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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 […].		PUBLIC VERSION This document is made available for information purposes only.

Subject: State Aid SA.53074 (2019/N) – Lithuania
Modification of investment aid approved under the Commission decision SA.36740 (2013/NN) aid to AB Klaipėdos nafta

Sir,

1. PROCEDURE

(1) Following pre-notification contacts, on 23 May 2019 Lithuania notified a State aid measure to support the liquefied natural gas terminal ("LNG Terminal") in Klaipėda, Lithuania.

(2) The Commission requested additional information on 27 May 2019, 12 June 2019 and 25 July 2019.

(3) The Lithuanian authorities replied and submitted additional information accordingly on 29 May 2019, 21 June 2019, 15 and 22 July and 26 July 2019.

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(4) By letter dated 21 June 2019, Lithuania agreed to waive its rights deriving from Article 342 TFEU in conjunction with Article 3 of Regulation 1/1958[1] and to have the present decision adopted and notified in English.

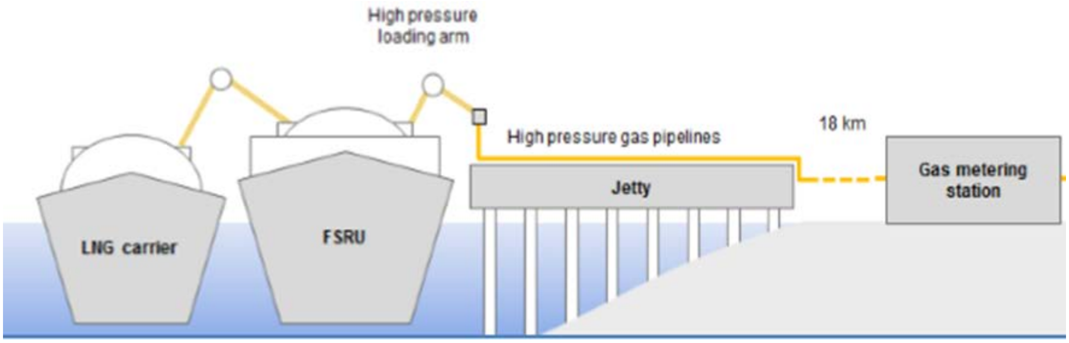
2. DESCRIPTION

2.1. Initial measure approved by 2013 Decision

(5) The Lithuanian LNG Terminal project was aimed at cutting Lithuania's dependence on a sole gas supplier OAO Gazprom ("Gazprom") and creating a competitive gas market by connecting Lithuania to the EU gas market. The project consisted of the construction and operation of an LNG Terminal, its connection to the natural gas transmission system of Lithuania and port infrastructure at Klaipėda seaport. The LNG Terminal started its operation on 1 January 2015.

(6) The LNG Terminal consisted of a floating liquefied natural gas storage and regasification unit ("FSRU") with its related energy structures and installations. The FSRU was provided by the Norwegian company Höegh LNG based on a 10-year lease agreement with purchase option to be exercised in 2024 by AB Klaipėdos Nafta ("KN"). See figure 1 below.

Figure 1: the LNG Terminal infrastructure



Source: AB "Klaipėdos nafta"

(7) In 2013 the Commission adopted a decision in case SA.36740 (2013/NN) - Aid to beneficiary – AB Klaipėdos Nafta (the "2013 Decision"). Based on this 2013 Decision, Lithuania granted operating and investment aid to support the LNG Terminal project to the beneficiary - KN. By the 2013 Decision, the Commission approved the following measures:

(8) As regards operating aid, the Commission approved operating aid to cover fixed operating costs such as LNG Terminal maintenance, insurance, personnel and marketing, and variable operating costs linked to the purchase of minimum quantities of LNG[2] to operate the LNG Terminal on a continuous basis. Variable

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[1] Regulation No 1 determining the languages to be used by the European Economic Community (OJ 17.6.10.1958, p. 385).

[2] This is a technical minimum LNG quantity necessary for the LNG Terminal to remain operational at all times. The Lithuanian Government is responsible for determining such quantities of the LNG necessary to ensure stable operation of the LNG Terminal.

operating costs were covered from the purchase obligation[3] and regasification tariff[4]. Fixed operating costs were covered from a special levy imposed upon all users of the natural gas transmission system, on top of the transmission fees (the „LNG Supplement“).

