



## EUROPEAN COMMISSION

Brussels, 8.12.2020  
C(2020) 8838 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>PUBLIC VERSION</p> <p>This document is made available for information purposes only.</p>
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Subject: **State aid SA.55388 (2020/N) – State aid to Cyprus LNG Terminal**

Excellency,

### 1. PROCEDURE

- (1) Following pre-notification contacts, on 26 October 2020, Cyprus notified to the Commission its intention to provide support to the construction of a liquefied natural gas ("LNG") terminal located in Vasilikos Bay, Cyprus (the "Project"), pursuant to Article 108(3) of the TFEU.
- (2) By letter dated 6 November 2020, Cyprus agreed to waive its rights deriving from Article 342 TFEU in conjunction with Article 3 of Regulation 1/1958 and to have the present decision adopted and notified in English.
- (3) The Commission requested additional information by e-mail of 3 November 2020, to which Cyprus replied by e-mail of 6 November 2020.

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## **2. DESCRIPTION**

### **2.1. Objective**

- (4) Cyprus is an energy isolated market with no interconnected generation capacity from other countries and with a high dependency on liquid fuels for power generation. The Cypriot authorities support the acquisition of a Floating Storage Regasification Unit (“FSRU”) and the development of the necessary gas infrastructure to supply gas to Cyprus.
- (5) According to the Cypriot authorities, the Project will contribute to market integration as it will enable Cyprus to connect with the Trans-European gas networks. The Project will improve Cyprus' security of energy supply and diversification of imported energy sources and fuels, by improving energy reliability and flexibility and by giving the country access to the global LNG market.
- (6) The Cypriot authorities also explained that the Project will contribute to the reduction of greenhouse gas emissions in the island and prepare a low carbon and competitive economy. The Project aims at reducing CO<sub>2</sub>, NO<sub>x</sub>, SO<sub>x</sub> and dust emissions associated with power generation in Cyprus. More specifically, the Project will improve the environmental characteristics of the country's power sector, by reducing CO<sub>2</sub> emissions by 595,000 tonnes annually - which represents more than 10% reduction in the national carbon emissions. It will also reduce annual SO<sub>2</sub> emissions by 6,000 tonnes and annual dust emissions by 175 tons on average.
- (7) The Cypriot authorities claim that the Project will also reduce the cost of electricity by enhancing the introduction of competition in the electricity market (facilitating the functioning of Independent Power Producers). It would reduce the Electricity Authority of Cyprus (“EAC”) average generation cost by at least 10% and up to 30%, thanks to the improved efficiency at EAC's power station with the use of gas, the reduced costs of emissions allowances and the lower cost of gas compared to petroleum products.
- (8) The Cypriot authorities claim that the Project will allow for greater penetration of renewable energy. According to the Cypriot authorities, Cyprus' ambitious long-term goals for renewable energy penetration require flexible capacity to match intermittent wind and solar, a role for which gas-fired generation is well suited.
- (9) The Project was included on the third<sup>1</sup> and fourth<sup>2</sup> list of Projects of Common Interest (PCIs) under the Priority Corridor - Southern Gas Corridor (SGC) as a project aimed at removing internal bottlenecks in Cyprus to end isolation and to allow for the transmission of gas from the Eastern Mediterranean region and at developing gas infrastructure in Cyprus (currently known as “Cyprus Gas2EU”).

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<sup>1</sup> Commission Delegated Regulation (EU) 2018/540 of 23 November 2017 amending Regulation (EU) No 347/2013 of the European Parliament and of the Council as regards the Union list of projects of common interest, C/2017/7834, OJ L 90, 6.4.2018, p. 38–58

<sup>2</sup> Commission Delegated Regulation (EU) 2020/389 of 31 October 2019 amending Regulation (EU) No 347/2013 of the European Parliament and of the Council as regards the Union list of projects of common interest, C/2019/7772, OJ L 74, 11.3.2020, p. 1–19

