

Possible coal and energy State aid cases based on publicly accessible information

Péter Staviczky (principal author) and **Phedon Nicolaides**

June 2015





Possible coal and energy State aid cases based on publicly accessible information¹

Appendix to the briefing State aid rules in the coal sector and linked energy sector under the Energy Community Treaty and European Law, available at: bankwatch.org/publications/EnCom-stateaid

The author has been provided with publicly available information on cases related to coal and electricity generation in some of the Energy Community Contracting Parties and asked to provide - to the extent possible - comments on the likelihood that these cases constitute State aid and the potential main issues to examine in each case.

Based on the information provided the issue of State aid and its assessment is relevant in each case.² The use of State resources can be confirmed in every case and most of the measures are selective. Again, the measures are addressed to a company either operating in the electricity sector or in the coal mining sector. As we have seen both are subject to competition and trade. The major question is therefore whether there is an advantage at the level of the economic operators or not. However given the level of details available this possibility cannot be either excluded or confirmed in the majority of the cases mentioned. With respect to the Contracting Parties, the following observations can be made.

Kosovo: Long-term power purchase agreement for new lignite plant

The Kosovo government has for several years been pushing the construction of a new lignite power plant. The current version would consist of 2x300 MW units and is currently undergoing a tender procedure for a strategic partner to build and operate the plant. The only bidder to submit a bid in December 2014 was ContourGlobal and at the time of writing (mid-May 2015) no definitive answers have been given as to whether the bid will be accepted or not.

In connection with the project, a long-term power purchase agreement is often mentioned, although few details are available. For example the World Bank, which plans to provide a partial risk guarantee for the project states: “In parallel, a Kosovo Electricity Market Model was being designed, which needed exceptions to the Energy Community Treaty regarding long-term Power Purchase Agreements (PPAs) for KRPP [ie. the new plant] and Kosovo B, requiring additional inputs from the advisors.”³

The Kosovo regulator ERO also mentions PPAs but nothing about their long-term nature: “The Kosovo e Re investors will have bilateral contracts between their project company, a licensed generator, and PES [Public supplier] in accordance with Article 8 of the Law on Electricity. These bilateral contracts are expected to take the form of power purchase agreements (PPAs).

1. Ref. to Annex.

2. The below list of cases does not mean that it is exhaustive and no other measures might imply State aid in these countries.

3. http://www-wds.worldbank.org/external/default/WDSContentServer/WDSP/IB/2012/12/20/000386194_20121220012442/Rendered/PDF/NonAsciiFileName0.pdf

Under each PPA, PES will purchase the capacity made available and, as dispatched, the energy delivered from the Kosovo B and the KRPP units, respectively.”⁴

Only from a presentation by Ms. Perparim Kabashi of the Energy Regulatory Office of Kosovo we can see that 20 years is the length of time being considered for the PPA.⁵

The issue of long-term power purchase agreements (PPA) was analysed beforehand and such PPAs explicitly raise the question of incompatibility with the State aid rules. Both the duration and the pricing and any related State collaterals or compensations will be most likely infringing State aid rules and would constitute operating aid. The only way not to grant incompatible aid is to have a framework agreement. Quantities and prices to be sold for the public buyer have to be defined each time based on current market price. Investors need to measure the capacities and demand on the market as well as future changes thereof and they should not take an investment decision based on PPAs but based on market reality.

Serbia: Kostolac B power plant and mine

The Kostolac B lignite power plant is currently undergoing environmental improvements, to be followed by the construction of an additional new unit, Kostolac B3 and expansion of the captive mine at Drmno. This process consists of two phases which are both being financed by the China Exim Bank.

- On December 29, 2011 a contract was signed between the Government of the Republic of Serbia and Chinese Exim Bank, for USD 293 000 000 85% of the cost of the full project Phase 1 - 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, part of the state-owned electricity company Elektroprivreda Srbije (EPS) is named as the end-user of the funds.⁶ Thus the state takes on all the responsibilities connected with paying back the loan.
- On 17 December 2014, a loan agreement was signed by the Minister of Finance on behalf of the Government of Serbia and the China Exim Bank for USD 608 260 000 for Phase 2 of the Kostolac power plant project,⁷ which comprises the construction of unit 3 of the Kostolac B power plant and the expansion of the Drmno mine. This amount makes up 85% of the Engineering, Procurement and Construction signed with Chinese company CMEC in November 2013 to carry out the works. The Law on ratification of the loan agreement was passed by the Serbian parliament on 19 January 2015,⁸ and the loan included in the 2015 Serbian budget.⁹
- In the 2015 state budget (Article 3) funds are reserved for a guarantee for commercial bank loans for the second phase of the Kostolac project, worth EUR 80 000 000. The description of the project is: JP Elektroprivreda Srbije Participation in the second phase of the TE-KO Kostolac project package (Construction of a new energy unit at the Drmno Kostolac B site phase II and expansion of the capacity of the mine).¹⁰ It is not yet known which commercial bank loans are in question and whether the loan contracts have been signed.

