



**CROATIAN ENERGY
REGULATORY AGENCY**
Ulica grada Vukovara 14
10000 Zagreb, Croatia

Classification: 310-05/16-02/57
Registry number: 371-06/16-18
Zagreb, 2 November 2016

LNG HRVATSKA d.o.o.
Savska cesta 88a
10000 Zagreb

SUBJECT: Coordinated decision on the allocation of investment costs regarding the Investment request for LNG terminal on the island of Krk

Dear Mr. Antunović,

Based on the Investment request for the project of LNG Terminal on the island of Krk in Croatia submitted on 9 July 2016, pursuant to Article 12(3) of Regulation (EU) No 347/2013 of the European Parliament and of the Council of 17 April 2013 on guidelines for trans-European energy infrastructure and repealing Decision No 1364/2006/EC and amending Regulations (EC) No 713/2009, (EC) No. 714/2009 and (EC) No 715/2009 (hereinafter: Regulation (EU) No 347/2013), we are informing you on the outcomes of the consultations between national regulatory authorities concerned and on the coordinated decision on the allocation of investment costs, as follows.

The LNG terminal project on the island of Krk is one of the strategic energy projects of the Republic of Croatia and also a project of common interest for the European Union. With its geographical location and planned capacity the LNG Terminal is intended for the supply of natural gas to several countries, primarily to countries of Central-East and South Eastern Europe. Given that these countries are highly dependent on natural gas supply from Russia, supply of natural gas from the LNG Terminal will represent one of the key alternatives of supply.

As stated in the cost-benefit analyses being part of the Investment request, both the financial and the economic profitability of the project was determined, based on the identified costs and benefits. The financial profitability of the project is of utmost importance for future owners and investors into the project whilst the economic profitability is important for the society in general.

Financial profitability of the project was determined by the revenue and expenditures assessment. Revenue was assessed based on the expected level of LNG Terminal service use and the relating tariffs, whilst costs have been assessed based on the analysis conducted of the operative, administrative and other processes which will take place during the LNG Terminal operation. The level of terminal service use was assessed during market research, i.e. the Open Season procedure and the final expression of interest was gathered. Final level of the LNG Terminal service use will be known after signing the Terminal Use Agreement.

Economic profitability of the project was determined by the cost-benefit analysis. Project benefits were assessed following the principle of avoiding costs for the wider social community. The identified benefits that social community will have from the construction of the LNG Terminal are saved cost of natural gas supply, saved cost of gas supply disruption and monetary flow.

Considering that the LNG Terminal will have a considerable cross-border impact, benefits for wider community have been assessed separately for each of the countries included in the analysis.

Construction of the LNG Terminal will contribute to achievement of European energy objectives and in particular to:

- further market integration and enhanced competitiveness in the natural gas market, and
- security of gas supply in the region.

Pursuant to Article 12(5) of Regulation (EU) No 347/2013, Croatian Energy Regulatory Agency (hereinafter: HERA) provides detailed information as the basis on which costs were allocated among Croatia and Hungary.

1. An evaluation of the identified impacts, including concerning network tariffs

By detailed cost-benefit analysis being part of the Investment request it has been calculated that the allowed tariff would amount to 3.95 EUR/MWh if the regulatory account were applied for the first 2 regulatory periods (3+5 years), taking into account the amount of gas for the LNG terminal resulting from the conducted Open Season procedure. The regulatory account allows for a possibility of setting the affordable tariff throughout the determined period.

However, taking into account that affordable costs relating to the LNG terminal services have been identified as the maximum infrastructure costs which the future LNG terminal users are ready to bear in order to utilize the option of an alternative gas supply, CBA analysis resulted with an affordable tariff of 2.44 EUR/MWh of natural gas delivered to the transmission system.

HERA considers aforementioned calculation as appropriate and notes that higher tariff than the affordable is not sustainable, and therefore any financial gap for the project to be sustainable should be covered by the financial support from the Connecting Europe Facility.

2. An evaluation of the business plan referred to in paragraph 3(b)

Business plan as a part of the Investment request provides detailed description of the process of development of the LNG terminal. It also gives analysis of regional gas markets and their development regarding results of conducted market test and future development of the LNG terminal. Furthermore, the business plan evaluates financial aspects for the project development, as addition to the CBA analysis. HERA considers the information and data contained in the business plan as being valid and justified.

3. Regional or Union-wide positive externalities, which the project would generate

In CBA analysis it has been calculated that total net benefits of the project are approximately 2.3 billion EUR, with the sharing among EU countries as follows: Croatia 77.6%, Hungary

15.0%, Austria 5.0% and Slovenia 2.4%. Therefore, following the ACER Recommendation No 5/2015, Croatia and Hungary are the only net beneficiary EU countries for which Cross-Border Cost Allocation has been submitted.

Furthermore, the project of LNG terminal on island Krk, as a part of the European gas corridor North-South, increases diversification of sources for gas supply in the region and other EU Member States. Furthermore, it significantly increases the security of gas supply in case of disruption, as well as N-1 criteria at the regional level. The project also contributes to the integration of gas markets through the reduction of congestion and increases the commercial viability by reducing CO₂ emission.

4. The result of the consultation of the project promoters concerned

Project promoter conducted consultations and meetings with concerned TSOs in the process of preparing the Investment request, as reported in detail in the submitted Investment request. Also, upon receiving the Investment request HERA and Hungarian Energy and Public Utility Regulatory Authority (MEKH) held joint consultations and the meeting was held on 26 September 2016 in Zagreb including the project promotor in the second part of meeting, where all relevant issues were discussed and clarified. Finally, as the outcome of the consultations and the meeting, it has been mutually agreed between HERA and MEKH that all costs are to be allocated to Croatia and no costs are to be allocated to Hungary. Accordingly, HERA and MEKH have jointly signed a "Statement about agreement on Cross-Border Cost Allocation for LNG Terminal on the island of Krk" (attached).

From the given results of the CBA analysis it has been concluded that resulting net benefits from the project for Croatia as the hosting country are higher than the costs of the project, so it has been mutually agreed among HERA and MEKH that there are no compensations required and that all costs are to be allocated to Croatia and no costs are to be allocated to Hungary.

However, in order to make the project of LNG Terminal on the island of Krk in Croatia sustainable, HERA considers the coverage of the determined financial gap by the financial support from the Connecting Europe Facility as the crucial step in the whole process, considering the project is commercially not viable and at the same time provides significant positive externalities in the region and other EU Member States.

With best regards,



Attachment:

"Statement about agreement on Cross-Border Cost Allocation for LNG Terminal on the island of Krk"