CYPRUS’ DETERMINATION TO BECOME A REGIONAL ENERGY HUB
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Executive Summary

Overview

Substantial amounts of gas under Cyprus’ seabed could turn the island into a regional energy hub that would transform its cash-strapped economy and diversify Europe’s energy portfolio. Building a liquefied natural gas (“LNG”) terminal in the island’s coastal area of Vasiliko is currently Cyprus’ main national project as it could allow the Republic of Cyprus to sell liquefied natural gas to European and East-Asian customers. Cyprus also has the ambition to attract the natural gas in the respective exclusive economic zones (“EEZ”) of Lebanon and Israel for liquefaction and shipping to export markets through the island’s facility. The commercial viability of the multi-billion dollar project is contingent on making important discoveries in Cyprus’ EEZ and/or on the participation of partners that would pool costs with Cyprus and bring the project to fruition.

This paper addresses the key challenges that Cyprus might face in its path to becoming an energy hub. It also highlights the island’s strategic advantages that could play a tremendous role in facilitating the transition. While recent developments may have threatened the progress of Cyprus’ strategic LNG project, Cyprus’ plans remain unchanged as the island is determined to leverage its assets to realise its aspiration of becoming a regional energy hub.

Key Findings

- The downsizing of Cyprus’ Aphrodite field will not discourage further exploratory drilling in Block 12 nor does it eliminate the island’s LNG plan
- Israel’s participation in the LNG project would resolve some of the financial difficulties that may be encountered but Israel’s eventual lack of participation will not cancel the project
- The next two years will be key in determining Cyprus’ hydrocarbon potential
- Successful activities in Cyprus’ EEZ in 2014 and 2015 will accelerate the building of the LNG terminal
- Cypriot officials believe that the involvement of major oil and gas companies in Cyprus (such as Total, Eni-Kogas) increases the chances of the project coming to fruition
- Cyprus’ friendly relations with its neighbours, strong banking system, Common Law jurisdiction, favorable tax regime, robust banking system and its strong professional services constitute solid grounds for the development of Cyprus’ LNG terminal
- Cyprus’ EU membership provides an environment of stability essential for attracting investors and growing the energy industry
Cyprus’ Determination to Become a Regional Energy Hub

I. Introduction

Noble Energy discovers the Aphrodite field in Cyprus’ EEZ

Substantial amounts of gas under Cyprus’ seabed could turn the island into a regional energy hub that would transform its cash-strapped economy and provide Europe with a new source of natural gas.

Eastern Mediterranean gas can contribute to increasing Europe’s energy security and diversifying its energy portfolio.

In late 2011, Noble Energy announced the discovery of the Aphrodite natural gas field in Cyprus’ EEZ and revealed an estimated gross resource range of 5 to 8 trillion cubic feet ("tcf"), with a gross mean of 7 tcf. Noble Energy operates the discovery with a 70 percent working interest; while Delek Drilling and Avner Oil Exploration each hold 15 percent stakes.

The Aphrodite gas field is an offshore gas field off the southern coast of Cyprus located at the exploratory drilling Block 12 in Cyprus’ exclusive economic zone.

Successful exploratory drillings offshore neighbouring Israel encouraged the belief that Aphrodite could indeed hold substantial amounts of gas, but it wasn’t until October 2013 that Noble Energy downsized the field to a range of 3.6 to 6 tcf, with a mean of approximately 5 tcf.

Becoming an energy hub is Cyprus’ strategic goal

Meanwhile, Cyprus had developed ambitious plans. Successfully extracting the natural gas from its waters would allow the cash-strapped island to build an LNG terminal and reach European and East-Asian markets.
An LNG terminal on the island’s coast could also attract the natural gas found in the respective exclusive economic zones of Lebanon and Israel for liquefaction and shipping to export markets through the island’s facility.

The natural gas finds off the island’s shores are also important for Cyprus’ own electricity generation given that natural gas independence would result in substantial reductions in the price of electricity, says George Demetriou, Vice President of the Limassol Chamber of Commerce and Industry responsible for the Services Sector and the spokesman of the Cyprus Chamber of Commerce and Industry on energy matters.