4. http://ero-ks.org/Vendimet/English/2013/Kosovo_Electricity_Market_Design_final_eng.pdf

5. http://www.naruc.org/international/Documents/ERO%20Issues_Commissioner%20Kabashi1.pdf

6. The Law on the ratification of the contract is available at: <http://www.istinomer.rs/wp-content/uploads/2015/11/Prilog-1-Zakon-Garancija-za-kredit-I-faza.pdf>

7. <http://www.parlament.gov.rs/upload/archive/files/lat/pdf/zakoni/2015/37-15%20lat.pdf>

8. Original: Zakon O Potvrđivanju Ugovora O Zajmu Za Kredit Za Povlašćenog Kupca Za Drugu Fazu Paket Projekta Kostolac - B Power Plant Project Između Vlade Republike Srbije, Koju Predstavlja Ministarstvo Finansija, Kao Zajmoprimca I Kineske Export Import Banke Kao Zajmodavca
<http://www.parlament.gov.rs/upload/archive/files/lat/pdf/zakoni/2015/37-15%20lat.pdf>

9. <http://www.parlament.gov.rs/upload/archive/files/lat/pdf/zakoni/2014/4598-14.pdf>

10. Original: ЈП „Електропривреда Србије” Учешће за другу фазу пакета пројеката ТЕ -КО Костолац (Изградња новог енергетског блока на локацији Дрмно Костолац Б Фаза II и проширење капацитета рудника)
<http://www.parlament.gov.rs/upload/archive/files/lat/pdf/zakoni/2014/4598-14.pdf>

Serbian NGO CRTA in early 2014 wrote a report on the first and second of these points (the loan agreement in the second point had not been signed at that time but it was planned, and money for it had been allocated in the 2014 Serbian budget). The report can be found in English here:
<http://bankwatch.org/sites/default/files/CRTAreport-Kostolac-subsidies-30Jun2014.pdf>

The measures listed in relation with the Kostolac B power plant raise the issue of State aid, but a definitive answer cannot be given. The involvement of the Chinese Exim Bank in itself does not indicate the use of State resources since China is not part of the EU or the Energy Community Treaty. However if the State is the other contracting party and receives the export credit to be used later for the upgrade and extension of the power plant, this changes the status of the measure.

The Serbian State then gains control over the amount of the export credits and with that they become State resources. It has to be noted that infrastructure and ports financing may also fall under State aid rules but they are out of the scope of the Energy Community Treaty. In general, infrastructure can be financed up to its funding gap under EU State aid rules.

As regards the power plant's environmental upgrade and extension with an additional 350 MW unit it has to be first examined, whether the project is viable and profitable under the market economy investor principle.

If the project creates enough revenues to cover costs, including depreciation, payments of the debts and profit above risk free return (normally the yield of State bonds with the tenure close to the project's lifecycle) weighted with the risks of the project, then one can argue the involvement of the State does not lead to advantage which cannot be obtained on the market. Any advantage coming from the Chinese Exim Bank should not be taken into account.

On the other hand, related to the state guarantees for the loans from commercial banks, a market price has to be paid for the State guarantees and the other conditions of the Commission's notice on State guarantees have to be met.

The same approach applies to the extension of the coal mine. For the two economic activities profitability has to be assessed together since the coal mined in the extended mine would be used in the power plant and they form one economic entity. All decisions of the State are interlinked and interdependent.

Therefore by applying the market economy investor principle, the financial exposure in all the measures and the expected return have to be assessed. The desulphurization system in itself may be eligible for environmental aid and its costs if they can be separated.

The main question here is whether the Energy Community acquis requires such a system. If yes, the project can be eligible only to the extent (costs) which it goes beyond these requirements (e.g. ensuring even lower emissions).

