The Legal 500 Country Comparative Guides

Croatia

ENERGY - OIL & GAS

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This country-specific Q&A provides an overview of energy - oil & gas laws and regulations applicable in Croatia.

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1. Does your jurisdiction have an established upstream oil and gas industry? What are the current production levels and what are the oil and gas reserve levels?

Both oil and natural gas are produced in Croatia, though not in significant amounts, and therefore the country is largely dependent on the import of these commodities.

The latest official data available from the Croatian Institute of Statistics is for the year 2018, and shows production levels of 732,000 tones of crude oil, 216,000 tones of LPG, and 1,230,106 m³ of natural gas.

The Hydrocarbon Agency estimates gas reserves to be around 1.3 trillion cubic feet in the northern Adriatic region. IHS Markit reports a possibility of natural oil reserves amounting to around 65 MMboe, most of which are unexplored.

2. How are rights to explore and exploit oil and gas resources granted? Please provide a brief overview of the structure of the regulatory regime for upstream oil and gas. Is the regime the same for both onshore and offshore?

The Act on the Exploration and Production of Hydrocarbons governs exploration and production of oil and gas resources in Croatia (the Hydrocarbons Act).

The exploration of hydrocarbons can be performed exclusively based on a Licence for the Exploration and Production of Hydrocarbons (the Licence) and an Agreement on the Exploration and Production of Hydrocarbons (the AEPH). The production of hydrocarbons can be performed based on an AEPH and a special Licence for Hydrocarbons Production, or based on an existing right to the production.

In general, the Licence is issued and AEPH is concluded based on a tendering procedure. Exceptionally, no tendering procedure is needed in case of issue of licences for the areas included in previous tendering procedures and for relinquished areas.

The tendering procedure for issuing of the Licences begins by adoption of the Government decision to tender, based on a proposal of the Hydrocarbon Agency received via the ministry competent for energy (the Ministry). A tender notice is published in the Official Gazette of the Republic of Croatia and the Official Journal of the European Union at least 90 days before the expiry of the deadline for the delivery of tenders. The tender notice contains information regarding the blocks available for the tendering procedure, an indicative date or deadline for issue of Licence, as well as criteria for the selection of tenderers.

The Hydrocarbon Agency carries out preparatory activities, drafts tender specifications and organizes presentations for investors. The tender specifications prescribe in detail the documents that need to be submitted to demonstrate financial, legal and technical capacity of the tenderers, payment of tendering security, grounds for excluding participants from the tendering procedure, etc.

Criteria for selection of the most favourable tenderer are:

- technical, financial and professional capacities of the tenderer or the consortium of tenderers,
- the manner in which the tenderer or the consortium plan to carry out the activities of production and exploration,
- overall quality of the submitted tender,
- financial conditions submitted by the tenderer,
- any lack of efficiency or responsibility in any form which has been displayed in other countries in previous activities.

The Commission opens, examines and evaluates the tenders and carries out all other relevant activities necessary for making a proposal to the Government for issuing of a Licence to selected tenderers.
Commission also negotiates with the selected tenderers on the terms of the AEPH.

In regard to offshore exploration and production, before issuance of a Licence, the Government may consult with the Coordinating Authority determined pursuant to the regulation governing the safety of offshore exploration and production of hydrocarbons. The Offshore Exploration and Exploitation of Hydrocarbons Safety Act specifies additional criteria for determination of technical and financial capacity of tenderers, participation of interested public, safety measures, etc.

Selected tenderers are issued a Licence by the Government. A separate Licence is issued for each individual exploration block (onshore or offshore). The AEPH must be concluded within 6 months from issuance of the Licence.

The Licence is granted for a period of up to 30 years, which includes the exploration period and the production period. Upon fulfilment of certain conditions, investors that obtained a Licence and concluded an AEPH are automatically granted the Licence for Hydrocarbons Production by Government decision.

4. What are the key features of the licence/production sharing contract/concession/other pursuant to which oil and gas companies undertake oil and gas exploration and exploitation?

There are two types of the AEPH which can be concluded pursuant to the Hydrocarbons Act, a Production Sharing Agreement (the PSA) and an Agreement on the Production of Hydrocarbons.

