

Cyprus/ February 2012

## **Hydrocarbon and the Geostrategic Significance of Cyprus: financial and political aspects**

The recent developments in the shores of Cyprus have attracted the attention of foreign governments, leading energy companies and naturally the attention of international media. The intensive interest that is shown towards Cyprus is justified when considering that another element has been added to the already very competitive strategic position of Cyprus: the discovery of natural gas. Located between Europe, Africa and Asia, the small island of Cyprus has always played an important role in history. Very often referred to as a 'bridge' or 'situated at a crossroad', Cyprus is persistently considered as the route to many trade and industry empires. The island's unique location and the recent advances in the energy sector, if treated suitably can result in major positive effects for both Cyprus and its neighbors.

In late 2011, the Noble Energy Company announced the discovery of 5-7 Tcf of natural gas in Block 12 of the Exclusive Economic Zone of Cyprus. The importance of this discovery is further enhanced by the fact that these are the estimated results from one single Block, whereas drilling in the other remaining 12 Blocks is expected to reveal the existence of additional natural gas deposits and even the existence of oil. The discovery is estimated to worth billions and it is expected to fulfill the electricity needs of the Republic of Cyprus for the next 210 years.

With the second licensing round being already launched, the competition among energy companies is expected to be rigorous in bidding for the remaining 12 Blocks. The attraction of energy companies is estimated to result in the increase of financial investments in the island. These financial investments will require infrastructure, maintenance, support services, financing and banking, and such demands will result in job creation and eventually in the stabilization of the economic environment of the Republic of Cyprus.

The joint exploitation of the region with neighboring countries such as Israel, Lebanon and Egypt, and the cooperation with the abovementioned countries in joint energy projects, will facilitate the exploitation procedure especially in situations where the natural gas or petroleum fields fall across the line separating Exclusive Economic Zones. Cyprus is enthusiastically supporting this prospective cooperation and Framework Agreements are at present being negotiated with Israel and Egypt, while negotiations with Lebanon are expected to be initiated soon.

### **Licensing procedure for Oil and Gas Prospection, Exploration and Exploitation**

The second licensing round for the remaining blocks has been launched and the invitation for all interested parties has been published in the Official Journal of the European Union. The Republic of Cyprus invites all interested persons to apply for hydrocarbon exploration licenses and subsequent hydrocarbon exploitation licenses in the Exclusive Economic Zones of Cyprus. All applications must be submitted within 90 days starting from 11.2.2012 (date of publication in the Official Journal of the European Union) and applications submitted after the deadline has passed will not be taken into consideration.

In 2007, the Government of Cyprus introduced a new oil and gas law fully harmonized with the EU Directive 94/22/EC. This new law, 'Hydrocarbons (Prospection, Exploration and Exploitation) Law', in combination with the

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‘Hydrocarbons (Prospection, Exploration and Exploitation) Regulations’ of 2007 and 2009 form the legal framework which regulates the granting of licenses for the prospection, exploration and exploitation of natural gas.

### Submission of Applications and Evaluation of Applications

In order for the applicants to be able to submit their applications, invitations for submitting applications must be published both in the Official Gazette of the Republic and the Official Journal of the European Union by the Council of Ministers. The applicants may then send their applications to the Ministry of Commerce, Industry and Tourism which together with an Advisory Committee evaluate such applications.

According to the 2007 Law there are certain criteria that have to be considered when evaluating the applications. These criteria regard national security and public interest; the technical and economic capacity of the applicant; the proposal presented by applicant demonstrating how the applicant will carry out the activities specified in the license; the price which the applicant is ready to pay in order to acquire the license; and any lack of competence and dependability shown by the applicant in undertakings under a previous license.

The 2007 Law also established safeguards concerning the granting of licenses by imposing specific conditions and requirements that have to be fulfilled. Therefore, licenses for prospection, exploration and exploitation of natural gas may be granted subject to conditions in order to guarantee:

- The correct execution of the activities allowed by the license;
- The monetary payment or payment in hydrocarbons;
- National security, public safety and public health;
- Protection of the environment
- Protection of biological and mineral resources and of national treasures possessing artistic, historic or archaeological value;
- The safety of transport, installations and workers;
- The management of hydrocarbons;
- The need to secure revenues to the Republic.

The above mentioned conditions are imposed in a way so as not to discriminate between applicants. The owner of a license is granted the right to prospect explore and exploit hydrocarbons in the section for which the license is granted subject to any conditions or requirements. The license is initially granted for a time period not exceeding three years and can be renewed up to two periods, each period not exceeding two years.