Serbia: Kolubara mining basin

In 2013 Serbian NGO CRTA undertook research on support by the Republic of Serbia to Public Enterprise Elektroprivreda Srbije (EPS) for the construction of the thermal power plant Kolubara B and to its subsidiary company Kolubara Mining Basin.¹¹

1. State guarantee for an EBRD loan of EUR 52 million for the Project "EPS Power II", which includes the purchase of a coal excavator, conveyor and spreader system for the Tamnava West field. Apart from a FOI (freedom of information) response from the Ministry of Energy, no detailed information on the award procedure for this guarantee and on its terms and conditions was made available.
2. State guarantee for KfW loan of amount of 25 million euro and direct grant of 9 million euro for the Project "Procurement of the ECS System". Apart from a FOI (freedom of information) Response of the Ministry of Energy, no detailed information on the award procedure for this guarantee and on its terms and conditions was made available.
3. State guarantee for the EBRD loan worth 80 million euro for the Kolubara Environmental Improvement project related, among other things, to the procurement of the specific equipment including excavator, conveyor, spreader system and power supply for Field "C" of the Kolubara lignite coal mining basin. The Guarantee Agreement between the Republic of Serbia and the European Bank for Reconstruction and Development was concluded on July 28, 2011 (Official Gazette 8/2011).

The Republic of Serbia unconditionally guaranteed, as primary obligor the due and punctual payment of any and all sums due under the Loan Agreement. Moreover, the Republic of Serbia undertook to take measures to provide EPS with adequate support to perform all of its obligations under the Loan Agreement in support of the successful realisation of the Project whenever there is reasonable cause to believe that the funds available to EPS would be inadequate to meet the estimated expenditures required for the carrying out of the Project. The agreement covers the entire loan, however it is not clear whether EPS paid any fee to the Serbian government for the service of providing the guarantee.

4. State guarantee for KfW loan of amount of 65 million euro and direct grant of 9 million euro for the same project named "Improving exploitation technology in Kolubara for increased efficiency of thermal power plants and reducing environmental impact". The Act on Ratification of Loan Agreement between the Republic of Serbia and the German Development Bank KfW was dated on December 24, 2012 (Official Gazette 121/2012). The Republic of Serbia undertook the obligation to settle the debt of the Public company "Electric Power Industry of Serbia" Belgrade (EPS) in the amount of 74 million euros, which includes the loan in the amount of 65 million euros and financial contributions (grants funds) in the amount of 9 million euros. The agreement covers the entire loan, however it is not clear whether EPS paid any fee to the Serbian government for the service of providing the guarantee.
5. Transfer of property (land and buildings) to support the construction of the Kolubara B thermal power plant. According to the Amendment to the EPS Establishment Act, dated on May 31, 2009, the Government of the Republic of Serbia transferred to EPS the ownership of the property (land and buildings) needed for the implementation of the Kolubara B project. The value of the property (land and buildings) transferred, according to present market prices, is RSD 1.4 billion (12.7 million euro, as per exchange rate on 18 November 2013). The property in question was transferred to EPS by the Government of Serbia's Decision on the Amendments to the Decision on the establishment of the public enterprise for production, distribution and trade of electricity (Official Gazette No 54/2010).

11. <http://www.istinomer.rs/teme/da-li-je-drzavna-pomoc-eps-u-u-interesu-gradana/>

All three guarantees mentioned in relation to Kolubara Mining Basin might have State aid implications. The key point is the coverage of the guarantees, which cannot be higher than 80%. The transfer of land can be in line with State aid rules in two ways (assuming that the value of the land is above the de minimis threshold). First, the market economy investor principle may be fulfilled if the price of the land is a profitable investment from the State's side. In this case again all State measures have to be assessed together since their aim is common and they are linked. Second, EPS may pay a market price for the land. This is not mentioned in the background materials. If land has been granted for free or below market price this advantage has also to be taken into account during the market economy investor assessment.

Montenegro: Value-added tax exemptions

On 17th February the Montenegrin Parliament ratified a new Law on amendments and supplements to the Law on Value Added Tax (Zakon o izmjenama i dopunama Zakona o porezu na odatu vrijednost).¹²

The Law seeks to add to the list of items on which zero percent VAT is paid (Article 25) the following:

“In Article 25 paragraph 1 after point 10, a new point is added which states:

„10a) supply of products and goods for the construction and equipping of hospitality facilities in the category of five star or higher, or energy production facilities;

After point 12 a new point is added which states:

„12a) supply of products, or services, which are carried out in line with a contract on a credit or loan concluded between Montenegro and international financial institutions, or other states or third parties in which Montenegro appears as guarantor, if it is foreseen in the contract that tax costs will not be paid from the money obtained.”

(The existing point 10 states: products and services which are used for exploration of oil bores in the open sea. The existing point 12 states: supply of products or services when it is foreseen with international agreements, or contracts on donations, that tax costs will not be paid with the money obtained).

