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REPORT ON STATE SUPPORT TO THE KOSTOLAC THERMAL POWER PLANT AND MINING BASIN

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Context

Following previous research conducted by CARTA in which it was discovered that the Republic of Serbia provided state support to the Kolubara Mining Basin and Kolubara B Thermal Power Plant public companies, CARTA carried out research on state support provided to the Kostolac Thermal Power Plant and Basin¹ (TE-KO Kostolac). This company operates within the Electric Power Industry of Serbia² (EPS) and as well as the power plant it also incorporates coal mines.

By joining the Energy Community of South East Europe in 2005 (ECSEE) and signing of the Stabilization and Association Agreement with the European Union in 2008, the Republic of Serbia committed to adopt and implement EU legislation relating to competition and state aid. These issues are regulated by Articles 18 and 19 of the Treaty establishing the Energy Community (Appendix 1) and Article 73 of the Stabilisation and Association Agreement between the European Communities and their Member States on one side and the Republic of Serbia on the other (Appendix 2). These regulations prohibit state aid which distorts or threatens to disrupt competition by favouring and/or allowing advantages to certain companies or energy resources.

The Energy Community of South East Europe was established in July 2006 after the ratification³ of the Treaty establishing the Energy Community between the EU and countries of South East Europe that had been signed in October 2005. Its main goals are to establish a stable regulatory and market framework and enable an efficient supply of energy, as preconditions necessary for the economic development and social stability of every country. By founding the Community, member states also intended to contribute to the development of alternative routes of energy and gas supplies, improvement of the environment, and promotion of energy efficiency and the use of renewable energy sources (Appendix 1).

1 [▣] Privredno društvo Termoelektrane i kopovi Kostolac

2 [▣] Elektroprivreda Srbije

3 [▣] Serbia ratified the Treaty on the Community in July 2006, while in October 2013 a decision was taken to extend the validity of the Treaty on the Community until 2026.

Research Methodology

The research was focused on investigation of all forms of state support provided to the Kostolac Thermal Power Plant and the Mining Basin (TE-KO Kostolac) in the period from 2006 until the present day, including the support from state and local budgets, as well as from other government funds and agencies.

The study covered a broad spectrum of state support, such as government loan guarantees, direct grants, tax exemptions, subsidies, loans, expropriation, land transfers, etc., transferred to the TE-KO Kostolac as the final beneficiary.

The methodology used in this research included content analysis of relevant documentation, media archives, as well as formal questions and official requests for access to public information (FOI requests) directed to the Government of the Republic of Serbia, Ministry of Energy, Development and Environment, Electric Power Industry of Serbia, and the Kostolac Thermal Power Plant and Mining Basins.

The research was conducted between February and mid-April 2014.

Research Findings

In its search for information on whether state support was provided to TE-KO Kostolac, the research team sent a request to EPS, the public company within which TE-KO Kostolac operates. EPS responded that it did not have any information in this regard (Appendix 3) and referred the research team to TE-KO Kostolac.

"In line with Articles 5 and 19 of the Law on Free Access to Information of Public Importance, we inform you that requested information is under the authority of TE-KO Kostolac" (Appendix 3). In response to a FOI request sent to TE-KO Kostolac, CRTA received an official response stating that no state support was provided to this company in the period from 2006 until now (Appendix 4). However, TE-KO Kostolac also acknowledged that a loan agreement was signed for the implementation of Phase I of the Kostolac B project to rehabilitate the existing power stations, and that further credit loans were envisaged for the implementation of Phase II of the Kostolac B project to construct a new unit, B3: "On December 26, 2012 the Republic of Serbia concluded a loan agreement with the Chinese Export-Import Bank (hereinafter Exim Bank)⁴ for the implementation of Phase I of the Kostolac B project, while the 2014 Serbian State Budget envisages another loan from the Chinese Export-Import Bank (Exim Bank) for the implementation of Phase II of the Kostolac B project (Appendix 4).

Since CRTA's research proves that state support to this company existed, the response from the TE-KO Kostolac could be interpreted either as a lack of understanding of what state support means or as an attempt to provoke the wrong conclusion.

