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**Subject: State aid SA.34359 (2012/N) – Poland**  
**Aid for the construction of the oil pipeline Brody-Adamowo**

Dear Sir,

The Commission wishes to inform Poland that, having examined the information supplied by your authorities on the matter referred to above, it has decided to raise no objections to the aid measure.

## **1. PROCEDURE**

- (1) Following pre-notification contacts, on 14 September 2012, the Polish authorities notified the Commission of the above measure pursuant to Article 108(3) of the TFEU. On 15 November 2012 and 21 January 2013, the Commission requested additional information, which Poland supplied, respectively, on 26 November 2012 and on 6 February 2013.

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## 2. DESCRIPTION OF THE PROJECT AND OF THE MEASURE

### 2.1 Project description

- (2) The Project concerns the construction of a pipeline connection for the transportation of oil between a tank depot in Brody (final point of the Odessa – Brody oil pipeline in Ukraine) and a storage depot in Adamowo in Poland, (the point of connection to the northern branch of the Druzhba pipeline) from where it runs to Płock, where it branches north towards Gdańsk and the Baltic sea and west towards Schwedt in Germany.
- (3) The notification covers an individual project to be implemented in line with the provisions of Council Regulation (EC) No 1083/2006 of 11 July 2006 laying down general provisions on the European Regional Development Fund, the European Social Fund and the Cohesion Fund and repealing Regulation (EC) No 1260/1999<sup>1</sup>, planned for implementation in the framework of the 2007-2013 Environment and Infrastructure Operational Programme (Hereinafter "EIOP"). The Individual project is an investment with strategic importance for the implementation of the operational programme. It is subject to subsidisation from the funds of the European Regional Development Fund (ERDF).
- (4) The infrastructure constructed by the Project will include an oil pipeline and its accompanying technical infrastructure. The main elements of infrastructure planned for construction as part of implementation of all stages of the project are as follows:
  - underground steel pipe conduit with a diameter of 32” (the total length of the planned Brody–Adamowo pipeline amounts to 371 km, of which 251 km is within Poland);
  - 1 main pumping station in Brody;
  - 10 cut-off valve stations, which should be installed on average every 30 km;
  - SCADA - an industrial computer controlled system.
- (5) The planned Project subsidy using the EIOP funds will be allocated only to the part of the Brody–Adamowo pipeline located within Poland<sup>2</sup>.
- (6) The legal basis of the measure is i) Ustawa z dnia 6 grudnia 2006 r. o zasadach prowadzenia polityki rozwoju (Act of 6 December 2006 on the principles of conduct of development Policy); ii) Program Operacyjny INFRASTRUKTURA I ŚRODOWISKO, Narodowe Strategiczne Ramy Odniesienia 2007 – 2013 (INFRASTRUCTURE AND ENVIRONMENT Operational Programme, National Strategic Reference Framework 2007-2013); iii) Program Operacyjny INFRASTRUKTURA I ŚRODOWISKO, Narodowe Strategiczne Ramy Odniesienia 2007 – 2013, Szczegółowy opis priorytetów, Działanie 10.1 (INFRASTRUCTURE AND ENVIRONMENT Operational

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<sup>1</sup> OJ L 210, 31.7.2006

<sup>2</sup> See map in Annex 1

Programme, National Strategic Reference Framework 2007 -2013, Detailed description of priorities, Action 10.1) as well as other more national legislation.