This amendment raises several questions:

- Is such an exemption in line with EU Directive 2006/112/EC¹³ on the common system of value added tax?
- In the case of loans from international financial institutions or other governments or third parties, does freeing the project from VAT and customs fees not provide support for a company or project that its competitors may not have?

In the case of large infrastructure projects, it might be argued that if there was an open tender for a particular project, competition was assured through this process. However competition was only assured within that particular project. The project as a whole still benefited from as well as a government guarantee, which may or may not be in line with state aid rules exemption from VAT, and competing projects may not have done. In certain cases there may be no competing projects, for example in the situation of a road from A-B where there is no competing railway, or in the case of communal water infrastructure where it is clear that everyone will use the same infrastructure. But in other cases, such as electricity generation facilities, there are competing facilities and companies and VAT exemptions give an unfair advantage to one facility over another.

12. <http://www.skupstina.me/index.php/me/sjednice-skupstine/item/3382-sednica-prvog-vanrednog-zasjedanja-u-2015-godini-deveti-dan>

13. Consolidated version with amendments available at <http://eur-lex.europa.eu/legal-content/en/TXT/?qid=1424717846509&uri=CELEX:02006L0112-20150101>

Further, it has several times been the case in Montenegro that the government has undertaken large infrastructure projects without a tender by signing interstate agreements with foreign governments. During the past few years, Montenegro has made use of Article 3 in its Law on Public Procurement (Montenegro Official Gazette, no. 42/11, 15.08.2011) allowing it to bypass tender procedures in cases where intergovernmental agreements are signed regarding a certain project.

Article 3 of the law states:

This law is not applicable to:

procurement which is carried out under special rules on the basis of international agreements or contracts between Montenegro and one or more states for a project which the contracting parties will carry out or jointly use;

Examples of occasions when no tender has been carried out but intergovernmental agreements have been signed for projects are for the Italy-Montenegro undersea electricity cable, and the 2014 agreement with China regarding the Bar-Boljare motorway.¹⁴ It is further intended to use this system for the Pljevlja II lignite power plant, for which a selection procedure is currently going on.¹⁵

- If equipment for electrical energy generation is exempt from customs fees and VAT, even if Montenegro is not yet obliged to apply EU VAT legislation, does this provide an advantage for Montenegrin electricity production which its neighbours do not have?

The issue of VAT measures and State aid is not well explored in the EU jurisprudence. The reason is mainly that EU law has harmonised the base and approximated the rates of most of indirect taxes including VAT. Therefore Member States are not allowed to make exemptions which are not permitted in the first place under the EU VAT Directive in force.

Based on the limited case law available it seems that granting VAT¹⁶ advantages to certain sectors is likely to be State aid in so far as a reduced rate is not authorised by the Commission.

This is a crucial issue since even under the current EU VAT Directive Member States may apply lower or preferential rates for certain products or services and this has not been questioned by the Commission.

With respect to exemptions from environmental taxes of large energy production facilities here the rules of the EEAG or the GBER can be applied if renewables or energy infrastructure costs are part of the project. Power plants generating electricity just from coal however cannot receive State aid under the EEAG or the GBER.

-
14. *Zakon o potvrđivanju Sporazuma između Vlade Crne Gore i Vlade Narodne Republike Kine o unapređenju saradnje u izgradnji infrastrukture "Službeni list Crne Gore - Međunarodni ugovori, broj 8/2013", 22.10.2013. <http://www.sluzbenilist.me/PravniAktDetalji.aspx?tag={BDD0EFBD-180C-4A30-9240-8DA40E21143C}>Zakon o autoputu Bar Boljare "Službeni list Crne Gore, broj 52/2014", 16.12.2014. <http://www.sluzbenilist.me/PravniAktDetalji.aspx?tag={35AE72ED-429E-4726-B9B9-7FA4D39DC32F}>*
 15. While several companies submitted offers, the Government admits that this is not a tender process and lays out its plans in the documents on the Realisation of Energy Projects and Information on Pljevlja II at. http://www.gov.me/sjednice_vlade/27 and http://www.gov.me/sjednice_vlade/28 respectively.
 16. Case C-172/03 Heiser [2005] ECR I-1627, and case C-308/01 GIL Insurance [2004] ECR I-4777.