(9) As regards investment aid, the Commission approved aid to cover the cost of the project such as project management, gas pipelines, gas metering station, jetty, and the lease of the FSRU. These costs were covered from the state guarantee and the LNG Supplement. The lease costs of the FSRU in particular were covered by the part of the LNG Supplement.

(10) State guarantees of 100 % of the amounted loans were granted to cover the loans from the European Investment Bank (EIB) and the Nordic Investment Bank (NIB). The remaining amount was foreseen to be financed from the commercial banks and/or KN capital. The loans from EIB, and from NIB and commercial banks were aimed at financing the LNG Terminal infrastructure: 1) high pressure natural gas pipeline connecting the LNG Terminal with the natural gas transmission system (18 km); 2) the port infrastructure at the Klaipėda seaport: the moorage of the FSRU and the jetty.

(11) The 2013 Decision also envisaged the purchase of the FSRU in 2024. Recital (100) of the 2013 Decision stated that the LNG Supplement would be used to cover costs of purchasing the FSRU, however the 2013 Decision did not approve any specific aid measure to finance the purchase of the FSRU.

(12) The notified measure concerns a modification of the way the investment costs are covered.

2.1.1. Investment aid and proportionality assessment performed under 2013 Decision

(13) As was already indicated in recital (9) the investment aid approved under the 2013 Decision was financed from two sources – the state guarantee and the LNG Supplement. The Commission performed a compatibility assessment of these two measures under Article 107(3)(c) of the Treaty of the Functioning of the European Union (“TFEU”).

(14) Based on the 2013 Decision[5], the proportionality assessment was made comparing the internal rate of return (“IRR”)[6] of the LNG Terminal project and the weighted average cost of capital (“WACC”)[7]. The Commission found that the investment aid measures resulted in an IRR of […] which was below the WACC estimated for the

[3] The Purchase Obligation was imposed on private and public undertakings operating in the regulated segment of electricity and heat generation. They bought the minimum volume of LNG from a selected supplier.

[4] Regasification tariff is a fee paid by the LNG Terminal user to the LNG Terminal operator for converting liquefied natural gas temperature back to natural gas at atmospheric temperature.

[5] See paragraphs 167-178 of the 2013 Decision.

[6] The internal rate of return is the return that the concrete LNG terminal project yields, based on the projected costs and revenues (including the aid) over the lifetime of the project.

[7] Weighted average capital cost is the minimum rate of return for investments expected by the particular industry or particular project.

industry ([…]). As a result, the investment aid complied with the proportionality criteria.

(15) For the purposes of the present notification Lithuania has provided an updated business plan which demonstrates the extent to which the assumptions made at the time have been confirmed. It shows that the general profitability of the project has decreased mostly due to higher than expected salary, LNG terminal maintenance and emission costs, higher FSRU leasing payments as well as due to taxes related to the jetty which were not considered in the business plan in 2013.

2.2. The notified measure – new state guarantee

(16) By the notified measure, the Lithuanian authorities will modify the financing mechanism for the FSRU leasing costs (part of the investment aid approved under the 2013 Decision). Under the 2013 Decision, the FSRU leasing costs were financed exclusively via the LNG Supplement. As the Lithuanian authorities now intend to reduce the financial burden for the Lithuanian gas consumers and reduce the LNG Supplement, they plan to replace the relevant part of LNG Supplement with a loan guaranteed by the Lithuanian State. The notified measure consists of this state guarantee designated to obtain this new loan aimed at financing the FSRU leasing costs in the period 2019-2024.

(17) The intended reduction of the LNG Supplement would amount to EUR 12.5 million in 2019, EUR 25 million per year from 2020 to 2023 and EUR 23 million in 2024, totalling at EUR 135.5 million.

(18) This reduction of the LNG Supplement and corresponding reduction of the State aid awarded in 2013 will be replaced by a loan of the same amount (EUR 135.5 million). The loan will be paid out in six instalments strictly corresponding to the reduction of the LNG supplement described above in recital (17): EUR 12.5 million in 2019, EUR 25 million per year from 2020 to 2023 and EUR 23 million in 2024. This loan will be paid back by UAB SGD Terminalas („SGD Terminalas") from 2025 to 2044 in yearly instalments.