## 2.2 The Beneficiary

- (7) The ‘Sarmatia’ International Pipeline Company (Międzynarodowe Przedsiębiorstwo Rurociągowie ‘Sarmatia’ spółka z ograniczoną odpowiedzialnością), hereinafter "Sarmatia" or "The Beneficiary", was created in July 2004 as a Special Purpose Vehicle (SPV) by the PERN ‘Przyjaźń’ S.A. Oil Pipeline Company (Przedsiębiorstwo Eksploatacji Rurociągów Naftowych ‘Przyjaźń’ S.A.) and the Ukrainian company O.S.A. ‘Ukrtransnafta’ in order to extend the Odessa–Brody pipeline towards Poland as a part of the future Euro-Asian Oil Transportation Corridor (EAOTC)<sup>3</sup>. On the day of 10 October 2007, PERN ‘Przyjaźń’ and O.S.A. ‘Ukrtransnafta’ made an Arrangement on three new participants joining the Company shareholders: State Oil Company of Azerbaijan Republic (SOCAR), Georgian Oil and Gas Corporation Ltd. (GOGC) and AB ‘Klaipedos Nafta’. On the same day, based on the Agreement on cooperation in the Energy Sector signed by Ministers from Azerbaijan, Georgia, Lithuania, Poland and Ukraine, MPR ‘Sarmatia’ Sp. z o.o. was appointed to be the Principal Coordinator of the EAOTC Project.
- (8) MPR ‘Sarmatia’ Sp. z o.o. is responsible for the comprehensive preparation and implementation of the oil pipeline construction at the Brody–Płock section.
- (9) The ownership structure of MPR ‘Sarmatia’ Sp. z o.o. is as follows:
  - PERN ‘Przyjaźń’ S.A. – 24.75 %
  - O.S.A. Ukrtransnafta – 24.75 %
  - SCOAR – 24.75 %
  - GOGC – 24.75 %
  - AB Klajpedos Nafta – 1 %
- (10) Each of the partners has the right to nominate one representative to the Company Board. The information concerning individual Company partners is presented below.
- (11) PERN Przyjaźń S.A. was created in 1959 on the basis of government agreements between the Soviet Union, Poland and the German Democratic Republic (GDR) on the oil transport and delivery and was a part of a greater Druzhba pipeline project, which was intended to connect the USSR with Poland, Czechoslovakia, GDR and Hungary. The company and the pipeline network commenced operation in 1962. Currently PERN ‘Przyjaźń’ S.A., acting as a joint-stock company wholly owned by the State Treasury.
- (12) O.S.A. ‘UkrTransNafta’ is an open stock company created by the government of Ukraine in June of 2001. Ukrtransnafta is a national operator, providing oil transport services using Ukrainian pipelines. It supervises the Odessa–Brody pipeline.

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<sup>3</sup> See map in Annex 1

- (13) State Oil Company of Azerbaijan Republic (SOCAR) is the national oil and gas company of Azerbaijan. It produces oil and natural gas, operates two national oil refineries and gas and oil pipelines passing through the country. SOCAR supervises the international consortia implementing new oil and gas projects in Azerbaijan.
- (14) Georgian Oil and Gas Corporation Ltd. (GOGC) was created in 2006 and is owned by the Georgian State Treasury. Its activities include the transport of oil and gas, engineering and construction.
- (15) AB 'Klaipėdos Nafta' was established in 1994. It was entrusted with the tasks of management of the reconstruction of oil terminal which was active since 1959 in the sea port of Klaipėda in Lithuania, and then the company became the operator of the new terminal.

### 2.3 Budget, duration, eligible costs and aid intensity

- (16) The planned Project implementation costs (including the costs which are eligible for EIOP subsidies) are presented in the table below.

**Table 1. Planned Project implementation costs**

<b>Item</b>	<b>Costs</b>	<b>Total Project costs in PLN (A)</b>	<b>Non-eligible costs* in PLN (B)</b>	<b>Eligible costs in PLN (C) = (A) – (B)</b>
1.	Fees for the preparation of plans and designs	103 704 064	42 053 065	61 651 000
2.	Purchase of real estate	56 902 424	12 475 072	44 427 352
3.	Construction works	929 764 036	357 752 865	572 011 171
4.	Equipment	989 112 223	338 839 046	650 273 177
5.	Unexpected expenses <sup>4</sup>	167 742 079	64 789 889	102 952 190
6.	Technical assistance	68 451 926	24 547 722	43 904 204
7.	Promotion and information activity	108 000	0	108 000
8.	Construction supervision	4 829 060	4 829 060	0
9.	Total (items 1-8)	2 320 613 812	845 282 718	1 475 327 094

<sup>4</sup> solutions may include inter alia using the HDD (Horizontal Directional Drilling) technology

10.	VAT	533 741 177	533 741 177	0
11.	<b>Total costs</b> (items 1-10)	<b>2 854 354 988</b>	<b>1 379 027 894</b>	<b>1 475 327 094</b>

\* The non-eligible expenses indicated in the table above include expenditures related to the implementation of the Project outside Poland (PLN 845 286 718) and the VAT (PLN 533 741 177).

(17) The table below presents the Project financing sources on the Brody–Adamowo section.

**Table 2. Project financing sources**

<b>COST</b>	<b>AMOUNT [millions PLN]</b>
Total eligible costs	1 475.3
EIOP subsidy	545
Beneficiary's own contribution including:	930.3
• Equity capital of the Beneficiary and its members	442.6
• Debt capital	487.7

(18) The aid is planned to support the expenditures related to the section of the pipeline in the territory of Poland, which account for approximately half of the total project costs. The aid intensity in proportion of the relevant costs would therefore amount to 36.9% of the costs incurred in the Polish section and to 19,1% of the total project costs.