The PSA is concluded between the Government and an investor after the issuance of the Licence in accordance with the Hydrocarbons Act. From the total quantity of recovered hydrocarbons the quantity corresponding to the value of the royalty and to the investor’s exploration and production costs are deducted. The agreement determines the division of the remaining quantities.

The Agreement on the Production of Hydrocarbons is concluded between the Government and an investor after the issuance of the Licence, or, in relation to an existing right, between the Ministry and an investor. Under such an agreement, the investor undertakes an obligation to pay a fee for the recovered quantities of hydrocarbons and is entitled to the total production of hydrocarbons.

The Hydrocarbon Agency prepares a first draft of the AEPH as part of the tender specifications, pursuant to the template agreement constituting Annex I of the Hydrocarbons Act. The template agreement is the PSA. The tenderers must agree to the material provisions of the PSA and suggest any amendments thereto in their tender.

Mandatory content of the AEPH is set out in the Hydrocarbons Act and includes: duration of exploration work and exploration phases, minimum work and expenditure obligations, rights and obligations regarding relinquishment, decommissioning plan and obligation to set up a decommissioning fund, obligations regarding H&S measures, dispute settlement provisions, etc. The PSA must contain additional provisions regarding the title to produced hydrocarbons, measuring of the produced quantities, the possibility of supplying the local market, cost recovery, royalties, etc.

4. Are there any unconventional hydrocarbon resources (such as shale gas) being exploited and is there a separate regulatory regime for unconventionals?

There is no special regulatory regime for unconventional hydrocarbon resources. No unconventional resources are currently being exploited.

5. Who are the key regulators for the upstream oil and gas industry?

The key regulators of the oil and gas industry are the Government, the Ministry, the Hydrocarbons Agency and the Croatian Energy Regulatory Agency.

Besides its political influence on the oil and gas sector and its regulation, the Government issues licences for the exploration and exploitation of oil and gas. The Government can also directly proscribe procedures, fees and market tariffs by issuing executive orders.

The Ministry drafts and gives suggestions of laws and other regulation in the oil and gas sector, as well as decisions on the approvals and selection of the most favourable tenderer for exploration and exploitation projects, enters into contracts for the exploitation of hydrocarbons with investors (in the Government’s name), and keeps records of various data relevant for this sector, inspects ongoing projects and undertakes other activities as required by the law.

The Hydrocarbons Agency monitors investors’ compliance with the terms of their exploration and exploitation contracts and contributes to the overall advancement of the hydrocarbons sector by
implementing best practices, reporting to the European Commission and advises the Ministry in any issues related to the regulation of hydrocarbons.

The Croatian Energy Regulatory Agency is an independent market regulator whose main purpose is to oversee all energy subjects on the Croatian market, from the point of their inception all through their operation and market presence, while also providing its input about energy regulatory matters to the Government and the Ministry and preparing an overall energy market annual report to the Croatian Parliament.

6. Is the government directly involved in the upstream oil and gas industry? Is there a government-owned oil and gas company?

Croatia has a 44.84% stake in what used to be the national oil company, INA d.d., in which the Hungarian MOL Group now holds a 49.08% stake. All of the crude oil produced in Croatia was produced by INA d.d.

INA d.d. is also the only entity in Croatia currently registered for the energy activity of production of natural gas.

The Government is otherwise directly involved in the upstream oil and gas industry as a party to agreements for the exploration and shared exploitation of hydrocarbons, which all investors interested in exploring and exploiting hydrocarbons on Croatian territory enter into.

7. Are there any special requirements for or restrictions on participation in the upstream oil and gas industry by foreign oil and gas companies?

Foreign oil and gas companies may participate in the upstream oil and gas industry under the same conditions and circumstances as domestic companies. However, the Ministry may decide to reject an investor seeking an oil or gas exploration or exploitation permit if the investor is owned by third countries or individuals from third countries (meaning non-EU countries) on the basis of national security concerns.

8. What are the key features of the environmental and health and safety regime that applies to upstream oil and gas activities?

Special evaluations, assessing the environmental impact of the planned exploration or exploitation of hydrocarbons must be made and approved. High health, safety and environmental standards are expected and enforced in building and maintaining of oil and gas fields and rigs, with mandatory participation of qualified personnel accredited by the Ministry. Croatia’s regular OSHA regime applies to workers on oil and gas rigs, specifically the more rigorous subset of rules, which refers to workers dealing with dangerous equipment and substances. These regulatory requirements are on par with EU standards.