## 2.2. Project description

- (10) The Cypriot authorities explained that by delivering infrastructure to import natural gas, the Project addresses the challenges that Cyprus faces with regards to the energy market. Once completed, the Project will allow the Vasilikos power station, the main supplier of electricity to Cyprus, to switch its operation from heavy fuel oil and diesel to natural gas. EAC will be the initial anchor buyer of the gas supplied through the project facilities.
- (11) The Project involves the acquisition of a Floating Storage Regasification Unit (“FSRU”) and the construction of associated infrastructure (including jetty, offshore and onshore pipeline) to import, store and regasify LNG back to its normal gaseous state. The FSRU will be permanently moored to the jetty about 1.3 km off the coast of Limassol in Vasilikos Bay and will connect directly to the adjacent and largest power station in the country, the Vasilikos power station.
- (12) The major elements of the Project are:
- Acquisition of a FSRU: an LNG carrier will be converted into a FSRU, identified as a Moss type LNG vessel built in 2002, with an LNG storage capacity of approximately 136,000 m<sup>3</sup> (see recital (13) below)
  - Construction of a jetty platform for permanent FSRU berthing (and FSU berthing if specified), including mooring equipment, loading platform, offshore components, shore protection work, etc
  - Construction of jetty-borne gas pipeline and installation of the Ship-to-Shore gas loading arms and fire-protection system
  - Construction of onshore gas pipeline and Onshore Above Ground Installation, which provides a means of isolating the jetty gas pipeline system from the onshore gas pipeline and all downstream systems, and provides a means of venting the jetty gas pipeline section in emergency situations
  - Construction of natural gas buffer solution, which is a piping arrangement that provides the system with additional gas capacity
  - Construction of a Pressure Reduction and Metering Station
- (13) The vessel to be converted is the LNG carrier "GALEA" owned by Shell Tankers Singapore Private Ltd, built in September 2002 by Mitsubishi Heavy Industries. The gross capacity of the vessel is 137,161 m<sup>3</sup>. The FSRU will be capable of accepting LNG from LNG carriers ranging in size from 120 000m<sup>3</sup> to 217 000m<sup>3</sup>. The FSRU will also have the potential to provide LNG Bunkering for smaller vessels from 1000 m<sup>3</sup> to 7000 m<sup>3</sup>, using Ship to Ship transfers from the FSRU.
- (14) Following a tender procedure, the Project will be developed under an Engineering, Procurement, Construction, Operations and Maintenance (“EPCOM”) contract by a single contracting entity comprising a joint venture of China Petroleum Pipeline Engineering CO LTD (“CPP”) and Metron Energy Applications S.A. (“METRON”) forming a consortium with Hudong-Zhonghua Shipbuilding CO LTD (“HUDONG”) and Wilhelmsen Ship Management Limited (“WSM”).
- (15) The Cypriot authorities confirmed that the tender procedure was conducted following EU public procurement rules for the award of the contract in question.
- (16) The Project will be constructed under a fixed price. The scheduled date for the Project completion is 24 months from signing the contract for the assigned commencement date which is the 28<sup>th</sup> September 2020. A minimum 20-year operation and maintenance period is envisaged for all onshore and offshore assets, with a target operating period of 40 years.

### 2.3. The energy market in Cyprus

- (17) Cyprus' energy sector faces major challenges arising from its isolation, small size and lack of indigenous resources. Cyprus is the only Member State of the European Union which remains fully isolated without any electricity or gas interconnections. In particular, 90% of its electricity supply relies on imported petroleum products.
- (18) As a consequence, Cyprus has one of the highest levels of CO<sub>2</sub> intensity in Europe, has among the highest electricity prices in Europe and relies on power plants burning heavy fuel oil.
- (19) The country has three main conventional power stations owned by EAC with a total capacity of 1478 MW. The Vasilikos Power Station has 830 MW of installed capacity with dual fuel capability (liquid fuels and natural gas). This power station is currently running on liquid fuels but will be switched to natural gas with the implementation of the Project.
- (20) There is an increasing penetration of renewables in Cyprus, with 122 MW of solar generation and 157.5 MW of wind generation, but these currently represent only a minor percentage of the current utilized capacity.
- (21) The energy markets in Cyprus are regulated by Cyprus Energy Regulatory Authority ("CERA") under Cyprus Law transposing the Directive 2009/73/EC ("Gas Directive")<sup>3</sup>. The Cypriot "2004 Natural Gas Market Regulation Act", which is transposing the Gas Directive, provides<sup>4</sup>, inter alia, that:
- CERA is responsible to approve the terms and conditions for the connection and access to the network, including the transmission and distribution tariffs as well as the terms, conditions and tariffs for accessing LNG and storage facilities (Section 7(1)(b));
  - CERA is competent to regulate and approve the natural gas supply bills (Section 23(1));
  - CERA is competent to secure that there are no cross subsidies between the transmission, distribution, storage, LNG and supply activities (Section 7(a)(j));
- (22) Cyprus qualifies both as an emergent market and as an isolated market under the Gas Directive.
- (23) As an isolated market, Cyprus derogated from Articles 4, 9, 37 and/or 38 of the Gas Directive. Such derogation shall expire from the moment when Cyprus cease to qualify as an isolated market. As an emergent market, Cyprus may derogate from Articles 4 and 9, Article 13(1) and (3), Articles 14 and 24, Article 25(5), Articles 26, 31 and 32, Article 37(1) and/or Article 38 of the Gas Directive. Such derogation shall expire from the moment when Cyprus ceases to qualify as as an emergent market.