(19) The timescale of the project covers the preparation, the implementation and the operation of the investment. The Project preparation phase was realised in 2010, the investment implementation phase was scheduled for 2011-2015 whereas the pipeline is foreseen to be operational from 2016 as soon as the first stage of construction has been completed. The operation phase falls for the period 2016-2035 (20 years). The duration of the individual aid will run from the adoption of the decision by the Commission until the end of 2015.

(20) The remaining assumptions of the project are the following:

- the discount rate applied in the financial analysis amounts to 5% (in accordance with EU recommendations “Cost-benefit analysis of investment Project – a Guide”);
- all costs and prices are provided in real terms;

- the asset write-off has been assumed after 25 years;
  - VAT is a non-eligible expense and is subject to refunding on general principles.
- (21) Poland presented the investment effectiveness ratios for the project. In the no aid scenario Poland indicated that the investment would not be financially profitable, as the financial rate of return (FRR with FRR/K representing the internal rate of return on own capital and FRR/C being the internal rate of return on investment) would be much lower than the discount rate of 5 %, and the net present value (NPV) would be negative. In the aid scenario the financial rate of return would be slightly lower than the considered discount rate, and the net present value still negative, as can be seen in the Table 3 below presenting the financial analysis of the eligible part of the Project. This is because the reference period used in the feasibility study for the project is 20 years, which is far shorter than the actual working life of the planned pipeline<sup>5</sup>. Consequently, the much longer working life of the infrastructure built under the project will enable more financial flows to be generated and so improve the FNPV/K indicator. The Polish authorities explained that the throughput of the pipeline to be built under the Project may be increased in the future by the implementation of separate projects, such as further pump stations and extensions of the pipeline. This will make it possible to generate greater financial flows, which will help improve the project's profitability and increase the value of the ENPV/K indicator.
- (22) When performing financial calculations for the Project, income from the transport of oil has been taken into account. The amount of income has been calculated by multiplying the tariff (costs of transport of 1 tonne at a specific distance) by the transported quantity (e.g. tonnes per year). The transport tariff for the Brody-Adamowo pipeline has been determined on the basis of the model composed of tariffs for nearby pipelines. These are sections of pipeline systems in such countries as: Belarus, Russia, Poland, Slovakia and Ukraine. The lowest tariff, amounting to EUR 0.58 (PLN 2.33) per tonne per 100 km was noted on the section of the northern line of the Druzhba pipeline in Belarus. The highest tariffs are charged for Ukrainian pipelines and they amount to ca. EUR 1.04 (PLN 4.18) per tonne per 100 km. The cash flow model does not take account of the (real) increase in the tariff during the entire period under consideration. In other words, it is assumed that the tariff on average will not grow faster than general inflation.
- (23) According to the information above submitted by the Polish authorities, the financial forecasts (in particular the projected cumulative positive net cash flow) indicate that the Project is economically viable.

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<sup>5</sup> As an indication of the pipeline's lifetime the Polish authorities explain that the Druzhba oil pipelines owned by PERN 'Przyjaźń' S.A. have been in operation since the 1950s and are expected to remain in use for at least another 10 years.

**Table 3. Financial ratios**

Financial ratio	return on investment		return on equity	
	(without aid)		(with aid)	
1. Financial rate of return (%)	1.45%	FRR/C	4.91%	FRR/K
2a. Updated net value (EUR million)	-114.1-	FNPV/C	-2.1	FNPV/K
2b. Updated net value (PLN million)	-459.0	FNPV/C	-8.2	FNPV/K

Source: Polish authorities

(24) The level of co-financing from EU funds in the Project has been determined using the “no over-compensation” method, according to which in the case of projects planned for co-financing from EU Funds, FRR should not exceed the value of the financial discount rate accepted for the purposes of the financial analysis, in order to avoid excessive return on the project at the expense of the EU taxpayer. The methodology of the financial analysis of the Project is compliant with instructions and guidelines contained in the following documents:

- “Cost-benefit analysis of investment Project – a Guide”, DG REGIO, European Commission, 2008
- “Guidance on the Methodology for carrying out Cost-Benefit Analysis – Working Document No. 4”, European Commission, 08/2006.

#### **2.4 The main objective of the project: "energy security"**

(25) The Polish authorities claim that the general objective related to the construction of the Brody-Adamowo pipeline is to increase energy security in Poland and other Member States of the European Union by supporting the diversification of energy sources and industrial routes. The projects intends to enhance the energy security by contributing to satisfying the forecast growth in oil demand in Central and Eastern Europe by ensuring cost-efficient transport of increased quantities of oil exported from the Caspian Sea Region while replacing shrinking oil supplies from the North Sea, which currently constitute a significant volume of crude oil supplies to Northern European refineries and by increasing supply security thanks to an additional and stable supply source — the producers of Caspian oil.

