



EUROPEAN COMMISSION

Brussels, 20.11.2013  
C(2013) 7884 final

<p>In the published version of this decision, some information has been omitted, pursuant to articles 24 and 25 of Council Regulation (EC) No 659/1999 of 22 March 1999 laying down detailed rules for the application of Article 93 of the EC Treaty, concerning non-disclosure of information covered by professional secrecy. The omissions are shown thus [...].</p>		<p style="text-align: center;">PUBLIC VERSION</p> <p>This document is made available for information purposes only.</p>
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**Subject: State aid SA.36740 (2013/NN) – Lithuania**  
**Aid to Klaipėdos Nafta – LNG Terminal**

Sir,

## **1. PROCEDURE**

- (1) On 28 October 2013 Lithuania notified aid measures related to the construction and operation of a liquefied natural gas terminal (the “LNG Terminal”) in the Klaipėda Seaport. Additional information was provided on 29 October 2013.
- (2) Prior to this notification, the Lithuanian Gas Association filed a complaint on 28 November 2012, arguing that the LNG Terminal would be receiving illegal and incompatible State aid.
- (3) The complaint was forwarded to Lithuania on 15 March 2013. Lithuania submitted its comments on 15 and 19 April 2013.
- (4) On 20 March 2013, the complainant was asked to substantiate his complaint on certain aspects but the complainant did not submit any additional information.

## **2. DESCRIPTION OF THE AID MEASURE**

### **2.1. Construction and operation of Liquefied Natural Gas terminal**

- (5) Lithuania aims to reduce its dependence on its sole gas supplier Gazprom and create a competitive gas market by connecting Lithuania to the EU gas market, thereby increasing security of energy supply. It therefore seeks the construction and operation of a Liquefied Natural Gas (“LNG”) Terminal and its connection to the natural gas

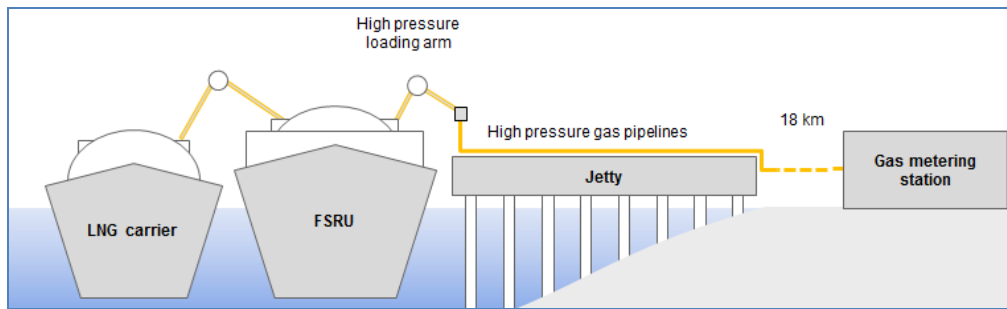
transmission system of Lithuania. The start of operation of the LNG Terminal is planned for 3 December 2014.

- (6) On 21 July 2010 the Lithuanian government appointed by decree *AB "Klaipėdos nafta"* ("KN") as the project development company for the LNG terminal. As such, KN is in charge of implementing the development and construction of the LNG Terminal infrastructure up until the LNG Terminal will be connected to the natural gas transmission system and its operation started. For reasons of security of supply, Lithuania also intends to designate KN as the operator of the terminal.
- (7) In terms of infrastructure, the project involves the construction of the LNG Terminal, of related port infrastructure at the Klaipėda Seaport and the connection with the gas network.
- (8) The LNG Terminal consists of the floating liquefied natural gas storage and regasification unit ("FSRU") with its related energy structures and installations. The FSRU will be constructed by Høegh LNG, selected through public tender, and will be made available to KN on the basis of a 10-year lease agreement with purchase option. The LNG Terminal is projected for a total storage capacity and size of 170k m<sup>3</sup> and a maximum technical regasification capacity up to 4 bcm annually (approx. 11mmcm/day).
- (9) The LNG Terminal Connection consists of a high pressure natural gas pipeline of 18 km connecting the LNG Terminal with the natural gas transmission system.
- (10) The moorage of the FSRU, as well as transportation and loading of the LNG to the LNG Terminal requires that additional port infrastructure is developed. It involves in particular the construction of the offshore jetty facility at the Klaipėda Seaport, as well as development of the port facilities allowing for harbouring of LNG carrier ships (e.g. port dredging, embankment, navigation and radiolocation facilities, etc.).
- (11) KN will directly undertake part of the necessary port infrastructure works (jetty facilities above the waterline). The Port authority (KVJUD, State controlled) is responsible for financing the rest of the port infrastructure works. KN will not have any title to the port infrastructure, because in accordance with applicable laws only the Republic of Lithuania may hold title to the seaport infrastructure. KN will therefore be compensated for the part of the costs (50%) relating to the construction of the jetty borne by it and will then use the port infrastructure on the basis of a contract with KVJUD. KN will be charged for the use of the port in the same way as other users do and will in addition pay an annual fee for the usage of the jetty, calculated based on the amount of investments by KVJUD into the infrastructure of the port (including the investments reimbursed to KN), taking into account a period of return of investments of 20 years and an internal rate of return ("IRR") of 5%. This return corresponds to the rate of return normally applying to other infrastructure developments in the port. In order to avoid excessive profits for KVJUD, the annual fee for the usage of the jetty shall be reduced by the amount of charges paid by KN and other users for the use of that piece of port infrastructure. It is currently estimated that KN will have to pay a yearly rent of EUR [...] million for the use of the jetty<sup>1</sup>.

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<sup>1</sup> The infrastructure is different from and additional to the infrastructure concerned in case SA.30742 – LT - Construction of Infrastructure for the Passenger and Cargo Ferries Terminal, approved on 22/02/12.

Figure 1: The LNG Terminal infrastructure



Source: AB "Klaipėdos nafta"

- (12) In addition, the natural gas transmission system will be reinforced and further developed in order to make it possible for consumers to be supplied with gas imported through the LNG Terminal up to the maximum technical regasification capacity of the LNG Terminal (i.e. 4 bcm annually). The following developments of the natural gas transmission system are planned:
- reconstruction of the natural gas pipeline *Klaipėda–Kursėnai* and increase of its diameter from 300 mm to 700 mm (northern natural gas supply corridor), which will enable natural gas supplies from the LNG Terminal up to 4 bcm annually. While this reconstruction is important for the LNG Terminal project, the reconstruction of this pipeline has been under examination since 2005 and included in the 2007 National Energy Strategy.
  - construction of the natural gas pipeline *Klaipėda–Jurbarkas* (southern natural gas supply corridor), which is planned for commencement of operation in 2013, which will allow for natural gas supplies from the LNG Terminal to the system up to 2 bcm annually. This gas pipeline is being planned already since 2005 by the transmission system operator for natural gas ("TSO").
- (13) Those works will be performed by the TSO. It is not excluded that the TSO will apply for subsidies for their realisation, or for part of them. Any such applications for subsidies are not part of the present notification.

## 2.2. The beneficiary

- (14) AB Klaipėdos nafta is a State owned company with the Lithuanian State holding 72.3% of the shares. The rest of shares are owned by private investors.
- (15) KN is also the owner and operator of the oil terminal in Klaipėda. Its activities in the oil sector are related to the services of transshipment of oil products from rail tanks to tanker ships. KN is not engaged in the trade of oil.
- (16) KN will not be engaged in trade in, and supply of, gas. UAB LITGAS, initially a 100% subsidiary of KN but since 15 October 2013 under control of Lietuvos Energija, UAB (which holds 2/3 of the shares), will engage in the supply of liquefied natural gas through the LNG Terminal.

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\* Business secret

### 2.3. Costs of the construction and operation

- (17) The project related infrastructure investments will require LTL 453M (approx. EUR 131.2M) for the project management (EUR 64.87 M), the gas pipelines connecting the terminal to the transmission system and the gas metering station (EUR 40.7 M) and the jetty (EUR 25.6 M). The lease<sup>2</sup> of the FSRU will cost EUR ~[...] M per 10 years of lease (with a net present value -"NPV"- of EUR [...] M) and its acquisition after 10 years of lease is estimated at the price of EUR [...] M (EUR [...] M in NPV).
- (18) The development of the Klaipėda Seaport infrastructure by the KVVJUD will involve costs of LTL 160M (approx. EUR 49.24M).
- (19) In total those infrastructure costs amount to EUR 508.28 M (in NPV).
- (20) Fixed operating costs (maintenance, personnel, insurances, marketing) for the terminal and related infrastructure over the period of depreciation of significant infrastructure (55 years for the connecting pipelines; see paragraph (60) on the depreciation periods for other relevant infrastructure) will amount to EUR [...] M (in NPV).
- (21) Variable operating costs (depending of regasified volume) are estimated at EUR [...] M (in NPV).

	2015F	2020F	2025F	2028F	2035F	2045F	2069F		
Regasified volume, bcm	[...]	[...]	[...]	[...]	[...]	[...]	[...]		
000 EUR	2015F	2020F	2025F	2028F	2035F	2045F	2069F	SUM (2015- 2069)	NPV 2015- 2069
Investment-related costs	[...]	[...]	[...]³	[...]⁴	[...]⁵	[...]⁶	[...]	[...]	[...]
Fixed operating costs	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]
Variable operating costs	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]
Financing expenses	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]

### 2.4. History of the project

- (22) In 2007 the Lithuanian Parliament concluded that an LNG Terminal would be the most appropriate type of infrastructure capable of ensuring an alternative supply of natural gas into Lithuania, thereby ensuring the national security of energy supply for Lithuania<sup>7</sup>.
- (23) On 27 December 2007, the Government of the Republic of Lithuania adopted Resolution No 1442 by which it approved the Implementation Plan for the National

<sup>2</sup> [Confidential – business secret – depreciation]

<sup>3</sup> [Confidential – business secret – depreciation]

<sup>4</sup> [Confidential – business secret – depreciation]

<sup>5</sup> [Confidential – business secret – depreciation]

<sup>6</sup> [Confidential – business secret – depreciation]

<sup>7</sup> Resolution No X-1046 of 18.01.2007 of the Parliament of the Republic of Lithuania approving the National Energy Strategy for 2008-2012.

Energy Strategy for 2008-2012 and required the Ministry of Economy to perform a feasibility study for an LNG terminal in Lithuania.

- (24) On 30 September 2010 the Lithuanian Parliament adopted Resolution No XI-1050 whereby it proposed to the Government to work out a detailed draft plan of development of an LNG terminal in Lithuania by 15 November 2010 and to provide for project finance from EU funds and private funds alongside funds from the State budget.
- (25) On 7 February 2012 the Government of the Republic of Lithuania adopted Resolution No 175 by which it approved amendments to the National Energy Strategy for 2008-2012. In this Resolution the Government decided to develop the LNG Terminal and nominated KN as the company responsible for the development of such project.
- (26) On 15 February 2012 the Government of the Republic of Lithuania adopted Resolution No 199 whereby it requested (i) KN to develop the LNG Terminal and (ii) the Ministry of Energy to adopt all decisions to ensure that KN shall be provided with all securities necessary to financing of the project, including *inter alia* a state guarantee.
- (27) In order to secure the development of the LNG Terminal as well as its prospective functioning Lithuania has enacted the LNG Terminal Law<sup>8</sup> on 22 June 2012.
- (28) This law states that the LNG Terminal and its connection to the transmission system shall be recognised as facilities of national strategic importance to national security. The LNG Terminal operator shall be recognised as company of strategic importance to national security. According to Article 4(1) of the LNG Terminal Law, the LNG Terminal project must be implemented by a company in which the State holds shares conferring at least 2/3 of voting rights.
- (29) According to Article 4(2) of the LNG Terminal Law, the company that will be entrusted with the project must carry out the infrastructure development and installation works for the LNG Terminal as well as the operation thereof under the procedures established by legal acts. According to Article 4(4) the implementation of the project will be supervised and controlled by the Ministry of Energy.
- (30) Article 9 of the LNG Terminal Law provides that the LNG Terminal and its connection to the transmission system shall be operated by the LNG Terminal operator in a way that ensures, under the procedure established by the legal acts, the secure and reliable functioning of the LNG facilities. Article 10(1) provides that the right to use the LNG Terminal infrastructure shall be ensured to users of the natural gas system on non-discriminatory terms.
- (31) Article 5(2) of the LNG Terminal Law institutes the "LNG Supplement", a special levy that will be imposed on users of the transmission system. It will be collected by the TSO and transferred to KN after approval of the regulator, i.e. the National Control Commission for Prices and Energy (hereinafter the "NRA"), in order to finance part of the costs of constructing and operating the terminal and related infrastructure.

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<sup>8</sup> Law on the Liquefied Natural Gas Terminal of the Republic of Lithuania (No XI-2053), of 12 June 2012 (State Gazette, 2012, No 68-3466).

- (32) Article 11 of the LNG Terminal Law stipulates an obligation on certain energy producers<sup>9</sup> to each buy allocated minimal quantities of natural gas imported through the LNG Terminal (the “Purchase obligation”) (see below paragraph 39).

## **2.5. Financing of the project, aid amount and duration**

- (33) The infrastructure investments to be undertaken by KN will essentially be financed by credited funds from international financing institutions (EIB, [\*\*\*other loan providers\*\*\*]).
- (34) State guarantees of 100% of the amount of loans will be granted to cover the loans from EIB and [\*\*\*other loan provider\*\*\*]<sup>10</sup> (at the total amount of EUR 116 million) against payment of a one-off fee of 0.1% on the respective loan amount.
- (35) In addition, the LNG Terminal Law provides that if KN cannot find sufficient financial means to cover its installation costs, it is entitled to obtain the remaining means from the "LNG Supplement" (see below recital (47)).
- (36) As of 3 December 2014 (start of operation), KN will cover the remaining investment costs, the lease of the FSRU and fixed operating costs (i.e. all operating expenses not dependent on the volumes of regasified gas) through the LNG Supplement that will be added to the transmission tariff.
- (37) KN will cover its variable operating costs through the revenue from regasification services. The Lithuanian regulator stipulates the methodology for the regulated tariffs to access the terminal. The methodology is at present included in Article 39 of Resolution No O3-367<sup>11</sup> and will be reviewed every 5 years. The methodology established in Article 39 of Resolution No O3-367 provides for the calculation of regasification tariffs based on the variable costs of regasification services, determined on the basis of technical parameters of the LNG Terminal and the annual amount of liquefied natural gas. It is expected that for the planned period of application, which corresponds to the duration of amortisation of significant infrastructure (55 years), the tariff revenues would amount to EUR [...] million (in nominal terms, corresponding to EUR [...] million in net present value). The part that results from the purchase obligation (0.54 bcm \* projected tariff\* 10) is estimated at around EUR [...] million (in nominal terms).

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<sup>9</sup> Those are electricity or heat producers assigned with public service obligations or whose price of produced energy is regulated. This encompasses Lietuvos Energija as well as central heating (co-generation) plants.

<sup>10</sup> The loan of EIB amounts to EUR 87 million. A loan for the approximate amount of EUR [...] million from [\*\*\*other loan provider\*\*\*] is in consideration. The remaining investment costs of approximately EUR [...] million will be financed with loans provided by commercial banks and/or financed from the capital of KN.

<sup>11</sup> Resolution of 13 September 2013 approving Methodology of Fixing State-regulated Prices in the Natural Gas Sector.

- (38) The following financial analysis of the notified project has been presented by the Lithuanian authorities:

000EUR	
NPV without State guarantee and LNG Supplement	-[...]
IRR with State guarantee and LNG Supplement	[...]
NPV with State guarantee and LNG Supplement	-[...] <sup>12</sup>
IRR with State guarantee and LNG Supplement	[...]%

## 2.6. Purchase obligation

- (39) In order to secure the development of the LNG terminal in the first years of operation, the LNG Terminal Law institutes a process by which LNG gas from the terminal has to be purchased by way of an obligation for certain electricity and heat producers to each buy allocated minimal quantities of natural gas through the LNG Terminal. Those companies on which the purchase (or off take) obligation is imposed are all undertakings active in the regulated market segment of the generation of electricity and heat. They are designated as "Obligated Purchasers" and include both private and public undertakings. The Government will set that minimum quantity in order to ensure a stable minimal operation of the terminal (in principle 0,54bcm)<sup>13</sup>. The gas will have to be purchased from the "Designated Supplier"<sup>14</sup> who will have to find the LNG suppliers delivering the gas through the terminal. All other consumers of natural gas active in Lithuania are free to purchase natural gas from the Designated Supplier, other suppliers, at the natural gas exchange, or to import them directly through the LNG Terminal. This Purchase obligation is to last for 10 years. It could be shortened if the development and integration of the Lithuanian natural gas market is sufficient to guarantee the minimum off-take that is required for the LNG Terminal to work on a steady mode.
- (40) The Lithuanian regulator will set the regulated profit margin of the "Designated Supplier" in its sales to the Obligated Purchasers.