(19) According to the Lithuanian authorities, as it is not possible for the beneficiary to take out such a loan to finance the leasing costs of the FSRU under the normal market conditions from commercial banks, the Nordic Investment Bank (NIB) will provide the loan. A state guarantee is required for this and will be issued by the Ministry of Finance of the Republic of Lithuania.

(20) The Lithuanian authorities also explained that this measure is part of a broader design contemplated for the FSRU, which also comprises the implementation of an additional measure at a later stage. This measure will result in a second state guarantee, which will be used to obtain a further loan aiming at financing the purchase of the FSRU after the expiry of the lease agreement in 2024. The implementation of this second measure is expected to take place only in December 2021, with the launch of a tender for the FSRU purchase and will be completed in 2024. The second measure will also require a separate State aid approval by the European Commission.

2.3. Beneficiary

(21) The beneficiary of the initial investment aid measure approved by the 2013 Decision was KN. KN is a State owned company with the Lithuanian State holding 72.3 % of the shares. 10.41 % of KN shares are owned by the private company -

UAB koncernas „Achemos grupė“. It is one of the largest industrial companies and one of the biggest gas consumers in Lithuania. The rest of the shares are owned by other private investors.[8]

(22) According to the Lithuanian authorities, KN will transfer its LNG operation activities to a dedicated subsidiary –SGD Terminalas. It will be a 100 % owned subsidiary of KN.

(23) SGD Terminalas will take out the loan for which the notified state guarantee will be granted. KN will take responsibility to cover all financial risks undertaken by SGD Terminalas for the current loan. This KN guarantee will be triggered before the notified state guarantee for the NIB loan can be called upon.

(24) SGD Terminalas will therefore become the beneficiary of the current measure.

2.4. Legal basis

(25) The national legal basis indicated by Lithuania is the Law on Liquefied Natural Gas Terminal ("LNGT Law")[9] as amended by the Law on the Amendment of the Law on Liquefied Natural Gas Terminal[10].

2.5. Cumulation, transparency

(26) Lithuania confirmed that the aid measure would not be cumulated with other forms of support to cover the same eligible costs.

(27) Lithuania confirmed that all the information regarding the notified measure will be published on the website: https://webgate.ec.europa.eu/competition/transparency.

3. ASSESSMENT

3.1. Existence of Aid

(28) According to Article 107(1) TFEU, the qualification of a measure as State aid requires the following conditions to be met cumulatively:

- the measure is financed through State resources;
- it grants a selective advantage liable to favour certain undertakings or the production of certain goods;
- the measure distorts or threatens to distort competition;
- it has the potential to affect trade between Member States.

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8 See KN shareholders structure at www.kn.lt/en/for-investors/share-trading/410?http=1.

9 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), as amended.

10 Law on the amendment of Articles 5 and 9 of Law No. Xi-2053 on the Liquefied Natural Gas Terminal, 18 December 2018 No. XIII-1786

3.1.1. *Transfer of State Resources and imputability*

(29) According to settled case-law, only advantages which are granted directly or indirectly through State resources are to be regarded as aid within meaning of Article 107(1) TFEU.

(30) The Commission notes that the state guarantee granted by the Lithuanian State covers 100 % of the EUR 135.5 million NIB loan. The Commission considers that in case of a default of the beneficiary, which would trigger the state guarantee, the Lithuanian State budget is likely to be directly affected. Furthermore, the Lithuanian State will not receive a normal guarantee fee. Therefore, the Commission views this state guarantee as being granted out of the State resources.

(31) The decision to grant this state guarantee to the beneficiary was taken directly by the Lithuanian State and is hence imputable to the State within the meaning of Article 107(1) TFEU.

3.1.2. *Economic Advantage*

(32) The Commission notes that the notified measure will provide an economic advantage to SGD Terminalas, because the company will obtain a state guarantee securing a loan for the financing of the FSRU leasing costs in the period 2019 – 2024.