(26) Currently, crude oil is transported to the territory of Poland using a single pipeline - the “Druzhba” pipeline. It enables crude oil to be delivered to and across Poland only from a single source. Given the ever increasing demand for crude oil and oil derivatives (see table 4 below) the oil transportation system which currently exists in Poland is insufficient both in terms of volume (limited capacity of the existing system) and supply security as it precludes supply of crude oil from other sources. In the light of these circumstances, the Polish

authorities believe that diversification of crude oil supplies to the Polish and EU markets is not only highly advisable but even indispensable.

**Table 4. Current and projected demand of crude oil in Poland**

MTOE (millions of tonnes of oil equivalent)	2010	2020
Demand for energy in transport	12.6	17.1
Public road transport	0.6	0.5
Private cars and motorcycles	6.7	9
Trucks	3.9	5.5
Railway	0.5	0.5
Aviation	0.4	0.8

Source: ILF et al. 2006

- (27) The Polish authorities highlight that the Project will contribute to increasing the volume of crude oil supplied not only to the Polish market but also to other EU member States from a source different from the previously existing ones. In fact, the existing Euro-Asian Oil Transportation Corridor (EAOTC) connects European refineries with crude oil resources located in the Caspian Sea region, i.e. in Kazakhstan and Azerbaijan, whereas the construction of the Brody–Adamowo pipeline will extend the “corridor” to reach Poland, followed by eastern Germany, the Baltic Sea Region, and subsequently – in a long-term perspective – North-western Europe. The Project assumes the construction of the Brody–Adamowo oil pipeline with an option of extending it to Płock, Gdańsk or in the western direction, in three stages, with capacities of ca. 10, 20 and 30 MTA. The planned capacity will be increased as the Project is implemented, mainly as a result of commissioning additional pumping stations along the route.
- (28) In addition, it is assumed that especially when higher capacities are offered, some of the crude oil supplied will be delivered to the port in Gdańsk for further export to the Baltic Sea region (extended area of the Project), and potentially to North-western Europe, which, according to the Polish authorities proves that the implementation of the Project is a common European interest. In particular, Poland assumes that out of 10 million tons of oil supplied annually, approximately 6 million tons could be received by oil refineries in Poland and 4 million tons could be supplied to other Member States, subject indeed to the specific volumes that MPR Sarmatia and its future customers may decide in future transport contracts.
- (29) The Polish authorities point out that alternatives to this project have been considered as regards oil transport. One of them is the crude oil transportation by oil tankers through Danish straits and Bosphorus and Dardanelles passages. A financial analysis was performed by the Polish authorities consisting in the estimation of costs of transportation with tankers from Supsa to Gdańsk (ca. USD 30/PLN 93 per tonne, excluding the exceptional situation of the recent economic crises and including port charges) and comparing them to the total



cost of transportation with the pipeline via the Brody-Adamowo route (approx. USD 26.2 to USD 29.2/PLN 81.2 to PLN 90.5 per tonne). As a result of the analyses, it was established that crude oil transportation using a pipeline was more competitive in every case, more so as tanker transportation rates are more volatile and unpredictable as compared to pipeline transportation fees.

- (30) Moreover, according to the Polish authorities, the pipeline option for crude oil transportation is supported also by other arguments than merely the costs, such as the fact that the availability of Bosphorus is limited especially in the winter season, which means that the transportation of 30 million tonnes per year would require an additional 250 tankers of 120 DWT per year to cross the strait both ways. Additionally, the Polish authorities claim that this alternative would increase the risk of accidents and environmental pollution due to emissions of harmful substances into the air, as well as a result of potential oil spills, which therefore constitute a less environmentally desirable alternative.

### 3. ASSESSMENT

#### 3.1 Existence of State aid within the meaning of Article 107(1) of the Treaty

- (31) Article 107(1) of the Treaty on the Functioning of the European Union ("TFEU") provides that "*any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods, shall, in so far as it affects trade between Member States, be incompatible with the common market*". The examination of the cumulative conditions set out therein is examined hereinafter.

##### 3.1.1 State resources and selective economic advantage

- (32) The aid is planned to be granted solely to the benefit of MPR Sarmatia from State resources within the meaning of Article 107(1) of the TFEU. This is due to the fact that the structural funds resources are paid to the Member State before being paid by the latter to the beneficiary and the money is therefore at the control of the Member State at the moment of the disbursement to the beneficiary. The choice of the project at hand and the transfer of Structural Funds resources from the EU budget to Poland are imputable to a decision and request of Poland.
- (33) As regards the presence of an economic advantage to the sole beneficiary, the planned grant shall enable the beneficiary to build and own assets at financial conditions not otherwise available on financial markets, thereby obtaining an economic advantage. The investments will take place with a smaller engagement of capital of MPR Sarmatia which normally would need to take place when the investments would need to be financed without aid. Therefore MPR Sarmatia can benefit to an extent of opportunity costs of the capital that it would otherwise need to finance the investments without the aid.