## 2.7. State guarantee for the loans issued by EIB and [\*\*\*other loan provider\*\*\*]

- (41) On 9 July 2013 KN signed an agreement with European Investment Bank (EIB) for a loan in the amount of up to 87 m EUR (the loan is provided in EURO). Before drawing on the loan, KN shall provide a state guarantee covering 100% of the loan.

<sup>12</sup> The calculation was based on a discount rate of [...]% (industry required rate of return, calculated by Swedbank). Lithuania also provided a sensitivity analysis on changes in discount rates showing that the NPV with aid further improves when the discount rate decreases. The NPV becomes positive once the discount rate is equal to or below [...].

<sup>13</sup> The Government will set that quantity upon declaration of KN on the quantity which is reasonably necessary for maintaining a minimum continuous mode of a stable LNG Terminal regasification technology process. The preliminary LNG Terminal Mandatory Quantity is 0.54 bcm annually based on technical FSRU characteristics and capabilities, which are set in the Time Charter Agreement, signed on March 2, 2012 between KN and Hoegh LNG. Appendices of the agreement outline all major technical parameters of the FSRU including the minimum send-out rate, i.e. 61 330 m<sup>3</sup>/h, which equals to 0.54 billion m<sup>3</sup> per year. This information is published on KN's web site <http://www.sgd.lt/index.php?id=spec&L=1> as well as mentioned in the LNG Terminal Business Plan.

<sup>14</sup> To be designated by the State on the basis of public procurement rules. It must be an undertaking in which the State has at least 2/3 of the voting rights.

- (42) In addition to the EIB loan, KN is currently negotiating with [\*\*\*other loan provider\*\*\*] for an additional loan amounting to ~[...] m EUR (~[...] m LTL). [\*\*\*parameters of the loan\*\*\*].
- (43) As a result, it is foreseen that the State shall guarantee loans issued by EIB and [\*\*\*other loan provider\*\*\*] in the value of ~115,96 m EUR (i.e. 400 m LTL).
- (44) According to the Resolution No XII-479 passed by the Lithuanian Parliament on 2 July 2013, the state guarantee for the 81.09 m EUR loan issued by EIB shall be provided on the following conditions:
- a) The premium for the state guarantee shall amount to 0.1% of the total value of the loan, i.e. EUR 81 090 (~0,28 m LTL). The guarantee premium shall be paid by single instalment at the moment of receipt of the state guarantee.
  - b) KN shall mortgage/pledge to the Ministry all property of the LNG Terminal in the value of 100% of the guaranteed loan. According to the assessment of Swedbank, the quality of such collateral is [...].
  - c) The term of the state guarantee shall correspond to the maturity of the loan, i.e. up to 20 years.
  - d) The state guarantee may be issued to KN only once it has received State aid clearance from the European Commission.
- (45) At present, the conditions of the state guarantee for the additional EUR 5.9 million of loan provided by EIB and the EUR ~[...] million of loan provided by [\*\*\*other loan provider\*\*\*] have not been decided. Nevertheless, Lithuania considers it likely that the State will provide a State guarantee on [\*\*\*- conditions of the guarantee\*\*\*] In case of significant changes to the conditions of the state guarantee, which could increase the value of State aid provided to KN in this regard, Lithuania undertakes to notify the modifications as required under Regulation (EC) No 659/1999.

## 2.8. The LNG Supplement

- (46) The LNG Supplement is collected on the basis of Art 5(2) of the LNG Terminal Law and administered in accordance with administrative rules ("AdminReg")<sup>15</sup>.
- (47) Following Article 5(2) of the LNG Terminal Law, the installation costs of the LNG Terminal, related infrastructure and the connection with the gas network which cannot be financed by other resources available to KN, as well as all the fixed operating costs of the LNG Terminal, related infrastructure and the connection to the gas network that are necessary<sup>16</sup> for ensuring the operation of the LNG Terminal, shall be covered by a levy imposed as a supplement to the natural gas transmission price (the "LNG

<sup>15</sup> Resolution No O3-294 of the National Control Commission for Prices and Energy of 9 October 2012: "On Adoption of the Regulation on Administration of the Funds for Full or Partial Compensation of Costs Necessary for Construction and Operation of the Liquefied Natural Gas Terminal, Its Infrastructure and Connection" (State Gazette, 2012, No 118-5973).

<sup>16</sup> The necessity of funds will be assessed by the NRA in view of the financial resources required for the implementation of the LNG Terminal investment project and in view of documents demonstrating that KN had no possibility to use other possible project funding sources or other means to ensure the funding of the project.



Supplement") in accordance with the procedure laid down by the NRA. The LNG Supplement shall be collected, administered and disbursed to the LNG Terminal Operator by the transmission system operator for natural gas ("TSO") under the terms laid down by the NRA.

- (48) Following Article 3 of the AdminReg, all users of the natural gas transmission system, including final consumers, are obliged to pay the LNG Supplement together with their other payments for the natural gas transmission service. The payments are collected by the TSO either directly from the user or from suppliers of natural gas in case the user has no direct contractual obligations with the TSO. The LNG Supplement is established by the NRA on an annual basis in proportion to the quantities of natural gas delivered for the purposes of the user (*i.e.* for consumption or further resale).
- (49) The collected funds are administered by the TSO in accordance with the terms and conditions set by the AdminReg. The TSO has to administer the LNG Supplement in separate accounts and through a bank account dedicated to the LNG Supplement administration. Also, the TSO has to publicly announce the amounts of the LNG Supplement collected and paid-off during each calendar month, as well as the level of funds in its possession during each calendar year.
- (50) The funds are transferred to KN upon the instruction by the NRA. As provided in Article 10.1 of the AdminReg, such funds may be transferred to KN not more than once in each annual quarter after the Ministry of Energy confirms the project related infrastructure investments implemented by KN and the NRA gives an order to the TSO to transfer the funds.
- (51) As regards the investment and fixed operating costs to be included into the LNG Supplement, each item has to be separately justified and validated by the NRA. Also, the NRA will verify that the costs were incurred before authorising the payment of the LNG Supplement to KN. Finally, the NRA will also set upper limits to costs that can be accepted so as to ensure that KN will operate efficiently. Costs incurred beyond that limit and that cannot be justified will not be compensated (see Article 9 – 11 of Resolution No O3-367).
- (52) The NRA serves as the authority in charge for setting the LNG Supplement, monitoring and controlling the entire process with regard to the administration of the funds collected by way of the LNG Supplement, and their payment. In this connection, the TSO has to publish, on a regular basis, information regarding the collected LNG Supplement, pay-offs to KN, administration costs incurred by the TSO and the overall balance of the administered funds collected through the LNG Supplement. Article 24 of the AdminReg also provides that the NRA has a right to obtain all information and documents required to control the administration of the LNG Supplement.

#### **LNG Supplement collected during the year of 2013**

- (53) Based on the calculations and justifications provided by KN, the NRA on 19 October 2012 approved investment costs into the LNG Terminal amounting to 113.8 m LTL (~33 m EUR). Those investment costs were therefore used as a basis for the LNG

Supplement of 2013<sup>17</sup>. The 2013 LNG Supplement also included administration costs of the TSO.

- (54) The 2013 LNG Supplement is collected by the TSO from the users of natural gas. It has not yet been transferred to KN. [...]

#### **LNG Supplement collected during the year of 2014**

- (55) On 27 June 2013, Article 5(2) of the LNG Terminal Law was amended. As of 2014, the LNG Supplement will cover the costs for (i) investments into the LNG Terminal if there are no possibilities to finance those investments from other sources available to KN; and for (ii) fixed operating costs which are necessary to ensure operation of the LNG Terminal.
- (56) It was anticipated that the 2014 LNG Supplement would entitle KN to obtain funds in the amount of 86.2 m LTL (~24,97 m EUR). Lithuania indicated that the 2014 LNG Supplement will not be collected in 2014 as it is expected that KN will be able to obtain sufficient funds through loans.

#### **LNG Supplement as of start of operation**

- (57) The LNG Terminal should commence its operations on 3 December 2014. As of that date, the LNG Supplement will cover the fixed operating costs which are necessary to ensure operation of the LNG Terminal.
- (58) This LNG Supplement will be calculated according to the formula and methodology set out in Article 35 of Resolution No O3-367 of 13 September 2013 on the regulated prices for the natural gas sector.

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<sup>17</sup> Resolution No O3-317 by the National Control Commission for Prices and Energy of 19 October 2012 “On Approval of the Funds for the Year 2013 for Full or Partial Compensation of Costs Necessary for Construction and Operation of the Liquefied Natural Gas Terminal, Its Infrastructure and Connection” (State Gazette, 2012, No 123-6229)

- (59) The part of the LNG Supplement covering fixed costs of the operation of the LNG terminal, its infrastructure and connection to the natural gas network (referred to as the "Safety component, D<sub>p, rib</sub>") will be calculated based on the following parameters<sup>18</sup>:
- Costs: The costs to be taken into account are investment-related costs like FSRU lease payments as well as fixed operating costs like lease of the jetty, maintenance and repairs; technical supervision; staff costs; tax costs; administrative costs; marketing and sales costs.
  - Return on capital: The LNG Supplement also allows for a return on capital on the LNG Terminal's Regulated Asset Base. The Regulated Asset Base will include: the connection gas pipeline, the gas metering station, the machinery and equipment (including the part of the investment costs relating to the jetty that is not compensated by the Port authority), management and accounting software, land (EUR 131 million). After the purchase of the FSRU, the Regulated Asset Base will also include it. The Regulated Asset Base decreases each year in proportion to the depreciation of the assets concerned. The WACC used to determine the return on capital will be set by the NRA. The NRA sets a return on capital for 5-year periods on the basis of the pre-tax Weighted Average Cost of Capital (WACC) formula<sup>19</sup>. Based on that methodology, the NRA has approved a WACC for the period 2014-2018 of 7.09%.

<sup>18</sup> The formula used is :

$$D_{p,rib} = \frac{S_{SGDT} + ROI_d + S_{SGDT}^{ADM}}{Q_p}; \text{ (Lt/ thousand m}^3\text{)},$$

Where: S<sub>SGDT</sub> – fixed annual cost of the LNG terminal, its infrastructure and connection which are calculated using the following formula: S<sub>SGDT</sub> = C<sub>DA</sub>+C<sub>M</sub>+C<sub>P</sub>+C<sub>T</sub>+C<sub>A</sub>+C<sub>S</sub>+C<sub>O</sub>+C<sub>NS</sub>, thousand Lt.

Where: C<sub>DA</sub> – depreciation (amortization) costs; C<sub>M</sub> – maintenance, repairs, technical supervision and operational costs; C<sub>P</sub> – staff costs; C<sub>T</sub> – tax costs; C<sub>A</sub> – administrative costs; C<sub>S</sub> – marketing and sales costs; C<sub>O</sub> – other fixed costs; And where: C<sub>NS</sub> - costs of LNG terminal, which are expected based on long term agreements: FSRU lease payments, FSRU operational costs, FSRU lease guarantee costs, lease of the jetty and other costs related to regasification activity and based on the long term agreements evaluating the forecast of the relevant currency ratio.

ROI<sub>d</sub> – return on investments into the LNG terminal's infrastructure part.

S<sub>SGDT,t+1</sub><sup>ADM</sup> – forecast for expected tariff administrative expenses for the calendar year.

Q<sub>p</sub> – the set base quantity of the natural gas (of the first regulatory year) to be transmitted through the gas transmission system (minus quantity of natural gas for transit), thousand. m<sup>3</sup>.

<sup>19</sup> Article 11.9.2 of resolution No O3-367 establishes the regulated asset return on the pre-tax Weighted Average Cost of Capital (WACC) formula:  $r = WACC = R_d \times D + R_e \times \frac{E}{1-t} \times E$ , whereas

R<sub>d</sub> - cost of debt is the 12 month average interest rate for new loans to non-financial corporations with the maturity of more than 1 year (source is taken Bank of Lithuania statistics);

D - part of the capital financed by debt is assumed 70%;

E - part of the capital financed by equity is assumed 30%;

t - corporate income tax in Lithuania is 15%;

R<sub>e</sub> - required rate on equity is based on the formula:  $R_e = R_f + (\beta_u + (1 + (1 - t) \times \frac{D}{E})) \times MRP$ , whereas

R<sub>f</sub> - risk free rate is the average yield of Lithuanian government securities a actions with the maturity of more than 10 years over last 10 years (source is taken from the Ministry of Finance statistics);

β<sub>u</sub> - unlevered beta is the average unlevered beta of American companies engaged in natural gas sector (source is taken from A. Damodaran database) but not higher than the average unlevered beta of European companies engaged in natural gas sector (source is taken from Council of European Energy Regulators (CEER) internal report).

- (60) It is expected that the LNG Supplement will be collected for a period of 55 years from the start of operation, which corresponds to the period of depreciation of the gas pipelines as defined by the NRA<sup>20</sup>. It will however be decreasing over time, in particular when various pieces of infrastructure are depreciated (machinery and equipment after 13 years, gas metering station after 18 years, jetty after 2 years, FSRU after 30 years and gas connection pipeline after 55 years). The LNG Supplement will be at maximum level in the first year of operation of the LNG Terminal (~ EUR [...] million) and decrease to around EUR [...] million as of 2045 when the FSRU is fully depreciated. It then progressively increases to EUR [...] million in 2069 due to higher maintenance costs at the end of the lifetime of the infrastructure.
- (61) It is expected that EUR ~ [\*\*\*- above EUR 1 billion\*\*\*] (nominal value) or ~ EUR [...] million (net present value) will be collected over that period.

	2015F	2020F	2025F	2045F	2069F		
Regasified volume, bcm	[...]	[...]	[...]	[...]	[...]		
000 EUR	2015F	2020F	2025F	2045F	2069F	SUM 2015-2069	NPV 2015-2069
Income from regasification fee	[...]	[...]	[...]	[...]	[...]	[...]	[...]
LNG supplement	[...]	[...]	[...]	[...]	[...]	[...]	[...]

## 2.9. Operation of the LNG Terminal and third party access

- (62) According to Article 10(1) of the LNG Terminal Law, users of the natural gas system have a right to use the LNG Terminal infrastructure on a non-discriminatory basis under agreements with the LNG Terminal Operator, which shall adopt rules for the use of the LNG Terminal in accordance with the requirements established by the NRA. Lithuania has confirmed that it is not planning to request an exemption from third-party access rules based on Article 36 of Directive 2009/73/EC.

## 2.10. Relationship with the EU legal framework

- (63) According to Regulation (EU) No 994/2010<sup>21</sup>, the diversification of gas routes and of sources of supply for the Union is essential for improving security of supply of the Union as a whole and its Member States individually (recital 7 of Regulation (EU) No 994/2010). It is therefore essential in the interests of a well-functioning gas market that the necessary investments in indigenous production and infrastructures, including storage and LNG regasification facilities, be made in good time, bearing in mind possibly supply disruptions (recital 27 of Regulation (EU) No 994/2010). Consequently, Member States are obliged to ensure that the necessary measures are taken so that by 3 December 2014 at the latest, in the event of a disruption of the single largest gas infrastructure, the capacity of the remaining infrastructure, determined according to the N-1 formula, is able to satisfy total natural gas demand

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**MRF** - market risk premium is the average difference between annual S&P500 return and 10-year U.S. Treasury rate over last 20 years + Country risk premium for Lithuania (source is taken from A. Damodaran database).

<sup>20</sup> Decision No O3-316 – Methodology for Gas Companies on Separation of Accounting, Distribution of Costs and Related Requirements.

<sup>21</sup> Regulation (EU) No 994/2010 of the European Parliament and of the Council of 20 October 2010 concerning measures to safeguard security of gas supply and repealing Council Directive 2004/67/EC, *OJL* 295, 12.11.2010, p. 1–22.

during a day of exceptionally high demand occurring with a statistical probability of once in 20 years (Article 6(1)).

