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<p>In the published version of this decision, some information has been omitted, pursuant to articles 24 and 25 of Council Regulation (EC) No 659/1999 of 22 March 1999 laying down detailed rules for the application of Article 93 of the EC Treaty, concerning non-disclosure of information covered by professional secrecy. The omissions are shown thus [...].</p>	<p style="text-align: center;">PUBLIC VERSION</p> <p>This document is made available for information purposes only.</p>
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**Subject: State Aid SA.45779 (2016/NN) – Malta
Delimara Gas and Power Energy Project**

Sir,

1. PROCEDURE

- (1) Following pre-notification contacts, on 28 June 2016 Malta notified a State aid measure to support the Delimara Gas and Power Energy Project (the "Project").
- (2) The Commission requested additional information by e-mail of 13 July 2016, to which Malta replied by e-mails of 19 and 27 July 2016.
- (3) Since the information available showed that part of the public funding had already been disbursed, on 1 July 2016, the Commission registered the measure as unlawful aid (2016/NN). Therefore, the procedural rules applicable are those laid

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down in Chapter III of Council Regulation (EU) 2015/1589¹ (Procedure regarding unlawful aid).

- (4) On 24 November 2016, Malta agreed that the present decision would be adopted and notified in English.

¹ Council Regulation (EU) 2015/1589 of 13 July 2015 laying down detailed rules for the application of Article 108 of the Treaty on the Functioning of the European Union (OJ L 248, 24.9.2015, p. 9).

2. DESCRIPTION

2.1. Objective

- (5) According to the Maltese authorities, the country faces a steadily increasing demand for energy and needs new and efficient generating capacity that will lower the cost of generation, improve the reliability of supply and effect significant environmental improvements.

2.1.1. *The energy market in Malta*

- (6) According to studies submitted by the Maltese authorities, annual consumption in the Maltese electricity market is currently 2.2 TWh, and is expected to rise to 2.47 TWh by the end of 2020. Peak load is expected to rise from around 430 MW in 2014 to around 530 MW by 2030. Night-time base load is expected to increase from around 145 MW to 180 MW. The average demand is expected to increase from around 280 MW in 2014 to 360 MW by 2030.
- (7) As regards supply, there is currently no domestic gas supply in Malta, and the installed generation capacity is generally outdated. In addition, Malta does not have any indigenous sources of conventional energy. Hydropower is not available in Malta and nuclear power generation is not a feasible option. Malta is heavily dependent on imported oil-based fuels as it is virtually the sole type of energy used for electricity generation in Malta. This heavy reliance on oil-based fuels has become over the years very expensive² and further exposes Malta to risks of prolonged pollution, oil price volatility and interruptions to imports.
- (8) The Maltese authorities claim that in spite of having some of the highest electricity prices in Europe, Enemalta Plc ("Enemalta"),³ which is the exclusive distributor of electricity in Malta, was still running at an operating loss until 2014. This was largely caused by dependence on an inefficient configuration of energy generation capacity. In addition, the current generation capacity is based on heavy fuel oil and is a major source of pollution.
- (9) As can be seen in the table below, conventional electricity in the past decades has been generated through two power stations, Marsa Power Station and Delimara Power Station.

² There has been a significant drop in fuel oil prices over the recent period. It is however impossible to predict whether this new trend will last and it just confirms the high volatility of oil prices.

³ Enemalta is a public undertaking and the sole entity in Malta having a license to perform all three functions of generation, distribution and supply of electricity.

Table 1: Existing large⁴ electricity generation in Malta

Table 1 - Existing Large Electricity Supply Capacity in Malta				
Power Station Block	Generation equipment	Gross supply capacity (MW)	Fuel	Year completed
Marsa B 7-8	2x steam turbine generators	120	Heavy Fuel Oil	1964-1987
Marsa B GT1	1x gas turbine	35	Gasoil	1990
Delimara 1 – ST	2x steam turbine generators	120	Heavy Fuel Oil	1992
Delimara 2A – GT	2x gas turbines	70	Gasoil	1996
Delimara 2B	CCGT Plant- 2x GT, 1x ST	110	Gasoil	1998
Delimara 3	8x Internal Combustion Engines	144	Heavy Fuel Oil	2012
Total		599		

- (10) The Maltese authorities explain that 40 % of installed electricity generation capacity is either nearing end of life or requires decommissioning for environmental motives.
- (11) The Marsa B 7-8 power plant has been shut down and the Delimara 1 power plant is earmarked for shut down by the end of 2016.⁵ It is intended that the Marsa B GT1 and the Delimara 2A plants are kept for emergency purposes as they are open cycle gas turbines and are relatively inefficient, and therefore expensive, to operate for long durations. Delimara 2B is intended to remain on standby, to be used in the event that the primary generation equipment fails, as back-up. In addition, this facility is also nearing the end of its technical, technological and economically useful life.
- (12) Once the phasing out is completed, the only remaining major operational generation facilities will be the Delimara 3 power plant and a 200 MW electricity interconnector with Sicily, which was completed in 2015.
- (13) The interconnector is the largest source of energy supply for Enemalta. However, the functioning of the interconnector is subject to constraints of the electricity market in Sicily and network congestion in Italy. The Maltese authorities explain that there have already been occasional restrictions of the supply of electricity imposed from the Italian side. In addition, being an underwater cable, there are risks that the interconnector is unavailable at times, in particular considering the lengthy repairs procedure for the subsea tract.
- (14) The Maltese authorities explain that, unlike in larger countries where single generators are not necessarily critical points of failure, a failure of the Malta-Sicily

⁴ All generation capacity except renewable sources.

⁵ This is to coincide with the commissioning of the new gas-fired power plant (D4).

interconnector would remove almost half of Malta's available capacity. The interconnector will account for approximately 38 % of Malta's total available capacity once Marsa B 7-8 and Delimara 1 power plants are decommissioned.

- (15) In addition, the Maltese authorities argue that, because of their inherent intermittency and the geophysical limitations on their deployment and costs, renewable sources of energy (RES) cannot ensure all the non-variable generation capacity Malta requires. According to Malta, the country is effectively in line with the trajectory set by Directive 2009/28/EC of the European Parliament and of the Council⁶. The Maltese authorities explain that the interim targets of 2 % for 2011-2012 and 3 % for 2013-2014 have been exceeded and they estimate to have reached 5 % target by the end of 2015.⁷ Generation from renewables will continue to benefit from priority dispatch, but nevertheless requires sufficient conventional capacity to provide back up when there is no wind or sun. On 26 August 2016 the Commission approved Malta's new support scheme for RES, which will contribute to the achievement of Malta's 2020 renewable energy target.⁸
- (16) As regards Demand Side Response ("DSR") measures, Malta explains that the domestic sector is not expected to provide an appreciable potential for DSR, given that this sector already has the lowest consumption within the EU on a per household basis. As regards the commercial and industrial sector, the level of generation capacity required to guarantee the desired level of security cannot be met through DSR. However, Malta is actively considering DSR measures to address short-term demand peaks.
- (17) Moreover, the Government of Malta intends, in the longer term, to implement a connection to the trans-European natural gas network via a gas pipeline with Sicily to deliver natural gas for the generation of electrical power. The expected timeline for this new investment (10 years) has been taken into account in the design of the Project.
- (18) To ensure system reliability and adequate generation capacity at all times, prudent management require electricity system operators to respect a contingency policy respecting an 'N-1' security criterion.⁹ In simple terms, this means that in case of loss of one of the largest power sources due to forced outage, damage or maintenance, the system would be able to supply all demand without fail.