Bosnia and Herzegovina: Coal mines

Law on financial consolidation of coal mines in the Federation of BiH according to calculated but not paid public income in the period 2009-2015 (Official Gazette 81/08, 109/12 and 5/14)¹⁷

This law seeks to clear unpaid debts for social contributions from various coal mines in the Federation of BiH. It is supplemented every year by separate decisions on the allocations of funds for this purpose either in the FBIH budget or a separate Decision.¹⁸ In 2012 the law was amended to reduce the amounts of assistance given to the mines in 2014 and 2015.

State Aid Council of BiH reports are available online for 2011, 2012, and 2013. In the 2011 report, no state aid is reported for coal mining in either of BiH's Entities.¹⁹ In the 2012 report for FBIH EUR 14 316 172 in state aid is listed,²⁰ which corresponds to the 28 million KM allocated by the law for that year. For 2013, EUR 14 384 685 is listed.²¹ Once the end of 2015 comes it is unclear whether more assistance is planned or not.

Financial consolidation of coal mines including clearing of unpaid public debts can be done since the adoption of Council Regulation 787/2010/EU only with the aim of the definitive closing of an uncompetitive mine. Rules on restructuring aid do not apply to the coal sector. The measure seems to be clearly financed from the general budget and by a State act. As the information does not refer to rescheduling and later repayment but to clearing of public debts the application of the market economy creditor principle²² is unlikely to be a realistic option. The measure seems to confer selective advantage to the undertakings concerned.

17. *Zakon o finansijskoj konsolidaciji rudnika uglja u Federaciji Bosne i Hercegovine*

<http://www.fbihvlada.gov.ba/bosanski/zakoni/2008/zakoni/34bos.htm> Amendments at:

[Http://www.parlamentfbih.gov.ba/dom_naroda/bos/parlament/propisi/usvojeni_p/Zakon_konsol_rudnika_uglja.pdf](http://www.parlamentfbih.gov.ba/dom_naroda/bos/parlament/propisi/usvojeni_p/Zakon_konsol_rudnika_uglja.pdf) and <http://www.fbihvlada.gov.ba/bosanski/zakoni/2014/zakoni/1.html>

18. 2009: 28 000 000 KM http://www.fbihvlada.gov.ba/bosanski/budzet/2009/4-Plan_rashoda.pdf

2010: 28 000 000 KM [http://www.fmf.gov.ba/budzet-](http://www.fmf.gov.ba/budzet-2010/izmjene_i_dopune/Plan%20rash.ek.kod%20hr.pdf)

[2010/izmjene_i_dopune/Plan%20rash.ek.kod%20hr.pdf](http://www.fmf.gov.ba/budzet-2010/izmjene_i_dopune/Plan%20rash.ek.kod%20hr.pdf)

2011: 28 000 000 KM <http://www.fmf.gov.ba/budzet-2012/budzet%20hr/Plan%20rash.ek.kod.pdf>

2012: 28 000 000 KM <http://www.fmf.gov.ba/budzet-2012/budzet%20hr/Plan%20rash.ek.kod.pdf>

2013: 28 000 000 KM <http://www.fbihvlada.gov.ba/bosanski/budzet/2013/Rashodi1-bos-srp.pdf>

2014: 20 000 000 KM <http://www.fbihvlada.gov.ba/bosanski/zakoni/2014/odluke/227.html>

2015: 20 000 000 KM foreseen:

http://parlamentfbih.gov.ba/dom_naroda/bos/parlament/propisi/El_materijali/Dokument%20okvirnog%20Budzeta%202015-2017.pdf

19. <http://www.szdp.gov.ba/izvjestaji/drzavnapomoc2011.pdf>

20. <http://www.szdp.gov.ba/izvjestaji/drzavnapomoc2012.pdf>

21. <http://www.szdp.gov.ba/izvjestaji/drzavnapomoc2013.pdf>

22. *Following the logic of the market economy investor principle the EU institutions apply the "market creditor principle" to cases where public debts are rescheduled. In these cases the State's activity is measured against the expected behaviour of a hypothetical private debtor. The main question in these procedures is whether the rescheduling of the public debt is the economically best solution for the State. Is it possible and is it reliable to claim back the amount due and interest due with the rescheduling by taking into account the collaterals, the amount of the debt, the financial status of the undertaking and the costs of the liquidation as well as the probability of success.*

Bosnia and Herzegovina: Construction of new coal power plants

In the Federation of BiH two coal power plants each with several units (Tuzla, Kakanj) are currently in operation and three new units are planned (Tuzla 7, Kakanj 8 and Banovići). Of these, Tuzla 7 and Banovići are progressing more visibly than Kakanj 8. In both cases certain measures are planned that may or may not qualify as state aid.