- (34) In the view of the direct benefits to Sarmatia in form of additional revenues covering full depreciation and in form of avoided costs of capital that would need to be used if the investments would not be financed without the aid, the aid will give a direct advantage within the meaning of Article 107(1) of the TFEU, to the beneficiary of the aid. As the financing by the State of a particular investment is considered conferring an advantage and this advantage is only granted to Sarmatia, that advantage is selective.

### ***3.1.2 Distortion of competition and affectation of trade between Member States***

- (35) The Commission notes that, whilst the activities of Sarmatia involve transport and trade of oil into Poland, that there are alternative routes for oil supply in Poland and other Member States of the European Union. As a result, competition exists for oil supplies, which risks being distorted by the aid to the construction of a construction of the oil pipeline between Brody and Adamowo. Likewise, oil is traded between Member States and, as pointed out by Poland (see recital 28), supplies entering the planned pipeline can be sourced thereafter, for instance, to other Member States of the European Union.
- (36) Accordingly, the aid distorts, or threatens to distort competition and affect trade between Member States.

### ***3.1.3 Conclusion on existence of the aid***

- (37) Taking the above into consideration the Commission concludes that the measure involves State aid within the meaning of Article 107 (1) of the TFEU.

### **Lawfulness of the aid**

- (38) Poland confirmed to the Commission that the payment of the aid is conditional upon the approval by the European Commission. Therefore Poland has fulfilled its obligation according to Article 108(3) of the TFEU by notifying the aid measure before its implementation. Poland furthermore commits to notifying in the future any changes that would constitute an alteration of the aid subject to the present notification.

### **Compatibility under Article 107(3)(c) of the TFEU**

- (39) The Commission notes that the measure primarily concerns the construction of an oil pipeline in Poland. The main objective of the aid is to increase security of supply of oil in Poland, by diversifying the supply routes.
- (40) The Commission therefore considers that the assessment of the compatibility of the measure with the internal market requires an assessment of the contribution of the measure to the development of the European Union market for oil and therefore needs to be based on Article 107(3)(c) TFEU which states that: “*aid to facilitate the development of certain economic activities or of certain economic areas, where such aid does not adversely affect trading conditions to an extent contrary to the common interest*” may be considered to be compatible with the internal market.

- (41) The compatibility of the measure with the internal market needs to be based on the direct application of Article 107(3)(c) TFEU, since aid for projects supporting energy infrastructure does not fall within the scope of the 2008 Environmental Aid Guidelines<sup>6</sup>, which are based on that Article.
- (42) Likewise, although the areas covered by the measure are eligible under the European Regional Development Fund, as well as Article 107 (3) (a) TFEU assisted areas within the meaning of the Guidelines on national regional aid for 2007-2013<sup>7</sup>, the aid is not primarily designed to contribute to regional development by supporting investment and job creation through the expansion and diversification of the economic activities located in the less-favoured regions, in particular by encouraging firms to set up new establishments there. Neither job creation nor setting up new establishments is the main objective of the aid.
- (43) It is established Commission practice<sup>8</sup>, notably in the area of aid to the construction of energy infrastructure<sup>8</sup>, that measures may be declared compatible directly under Art. 107(3)(c) TFEU, if they are necessary and proportionate and if the positive effects for the common objective outbalance the negative effects on competition and trade. In this regard, the Commission considers it appropriate to assess the following three questions:
- 1) Is the aid measure aimed at a well-defined objective of common interest<sup>9</sup>?
  - 2) Is the aid well designed to deliver the objective of common interest? In particular:
    - a) Is the aid measure an appropriate and necessary instrument, i.e. are there other, better-placed instruments<sup>10</sup>?
    - b) Is there an incentive effect, i.e. does the aid change the behaviour of firms?
    - c) Is the aid measure proportional, i.e. could the same change in behaviour be obtained with less aid?
  - 3) Are the distortions of competition and the effect on trade limited, so that the overall balance is positive?

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<sup>6</sup> OJ C 82 of 01.04.2008

<sup>7</sup> OJ C 54, 4.3.2006, p. 13

<sup>8</sup> See, among other cases, Commission Decisions in cases (N56/2009) modernisation of electricity distribution networks in Poland, (N542/2010), Interconnector and power line Poland – Lithuania, (N629/2009) Electricity and national gas network in Romania, (N594/2009) Gas pipelines in Poland, SA 33 823 (212/N) Electricity cable Aland – Finland (mainland), SA.31953 (2011/N) Construction of a LNG Terminal in Swinoujsciu, SA.29870 (N 660/2009) – Poland Aid to PGNiG for underground gas storage.