⁶ Directive 2009/28/EC of the European Parliament and of the Council of 23 April 2009 on the promotion of the use of energy from renewable sources and amending and subsequently repealing Directives 2001/77/EC and 2003/30/EC (OJ L 140, 5.6.2009, p. 16).

⁷ According to the Commission's Country Report Malta 2016, available at http://ec.europa.eu/europe2020/pdf/csr2016/cr2016_malta_en.pdf, Malta's renewable energy share has reached 4.7 % in 2014, above the indicative trajectory towards the 2020 target. However, significant renewables deployment is needed in view of the steep trajectory towards 2020.

⁸ Commission Decision of 26 August 2016 in case SA.43995 Competitive Bidding Process for Renewables Sources of Energy Installations, OJ C 369 of 07.10.2016.

⁹ See the draft Regulation establishing a guideline on electricity transmission system operation, available at <https://ec.europa.eu/energy/sites/ener/files/documents/SystemOperationGuideline%20final%28provisional%2904052016.pdf>.

- (19) The Maltese authorities claim that without new generation facilities, Malta would not be in a position to ensure that the security of supply is satisfied in case of failure of the interconnector.

2.2. The Project

- (20) The National Energy Policy for the Maltese Islands 2012 set out the energy-related targets for 2020-2050 and is intended to: "Determine a strategy to replace the Delimara plant that is flexible and that diversifies Malta from the use of oil as an energy source whilst at the same time ascertaining security of supply" and "Switch island generation plant to natural gas".
- (21) In April 2013, the Ministry responsible for Energy embarked on a roadmap (the "Energy Roadmap") which included, among other things, enhancing and strengthening the security of supply of the country whilst ensuring the availability of appropriate back up capacity, and overhauling the generation capacity of the country with a view to achieving higher efficiency gains whilst stimulating investment in natural gas infrastructures.
- (22) The Maltese authorities explain that a critical component of the Ministry's strategy in achieving those objectives consisted in the establishment of a long term power purchase agreement and a gas supply agreement to be entered into between Enemalta and an established and experienced private power and gas operator.
- (23) Enemalta explored several options for future investments in generation and interconnection capacity in Malta, through public consultations,¹⁰ and with the assistance of external consultants.¹¹ The Enemalta Energy Generation Plan (EGP) 2006-2015 had examined several alternative technology options. In addition, alternative natural gas infrastructures had been considered in a feasibility study entitled "Energy Interconnection Europe", commissioned by the Malta Resources Authority.
- (24) After assessing possible future solutions, the Maltese authorities determined that the most appropriate solution for Malta's needs consists of the improvement of the operational efficiency resulting from a new combined cycle gas turbine ("CCGT" or "Delimara 4"),¹² the switch to gas from fuel oil of the recently built Delimara 3 plant, the closing down of the old Marsa Power Station, the ongoing and planned investments in the distribution and transmission networks, and the ongoing possibility to access the European electricity market via the electricity interconnector with Sicily.
- (25) In the light of the above, the Maltese authorities seek the construction and operation of a gas and power project (Delimara 4) on the Delimara site intended to

¹⁰ When elaborating the National Energy Policy, two consultations were carried out by the Maltese Authorities in 2006 and in 2009.

¹¹ See for more details: IPA Report Fuel Optimization (Study prepared for Enemalta Corporation), November 12, 2010. Further studies and analyses were performed by Enemalta, and a study was commissioned [...].

¹² Various alternative technology options and configurations were assessed: diesel fuelled engines, open cycle gas turbines, combined cycle gas turbines, refurbishing the existing steam plants and an additional interconnector. The choice of natural gas was also taken after exploring a variety of alternative fuel configurations that could potentially be used for power generation in Malta, including RES.

replace, on the one hand, existing, less efficient and less environmentally friendly power generation capacities, and, on the other, diversify sources of energy in Malta by the development of a Floating Liquefied Natural Gas ("LNG") Storage Unit (the "FSU"), i.e. the Delimara Gas and Power Energy Project.

- (26) The FSU will be linked to regasification facilities onshore at the Delimara site to facilitate the supply of natural gas (from LNG) to a CCGT as well as to an existing power plant to be retrofitted for natural gas, the Delimara 3 plant.
- (27) The FSU is a modified LNG carrier vessel with a storage capacity of up to 125 000 m³ of LNG. The FSU will receive and store LNG delivered by conventional LNG delivery carriers and deliver LNG (by way of gas pipes attached to a fixed jetty) to the onshore re-gasification unit.
- (28) The customer of the power and gas supplied by the Project is Enemalta, which is a State-controlled undertaking and the main provider of electricity generation and distribution services in the Maltese Islands.
- (29) The CCGT power station will have a nominal output of 50 MW for each of three gas turbines and 65 MW for a single steam turbine, adding up to a nominal output of 215 MW. By allowing the removal from service of the existing ageing generation capacities in Malta, Delimara 4 will provide the desired level of security and re-establish compliance with the N-1 criterion.
- (30) According to Malta, the future capacities would just be sufficient to face future demand assuming that all capacities are functional and used to the maximum of their capacity.

Table 2 - Future electricity generation capacities in Malta	
Delimara 3	144 MW
Delimara 4	215 MW
Interconnector	200 MW
RES production at peak demand time	20 MW - 140MW
Total	579 MW - 699 MW
2030 demand - peak	530 MW
2030 demand - upper centile	490 MW

- (31) The Maltese authorities claim that, being the cheapest, cleanest and most efficient plant (with efficiency ratings of about 52-54 %), Delimara 4 is expected to act as the primary domestic base load plant of the new generation mix once it is fully operational in a combined cycle mode.¹³ In addition, it will significantly reduce emissions levels.¹⁴

¹³ On the other hand, Delimara 3 is expected to act as a peak load plant in periods during which the capacity of Delimara 4 alone would not be enough to meet energy demands at any point in time. The Delimara 3 plant is expected to be converted to gas in two phases with phase 1 being converted to run on both gas and gas oil and phase 2 running on natural gas only. The combined efficiency of the whole plant once converted is expected to be in the region of 49 %.

¹⁴ In particular, 28 % reduction in CO₂, up to 79 % reduction in Oxides of Nitrogen, and up to 99 % reduction in Sulphur Dioxide compared to old generation sources.

- (32) The Project will be realised by the company Electrogas Malta Limited ("EGM") which was selected on the basis of a competitive tender procedure by Enemalta (see Section 2.4 below).

2.3. The measures

2.3.1. Introduction

- (33) In terms of the contractual structure, the Project is governed by a set of transaction agreements that ensure its financing and realization.
- (34) The contractual structure envisaged for the development of the Project involves (i) a Security of Supply Agreement ("SSA"), (ii) an 18-year Power Purchase Agreement ("PPA") supplying up to 215 MW of energy every hour from the new Delimara 4 CCGT power plant to be constructed and (iii) an 18-year Gas Supply Agreement ("GSA") providing the volume of gas required to meet demand to both the Delimara 3 facility – having a capacity of around 144 MW – and the Delimara 4 power plant. All agreements regarding the Project (including the SSA, PPA and GSA) are referred to collectively as the "Transaction Agreements".
- (35) According to the Maltese authorities, in view of ensuring Malta's security of supply, the Transaction Agreements specifically require the facilities related to the Project to be dedicated solely for use by Enemalta.¹⁵
- (36) According to the Transaction Agreements, Enemalta will be benefiting from a fixed price for both electricity and gas for the first five years of supply.
- (37) In particular, EGM has agreed to make available electricity and gas to Enemalta, and supply electrical energy and gas when dispatched and nominated by Enemalta, for an eighteen (18) year term, pursuant to, inter alia, the terms of an Implementation Agreement (IA), the PPA, the GSA and the SSA, all of which are to be executed by EGM and Enemalta and the Government of Malta as the case may be.
- (38) The IA is an agreement between EGM and Enemalta, whereby EGM agrees to finance, design construct, build, own, operate and transfer to Enemalta at the end of the term (i) Delimara 4 and (ii) the LNG regasification facility. EGM also agrees to procure LNG on a fixed and indexed priced basis for consumption as gas in Delimara 4 and delivery as gas to Delimara 3, and to procure and maintain the FSU for the term.
- (39) The IA will remain in force for eighteen years from the date on which the first Delimara 4 gas turbine satisfies the pre-agreed acceptance criteria set out in the PPA. In addition, the IA sets the term of the PPA and GSA, both of which shall become effective and expire on the same date as the IA, subject to early termination of the GSA at the option of Enemalta (known as the "GSA Exit").
- (40) The GSA Exit is designed to safeguard the envisaged future gas interconnector with Sicily considering that a ten year period would be sufficient for it to be implemented. The Maltese authorities explained that a Conversion Term