**The downsizing of the Aphrodite field will not affect Cyprus’ plans**

The downsizing of the Lady of Cyprus gas field in Block 12 by Noble Energy raised the question of whether Cyprus will still go ahead with its multi-billion dollar LNG plant, and in the affirmative, if it can proceed without a helping hand from its Eastern Mediterranean neighbours such as Lebanon or Israel.

**Lebanon’s collaboration is too early to discuss**

Lebanon, despite attracting more than 52 companies to its pre-qualification round, has not yet launched its first bidding round and hence has not awarded licences that would allow the country to tap into the hydrocarbon wealth believed to be hidden off its shores.

Recent estimates resulting from seismic surveys indicate that there is a 50% probability that 45% of Lebanese waters could contain up to 96 tcf of natural gas, according to the Lebanese Minister of Energy Gebran Bassil.²

Before such quantities are confirmed and activities commence, Lebanon needs to form a government that would pass two essential decrees (one delimitating the offshore blocks and the second approving the model exploration and production agreement).

**Israel’s collaboration remains uncertain**

Israel, ahead in the game, has not yet formulated an export strategy that would shed light on how it plans to transport and sell the gas in its 10 Tcf Tamar and 18 Tcf Leviathan fields.

Only in October 2013 did Israel confirm its decision to export around 40% of the natural gas found off its shores when its Supreme Court rejected a petition filed against Prime Minister Benjamin Netanyahu’s cabinet June 2013 decision on gas exports.
How the country will choose to direct its gas remains undecided. Pooling costs with Cyprus would increase the island’s chances of concretising its LNG plans in the Vasiliko coastal area of Cyprus located between Larnaca and Limassol, and in a shorter period of time.

The Republic of Cyprus repeatedly urged its Israeli neighbour to opt for an energy collaboration through the island’s facility. While Israel has shown interest in the project, it has not yet dismissed other possibilities, including for example a possible collaboration with Turkey that would involve building a pipeline connecting the Leviathan to Europe. Resumed diplomatic relations between Turkey and Israel render this scenario at least possible.

**Cyprus’ plans remain unchanged**

Israel’s collaboration with Cyprus is still purely hypothetical. Lebanon’s collaboration is too early to examine. The quantities of natural gas encountered today in Cyprus might not justify alone the pursuit of the project. However, things are likely to change in the future.

Noble Energy considered the results of the appraisal drilling in Aphrodite as encouraging further exploration activities within Block 12 of Cyprus’ EEZ. There are good indications from recent seismic surveys that two other fields in Block 12 could hold 2 Tcf each.

Noble Energy, Delek Drilling and Avner Exploration plan to start exploration drilling at one of these fields in Q4 2014, says Giorgos Shammas, Chairman of the Cyprus Energy Regulatory Authority. The island is determined to leverage its strategic assets to the benefit of its national energy project.
II. **Cyprus’ strategic advantages as an energy hub**

**Cyprus has international oil and gas companies interested in its project**

In June 2013, Cyprus signed a Memorandum of Understanding (“MOU”) with Houston-based Noble Energy International, Israel’s Delek Drilling and Avner Oil, launching talks for the construction of a liquefied natural gas terminal on the island to tap vast reserves in the Eastern Mediterranean.

In November 2013, Cyprus also signed an MOU with France’s Total on the feasibility of participating in an LNG project on the island. Eni’s CEO Paolo Scaroni also revealed the Italian company’s interest in eventually participating in the LNG project should its exploration activities off the shores of the island prove successful.

The government of Cyprus has issued exploration licenses for Blocks 10 and 11 to Total and for blocks 2, 3 and 9 to the Eni-KOGAS consortium.

Eni/Kogas plans to commence exploration drilling in late 2014, and completion is scheduled by mid-2015. Total scheduled its exploration drilling in Q1 2015. Should they encounter substantial amounts of gas under the island’s seabed, the companies will build further trains in Cyprus’ LNG terminal for exports.

Cypriot officials are however determined to bring the project to fruition in the shortest delay motivated by strategic advantages that put Cyprus in a favorable position compared to its Eastern Mediterranean neighbours.