- (64) Lithuania has explained that, given the current market and infrastructure context, Lithuania can currently not implement the N-1 criterion: on the one hand, only one-direction natural gas flows from Belarus to Lithuania are enabled through a single operational cross-border pipeline; on the other hand, natural gas stocks stored in the Inčukalns underground storage do not comply with this criterion because of limited storage capacities and restricted cross-border flows from Latvia to Lithuania.
- (65) Moreover, Annex I of Regulation (EU) No 994/2010 requires for such secured infrastructure to be an alternative for single-source supplies of natural gas. In this regard, Lithuania doubts that current stocks in Inčukalns can be treated as “alternative” as reloading of the stocks in Inčukalns requires for natural gas supplies from Russia.
- (66) Therefore, Lithuania views the LNG Terminal and a cross-border natural gas connection with Poland from the technical point of view as the only viable and feasible developments towards enhanced security of supply and implementation of the N-1 criterion. Given that the connection with Poland could be finalized by 2018–2020 at the earliest, the LNG Terminal is the sole opportunity to meet the deadline of 3 December 2014, as it is mandatorily established by Regulation (EU) No 994/2010.
- (67) Within the context of measures taken to achieve security of energy supply, Member States enjoy a wide discretion in providing for, commissioning and organising public service obligations (recital 48 of Regulation (EU) No 994/2010).

## 2.11. Security of supply issue and gas market context

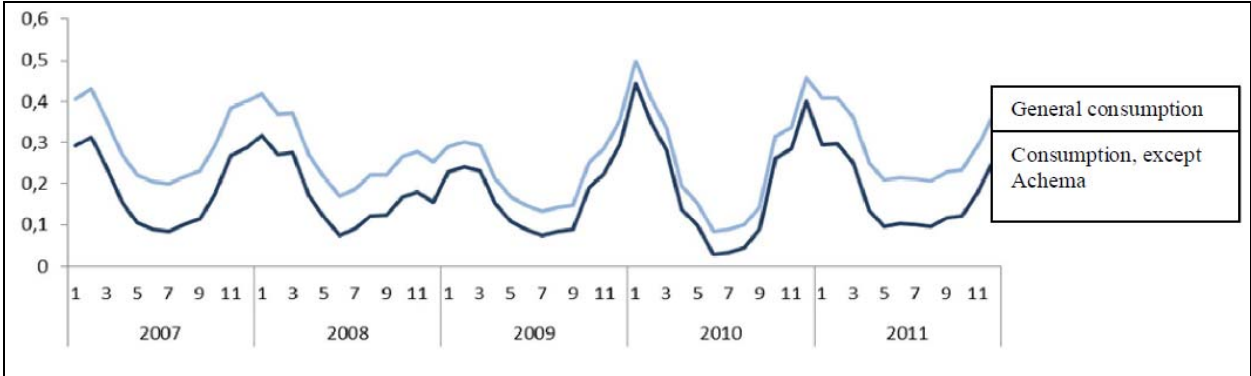
- (68) The Lithuanian gas market is completely dependent on imports. As a result, the market is dominated by import contracts with the single external supplier – OAO “Gazprom” from Russia. The Lithuanian natural gas system is connected only to the Russian natural gas system: directly (cross-border interconnection with the Kaliningrad Area) and indirectly (through Belarus and Latvia). As a result, the entire natural gas demand in Lithuania is covered by imports from one single external source. Given the share of gas in the energy mix, Lithuania is dependent on Russian gas for 30% of its energy needs (compared to 6.5% on average in Europe).



Source: *Natural Gas Europe*

- (69) Due to the dependence on a single source of supply and the risks associated therewith, Lithuania intends to develop infrastructure which would enable an alternative supply of natural gas into Lithuania, in order to ensure security of energy supply and conformity with the requirements of Regulation (EU) No 994/2010 (i.e. to ensure natural gas infrastructure standard (N-1)).
- (70) One of the primary goals of the LNG Terminal is to ensure the primary necessity supply of natural gas to household consumers, producers of heat (during heating season) and industries, the manufacturing processes of which do require for natural gas supplies. Natural gas demand of such priority consumers in Lithuania amounts from 0.9 to 1.5 bcm annually (as determined in Resolution No 163 of the Government of the Republic of Lithuania „Approval of the Description of Measures Ensuring Natural Gas Supply Security” of 26 February 2008); monthly consumption varies significantly: during the cold season consumption demand may be up to 5 times higher than in summer.
- (71) The diagram below shows that the overall natural gas consumption demand in Lithuania is highly influenced by seasonality, especially when excluding the natural gas consumption demand of AB “Achema”. This implies that the capacity of an LNG Terminal will have to meet not only a certain annual demand but also daily demand, in particular in winter times.

*Natural gas consumption demand in Lithuania (monthly levels, bcm)*



*Source: The Lithuanian Department of Statistics (Statistics Lithuania)*

- (72) With regard to such data of Lithuanian consumption of natural gas Lithuania commissioned a study into the most suitable capacity of the LNG Terminal. The feasibility study analysed the existing fleet market, project timeline and associated infrastructure and proposed several solutions. On the basis of this feasibility study, it appeared that the LNG Terminal capacity that would optimize security of supply would amount to 11 mmcm daily, i.e. 4 bcm annually; this capacity (in combination with the gas stored in the Inčukalns underground storage facility in Latvia and an improvement of the transmission system) would make it possible to cover the primary necessity demand (in particular daily demand in winter) independently from external suppliers (currently only Gazprom as dominant supplier).
- (73) The LNG Terminal with its planned initial capacities of up to 2 bcm annually (due to limitations of the transmission pipelines) will ensure that even during the coldest winter an interruptible supply of natural gas would be guaranteed for most vulnerable

consumers<sup>22</sup>. This ability to meet the priority consumption demand would be ensured also in case natural gas deliveries from Russia would be restricted or terminated, as was the case during the Ukraine natural gas crisis in 2009.<sup>23</sup> Indeed, the storage capacity of 170k m<sup>3</sup> of the LNG Terminal will allow uninterrupted natural gas supplies to the most vulnerable consumers for a period of 14-30 days.

- (74) Lithuania also views such infrastructure as an effective tool to move from a situation where its single source supplier holds a monopoly to a Lithuanian natural gas market open to worldwide competition of LNG suppliers. As importers and wholesale suppliers of natural gas in Lithuania are able to purchase natural gas only from OAO “Gazprom”, its designated intermediaries or business partners, there is no choice for alternative deliveries of natural gas to Lithuania and hardly any competition on the different market levels (wholesale, retail) exists. The lack of competition is revealed by price comparisons, showing that the Baltic States (together with other Eastern and Southern EU Member States) continue to pay some of the most expensive gas prices in Europe, with Lithuania paying the highest wholesale price for Russian gas in the region, sometimes up to 20% higher than the neighbours Estonia and Latvia<sup>24</sup>.
- (75) Lithuania considers that the development and extension of cross-border interconnections with other Baltic States itself would not solve the natural gas dependency issue, as all the Baltic States (as well as Finland) are also relying on natural gas supplies from Russia. Consequently, the LNG Terminal and the cross-border interconnection pipeline to Poland are seen as the only technical alternatives for the diversification of natural gas imports, *i.e.* for allowing the supply of natural gas from different suppliers under competitive conditions. The cross-border interconnection pipeline to Poland will however be available only as of 2018-2020. In addition, Lithuania has explained that the cross-border interconnection with Poland will not result in the same level of security of natural gas supply as will be ensured by the LNG Terminal, mainly because of the diversity for natural gas supply alternatives worldwide which the LNG Terminal allows and the ability to use the LNG Terminal as temporary natural gas storage. Lithuania therefore sees the construction of the cross-border pipeline to Poland not as an alternative, but as complementary to the LNG Terminal project in terms of creating a competitive market, and the latter as the only possibility to achieve the objective of security of energy supply within the framework of Regulation (EU) No 994/2010.

## **2.12. Commercial constraints of the LNG Terminal in the market context**

- (76) Despite extremely high gas prices in Lithuania that should normally attract investors, no commercial LNG Terminal has been developed so far. This seems to be due to the strong position of Gazprom on the Lithuanian market making the development of alternative competitive supplies extremely difficult, in particular as long as no

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<sup>22</sup> Natural gas demand of household consumers, producers of heat (during heating season) and industries, the manufacturing processes of which require for interruptible natural gas supplies, ranges from 0.9 to 1.5 bcm annually.

<sup>23</sup> Which formed the background to Regulation (EU) No 1994/2010 (see recital 27).

<sup>24</sup> Quarterly Report on European Gas Markets, Volume 4 (Issue 4: October 2011 – December 2011) and Volume 5 (Issue 1: January 2012 – March 2012). [http://ec.europa.eu/energy/observatory/gas/doc/qregam\\_2011\\_quarter4\\_2012\\_quarter1.pdf](http://ec.europa.eu/energy/observatory/gas/doc/qregam_2011_quarter4_2012_quarter1.pdf); See also for more recent data, Quarterly Report on European Gas Markets, Volume 5, Issue 4 (Fourth Quarter of 2012); Volume 6, Issue 1 (First Quarter of 2013); Volume 6 Issue 2 (Second Quarter of 2013).

customer base can be secured. In addition, the difference between prices in Lithuania and other EU Member States supplied by Gazprom (difference in prices of 40% between Lithuania and Germany<sup>25</sup>; difference in prices of 24% between Lithuania and Hungary<sup>26</sup>) reveals that if subject to competitive pressure, Gazprom could easily undercut LNG gas provided by competitors even without resorting to sales below costs. This would then make gas supplied through the LNG Terminal comparatively unattractive for the users of the terminal and the terminal would as a consequence remain unused.

- (77) In this connection, Lithuania has indicated that in case costs of the LNG Terminal would not be covered by the LNG Supplement and instead would be included into the regasification tariff paid by importers of LNG, the fees charged by KN to LNG importers to cover its costs could raise to [...]
- (78) Lithuania has submitted several simulations on the evolution of the regasification tariffs with and without the LNG Supplement as well as with or without the Purchase obligation. According to KN's financial projections, [...].

Main assumptions	
Gazprom price, EUR/mmbtu	[...] (August 2013)
Gazprom price -[...]%	[...]
Gazprom price -[...]%	[...]
Gazprom price -[...]%	[...]
LNG import price, EUR/mmbtu	[...]

<sup>25</sup> Quarterly Report on European Gas Markets, Volume 4 (Issue 4: October 2011 – December 2011) and Volume 5 (Issue 1: January 2012 – March 2012).

[http://ec.europa.eu/energy/observatory/gas/doc/qregam\\_2011\\_quarter4\\_2012\\_quarter1.pdf](http://ec.europa.eu/energy/observatory/gas/doc/qregam_2011_quarter4_2012_quarter1.pdf).

<sup>26</sup> Quarterly Report on European Gas Markets, Volume 6, Issue 1 (First Quarter of 2013); Volume 6 Issue 2 (Second Quarter of 2013).



BEFORE PURCHASE OF FSRU					
<b>Main assumptions</b>					
Annual terminal costs, mln. EUR before FSRU purchase option implementation	[...]				
<b>Regasified commodity price by different load mode</b>					
<b>Operation regime</b>	<b>On a need basis</b>	<b>FSRU different operation modes</b>			
FSRU load mode, bcm	[...]	[...]	[...]	[...]	[...]
Variable costs, mln. EUR	[...]	[...]	[...]	[...]	[...]
<i>Regasified gas price, EUR/mmbtu (in the case LNG Supplement is established)</i>	[...]	[...]	[...]	[...]	[...]
<i>Regasified gas price, EUR/mmbtu (if all costs covered by the LNG Supplement have to be borne by users)</i>	[...]	[...]	[...]	[...]	[...]
AFTER PURCHASE OF FSRU					
Annual terminal costs, mln. EUR after FSRU purchase option implementation	[...]				
<b>Regasified commodity price by different load mode</b>					
<b>Operation regime</b>	<b>On a need basis</b>	<b>FSRU different operation modes</b>			
FSRU load mode, bcm	[...]	[...]	[...]	[...]	[...]
Variable costs, mln. EUR	[...]	[...]	[...]	[...]	[...]
<i>Regasified gas price, EUR/mmbtu (in the case LNG Supplement is established)</i>	[...]	[...]	[...]	[...]	[...]
<i>Regasified gas price, EUR/mmbtu (if all costs covered by the LNG Supplement have to be borne by users)</i>	[...]	[...]	[...]	[...]	[...]

- (79) Lithuania has concluded on that basis that the willingness of a company to undertake the development and operation of an LNG Terminal in Lithuania can only be ensured if financial support is provided to make the project viable. In order to stimulate the realisation of the project, Lithuania has thus announced from the start the willingness to secure State support (see recitals (24) and (26)).

### 2.13. The complaint by the Lithuanian Gas Association

- (80) The Lithuanian Gas Association is an association representing gas companies importing and supplying natural gas for re-sale to the wholesale and to the retail market (AB Lietuvos Dujos<sup>27</sup>, UAB Dujotekana<sup>28</sup>, UAB Haupas<sup>29</sup>, UAB SG Dujos),

<sup>27</sup> Natural gas undertaking which performs the DSO and TSO functions (until unbundling is complete) and acts as the largest natural gas supplier both in the wholesale and in retail markets. It has a take-or-pay contract with Gazprom which, in addition, owns 37.1% of its shares.

the Association Lietuvos Dujotiekio Statyba, comprising 16 companies engaged in the construction of gas pipelines inside and outside Lithuania, as well as some educational and scientific institutions). In its complaint, the Lithuanian Gas Association objects to the LNG Supplement, the State guarantee and the possible use of the land and port facilities of Klaipeda State Seaport without paying a market-based price as constituting illegal and incompatible aid.

- (81) The complainant argues in particular that those various advantages have been granted without notification to the Commission, cannot be viewed as fulfilling the Altmark conditions established by the Court of Justice and seem difficult to be justified under Article 107(3)(c) of the Treaty on the Functioning of the European Union ("TFEU").
- (82) As regards the Altmark conditions, the complainant considers that no proper entrustment has taken place, no clear public service obligations have been imposed and that in any event there is no market failure and need for any measure to ensure security of supply in Lithuania. In this connection, the complainant underlines that the LNG market is international and competitive. The complainant further submits that the parameters for the compensation have not been set in advance and that nothing ensures that no overcompensation will take place. In particular the cumulation of the LNG Supplement and the Purchase obligation could lead to overcompensation.
- (83) The complainant also considers that KN was not selected in accordance with EU procurement rules, which prevents that the aid can be declared compatible with Article 106(2) TFEU under the SGEI Framework.
- (84) Finally, the complainant stresses that both the Purchase obligation and the LNG Supplement infringe the EU Gas Directive 2009/73 and EU Gas Regulation 715/2009 and cannot be justified under Article 3(2) of the Gas Directive. Concerning the LNG Supplement, the complainant has in particular argued that it would infringe Article 13(1) of Gas Regulation 715/2009 and would also constitute a special levy prohibited by Articles 30/110 TFEU.
- (85) As regards Article 107(3)(c) TFEU, the complaint alleges that the aid cannot be approved as it would constitute operating aid.

## **2.14. Observations of Lithuania**

### *2.14.1. On the presence of State aid*

- (86) Lithuania considers that only the State guarantee contains aid elements.
- (87) By contrast, Lithuania argues that the LNG Supplement does not constitute State aid as it would not confer a selective advantage since it merely serves to put pipeline gas and LNG on equal footing in terms of infrastructure financing. Alternatively, Lithuania considers that it complies with the Altmark conditions. On the conditions for the use of the jetty and the port, Lithuania has explained that the arrangements between KN and the Port Authority on the lease of the jetty corresponded to normal

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<sup>28</sup> Second largest natural gas supplier both in the wholesale and retail markets. It has a take-or-pay supply contact with LT Gas Stream AG, an intermediary seller of natural gas fully owned by OAO "Gazprom".

<sup>29</sup> Sole supplier of natural gas in the isolated natural gas system of the Druskininkai region. It is owned by OAO "Gazprom" and has a take-or-pay gas supply contract with Gazprom.

market terms and do not imply any advantage for KN. Lithuania also considers that the Purchase obligation does not constitute an aid because it is not financed from State resources, given that the Purchase obligation is imposed on both public and private companies alike.

#### 2.14.2. *On the compatibility of State aid*

- (88) Lithuania submits that, in any event, even if the LNG Supplement and the Purchase obligation had to be considered as State aid, it would be compatible under Article 107(3)(c) TFEU or alternatively would comply with the SGEI rules laid down in the SGEI Framework.

### 3. ASSESSMENT

#### 3.1. Existence of State aid within the meaning of Article 107(1) TFEU

- (89) Article 107(1) TFEU provides that “*any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods, shall, in so far as it affects trade between Member States, be incompatible with the common market*”. The cumulative conditions set out therein are examined below.