¹⁵ This provision reflects the derogations from which Malta benefits pursuant to Article 44 of Directive 2009/72/EC ("Electricity Directive") and ensures that this level of security of supply is maintained should there be a change in policy in this regard.

Agreement between Enemalta and EGM shall provide a more detailed discipline in this respect.

- (41) The IA includes "Take or Pay" provisions obliging Enemalta to consume or pay for agreed quantities of gas over specified reference periods. The quantities of gas subject to the "Take or Pay" obligation may be consumed as gas for the Delimara 3 plant or as electricity dispatched from Delimara 4, at the choice of Enemalta.
- (42) On the basis of the Transaction Agreements, EGM will become the principal source of gas supplied to Enemalta, and, therefore, the principal source of energy for those living on the Maltese Islands.

2.3.2. Power Purchase Agreement

- (43) The PPA is an agreement between EGM and Enemalta, whereby EGM agrees to make available electrical energy to Enemalta, and to supply electrical energy when dispatched by Enemalta. In turn, Enemalta agrees to pay for availability of Delimara 4 and the electrical output delivered by EGM to Enemalta's network. The Energy Availability Payment and the Energy Delivery Payments are calculated on the basis of formulas.

2.3.3. Gas Supply Agreement

- (44) The GSA is an agreement between EGM and Enemalta, whereby EGM agrees to make gas available to Enemalta, and to supply gas to Delimara 3 when nominated by Enemalta. In turn, Enemalta agrees to pay for the availability of the LNG facility and the gas delivered by EGM to Delimara 3. The Gas Availability Payment and the Gas Delivery Payments are calculated on the basis of formulas.

2.3.4. Security of Supply Agreement

- (45) The SSA has been drawn up as a tripartite agreement to be entered into between the Government of Malta, Enemalta and EGM to ensure that, should any circumstance arise which is capable of leading to the termination of the IA, PPA and GSA, or in the event that Enemalta is unable to continue procuring electricity and/or gas from EGM, the Government of Malta will be able to assume Enemalta's obligations under the relevant supply arrangements. Those mechanisms therefore provide for intervention of the Government of Malta in the event that the uninterrupted supply of power and gas for the Maltese Islands is prejudiced.
- (46) In the circumstances mentioned above, the SSA would be triggered. The Maltese Government's obligations under the SSA, once it is triggered, are to purchase electricity and gas on terms that were agreed in the PPA and GSA.

2.4. Beneficiary

- (47) The beneficiary of the measures is the developer of the Project, namely the company Electrogas Malta Limited ("EGM"), a project company owned by the members of Electrogas Malta Consortium ("EMC") as shown in Table 3 below. EMC was selected on the basis of a competitive tender procedure by Enemalta.

Table 3

Shareholders in EGM ¹⁶	Ownership stake
GEM Holdings Limited (comprising Tumas Group, Gasan Group and CP Holdings Limited)	33.3 %
Siemens Project Ventures	33.3 %
SOCAR Trading SA	33.3 %

- (48) EGM has to design, build and operate the on-shore CCGT Delimara 4 power station and the FSU. According to the Maltese authorities, EGM is also required to source a minimum supply of LNG amounting to [...] ¹⁷ per year to be used for both Delimara 4 and Delimara 3.
- (49) The total investment in the infrastructure is expected to be in the region of EUR 462 million and will be fully financed by the company EGM and its shareholders.
- (50) EGM will have formal title to the assets and will be party to the various agreements and contracts necessary for the operation and maintenance of the Project, including those concluded with Enemalta and with the Government of Malta.
- (51) Enemalta was the initial owner of EGM (previously named Malta Power and Gas Limited) having set it up especially for the implementation of the Project. Enemalta sold its shareholding to EMC as contemplated in the competitive procedure relating to the Project.
- (52) EGM is responsible for the development, financing and construction of the facilities required to supply energy and gas to Enemalta in accordance with the terms, conditions and schedule agreed with Enemalta by way of the contractual structure described above.

2.4.1. Selection procedure

- (53) According to the Maltese authorities, even though the Project is not subject to public procurement requirements, ¹⁸ Enemalta followed an open, transparent and non-discriminatory competitive process.
- (54) On 11 April 2013 Enemalta issued an Expression of Interest and Capability (“EoIC”) for any party who would be willing to and able to supply and deliver natural gas to Enemalta under the terms of a long-term GSA and who could also

¹⁶ Gasol Plc was initially also a member of the consortium but the other three shareholders eventually acquired their stake.

¹⁷ The Commission understands this reference as a standard unit of measurement used to denote both the amount of heat energy in fuels and the ability of appliances and air conditioning systems to produce heating or cooling.

¹⁸ The Maltese authorities explain that, if the Transaction Agreements were to be categorised as relating to the award of a concession contract, Directive 2004/17/EC would not apply by virtue of its Article 18. Similarly, if the Transaction Agreements were to be qualified as supply contracts, Directive 2004/17/EC would not apply pursuant to its Article 26 (see recitals (134)-(136) below).

supply and deliver electricity to Enemalta under the terms of a long-term PPA. The EoIC was published on TED and the European official journal. The EoIC required interested bidders to propose initial ideas on the design, build and operations of the facilities as well as determine their capabilities in sourcing the supply of gas.

- (55) An independent panel of experts chaired by the programme director was set up with the remit of evaluating the EoIC submissions received from interested bidders. The experts were provided with a clearly defined set of criteria that had to be used in making their decision. The criteria to be used for short listing were clearly outlined in the EoIC.
- (56) Throughout the EoIC, bidders were offered the opportunity to raise queries through a formal clarifications process. A number of requests came from bidders asking whether the Government of Malta would be providing some form of guarantee in the light of the non-investment grade credit rating of Enemalta. After consulting with the Government of Malta, a reply was sent by Enemalta indicating that a clear decision would be made at the Request for Proposal (RfP) stage.
- (57) A total of 18 expressions of interest were received in reply to the EoIC submitted by bidders from all across Europe and beyond. Out of these, six were shortlisted.
- (58) On 6 July 2013, an RfP was launched inviting the six shortlisted candidates to submit their detailed technical and financial proposals by 20 September 2013. In reply to the bidders' request, it was suggested that an SSA would back up the Project. In particular, it was clearly stated that the SSA would provide for the Government of Malta to assume Enemalta's obligations to purchase electricity and gas in certain specified circumstances, such as those which would lead to termination of the agreements.
- (59) Three bidders submitted offers. One of them was disqualified since the performance guarantee was not submitted as was required by the terms of the RfP.
- (60) An in-depth analysis of the price proposals was carried out on the basis of four price parameters:
 - The lifetime average price of energy supplies from the successful bidder's electricity facilities per MWh of electricity sold in accordance with the term of the PPA;
 - The lifetime average price of gas supplies from the successful bidder's gas facilities per MMBtu of gas sold in accordance with the terms of the GSA;
 - The remaining useful life payment of the successful bidder's electricity facilities beyond the duration of the PPA, expressed in EUR millions; and
 - The remaining useful life payment of the successful bidder's gas facilities beyond the duration of the PPA and the GSA, expressed in EUR millions (rendered indispensable by the fact that there is no other potential acquirer for those assets).
- (61) Following a consolidated evaluation of both bids, the final scores for each bidder were the following:

	Electrogas Malta Consortium (EMC)	[...]
Life Time Average Price	EUR 95.99	[...]
Final Score	92.2	71.3

- (62) On the basis of the above, the evaluation committee designated EMC as the preferred bidder on 4 December 2013, and it was awarded the Project. [...] did not appeal the decision made by the evaluation committee.