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<sup>3</sup> Directive 2009/73/EC of the European Parliament and of the Council of 13 July 2009 concerning common rules for the internal market in natural gas and repealing Directive 2003/55/EC - *OJ L 211, 14.8.2009, p. 94–136*

<sup>4</sup> Government Gazette I (I) No 3852, 30.4.2004 – Law 183 of 2004 – published here: [https://www.cera.org.cy/Templates/00001/data/nomothesia/ethniki/fysiko%20aerio/nomos/Nomos\\_2004-2020.pdf](https://www.cera.org.cy/Templates/00001/data/nomothesia/ethniki/fysiko%20aerio/nomos/Nomos_2004-2020.pdf)

- (24) In line with the exemptions as an emergent market, there will be a monopoly in the supply of natural gas while the emergent market status lasts, and the supplier is responsible to conclude all relevant contracts for the import of natural gas, including LNG as well as all contracts for the supply of natural gas to consumers of all categories.

#### **2.4. The measure: State guarantee on loans issued by EIB and EBRD**

- (25) The Natural Gas Infrastructure Company of Cyprus (“ETYFA”) is going to sign an agreement with European Investment Bank (“EIB”) for a loan of EUR 150 million. The signature will take place before the end of 2020. This loan is granted under the condition that it is backed by a State guarantee covering 100% of the amount borrowed.
- (26) In addition to this EIB loan, ETYFA also signed on 31 July 2020 an agreement for a loan for EUR 80 million from European Bank for Recovery and development (“EBRD”). This loan is granted under the condition that it is backed by a State guarantee covering 100% of the amount borrowed.
- (27) As a result, a State guarantee covering 100% of the total borrowed amount is required in order to access both loans (“the Measure”). The State guarantee will apply to both loans, covering the total amount of EUR 230 million. The term of State guarantee corresponds to the maturity of the loan, i.e. up to 20 years. ETYFA will not pay any premium in exchange for this State guarantee.

#### **2.5. The beneficiary**

- (28) The Natural Gas Infrastructure Company of Cyprus (“ETYFA”) will carry out the development of the necessary infrastructure and is the beneficiary of the measure. ETYFA is a special purpose vehicle that was established in 2018 and registered as a private company with the objective of undertaking the construction and management and operation of the Project.
- (29) The equity shares of ETYFA are owned by both the Cyprus National Gas Public Company (DEFA) for 70% and by EAC for the remaining 30%.
- (30) DEFA was established in November 2007 by the Government of Cyprus (“GoC”) to facilitate the importation and distribution of natural gas to the Cyprus energy market. The GoC holds one hundred percent of DEFA’s total share capital.
- (31) The Council of Ministers of the Republic of Cyprus has decided on 18 June 2008 to appoint DEFA as the sole importer and distributor of natural gas in Cyprus. DEFA owns (with the exception of LNG facilities) and manages all natural gas infrastructures in the country, in other words the transmission and distribution networks. It is also responsible to develop the relevant infrastructures, with a development programme to be approved by CERA.
- (32) DEFA is currently a limited liability company under private law. Under the Republic of Cyprus constitution no monopoly for the energy or water sectors is allowed for private law entities. As a result DEFA will have to transform and be established as a Public Law Entity, through a dedicated law. The adoption of this law is expected for 2021.
- (33) DEFA will have the exclusive right to import and supply natural gas to consumers in Cyprus in accordance with the derogations for isolated and emergent market, as stated in recital (23).

- (34) The EAC is a vertically integrated electricity company, also fully owned by the GoC. The EAC is responsible for the distribution and supply of electricity to all classes of consumers in Cyprus, including for the distribution of electricity produced by a number of privately-owned renewable energy facilities.
- (35) The EAC owns and operates three thermal power stations located at Vasilikos, Dekeleia and Moni with a total installed capacity of 1,478 MW. The EAC plants located at Vasilikos have a dual fuel capability and represent an installed capacity of 830MW.
- (36) The EAC will initially be the sole consumer of natural gas when the Project is brought into operation. The EAC will enter into a gas sales agreement (“GSA”) with DEFA for the sale and purchase of gas for use at the Vasilikos power station.
- (37) The gas price under the GSA will reflect the price at which DEFA procures the LNG, the variable element of the terminal use agreement fee and a risk margin to DEFA. All relevant fees and margins are subject to regulatory approval since the natural gas market of Cyprus is regulated by the CERA and the legal framework is fully harmonised with the Third Energy Package and the Directive 2009/73/EC.
- (38) It is expected that independent gas-fired generation projects will be constructed in the next few years (it is acknowledged that this will necessitate future decisions regarding the development of additional facilities and a pipeline network). These additional buyers are expected to participate and nominate their requirements in an Open Season Procedure<sup>5</sup>, and will pay the same fees per unit of Gas as EAC. The Project is not conditional on the development of these independent projects.

## 2.6. Costs and financing of the Project

### 2.6.1. Costs of the Project

- (39) The capital costs of the Project are estimated around EUR 305 million, spread over three years (2019 – 2021). [\*\*\*capital expenditure table\*\*\*]
- (40) The Project capital costs will be financed through a combination of equity and debt.