##### 3.1.1. *The direct grant financed from the LNG Supplement*

- (90) As held by the Court, State resources encompass both advantages which are granted directly by the State and those granted by a public or private body designated or established by the State<sup>30</sup>. The Commission considers that the LNG Supplement constitutes a resource that is under the control of the State for the following reasons:
- (91) The LNG Supplement has been established by the State: it is enshrined in the LNG Terminal Law and its amount is set by the regulator based on the calculation parameters enshrined in the LNG Terminal Law (Article 5).
- (92) The LNG Supplement is a surcharge (levy) and not a transmission fee as it does not serve to finance the transmission services (no remuneration).
- (93) The State has appointed the TSO as the administrator of the LNG Supplement. It has also established for what purpose the LNG Supplement will serve, how (from whom) it is to be collected and to whom it must be transferred. In fact the TSO cannot appropriate for itself the LNG Supplement and the State is guiding the use of the funds.
- (94) Finally, the Commission notes that the TSO is strictly monitored by the regulator in the way it is administering the surcharge. Indeed, the NRA monitors and controls the entire process with regard to the administration and transfer to KN of the funds collected by way of the LNG Supplement. In doing so, it performs the following functions:

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<sup>30</sup> Case 76/78 *Steinike & Weinlig v Germany* [1977] ECR 595, paragraph 21; Case C-379/98 *PreussenElektra* [2001] ECR I-2099, paragraph 58.

- It adopts the rules for the collection, administration and disbursement of the funds collected as the LNG Supplement;
  - approves the costs justified by KN to be included in the LNG Supplement and establishes the LNG Supplement on an annual basis;
  - reviews and recalculates, when needed, the LNG Supplement in case of changes in the cost structure of the LNG Terminal;
  - monitors administration of the LNG Supplement assigned to the TSO;
  - monitors actions by the TSO undertaken to ensure financial security of the funds collected by way of the LNG Supplement;
  - gives instructions to the TSO for payment allowances from the funds collected as the LNG Supplement, once it has controlled that costs actually occurred.
- (95) The Ministry of Energy is also involved in the procedures for approval of KN's investments to be compensated by the LNG Supplement, as specified under Article 10.1 of the AdminReg. Such competence by the Ministry of Energy, as the authority responsible for supervision of the project implementation, derives from Article 4(4) of the LNG Terminal Law.
- (96) On the basis of those elements, the Commission concludes that the TSO has been entrusted by the State with the administration of a State resource, i.e. the LNG Supplement. The Commission notes in this respect that by contrast to the *Pearle* (C-345/02) and *Doux Elevage* (C-677/11) judgments, the LNG Supplement does not result from an initiative of the TSO but from the State, and serves to finance a policy of the State, as set out in the various legal acts presented above in section 2.4.
- (97) Finally, the Commission notes that, as of the date of the effective unbundling of the TSO (31/10/2014), Lithuania has indicated that the TSO (which is the entity designated by law to collect and transfer the money and which is currently under the private ownership of AOA "Gazprom" and E.ON Ruhrgas) would be unbundled to an undertaking that would be State controlled.
- (98) The monies collected from the LNG-Supplement will be paid to cover the investment and fixed operating costs of the terminal. This leads to a socialization of costs similar to what is done for interconnectors for instance. For this reason, Lithuania argues that the payment of a grant financed from the LNG-Supplement does not provide KN with any economic advantage.
- (99) However, the view that no advantage is conferred on KN cannot be upheld. Under the LNG Terminal Law, the funds collected from the LNG Supplement are only made available to KN for use in the construction and operation of the specific LNG Terminal at Klaipeda, not to other market players for other actual or potential LNG terminal projects. Indeed, as results from its Article 1(2), the LNG Terminal Law establishes a special regulation for the LNG Terminal to be constructed in the Klaipeda Part. While LNG terminals constructed in Lithuania on the initiative of private persons are rather unlikely given the market circumstances, should they materialise, they would be subject to the Natural Gas Law and not the LNG Terminal Law and will not be entitled to receive proceeds from the LNG Supplement.

(100) The advantage from the LNG Supplement comes in two forms:

A) The LNG Supplement collected after 3 December 2014 will be paid out to KN at regular intervals after the start of operation. It is equivalent to a grant.

Over 55 years, this LNG Supplement is expected to amount to EUR [\*\*\*- above EUR 1 billion\*\*\*] in total (nominal terms). It will cover investment related costs like the lease and purchase of the FSRU, depreciation costs, return on capital and fixed operating costs.

B) The LNG Supplement for the years 2013-2014 actually functions more like a financial back-up or a guarantee in that the funds are available for KN should KN not obtain necessary financial resources from loans. This guarantee element can improve its position when negotiating loan conditions as it provides security vis-à-vis prospective lenders as to KN's ability to finance the rest of the investment costs. This advantage is difficult to quantify but will at the maximum correspond to the amount of EUR 58 million that would have been available in 2013-2014 should KN not be able to obtain the loans required to finance the investments.

### 3.1.2. The State Guarantee

(101) In line with the Guarantee Notice<sup>31</sup> a state guarantee can be deemed to be market conform if a market-oriented price is paid for it. Whereas Lithuania is not claiming that the fee charged on the guarantees described in section 2.7. is market conform, the Commission has nevertheless assessed this question.

(102) In its practice, the Commission uses various methodologies to analyse whether a guarantee price is market conform and, if not, for establishing the aid element therein. First, it may be possible to compare the guarantee price to the price for a guarantee of a similar amount, duration, collateral and risk level provided by a private bank to the same company, or even in relation to the same loan (*close comparator method*). Second, in case there is no such readily available information to indicate the market conform guarantee remuneration, it may be possible to establish a guarantee premium benchmark on the financial markets (*benchmarking method*). For example, CDS rates or bond spreads of a comparable group of companies can provide a market benchmark for the guarantee premium<sup>32</sup>. Alternatively, where market benchmarks are not available (or as a cross-check where market benchmarks are available), a cost-based approach such as Risk Adjusted Return On Capital ("RAROC") can be used to establish the different cost elements of a guarantee, i.e. the expected loss related to credit risk, the required return on capital, and a normal administration fee (*costing approach*).

(103) Both the above described benchmarking method on the basis of CDS spreads or bond spreads and the costing approach may be faced with the problem that the obtained

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<sup>31</sup> Commission Notice on the application of Articles 87 and 88 of the EC Treaty to State aid in the form of guarantees, OJ C 155/10, 20.6.2008, art.3.2(d)

<sup>32</sup> In order to have proper benchmark, it is important however that not only the *group of companies* is comparable (notably in terms of rating), but also that the *state guarantor* in question has a good enough credit standing. If this is not the case, the guarantee premium benchmark obtained on the basis of CDS is likely to overstate the value of the guarantee to the company (and bank/loan provider) in question, as CDS spreads typically relate to guarantors with a very strong credit standing.

estimate for a market oriented price is appropriate in the case of guarantors with a very strong credit standing. The estimate may, however, overstate the value of the guarantee to the company (and the loan provider/bank) in question when the state guarantor has a significantly lower credit standing. In those cases, an indirect approach based on a comparison of interest rates with and without state guarantee may be envisaged (*rate differential approach*). Based on that method, the market conform guarantee premium is determined such that the total financial remuneration paid by the beneficiary (the sum of the remuneration for the received funding from private third parties, the guarantee premium plus any fees) is equal to or higher than the total interest rate that the company would pay should it raise equivalent but non state-guaranteed funding from third parties<sup>33</sup>. In other words, the market conform guarantee premium for a state guarantee is defined as the difference in financing cost with and without state guarantee.

- (104) Lithuania provided an assessment of the State aid element in the guarantees described in section 2.7., applying a rate differential approach provided by Swedbank according to the following formula: Market conform state guarantee premium (%) = Borrowing rate with pledging of LNG Terminal without a state guarantee – Borrowing rate with state guarantee. For the calculation of the two borrowing rates (interest rates) with and without state guarantee Lithuania uses a costing method, similar to a RAROC approach, according to which the borrowing rate is defined as follows: *Borrowing rate = Pre-tax required return on capital + Cost of borrowed funds + Risk cost + Operational cost*. Swedbank estimates three scenarios (Moderate, Conservative and Higher Risk) to calculate a range for the borrowing rates. On that basis Lithuania obtains a range for the price of the market conform guarantee from [...] % p.a. in the Moderate scenario to [...] % p.a. in the Higher Risk scenario. After deduction of the 0.1% fee that will be paid by KN and discounting at 2.08%<sup>34</sup>, Lithuania has estimated the value of the State aid element in the guarantees described in section 2.7. for a total amount of around EUR 116 million as being in the range of EUR [...] million to EUR [...] million.
- (105) In principle, the rate differential approach of Swedbank appears reasonable in that it establishes the guarantee premium by comparing the loan with and without a state guarantee. This method corresponds to the fall back option presented in the Guarantee Notice in case no proper guarantee premium benchmark can be found on the financial markets.
- (106) The Commission considers that in the present case, indeed, using the benchmarking approach with CDS spreads or the costing approach would not be fully appropriate. As pointed out, this approach may be faced with the issue that the obtained estimate for a market oriented price primarily relates to guarantors with a very strong credit standing. The estimate may hence overstate the value of the guarantee to the company (and the loan provider/bank) in question when the state guarantor has a significantly lower credit standing. As currently, Lithuania's credit rating is BBB (by S&P), BBB+ (by

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<sup>33</sup> Where no good market benchmarks for the interest rate exist, a costing approach can be used to establish the different cost elements of the loan interest rate.

<sup>34</sup> The discount factor of 2.08% is equal to the sum of the base rate for Lithuania (1.08%) plus 100 bps calculated according to the Communication from the Commission on the revision of the method for setting the reference and discount rates (2008/C14/02).

Fitch) and Baa1 (by Moody's), a benchmarking with CDS spreads may not be fully appropriate and a rate differential approach is more adequate in this case.

- (107) The conclusions of Swedbank are contingent upon the creditworthiness of the company taken into account for estimating the borrowing rates. The PD (probability of default) used by Swedbank to calculate the borrowing rates of the company without state guarantee is [...] and [...]. This range of PD coincides roughly with the average default rates reported by credit rating agencies for companies rated [...]<sup>35</sup>. It suggests that Swedbank assumes that the company would have a rating of [...].
- (108) In order to compare under the rate differential approach the interest rates with and without state guarantee it is possible to use, as Swedbank did, the RAROC methodology. It is, in principle, also possible to determine the interest rates by using CDS samples. Using the rating of KN which was indicated by Swedbank, i.e. at around [...] (including government support), the interest rate of the loan<sup>36</sup> without a state guarantee can be estimated on the basis of a CDS sample of companies rated [...]. The sample<sup>37</sup> statistics have an interquartile range of 1.6% - 2.4% with a median at 2.0%..
- (109) A pledge on the LNG Terminal would provide for a fairly large coverage of the whole exposure of EUR 116 million with a loss given default (LGD) of around 14% (=1-100/116). One possibility to account for the collateral is to apply a reasonable adjustment factor of [...]<sup>38</sup>. The resulting risk margin would be [...]. Another possibility to account for the collateral would be to apply the methodology used by credit rating agencies and notch up KN's rating with one notch<sup>39</sup>. In that case the rating of [...] improves up to [...]. The CDS sample of companies rated [...] has an interquartile range of the spreads of [...]. Consequently the risk margin of a loan to a company with a rating of [...] and with [...] could be estimated in the range of [...]%, depending on the method.
- (110) In the case of the loan with state guarantee the recovery rate will be improved because a claim to the state is usually associated with a high recovery rate between 95% and 100% (and respectively low LGD). In addition, the creditworthiness of the firm tends to become aligned to that of the state, so that the credit rating of KN would go up to the level of the rating of the state<sup>40</sup>. In the case at hand Lithuania has a rating of BBB (by S&P). The CDS sample of BBB rated companies shows an interquartile range of 1.2% to 2.0% with a median at 1.5%. In order to take into account the high recovery rate (respectively low LGD) one can apply the adjustment factor of [...] on that rate (as

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<sup>35</sup> See for example Standard and Poor's "2012 Annual Global Corporate Default Study And Rating Transitions", 18.03.2013, Table 9, p. 29.

<sup>36</sup> Here the assessment refers only to the risk margin as the base rate and the loan fees would be equal in the case of loan with state guarantee and without state guarantee and will be cancelled in the formula.

<sup>37</sup> The sample consists of 43 observations of companies rated BBB- by S&P.

<sup>38</sup> The adjustment factor broadly reflects the difference in LGD between the collateralisation categories "High" (LGD < 30%) and "Normal" (30% < LGD < 60%) set out in the 2008 Reference Rate Communication. In order to obtain a conservative estimate, the adjustment factor of [...] is derived by using [...]. See also Commission Decision of 3 October 2012 in Case SA.23600 – Germany – Financing arrangements concerning Munich Airport Terminal 2, para 111.

<sup>39</sup> Method used by credit rating agencies, for example explained by Standard and Poor's in "A Guide to the Loan Market", September 2011, according to which in the case of substantial recovery prospects (RR between 70% and 90%) the issuer rating will be notched up once.

<sup>40</sup> See also S&P "Rating Government-Related Entities: Methodology And Assumptions" 9.12.2010.

explained above for the case of  $LGD < [\dots]$ . The resulting risk margin for the loan with the state guarantee would be  $[\dots]$ .

- (111) Using the differential approach based on the above CDS samples above would provide a range for the price of the guarantee between  $[\dots]$ .
- (112) It may be argued that in this particular case the offered collateral, namely the LNG Terminal, does not have the claimed market value. As explained by Lithuania, the LNG Terminal would not be viable on the market without the state support. This raises concerns that the collateral value can be realised in case of default of Klaipedos Nafta (i.e. by selling the LNG Terminal on the market).
- (113) If the collateral is not accepted the guarantee price as a result of the above formula would be  $[\dots]$ .
- (114) Based on market data, the calculations for the rate differential approach presented above are summarised in the following table (yearly rates):

	Collateral	No collateral
Overall rating used by Swedbank	$[\dots]$	$[\dots]$

- (115) On this basis, the following aid element can be calculated, taking into account the fee of 0.1% and a discount rate of 2.08%:

	Collateral	No Collateral
Overall rating used by Swedbank	EUR $[\dots]$ M - EUR $[\dots]$ M	EUR $[\dots]$ M

- (116) According to the estimation of Swedbank, the market guarantee premium would be in the range of  $[\dots]\%$  to  $[\dots]\%$ . This estimation is very close to the calculations based on the rate differential approach using CDS data showing a guarantee premium in the range between  $[\dots]\%$  and  $[\dots]\%$  p.a. (with collateral) or  $[\dots]\%$  p.a. (if no collateral).
- (117) Based on the elements above, the Commission concludes that the approach of Lithuania is reasonable as it corresponds to the fall back option presented in the Guarantee Notice in case no proper guarantee premium benchmark can be found on the financial markets.

### 3.1.3. The Purchase obligation

- (118) The Purchase obligation constitutes an advantage for the LNG Terminal operator as it guarantees a minimum stable use of the LNG Terminal.
- (119) It is financed from State resources as the Designated Supplier is State owned and is the entity that will make use of the LNG Terminal for the guaranteed 0,5 bcm and pay the regasification fee to the LNG Terminal operator for this volume.



### 3.1.4. *Conditions for the use of the port facilities*

- (120) The complainant has argued that KN might also obtain State aid in the form of preferential conditions for the use of the port facilities and the port services provided by KVVJUD. The complainant did not, however, substantiate its complaint.
- (121) As indicated in recital (11), KN will directly undertake part of the necessary port infrastructure works (jetty facilities above the waterline). KVVJUD is responsible for financing the rest of the port infrastructure works. KN will not have any title to the port infrastructure, because in accordance with applicable laws only the Republic of Lithuania may hold title to the seaport infrastructure. KN will therefore be compensated for 50% of the costs relating to the construction of the jetty. However, KN will then use the port infrastructure on the basis of a contract with KVVJUD. KN will have to pay a charge for the use of the port in the same way as other users do and will, in addition, pay an annual fee for the usage of the jetty, calculated based on the amount of investments of KVVJUD (including KN's own costs as compensated) into the infrastructure of the port, taking into account a period of return of investments of 20 years and an internal rate of return of 5% (corresponding to the rate of return normally applying to other infrastructure developments in the port). In order to avoid excessive profits for KVVJUD, the annual fee for the usage of the jetty shall be reduced by the amount of charges paid by KN for the use of the port. It is currently estimated that KN will have to pay a yearly rent of EUR [...] million for the use of the port infrastructure<sup>41</sup>.
- (122) This information provided by Lithuania shows that the use of the port will be made on market terms, i.e. on terms equivalent to those applying to other port users.
- (123) In particular, as results from recital (11), the lease of the jetty has been calculated on the basis of the investments of KVVJUD and those of KN, in so far as they were compensated by KVVJUD, into the infrastructure of the port, taking into account a period of return of investments of 20 years and an internal rate of return of 5%. As this corresponds to the rate of return normally applying to other infrastructure developments in the port, the lease for the jetty appears to correspond to market conditions.
- (124) As to the partial compensation of the works undertaken by KN for the jetty infrastructure, it appears to be the normal consequence of the fact that KN is not allowed to hold any title to the jetty infrastructure. The Commission understands that the compensation will be based on the costs actually incurred by KN for the construction. In addition, the compensation paid for those costs by KVVJUD will be included in the overall investment amount for the port infrastructure that shall serve as a basis to calculate the lease of the jetty. KN will thus pay a user charge for using the port infrastructure linked to the LNG Terminal that it has not financed itself.
- (125) As to the reduction of the lease of the jetty by the part of the user charges relating to the part of the port used for the LNG Terminal, it is linked to the principle of avoiding undue profits for KVVJUD. Indeed the reduction is limited to the part of the user charges calculated for the use of the terminal and thus the use of the jetty. Were these

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<sup>41</sup> The infrastructure is different from and additional to the infrastructure concerned in case SA.30742 – LT - Construction of Infrastructure for the Passenger and Cargo Ferries Terminal approved on 22/02/12.

charges not to be deducted, KVJUD would be remunerated twice (through user charges linked to the use of the port related to the LNG Terminal, including the jetty, and the lease of the jetty).