All licenses will have the form of a model production sharing contract whose particular terms and conditions will be agreed upon by the relevant parties. Once the contract is finalized and the parties mutually agree on its terms and conditions, the contract is sent to the Council of Ministers for consent and for surrendering the relevant license.

### Information submitted by the Applicant

When submitting an application for a prospection license, such application must include the following information:

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- The name, address and nationality of the applicant;
- The applicant’s place of incorporation;
- The method of financing the prospecting activities; and
- The applicant’s prior practice on hydrocarbon prospection.

An application for an exploration license must contain the above information requested by prospection licenses but it must additionally include information concerning the relationship of the applicant with its parent company (if applicable) and its relationship with affiliated persons. And if such parent- subsidiary relationship is in place, the application must also include annual reports, audited balance sheets , profit and loss statements for the past three years, and any other reports which the applicant and its parent company may have filed to the competent authority for capital market and dealings with securities, during the past three years;

Finally, exploitation licenses must include the particular information stated below:

- The portrayal of the area or areas for which an application has been made ;
- A thorough description of the planned exploration program;
- Commitment to minimum assurances concerning work and expenditure throughout the exploration period;
- The impact which the exploration activities are expected to have on the environment and the actions that the exploration work program plans to perform in order to deal with it;
- Plans regarding the training and employment of nationals of the Republic;
- Plans for financial consideration and/or sharing production between the applicant and the Government of the Republic;
- Any agreement between any persons relating to the method of financing the hydrocarbons operations; and
- Any other information as may be required by the Minister.

### Supplementary shipping legislation

Circular 15/2005 of the Department of Merchant Shipping includes regulations relating to the prospection, exploration and exploitation of natural gas.

### Mobile Offshore Drilling Units

The Circular deals with the treatment of Mobile Offshore Drilling Units (MODU) which are defined as “ those vessels capable of being engaged in drilling operations for the exploration for or exploitation of resources beneath the seabed, such as liquid or gaseous hydrocarbons, sulphur or salt.”

The only requirement for registration under the Cypriot flag is that such a vessel may not exceed 25 years of age. However, a vessel over 25 years of age may be registered given that they undertake an entry inspection with a satisfactory outcome and where required, it must be managed by a Cyprus or other EU shipmanagement company.

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## Research Ships

Research ships are also covered by this Circular and they are defined as “ those vessels having on board scientific instruments and other equipment and used exclusively for scientific research purposes. ”

The requirements for registration under the Cypriot flag that apply for Mobile Offshore Drilling Units also apply to research vessels as well.

## Cargo Vessels and Ocean Tug Boats

Cargo Vessels and Tug Boats not exceeding 20 years of age may be registered provided that they undergo a successful entry assessment, which concluded in success.

Vessels over 20 years of age but not exceeding 23 years of age may be registered if they undergo a successful entry assessment, which concluded in success. Additionally, where it is required by law, vessels falling in this category should comply with the ISM Code, they should be managed by a ship company having its principal place of management in the EU.

Vessels over 23 years cannot be admitted to the Cyprus Ship Registry.

-A vessel of a gross tonnage less than 100 and younger than 20 years old may register without any extra requirements.

Vessels of a gross tonnage less than 100 and over 20 years of age but not exceeding 23 year may be registered if they undergo an entry assessment, which concluded in success.

## Conclusion

In late 2011 a major discovery of natural gas was made in Block 12 by Noble Energy and the present data demonstrate that there are additional deposits in the other Blocks whereas it is highly probable that there are also oil deposits in the designated area. The second licensing round has now begun and the enthusiasm of energy companies, of the government and of citizens is more than justified. Cyprus has committed to move forward in the sector of energy always in line with international and EU law and with respect to its neighboring countries. The discovery of natural gas will almost certainly mark the island’s course in history and restructure its strategic significance.

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Eurofast in recent years has achieved worldwide market recognition for its exceptional tax advice, capabilities and innovation in the area of international tax planning. In 2011 Eurofast has been voted “Cyprus Tax Firm of the year 2011” and “Tier One Tax Transactional Practice in Cyprus” by International Tax Review (ITR). In 2010 Taxand has been voted “European Indirect Tax Firm of the Year” by ITR, “Best Tax Practice in Cyprus 2010” by the European CEO and also ranked “Tier One Advisor” in Cyprus by ITR.

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