The TE-KO Kostolac also responded that a contract was concluded with the Fund for Environmental Protection, but was never realized due to the Fund's termination:

"On September 9, 2011 an Agreement on co-financing the project 'Biological re-cultivation of the ash and slag using modern Terracottem technology' (Appendix 5) was concluded between the Fund for Environmental Protection, Belgrade and public company Kostolac Thermal Power Plant and Mines Kostolac. A grant for the amount of 20,000,000.00 dinars (198,000 euro, at the exchange rate of 101.28 dinars for one euro in effect on September 9, 2011) was approved for co-funding of the project 'Biological re-cultivation of the ash and slag using modern technology Terracottem' which was not implemented because the Fund for Environmental Protection from Belgrade ceased to exist" - TE-KO Kostolac' response (Appendix 4).

The Law on the termination of the Fund for Environmental Protection is enclosed (Appendix 6).

On March 18, 2014, CRTA sent another FOI request to the Government of Serbia in order to retrieve the loan agreement made with the Chinese Exim Bank for the

4 ² Export - import bank (Exim Bank)

implementation of Phase I of the Kostolac B project (Appendix 7). CRTA has not received any response yet.

Since CRTA did not receive any response from the Office for Media Relations of the Government of Serbia even after the expiration of the 15 days deadline, the organisation filed a complaint to the Commissioner for Information of Public Importance and Personal Data Protection on March 8, 2014. (Appendix 8).

Although CRTA did not obtain the Loan Agreement for the implementation of Phase I of the Kostolac B project, signed with the Chinese Exim Bank, the organisation managed to acquire the Law on Ratification of the Loan Agreement for a privileged buyer for the first phase of the project package Kostolac B Power Plant Projects between the Government of Serbia as the borrower and China Exim Bank as the lender (Appendix 9). The content of this Act is summarized in the report below.

After obtaining the relevant documents and information, this research showed that several forms of state support have been given to TE-KO Kostolac since 2006, and that the Republic of Serbia has implemented these support measures through:

I. Signing of a contract between the Government of the Republic of Serbia and Chinese Exim Bank on December 29, 2011, for the amount of 334,63 million US dollars, envisaged for reconstruction of blocks B1 and B2 of TE-KO Kostolac, construction of a desulphurization system, building of a landing dock on the Danube and construction of railway infrastructure. In this contract, the Republic of Serbia is the borrower, responsible for paying back the loan amount, while TE-KO Kostolac is named as the end-user of the funds;

II. In the 2014 State Budget funds are reserved as a guarantee for a loan for the second phase of the Kostolac B project for the amount of 715.6 million US dollars, envisaged for the construction of the third block of the thermal power plant Kostolac B and expansion of the Drmno open cast mine;

III. Potential exemption from taxes and customs fees for the transport infrastructure projects within the first phase of the Kostolac B project.

I Signing of the loan agreement (First phase of the Kostolac B project)

The article "Agreement on Chinese loan for TE-KO Kostolac signed⁵", published by the Politika daily on December 29, 2011, reported that a contract for the first phase of the project for revitalization of the Kostolac B thermal power plant, for the total amount of 334.63 million US dollars, had been signed between Chinese and Serbian representatives.⁶ The first phase of the project envisaged the reconstruction of the existing blocks B1 and B2 in Kostolac thermal power plant (worth 176.31 million US dollars), construction of a desulphurization system (worth 130.5 million US dollars), building of a landing dock on the Danube (worth 15.86 million US dollars) and construction of railway infrastructure (worth 21.96 million US dollars).

⁵ [□] Politika Daily Website

⁶ [□] Even though the TE-KO Kostolac' response to CRTA's FOI request states that the contract for the first phase of the project was signed on December 26, 2012, the Law on Ratification of the Preferential Buyer Loan Agreement for the first phase of the project package "Kostolac B power plant projects" between the Government of Serbia as the borrower and the Exim Bank as the lender (Appendix 7) states that the contract was signed on December 26, 2011.

"As stated at the signing event, 85 percent of the value of the project (293 million US dollars) will be financed by the Exim Bank loan under preferential terms. The term of the loan would be fifteen years, including the grace period of five years, the interest rate would be three percent per year, and the repayment period ten years" Politika reported.