Tuzla 7, 450 MW lignite power plant

In July 2014 the parliament of the Federation of BiH published a paper on the progress with the project prepared by project promoter JP Elektroprivreda Bosne i Hercegovine.²³ The paper provided some basic details about the project and the offers that had been received during the tender. In April 2014 when the final offers were due, only the Gezhouba consortium submitted an offer. Gezhouba offered two options, of which one involving a Preferred Buyer's Credit, at a cost of EUR 785.7 million, was considered economically viable by EPBiH. The plan is that the China ExIm Bank will provide a loan of EUR 667 802 500 (85% of the Engineering, Procurement and Construction (EPC) contract of EUR 785 650 000).²⁴ Little is known about where the other 15% of the financing will come from as it is said in the EPBiH document that it will come from the company's own resources.²⁵ The EPC contract was signed with Gezhouba in late August 2014,²⁶ while a Memorandum of Understanding was signed between the Federation of BiH entity and ExIm Bank at a China-CEE summit in December 2014.²⁷

Two issues arise from the EPBiH document which may raise state aid issues:

- Possible state guarantee for the planned loan from the China ExIm bank by the government of the Federation of BiH entity. No information is given about whether EPBiH will have to pay for the guarantee or what percentage of the loan would be guaranteed. The parts of the document which explicitly mention a sub-sovereign guarantee are:

p.9: "The government will consider ensuring a guarantee for the financing of the project. The necessary guarantee will be considered when the financial structure of the project is defined".²⁸

p.16: Guarantee for the payment of the loan: Sub-sovereign guarantee of the Government of the Federation of BiH or sub-sovereign borrowing plus mortgage on unit 7, escrow account for income from PPA²⁹ and guarantee by JP Elektroprivreda BiH d.d. - Sarajevo.³⁰

- The prices of the EPC contract on p.18 and 33 of the document are quoted without Value-Added Tax ("bez PDV-a"). No further information confirming whether the project is to be exempted from VAT is available so far. However BiH's Law on Value-Added Tax (Official Gazette of BiH, 09/05, amended by 35/05 and 100/08) Part 4 on exemption from VAT does not list energy generation facilities among the activities that may be exempted from VAT.

23. http://predstavnickidom-pfbih.gov.ba/upload/file/sjednice/31_sjednica/28.pdf

24. http://www.fbihvlada.gov.ba/bosanski/aktuelno.php?akt_id=4483

25. http://predstavnickidom-pfbih.gov.ba/upload/file/sjednice/31_sjednica/28.pdf, p.16

26. http://www.cggc.cc/2014-09/10/content_18574821.htm

27. <http://www.elektroprivreda.ba/novost/14802/memorandum-of-understanding-on-funding-the-project-block-7>

28. Original: Vlada će razmotriti obezbijedivanje garancija za finansiranje projekta. Potrebne garancije će biti razmatrane kada se definiše finasijsko [sic] strukturiranje projekta.

29. Confusingly, the document uses 'PPA' to describe "Project Partnership Agreement" as well as "Power Purchase Agreement". The context here would seem more likely to indicate "Power Purchase Agreement", however there is little information about whether a long-term power purchase agreement is planned. It is mentioned as one of a list of possibilities for the project model on p. 10: "Concluding a financial structure without forming a joint venture company by securing Project financing through a Long-Term Power Purchase Agreement, in which the partner secures a guarantee for the Project finance and prices in the LT PPA which enable it, and JP Elektroprivreda BiH d.d. - Sarajevo independently builds and uses the facility." However in the conclusions on p. 39 it appears more likely that Gezhouba will be an EPC contractor supplying equipment and securing project financing. This is in line with other coal power plants in southeast Europe financed and potentially financed by China ExIm Bank and China Development Bank.

30. Original: Garancija otplate kredite: Sub-suverena garancija Vlade Federacije BiH ili Sub-suverene pozajmnicke plus hipoteka na blok 7, založni račun (escrow) za prihod od PPA i garancija JP Elektroprivreda BiH d.d. - Sarajevo

- Some financial services are exempt from VAT (Article 25),³¹ so there may be some elements of the EPC contract which are not subject to VAT, but these should be relatively minor compared to the overall size of the contract. VAT in BiH is set at 17% so if this was applied to the whole cost of construction of unit 7 (EUR 785 650 000), the value of the exemption would be EUR 133 560 500.

