unlikely to be an issue in relation to gas as CERA's regulatory powers are currently suspended (see *Question 24*).

REFORM

26. Are there plans for changes to the legal and regulatory framework?

While the overarching legal and regulatory framework exists, a substantial amount of detail will need to be put in place as Cyprus develops into an exporter of hydrocarbons. For example, it will be necessary to construct a:

- Submarine pipeline to transport the natural gas from the gas fields to Cyprus.
- Liquefaction and export facility.
- Domestic gas distribution network.

These projects are estimated to cost around EUR10 billion at current prices.

ONLINE RESOURCES

W www.mcit.gov.cy/mcit/mcit.nsf/dmlhcarbon_en/dmlhcarbon_en?OpenDocument

Description. This is the official website of the Ministry of Commerce, Industry and Tourism (MCIT) for the second round of hydrocarbons licensing. The website includes the initial announcement, evaluation criteria, non-binding English translations of the Hydrocarbons Law and Hydrocarbons Regulations, the model EPSC, the strategic environmental assessment (SEA), and the opinion on the SEA by the environmental authority.

W www.defa.com.cy/en/icons.html

Description. The Natural Gas Public Company of Cyprus (DEFA) website has copies of the official text of all legislation affecting the natural gas sector (in Greek).

W www.cera.org.cy

Description. The Cyprus Energy Regulatory Authority (CERA) website has copies of the official text of the Natural Gas Law and Law 199(I)/2007 amending the Law on the Regulation of the Natural Gas Market 2004 (in Greek). The website itself is in the Greek language.