3.1.3. *Selectivity*

(33) The state guarantee is granted only to SGD Terminalas, therefore the Commission considers that the measure is selective.

3.1.4. *Effect on Trade and Distortion of Competition*

(34) The Lithuanian gas market is currently connected to the EU gas market with competition among alternative suppliers. The Commission observes that there is already an operating LNG terminal in Swinoujscie (Poland), and other LNG terminals in Western Europe, such as Belgium, Netherlands, France and others. Favouring a particular LNG terminal's operator, may strengthen SGD Terminalas position on the EU gas market. It follows that the measure is therefore likely to distort or threaten to distort competition and affect trade between Member States.

3.1.5. *Conclusion on the Existence of State aid*

(35) On the basis of the above-mentioned elements, the Commission concludes that the measure constitutes State aid within the meaning of Article 107(1) TFEU.

3.2. Legality of the aid

(36) By notifying the amendments before their implementation, the Lithuanian authorities respect the standstill obligation laid down in Article 108(3) TFEU.

3.3. Compatibility under Article 107(3)(c) of the TFEU

(37) By the notified measure the Lithuanian authorities intend to modify the financing mechanism of the LNG Terminal approved in the 2013 Decision by replacing a part of the LNG Supplement designated to finance the FSRU leasing costs with the loan guaranteed by the Lithuanian State. The Commission considers that the

notified measure constitutes a mere modification of the financing mechanism of the measure approved under the 2013 Decision. As the initial investment aid was approved under Article 107(3)(c) of TFEU, the Commission considers that the modification (ie. the state guarantee) should also be assessed based on the same compatibility principles as in the 2013 Decision.

3.3.1. Legal basis for assessment

(38) In established Commission practise the aid measure can be declared as compatible under Article 107(3)(c) of TFEU, if it is necessary and proportionate and if the positive effects for the common interest objective outbalance the negative effects on competition and trade. In this regard, the Commission considers it appropriate to assess the following:

a) Objective of common interest

b) Appropriateness and necessity

c) Incentive effect

d) Proportionality

e) Distortions of competition and effect on trade

3.3.2. Objective

(39) As stated in recitals (136) – (145) of the 2013 Decision, the investments into the LNG Terminal in Lithuania pursue a well-defined objective of common interest. The LNG Terminal was aimed at increasing security of supply of gaseous fuels to Lithuania by diversifying sources of supply and therefore improving the stability and continuity of the supply of gaseous fuels to final customers in Lithuania, hence reducing the risk of an interruption in supply. Furthermore, the objective of the construction of the LNG Terminal together with other investments in the Baltic countries and in neighbouring countries was to contribute to increasing the integration of the regional gas market in the EU, in particular markets in central and eastern Member States of the EU. The Commission concluded that the security of supply of gas in Lithuania was a well-defined objective of common interest.

(40) Before the commissioning of the LNG Terminal, the Lithuanian gas market was dominated by Gazprom. Since the start of the operation of the LNG Terminal in 2015, Lithuania's natural gas prices dropped by 50 %.[11] The LNG Terminal is the only viable alternative to Gazprom gas as no interconnection link with neighbouring Member States has been built since the 2013 Decision.

(41) The notified measure is an amendment of the aid measure approved by the 2013 Decision. By the notified measure, the Lithuanian authorities intend to replace the part of the LNG Supplement designated to finance the FSRU leasing costs with a loan guaranteed by the Lithuanian State. As the notified measure (ie. the state guarantee for the loan aiming at financing the leasing costs of the FSRU) is a mere modification of the financing mechanism approved under the 2013 Decision, the Commission considers that the objective of common interest identified in the 2013

[11] Information provided by the Lithuanian authorities, Notification Form, p. 6.

Decision as security of gas supply in Lithuania remains the same for the current measure.

(42) It follows that the aid measure pursues a well-defined objective of common interest.

3.3.3. Appropriateness and necessity

(43) As stated in recitals (146) – (157) of the 2013 Decision, the Commission noted that the LNG Terminal would never be competitive without the support of the LNG Supplement. The Commission also concluded that without the LNG Supplement, the LNG Terminal would not be competitive or viable, and consequently there would be a funding gap. Consequently, the investment project would not have materialised and delivered its contribution to ensure security of supply.

