Recent oil and gas developments in Cyprus: hydrocarbons exploration and exploitation licensing

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The Republic of Cyprus, an EU member state, is a small isolated energy system with no interconnection links to other countries. Cyprus operates on a system that is largely dependent on heavy fuel for most of its energy consumption. In 2011, significant offshore reserves of approximately 7 trillion cubic feet of natural gas were found in Cyprus' Exclusive Economic Zone (EEZ). This has given rise to an ambitious energy strategy.

The regulatory regime

Cyprus is a contracting party to a number of international instruments relevant to the exploration and exploitation of hydrocarbons within its EEZ, the most important being the United Nations Convention of the Law of the Sea (UNCLOS). It has transposed into its domestic legal order EU legislative instruments such as Directive 94/22/EC on the Conditions for Granting and using Authorisations for the Exploration and Production of Hydrocarbons.

The primary national legislation on hydrocarbons exploration and exploitation is the Hydrocarbons (Prospecting, Exploration and Exploitation) Law 4(0) of 2007, as amended by Laws 126(0)/2013 and 29(0)/2014 (Hydrocarbons Law), supplemented by subsidiary legislation, namely the Hydrocarbons (Prospecting, Exploration and Exploitation) Regulations of 2007 and 2009 (Hydrocarbons Regulations). The Hydrocarbons Law and Hydrocarbons Regulations provide for, inter alia, the criteria that applies to licensing applications for prospecting, exploration and exploitation of hydrocarbons in Cyprus.

The state grants participants mineral rights for the development of oil and natural gas reserves through different types of licences. In addition, contractual rights, as reflected in the Model Production Sharing Contract (MPSCL), provide the private contracting party with the right to free access and operation within the contracted area.

Under the Hydrocarbons Regulations, three types of licences are available:

- **Prospecting licence.** The prospecting licence is valid for up to one year and allows the holder to conduct 2D or 3D seismic surveys and gravity and magnetic surveys.

- **Exploration licence.** The exploration licence is valid for three years and offers the prospect of an additional two renewals of the licence. The exploration licence offers the licensee the right to carry out the same surveys as allowed under the prospecting licence and additional exploratory drilling. On each renewal, 25% of the initial area is relinquished. On expiration of the licence, 100% of the initial area is relinquished.

- **Exploitation licence.** The exploitation licence is granted primarily for 25 years. This can be later renewed for up to ten years on the fulfillment of the licensee's obligations.

With regard to the export of hydrocarbons, the licensee is entitled to export to any country with the exception of entities controlled by countries hostile to Cyprus (clause 28.4, MPSCL). Any holder of a licence for hydrocarbons exploration or exploitation that wishes to transfer its authorisation or assign its rights arising from the licence to another entity under section 27 of the Hydrocarbons Law, must submit a written application to the Minister of Energy, Commerce, Industry and Tourism (Regulation 12(0), Hydrocarbons Regulations). The minister, after considering the application, submits an opinion to the Council of Ministers to make its decision.

Where the application for transfer of a licence or assignment of rights arising from a licence is approved by the Council of Ministers, the amendment of the existing licence is effective from the moment the interested party is notified of the Council of Ministers' decision, in writing. There is no need for a new contract.

First and second offshore licensing rounds

In October 2013, Houston-based Noble Energy, the licensee for block 12 in Cyprus' EEZ, carried out appraisal drillings in block 12. The results have confirmed natural gas reserves of 3.6 to 6 trillion cubic feet (tcf), with a gross mean of 5 tcf.

Inevitably, the second licensing round of offshore blocks tender by the Cypriot Government resulted in increased interest:

- Four licences for hydrocarbons exploration in offshore blocks were awarded by the government for blocks 2, 3, 9 and 11, all adjacent to block 12.
- Licences for blocks 2 and 3 were awarded to a consortium of Italy's ENI and Kogas from South Korea.
- The licence for block 9 was awarded to a consortium of the French company Total (operator), Novatec and GPB Global Resources.
- Total was also granted hydrocarbon exploration licences in blocks 10 and 11, after signing two production sharing contracts with the Ministry of Energy in February 2013.
- Total has also been granted a licence by the Agriculture Minister for seismic exploration for oil and gas in block 10 and in parts of blocks 6, 7 and 11 of Cyprus' EEZ.