2.4.2. *The entrustment of the Service of General Economic Interest (SGEI)*

- (63) The Maltese authorities explain that at the time of the EoIC, Article 3(5) of the 1977 Enemalta Act, which established and set out the functions of Enemalta as a corporation, provided that Enemalta could grant to any third party, whether as an independent contractor or otherwise, the right to perform any functions or operations which Enemalta was itself authorised and empowered or obliged to carry out in accordance with that Act.
- (64) The 1977 Enemalta Act was repealed in August 2014 by the 2014 Enemalta Act, to make provision for the transfer of all the assets, rights, liabilities and obligations of Enemalta Corporation to Enemalta plc and to continue regulating its functions as the designated distribution system operator. On 2 October 2014, by virtue of a public service agreement and pursuant to Recital 5 and Article 3(2) of the Directive 2009/72/EC of the European Parliament and of the Council¹⁹ ("Electricity Directive"), the Government of Malta entrusted Enemalta with the public service obligation ("PSO") to provide and maintain a reliable and continuous source of supply of electricity in Malta.
- (65) By contracting with EGM for the supply of gas and electricity to Enemalta, the latter delegated part of its PSOs to EGM in compliance with Article 3(5) of the 1977 Enemalta Act.
- (66) The Maltese authorities explained that, in order to comply with the provisions of the 2014 Enemalta Act, the Government of Malta will adopt a new act confirming its consent for such delegation.
- (67) As regards the existence of a genuine and clearly defined SGEI, the Maltese authorities argue that the measures are indispensable to ensure security of supply, which is an objective which justifies PSOs. In particular, the measures guarantee system reliability and adequate generation capacity at all times, as per the N-1 requirements.
- (68) According to Malta, the following reasons stand in the way of market forces delivering new generation capacity that is needed to ensure security of supply:

¹⁹ Directive 2009/72/EC of the European Parliament and of the Council of 13 July 2009 concerning common rules for the internal market in electricity and repealing Directive 2003/54/EC (OJ L 211, 14.8.2009, p. 29).

- (a) In spite of high generation prices and the inefficiency of installed generation capacity, no private investor has, so far, entered the Maltese energy market without State intervention, i.e. the tender organized for the development of the Project.
 - (b) Enemalta is entrusted by the Government of Malta to act as the sole network and system operator and electricity supplier. The existence of a sole buyer in a market (monopsony) means that investors in the upstream market lack bargaining power when their investment is realised. More specifically, Enemalta cannot credibly commit to purchasing electricity at a price that compensates investors for their reasonable costs without a set of contractual arrangements and guarantees similar to the ones in place for Delimara 4. Enemalta would have an incentive to 'hold up' the investors by paying a price lower than initially agreed but one that covers investors' marginal costs and gives them sufficient incentives to keep operating.
 - (c) In Malta, there is no wholesale market in which generators can sell their electricity and no market-wide capacity remuneration mechanism, and hence no market price for electricity produced or capacity made available.
 - (d) The negative externalities of oil based plants related to the environment are not taxed.
- (69) As regards the amount of compensation for the SGEI, the Maltese authorities explain that Delimara 4 and the Gas Facilities will be entirely dedicated for the attainment of the PSO. According to the Maltese authorities, as there is no energy market in Malta, the revenues accruing to EGM are fixed throughout the expected duration of the PPA and GSA and by way of the fact that all payments in the contracts are fixed by way of formulae. The Transaction Agreements clearly set out how the price for the PPA and the GSA is determined. Payments under the Transaction Agreements constitute the compensation for the provision of the PSO.
- (70) As regards the period of entrustment, the Maltese authorities claim that the operating life of a CCGT plant can range between 25 and 35 years.²⁰ In this regard, the eighteen year duration of the period of entrustment is substantially shorter than the period over which the fixed assets associated with the Project would be expected to be amortised.
- (71) The Maltese authorities confirm that pursuant to Clause 20.1.3 of the IA, EGM has undertaken not to engage in any business or activity other than those which are related to the Project. In compliance with Article 6(2) of Commission Directive 2006/111/EC²¹ the Maltese authorities commit to ensure that the relationship with EGM (directly or indirectly through Enemalta) remains transparent. In particular, the Government of Malta will keep all the relevant financial information for five years and forward it to the Commission upon request. In addition, the content and

²⁰ See Appendix A of the Mott MacDonald 2010 UK Electricity Generation Cost update (https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/65716/71-uk-electricity-generation-costs-update-.pdf).

²¹ Commission Directive 2006/111/EC of 16 November 2006 on the transparency of financial relations between Member States and public undertakings as well as on financial transparency within certain undertakings (OJ L 318, 17.11.2006, p. 17).

duration of the PSO as well as the identity of the currently entrusted undertaking will be published accordingly as per relevant EU regulations.

- (72) As regards the avoidance of overcompensation, the Maltese authorities argue that the measures do not lead to overcompensation since by comparing the expected Internal Rate of Return ("IRR") of the Project with a benchmark rate of return, it appears that EGM's expected IRR over the duration of the Project is lower than the calculated benchmark rate of return.
- (73) The Maltese authorities will publish the following information on a publicly accessible website:
- (a) the results of the public consultations undertaken when drawing up the National Energy Policy;
 - (b) the content and duration of the PSO, in particular, a description of the main terms of the IA, PPA, GSA and SSA, as well as their duration;
 - (c) identify EGM as the beneficiary of the aid and the fact that the SGEI is to be performed in Malta; and
 - (d) identify the aid amount on a yearly basis.

2.5. Financing and reasonable return

- (74) The Project will be financed through private investments and loans contracted by EGM. The loans will be repaid from EGM's revenues from the PPA and GSA (price of energy and gas and the availability payments).²²
- (75) The expected IRR of the Project has been estimated by an external consultant (Oxera) to be 7.0 % on a pre-tax nominal basis. The projected revenues include the delivery and availability charges to be received by EGM under both the PPA and the GSA. The operating costs of the projects were calculated based on information provided by EGM.
- (76) The Maltese authorities explain that the IRR of the Project decreased from the original expected rate of 9.2 % calculated in May 2015, due to cost increases and delivery delays. Those cost increases left the agreed tariff structure, i.e. the projected revenues of EGM, unchanged. In fact, EGM has borne the risk associated with the integration issues resulting from multiple, parallel construction processes. This 'interface risk' has been a key driver of the cost overruns and delivery delays.
- (77) The Maltese authorities explain that an economic analysis undertaken by an external consultant shows that the appropriate benchmark rate of return for EGM is 8.3-9.9 % on a pre-tax nominal basis. The expected IRR of the Project is therefore below the expected benchmark rate of return.