### 2.6.2. Financing of the Project

- (41) The equity of the Project will be shared between DEFA and EAC. The Project was awarded EU funding of EUR 101 million under the Connecting Europe Facility (“CEF”) on 9 February 2018<sup>6</sup>. This amount constitutes DEFA’s 70% equity contribution to the Project. EAC has subscribed for the remaining 30% shareholding in ETYFA for a consideration of EUR 43 million.

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<sup>5</sup> An Open Season Procedure is a process which allows a project sponsor to efficiently identify market needs for an infrastructure and to allocate capacity in a transparent and non-discriminatory basis.

<sup>6</sup> More details on the CEF Financing can be found on: [https://ec.europa.eu/inea/sites/inea/files/2017\\_cef\\_energy\\_call\\_selection\\_decision.pdf](https://ec.europa.eu/inea/sites/inea/files/2017_cef_energy_call_selection_decision.pdf)  
[https://ec.europa.eu/inea/sites/inea/files/2017\\_cef\\_energy\\_call\\_selection\\_decision\\_annex.pdf](https://ec.europa.eu/inea/sites/inea/files/2017_cef_energy_call_selection_decision_annex.pdf) The Grant Agreement with INEA was signed on the 09 July 2018.

- (42) In addition, the project will be financed with a loan of EUR 80 million from EBRD, with a maturity of 20 years and a grace period of 3 years. The loan will reimbursed on a semi-annual basis based on a floating rate of “Euribor [...]”.
- (43) The Project will also be financed with a loan of EUR 150 million from the EIB, with a maturity of 20 years and a grace period of 4 years. The loan will reimbursed on a semi-annual basis based on a fixed rate, depending on the prevailing interest rate at the date of disbursement. The current indicative interest rate is [0-5] %.
- (44) Both loans will be secured through a State guarantee from the GoC.

### 2.6.3. *Revenues from the Project and funding gap*

- (45) The Project will generate revenues based on regulated tariffs.
- (46) The supplier, DEFA, will be responsible to deliver natural gas at the entrance of each consumer’s premise. The respective supply contracts set a price which shall cover both the cost of the supply of the quantity of natural gas and the cost to use the natural gas infrastructure, in respect to every consumer category, as well as a reasonable profit for DEFA. As detailed in the Statement on Regulatory Practice and Natural Gas Tariff Methodology published in April 2019 ( “the Methodology”)<sup>7</sup>, tariffs are calculated with reference to a “permitted revenue” which allows for recovery of operating expenses and depreciation plus a return. This return is the Weighted Average Cost of Capital (WACC) as determined by the regulator on the regulated asset base, currently set at [0-10] % - see recital (52).
- (47) Final consumers will be classified in categories depending on their final use of natural gas. The final supply tariff in each consumer category will be approved by CERA, upon a recommendation of the supplier, in accordance with the provisions of the Methodology.
- (48) The Methodology states that the proper implementation of the operating and accounting separation in the vertically integrated undertaking as well as the full involvement of CERA in the approval of the relevant infrastructure development programmes, the determination of the necessary operator and supplier revenue as well as the approval of supply tariffs, ensure the smooth transition to the free market status, upon the expiry of the emergent market status.
- (49) The Methodology makes provision about what shall apply during the emergent market period and does not extend to the completely liberalised market status, where there will be eligible clients, more suppliers than the monopoly one as well as free access of third parties to all natural gas facilities, as defined in European legislation. The expiry of the emergent market status will be accompanied by the issue of a new Regulatory Practice Statement, in accordance with the provisions regarding the fully liberalised natural gas market.
- (50) The Cypriot Authorities have provided a projection of the revenues and costs over the expected LNG terminal life-cycle of 20 years, over the period 2022-2041. Revenues from the terminal are primarily based on the regulated tariffs for the regasification services approved by CERA in accordance with the Methodology. The Methodology complies with the principle of financial neutrality of the operators and the monopoly supplier, so as to cover their costs plus a reasonable return.

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<sup>7</sup> See “Statement on regulatory practice and tariff methodology for natural gas” – April 2019.