According to the Law on Ratification of the Preferential Buyer Loan Agreement for the first phase of the project package "Kostolac B power plant projects" between the Government of Serbia as the borrower and the Exim Bank as lender (Appendix 9), the state took on the loan repayment for TE-KO Kostolac, the end-user of the loaned funds. According to this Law, the Government of the Republic of Serbia, as the borrower, is obliged to repay the Exim Bank, as the lender, the entire withdrawn and unpaid amount of the loan principal, the entire accrued interest and all other obligations of the borrower, payable in accordance with the terms of the agreement. This Law also defines the public company Electric Power Industry of Serbia (EPS) as the procuring entity and TE-KO Kostolac as the final beneficiary. (Appendix 9) Article 3 of the 2012 State Budget confirms that the Republic of Serbia will allocate 293 million US dollars as a guarantee to the Export-Import Bank of China (Exim Bank) for the revitalization of the TE-KO Kostolac. (Appendix 10)

II Providing loan guarantees (Second phase of the Kostolac B project)

With regard to the loan for the second phase of the Kostolac B project, the Ministry of Energy, Development and Environmental Protection published a notice that on November 20, 2013 the Ministry signed a contract for the construction of the third block of the Kostolac B thermal power plant, with a total capacity of 350 MW, and for the expansion of the Drmno open cast mine (within TE-KO Kostolac) with the Chinese corporation CMEC (China Machinery Engineering Corporation)⁷.

"The total value of the second phase of the project package to be implemented in cooperation with Chinese partners is 715. million US dollars, and the funds for its implementation will be provided through a preferential loan, with a guarantee from the Government of Serbia," the Ministry announced on its website.

The second phase of the Kostolac project package includes two major projects - the construction of the new unit B3, with total capacity of 350 MW at the TE-KO Kostolac B site, and the expansion of capacity of the Drmno open cast mine Drmno to produce 12 million tonnes of coal per year.

The second phase of the project package should be financed through a new loan from the Chinese Exim Bank for the amount of 609 million US dollars under preferential terms, as part of the financial package from the Chinese government to 16 countries of Central and Eastern Europe⁸.

Even though the National Assembly of the Republic of Serbia has not yet voted for this loan, it has been officially announced that guarantees would be approved. In evidence to this statement, the 2014 State Budget envisages guarantees for this loan.

7 ² Website of Ministry of Energy, Development and Environmental Protection of Republic of Serbia

8 ² RTS web page

Article 3 of the 2014 State Budget authorizes the Republic of Serbia to issue two guarantees for TE-KO Kostolac (Appendix 11). The first guarantee is for the amount of 107 million US dollars, for un-named commercial banks. The 2014 State Budget defines that guarantees will be provided for participation in the second phase of the TE-KO Kostolac project package (construction of the new power plant unit at the Drmno site - Kostolac B, Phase II and the mine expansion), (Appendix 11, Article 3, Table with headline Poslovnim bankama, line number 3).

Besides this one, another guarantee will be provided for TE-KO Kostolac. Article 3, paragraph B (project and program loans), of the 2014 State Budget defines that a guarantee will be given to the Chinese Export Bank (Exim Bank) for the amount of 608,260,000 US dollars for the implementation of the second phase of the project package TE-KO Kostolac (construction of the new power plant unit at the Drmno site and expansion of the mine). (Appendix 11)

III Potential exemption from taxes and customs duties

Among different types of direct or indirect support, exemption from customs duties and VAT is also considered as state support. In this case, the state support relates to transport infrastructure built on the basis of the Agreement on economic and technical cooperation in the field of infrastructure between the Government of the Republic of Serbia and the Government of the People's Republic of China (Appendix 12).

The Law on Ratification of Annex no. 2 of the Agreement on economic and technical cooperation in the field of infrastructure between the Government of the Republic of Serbia and the Government of the People's Republic of China states:

"The import and supply of goods and services for the implementation of transport infrastructure projects, including the execution of agreements, contracts, programs and projects developed in accordance with the Article 4 of the Agreement, are not subject to customs duties and value added tax (VAT) in the territory of the Republic of Serbia, with regard to the execution of such agreements, contracts, programs and projects by the contractor" (Appendix 13).