²² Until EGM is able to finance the Project through private investments and loans, i.e. once all Transaction Agreements are signed, the Government of Malta has set-up temporary State credit guarantees valid for a maximum of 22 months in favour of EGM. The set-up State guarantees are temporary and once all Transaction Agreements are signed they will cease to exist. They are outside the scope of the present decision.

- (78) In order to ensure the robustness of the results, the external consultant has also carried out a sensitivity analysis of the expected IRR with respect to key input parameters, namely, heat rates, forced outage rates, operating costs, Brent prices, and terminal value. In addition, the GSA exit scenario – in which the GSA is terminated around 10 years after the start of operations – was considered. According to the Maltese authorities, in all cases the IRR is comfortably below the midpoint and upper-bound estimate of the benchmark rate of return. Therefore, the Maltese authorities observe that the results of the analysis are robust to fluctuations in the key assumptions.

2.6. Competition context

- (79) The Maltese authorities confirm that the dispatch of different generation sources is carried out on an economic basis by Enemalta in its role as the system operator with the aim of minimising the overall system cost. This ensures that the cheapest generation sources are dispatched first and that Delimara 4 does not displace any generation sources that are more economic.
- (80) In particular, RES would always be dispatched ahead of Delimara 4 because they have very low marginal cost. Imports from Sicily would also be dispatched before Delimara 4 when the cost of imported energy is less than the cost of electricity generated by Delimara 4. The Take or Pay obligations will not prevent Enemalta from dispatching electricity from the interconnector if it is more affordable, nor will it lead to excess supply of gas/electricity to Enemalta.
- (81) Enemalta will also call on demand reduction if the exercise price is lower than the cost of the marginal generation source. Hence dispatch of DSR measures relative to generation would also take place on an economic basis. Delimara 4 would therefore not be expected to displace DSR because DSR generally has a high exercise price and would compete with high-cost peaking units rather than base load plants such as Delimara 4.
- (82) In addition, given the relatively high efficiency of Delimara 4, the Maltese authorities expect it to be dispatched ahead of less efficient peaking units such as Delimara 3.
- (83) According to the Maltese authorities, the variable costs of Delimara 4 will be determined largely by the cost of gas imported under the terms of the IA. While the IA provides for a five year price fix on the supply of [...] of LNG, variations around that amount are priced at the spot price of LNG. Hence, when dispatching Delimara 4, Enemalta will take into account the market price of LNG that would be paid on the margin. This would demonstrate that Delimara 4 will be dispatched on the basis of actual spot market prices and will therefore not distort competition between different electricity supply sources in Malta.
- (84) According to Malta, this will also ensure that Delimara 4 does not distort trade with other Member States, namely Italy, because Delimara 4 will only be dispatched ahead of interconnector imports if this results in lower system cost overall. Dispatch modelling on the basis of 2014 prices and demand shows that, in the scenario where Delimara 4 is built, the interconnector would be used to import power to Malta in 60.3 % of periods and would export power from Malta in 2.9 % of periods. According to Malta, this further demonstrates the relative shortage of

generation capacity in Malta and the requirement for investment in Delimara 4 to be realised.

- (85) Additionally, the Maltese authorities explain that Enemalta has reserved the right with the Italian transmission system operator to export electricity for technical grid balancing reasons.²³ This further shows that the arrangements in place for energy exchange between Malta and Italy are set to minimise overall system cost.
- (86) Finally, in order to prevent an inefficient use of resources (i.e. where electricity would be purchased and eventually not consumed), Enemalta has invested in dispatch optimisation software to ensure that it dispatches sources as described above, taking into consideration any physical constraints on the local network, if any.

3. ASSESSMENT

3.1. Existence of Aid

- (87) 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 internal market.
- (88) In order to conclude whether state aid is present, the Commission must assess whether the cumulative criteria of Article 107(1) TFEU (i.e. transfer of State resources and imputability to the State, selective advantage, potential distortion of competition and affectation of intra-EU trade) are met for the measure under assessment.

3.1.1. Transfer of State Resources and imputability

- (89) Resources of public undertakings also constitute State resources within the meaning of Article 107(1) TFEU because the State is capable of directing the use of these resources.²⁴ As stated above, Enemalta is a State controlled undertaking. Enemalta committed to perform under certain terms an Energy Availability Payment and an Energy Delivery Payment under the PPA, and a Gas Availability Payment and a Gas Delivery Payment under the GSA. In addition, under the SSA the Government of Malta commits to take over the rights and obligations undertaken by Enemalta pursuant to the IA, PPA, and GSA.
- (90) As regards imputability to the State, the decision to fund the Project through a PPA and a GSA was taken by Enemalta, an undertaking controlled by the State, to implement a clearly defined State policy, as described in recitals (20)-(22) above. The Government of Malta was also involved in the adoption of the measures as

²³ For example, in case of local loss of load, Enemalta can export electricity to Sicily rather than shut down local generation plant and restart it back a few hours later.

²⁴ Judgment of the Court of Justice of 16 May 2002, *France v Commission (Stardust)*, C-482/99, ECLI:EU:C:2002:294, paragraph 38. See also Judgment of the Court of Justice of 29 April 2004, *Greece v Commission*, C-278/00, ECLI:EU:C:2004:239, paragraphs 53 and 54, and Judgment of the Court of Justice of 8 May 2003, *Italy and SIM 2 Multimedia SpA v Commission*, Joined Cases C-328/99 and C-399/00, ECLI:EU:C:2003:252, paragraphs 33 and 34.

confirmed by recital (56) above and will adopt a new act confirming its consent for the delegation of part of Enemalta's PSO to EGM.

- (91) On the basis of those elements, the Commission concludes that the measures have been provided to EGM by the State through State resources, i.e. the steady stream of payments from Enemalta and, potentially, the Government of Malta.

3.1.2. Economic Advantage

- (92) The measures provide an economic advantage to EGM as they ensure a certain IRR and a steady stream of revenues.
- (93) As regards compensation for costs incurred to provide an SGEI, the Court made clear in the Altmark judgment that the granting of an advantage can be excluded if four cumulative conditions are met.²⁵ First, the recipient undertaking must actually have PSOs to discharge, and the obligations must be clearly defined. Second, the parameters on the basis of which the compensation is calculated must be established in advance in an objective and transparent manner. Third, the compensation cannot exceed what is necessary to cover all or part of the costs incurred in the discharge of PSOs, taking into account the relevant receipts and a reasonable profit. Fourth, where the undertaking that is to discharge PSOs is not chosen following a public procurement procedure to select a tenderer capable of providing these services at the least cost to the community, the level of compensation needed must be determined on the basis of an analysis of the costs which a typical undertaking, well-run and adequately provided with means to meet the public service requirements, would have incurred in discharging those obligations, taking into account the relevant receipts and a reasonable profit for discharging the obligations.
- (94) The measure may arguably meet some of the first three criteria, but not the fourth criterion as the outcome of the tender was influenced by the SSA which was added to the contractual structure during the tender procedure (see recital (58) above). Since that element was not known at the beginning of the procedure, the organised tender procedure did not guarantee the achievement of the least cost to the community. In addition, the Maltese authorities have not provided any information demonstrating that the level of compensation was established according to the costs of a typical, well-run undertaking.
- (95) The Commission therefore concludes that the fourth Altmark condition does not appear to have been complied with in relation to the measures. Considering the cumulative nature of the Altmark conditions, there is no need for the Commission to examine whether the other conditions have been met in the present case. Accordingly, the measures confer on EGM an economic advantage within the meaning of Article 107(1) TFEU.

3.1.3. Selectivity

- (96) The public financing is granted specifically to EGM pursuant to the Transaction Agreements and is, therefore, selective.

