



EUROPEAN COMMISSION

Brussels, 20.VII.2005

C (2005) 2719 final

**Subject: State aid N597/2004 – Czech Republic  
Lignit Hodonín, s.r.o.**

Excellency,

The Commission wishes to inform the Czech Republic 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.

## **I. PROCEDURE**

- (1) By letter of 13 December 2004, registered on 15 December 2004, the Czech Republic notified its intention to provide aid in favour of Lignit Hodonín, s.r.o. By letter dated 19 January 2005, the Commission requested additional information. The Czech Republic submitted the requested information by letter dated 18 February 2005, registered on 22 February 2005.
- (2) An additional request for information was sent on 10 March 2005, followed by 2 meetings with the Permanent Representation of the Czech Republic on 15 March and 18 April 2005.
- (3) The Czech Republic asked for a prolongation of the submission deadline by letters of 11 April, 26 April and 13 May 2005. The Commission accepted the period extension by letters of 13 April, 29 April and 17 May 2005. The requested information was submitted to the Commission on 20 May 2005, registered on 23 May 2005.

## **II. DESCRIPTION**

### *1. The beneficiary*

- (4) The beneficiary of the aid is Lignit Hodonín, s.r.o. (hereinafter “Lignit Hodonín”), a limited liability company created in 1994 as the result of

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privatisation of the former South Bohemian Lignite Mines. Lignit Hodonín operates the only ortho-lignite mine (Mikulčice) in the Czech Republic. Lignit Hodonín is situated in the South-east region of the Czech Republic and during the last years exploited annually ca 500 thousand tonnes of ortho-lignite. With 392 employees it is one of the largest and most important employers in the Hodonín region, which is an assisted area in virtue of Art. 87(3)(a) with the regional aid intensity ceiling 48%.

## 2. *The product*

- (5) According to the expert opinions issued by the Technical University in Ostrava and an authorized expert in the area of mining, the lignite mined in Hodonín is classified as coal C – ortho-lignite pursuant the international codification system for coal laid down by the United Nations Economic Commission for Europe referred to in Art. 2 Council Regulation (EC) No. 1407/2002<sup>1</sup>. Its average caloric value is currently about 8 MJ/kg (8.3 MJ in 2004), after the implementation of the investment project the lignite mined from the new deposits is estimated by expert opinions to reach the average caloric value of 9.5 MJ/kg and remains to be classified as ortho-lignite.
- (6) The mine is classified as an underground mine.
- (7) Basically the entire production of the company (98%) is consumed by the Hodonín power plant owned by the largest Czech Power Company (ČEZ), which is located close to the mine and which directly supplies the cities Hodonín (Czech Republic) and Holíč (Slovak Republic) with electricity and thermal energy. In 1997 a reconstruction of the power plant was concluded which optimised the production cycle based on the ortho-lignite and allowed to operate under environmentally acceptable conditions. The output of the power plant is 45 MW, which contributes by 1% to the electrification system in the Czech Republic.

## 3. *The investment project*

- (8) In February 2004 the general meeting of Lignit Hodonín decided to end the production for reasons of depletion of the current lignite deposit. The mine was going to be closed down and all current 392 employees dismissed by 31 December 2004.
- (9) In June 2004 a new business partner entered and developed a new strategy to continue the mining activities. In July 2004 a renewable long-term agreement with ČEZ was concluded for the period of 2005 – 2010. The Czech authorities explain that the contract concerned originally only the complete exploitation of the remaining lignite in the current deposit, which was of low quality. However, the company developed an investment project that would enable to open new lignite deposits of higher quality ortho-lignite (average caloric value

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<sup>1</sup> O.J. L 205, 02/08/2002, p. 1-8.

of ca 9.5 MJ/kg). The new deposits are accessible only through the existing ones and should not be depleted before 2050, at the current mining rates.