- (51) Tariffs for the project are set with reference to the revenues allowed, defined as the calculated annual charge received by the owner of the LNG facilities. The revenues allowed include a capital component and an operating component.
- (52) The capital component includes the allowed rate of return on the Regulated Asset Value Base (RAVB)<sup>8</sup> and depreciation<sup>9</sup>. The allowed rate of return on the RAVB corresponds to the WACC and has been set by the regulator initially at [0-10]%. This WACC is based upon the assumptions of a debt-to-equity ratio of 60:40, a cost of equity of [0-10]% and a cost of debt of [0-10]%.
- (53) During the periodic regulatory review, CERA may decide to index the WACC or the data used for the determination of the WACC so that the WACC will be varied during the regulatory control period. The objective of such indexing is the protection of the undertaking which undertakes the regulated activity from uncontrollable changes in its financing cost.
- (54) The operating component of revenues allowed includes elements such as maintenance, security, management, protection, advisory, legal services, insurance, human resources, training and information technology (IT), lease of buildings, etc.
- (55) The revenues from the Project will be submitted for approval to CERA on an annual basis. At the end of each year there will be an audit comparing the revenues allowed with the actual costs. Any differences arising and approved by CERA will result in an adjustment to the following year's allowed revenues.
- (56) CERA either on its own initiative or upon a request from an operator, may review the revenues allowed for a year of the current regulatory control period only in the event of a positive or negative deviation of the revenues allowed which is greater than 10% for the year concerned and only for reasons due to a difference between the actual against the budgeted sizes for capital expenditure, the uncontrollable operating expenditures and/or the parameters affecting the calculation of the WACC.
- (57) Any positive or negative deviation less than 10% will taken into account in the calculation of the revenue allowed for the following regulatory control period, referred in each year of the period in a manner to be determined by a decision of CERA.
- (58) The Cypriot authorities provided the calculation of the funding gap related to the project, i.e. the net present value of the project operating and investment cash flows, deprived of state support. In order to calculate the net present value of the funding gap, Cyprus used the regulated WACC as the discount rate of [0-10]% as defined by

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<sup>8</sup> With the regulated Asset base is defined by the following formula :

$$RAB_t = RAB_{t-1} + It - St - Dt - Gt + \Delta WC_t$$

Where:  $RAB_t \equiv$  Regulated fixed asset base year t.

$It \equiv$  Investments (capital expenditure) in year t

$St \equiv$  Sales/allocations in the year t

$Dt \equiv$  Depreciation in the year t

$Gt \equiv$  National or EU grants in the year t

$\Delta WC_t \equiv$  Change in working capital in year t

<sup>9</sup>  $CoC = \text{Regulated Asset Base} \times WACC + \text{Depreciation}$



the regulator. According to the Cypriot authorities, the funding gap would amount to EUR [50-300] million.

## **2.7. Legal basis**

- (59) The national legal basis indicated by Cyprus is the decision from the Cypriot Council of Ministers<sup>10</sup> of 7 October 2020 to grant the State guarantee both to the EIB for the conclusion of a loan of up to EUR 150 Million, and to the EBRD for the conclusion of a loan of EUR 80 Million.

## **2.8. Cumulation and Transparency**

- (60) Cyprus has confirmed that the measures will not be cumulated with other aid sharing the same eligible costs.
- (61) Cyprus 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. The existence of State aid according to Article 107(1) TFEU**

- (62) By virtue of Article 107(1) of the TFEU *"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 internal market."*
- (63) 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.

#### *3.1.1. State Resources and imputability*

- (64) 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.
- (65) The Commission notes that the State guarantee granted by the Cypriot State covers 100 % of both EIB and EBRD loans, amounting to up to EUR 230 million. The Commission considers that in case of a default of the beneficiary which would trigger the State guarantee, the Cypriot State budget is likely to be directly affected. Therefore the State guarantee involves State resources, since it entails a concrete risk

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<sup>10</sup> The decision of the Council of Ministers is considered to be a secondary legislation. The Council decisions will be published on the website of the Council of Ministers Secretariat (<http://www.cm.gov.cy>) and afterwards on the Official Gazette of the Republic.

for the State budget to be burdened in case that guarantee is triggered. Furthermore, State resources are also involved because the Cypriot State will not receive a guarantee premium that conforms to market prices, and therefore waives part of the fee that a market operator would have sought, which reflects a cost for the State budget.

- (66) Therefore, the Commission views this State guarantee as being granted out of the State resources.
- (67) The decision to grant this State guarantee to the beneficiary was taken directly by the Cypriot State and is hence imputable to the State within the meaning of Article 107(1) TFEU.

#### *3.1.2. Economic Advantage*

- (68) In line with the Guarantee Notice<sup>11</sup>, a State guarantee can be deemed market conform if a market-oriented price is paid for it. ETYFA is not paying any fee to the Cypriot authorities for the Guarantee.
- (69) The Commission notes that the notified measure will provide an economic advantage to ETYFA, because the company will obtain a State guarantee securing a loan for the project, without paying any fee on this guarantee. Such a guarantee, without paying any fee, would not have been provided by a market economy operator. Therefore, that guarantee confers an advantage which would not be available under normal market conditions.

#### *3.1.3. Selectivity*

- (70) The Commission notes that the notified measure is granted specifically to ETYFA. Therefore the Commission considers that the measure is selective.

#### *3.1.4. Distortion of competition and effect on trade between Member States*

- (71) One of the objectives of the Project is to replace oil fuelled power generation for environmental and diversification reasons. Given that gas and oil products are subject to trade between Cyprus and other Member States, the measure is liable to affect the patterns of trade between Member States.
- (72) In addition, the Project will allow the Vasilikos power station to switch its operation from heavy fuel oil and diesel to gas. This power plant competes with other forms of power generation, such as renewables.
- (73) In the light of the above, the measure distorts or threatens to distort competition and is likely to affect trade between Member States.