- (126) On that basis, the Commission concludes that the conditions for use of the jetty infrastructure do not provide an advantage to KN.

*3.1.5. Obligation for the TSO to extend the transmission system*

- (127) The Commission notes that the reinforcement, extension and improvement of the transmission system belong to the tasks of the TSO<sup>42</sup>. In addition, Lithuania has indicated that the extension of the transmission system had been planned by the TSO for some time and irrespective of the LNG Terminal project. On that basis, the Commission concludes, that the extension of the transmission system does not constitute a selective advantage for KN.

*3.1.6. Distortion of competition and affectation of trade between Member States*

- (128) The Lithuanian authorities consider that the LNG Terminal cannot affect competition and trade because as of now there is no trade with other Member States and because the terminal will have a beneficial impact on competition. However, the LNG Terminal will offer services (LNG unloading, regasification and supply to the transmission system) to gas traders/suppliers. The gas market is liberalised at the EU level and gas is traded across the EU. It is thus likely that the LNG Terminal will have an impact on competition and will also affect trade patterns in the EU. The fact that the construction of the LNG Terminal might change the market structure in such a way that in the medium term more competition arises does not alter the fact that it will change competition and trade patterns.

*3.1.7. Conclusion*

- (129) On the basis of the elements examined in sections 3.1.1 to 3.1.6, the Commission concludes that the state guarantees described in section 2.7., the disbursement of the LNG Supplement and the revenues resulting from the Purchase obligation constitute State aid within the meaning of Article 107(1) TFEU.

**3.2. Legality of the aid**

- (130) The State guarantees described in Section 2.7 of this decision will be provided only after the Commission's approval.
- (131) Article 5(2) of the LNG Terminal Law that establishes the LNG Supplement to cover fixed operating costs of the LNG Terminal and its connection to the gas network and the Purchase obligation have not yet created enforceable rights as the LNG Terminal is not yet operational and the operator of the LNG Terminal has not yet been designated formally.
- (132) However, Article 5(2) of the LNG Terminal Law that establishes the possibility for the LNG Terminal developer to obtain the LNG Supplement to cover investment costs which cannot be financed by other resources available is already in force and provides

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<sup>42</sup> See Article 13 of the Gas Directive 2003/73/EC.

KN with enforceable rights given that KN has already been designated as the project developer. This part of the aid measures has thus been granted in breach of the standstill obligation enshrined in Article 108 TFEU.

### 3.3. Compatibility under Article 107(3)(c) TFEU

- (133) The measure concerns the construction and operation of an LNG terminal in Lithuania with no prospect for these investments to be financed on regular commercial conditions i.e. from the company funds and recouped from tariffs, in the long term.
- (134) The Commission therefore considers that, in keeping with past decision-making practice in the area of energy infrastructure<sup>43</sup>, the assessment of the compatibility of the aid measures identified in sections 3.1.1 to 3.1.3 with the internal market requires an evaluation of their contribution to the development of the European Union market for gas and to security of supply in the European Union. Therefore, the aid measures are assessed directly on the basis of Article 107(3)(c) TFEU which states that “*aid to facilitate the development of certain economic activities or of certain economic areas, where such aid does not adversely affect trading conditions to an extent contrary to the common interest*” may be considered to be compatible with the internal market.
- (135) It is established Commission practice that aid measures supporting the construction of energy infrastructure may be declared compatible directly under Article 107(3)(c) TFEU if they are necessary and proportionate and if the positive effects for the objective of common interest pursued outbalance the negative effects on competition and trade. In this regard, the Commission considers it appropriate to assess the following three questions:
- a) Is the aid measure aimed at a well-defined objective of common interest<sup>44</sup>?
  - b) Is the aid well designed to deliver the objective of common interest? In particular:
    - i. Is the aid measure an appropriate and necessary instrument, i.e. are there other, better-targeted instruments<sup>45</sup>?
    - ii. Is there an incentive effect, i.e. does the aid change the behaviour of firms?
    - iii. Is the aid measure proportionate, i.e. could the same change in behaviour be obtained with less aid?

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<sup>43</sup> See, in particular Commission Decisions in cases SA.35255 Aid to PSE Operator S.A. for the construction of Stanisławów power station; N 594/2009 Aid to Gaz-System SA for gas transmission networks in Poland; SA 33823 (2012/N) Electricity cable Aland – Finland (mainland); SA.31953 (2011/N) Construction of a LNG Terminal in Świnoujście, Poland; SA.29870 (N 660/2009) Gas pipeline Rembelszczyzna – Gustorzyn (phase III); SA.35164 Greece Compressor Station At Nea Messimvria (2013/NN); SA.35166 (2013/NN) Greece, High Pressure Natural Gas Pipeline to Aliveri; SA.35167 (2013/NN) High Pressure Natural Gas Pipeline Ag. Theodori – Megalopoli.

<sup>44</sup> Judgement of the General Court of 14 January 2009 in Case T-162/06 Kronoply v. Commission, [2009] ECR II-1, in particular paragraphs 65, 66, 74, 75.

<sup>45</sup> Judgement of the General Court of 7 June 2001 in Case T-187/99 Agrana Zucker und Stärke v. Commission [2001] ECR II-1587, paragraph 74; Judgement of the General Court of 14 May 2002 in Case T-126/99 Graphischer Maschinenbau v. Commission [2002] ECR II-2427, paragraphs 41-43; Judgement of the Court of 15 April 2008 in Case C-390/06 Nuova Agricast [2008] ECR I-2577, paragraphs 68-69.

- c) Are the distortions of competition and the effect on trade limited, so that the overall balance is positive?

*3.3.1. Objective of Common Interest*

- (136) The aid measure has to aim at a well-defined objective of common interest. When an objective has been recognised by the Union as being in the common interest of the EU Member States, it follows that it is an objective of common interest.
- (137) Pursuant to Article 194 TFEU, in the context of the establishment and functioning of the internal market, the Union policy on energy shall aim inter alia to ensure security of energy supply in the Union. In this respect, the Commission has already decided that aid granted for the construction or expansion of LNG terminals may contribute to improving the security of supply in the Union and the functioning of the internal energy market<sup>46</sup>. The importance of diversification of gas routes and of sources of supply for the Union for improving security of supply of the Union as a whole and its Member States individually has further been recognized by the Union in Regulation (EU) No 994/2010 (recital 7). Also, as explained in recital (63) above, the Union has recognized that it is essential in the interests of a well-functioning gas market that the necessary investments in indigenous production and infrastructures, including LNG regasification facilities, be made in good time, bearing in mind possible supply disruptions.
- (138) The Court has also confirmed that the objective of guaranteeing adequate investment in the electricity and gas distribution systems is designed to ensure, inter alia, security of energy supply, an objective which the Court has also recognised as being an overriding reason in the public interest<sup>47</sup>.
- (139) The notified aid measures aim at supporting the development of an LNG Terminal in the Klaipeda port. As a consequence, they will contribute to increasing security of supply of gaseous fuels to Lithuania, as the LNG Terminal will diversify sources of supply and thereby improve the stability and continuity of the supply of gaseous fuels to final customers in Lithuania, with the effect of reducing the risk of an interruption in supply.
- (140) In addition, as mentioned in recital (73) above the storage capacity of the LNG Terminal will ensure uninterrupted natural gas supplies to the most vulnerable consumers for a period of 14-30 days.
- (141) As explained in recitals (70) and (73), the capacity of the terminal will allow covering the demand on the Lithuanian market once the transmission system has been improved, so that the LNG Terminal can greatly mitigate the risk of interruption in gas supplies to end consumers. In that respect, Lithuania's current dependence on a single source of supply indicates a risk to secure supplies which requires urgent action, as the

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<sup>46</sup> SA.31953 (2011/N) Construction of a LNG Terminal in Świnoujście, Poland; SA.35165 (2013/NN) and SA.35977 (2012/N) Greece: Upgrade of the Liquefied Natural Gas (LNG) Terminal in Revithoussa.

<sup>47</sup> Judgment of the Court of 22 October 2013 in Joined Cases C-105/12 to C-107/12, *Staat der Nederlanden v Essent and Others*, paragraph 59 and case-law cited.

Commission has recognized in its Communication on the Energy Infrastructure priorities for 2020 and beyond<sup>48</sup>.

- (142) Moreover, if need be, the operation of the LNG Terminal could reduce for Lithuania the need for gas storage in Latvia, thereby increasing the available storage capacity for Latvia and Estonia<sup>49</sup> and improving their security of supply.
- (143) Finally, as explained in section 2.10 the construction of an LNG terminal in Lithuania will ensure, in accordance with the N-1 rule, that in the event of a disruption of supplies from the single largest gas infrastructure the capacity of the remaining infrastructure is able to satisfy total natural gas demand during a day of exceptionally high demand occurring with a statistical probability of once in 20 years.
- (144) Additionally, the construction of the LNG Terminal together with other planned investments in the Baltic countries and in neighbouring countries would contribute to increase the integration of the regional gas market in the EU, in particular markets in the Central and Eastern Member States of the EU. This will on its turn improve the security of supply of the EU as a whole.
- (145) It follows that, since the planned LNG Terminal shall help to ensure security of supply of gas, the aid measures aim at supporting a well-defined objective of common interest recognised by the EU.

### 3.3.2. *Aid well designed to deliver the objective of common interest*

#### 3.3.2.1. *Appropriate and Necessary Instrument*

- (146) In the Second Strategic Energy Review<sup>50</sup>, the Commission included LNG terminals and LNG storage facilities on the list of measures enhancing liquidity and diversification of the gas market in the EU. The Commission also considered that *“liquefied natural gas (LNG) and adequate gas storage are important in providing liquidity and diversity to EU gas markets. Sufficient LNG capacity consisting of liquefaction facilities in the producing countries and LNG terminals and ship-based regasification in the EU should be available to all Member States, either directly or through other Member States on the basis of a solidarity arrangement. This is particularly important for Member States currently overwhelmingly dependent on a single gas supplier”*.
- (147) The adequacy of LNG terminals and storage facilities to deliver the objective of common interest is further reiterated in the Commission Communication Energy

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<sup>48</sup> Communication COM(2010) 677 final from the Commission to the European Parliament, the Council, the European Economic and Social Committee and The Committee of the Regions: Energy infrastructure priorities for 2020 and beyond - A Blueprint for an integrated European energy network. See accompanying impact assessment (Communication staff working document SEC(2010) 1395 final), section 2.5.

<sup>49</sup> The Inčukalns Underground Gas Storage Facility is the only functioning gas-storage facility in the Baltic States. It is used to supply gas during the heating season to customers in Latvia, Estonia, northwestern Russia, and (in smaller amounts) Lithuania.

<sup>50</sup> Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and The Committee of the Regions – Second Strategic Energy Review: "An EU Energy Security and Solidarity Action Plan", COM(2008) 781.

infrastructure priorities for 2020 and beyond<sup>51</sup>, which noted that every European region should implement infrastructure allowing physical access to at least two different sources. Meanwhile, the infrastructure standards introduced in the Security of Gas Supply Regulation 994/2010<sup>52</sup> impose obligations in terms of security of supply that increase the need for flexible supply, such as LNG, among other policy options.

- (148) The gas market in Lithuania has failed so far to provide for a project delivering a similar contribution to the achievement of the objective of security of supply without State support. This lack of investment is striking in a market in which gas prices are amongst the most expensive in Europe: gas prices in Lithuania are the second highest in Europe (after Bulgaria) and are significantly higher when compared to other EU Member States (including Latvia and Estonia).
- (149) As explained in section 2.12, the absence of market interest to invest in alternative infrastructure is essentially due to the specific situation of the Lithuanian gas market that is dominated by a single supplier having a commercial margin sufficient to enable it to undercut LNG prices if users of LNG have to pay on top of the LNG price also a regasification fee calculated so as to cover the entire costs of the LNG terminal<sup>53</sup>.
- (150) As results from the simulations in recital (78), LNG regasified in the terminal could [\*\*\*business secret\*\*\*]
- (151) [\*\*\*business strategy<sup>54</sup>\*\*\*]
- (152) [\*\*\*business strategy\*\*\*]
- (153) The simulations provided by Lithuania show that without the LNG Supplement and the Purchase obligation, the LNG Terminal would not be competitive or viable. There would be a funding gap and the investment would not be realised. Without the aid, the terminal project would not materialise and deliver its contribution to ensure security of supply.
- (154) As to the State guarantees described in section 2.7 of the decision, it will enable KN to obtain loans for the main portion of the investments. This reduces the costs of the project but also the amount of aid necessary to be financed from the LNG Supplement. In particular, the State guarantee will give KN access to loans in the amount of EUR 116 million instead of EUR 73 million as initially projected.

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<sup>51</sup> Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and The Committee of the Regions Energy infrastructure priorities for 2020 and beyond - A Blueprint for an integrated European energy network COM(2010) 677 final of 17.11.2010.

<sup>52</sup> Regulation (EU) No 994/2010 of the European Parliament and of the Council of 20 October 2010 concerning measures to safeguard security of gas supply and repealing Council Directive 2004/67/EC, *OJL* 295, 12.11.2010, p. 1–22.

<sup>53</sup> See also, Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and The Committee of the Regions Energy infrastructure priorities for 2020 and beyond - A Blueprint for an integrated European energy network COM(2010) 677 final of 17.11.2010. See p. 34.

<sup>54</sup> [\*\*\*business strategy\*\*\*]

- (155) The Commission notes that no other type of investment would provide Lithuania with the same degree of security of supply. Increasing the capacity of the interconnector between Lithuania and Latvia would not solve Lithuania's security of supply issue, as the natural gas supplied to Latvia is imported from the same single supply source as in Lithuania (AOA "Gazprom"). Increasing storage capacity in Latvia or building a storage facility in Lithuania would not solve the issue of the dependency on one single supply source either as the gas that is stored can, in the absence of an LNG Terminal be imported only from AOA "Gazprom". While the interconnector planned between Poland and Lithuania might also contribute to ensuring security of supply in Lithuania, this interconnector will not be in operation before 2018-2020, while the terminal should enable Lithuania to meet the N-1 requirement by December 2014, in line with the requirement in Article 6(1) of Regulation (EU) No 994/2010. In addition, The LNG Terminal will ensure diversification of supply sources to a degree that would not likely be achieved through the interconnector with Poland. Finally, the LNG Terminal can be used as temporary natural gas storage, which is not possible with the interconnector (see recital (75)).
- (156) Finally, the Commission has also examined the appropriateness of the aid by comparison to the other LNG projects under consideration, i.e. the Eastern Baltic regional LNG terminal in Estonia or Finland. The Commission notes that Lithuania is in a particular situation regarding its gas contracts with its single gas supplier, as those long-term contracts are expiring in 2015. The absence of a terminal by the end of 2014 risks aggravating dependence on one source of supply and lack of competition. Only the LNG Terminal in Lithuania offers such a short term solution given that - based on the information provided by the promoters of the other projects during the identification exercise of projects of common interest pursuant to Regulation 347/2013 - the alternative solutions would be available only after the expiry of the long-term gas purchase contract. Also, Lithuania undertook to facilitate the realisation of the interconnector (Poland – Lithuania) and the Eastern Baltic regional LNG terminal, notwithstanding the Klaipeda project.
- (157) Consequently, the Commission considers that, under these circumstances (in particular the specific market situation and the potential ability for Gazprom to lower its prices, both due to potential ample price-cost margins, and based on a strategic decision to reduce profitability in the short term to ensure higher profits in the medium and long term), granting State aid for the investment into the LNG Terminal is an appropriate and necessary instrument.