Banovići power plant 300 MW

The tender procedure for the Banovići brown coal power plant near Tuzla is still ongoing. 11 offers were submitted in the pre-qualification round in 2014 and in July the FBiH parliament discussed the project. No conclusions from the discussion were published by the Parliament but the Banovići Mine Company published a statement on its website saying that the Parliament had approved the continuation of activities on developing the power plant and that the conclusions had obliged the Ministry of Finance to deliver a bank guarantee to the Mine Company in the following few days.³² Due to the fact that the EPC contractor and therefore the financier of the project has not been chosen, we assume this formulation refers rather to an indicative letter from the Government rather than a final guarantee contract. The Parliament conclusions have not been published so far.

Public measures related to the building of coal fuelled power plants can be in line with State aid rules, if 1. the market economy investor principle is fulfilled, namely the guarantee is on market terms based on the Commission's relevant notice, or if 2. the power plant will be subject to SGEI obligation to use indigenous coal under the Electricity Directive. Granting regional aid is also in theory open, but compliance is hard to achieve. Possible VAT exemptions might also lead to State aid. As regards the Banovići project, it must be stressed that any non-market based measure granted during the tender and not being part of the tender documentation is flawing the competition for the project and granting selective advantage to the bidder selected based on different conditions.

Ukraine: Cross-subsidies

Ukraine's electricity market is strictly regulated by the National Commission for State Energy and Public Utilities Regulation, which defines tariffs for different types of generation utilities and sets prices for consumers. The system is based on a common whole-sale price of electricity for all regions (which are serviced by respective network operators Oblenergos), with no account paid to differences in cost of network infrastructure maintenance and regional economic specifics (high or low demand, condition of local utilities).

Prices for population and industries are set nation-wide, creating a structural imbalance by artificially high prices for industry and businesses and low prices for population. The system is plagued with cross-subsidies between different types of consumers (industry is subsidizing population) and different types of utilities (nuclear is subsidizing coal-fired generation and CHP, hydropower was also doing so until recently).

The "Wholesale electricity market" or Energorynok is a central administrative body responsible for financial transactions. Oblenergos are regional network operators (each for every Oblast), of which several are already privatized and others are on sale. They are responsible for electricity distribution (which they buy from Energorynok), network maintenance, connection for new users and utilities.

DTEK and all other generation utilities (including CPP and RES) sell electricity to "Wholesale electricity market" at regulated prices. Energoatom, public operator of nuclear plants gets only 0.42 UAH/kWh while coal power plants are getting 0.93 UAH/kWh.³³

Running costs for coal plants are indeed normally higher than for nuclear power, but in Ukraine the difference is much higher than "normal" due to state and regulatory capture, which occurred along with privatization of public energy utilities.

31. http://www.uino.gov.ba/download/Dokumenti/Dokumenti/bos/Porezi/PDV/Zakon_o_PDV.pdf

32. <http://rmub.ba/parlament-fbih-dao-saglasnost-za-nastavak-aktivnosti-na-izgradnji-te-banovici/> Original formulation: "Ministarstvo finansija FBiH je obavezno po zaključku Vlade FBiH da u narednim danima dostavi rudniku Banovići bankovnu garanciju."

33. Energorynok official data for April 2015 <http://www.er.gov.ua/doc.php?f=3106>

Now the dominant company DTEK owned by Rinat Akhmetov is losing its influence, as DTEK has not been granted permission to import electricity from Russia and the tariff for thermal power plants at the beginning of the year was reduced by 10%.³⁴

Compared to other countries' running costs for coal generation, Ukraine's are relatively low, which is possible for DTEK due to integrated mining (they buy their own coal), cheap workforce, no operating cost for de-SOx and de-NOx pollution control equipment. On the other hand, the current tariff for nuclear does not even cover all the running costs (not to mention decommissioning and proper waste management) and Energoatom has a constant lack of financing.