#### *3.1.5. Conclusion with regard to the presence of State aid*

- (74) 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.

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<sup>11</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)

### 3.2. Lawfulness of the aid

- (75) The Commission notes that the State guarantee will be provided only after the Commission's approval, thus in compliance with the standstill obligation enshrined in Article 108 TFEU.

### 3.3. Compatibility

#### 3.3.1. Legal basis for assessment

- (76) The notified measure aims to finance the construction of an LNG terminal regasification station in Cyprus. Support for LNG/gas infrastructure falls within the scope of the Commission Guidelines on State aid for environmental protection and energy 2014-2020<sup>12</sup> (hereinafter "EEAG"), section 3.8 "Aid to energy infrastructure". The project constitutes a gas energy infrastructure in line with point 31(b) of Section 1.3. Definitions of the EEAG.
- (77) Article 107(3)(c) TFEU states that aid to facilitate the development of certain economic activities or of certain economic areas may be considered to be compatible with the internal market where such aid does not adversely affect trading conditions to an extent contrary to the common interest. In established Commission practice the aid measure can be declared as compatible under Article 107(3)(c) TFEU, if it contributes to the development of an economic activity; it is necessary and appropriate; has an incentive effect; is proportionate; and the positive effects outbalance the negative effects on competition and trade, and therefore it avoids undue negative effects on competition and trade between Member States. In this regard, the Commission considers it appropriate to assess the following:
- a) Development of an economic activity
  - b) Appropriateness and necessity
  - c) Incentive effect
  - d) Proportionality
  - e) Distortions of competition and effect on trade

#### 3.3.2. Development of an economic activity

- (78) Article 107(3)(c) TFEU provides that the Commission may declare compatible "*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*". Therefore, compatible aid under that provision of the Treaty must contribute to the development of certain economic activity.<sup>13</sup>
- (79) 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

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<sup>12</sup> OJ C 200, 28 July 2014, p. 1

<sup>13</sup> C-594/18 P *Austria v Commission* EU:C:2020:742, paras 20 and 24.

that aid to 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>14</sup>.

- (80) The project will contribute to increase the integration of the regional gas market in the EU by lifting the isolation of Cyprus. Consequently, the project will help ensuring security of supply of gas, by establishing appropriate connections and diversification of supply sources with other EU member States. In the longer-term the availability of natural gas will facilitate the development of a liberalised wholesale energy market. Therefore, the aid measure aims at supporting the development of an economic activity while contributing to improving security of energy supply, which is part of the objectives referred to in Article 194 TFEU.
- (81) In line with point 202 of the EEAG, the Commission presumes that energy infrastructure is a precondition for a functioning energy market. It enhances the integration of different energy sources and energy supplies in under-developed networks. The Commission therefore considers that aid to energy infrastructure contributes to enhance the energy security of supply in the country.
- (82) The notified measure will enable ETYFA to obtain favourable lending conditions offered by the two European banks, which will minimize the financing costs and therefore lead to a lower regasification tariff. Consequently, the reduced regasification tariff will result in a lower price of electricity for the final energy consumers.
- (83) The project will also contribute to promote competition, especially in the electricity sector, by diversifying and complementing the supply sources. The construction of the terminal, with the use of State Guarantees, will enable the proper functioning of the electricity market in Cyprus, thus leading to more competition and to lower electricity prices to final consumers. The project is therefore expected to lead to a reduction of Cyprus's electricity costs, currently among the highest in Europe.
- (84) The notified measure will therefore support directly to the economic activity of the LNG terminal and will contribute indirectly to economic stimulus resulting from affordability of electricity for energy consumers.
- (85) The project will also promote sustainability, by reducing emissions, supporting intermittent renewable generation and enhancing deployment of renewable gas, considering that the project promotes the use of natural gas/LNG as alternative source. By using gas to replace expensive and polluting heavy fuel oil in electricity generation, the project is expected to reduce CO<sub>2</sub> emissions by 595,000 tonnes annually and substantially improve local air quality.
- (86) Considering the above, the Commission concludes that the notified aid measure supports the development of economic activities of an LNG terminal in a manner that facilitates the reduction of emissions and improves the security of energy supply in Cyprus.

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<sup>14</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.