More licences are due to be awarded as the government continues to evaluate the bids for the remaining blocks, with the exception of blocks 1, 4 and 13 for which no bids have been made. The government has high hopes it will complete the necessary infrastructure, including the pipelines and liquefaction plant, by 2018 and begin exporting natural gas in 2020.

At the same time as these licensing developments, the Cypriot Government, under section 16 of the Hydrocarbons Law,
established a State-owned company to manage the state’s participation in hydrocarbons prospecting, exploration and exploitation activities. This company, initially named the Cyprus National Hydrocarbons Company, and renamed the Cyprus Hydrocarbons Company (CHC) in 2014, will also represent the state in production sharing contracts and will carry out, under ministerial supervision, dealings relating to any liquefaction and export facilities which may be constructed in Cyprus. The government has appointed staff with extensive academic and practical experience in the energy sector to lead the CHC.

Environmental aspects of hydrocarbon exploration

Directive 2001/42/EC on the assessment of the effects of certain plans and programmes on the environment (Strategic Environmental Assessment Directive) was transposed into domestic law by the Assessments of the Effects on the Environment of Certain Plans and/or Programmes Law 140(1) of 2005.

To further the purpose of the legislation, the Ministry of Commerce, Tourism and Industry has developed the Strategic Environmental Assessment (SEA) to ensure environmental protection and sustainable development in relation to hydrocarbons exploration and exploitation within the EEZ of Cyprus.

A licensee for the exploration and/or exploitation of hydrocarbons must comply with the SEA’s recommendations and results, as well as the opinion issued by the Environmental Authority (of the Ministry of Agriculture, Environment and Natural Resources) on the exploitation and exploration operations. In addition, the licensee must also conduct:

- A preliminary Environmental Impact Assessment study before the initiation of any exploration work.
- A full Environmental Impact Assessment study before the initiation of any exploitation work.

Both these must comply with the provisions of the SEA, the Environmental Authority’s opinion and the applicable legislation.

The licensee is particularly required to take all necessary measures to comply with the (Regulation 15, Hydrocarbons Regulations):

- International Convention on Civil Liability for Oil Pollution Damage (effective 19 June 1975).
- Protocol to the above Convention (effective 8 April 1981).
- Law 63 of 1989 which ratifies the Convention on behalf of Cyprus.

Finally, the licensee must, when carrying out offshore operations, ensure that the constructions and installations erected are fitted with navigational aids and are illuminated between sunset and sunrise in accordance with the (Regulation 19(2)(b), Hydrocarbons Regulations):

- Resolutions MEPC 14(20) of 1984, MEPC 16(22) and MEPC 21(22) of 1985 (ratified in Cyprus by Law 57 of 1989).

A licence holder must remove all installations, structures, plants, appliances, equipment and pipelines in accordance to the agreed abandonment plan, unless otherwise authorised (Hydrocarbon Regulations). The competent minister has the right to require a guarantee estimating abandonment and restoration costs or the establishment of a reserve. Further, a licensee who is planning to abandon any well must inform the competent minister in writing two days before the abandonment and in the case of a producing well, 30 days before the abandonment.

Decommissioning is stipulated in the Model PSC of Cyprus. A decommissioning plan and estimated decommissioning expenditure must be submitted within the period of six years before the anticipated decommissioning date of the field or as soon as possible before the termination or relinquishment of part of any exploitation area. The Minister of Commerce, Industry and Tourism is responsible for revising and requesting amendments and approving the decommissioning plan. For the successful implementation of the decommissioning plan, the licensee must form a reserve fund from the date of the approval of the development and production plan.

Dispute resolution

In the event of any disputes arising between hydrocarbons licensees and the government regarding the interpretation or implementation of any provisions of the Model PSC, these must be attempted to be resolved amicably via negotiations not exceeding the period of 60 days after receipt of notice by the parties.

If these negotiations fail, the International Centre for Technical Expertise of the International Chamber of Commerce can appoint an expert at the request of the parties and determine his technical expertise to decide the dispute. If the dispute cannot be resolved through an amicable settlement or expert determination or if one of the parties wishes to challenge the expert’s decision, the dispute proceeds to arbitration.

CERA decisions regarding natural gas regulation are subject to administrative review by the Supreme Court of Cyprus (Article 146, Constitution of the Republic of Cyprus).