- (10) According to the information from the Czech authorities, Lignit Hodonín was not able to obtain external private resources of more than ca 10% of the investment costs for the project implementation, since the banks and private investors in the Czech Republic are not able to analyse and accept the risk connected with mining projects. Moreover, such projects are not too attractive due to their relatively low profitability and the fact that the return is only generated in a long term. In this situation, the Czech government decided to grant an aid in order to implement the project since it has positive effects on development of the region and, especially, enables maintaining the jobs in an assisted area by virtue of Art. 87(3)(a).
- (11) The total costs of the investments reach CZK 324 million (€10.2 million) and consists in:

	in thousands CZK
Mining buildings:	
Pairs of opening tunnels	32.200
Draining bases	20.100
Draining and exploration shaft	11.100
Exploration and draining base	30.100
Cross-drift	20.000
<b>Mining buildings total</b>	<b>113.500</b>
Mining technology:	
Heading machine	10.000
Hydraulics	14.000
Mining complex	105.000
Operating mining technology (LZH train, rails, cracking mills, transformer, electro...)	19.000
Belt and collar conveyors	40.500
<b>Mining technology total</b>	<b>188.500</b>
Technological equipment (belt shaft, electro installation equipment, draining wells...)	<b>22.000</b>
<b>INVESTMENT TOTAL</b>	<b>324.000</b>

- (12) The investment will be maintained for at least 5 years.

4. *The aid*

- (13) The notified aid consists in a grant of CZK 155.5 million (€5 million) covering 48% of the gross investment. 9.26% of the investment is covered by a bank loan granted under commercial terms and the rest of 42.74% by company's own resources.

- (14) The aid covers the investment costs of tangible assets in the form of the new mining technology equipment listed in point 11. The aid is granted as a direct grant and is not cumulated with any other form of aid.

5. *The market*

- (15) According to data provided by the Czech Republic, there are no international ortho-lignite markets. The ortho-lignite is a marginal primary energy raw material with low caloric value and significant transport costs, therefore it is consumed in situ or within a short distance from the mine (maximum 50 km). It is used mainly in regions with no alternative primary energy sources, where energy has to be transported from other areas.
- (16) Ortho-lignite is internationally traded only exceptionally and because of the specificity of its consumption, there is no excess capacity. The ortho-lignite prices are closely connected with the possibility of its direct utilisation. Some electricity producers are also owners of ortho-lignite mines or conclude exclusive purchase contracts with lignite producers. Although there is a Slovakian lignite mine Baňa Záhorie, a.s. located in the Czech-Slovak border region, it would not be immediately capable to replace the whole production of Lignit Hodonín, since it produces only ca 400,000 tonnes of lignite, which is less than the Hodonín power plant is currently supplied with. Moreover, Baňa Záhorie, a.s. currently supplies with lignite three customers in Slovakia; heating plant in Zvolen, power plant in Nováky and company Chemko Strážske.
- (17) In addition, ortho-lignite can be substituted by meta-lignite,<sup>2</sup> which is internationally traded.<sup>3</sup> Considering the fact that the Czech Republic is an important producer of meta-lignite with the production of ca 47,350 thousand tonnes, the production of Lignit Hodonín represents about 1% of the all lignite mined in the country.

6. *Importance of the investment project for the region*

- (18) The Hodonín district is located in the South-east of the Czech Republic at the border with Slovakia. The traditionally agricultural region suffers from structural difficulties which are related to its geographical position and the decline of the agricultural production. There is a notable efflux of young people and business activities from the region. The region is an assisted area pursuant Art. 87(3)(a) with 13.7% unemployment rate<sup>4</sup>.

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<sup>2</sup> According to the classification referred to in paragraph 5.

<sup>3</sup> According to the publication of the European Association for Coal and Lignite EURACOAL “Coal industry across Europe”, October 2003, the Czech Republic exports to Germany, Slovakia, Austria and Hungary (p. 19) in total ca 6 million tonnes hard coal and 1,8 million tonnes lignite).

<sup>4</sup> Available data from July 2004.