9. How does the government derive value from oil and gas resources (royalties/production sharing/taxes)? Are there any special tax deductions or incentives offered?

The investor pays a fee for the exploration and production of hydrocarbons which may consist of a monetary fee and of a share of the produced hydrocarbons.

The monetary fee consists of different fees and royalties (for the exploration block, for the determined exploitation field area, for the conclusion of the Agreement on the Exploration and Production of Hydrocarbons, for the produced quantities, for the realized hydrocarbon production and for administrative costs). The criteria for determination of the fees and some of the fees are specified in the Regulation on Fees for Exploration and Production of Hydrocarbons.

The Republic of Croatia may also receive a share of the produced hydrocarbons.

According to the template PSA, royalties are calculated on a monthly basis as a percentage of the value of all recovered petroleum. The investor may sell that petroleum to fulfill its obligation to pay the royalty. Also, under the PSA, the recovery of investor’s costs has a cost recovery ceiling.

Tax deductions or incentives may be offered to the investors pursuant to tax legislations.

10. Are there any restrictions on export, local content obligations or domestic supply obligations?

Under the Hydrocarbons Act, the Republic of Croatia has a pre-emption right to purchase the produced hydrocarbons owned by an investor based on market conditions. The current template of the PSA provides for
such obligation only in case of natural gas production.

If the hydrocarbons available to the Republic of Croatia are not sufficient for meeting the demand of domestic market, the investor shall be obliged, based on a decision of the Government, to sell to Republic of Croatia the produced hydrocarbons belonging to the investor unless they were already sold by previously concluded contracts.

According to the Croatian Energy Act, in case of a market disturbance due to an unexpected or continuous energy shortage, direct jeopardy to the independence or unity of the state as well as large natural disasters or technological catastrophes (situations of crisis) the Government may enact measures restricting or imposing special requirements regarding the import and export of energy, which includes produced hydrocarbons, mandating delivery of energy to certain buyers, imposing special restriction on certain energy activities, etc.

Under the template PSA, in case of war, possibility of war or grave national emergency, the Government may request in writing all or a part of the crude oil and natural gas produced from the exploitation field(s) and require the investor to increase such production to the extent required.

As to the local content obligations, the template PSA provides that, subject to applicable law, the investor and its subcontractors shall give preference to: i) employment of Croatian and EU workers having necessary skills and competences, and ii) to Croatian and EU companies for their goods, works and services if they can provide them under equivalent conditions in terms of price, quantity, quality, etc.

11. Does the regulatory regime include any specific decommissioning obligations?

The investor has the obligations:

- to provide appropriate security for decommissioning during the research phase, as determined in the AEPH, and
- to prepare a detailed decommissioning plan during the production phase and to establish a decommissioning fund.

After the completion of petroleum operations, the investor has the obligation to decommission the exploration block or exploitation field in accordance with the Hydrocarbons Act, special H&S regulations, international good oilfield practices and to inform the petroleum and environmental protection inspections thereof.

12. What is the regulatory regime that applies to the construction and operation of offshore and onshore oil and gas pipelines?

Existing offshore and onshore oil and gas pipelines are owned and operated by state-owned entities, JANAF d.d. as the oil pipeline operator, and PLINACRO d.o.o. as the gas pipeline operator.

The construction, maintenance and operation of energy infrastructure is part of the National Strategy of Energy Development and the Program for its implementation. The construction of new pipelines is further subject to licensing, issuing of building and location permits, ecological impact assessments, as well as legislation concerning property rights and expropriation, amongst others. Offshore pipelines also have to consider the regulation of maritime domains.

Pipeline operators have to provide energy market subjects access to the pipelines in a fair, open market manner and under non-discriminatory terms and are charged with the maintenance of the pipelines.

13. What is the regulatory regime that applies to LNG liquefaction and LNG
receiving terminals? Are there any such terminals in your jurisdiction?

The regulatory regime that applies to LNG liquefaction and LNG receiving terminals is primarily designated by the Gas Market Act, Act on the Liquid Natural Gas Terminal and the Rules of Usage of the LNG terminal.