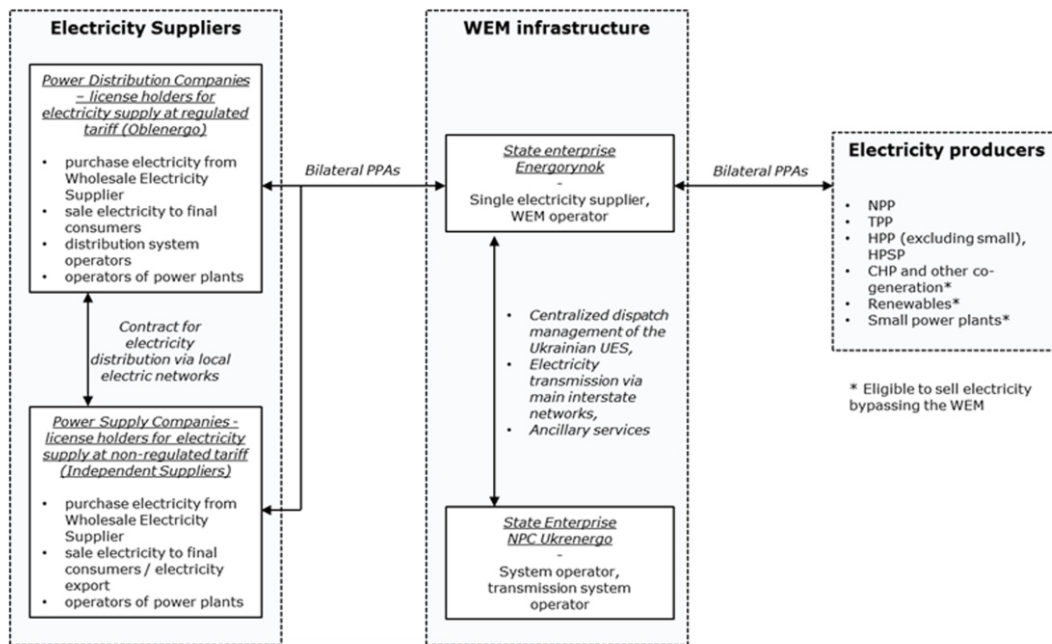


Figure 1: Ukraine's wholesale electricity market structure³⁵

Ukraine: Electricity exports

Since 2010 DTEK has held a monopoly on electricity exports from Ukraine. But when exporting DTEK is officially not supplying electricity from its own TPPs, it buys electricity from "Wholesale electricity market" and re-sells it. Energorynok is selling electricity for Oblenergos and for exporters (DTEK) at the same regulated price which changes every few weeks. This is even the case for Burshtyn Island, where Burshtyn TPP, owned by DTEK, is producing more than 90% of electricity.

From 28 March 2012 to 1 January 2015 DTEK was buying electricity from state enterprise "Wholesale electricity market" at the same price as Oblenergos and re-selling it for CEE countries (Hungary, Romania, Slovakia and Poland) at much higher prices through its Dutch-registered entities. DTEK was buying electricity at an averaged price (subsidized by hydro and nuclear) and re-selling it in CEE as coal-based + interest increase. Exceptionally favourable conditions existed for DTEK before 2014 due to the political influence of Akhmetov. Due to the special organization of the energy "market," for each kWh of exported electricity DTEK was getting a structural margin on the difference between the tariff for TPPs and the wholesale electricity price.

Since 1 January 2015 the price for exporters has been increased by adding to the "wholesale price" subsidy certificates, which are intended for additional coverage for the imbalance caused by low prices for the population. The amount of subsidy certificates (representing virtual money) is defined manually by the National Commission for State Energy and Public Utilities Regulation. The same scheme worked before March 2012.

34. *The Insider: "Webs of Hryhoryshyn and Akhmetov"* <http://www.theinsider.ua/business/gosudarstvennye-Seti-grigorishina-i-akhmetova/>

35. *Ukraine's energy sector overview* <https://imepower.wordpress.com/sector-overview/>

As a result, electricity export prices have increased, making DTEK less competitive as a supplier in the CEE region. Currently DTEK's monopoly on electricity exports and overall dominant position is being challenged by rivals and new governmental policies.

The system described can be identified as takeover of electricity with price differentiation between the source of energy used. Setting a regulated price for the population is allowed under the Electricity Directive, but not for undertakings. In addition, prices paid by the wholesale buyer should not discriminate between energy sources.

Furthermore this is State aid, if compensated by State resources or if it leads to losses on the part of the State owned wholesaler. The current rules under the EEAG and the GBER do not allow the purchasing of electricity from renewables or low carbon technologies at a fixed price but just any top-up above the market price.

Based on the information provided, it seems that the Ukrainian electricity regulation does not follow the relevant EU rules and financing of the costs of the carbon-intensive technologies from less carbon-intensive sources is against the environmental objectives. It can only be compatible if it is linked to an SGEI obligation to use domestic coal up to 15% of the country's demand as in the cases summarised in previous sections.

Again, based on the information provided, DTEK's margin earned on the exports of electricity does not seem to constitute State aid as no State resources are involved. This might fall into the category of regulatory act without the involvement of State resources. It has to be added, however, that under the EU Electricity Directive the cross-border supply has to be sold on tender for the highest bidder. In the absence of tender the State may forego revenues, which might lead to the granting of indirect State aid.