²⁵ Judgment of the Court of Justice of 24 July 2003, Altmark Trans, C-280/00, ECLI:EU:C:2003:415, paragraph 87 to 95.

3.1.4. Effect on Trade and Distortion of Competition

- (97) One of the objectives of the Project is to push oil fuelled generation out of the market for environmental and diversification reasons. Given that gas and oil products are subject to trade between Malta and other Member States and electricity will be subject to trade between Malta and other Member States, the measures are liable to affect the patterns of trade between Member States. In addition, the project also competes with RES generation and the interconnector.
- (98) In the light of the above, the measures distort or threaten to distort competition and are likely to affect trade between Member States.

3.1.5. Conclusion on the Existence of State aid

- (99) On the basis of the above-mentioned elements, the Commission concludes that the measures constitute State aid within the meaning of Article 107(1) TFEU.

3.2. Legality of the aid

- (100) The Commission notes that the measures identified were granted to EGM in breach of the notification and stand-still obligations laid down in Article 108(3) TFEU. Thus, the measures granted to EGM constitute unlawful State aid.

3.3. Compatibility

3.3.1. Legal basis for assessment

- (101) On the basis of point 11 of the 2012 SGEI Framework,²⁶ the Commission considers that, “At the current stage of development of the internal market, State aid falling outside the scope of Decision 2012/21/EU may be declared compatible with Article 106(2) TFEU if it is necessary for the operation of the service of general economic interest concerned and does not affect the development of trade to such an extent as to be contrary to the interests of the Union.”²⁷
- (102) The 2012 SGEI Framework describes the conditions to be met to achieve such balance.

3.3.2. Genuine service of general economic interest as referred to in Article 106 TFEU

- (103) As indicated in point 13 of the 2012 SGEI Framework, Member States have a wide margin of discretion regarding the nature of services that could be classified as being SGEI. The Commission's task is to ensure that the margin of discretion is applied without manifest error as regards the definition of SGEI. The Commission's competence in this respect is limited to checking whether the Member State has made a manifest error when defining the service as an SGEI and to assessing any State aid involved in the compensation.

²⁶ Communication from the Commission – European Union framework for State aid in the form of public service compensation (2011) 2012/C 8/03 OJ C8, 11.1.2012, p.15, referred to herein as the 2012 SGEI Framework or the Framework.

²⁷ The present aid measure does not fall under the scope of Decision 2012/21/EU since the foreseen public service compensation does not fall within the categories of its Article 2(1).

- (104) However, as foreseen in point 46 of the 2012 SGEI Communication,²⁸ where specific Union rules exist, the Member States' discretion is bound by those rules, without prejudice to the Commission's duty to carry out an assessment of whether the SGEI has been correctly defined for the purpose of State aid control. Therefore, the measure would be incompatible with Article 106(2) TFUE if it infringes specific EU law provisions. In the case at hand, the relevant provisions are laid down in the Electricity Directive.
- (105) As described above, EGM is obliged, by way of the Transaction Agreements, to provide electricity and gas to Enemalta at its request. The PSO has been set up with the aim of ensuring security of supply, and contributing to environmental protection and energy affordability.
- (106) In this respect, the Commission notes that the PSO complies with Article 3(2) of the Electricity Directive since:
- (a) They are justified in the general economic interest as they aim to ensure security of supply, which is specifically recognised in the Directive as a legitimate objective for imposing PSOs in the electricity sector;
 - (b) They are proportionate since the use of a CCGT plant, sourced by a local gas terminal, was found to be the best available option in the Maltese context to ensure security of supply; and
 - (c) They are clearly defined, transparent, non-discriminatory and verifiable (see Section 3.3.3 below).
- (107) The Commission also notes that, since the PSO compensation is granted to EGM following an open and non-discriminatory public procurement procedure, Article 3(6) of the Electricity Directive is also complied with.
- (108) As regards security of supply, although Union rules consider it as an objective that might justify PSOs, this legitimate objective can be achieved by different means, whose impact on competition and trade between Member States may be very different. In many cases, security of supply can be improved by developing new interconnection infrastructure between Member States, by increasing the capacity of the existing interconnections, by improving the design of the market or, ultimately, by introducing market wide capacity mechanisms.
- (109) In general, the provision or the increase of normal capacity generation cannot be considered an SGEI. In fact, under normal circumstances, the market should spontaneously provide to cover expected demand (or expected increases of demand) under normal market and regulatory conditions.²⁹

²⁸ Communication from the Commission on the application of the European Union State aid rules to compensation granted for the provision of services of general economic interest (OJ C 8, 11.1.2012, p. 4–14).

²⁹ See Commission Decision in case N 475/2003 – Ireland, public service obligations in respect of new electricity generation capacity for security of supply, recital 35. Indeed, in a liberalised market, as with other products, private investors are expected to ensure that sufficient capacity is available to meet demand. In general terms, the price mechanism is the way that this is expected to be achieved in the competitive market. As prices rise investment will become viable and either more capacity will come on stream, or demand will be constrained. A transparent and reliable price mechanism for wholesale electricity is sufficient in this respect.

- (110) However, the Commission notes that in a small system where a large proportion of the total installed capacity is provided by a single unit, intervention by the national authorities by way of ensuring local generation is more likely to be required to ensure that the N-1 criterion is respected. Moreover, certain local generation is necessary for frequency control and balancing of the grid.
- (111) The Commission highlights that the specificities of the island of Malta as a small and isolated electricity system with peculiar characteristics which make it distinct from that of other Member States are recognised in EU law. In particular, Malta uniquely has automatic derogations from Articles 9 (unbundling of transmission systems and transmission system operators), 26 (unbundling of distribution system operators), 32 (third-party access) and 33 (market opening and reciprocity) of the Electricity Directive. In these circumstances, it appears that the market cannot adequately deliver the desired level of services.
- (112) The peak demand in the Maltese market is only 530 MW, 449 MW of which can be provided by the Delimara power stations. In addition, 40 % of installed electricity generation capacity is either nearing end of life or requires decommissioning for environmental motives. In addition, Malta has limited RES capacity due to its limited space and its generation is therefore currently based on heavy fuel oil and antiquated inefficient generation capacities which is damaging to the environment and leads to high prices for consumers. The measures will ensure diversification of the generation and sources of fuels used on the island and reduce emissions from electricity generation.
- (113) Since Malta has to respect the N-1 criterion, adequate capacity shall be ensured not only to meet demand but also to replace the interconnector if it is unavailable. In other words, the N-1 criterion obliges Malta to increase its capacity at least by 200 MW (i.e. the capacity of the interconnector). The Commission considers that, in this particular case, the market could not provide price signals for sufficient investment to meet the N-1 criterion since the relatively large amount of backup capacity required compared to peak demand in Malta would rarely run and not be commercially viable.
- (114) Finally, although Malta has a relatively large amount of interconnection compared to its installed capacity, the electricity interconnector with Sicily is a long deep underwater cable that may significantly suffer from disruptions (see recitals (13)-(14) above). In addition, Malta has not pointed to any future interconnection projects concerning electricity. In any event, due to the geographical specificities of Malta, the creation of such infrastructure would be very costly.
- (115) The Commission therefore concludes that, considering the specific circumstances of the case, the Project will provide an adequate level of security of supply by re-establishing compliance with the N-1 criterion.

Public consultation

- (116) Finally, point 14 of the 2012 SGEI Framework requires Member States to show that they have given proper consideration to the public service needs supported by way of a public consultation or other appropriate instruments to take the interests of users and providers into account.