<sup>9</sup> Judgement of the court of 14 January 2009, Kronoply v. Commission (T-162/06, Rec. p. II-1; especially points 65, 66, 74, 75)

<sup>10</sup> Judgement of the Court of 7 June 2001, Agrana Zucker und Stärke / Commission (T-187/99, Rec. p. II-1587) (cf. point 74); Judgement of the Court of 14 May 2002, Graphischer Maschinenbau / Commission (T-126/99, Rec. p. II-2427) (cf. points 41-43); Judgement of the Court of 15 April 2008, Nuova Agricast (C-390/06, Rec. p. I-2577) (cf. points 68-69).

### *Objective of Common Interest*

- (44) An objective of common interest is an objective which has been recognised by the EU as being in the common interest of the EU Member States.
- (45) Pursuant to Article 194 TFEU, “In the context of the establishment and functioning of the internal market and with regard to the need to preserve and improve the environment, Union policy on energy shall aim, in a spirit of solidarity between Member States, to:
- a) ensure the functioning of the energy market;
  - b) ensure security of energy supply in the Union;
  - (...)
  - c) promote the interconnection of energy networks.”.
- (46) The notified project will contribute to increasing security of supply of oil to Poland, as it will diversify sources of supply and therefore improve the stability and continuity of the supply of oil to final customers in Poland and the EU. The projections of demand growth portrayed in Table 4 above, indicate that an alternative to the Druzhba pipeline is desirable for Poland. Likewise, as described in recital 28, approximately 40% of oil sourced from the Brody-Adamowo pipeline may ultimately be sold in EU Member States other than Poland. The construction of the Brody-Adamowo pipeline is therefore consistent with the need to increase and diversify the sources and supply routes for oil.
- (47) In the Communication COM(2010) 677 of 17 November 2010 from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions: Energy infrastructure priorities for 2020 and beyond –it was directly indicated (page 42) that “the upgrade of the Odessa-Brody pipeline in Ukraine (connecting the Black Sea oil terminal to the Southern branch of Druzhba at Brody) and its planned extension to Poland (Brody-Adamowo)” is a method to warrant crude oil supply. The Project is quoted as an effective element of the system of responses to potential disruptions of supply to Central and Eastern Europe.
- (48) Therefore, it should be pointed out that the Project implements the essential objective of the Treaty’s energy policy, namely ensuring security of energy supply by building new crude oil transportation infrastructure.

### *Appropriate Instrument*

- (49) It should be pointed out that alternatives to diversify oil supply by means of crude oil transportation by oil tankers were examined by the Polish authorities on the basis of objective factors and found less efficient, on balance (see recital (29)). The Commission acknowledges that, in the present circumstances, transportation of oil via a pipeline is cheaper, more reliable and cost effective.
- (50) It can be concluded that the construction of the Brody–Adamowo pipeline adequately addresses the problem of security of oil supply by fostering diversification of supply routes, and the provision of investment aid for the

construction of the pipeline is an appropriate instrument to achieve the objective. This conclusion is without prejudice to the findings of an environmental impact assessment, no definitive conclusion being possible on the alleged environmental benefits of it as compared with the alternatives examined.

#### *Incentive Effect*

- (51) State aid provides an incentive effect if the aid changes the recipient's behaviour towards reaching the objective of common interest. As shown in table 3 above, the provision of state aid is indeed crucial for the implementation of the Project. The Commission verified the financial data and whether the methodology used has been in accordance with the guidelines listed in recital (24) above.
- (52) The results of the financial analysis indicate that the option with no state aid provided is financially unviable – the return of 1.45% is significantly lower than the discount rate of 5%, while the Net Present Value (NPV) is negative. With the planned state aid, the return is close to the discount rate of 5%, while the NPV is still negative. If there was no state aid provided, the rate of return on the Project would be unacceptable for a rational private investor and would discourage it from the implementation of the Project.
- (53) The aid therefore provides an incentive for the beneficiary to change its behaviour, i.e. to carry out the investment and thus to achieve broader objectives essential both from Poland's perspective and from the perspective of the common interest of the EU which include, inter alia, ensuring energy security through supply diversification.
- (54) It can be therefore concluded that the aid has an incentive effect, as it provides the necessary incentive for the beneficiary to undertake the project.