#### 3.3.2.2. Incentive Effect

- (158) Lithuania demonstrated that the aid measures listed in sections 3.3.1 to 3.1.3. improve the financial indicators of the project up to a level that can be acceptable for the beneficiary to make the investment viable. While the net present value would be [...], the generated internal rate of return (IRR) of the project for a duration of 55 years would reach [...] % with the aid measures (State guarantees, revenues from LNG Supplement and Purchase obligation). This IRR is below the weighted average cost of capital (WACC) estimated by Swedbank for this industry ([...]).
- (159) By using the WACC calculated for the sector as discount rate, the net present value (NPV) of the project is negative. However, sensitivity analysis shows that the NPV becomes positive once a discount rate of [...] % or lower is used. This strong

dependency on the discount rate used is typical for the case with projects of long duration, where small changes in the discount rate can have a large impact on the project overall profitability. Therefore, one cannot attribute the same value to a net present value calculation for projects of long duration like the LNG Terminal at issue as for projects of shorter duration.

- (160) While below the WACC of the sector, the IRR of the project is nevertheless sufficient to incentivize the investment. In this connection, it should be noted that the WACC calculated by Swedbank has been determined on the basis of various LNG projects including projects having a higher commercial risk profile than the LNG Terminal at the Klaipeda port, which will benefit from a Purchase obligation and the guarantee to be reimbursed fixed operating costs through the LNG Supplement. The payment of the LNG Supplement and the Purchase obligation reduce the risks of the terminal activity, hence making the sector WACC unlikely to adequately reflect the profitability expectation of the project.
- (161) The Commission notes in particular that the calculation of the sector WACC is based on weights which give a larger importance to the cost of equity (67 per cent), based on an average of 26 gas companies active in Europe, than to debt (33 per cent). While this assessment can be considered analytically robust, in that it makes use of the standard WACC calculation and of the Capital Asset Pricing Model, it is also likely that the companies taken into consideration to establish the equity weight might not be fully representative of the situation of KN. In particular, such data are based on the fully commercial activities of those companies, which therefore are not directly comparable to the LNG Terminal at Klaipeda Port. It is therefore likely that the sector WACC overestimates the cost of capital of the terminal.
- (162) Conversely, in the absence of aid, the project would yield no positive rate of return and a significantly negative net present value, making it unattractive to market investors.
- (163) The Commission concludes that the project IRR can be regarded as a reasonable estimate for the project and that its level provides an incentive effect.
- (164) Beyond profitability considerations, State aid to a particular activity or investment lacks incentive effect where the beneficiary is legally obliged to perform them. In this respect, the construction of the planned LNG Terminal allows conformity with Regulation No 994/2010 but the specific project is not mandated by it. In particular, Regulation (EU) No 994/2010 does not oblige specific undertakings or the Member States to have predefined minimum levels of regasification capacity<sup>55</sup>. In any event, Regulation (EU) No 994/2010 does not impose either on Lithuania or on KN the obligation to develop an LNG Terminal with a predefined capacity, so that the aid has an incentive effect in this case.
- (165) In parallel to designating KN as project developer, the State also announced that it would provide KN with the support necessary to carry out the project (see in particular Parliament Resolution No XI-1050 and Government Resolution No 199, described in recitals (24) and (26) of this Decision). The commitment of the Lithuanian State to

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<sup>55</sup> See Commission Decision of 16.4.2013 in case State aid SA.34938 (2012/N) – Poland- Aid to increase the capacity of PGNiG's gas storage facility in Husow, recitals 14 and 46.



provide financial support for the construction of the terminal has been made before KN started the construction of the terminal<sup>56</sup>.

- (166) It can be therefore concluded that the aid has an incentive effect, as it provides the necessary incentive for the beneficiary to undertake the project.

### 3.3.2.3. Proportionality

- (167) A State aid measure is proportionate if the measure is designed in a way that the aid as such is kept to the minimum.
- (168) In terms of infrastructure, the project investment costs will amount to EUR [...] million and the aid will amount to between EUR [...], depending on the valuation of the State guarantee and the importance of the LNG Supplement in 2013-2014.

*Total investment costs:*

000EUR	Nominal value	Present value
LNG Terminal infrastructure	131 188	131 188
FSRU <sup>57</sup>	[...]	[...]
<i>Lease payments</i>	[...]	[...]
<i>Acquisition</i>	[...]	[...]
<b>Return on investment Terminal</b>	[...]	[...]
<b>Return on investments into FSRU</b>	[...]	[...]
<b>Total investment costs</b>	[...]	[...]

*Investment aid – range:*

000 EUR	Low	High
State guarantee	4 000 <sup>58</sup>	14 000 <sup>59</sup>
LNG Supplement 2013-2014	0 <sup>60</sup>	58 000 <sup>61</sup>
LNG Supplement 2015-2069 (covering investment-related costs) – (NPV)	444 184	444 184
<b>Total</b>	<b>448 184</b>	<b>516 184</b>

- (169) In terms of fixed operating costs<sup>62</sup> (EUR 920 million in nominal value, EUR [...] million in NPV), the LNG Supplement will cover up to 100% of those costs.
- (170) In terms of variable operating costs, the Purchase obligation will cover EUR 37 million out of EUR [...] million in nominal terms.

<sup>56</sup> The conclusion of the lease contract with Höegh occurred on 02/03/2012, i.e. after the State entrusted KN with the task of developing the terminal and committed to provide KN with the necessary financial means.

<sup>57</sup> According to International Financial Reporting Standards (IFRS) applicable to KN, KN will include the FSRU on its balance sheets as equity. The lease with purchase option of FSRU is therefore assimilated to an investment.

<sup>58</sup> With most favourable valuation of aid element in guarantee (see recital (115)).

<sup>59</sup> Least favourable valuation of aid element in guarantee (see recital (104)).

<sup>60</sup> If no LNG Supplement is paid in 2013-2014.

<sup>61</sup> If LNG Supplement 2013-2014 is paid in its totality.

<sup>62</sup> Maintenance of FSRU, salaries, insurances, marketing and lease of jetty.

- (171) In nominal terms, the LNG Supplement and Purchase obligation covering operating expenses amount to EUR 957 million.
- (172) In assessing the proportionality of the aid, the return made possible for the LNG Terminal should be taken into account. For the measure at hand, the internal rate of return which is expected to be generated by the project is [...]%. This expected IRR is lower than the WACC of [...]% calculated for the sector. The WACC can be seen as the minimum rate of return for investments expected in a particular industry, at which rate of return the NPV of the cash flows of a project becomes equal to zero.
- (173) In addition, the return on capital of the project will be regulated based on the WACC set by the NRA. For the period 2014-2018 the regulated WACC has been set at 7.09%. This rate will be applied only to the Regulated Asset Base<sup>63</sup>.
- (174) Also, regasification tariffs are regulated and strictly limited to variable operating costs.
- (175) Finally, the NRA will closely monitor eligibility of costs and absence of excessive profits.
- (176) Based on the above, the Commission considers that there are sufficient safeguards in place to ensure that the aid will not provide KN with excessive profits on the planned investment.
- (177) Moreover, the Lithuanian State has combined several aid instruments so as to keep the aid to the minimum. The Commission notes in particular that the LNG Supplement of 2013 and 2014 will only be paid out if KN cannot obtain sufficient bank loans. Also, the choice of a State guarantee instead of an outright grant reduces the amount of aid required. Likewise, the Purchase obligation limits the amount of the LNG Supplement to the minimum possible to ensure viability of the investment.
- (178) In view of the above it can thus be concluded that the State aid granted for the envisaged measures is limited to the minimum necessary and overall proportionate.

### 3.3.3. *Distortion of Competition and Balancing Test*

- (179) Given that the capacity of the LNG Terminal is essentially tailored so as to satisfy demand in Lithuania, it will not hinder the preparation of similar investments in Poland and Finland.
- (180) As regards Lithuania itself, the measure will strengthen the competitive position of KN, thereby reducing the likelihood that alternative investors build LNG terminals in the same area. It might also reduce the need for imports of gas from Russia through interconnectors.
- (181) At the same time, the construction of the LNG Terminal in Klaipėda creates a number of benefits for competition:

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<sup>63</sup> The Regulated Asset Base will include the connection gas pipeline, the gas metering station, the machinery and equipment (including the part of the investment costs relating to the jetty that is not compensated by the Port authority), management and accounting software and land (EUR 131 million). After the purchase of the FSRU, the Regulated Asset Base will also include it.

- (182) First, it contributes to an important objective of common interest, namely security of supply, as already explained above in section 3.3.1.
- (183) Second, it opens up the Lithuanian market to all interested entities without the limitations typical for pipelines and allows gas suppliers from Lithuania access to gas supplies from sources located in various parts of the world. In that context, the measure has the potential to increase the amounts of gas trade to and from Lithuania. The project is thus likely to have a positive effect on the development of competition on the wholesale and retail gas market in Lithuania and thus to support a reduction of prices of gas and flexibility in gas supplies favourable for end customers. Given the monitoring by the NRA of the claimed investment costs as to their eligibility for financial support, the aid cannot be used to fund activities on other markets.
- (184) Third, the LNG Terminal will be operated pursuant to effective third party access rules. These access rules should ensure effective competition among the prospective downstream customers of the terminal, the benefits of which counterbalance the negative effects on competition upstream.
- (185) Fourth, from an infrastructure point of view, the aid for the terminal will have the effect of putting LNG on an equal footing with pipeline gas at the border.
- (186) In this regard, it should be noted that importers of natural gas through pipeline purchase gas at the national border and thereafter transfer natural gas to their customers using the national natural gas transmission system. Although separate parts of that system are designated specifically to import the gas (e.g. pipelines specifically designated for import of gas and gas metering stations), all such costs of the delivery of natural gas are socialized and covered by all consumers of natural gas in Lithuania. Hence, the costs of import of natural gas are calculated according to the formula: Price of natural gas to ultimate customer = price of natural gas at Lithuanian border per m<sup>3</sup> + price of transmission of natural gas in Lithuania per m<sup>3</sup>.
- (187) Differently from the import of natural gas through pipeline, which requires specific pipeline connections with the Belorussian gas transmission system, LNG suppliers need an LNG terminal to deliver LNG to the Lithuanian gas transmission system. Hence, the costs of import of LNG could be calculated according to the formula: Price of (LNG) natural gas to ultimate customer = price of LNG at Lithuanian border (LNG Terminal) per m<sup>3</sup> + LNG terminal service fees + price of transmission of natural gas in Lithuania per m<sup>3</sup>.
- (188) As the price of the transmission of natural gas in Lithuania is the same for LNG and pipeline suppliers, competition between LNG and natural gas at the Lithuanian border can be created by keeping LNG terminal services fees to the minimum. The socialisation of the costs of the LNG Terminal through the LNG Supplement allows to import natural gas into Lithuania in the same way as any other infrastructure used for the import of natural gas into Lithuania through pipelines (including, e.g., pipelines specifically designated for import of gas and gas metering stations). In order to ensure non-discrimination and technological neutrality, the LNG Supplement is calculated based on the same principles that apply to tariffs for pipeline gas:

- (a) costs are socialized and spread across all consumers of natural gas;
  - (b) socialization of the costs of the LNG Terminal includes the same cost elements which are socialized in respect of infrastructure used for the import of natural gas through pipelines, i.e. capital expenditures and operating expenses; the variable operating costs will however have to be paid by the users of the LNG Terminal.
- (189) On balance, it can be concluded that the contribution to an important objective of common interest as well as these positive effects on competition outweigh the negative effects on competition identified above.
- (190) However, the Commission notes that the aid measures are not limited to investment aid only. Indeed the LNG Supplement as of the start of operation will also cover certain fixed operating costs while the Purchase obligation covers part of the variable operating costs. The aid thus covers costs that an LNG terminal operator has to bear in his day-to-day operations (operation and maintenance of the FSRU, personnel and marketing costs, insurances, fuel costs). Unlike aid covering investment costs, the planned aid to cover operating costs and the Purchase obligation constitute operating aid which, in general is not considered as facilitating the development of certain economic activities within the meaning of Article 107(3)(c) TFEU.<sup>64</sup>
- (191) While all aid measures taken together and including the operating aid fulfil the conditions mentioned above, in particular on proportionality and necessity, it remains questionable whether aid covering the operating expenses of the terminal operator could be considered compatible with the internal market under Article 107(3)(c) TFEU. This issue can however remain open as KN has been entrusted with a Service of General Economic Interest ("SGEI") and has been imposed SGEI obligations for which the Purchase obligation and the LNG Supplement covering operating expenses constitutes the compensation (see section 3.4 below).

#### 3.3.4. Conclusion

- (192) On the basis of the elements above, the Commission concludes that the State guarantee and the LNG Supplement, in so far as it covers investment related costs are compatible with the internal market, pursuant to Article 107(3)(c) TFEU.

### 3.4. Application of Article 106 (2) TFEU

- (193) In its notification, Lithuania submitted that KN will be entrusted with the particular task of an SGEI with regard to the operation of the LNG Terminal, for a period of 55 years, and that the compensation granted in this respect would therefore fall under Article 106(2) TFEU.
- (194) Article 14 of the TFEU requires the Union and the Member States, without prejudice to Articles 93, 106 and 107 of the TFEU, to use their respective powers in such a way as to make sure that services of general economic interest operate on the basis of principles and conditions, particularly economic and financial conditions, which

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<sup>64</sup> Case T-459/93 *Siemens SA v Commission* [1995] ECR II-1675, paragraph 48. See also Case T-396/08 *Freistaat Sachsen and Land Sachsen-Anhalt v Commission*, 8 July 2010, ECR 2010 II-141 paragraphs 46-48; Case C-156/98 *Germany v Commission* [2000] ECR I-6857, paragraph 30, with further references.

enable them to fulfil their missions. For certain services of general economic interest to fulfil their mission, financial support from the State may prove necessary to cover some or all of the specific costs resulting from the public service obligations.

- (195) Article 106(2) TFEU states that: "*Undertakings entrusted with the operation of services of general economic interest or having the character of a revenue-producing monopoly shall be subject to the rules contained in the Treaties, in particular to the rules on competition, in so far as the application of such rules does not obstruct the performance, in law or in fact, of the particular tasks assigned to them. The development of trade must not be affected to such an extent as would be contrary to the interests of the Union*".
- (196) The conditions under which the Commission applies Article 106(2) TFEU to compensations for the provision of SGEIs are laid down in the Framework for State aid in the form of public service compensation (hereinafter "the 2012 SGEI Framework")<sup>65</sup>. According to point 11 thereof, State aid may be declared compatible with Article 106(2) TFEU if it is necessary for the operation of the SGEI concerned and does not affect the development of trade to such an extent as to be contrary to the interests of the Union.

#### **3.4.1. Definition and entrustment of an SGEI mission**

- (197) Point 12 of the 2012 SGEI Framework requires that the aid be granted for a genuine and correctly defined service of general economic interest.
- (198) The concept of service of general economic interest is an evolving notion that depends, among other things, on the needs of citizens, technological and market developments and social and political preferences in the Member State concerned. The Court of Justice has established that SGEIs are services that exhibit special characteristics as compared with those of other economic activities.
- (199) In the absence of specific Union rules defining the scope for the existence of an SGEI, Member States have a wide margin of discretion in defining a given service as an SGEI and in granting compensation to the service provider. The Commission's competence in this respect is limited to checking whether the Member State has made a manifest error when defining the service as an SGEI<sup>66</sup> and to assessing any State aid involved in the compensation. Where specific Union rules exist, the Member States' discretion is further bound by those rules, without prejudice to the Commission's duty to carry out an assessment of whether the SGEI has been correctly defined for the purpose of State aid control.
- (200) Generally speaking, the entrustment of a particular public service task implies the supply of services which, if it were to consider its own commercial interest, an undertaking would not assume or would not assume to the same extent or under the same conditions. Applying a general interest criterion, Member States or the Union may attach specific obligations to such services.

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<sup>65</sup> Communication from the Commission: European Union framework for State aid in the form of public service compensation (2011), OJ C 8, 11.1.2012, p. 15.

<sup>66</sup> Case T-289/03 BUPA and Others v Commission [2008] ECR II-81, paragraphs 166-169 and 172; Case T-17/02 Fred Olsen [2005] ECR II-2031, paragraph 216.