The recent negative developments - the downsizing of Aphrodite and Israel’s alternative solutions - might impact the LNG project in terms of timing, but will not change the government of Cyprus’ firm determination to turn Cyprus into an energy hub, says Shammas.

The prospects of Cyprus’ EEZ and the Levantine basin are excellent and indicate a strong likelihood of encountering additional reserves, adds Shammas. Cyprus will take advantage of its strong assets to embrace its new energy industry and transform its economy.
Cyprus has good relations with its neighbours

Liquefied natural gas has the advantage of flexibility in transportation. LNG commercialisation is usually the preferred path as it offers the producer the freedom to choose the export market without transportation obstacles.

Noble Energy has recently announced that Israel plans to start exporting to immediate neighbours - Jordan, Egypt and the Palestinian Authority - before considering further markets.

Such an endeavour would eliminate the problem of export routes and would take advantage of the current energy crises hitting Egypt and Jordan putting the two countries in situations of energy vulnerability.

Like Jordan, Israel was historically dependent on Egypt for its domestic natural gas consumption. The natural gas finds off the shores of Israel did not come a moment too early given that not only did Egypt stop supplying Israel with natural gas in the aftermath of the Arab Spring that toppled Husni Mubarak in 2011, but it also reduced its supplies to Jordan.

Egypt itself is currently suffering from its own gas shortfalls due to a growing population and export obligations. Needless to say that Israel’s history of tensed relations with its Arab neighbours puts it in a vulnerable situation and could justify Israel’s quest to diversify its export destinations.

Cyprus has historically had friendly relations with both its Arab neighbours and Israel and could for that reason be an attractive destination for Israeli gas. Israel could use the LNG facility in Vasiliko to process and transport its gas and reach European and/or Asian markets where prices are lucrative and achieve export diversification, said a senior Cypriot government official.

Cypriot gas could play a key role in restoring peace and stability in the region, added the official. The island played a leading role in regional bilateral agreements and could play in the future an important role in facilitating regional alliances.
Investors require certainty and clarity to invest. Companies require stability to operate as they do not only invest in natural gas but also in peace, added the senior Cypriot government official.

Cyprus’ friendly relations with its surroundings allowed for successful completion of regional maritime agreements.

A maritime border agreement was signed between Cyprus and Lebanon in 2007. The agreement was ratified by Cyprus but it was not ratified by the Lebanese Parliament.

Cyprus and Israel signed the third delimitation agreement in December 2010 based on the principle of equidistance.

Israel and Lebanon have not reached an agreement on their maritime borders given that the two countries are in a state of war and Lebanon does not recognize the state of Israel.

In 2010, Lebanon unilaterally submitted to the UN a chart of geographical coordinates defining the western, northern and southern limits of its exclusive economic zone.

In 2011, Lebanon contested the Israeli-Cypriot agreement arguing that it conflicts with Lebanon’s EEZ. To avoid a tacit acceptance of Lebanon’s unilateral delimitation of borders, Israel submitted in July 2011 its position on the delimitation of borders between the two countries. The conflict is still pending and the disputed territory is equivalent to approximately 850 square kilometers.

Americans have recently attempted to mediate between the two countries and significant progress has been achieved according to the Lebanese Minister of Energy. Cyprus, with its clear interest in defining a clear border between the three countries to attract investors and promote joint exploration ventures can be part of a success story.

In addition to delimitation, Cyprus is currently leading efforts to sign a unitization agreement with Lebanon that would set out the principles according to which common reservoirs crossing the maritime borders between the two countries would be split.

Cyprus and Lebanon maintain excellent relations and the last few months were marked by the recent visit of the Lebanese Minister of Energy to his Cypriot counterpart in Nicosia in an effort to move things forward, assures Shammas.

Despite pending maritime border issues, Cypriot officials believe that natural gas will bring cooperation and prosperity to the region and that companies should not fear to participate in the Eastern Mediterranean path towards energy production given that the blocks awarded in Cyprus’ EEZ are located in uncontested areas of Cyprus’ waters, assures the senior Cypriot government official.
Cyprus is a Common Law jurisdiction

Cyprus has a well-functioning common law legal system based on principles established through historical links with the United Kingdom. The familiarity of the legal and commercial systems assists international business people in working within the Cypriot commercial environment. English is spoken universally and is the accepted language of business.