(44) The Commission notes, the objective of common interest, as identified in recitals (39) - (42) above, can be achieved by different aid instruments. The Lithuanian authorities have the choice between various aid forms, and they can chose an instrument that they consider the most appropriate to achieve the objective of common interest.

(45) Furthermore, in recital (154) of the 2013 Decision the Commission already recognized that the state guarantee, which was provided to secure the KN loan, was an appropriate aid instrument as it enabled KN to obtain loans for the main portion of the infrastructure investments and reduced the costs of the project.

(46) The Commission observes that the notified measure is a mere modification of the financing mechanism of the FSRU leasing cost, which was approved under the 2013 Decision. In order to reduce the financial burden for the Lithuanian gas consumers the part of the LNG Supplement designated to finance the FSRU leasing costs is to be replaced with an institutional bank loan guaranteed by the Lithuanian State. The Commission considers that the state guarantee to secure institutional bank loan secured by the state guarantee is an appropriate instrument to ensure the operation of the LNG Terminal.

(47) The Commission also notes that, based on the information provided by the Lithuanian authorities, under the normal market conditions no commercial bank would grant a loan to finance FSRU leasing costs. The loan was made available only by NIB under the condition of securing it with the state guarantee. The state guarantee is therefore necessary to enable the beneficiary to obtain the loan from NIB and to maintain the operation of the LNG Terminal.

(48) Therefore, it follows that the notified state guarantee is an appropriate and necessary instrument.

3.3.4. Incentive effect

(49) The incentive effect occurs, if the aid induces the beneficiary to change its behaviour towards reaching the objective of common interest which it would not do without the aid.

(50) As stated in recitals (158) – (166) of the 2013 Decision, the Commission found that the aid leads to improving the financial indicators of the LNG Terminal to a level that can be acceptable for KN and hence provides an appropriate incentive for to carry on the project. The payment of the LNG Supplement reduces the risks of the

LNG Terminal's activity. The Commission also concluded that 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.

(51) The Commission observes that, assuming that the part of the LNG Supplement financing the FSRU leasing costs was removed, SGD Terminalas would not be able to obtain a loan on the market if it was not secured by the state guarantee. The Commission notes that lack of the state guarantee would undermine the security of cash flows and the viability of the whole project in the remaining years.

(52) Therefore, can be concluded that the aid has an incentive effect, as it provides the necessary incentive for SGD Terminalas to operate the LNG Terminal.

3.3.5. Proportionality

(53) As stated in recitals (167) – (178) of the 2013 Decision, in order to ensure that proportionality criteria is met, the aid must be kept to the minimum. To this end, the Commission assessed in the 2013 Decision the return made possible for the LNG Terminal by comparing the expected internal rate of return (IRR) to be generated by the project and the weighted average cost of capital (WACC) calculated for this sector. The Commission concluded that there were sufficient safeguards in place to ensure that the aid would not provide KN with excessive profits on the investment.

(54) In order to assess whether the notified measure is proportionate, the Commission has to calculate the amount of aid that will result from the state guarantee. Based on the amount of aid, the Commission has then calculated the IRR of the project and compare it with the WACC.

3.3.5.1. The Legal framework for aid amount calculation

(55) The Commission notes that, as the notified measure involves a state guarantee, the relevant legal framework for the calculation of its aid equivalent is the Commission Notice on the application of Articles 87 and 88 of the EC Treaty to State aid in the form of guarantees (the "Guarantee Notice")[12].

(56) Pursuant to Section 4.2. of the Guarantee Notice, the calculation of the cash grant equivalent of a guarantee equals the difference between the market price of the guarantee and the price actually paid. According to the Lithuanian authorities, no commercial bank would have provided a loan to SGD Terminalas without the guarantee.

(57) The Commission observes that as there is no market interest rate which could serve as a reference, a reference rate needs to be determined in line with the Commission Communication on the revision of the method for setting the reference and discount rates (the "Communication on reference rates")[13]. This should take into account the relevant risk profile linked to the operation covered as well as the characteristics of the undertaking guaranteed and the collaterals provided.