- (117) As indicated above in recital (23) above, since 2006 Enemalta has explored several options for future investments in generation and interconnection capacity in Malta through public consultations and with the assistance of external consultants. This consultation process led to the conclusion that a 215 MW CCGT plant and the gas infrastructures are indispensable to ensure security of supply.
- (118) The Commission therefore concludes that EGM's PSO to make available electricity and gas to Enemalta, and supply electricity and gas when dispatched and nominated by Enemalta, constitutes a recognised genuine SGEI as referred to in Article 106 TFEU.

3.3.3. *Need for an entrustment act specifying the PSOs and the methods of calculating compensation*

- (119) As indicated in section 2.3 of the 2012 SGEI Framework, the concept of service of general economic interest within the meaning of Article 106 TFEU means that the undertaking or undertakings in question have been entrusted with the operation of the service of general economic interest by way of one or more official acts.
- (120) These acts must specify, in particular i) the precise nature of the PSO and its duration; ii) the undertakings concerned and territory concerned; (iii) the nature of any exclusive rights assigned to the undertakings concerned; (iv) the parameters for calculating, controlling and reviewing the compensation; and (v) the arrangements for avoiding and repaying any overcompensation.
- (121) EGM has been entrusted by the Maltese State through Enemalta with the operation of an SGEI to ensure security of supply by means of the Transaction Agreements. Enemalta is itself responsible for operating, maintaining and developing a secure, reliable and efficient electricity distribution system to ensure continuity of electricity supply in Malta with due regard for the environment and energy efficiency. Under Maltese law, these obligations constitute PSOs for the attainment, among others, of the objective of security of supply.³⁰
- (122) The entrusting acts consist in the Transaction Agreements which clearly define the nature of EGM's PSOs. In fact, EGM is obliged to make available electricity and gas to Enemalta, and supply electricity and gas when dispatched and nominated by Enemalta, for an 18 year term, pursuant to, inter alia, the terms of the IA, PPA, GSA and SSA (see Sections 2.3.1 to 2.3.4 above). As for the SSA, it will continue to be in full force and effect until the later of 25 years after the date of its signature or the expiry of the IA, PPA and GSA.
- (123) The Transaction Agreements clearly designate EGM as the holder of the PSOs. As for the territory covered by these obligations, it is the territory of the Maltese islands. No exclusive rights have been granted to EGM.
- (124) As regards the parameters for calculating the compensation, the Maltese authorities explain that Delimara 4 and the Gas Facilities will be entirely dedicated for the

³⁰ See Commission Decision in cases N 419/2009 – Malta – Investments on electricity transmission and interconnector infrastructure and C 32/10 (ex N 520/09) — Malta – Environmental Project for Delimara Power Station — Invitation to submit comments pursuant to Article 108(2) TFEU where Enemalta was acknowledged as "*the sole producer capable of ensuring continued supply of electricity to meet the needs of Malta as to base load and reserve capacity supply to meet the service needs of Maltese business and residential consumers*".

attainment of PSOs. Therefore, the price for the PPA and GSA is equal to the compensation. Since the Transaction Agreements clearly set out how the price for the PPA and the GSA is determined, the entrustment acts contain the parameters for calculating the compensation.

- (125) Finally, by providing for the formulae for the calculation of all revenues EGM is entitled to – which are dependant only on the price of LNG and costs – the Transaction Agreements provide the arrangements to avoid overcompensation.
- (126) In the light of the above, the Commission concludes that the entrustment act complies with the requirements of section 2.3 of the 2012 SGEI Framework.

3.3.4. Duration of the period of entrustment

- (127) As indicated in section 2.4 of the 2012 SGEI Framework, "the duration of the period of entrustment should be justified by reference to objective criteria such as the need to amortise non-transferable fixed assets. In principle, the duration of the period of entrustment should not exceed the period required for the depreciation of the most significant assets required to provide the SGEI."
- (128) Since the eighteen year duration of the period of entrustment is shorter than the operating life of a CCGT plant (see recital (70) above), the Commission concludes that in this case the period of entrustment is justified.

3.3.5. Compliance with Directive 2006/111/EC

- (129) According to point 18 of the 2012 SGEI Framework: "Aid will be considered compatible with the Internal Market on the basis of Article 106(2) of the Treaty only where the undertaking complies, where applicable, with Directive 2006/111/EC on the transparency of financial relations between Member States and public undertakings as well as on financial transparency within certain undertakings".
- (130) Under Article 2(d) of Directive 2006/111/EC, any undertaking that is entrusted with the operation of an SGEI pursuant to Article 106(2) TFEU, that receives public service compensation in any form whatsoever in relation to such service and that carries out other activities, is an undertaking required to maintain separate accounts.
- (131) As described in recital (71) above, EGM's activities will be limited to PSOs as it will not carry out any commercial activity. Therefore, the rule regarding the separation of accounts does not apply to it.
- (132) In addition, the Maltese authorities committed to keep all the relevant financial information for five years and forward it to the Commission upon request. The content and duration of the PSO as well as the identity of the currently entrusted undertaking will also be published accordingly as per relevant EU regulations.

3.3.6. Public procurement requirements

- (133) Point 19 of the 2012 SGEI Framework requires that the responsible authority entrusts the provision of the service in question in compliance with the applicable Union rules in the area of public procurement.

- (134) From the point of view of EU Public Procurement law, Directive 2004/17/EC of the European Parliament and of the Council³¹ ("Procurement Directive") was the applicable Directive at the time of the launching of the competitive procedure for the award of the transaction agreements of the Malta Energy Project. Furthermore, there is no doubt that Enemalta is a contracting entity within the meaning of Article 2 of this Directive.
- (135) However, the IA, which appears to constitute a concession contract within the meaning of Article 1(3) of the Procurement Directive, is excluded from the scope of this Directive on the basis of its Article 18.
- (136) Concerning the PPA and the GSA, they are both also excluded from the scope of the Procurement Directive. Indeed, Article 26 (b) of the Procurement Directive excludes from its scope contracts for the supply of energy or of fuels for the production of energy if awarded by contracting entities operating themselves in the energy sector, such as it is the case of Enemalta.
- (137) For what regards the observation of the general principles of the TFEU, the Commission considers that these principles have been indeed complied with, the award of the Transaction Agreements to EGM being the result of a competitive procedure with a previous publication in the Official Journal of the European Union and involving 18 bidders.
- (138) The Commission concludes therefore that the requirements of paragraph 19 of the 2012 SGEI Framework have been respected.

3.3.7. Absence of discrimination

- (139) Point 20 of the 2012 SGEI Framework provides that where the authority assigns the provision of the same SGEI to several undertakings, the compensation should be calculated on the basis of the same method for each undertaking.
- (140) As the SGEI at issue is exclusively assigned to EGM, there cannot be any discrimination.³²

3.3.8. Amount of compensation

- (141) Point 21 of the 2012 SGEI Framework states that "(...) the amount of the compensation must not exceed what is necessary to cover the cost of discharging the PSOs, including a reasonable profit". The amount of compensation can be established on the basis of either the expected costs and revenues or the costs and revenues actually incurred or a combination of the two (point 22 of the 2012 SGEI Framework). Where the compensation is based, in whole or in part, on expected costs and revenues, they must be specified in the entrustment act. They must be based on plausible and observable parameters concerning the economic environment in which the SGEI is being provided and rely, where appropriate, on the expertise of sector regulators or of other entities independent from the

³¹ Directive 2004/17/EC of the European Parliament and of the Council of 31 March 2004 coordinating the procurement procedures of entities operating in the water, energy, transport and postal services sectors (OJ L 134, 30.4.2004, p. 1).

³² See Commission Decision in Case SA.36740 (2013/NN) – Lithuania, Aid to Klaipėdos Nafta – LNG Terminal, para. 237.

undertaking. Member States must indicate the sources on which these expectations are based (point 23 of the 2012 SGEI Framework).