#### *Proportionality*

- (55) A State aid measure is proportional if the measure is designed in a way that the aid as such is kept to the minimum.
- (56) The amount of Project co-financing from the ERDF applied for (PLN 545 million) results from the financial analysis presented above. The Commission has no reason to question the long term viability of the project as the income has been estimated by the Polish authorities based on conservative assumptions regarding the forecasts of demand and on an average of tariffs applied in the region (see recital (22) above).
- (57) According to the calculation, aid intensity for the Project is 36.94%, while the methodology used to calculate it ensures that the amount of state aid would not exceed the amount necessary to carry out the investment and to achieve the assumed objectives. This indicates that the aid shall not provide Sarmatia with excessive profits on the planned investment as the profits are limited to the income from the transport of oil, based on the tariff set taking into account the nearby pipelines. The tariff setting method also ensures that the financial rate of return on equity (FRR/K) with the subsidy calculated in the analysis of the

project's financial viability does not exceed the maximum financial value of the discount rate.

- (58) In addition, the beneficiary will be bound by the grant agreement to systematically report its financial results to the granting authority for five years after the completion of the project. The granting authority will analyse the above results for the purpose of monitoring the above financial indicators. Should the indicators be exceeded, the beneficiary will have to recalculate the amount of the subsidy and return the difference between the newly calculated amount and the initial subsidy.
- (59) Given the above, the principle of proportionality of state aid for the investment was fulfilled and it was demonstrated that the aid could not be lower to have the Project implemented in the assumed scope and to have the said objectives attained. It can thus be concluded that the State aid granted for the envisaged measures is proportional, as it is limited to the minimum necessary.

#### *Distortion of Competition and Balancing Test*

- (60) The Polish authorities undertake that transparent terms and conditions will be set, upon which the infrastructure will be made available to all crude oil suppliers – prospective business partners of the Beneficiary/operators. Infrastructure will be made available upon equal, non-discriminatory terms, with no preference given to any of the suppliers. The tariff for crude oil transportation using the pipeline will be set by Sarmatia in consultation with infrastructure operators and taking into account the necessity to return the investment expenses in the part not financed by the funds of the Operational Programme Infrastructure and Environment.
- (61) The Beneficiary is planning to, in consultation with PERN “Przyjaźń” S.A. and O.S.A. “Ukrtransnafta”, conduct an Open Season procedure, which would establish the financial and technical terms and conditions for crude oil transportation and to conclude agreements with customers upon market terms. The Open Season procedure (procedure of making the transportation capacity of the new planned infrastructure available) will be held in compliance with the relevant practices applied in the implementation of infrastructure projects.
- (62) To sum up, it appears that the possible distortion of competition is sufficiently mitigated by planned flanking measures as to access to the infrastructure and Open Season procedure and further offset by the broader benefits resulting from the implementation of the Project, and in particular in the context of the achievement of the objective of common economic interest of securing and diversifying energy supplies.

#### *Conclusion on the compatibility of the aid*

- (63) The Commission thus concludes that the aid measure pursues an objective of common interest in a necessary and proportionate way and is therefore compatible with internal market in accordance with Article 107 (3) (c) of the TFEU.

#### 4. CONCLUSION

- (64) The Commission has accordingly decided not to raise objections to the notified measure, because the aid can be found compatible with the internal market in accordance with Article 107 (3) (c) of the TFEU.

The Commission reminds the Polish Authorities that, in accordance with article 108 (3) of the TFEU, plans to refinance, alter or change this aid have to be notified to the Commission pursuant to provisions of the Commission Regulation (EC) No 794/2004 implementing Council Regulation (EC) No 659/1999 laying down detailed rules for the application of Article 93 of the EC Treaty [now 108 of the TFEU] (OJ L 140, 30.4.2004, p.1).

If this letter contains confidential information which should not be disclosed to third parties, please inform the Commission within fifteen working days of the date of receipt. If the Commission does not receive a reasoned request by that deadline, you will be deemed to agree to the disclosure to third parties and to the publication of the full text of the letter in the authentic language on the Internet site:

<http://ec.europa.eu/competition/elojade/isef/index.cfm>

Your request should be sent by registered letter or fax to:

European Commission  
Directorate-General of Competition  
State Aid Registry  
1049 BRUSSELS  
Belgium  
Telefax n°: + 32-2-296.12.42

Please, mention the name and number of the case in all the correspondence.