The Agreement for the implementation of the Phase I project package - revitalization of TE-KO Kostolac B, for a total value of 334,63 million US dollars, was signed in accordance with the Agreement on strategic partnership and the Agreement on cooperation in the field of infrastructure between China and Serbia (August 2009)⁹. The first phase of the project Kostolac B envisages the construction of transport infrastructure facilities as well - a landing dock on the Danube and railway infrastructure. Accordingly, the Annex 2 of the Agreement on economic and technical cooperation in the field of infrastructure between the Government of the Republic of Serbia and the Government of the People's Republic of China can be applied to the transport infrastructure facilities to be constructed within the first phase of the Kostolac B project, which is also a form of the state support to TE-KO Kostolac.

9 ⁹ Politika Daily Website

Conclusion

According to the information and documents obtained within this research, it can be concluded that the Republic of Serbia has provided support to TE-KO Kostolac in several ways since 2006 and is planning to provide further support by approving loan guarantees in the National Assembly for the construction of Kostolac unit B3.

1. Signing of the Preferential Buyer Loan Agreement for Phase I of the Kostolac B Power Plant project between the Government of Serbia as the borrower and the Chinese Export - Import Bank (Exim Bank) as the lender for the amount of 293 million US dollars (Appendix 9, Appendix 10). The total value of the project in this phase is 334,63 million US dollars, while 85 per cent of the value - 293 million US dollars - will be financed by China's Exim Bank. According to the Agreement signed with the Exim Bank, the Government of Serbia is responsible for repayment of the loan and interest, while TE-KO Kostolac is defined as the final beneficiary.

2. Signing of the Agreement for construction of the third block of TE-KO Kostolac B with 350 MW capacity and expansion of the Drmno open cast mine (within TE-KO Kostolac) for the amount of 715,6 million US dollars (Appendix 11). The Government of Serbia has allocated 715,206,000 US dollars within the 2014 State Budget for a loan guarantee for TE-KO Kostolac.

3. Possible exemption from VAT and customs duties for the import and supply of goods and services for the implementation of transport infrastructure projects in the first phase of the Kostolac B project (Appendix 12, Appendix 13). The total value of the two infrastructure projects is 37,82 million US dollars (construction of the landing dock on the Danube worth 15,86 million US dollars and construction of railway infrastructure worth 21,96 million US dollars).

Appendices

1. Appendix 1–Law on ratification of the Energy Community Treaty (<http://goo.gl/XWLyfl>);
2. Appendix 2 - Law on ratification of the Stabilization and Association Agreement (<http://goo.gl/J0rj8f>);
3. Appendix 3–Electric Power Industry of Serbia's answer to a request for access to public information;
4. Appendix 4–Reply received from TE-KO Kostolac to a request for access to information of public importance;
5. Appendix 5–Agreement on co-financing the project "Biological reclamation of ash and slag using modern technology terracotta". (The document was sent by TE-KO Kostolac);
6. Appendix 6 - Law on the Termination of the Fund for Environmental Protection (<http://goo.gl/NHjlvb>);
7. Appendix 7 - A request for Access to Public Information was sent to the Office of Media Relations of the Republic of Serbia;
8. Appendix 8–Appeal to the Commissioner for information of public importance;
9. Appendix 9 - The Law on Ratification of the Loan Agreement for the loan for the first phase of Kostolac B (<http://goo.gl/oEKJ3L>);
10. Appendix 10–Republic of Serbia Budget Law 2012 (goo.gl/NkaET1)
11. Appendix 11 - Republic of Serbia Budget Law 2014 (<http://goo.gl/tyzPLH>)
12. Appendix 12–Law on Ratification of the Agreement on economic and technical cooperation in the field of infrastructure between Serbia and China (<http://goo.gl/Y1C1b5>);
13. Appendix 13–Law on Ratification of Annex 2 of the Agreement on economic and technical cooperation in the field of infrastructure between Serbia and China (<http://goo.gl/OtLgeV>);