### *3.3.3. Need for State intervention*

- (87) In order to demonstrate the necessity of the measure, it has to be established that the measure is targeted towards a situation where aid can bring about a material improvement that the market alone cannot deliver.
- (88) Pursuant to paragraph 206 of the EEAG, the Commission presumes that for infrastructure investments which fall in the approved list of PCIs (see recital (9)), the market failures in terms of positive externalities and coordination problems are such that financing by means of tariffs may not be sufficient.
- (89) Pursuant to paragraph 207 of the EEAG, the Commission will carry out a case-by-case assessment of the need for State aid, for projects falling under paragraph 206 that are partially or wholly exempted from internal energy market legislation. In its assessment, the Commission will consider the following factors: i) to what extent a market failure leads to a sub-optimal provision of the necessary infrastructure; ii) to what extent the infrastructure is open to third party access and subject to tariff regulation; and (iii) to what extent the project contributes to the Union's security of energy supply.
- (90) The existence of market failure is justified by the lack of appropriate funding possibilities on the market, in order to fund such a large project in Cyprus over the long-term. The notified measure is a precondition in order to gain access to the loans from EIB and EBRD. As stated in recitals (25) and (26), ETYFA would not have been able to obtain the loans from EBRD and from EIB if they were not secured by the State guarantee.
- (91) The Cypriot authorities informed the Commission that the Project would not have been developed without this State guarantee. In the absence of the aid measure and subsequently of the loans, the project would not have been capable of attracting a funding of this importance on the private market.
- (92) The Cypriot authorities have explained that tariffs for natural gas will be regulated by the CERA. According to recital (38), the Open Season Procedure will be open to third parties, which will pay to DEFA the same fees per unit of Gas as EAC.
- (93) As stated in recitals (79) and (80), the aid to the construction of LNG Terminals may contribute to improving the security of supply in the Union and the functioning of the internal energy market. The Project is expected to improve Cyprus's energy security by improving energy reliability and flexibility and by giving the country access to the global LNG market, as stated in recital (5).
- (94) The Commission therefore concludes that the notified aid measure is necessary for the construction of the LNG terminal.

### *3.3.4. Appropriate instrument*

- (95) To determine whether a measure is appropriate, it needs to be assessed whether other, less distortive policy instruments or types of aid can achieve the same objective. The Cypriot authorities have the choice between various aid forms, and they can choose an instrument that they consider the most appropriate to achieve the objective of the measure.
- (96) According to paragraph 209 of the EEAG, although infrastructure projects are to be financed through tariffs, State aid may be considered an appropriate instrument for

funding energy infrastructure in the case of Projects of Common Interest and infrastructure investments in assisted areas.

- (97) The Cypriot authorities claim that the Project does not benefit from any other forms of State aid, apart from the State guarantee. Both EIB and EBRD have requested a State guarantee in order to be able to provide loans. Therefore, the State guarantee is deemed a necessary condition, in order to get access to the debt market. According to the Cypriot authorities, other sources of financing that do not involve any State intervention were not available to the Project.
- (98) The Commission notes that, in line with point 209 of the EEAG, the full implementation of the 'user pays' principle, on which tariff regulation is based is not possible in the present case, because in the absence of State guarantee, the loans could not be granted and the project would not materialise, due to lack of funding. There are no other equivalent projects through which Cyprus could reach the same level of security of supply, competition promotion and environmental benefits.
- (99) The Cypriot authorities notified that the State Guarantee is a pre-requisite to secure financing from the EIB and from the EBRD to construct the LNG Import Terminal and that there is no any other alternative instrument with smaller cost to end the energy isolation of Cyprus, develop a national gas market (which does not exist currently), promote competition in the electricity market, facilitate the further promotion of renewable energy sources and reduce greenhouse gas emissions.
- (100) Given the PCI status of the project and the need from EIB and EBRD of a State guarantee to assure the loans, the Commission considers that the notified measure is appropriate to bring the LNG project forward.

### *3.3.5. Incentive effect*

- (101) An aid has an incentive effect if it incentivises the beneficiary to change its behaviour towards the development of certain economic activity pursued by the aid and if the change in behaviour would not occur without the aid.<sup>15</sup>
- (102) According to point 210 of the EEAG, the incentive effect of the aid will be assessed on the basis of the conditions set out in Section 3.2.4 - points 49 and following of the EEAG. In line with point 49 EEAG, the incentive effect occurs, if the aid induces the beneficiary to change their behaviour to increase the level of environmental protection or to improve the functioning of a secure, affordable and sustainable energy market, a change in behaviour which it would not undertake without the aid.
- (103) The simulations provided by Cyprus show that the LNG terminal would not be able to obtain a loan on the market if it was not secured by the State guarantee. Without the aid, the terminal project could not materialise and deliver its contribution to ensure security of supply and to lower GHG emissions.
- (104) Taking into account the above consideration, it can be concluded that the aid has an incentive effect, as it provides the necessary incentive for ETYFA to operate the LNG Terminal. The project would not be carried out in the absence of the notified measure and the notified measure has an incentive effect for the realisation of the project, in accordance with sections 3.8.4 and 3.2.4 of the EEAG.

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<sup>15</sup> See in that sense points 49 and 144 of the EEAG, as well as the *Hinkley* judgment in footnote 13 above.