Cyprus being a common law jurisdiction plays a major role in attracting investors. Common law gives strong respect for precedent allowing consistency and prediction, both important elements in commercial transactions. In common law systems, judicial cases are regarded as the most important source of law. Judges abide by precedents allowing parties to reasonably predict whether a certain action is lawful or unlawful. Common law is usually the system of choice when it comes to international commercial transactions, which puts Cyprus in an advantageous position.

Additionally, access to foreign entities is facilitated given that it is Cyprus’ policy to welcome the presence of international oil and gas companies, says Christos Mavrellis, vice chairman of the board of directors of CIPA (Cyprus Investment Promotion Agency) and senior partner of Chrysses Demetriades & Co Law Office.

Cyprus has a favorable tax regime

Cyprus has become a favored location for international commerce as well as for reputable multinationals seeking a legitimate tax efficient jurisdiction raising Cyprus to a new level of international business.

Cyprus has all the tax attributes expected from an international financial center: its tax legislation is predictable and straightforward. Relations between the business community and the tax authorities are excellent and efficient. The transparency of the tax system enhances Cyprus’ competitiveness and contributes in making Cyprus a jurisdiction of choice for international operations. Cyprus has a corporate income tax rate of 12.5%, which is the lowest corporate tax rate in the European Union.

Moreover, dividend income is exempt from tax irrespective of its source provided that the company paying the dividend either engages directly or indirectly in more than 50% of activities that give rise to non-investment income or the tax burden on the dividend paying company’s income is not lower than 6.25% explains Mavrellis. Additionally, dividends paid to non-resident shareholders are exempt from withholding tax in Cyprus.

Another important point to add is the wide network of tax treaties between Cyprus and more than 50 countries including countries in North America, Western and Eastern Europe.
Generally, most treaties provide for reduced or nil rates of withholding tax on dividends, interest and royalties paid from the treaty country and the avoidance of double taxation in the case where a resident in one of the treaty countries derives income from the other treaty country. The tax system in Cyprus raises the country to a new level of international business that will substantially contribute in facilitating the island’s path towards becoming an energy hub.

**Cyprus is a member of the European Union**

Cyprus joined the European Union in 2004, resulting in an economy offering a great number of advantages within a common European market. Reputation and stability are the main advantages deriving from Cyprus’ membership. The Euro was adopted by Cyprus as its unit of currency on 1 January 2008, further confirming the country’s macroeconomic stability and its commitment to low inflation, low interest rates and high growth.

Cyprus participates in the European Union’s internal market where there is free movement of goods, services and capital. European citizens are able to conduct business, travel to, and live in Cyprus with no legal restrictions. Demonstrating a stable financial and business-friendly environment since the 1970s, Cyprus has attracted foreign investment and capital flows for decades.

The country’s financial and regulatory environment is harmonized with that of the European Union and the Cyprus tax system is aligned with European principles of equality within the framework of the European Union.

Cyprus at the gateway between Europe and the rest of the world will also allow the Eastern Mediterranean region to fulfill the EU’s additional gas needs, ensure its security of supply and provide it with an additional source of natural gas, hence contributing in diversifying Europe’s energy portfolio.

**Cyprus has a strong banking system**

Cyprus was severely hit by the Eurozone crisis and its banking sector was seriously impacted by the outcome of the Troika deal and the winding down of Laiki Bank.

Cyprus is currently undergoing a restructuring process launched in March 2013. Cypriots are however confident that the outcome will only benefit Cyprus and will result in a stronger banking sector that will serve the interests of businesses and individuals with interests in Cyprus.
In the second review since the bailout\textsuperscript{4}, and in a press release dated 20 December 2013, the IMF approved the disbursement of €83.5 million and said that the Cypriot authorities have made a “full and timely implementation of the adjustment program, as well as broad public support, is therefore crucial to restore confidence and growth. [...] Considerable progress has been made in stabilizing the financial sector.”