- (201) The Commission thus considers that it would not be appropriate to attach specific public service obligations to an activity which is already provided or can be provided satisfactorily and under conditions, such as price, objective quality characteristics, continuity and access to the service, consistent with the public interest as defined by the State, by undertakings operating under normal market conditions.
- (202) Lithuania views the LNG Terminal as indispensable to ensure security of supply through diversification of gas sources. To achieve that objective, Lithuania considers it necessary to impose on the operator of the LNG Terminal the obligation to operate the terminal under non-discriminatory conditions at regulated tariffs.
- (203) In this connection, the Commission notes that Union rules consider security of supply as an objective that might justify public service obligations (Article 3(2) of Directive 2009/73).
- (204) The specificity of the task of the terminal operator is that it has to provide regasification services to any operator requesting those services irrespective of whether the terminal is used on a need basis or under a steady regime.
- (205) The complainant has argued that the operation of the terminal could not qualify as an SGEI because the LNG market is an open and internationally competitive, fully commercial market and there is no evidence of any market failure which would justify the designation of the LNG Terminal as an SGEI or the entrustment of KN with an SGEI. In addition, the Gas Directive 2009/73 limits the Member States discretion to define an activity currently subject to full market opening and competition as SGEI.
- (206) The Commission would agree that in a competitive market where security of supply is already ensured by market forces, the designation of an LNG terminal as SGEI would not be warranted. However, the situation of Lithuania in this regard is very specific. While the Commission does not deny that the LNG market in general is an open and internationally competitive market, it also notes that Lithuania has so far no access to that market. Rather, it is fully dependent on one single supply source, which raises security of supply issues (see also recital (141)).
- (207) Indeed, as has been explained earlier, Lithuania is faced with the situation of a market failure. Despite very high gas prices, the market has so far failed to deliver the infrastructure needed to give Lithuania access to other competing supply sources. While there are developments with regard to certain projects, in particular the interconnector between Poland and Lithuania, these will not be operational for a number of years (in the case of the mentioned interconnector not before around 2018-2020) and would in any event not provide the same level of security of supply as the LNG Terminal (see recital (75) above). The failure of the market to invest in LNG terminals or any other infrastructure achieving the integration of the Baltic States into the EU energy market has been also acknowledged by the Commission in its Communication “*A Blueprint for integrated European energy network*”<sup>67</sup>.

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<sup>67</sup> Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and The Committee of the Regions Energy infrastructure priorities for 2020 and beyond - A Blueprint for an integrated European energy network COM(2010) 677 final of 17.11.2010. See section 3.2.3.

- (208) Moreover, the mere construction of an LNG terminal would not ensure security of supply. Rather, this will require that it is maintained operational even under difficult market conditions and provides third party access to any operator wishing to import LNG with supplies at regulated tariffs, irrespective of the load mode. However, given the market situation described above in Section 2.12 it is unlikely that an LNG operator would have the incentive and/or economic capacity to operate the terminal under market conditions throughout its lifetime of operations (i.e., during the depreciation period of its most significant assets).
- (209) Moreover, as the terminal is to be operated under third party access rules, downstream gas suppliers and, ultimately, society as a whole (end customers) will benefit from the service.
- (210) Finally, as to the limitations that the Gas Directive 2009/73 would set to the margin of Member States to define certain services as SGEI, the Commission notes, as already mentioned in recital (203), that the reason why Lithuania considers it as necessary to impose SGEI obligations on the operator of the LNG Terminal, namely security of supply, is also listed in the Gas Directive as a legitimate objective which public services obligations in the gas sector could pursue.
- (211) As results from the above considerations, the SGEI with which the operator of the LNG Terminal will be entrusted is aimed at ensuring security of supply. In addition, as will be explained in more detail below in sections 3.4.2 to 3.4.9, the obligations imposed are clearly defined, transparent and verifiable. The obligations are also non-discriminatory. They will be imposed only on KN in view of its specific characteristics as being the only suitable operator to provide the SGEI (see also section 3.4.4). Finally, the Commission notes that the LNG Terminal will be operated under the third party access regime, thereby granting any EU gas supplier the same opportunity to supply end customers in Lithuania.
- (212) As to the Purchase obligation, the Commission notes first that the complainant had also launched a separate complaint with the Commission claiming infringement of the Gas Directive 2009/73/EC. Indeed, the Purchase obligation could be seen as a public service obligation in the sense of Article 3(2) of the Gas Directive, which comprises two elements: the obligation for a number of electricity and heating companies (downstream) to purchase a certain amount of gas coupled with an obligation on the Designated Supplier to supply them (upstream)<sup>68</sup>. However, the Commission considers that this public service obligation respects the requirements of Article 3(2) of the Directive 2009/73/EC. In particular, (i) the obligation is justified in the general economic interest as it aims to ensure security of supply, which is specifically recognized in the Directive as a legitimate objective for imposing public service obligations in the gas sector; (ii) the obligation is clearly defined, transparent and verifiable (the conditions for its performance being clearly set in the national legislation) and does not jeopardize equality of access for natural gas undertakings to national consumers; (iii) the obligation is non-discriminatory as it concerns undertakings in the heating and electricity sector which are under the regulated regime in conjunction with ensuring security of supplies and reserves, cogeneration or heat production. It does not create asymmetric rights with respect to access to the terminal

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<sup>68</sup> The public service obligation has been notified to the Commission on 31 October 2013 under Article 3(11) of Directive 2009/73/EC.

but rather has the intention of ensuring the sustainable minimum operation of the terminal on which basis sustained access is granted in a regulated access regime as determined by the national regulatory authority. As far as the Obligated Designated Supplier is concerned, the LNG Terminal Law envisages its appointment following a procurement procedure. Finally, the obligation is imposed in the same proportion on all undertakings active in the market segment of regulated generation of electricity and heat; (iv) the obligation is a proportionate tool for the objective it pursues – security of supply, taking into account the need to ensure a stable operation of the LNG Terminal, the technical constraints of the FSRU (no autonomous cooling mechanism, meaning that the FSRU requires at least 6 or 7 cargoes, equaling about 0.5 bcm of gas, to be transported to the terminal over the course of the year) and the market conditions in Lithuania that would make it extremely difficult for the terminal to develop the minimum required customer base upon the start of its operations. Importantly, the public service obligation is set out in the national legislation as an interim regulatory measure. The LNG Terminal Law envisages that it could last for a maximum of 10 years from the start of operation of the LNG Terminal but the Government could terminate or suspend its implementation before the maximum period ends, provided that the regulator concludes that the development and integration of the natural gas market of Lithuania is sufficient to guarantee a stable functioning of the terminal without a purchase obligation. The law envisages a periodic review mechanism whereby the regulator should evaluate annually the market conditions in this respect.

- (213) The SGEI Framework also requires that “*Member States should show that they have given proper consideration to the public service needs supported by way of a public consultation or other appropriate instruments to take the interests of users and providers into account*” (§ 14).
- (214) In this connection, the Commission observes that the LNG Terminal project has been debated several times in the Lithuanian Parliament which adopted a national energy strategy in 2007<sup>69</sup>, identified the need to eliminate dependency on a single external source of natural gas (as this would lead to increasing prices of natural gas and did not ensure security of supply) and also decided on the need to perform a feasibility study for an LNG terminal. On 30 September 2010, the Lithuanian Parliament adopted Resolution No XI-1050 whereby it declared the need for Lithuania to develop an LNG terminal and requested the Government to perform a detailed feasibility study of the LNG Terminal project. On this basis, the Lithuanian Parliament adopted the LNG Terminal Law No XI-2053 on 12 June 2012 that established the framework for the development of the LNG Terminal. This shows that the LNG Terminal project has been examined and publicly debated in Lithuania already since 2007.
- (215) For all those reasons, the Commission concludes that the entrustment of KN with the task of operating the LNG Terminal under a third party access regime and at regulated tariffs constitutes a genuine SGEI.

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<sup>69</sup> 18-01-2007 the Parliament of the Republic of Lithuania adopted resolution No X-1046 whereby it approved the National energy strategy for 2008-2012.



3.4.2. *Need for an entrustment act specifying the SGEI obligations and the method of calculating compensation.*

- (216) According to point 16 of the SGEI Framework, the entrustment act shall include: the content and duration of the obligations imposed to deliver the SGEI, the undertaking carrying out the SGEI and the territory concerned, the nature of any exclusive or special rights, the description of the compensation mechanism and the parameters for calculating, monitoring and reviewing the compensation, as well as the arrangements for avoiding and recovering any overcompensation.
- (217) The LNG Terminal Law contains the provisions detailing the tasks, obligations and rights of the operator of the LNG Terminal as well as the territory concerned. In particular, the LNG Terminal Law imposes the following on the company managing the LNG Terminal: it must operate the LNG Terminal (Article 9 of the LNG Terminal Law) and provide all users of the natural gas system with the possibility to use the LNG Terminal on a non-discriminatory basis (Article 10 of the LNG Terminal Law) at regulated tariffs (Article 11(10) of the LNG Terminal Law).
- (218) The entrustment of KN as project developer for the LNG Terminal results from Resolution No 199 of 15 February 2012 of the Government of the Republic of Lithuania “*On Implementation of the Law on the Liquefied Natural Gas Terminal of the Republic of Lithuania*”, which nominated KN as the company that shall develop the LNG Terminal (including the FSRU, the connection pipeline and the jetty).
- (219) Article 4(3) of the LNG Terminal Law states that the company that has been designated to develop the terminal shall obtain the licence for liquefaction of natural gas. This company, thus KN, will be designated as the LNG Terminal Operator (see Article 4(3) of the LNG Terminal law, read in conjunction with Article 2(5) of the LNG Terminal Law). This reading has been confirmed by Lithuania which explained that – on the basis of the LNG Terminal Law and given the nature of the project and the security requirements applying to the project – KN is the most likely undertaking to be entrusted with the operation of the terminal. In this connection, the Commission takes note of the commitment provided by Lithuania that the operation of the LNG Terminal for the duration of the SGEI (see recital (219) below) will be entrusted by means of an official act prior to the start of operation.
- (220) According to paragraph 17 of the 2012 SGEI Framework, the duration of the entrustment period should be justified by reference to objective criteria, such as the need to amortise non-transferable assets, and in principle should not exceed the period required for the depreciation of the most significant assets required to provide the SGEI.
- (221) As to the duration, the Commission takes note of Lithuania's commitment that the formal entrustment of the LNG Terminal operator with the SGEI shall be the lifetime of the LNG Terminal and its constituent elements, i.e. 55 years. This period of 55 years corresponds to an objective criterion, namely the depreciation period of the pipeline connecting the LNG Terminal to the gas network, one of the most significant assets required to provide the SGEI (as no gas could be supplied through the LNG Terminal without the pipeline connection). This depreciation period is also the period of depreciation that the NRA takes into account for pipelines.

- (222) The LNG Terminal Law also specifies the special rights of the LNG Terminal Operator. It describes in particular the obligation imposed on a limited number of undertakings to procure a minimum amount of LNG to ensure a minimum stable operation of the LNG Terminal. The exact quantity in this respect shall be set by the Minister and is expected to be 0.54 bcm. This Purchase obligation will be applied only for a period of up to 10 years.
- (223) Article 5(2) of the LNGT law provides that the LNG Supplement will include the fixed costs necessary to ensure operation of the LNG Terminal (fixed operating costs). The NRA has laid down the more detailed rules and procedure on how the LNG Supplement would be established, monitored and reviewed to avoid any overcompensation (see Section 2.8, see also recital (94)).

#### 3.4.3. *Compliance with the transparency directive and separation of accounts*

- (224) According to point 18 of the 2012 SGEI Framework, aid will be considered compatible with the internal market on the basis of Article 106(2) TFEU only where the undertaking complies, where applicable, with Directive 2006/111/EC. Where an undertaking carries out activities falling both inside and outside the scope of the SGEI, the internal accounts must show separately the costs and revenues associated with the SGEI and those of the other services (point 44 of the 2012 SGEI Framework).
- (225) Article 1(1) of Directive 2006/111/EC establishes that the Member States shall ensure that financial relations between public authorities and public undertakings<sup>70</sup> are transparent, so that the following emerge clearly: (a) public funds made available directly by public authorities to the public undertakings concerned; (b) public funds made available by public authorities through the intermediary of public undertakings or financial institutions; (c) the use to which these public funds are actually put.
- (226) Under Article 2(d), any undertaking that enjoys a special or exclusive right granted by a Member State pursuant to Article 106(1) TFEU or is entrusted with the operation of an SGEI pursuant to Article 106(2) TFEU, that receives public service compensation in any form whatsoever in relation to such service and that carries on other activities, is an undertaking required to maintain separate accounts. Its financial and organisational structure must be correctly reflected in the separate accounts, so that the following emerge clearly: (a) the costs and revenues associated with different activities; (b) full details of the methods by which costs and revenues are assigned or allocated to different activities (Article 1(2)).
- (227) The Lithuania authorities have further indicated that in Lithuania Directive 2006/111/EC is implemented by the Resolution of the Government of the Republic of Lithuania No 768 dated 14 July 2005. KN is on the list of undertakings for which the responsible ministry has to comply with the transparency and separate accounts requirements of that Resolution.
- (228) Lithuania has further confirmed that KN will carry out a separation of accounts in relation to the LNG Terminal activities, in line with the requirements of Article 4 of Directive 2006/111/EC and point 12 of the SGEI Framework.

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<sup>70</sup> 'Public undertakings' mean any undertaking over which the public authorities may exercise directly or indirectly a dominant influence by virtue of their ownership of it, their financial participation therein, or the rules which govern it (Article 2(b) of Directive 2006/111/EC).

#### 3.4.4. Compliance with Procurement rules

- (229) According to point 19 of the SGEI Framework, aid will be considered compatible with the internal market on the basis of Article 106(2) TFEU only where the responsible authority, when entrusting the provision of the service to the undertaking in question, has complied or commits to comply with the applicable Union rules in the area of public procurement. The complainant has argued that KN has not been selected in accordance with EU public procurement rules.
- (230) It appears from the information submitted by Lithuania that the task of operating the LNG Terminal which shall be entrusted to KN concerns a type of service that falls under the material scope of Directive 2004/18/EC on procurement in the public sector. The value of the service exceeds the application threshold of Directive 2004/18/EC ("the Directive"). The awarding authority is a contracting authority in the sense of Article 1(9) of the Directive and therefore falls under its personal scope. Depending in particular on the assessment of the chosen payment method and the distribution of operational risks between the contracting authority and KN, the entrustment is either a public service contract in the sense of Article 1(2)(d) of the Directive or, alternatively, a service concession to be assessed directly under the Treaty. Ultimately, it is not necessary to decide this question: In principle, the entrustment of KN should be preceded by a transparent competitive procedure (if the contract is a concession) or a public procurement procedure conducted according to the procedural rules of Directive 2004/18/EC (if the contract is a public service contract). At the same time, the exemption from procurement rules on which Lithuania relies is equally applicable to both types of contracts.<sup>71</sup>
- (231) According to the information submitted by Lithuania, the contract is not subject to Directive 2004/18/EC or the Treaty principles, because it concerns essential security interests of Lithuania in the sense of Article 14 of Directive 2004/18/EC. That article reads: *'This Directive shall not apply to public contracts when they are declared to be secret, when their performance must be accompanied by special security measures in accordance with the laws, regulations or administrative provisions in force in the Member State concerned, or when the protection of the essential interests of that Member State so requires.'* It thus provides for three possible grounds for exemption. In order to exempt a contract from competition on the basis of the third ground, it must be proven that there is a real risk to the essential interests of the Member State concerned and that the measure chosen by the Member State (i.e. direct award) is suitable to protect that interest and is proportionate with regard to the aim it seeks to achieve.
- (232) The LNG Terminal project is of major importance for Lithuania. As already explained, Lithuania depends only on one single supplier for its gas demand (Gazprom/Russia) and has an urgent need to develop access to alternative sources of supply to ensure its security of supply. In order to develop access to alternative gas supply sources, the project can only fruitfully be implemented by an entity that is independent both on the corporate but also on the economic level from the single supplier. However, if the project manager (operator) would be selected in a transparent competitive procedure

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<sup>71</sup> See Judgment of the General Court of 20 May 2010 in Case T-258/06 *Germany v Commission* [2010] ECR II-2027, paragraph 141. See also Article 62 in conjunction with Article 52(1) TFEU on the possible restriction of the freedom of services on public security grounds.

under Directive 2004/18/EC or the Treaty, there would be a risk that it would have (at the time of the tender) or later develop ties to the single supplier that would allow the latter to influence its market behaviour in a way that could negatively affect the fulfilment of its SGEI mission. In fact, currently the single gas supplier has corporate and/or economic bonds with a vast number of undertakings in Lithuania, in particular companies active in the gas sector and Lithuania has provided examples of energy-related projects that had to be cancelled following various interventions at different levels of the single gas supplier.