### 3.3.6. *Proportionality*

- (105) A state aid measure is proportional if the measure is designed in a way that the aid is kept to the minimum necessary to achieve the objective sought. Pursuant to point 211 of the EEAG in conjunction with point 212 of the EEAG, aid measures in support of infrastructure should not exceed an aid intensity of 100% of the eligible costs, defined as a funding gap.
- (106) In order to assess whether the notified measure is proportionate, the Commission calculated the amount of aid that will result from the State guarantee, and compared it the funding gap.

#### 3.3.6.1. The Legal framework for aid amount calculation

- (107) 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")<sup>16</sup>.
- (108) 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 Cypriot authorities, no commercial bank would have provided a loan to ETYFA without the State guarantee.
- (109) 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")<sup>17</sup>. 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.

#### 3.3.6.2. Assessment of proportionality

- (110) Cyprus provided an assessment of the State aid element in the guarantees, applying a rate differential approach. Following the Communication on reference rates, this assessment is based on a rate of 400 bps in absence of credit rating of the beneficiary. It establishes the guarantee premium by comparing the loan with and without a State guarantee; the 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.
- (111) This rate of 400 bps has been compared with the financing conditions applicable to other companies operating LNG terminals in Europe<sup>18</sup>, and considered as being a defensive assumption.
- (112) Cyprus has estimated the cash equivalent value of the state aid element in the guarantees for loans amounting to a total of EUR 230 million as being equal to EUR

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<sup>16</sup> OJ C 155, 20.6.2008, p. 10–22.

<sup>17</sup> OJ C 14, 19.1.2008, p. 6–9.

<sup>18</sup> Compared with, among others, LNG terminal in Lithuania (SA.57032)

99.22 million. This cash equivalent results from the difference between the alleged financing costs at arm's length conditions (400bps) and the actual financing conditions obtained by the beneficiary for the loan.

- (113) As stated in recital (58), Cyprus provided the calculation of the funding gap related to the project, amounting to EUR [50-300] million.
- (114) Cyprus claims that, in absence of the aid measure, the project would not have been able to attract the debt funding.
- (115) The Commission considers that Cyprus has satisfactorily demonstrated that the net present value of the State aid component, namely the State aid guarantee, would not exceed the funding gap, accordingly with point 212 of the EEAG. The Commission concludes therefore that the notified measure does not entail overcompensation, in accordance with points 211 and 212 of the EEAG.

### *3.3.7. Avoidance of any undue negative effects on competition and trade*

- (116) In line with paragraph 215 of EEAG, in the case of infrastructure partially or wholly exempted from, or not subject to, internal energy market legislation, the Commission will carry out a case-by-case assessment of the potential distortions of competition taking into account, in particular, the degree of third party access to the aided infrastructure, access to alternative infrastructure and the market share of the beneficiary.
- (117) The Commission notes that the measure will enable the development of an LNG terminal in Cyprus which is necessary to contribute to enhancing the security of supply and to reducing GHG emissions.
- (118) The Cypriot authorities notified that there are no negative effects of the State Aid on competition and trade. The Gas Directive provides Cyprus with derogations, in order to allow time for the development of a functioning, competitive gas market. There is currently no natural gas in the country's energy mix.
- (119) The LNG terminal will be operated by a monopoly in the supply of natural gas while the emergent market status lasts, the unique supplier being responsible to conclude all contracts for the import of natural gas in the country.
- (120) At the same time, the effect on trade will be minimised by the fact that Third parties will have access to the infrastructure in an Open Season Procedure, as described in recital (38), guaranteeing that third parties will pay the same fees per unit of Gas as EAC. There is currently no alternative LNG infrastructure in Cyprus.
- (121) On the balance, the potential distortion of market competition is limited due to the specific characteristics of this market i.e. the isolation of the market without any gas or electricity interconnection. Moreover, such potential distortion of market competition is outweighed by the positive effects of the aid on the environment, inasmuch as the Project will contribute to the reduction of greenhouse gas emissions in Cyprus and prepare a low carbon economy (see recital 6).
- (122) The Commission concludes that the notified aid measure has no undue negative effect on competition and trade.



### **3.4. Transparency**

(123) Member States are required under Section 3.2.7 of the EEAG to publish as of 1 July 2016 certain information related to the beneficiaries of aid.

(124) As seen in recital (61), since the Cypriot authorities have committed to publish the relevant information on an indicated website<sup>19</sup>, the EEAG provisions on Transparency can be considered as complied with.

### **4. CONCLUSION**

(125) In light of the above the Commission considers that the notified measures are compatible with the internal market in accordance with Article 107 (3) (c) TFEU, as they comply with Section 3.8 of the EEAG.

(126) The Commission reminds the Cypriot 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)<sup>20</sup>.

Yours faithfully  
For the Commission

Margrethe VESTAGER  
Executive Vice President

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<sup>19</sup> <http://www.publicaid.gov.cy/>

<sup>20</sup> OJ L 140, 30.4.2004, p1.