- (142) The net costs necessary, or expected to be necessary, should be calculated using the net avoided cost methodology where required or possible, or use alternative methods such as the cost allocation methodology (points 24, 27 of the 2012 SGEI Framework). The net avoided cost methodology is based on determining the difference between the net cost for the provider of the service without the SGEI obligation and the cost for the provider with the SGEI obligation (point 25 of the 2012 SGEI Framework).
- (143) In the present case, the Commission considers that: (i) the facilities and EGM's activity are fully dedicated to the SGEI; and (ii) there is no counterfactual scenario in which the EGM would nevertheless undertake to realise the project in the absence of the SGEI obligation. For these reasons, the net avoided cost method does not seem appropriate. Where duly justified, the Commission can accept alternative methods for calculating the net cost necessary to discharge the PSOs, such as the methodology based on cost allocation.
- (144) Under the cost allocation methodology, the maximum amount of compensation should be calculated as the difference between revenues from fulfilling the SGEI obligation and costs (including a reasonable profit). However, in the present case, revenues are fixed through the PPA, as there is no energy market in Malta in which EGM can sell at a "market price". Accordingly, the compensation provided to EGM is equal to the purchase price of the measures.
- (145) Therefore, insofar as the return on the Project does not exceed a suitable benchmark rate of return, the amount of compensation would not exceed the net costs associated with providing the SGEI.

Revenue

- (146) The revenue to be taken into account must include at least the entire revenue earned from the SGEI. In this case, the revenue earned by EGM for the SGEI is equivalent to the payments performed by Enemalta under the Transaction Agreements.
- (147) Therefore, the expected project returns have been calculated reflecting the terms of all the Transaction Agreements, considered together. The projected revenues include the delivery and availability charges to be received by EGM under both the PPA and the GSA.
- (148) The Commission considers that given the fact that during the PPA duration (18 years) the plant can only sell electricity to Enemalta when Enemalta call it and the revenue it receives is set by formulas, no windfall profits appear possible even if the market in Malta develops in the future and there would be a chance that future Maltese electricity prices increase.

Reasonable profit

- (149) The Framework allows for the entity fulfilling the PSOs to achieve a reasonable profit. This is the rate of return on capital that would be required for a typical company considering whether or not to provide the SGEI for the whole duration of

the entrustment act, taking into account the level of risk (point 33). Where duly justified, other profit level indicators can be used (point 34).

- (150) In this case, the Commission considers that the fact that EGM was selected following a competitive process ensures that the aid element contained in the PPA, GSA and SSA was kept to a minimum and is proportionate.
- (151) In addition, as indicated in recital (75), the project is expected to yield an IRR of 7.0 % on a pre-tax nominal basis. The fact that the IRR decreased is also an indication that the risk of cost increases is borne by EGM (see recital (76) above).
- (152) As described in recital (75) above, the expected IRR of the Project is below the expected benchmark rate of return and is also below the central estimate of the expected benchmark rate of return calculated in the context of the sensitivity analysis described in recital (77) above. In addition, the expected IRR of the Project appears to be in line with the ones accepted by the Commission in previous decisions concerning similar cases.³³

Efficiency incentives

- (153) As regards the efficiency incentives, point 39 of the 2012 SGEI Framework, provides that "In devising the method of compensation, Member States must introduce incentives for the efficient provision of SGEI at high standard, unless they can duly justify that it is not feasible or appropriate to do so". In this case, the upfront definition of a fixed compensation level anticipates and incorporates the efficiency gains that EGM can be expected to make over the lifetime of the entrustment act. In particular, the fixed compensation is calculated based on a fixed heat rate. If EGM delivers a more efficient heat rate from Delimara 4, it will increase its profitability.
- (154) As EGM does not carry out activities outside the scope of the SGEI nor provide several SGEIs, point 44 of the 2012 SGEI Framework does not apply.

Overcompensation

- (155) Point 16(e) of the 2012 SGEI Framework requires that the act of entrustment includes arrangements for avoiding and recovering overcompensation. The latter should be understood as compensation that the undertaking receives in excess of the amount of aid as defined in point 21 for the whole duration of the contract (point 47).
- (156) Point 49 of the Framework states that "Member States must ensure that the compensation granted for operating the SGEI meets the requirements set out in this Communication and in particular that undertakings are not receiving compensation in excess of the amount determined in accordance with the requirements set out in this section. They must provide evidence upon request from the Commission. They must carry out regular checks, or ensure that such checks are carried out, at the end of the period of entrustment and, in any event, at intervals of not more than three

³³ For example, see Commission Decision of 5 October 2011 in case SA.31953 – Poland, Construction of a LNG Terminal in Swinoujsciu, Commission Decision of 20 November 2013 in case SA.36740 (2013/NN) – Lithuania, Aid to Klaipėdos Nafta – LNG Terminal, and Commission Decision of 22 September 2015 in case SA.39515 – Finland, Individual aid to LNG infrastructure.

years. For aid granted by means other than a public procurement procedure with publication, checks should normally be made at least every two years”.

- (157) In this case, the Commission considers that Malta has defined upfront a fixed compensation level, through the Transaction Agreements, which adequately anticipates and incorporates the efficiency gains that the public service provider can be expected to make over the period of entrustment, on the basis of an allocation of costs and revenues and of reasonable expectations (see recitals (143)-(154) above).
- (158) Since the maximum level of profit to which EGM is entitled in accordance with the entrustment act appears reasonable from an ex ante perspective, the Commission concludes that the measures do not lead to overcompensation.

3.3.9. Additional requirements which may be necessary to ensure that the development of trade is not affected to an extent contrary to the interests of the Union

- (159) The requirements set out in Sections 3.3.1 to 3.3.8 are usually sufficient to ensure that the aid does not distort competition in a way that is contrary to the interests of the Union.
- (160) In this case, the Commission considers that no serious competition distortions in the internal market have remained unaddressed and that the aid cannot affect trade to such an extent as would be contrary to the interests of the Union. In fact, Malta conducted extensive studies to determine the best solution to achieve all its objectives. In addition, the Maltese authorities explained that the cheapest generation sources will be dispatched first and that Delimara 4 shall not displace any generation sources that are more economic (see recitals (79)-(86) above).
- (161) As regards competition between the Project and the interconnector (or any future interconnection projects), Malta has explained that imports will be accepted whenever they are cheaper than the marginal cost of local generation. This ensures efficient market functioning and will avoid any detrimental impact on the Italian market or any markets with which Malta is connected in the future.

3.3.10. Transparency

- (162) Point 60 of the Framework provides that Member States must publish, for each SGEI compensation they grant: (i) the results of the public consultation, (ii) the content and duration of the PSO, (iii) the undertakings and the territory concerned and (iv) the amounts of aid granted to the undertakings on a yearly basis.
- (163) In this case, the Maltese authorities will publish the above-mentioned information on a publicly accessible website (see recital (73) above).

4. CONCLUSION

The Commission regrets that Malta put the aid in question into effect, in breach of Article 108(3) of the Treaty on the Functioning of the European Union.

However, it has decided, on the basis of the foregoing assessment, not to raise objections to the aid on the grounds that it is compatible with the internal market pursuant to Article 106(2) of the Treaty on the Functioning of the European Union.

The Commission notes that Malta has agreed that the present decision would be adopted, notified and published in the English language.

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 electronically to the following address:

European Commission,
Directorate-General Competition
State Aid Greffe
B-1049 Brussels
Stateaidgreffe@ec.europa.eu

Yours faithfully
For the Commission

Margrethe VESTAGER
Member of the Commission