Cyprus retains core strengths in financial services and is considered a centre of excellence for the management and administration of funds and as a location of choice for foreign exchange companies.

Commercial banking in Cyprus follows the British and European Union models and is of a very high standard. Over 40 Cypriot and international banks operate in Cyprus. The banking system conforms to EC directives under the regulation of the constitutionally independent Central Bank of Cyprus as integrated with the Eurosystem.

Cyprus does not depend on its natural gas wealth for the repayment of its debt, explains Demetriou. Demetriou believes that Cyprus’ economy will be able to stand on its feet regardless of the hydrocarbon under its seabed. He adds that Cyprus is currently working simultaneously on two strategic national goals: the first is restoring the Cyprus economy and recovering from the crisis and the second is professionally developing the natural gas industry that can turn Cyprus into a major natural gas producer.

Mavrellis explains that oil and gas explorations mean a lot to a small economy like Cyprus. Bringing this new hydrocarbon wealth to the surface will create thousands of employment opportunities, he adds, and the government plans to create a fund that will ensure that the benefits are saved for future generations.

**Cyprus offers strong legal and professional services**

Cyprus’ ancillary industry creates the ideal environment for the development of the energy industry. Cyprus has an excellent multi-lingual workforce that will no doubt contribute in ensuring the natural gas industry operates at a high level of excellence and professionalism.

Cyprus has over 2,500 lawyers who can act as both solicitors and barristers and 4,000 certified accountants and auditors, mostly UK educated and certified, according to the Institute of Certified Public Accountants of Cyprus (ICPAC). Additionally, Cyprus has a few thousand fiduciary services professionals/ancillary services providers.
Major companies elect Cyprus as their place of incorporation

Major projects are already ongoing and contribute in Cyprus’ transformation from being solely a touristic destination to becoming a regional energy hub. One of the most important projects taking place in the island is the building of an oil storage terminal by VTT Vasiliko\(^5\) that is expected to transform Cyprus into an oil storing and trading hub.

The project will no doubt yield substantial financial benefits for the island. It will contribute with capital injections to the Cypriot economy (over €18 million of yearly revenues through tax, duties and port fees) and it will have multiple positive effects to the wider society; from jobs created (over 500 jobs during construction and over 40 jobs once operational in Q1 2014) to the reduction of fuel costs due to the increased competition.

Therefore it should strengthen international confidence in Cyprus for foreign investments and business activities. The investment is in the order of €300 million, which is about 1.7% of the GDP in Cyprus.

The fact a major company with international presence chose Cyprus as a place of incorporation is no coincidence, explains George Papanastasiou, Managing Director for VTT Vasiliko Ltd, a subsidiary to VTTI.

Cyprus is strategically located, a member of the EU, has a deep sea water close to shore to accommodate large ships, a modern economy and a highly educated and English-speaking workforce adds Papanastasiou. Such a project consolidates Cyprus’ holistic effort to become an energy bridge and a major regional energy hub.

Cyprus is an ideal place to live

Cyprus’ attractiveness extends beyond technicalities. The island of Cyprus offers a great quality of life, a high level of health service, long hours of sunshine and schools in foreign languages allowing foreign employees to embrace the life on the island, say George Demetriou and Christos Mavrellis.
III. Conclusions

Cyprus has a new learning curve to embrace and a lot of efforts to invest in order to achieve its strategic and national ambition of becoming a regional energy hub.

Such a transition is a real challenge for a country that is new to the energy game and the challenge is further complicated by peculiar geopolitics, warns Dr. Christodoulos Pelaghias, Managing Partner of Pelaghias LLC.

Cyprus needs to leverage its good relations with its neighbours and undertake a thorough assessment of how the international energy business works in order to succeed in its plan to monetize its riches and transform its economy, adds Pelaghias.

There is however no doubt that the island will overcome the various obstacles encountered and use its hydrocarbon blessing not only to the benefit of its economy and its people but also to restore peace and stability in the region and create an atmosphere of positivity and cooperation that will boost the whole Eastern Mediterranean region and resolve current geopolitical deadlocks.

Endnotes and References