State immunity

Under Article 3(1) of the Hydrocarbons Law and to conform with public international law, the ownership of hydrocarbons, as part of the state’s natural resources, vests with the state at all times. In addition, the rights over resources situated in offshore Cyprus must be exercised in conjunction with the continental shelf rights under the United Nations Convention of the Law of the Sea (UNCLOS).

The Supreme Court of Cyprus, in adjudicating matters involving foreign states as defendants, has subscribed to the functional doctrine of state immunity. Immunity is afforded for acts performed in the exercise of sovereign power (acta de jure imperii), but withdrawn in respect of acts of a commercial or private law nature (acta de jure gestionis). In relation to waiving sovereign immunity, the state is, in most cases, held to have waived this by its express submission to the foreign courts, which however does not arise by the mere agreement in a contract to a choice of court clause.

In alignment with the Supreme Court’s position on state immunity, it could be inferred that the Republic of Cyprus can be a defendant in a number of different proceedings relating to a contract, depending on the circumstances and the precise cause of action the facts give rise to. It does not generally enjoy immunity in relation to civil and commercial disputes. At common law, the state assumes the status of a private person when it is a party to a contract and loses any immunity it may have enjoyed in the course of exercising its public authority. State-owned companies, like the state itself, do not enjoy immunity in contractual claims before the Cypriot courts in civil and commercial matters.

Constitutionally, the Republic of Cyprus can be liable for any wrongful act or omission causing damage, taking place in the exercise or purported exercise of the duties of officers or authorities of the Republic (Article 172, Constitution of the Republic of Cyprus). The state could therefore be sued in the Cypriot courts for any act or omission causing damage to another party, arguably including breach of contract or any dispute arising from a contract that causes damage for which restitution can be pursued at common law and/or by statute.
Conclusion

In response to this comprehensive legal framework, big multinational players have jumped on board, confirming the Cypriot Government’s plans to see potential hydrocarbons reserves being exploited. The outlook for Cyprus’ role as an energy hub in the Mediterranean is highly positive.

Speaking at a conference organised in July 2014 by the European Commission and the Governments of Cyprus and Malta, George Lakkotrypis, the Minister for Energy, Commerce, Industry and Tourism, underlined that “Cyprus, as the southernmost EU member state in a volatile and troubled region, has the potential to become a regional liquefaction hub and contribute to the long-term geopolitical stability, promoting peace and economic development.”

At the same time, the geopolitical significance of Cyprus’ hydrocarbons reserves has also emerged. Apart from having the potential of acting as a catalyst towards reaching a comprehensive solution to the Cyprus problem, exploitation of Cyprus’ hydrocarbons reserves could facilitate wider re-positioning of Cyprus’ role in the region. During his visit to Cyprus in May 2014, US Vice-President Joe Biden underscored the value the US attaches to growing co-operation with Cyprus: “This relationship is now a genuine strategic partnership which holds great promise.”

If exploited, the hydrocarbons reserves in offshore Cyprus and Israel have the potential to substantially reduce Europe’s reliance on Russia for energy supplies.

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Recent transactions
- Acting for Glencore in notification and clearance of a cross-border acquisition.
- Acting for Henkel in notification and clearance of a cross-border acquisition.
- Acting for Bank of Cyprus in commercial litigation.
- Advising the Organisation for Security and Co-operation in Europe on EU law.
- Retained by family and estate of victims in fatal 2011 explosion causing EUR2 billion in damages.

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Professional associations/memberships. Association of International Petroleum Negotiators (AIPN); European Competition Lawyers Forum; Chartered Institute of Arbitrators; British Institute of Comparative and International Law; European Society of International Law; Cyprus Bar Association and the International Bar Association (IBA); Honourable Society of the Inner Temple.

Relevant publications
- Cyprus chapter, Litigation and Dispute Resolution, Global Legal Insights, 3rd and 4th editions (GLG).
- Co-author, Oxford Competition Laws (OUP).
- Cyprus chapter, Merger Control, Global Legal Insights, 3rd ed. (GLG).
- Cyprus chapter, Merger Control, Getting the Deal Through, 2011-2015 (LBR).
- Cyprus chapter, Litigation and Dispute Resolution, ICLG, 2010 (GLG).
- Oil Regulation and Natural Gas, Cyprus Law Digest (2013).