- (233) Against this background, and in order to avoid any undue pressure or influence to be exercised on the contractor, Lithuania concluded that the project manager (operator) would have to be state-controlled and would have to meet certain security requirements.
- (234) In the present case, the State exerts total control over the activities of KN, and in addition KN is seriously vetted from a national security point of view:
- AB Klaipėdos nafta (KN) has the status of an 'enterprise important for national security' under Lithuanian law.
  - In line with its status under the LNG Law and the Law on Objects and Enterprises Important for National Security, KN and the LNG Terminal project are treated by state institutions as having top importance for national security.
  - KN is subject to heightened security requirements (physical and information security) set by the Lithuanian Government and competent governmental bodies.
  - [\*\*\*further security measures\*\*\*]
- (235) Finally, Lithuania has pointed out that, in addition to the control and security requirements, the project developer and operator had to demonstrate certain technical capabilities (having experience in the sector or in a similar activity and being able to develop and operate the project in the Klaipėda Port). It also notes that KN has sufficient personnel and financial resources and, as the company operating the oil terminal in the Klaipėda Port, was the most suitable project developer and operator.
- (236) Based on those elements, the Commission concludes that KN is in a unique position of being able to provide the requested service and meeting the security requirements necessary for the completion of the project and finds that the exemption from procurement rules for the protection of essential (security) interests within the meaning of Article 14 of Directive 2004/18/EC applies in this case.

#### 3.4.5. *Absence of discrimination*

- (237) According to point 20 of the 2012 SGEI Framework, "[w]here an authority assigns the provision of the same SGEI to several undertakings, the compensation should be calculated on the basis of the same method in respect of each undertaking". As the SGEI at issue is exclusively assigned to KN, the Commission considers that there cannot be a question of discrimination in the sense of point 20 of the 2012 SGEI Framework.

#### 3.4.6. Amount of compensation

- (238) According to point 21 of the 2012 SGEI Framework, the "*compensation must not exceed what is necessary to cover the net cost of discharging the public service obligations, including a reasonable profit*". The amount of compensation can be established on the basis of either the expected costs and revenues or the costs and revenues actually incurred or a combination of the two (point 22). Where the compensation is based, in whole or in part, on expected costs and revenues, they must be specified in the entrustment act. They must be based on plausible and observable parameters concerning the economic environment in which the SGEI is being provided and rely, where appropriate on the expertise of sector regulators or of other entities independent from the undertaking. Member States must indicate the sources on which these expectations are based (point 23).
- (239) The net costs necessary, or expected to be necessary, should be calculated using the net avoided cost methodology where required or possible, or use alternative methods such as the cost allocation methodology (points 24, 27). The net avoided cost methodology is based on determining the difference between the net cost for the provider of the service without the SGEI obligation and the cost of the provider with the SGEI obligation (point 25).
- (240) Reasonable profit should be taken to mean the rate of return on capital that would be required by a typical company considering whether or not to provide the SGEI for the whole duration of the entrustment act, taking into account the level of risk (point 33). Where duly justified, other profit level indicators can be used (point 34).
- (241) In the present case, the Commission considers that without the obligation to operate the LNG Terminal, the operator would not operate the terminal at all. An operator would operate the terminal only if it can obtain sufficient revenues to cover costs and a reasonable profit. Given the specific conditions of the Lithuanian gas market described under Section 2.12 and the costs of operating the terminal, a service price (tariff) covering all costs would render the terminal unattractive for customers and the terminal would therefore not be used. For that reason, the Commission concludes that in the present case the costs to be taken into account for the compensation are the costs of operating the LNG Terminal.
- (242) The compensation does not cover all costs of the terminal but only fixed operating costs and a portion of the variable operating costs (variable costs resulting from the regasification of 0.54 bcm yearly during 10 years).
- (243) The terminal will also generate revenues from the regasification services and the terminal operator will have to cover its (remaining) variable operating costs from those revenues.
- (244) As the regasification tariff is regulated and calculated strictly on the basis of the variable operating costs, it cannot generate any profits for KN.
- (245) As to the Purchase obligation, it ensures a stable functioning of the terminal but does not generate any profits as the gas falling under the Purchase obligation is again regasified at the regulated tariff which covers only the variable operating costs linked to the regasification service provided.

- (246) As indicated in recital (38), the project is expected to yield an internal rate of return of [...]%.
- (247) According to point 36 the 2012 SGEI Framework, a rate of return on capital that does not exceed the relevant swap rate plus a premium of 100 basis points (bps) is regarded as reasonable in any event. The relevant swap rate is the swap rate whose maturity and currency correspond to the duration and currency of the entrustment act. Where the provision of the SGEI is not connected with a substantial commercial or contractual risk, for instance because the net cost incurred in providing the service of general economic interest is essentially compensated *ex post* in full, the reasonable profit may not exceed the level that corresponds to the SWAP rate plus 100bps. Such a compensation mechanism is strictly limited to cases where the Member State is able to justify that it is not feasible or appropriate to take into account productive efficiency and to have a contract design which gives incentives to achieve efficiency gains. By contrast, where the provision of the SGEI is connected with a substantial commercial or contractual risk, for instance because the compensation takes the form of a fixed lump sum payment covering expected net costs and a reasonable profit and the undertaking operates in a competitive environment, the reasonable profit may not exceed the level that corresponds to a rate of return on capital that is commensurate with the level of risk. That rate should be determined where possible by reference to the rate of return on capital that is achieved on similar types of public service contracts awarded under competitive conditions (for example, contracts awarded under a tender). Where it is not possible to apply that method, other methods for establishing a return on capital may also be used, upon justification, for instance by comparing the return with the weighted average cost of capital (WACC) of the company in relation to the activity in question, or with the average return on capital for the sector in recent years, taking into account whether historical data can be appropriate for forward-looking purposes.
- (248) The Commission has published SWAP rate proxies for the purpose of applying the SGEI Framework<sup>72</sup> in countries without such SWAP rates. The SWAP rate with the longest maturity is 10 years. The 10-year proxy for Lithuania (LTL) is now 3.84%. If increased by 100bps, this gives 4.84%. However, given the length of the SGEI at issue (55 years), compared to the maturity of 10 years, this proxy potentially underestimates considerably the SWAP rate that should normally be used as a benchmark in this case.
- (249) More generally, the Commission considers that the SWAP rate + 100bps benchmark normally foreseen in the SGEI Framework is not fully appropriate given the circumstances of the present case. Despite the public service compensation, the operation of the LNG Terminal is subject to commercial risk. It will take place in a competitive market and, while during the first years the Purchase obligation will ensure a stable minimum functioning of the LNG Terminal, this guarantee disappears at least after 10 years (for a service that will have to be continued for 45 additional years). Also, the Commission notes that the provider of the SGEI is not compensated for the totality of costs since the compensation paid *ex post* for the SGEI at issue covers fixed operating costs in full but only a small proportion of variable operating costs; hence, at least a part of the variable operating costs is not covered by any compensation. Finally, the project does not benefit from a guaranteed rate of return. The regulator will establish every 5 years the WACC on the regulated asset base. The

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<sup>72</sup> [http://ec.europa.eu/competition/state\\_aid/legislation/swap\\_rates\\_en.html](http://ec.europa.eu/competition/state_aid/legislation/swap_rates_en.html)

WACC is established by reference to the optimum structure of finance assuring the least cost of capital. If KN's activities yield less than the WACC, it will not obtain extra compensation. The Commission therefore considers that the benchmark of SWAP rate +100bps, which corresponds to the return on a totally risk free project (and for which the Commission lacks precise data as regards a proxy SWAP rate for a 55 years project as explained under recital (246), should not be applied under the specific circumstances of this case.

- (250) The Commission notes that the internal rate of return of the terminal over the 55 year period ([...]%) is lower than the regulated WACC (7.09%) and the sector calculated WACC ([...]%).
- (251) The internal rate of return of the project is thus somewhat above 100 bps compared to the risk free rate (around 4.84%) but clearly below the WACC of the sector ([...]%). This level of rate of return appears to be justified in view of the fact that the provision of the SGEI bears some commercial risks but at the same time is probably better shielded from risk than a certain number of other LNG terminal projects in the EU, in particular those that served as the basis for the WACC calculation. The SGEI compensation and the Purchase obligation reduce the risks of the terminal operation, hence making the sector WACC unlikely to well reflect the profitability expectation of the project.<sup>73</sup>
- (252) The Commission concludes that the project internal rate of return can be regarded as a reasonable estimate for the project, and that its level is appropriate.
- (253) With regard to efficiency incentives, point 39 of the 2012 SGEI Framework requires that Member States introduce incentives for the efficient provision of SGEI of a high standard, unless they can duly justify that it is not feasible or appropriate to do so. Any such mechanism for incentivising efficiency improvements must be based on objective and measurable criteria set out in the entrustment act and subject to transparent *ex post* assessment carried out by an entity independent from the SGEI provider (point 42).
- (254) In this connection, Article 11 of Resolution No O3-367 contains a mechanism aimed at inducing the provider of the SGEI to work efficiently. For a certain number of operating expenses (repairs, maintenance, personnel, insurances, marketing and administrative costs) the NRA establishes upper limits for the price of the regulated service concerned (here the regasification). To that end, the NRA also defines the costs that can be taken into account for the payment of the LNG Supplement. Costs that go beyond that limit and cannot be justified by KN are not compensated. If the costs are lower, then only the actually incurred costs are compensated.

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<sup>73</sup> The Commission notes in particular that the calculation of the sector WACC is based on weights which give a larger importance to the cost of equity (67 per cent, based on an average of 26 gas companies active in Europe) than to debt (33 per cent). While this assessment can be considered analytically robust, in that it makes use of the standard WACC calculation and of the Capital Asset Pricing Model, it is also likely that the companies taken into consideration to establish the equity weight might not be fully representative of the situation of the beneficiary. In particular, such data are based on the fully commercial activities of those companies, which therefore are not directly comparable to the provision of an SGEI. It is therefore likely that the sector WACC overestimates the cost of capital of the terminal.

- (255) Following Article 9 of Resolution No O3-367, when the NRA is setting the upper limit for the price of services in the natural gas sector, the following shall be taken into account:
- 1) the amount of costs of the regulated activity fixed and actually attributed by the NRA to the respective businesses and services (products), including the return on investment;
  - 2) the volume of services actually supplied in the previous regulation period;
  - 3) the cost data of comparable natural gas companies in Lithuania and/or European Union Member States which are published on the NRA's website;
  - 4) the performance indices of KN in the previous regulation period;
  - 5) the anticipated changes in the activity of KN for the next regulation period, including investments realized in coordination with the NRA and which would have an impact on the volume of costs, the return on investment and the volume of supplied services.
  - 6) any significant events that occurred after the previous regulating period and that would have an impact on the amount and structure of costs.
- (256) Article 11.3.1 and Article 11.6.1 of Resolution No O3-367 further states that if the undertaking concerned operated inefficiently during the previous regulation period, i.e., the operating expenses (OPEX) during the previous regulation period were higher than those fixed by the NRA, the annual amount of the costs fixed by the NRA shall be taken into account. In case of such an inefficient performance the payment of the LNG Supplement will not be compensated and thus will be reduced to the annual amount of the costs fixed by the NRA.
- (257) A further incentive to operate efficiently relates to the adjustment to inflation. The costs that are taken into account for setting the LNG Supplement and the compensation will be increased only by half of the inflation coefficient and not more than 3%.
- (258) Finally, Lithuania has explained that further efficiency mechanisms are not needed given the competitive pressure that the LNG Terminal will face. As the regasification fee will constitute an additional cost for LNG shippers compared to imports of pipeline gas, the LNG Terminal will be incentivized through competition with pipeline gas to operate as efficiently as possible so as to offer the lowest regasification tariff possible in order to remain competitive.
- (259) On the basis of those elements, the Commission concludes that Lithuania has introduced efficiency incentives that are based on objective and measurable criteria that are set out in advance and are subject to an ex post assessment carried out by an entity independent from the SGEI provider, namely the NRA. The efficiency incentive is sufficient and appropriate in this case given the competitive pressure on the LNG Terminal resulting from existing gas interconnectors.



#### 3.4.7. *Absence of overcompensation*

- (260) Point 16(e) of the 2012 SGEI Framework requires that the act of entrustment includes arrangements for avoiding and recovering overcompensation. The latter should be understood as compensation that the undertaking receives in excess of the amount of aid as defined in point 21 for the whole duration of the contract (point 47).
- (261) The NRA verifies eligibility of costs before setting the yearly LNG Supplement each year, and also verifies that the costs actually occurred before authorizing the payment of the LNG Supplement. In addition, the NRA sets the rate of return of the investment and must ensure that the operator only obtains a reasonable profit.
- (262) On that basis, the Commission finds that the Lithuanian legislation has provided for sufficient arrangements to avoid overcompensation.

#### 3.4.8. *Additional requirements*

- (263) Points 51 *et seq.* of the SGEI Framework provide for additional requirements in case of exceptional circumstances where the aid is likely to give rise to serious competition distortions and to affect trade to such an extent as would be contrary to the interest of the Union.
- (264) These exceptional circumstances are not present here. In particular, the provision of the SGEI does not distort competition in a way that is contrary to the interest of the Union. On the contrary, the LNG Terminal will connect Lithuania with the rest of the EU gas market and its operation will give Lithuania access to the worldwide LNG market, on non-discriminatory terms (third party access regime). The project will actually stimulate competition on the wholesale and retail gas market. Also, as results from the elements described in recitals (185) to (189), it will not distort competition to an extent contrary to the common interest with the supply of gas through existing and future interconnectors. Finally, as the capacity of the LNG Terminal is targeted for the Lithuanian market only, it will not influence negatively other LNG terminal projects in Poland and Estonia or Finland. Therefore, the Commission considers that there is no need for additional requirements<sup>74</sup>.

#### 3.4.9. *Transparency according to the 2012 SGEI Framework*

- (265) Lithuania complies with the transparency requirements set out at point 60 of the 2012 SGEI Framework. In particular, the legal provisions have already been published and the amount of the LNG Supplement will be published as well.

#### 3.4.10. *Conclusion on the compatibility of the aid on the basis of the 2012 SGEI Framework*

- (266) On the basis of the elements examined under sections 3.4.1 to 3.4.9, the Commission concludes that the operating aid based on the LNG Supplement and the Purchase obligation fulfil the conditions of the 2012 SGEI Framework and is thus compatible with the internal market pursuant to Article 106(2) TFEU.

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<sup>74</sup> See also Commission decision of 18 September 2013 – State aid SA.37030 (2013/N) – Ireland – Sale of State assets, recital 44-45.

### **3.5. Compliance of the LNG Supplement with the Gas Directive and Articles 30/110 TFEU**

- (267) The complainant submits that the Gas Directive 2009/73/EC and the Gas Regulation (EC) No 715/2009 prohibit transmission fees to cover costs that are not linked to transmission and prohibit cross-subsidisation between transmission and LNG activities. The complainant submits that the LNG Supplement is actually a special levy and not a legitimate component of the transmission tariff that is collected from the TSO and paid to one domestic company only. It is therefore a charge prohibited by Articles 30/110 TFEU.
- (268) As regards the Gas Directive 2009/73/EC and Gas Regulation (EC) No 715/2009, the Commission notes that the LNG Supplement does indeed not constitute a transmission fee and is not supposed to cover part of the transmission costs. Neither does it constitute a part of the transmission fee that would be divested from the TSO to cross-subsidize the LNG activity. As the complainant has correctly identified, the LNG Supplement constitutes a special levy that serves to finance the (investment and operational) costs of the LNG Terminal. Provided that this special levy is clearly identified as such and does not accrue to the TSO as an excessive profit for its transmission tasks, the Gas Directive 2009/73 and the Gas Regulation (EC) No 715/2009 do not prohibit that the TSO is mandated to collect special levies established by the State from gas users.
- (269) As regards Articles 30 and 110 TFEU, the Commission recalls that their application is alternative. The LNG Supplement comes under a general system of internal taxation on goods as it does not constitute a charge levied at the time of or by reason of importation. It therefore has to be assessed in the light of Article 110 TFEU. The Commission notes that the LNG Supplement does not result in a higher taxation imposed on products from other Member States than on similar or competing domestic products. Indeed there is no domestic gas production in Lithuania and the entire gas demand is supplied from imports. Consequently, the LNG Supplement is not contrary to Article 110 TFEU.

## **4. CONCLUSION**

The Commission regrets that Lithuania put the part of the aid measures related to the investment (i.e. the LNG Supplement for 2013-2014) into effect, in breach of Article 108(3) TFEU.

However, it has decided, on the basis of the foregoing assessment, to consider the aid to be compatible with the internal market, pursuant to Articles 107(3)(c) as regards the investment aid and pursuant to 106(2) TFEU as regards the operating aid.

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For the Commission

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