In the Republic of Croatia there are no operating LNG terminals at the moment. The first (floating) LNG terminal is currently being developed on the island of Krk.

The LNG terminal has the purpose to secure energy needs and increase security of gas supply through the provision of new gas supply route for the countries of Central and South-East Europe. The terminal is planned to begin with operation on 1 January 2021.

Development and construction of the LNG terminal is supported by the European Union by the contribution of EUR 101.4 million from the Connecting Europe Facility, which is centrally managed by the European Commission through the Innovation and Networks Executive Agency (INEA). The overall costs of the project are estimated to EUR 233.6 million and are to be financed by direct financial contribution of EUR 100 million from the Croatian state budget and a direct equity contribution of EUR 32.2 million from the LNG terminal company shareholders.

14. What is the regulatory regime that applies to gas storage (not LNG)? Are there any gas storage facilities in your jurisdiction?

In the Republic of Croatia there is one gas storage system - gas storage Okoli, located some 60 km from Zagreb. Gas storage system is operated by the indirectly state-owned operator, company Underground gas storage Ltd.

The functioning of the gas storage and the work of the operator are regulated by the Gas Market Act, Rules of Use of the Gas Storage System and certain other energy rules and procedures.

Rules of Use of the Gas Storage System regulate the reservation and capacity usage procedure, nomination of usage of the storage, trading with the storage capacities, services of storage system operator and general terms and conditions for the use of the storage.

The storage has an operating volume of 5 050 000 000 kWh and serves as a seasonal storage facility where the technological process is carried out in two cycles: injection cycle from April until September and withdrawal cycle from October until March. The operating volume of the standard bundled unit (SBU) is determined in the amount of 50 GWh i.e. 50 000 000 kWh.

According to the current legislative framework, the storage system operator has to allocate appropriate amount of SBUs for the public service supply. At the moment, 60% of the gas storage capacities are held by state-owned HEP d.d., acting as a wholesale gas supplier.

15. Is there a gas transmission and distribution system in your jurisdiction? How is gas distribution and transmission infrastructure owned and regulated? Is there a third party access regime?

In the Republic of Croatia there is one sole transmission system operator and around 30 distribution system operators. Transmission and distribution systems are systems owned by and/or managed by the system operators.

Gas transmission system operator Plinacro Ltd. is fully state-owned and it is in charge for transmission and transit of natural gas, management (supervision and direction), maintenance, development and construction of the gas transmission system, as well as for enabling non-discriminatory access to the transmission system (when it is financially, technically and technologically reasonable and justified), balancing the amount of gas in the transmission system, and connecting with other gas systems.

Gas distribution system operators are responsible for functioning, maintenance, and development of a distribution system on certain designated area. Distribution system operators are also responsible for connecting of the respective distribution system with other systems and ensuring the long-term capability of the system to meet the reasonable needs for gas distribution.

Gas transmission and gas distribution are so-called regulated energy activities (as opposed to market energy activities).

Gas distribution and distribution system construction are awarded as concessions for the territory of certain local or regional municipalities by the competent authority of a municipality.
In principle, transmission and distribution system operator are obliged to provide efficient and non-discriminatory third-party access to the system.

**16. Is there a competitive and privatised downstream gas market or is gas supplied to end-customers by one or more incumbent/government-owned suppliers? Can customers choose their supplier?**

In the past couple of years downstream gas market has been liberalised. Currently, both incumbent suppliers and a few new suppliers are present at the market. Customers may freely choose their supplier.

Notwithstanding the liberalisation, the Gas Market Act also recognizes a special category of end customers - households, that enjoy a special regime under which the gas supply is made. Pursuant to the Gas Market Act, households have the right of gas supply under regulated conditions by the public service suppliers. Those regulated conditions relate to the price under which the households have the right to purchase gas from the public service suppliers and the fact that the public service suppliers can not refuse to supply these customers.

In order to enable the provision of public service gas supply, the Gas Market Act provides for the obligation of the wholesale gas supplier to offer gas supply at the wholesale level to public service suppliers at a regulated price. According to current legal framework, the wholesale gas supplier shall continue to offer supply to public service suppliers until 31 March 2021.

**17. How is the downstream gas market regulated?**

The Croatian gas market is organized pursuant to the Energy Act, the Regulation of Energy Activities, the Gas Market Act, and secondary legislation arising from the Gas Market Act. Responsibility of gas market stakeholders is established according to the balance group model.