For the Commission

*Joaquín ALMUNIA*  
Vice-President

## Annex1

Figure 1 EAOTC route with the Brody-Plock oil pipeline

The new pipeline (in blue) is restricted to the Sarmatia part between Brody and Adamowo. The remaining part (in red) represents the existing network of pipelines

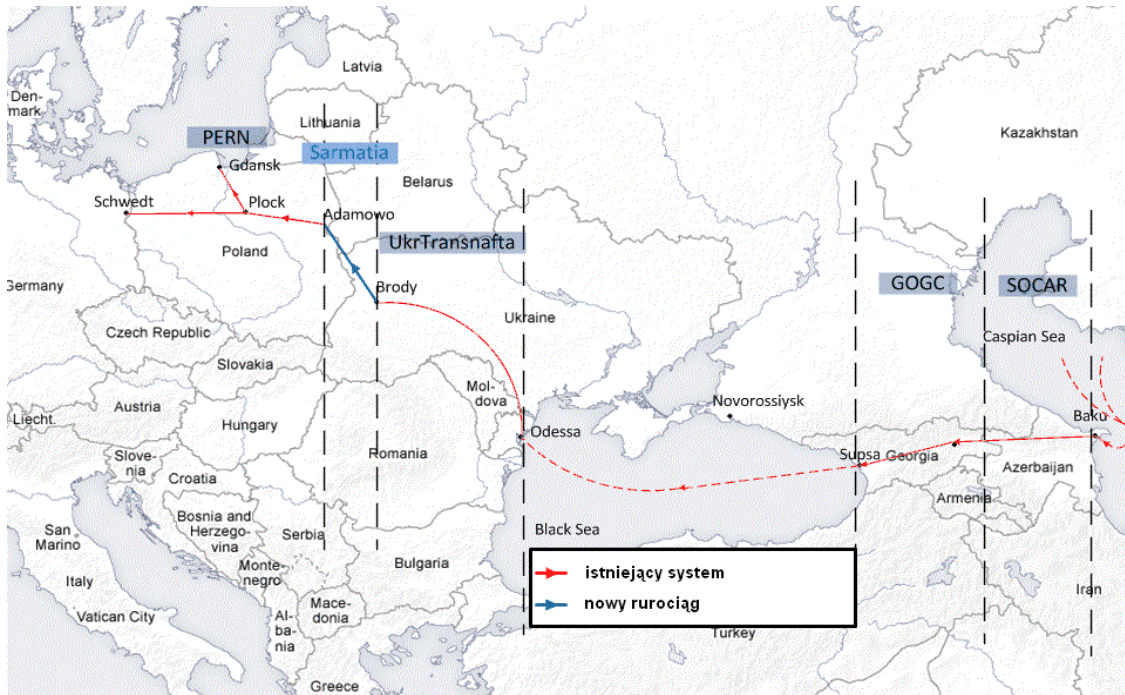
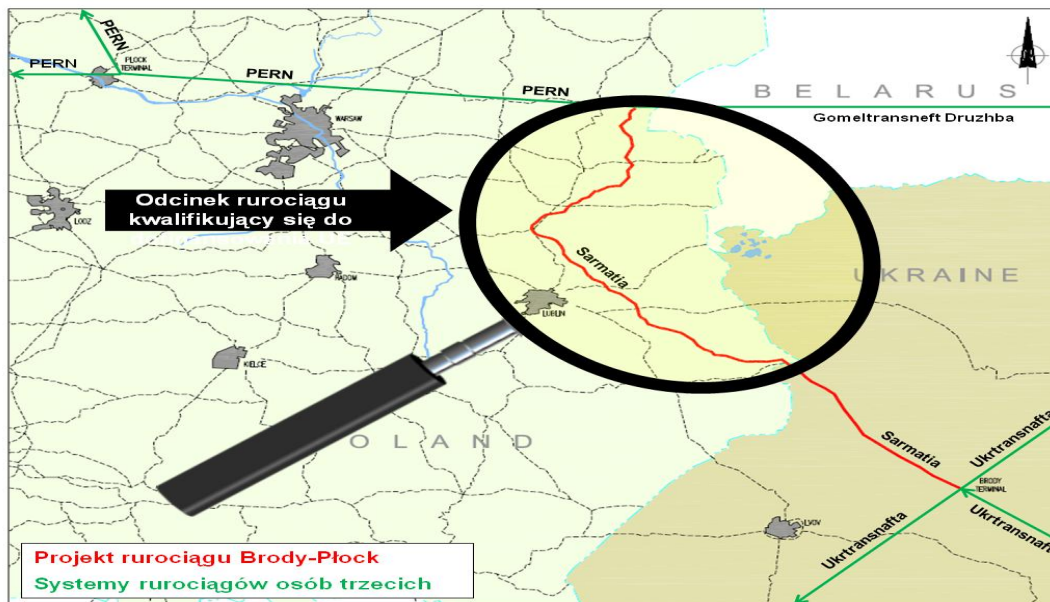


Figure 2. Brody-Adamowo pipeline and the eligible section from the Ukraine-Polish border to Adamowo as presented by the Polish authorities



Pipeline section eligible for a subsidy  
**The Brody-Plock pipeline project**  
 Pipeline systems of third parties