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[12] OJ C 155, 20.6.2008, p. 10–22.

[13] OJ C 14, 19.1.2008, p. 6–9.

3.3.5.2. Assessment of proportionality

(58) According to the calculations provided by the Lithuanian authorities, the net present value of the cash equivalent of the state guarantee amounts to […]. This cash equivalent results from the difference between the alleged financing costs at arm's length conditions ([…], which is the sum of a margin rate of […] and a negative base rate of […]) and the actual financing conditions ([…] %) obtained by the beneficiary for the loan. The Lithuanian authorities explained that they applied the base rate from the Communication on reference rates which applies when the credit rating is deemed as good (BBB), combined with a low level of collateralisation.

(59) Lithuania submits that with such quantification of the state guarantee, the internal rate of return (project IRR) would amount to […], all other things equal, and disregarding any additional state guarantee granted in the future, to be compared with the WACC. According to Lithuania, from the KN shareholder's perspective the industry WACC amounts to […] (approximately […] lower than in 2013 mainly due to the decreased risk of Lithuania). The measure would therefore not trigger overcompensation.

(60) The Commission observes that Lithuania has calculated the aid element (gross grant equivalent) in the state guarantee in line with the State aid rules. SGD Terminalas is a newly established company, however, it is legally covered by its mother company - KN for any financial risk in case of a default on the loan. Therefore, the applied margin rate of […] is in line with the level specified by the Communication on reference rates corresponding to a low level of collateralisation and a good (BBB) credit rating. The Commission notes that compared with an actual interest rate charged on the loan of […], the cash equivalent of the state guarantee would indeed amount to […]. Such a cash equivalent would trigger an internal rate of return of […], all other parameters remaining equal, to be compared with a WACC of […].

(61) The Commission concludes therefore that, the measure remains proportionate because the profitability entailed by the measure (project IRR of […]) remains below the weighted average cost of capital required by the market for this type of project (WACC of […]).

3.3.6. Distortion of competition and balancing test

(62) As explained in recitals (179) – (191) of the 2013 Decision, the Commission performed a balancing test in order to conclude that the contribution to an important objective of common interest as well as the positive effects on competition outweigh some identified negative effects on competition.

(63) The notified measure enables keeping the LNG Terminal operational. The Commission notes the operation of the LNG Terminal creates a number of benefits for competition, in particular increasing diversification and security of supply, reducing isolation of the Baltic region and its dependency on a single supplier and reinforcing internal grid infrastructures accordingly.

(64) Currently, Gazprom is still the major gas supplier in Lithuania and the Baltic region countries. Gazprom currently supplies more than 50% of gas in Lithuania. The Commission notes that Lithuania is still poorly interconnected as it has the single interconnection with Latvia, which is also dependent on Gazprom gas

supplies. The Commission considers that, based on the information provided by the Lithuanian authorities, maintaining the LNG Terminal operational until 2024 will have substantial beneficial effects by further diversifying not only the Lithuanian upstream gas market but also upstream gas markets in the Baltic region.

(65) Moreover, replacing the LNG Supplement with the loan from NIB guaranteed by the Lithuanian State should be beneficial to the gas consumers in Lithuania. As the financial burden of the LNG Supplement to natural gas consumers will be reduced, it will make natural gas prices more competitive and have positive impact on competition.

(66) Therefore, on balance, the Commission concludes that the contribution to an important objective of common interest as well as the positive effects on competition outweigh the negative effects on competition identified above.

4. CONCLUSION

(67) The Commission has accordingly decided not to raise objections to the aid on the grounds that it is compatible with the internal market pursuant to Article 107(3)(c) of the Treaty on the Functioning of the European Union.

(68) The Commission reminds the Lithuania authorities that in accordance with Article 108 (3) TFEU, any plans to refinance, alter or change this aid have to be notified to the Commission pursuant to the provisions of the Commission Regulation (EC) 794/2004 implementing Council Regulation (EC) No 659/1999 laying down detailed rules for the application of Article 93 of the EC Treaty (now Article 108 TFEU)[14].

Yours faithfully
For the Commission

Margrethe VESTAGER
Member of the Commission

[14] OJ L 140, 30.4.2004, p. 1.