Gas market is characterized by continued market opening and further improvement of existing by-laws.

Considering that the price of gas for household customers is still regulated, the retail gas market for households is hindered, with only limited gas suppliers offering market-based (unregulated) gas supply contracts to households.

The retail market for business customers is liberalized in terms that business customers are entitled to choose their supplier and can freely negotiate the price and other terms of gas supply. Rules set out by the regulator that prescribe mandatory minimal content of the gas supply agreements apply equally to all market participants.

Opening of the retail market business customers caused a number of questions in relation to the permitted market behaviour of the suppliers (complaints concerning the behaviour of market participants, complaints regarding the supplier switching procedure, etc.). Therefore, the work and positioning of the regulator towards such questions and problems is of key importance for future development and functioning of this market segment.

**18. Have there been any significant recent changes in government policy and regulation in relation to the oil and gas industry?**

Recent regulatory developments in the natural gas industry and market relate primarily to the development of the LNG terminal project.

While the state and its competent authorities have shown perseverance and determination to finish the project of LNG terminal, first round in the open season proceedings resulted with negative economic test. As a consequence thereof, the planned capacity of the FSRU ship has been decreased to correspond to the market situation in Croatia and the region.

The Gas Market Act provides that the function of the wholesale gas market supplier – supplier of the public service gas suppliers, would be abolished after 31 March 2021. Also, as of that date the public service gas supply would be performed by public service suppliers selected on public tenders. It is expected that the new framework will contribute to the opening of market for household supply. However, it remains to be seen if such deregulation will be postponed again.

**19. What key challenges have been identified by the government and/or industry in relation to your jurisdiction’s oil and gas industry? In this context, has the Covid-19 pandemic had an impact on the oil and gas industry and if so, how has the government and/or industry responded to it?**
The upstream oil and gas industry is primarily limited by the low availability of natural resources. General energy strategy of the Republic of Croatia is to compensate for the decrease of domestic oil and gas production by supporting new exploration and production activities.

The European Commission initiated two infringement procedures against the Republic of Croatia due to non-compliance of previous gas legislation with the Gas Directive (Directive 2009/73/EC) and the Gas Regulation (Regulation (EC) No 715/2009) and on 2 July 2020 issued a reasoned opinion in relation thereto. Therefore, the key challenge in the gas sector for Croatia is to ensure full compliance of the gas regulations with EU law while at the same time maintaining security of supply.

The global economy has been shaken for some time now by the COVID-19 pandemic that has not bypassed the Croatian energy sector whose weakness to COVID-19 is primarily visible in falling demand and, consequently, the price of oil and natural gas.

The government and the industry undertook various measures in order to secure the energy supply during the COVID-19 pandemic and to further consider the possibilities for the energy sector to help in the recovery after the crisis.

In response to the operational challenges associated with COVID-19 pandemic and the measures taken to limit its outbreak, the industry has implemented business arrangements to ensure the 24/7 continuity of essential energy operations, whilst protecting the health and safety of staff.

Croatian oil and gas sector and market proved healthy insofar there was no need for immediate, tailor-made COVID-19 measures. However, business entities from the sector remain eligible for general measures brought by the Croatian government in order to fight negative economic impact of the pandemic: tax measures and government reliefs, economic stimulus measures aimed at preserving financial liquidity, employment-related measures such as job preservation measures and grants for supporting reduced working hours.

20. Are there any policies or regulatory requirements relating to the oil and gas industry which reflect/implement the global trend towards the low-carbon energy transition?

As Croatia strives to achieve a greater level of energy independence, current regulatory framework does not intend to stifle the development of the oil and gas industries. However, in keeping up with EU requirements and renewable energy goals, as well as its own tendencies for clean energy, the energy strategy is shifting towards the renewable energy sources, as elaborated in the final draft of the Integrated National Energy and Climate Plan for the Republic of Croatia for 2021 – 2030, which emphasizes decarbonisation as one of its most important objectives. The Plan also touches on the predicted decrease in the use of hydrocarbons, but acknowledges their nevertheless considerable share in overall energy consumption in Croatia and encourages the further development of exploration sites and infrastructure.

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