- (19) The most significant impact of the project is in terms of employment. With 392 employees is the company one of the largest employers in the region, which was recently left by two other important employers which caused a loss of another ca 350 direct jobs. The Czech authorities consider the safeguarding of 350 direct and 150 indirect jobs by the project as important for the development of the region from the economic as well as social perspective.
- (20) Although the mining in the Hodonín region has a long history starting at the beginning of the last century, the project itself does not result solely in continuation of the company's in business, but represents a new investment brought into the region, which has additional effects in terms of new technology inflow, support of related services and manufactures through increased demand of the company carrying out the investment or cooperation with educational institutions.
- (21) Moreover, the company already developed follow-up investment projects which would be financed by company's own resources, would involve other companies with corresponding expertise and could create additional 100 new jobs. The planned projects focus on fuel mixtures production on the basis of lignite, fytomass and waste, production of biolignite as fuel mixture and production of recultivation mixtures and fertilisers, which are envisaged to be implemented 2006 - 2015.

### **III. ASSESSMENT**

#### *1. State aid in the sense of Article 87(1) of the Treaty*

- (22) Art. 87 (1) of the EC Treaty lays down that, except where otherwise provided, aid which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods is, insofar as it affects trade among Member States, incompatible with the common market. The notified grant must be regarded as aid within the meaning of this Article since it derives from State resources and grants a selective advantage to Lignite Hodonín, which otherwise would have to bear the entire costs of the investment on its own.
- (23) Regarding the effect on trade between the Member States and distortion of competition, even though this effect can be expected to be rather limited, the following can be observed. In case of closure of the mine, the power plant would likely switch to meta-lignite supply from other mines in the Czech Republic (see para 33). Since these mines are exporting lignite, such a move could lead to less export to other Member States. In addition, in spite of certain transport costs, it cannot be excluded that in case of closure of the beneficiary, the Hodonín power plant would seek the lignite supply from the mine in Slovakia (mentioned in para 16). The aid therefore can reduce intra-Community trade.<sup>5</sup> On the basis of these considerations the measure at stake is

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<sup>5</sup> See, e.g. Court's judgement in Joint cases C-278/92, C-279/92 and C-280/92, para 40: "According to the case-law of the Court, when State financial aid strengthens the position of an undertaking compared with other undertakings competing in intra-Community trade the latter must be regarded as affected by that aid (judgment in Case 730/79 Philip Morris v Commission [1980] ECR 2671,

capable of distorting competition and affecting trade between the Member States and constitutes, therefore, State aid within the meaning of Art. 87(1) EC. 2. *Compatibility with the common market*

- (24) The measure in question is to be assessed in the light of Art. 87(3)(a), which provides for the derogation from the general prohibition of State aid for areas where the standard of living is abnormally low or where there is serious underemployment. Hodonín is situated in a NUTS II region with a GDP per capita of 55.6% of the Community average. The unemployment rate reached 13.7% and would further increase in case of the closure of the company, whereas the average was 9.2% in the Czech Republic<sup>6</sup>.
- (25) Due to its low caloric value and the classification as Coal C – ortho-lignite, the product does not fulfil the relevant criteria to be covered by the Council Regulation (EC) 1407/2002 on State aid to the coal industry<sup>7</sup>. As it falls outside the scope of sectoral State aid rules, in order to decide on the compatibility of the aid with the common market, the aid has to be scrutinised under the Guidelines on national regional aid (the “guidelines”)<sup>8</sup>. The Multisectoral framework on regional aid for large investment projects<sup>9</sup> is not applicable in this case since the amount of aid is too low.
- (26) The notified aid is an aid for initial investment within the meaning of Section 4 point 4.4 first paragraph of the guidelines since it represents the extension of an existing establishment in terms of opening new lignite deposits operated by new technology.
- (27) Point 4.4 second paragraph of the guidelines refers to ineligibility of a firm in difficulty for the aid for initial investment. Although Lignit Hodonín would have to close down the production without receiving the aid, it is not to be regarded as a firm in difficulty in the sense of the Rescue and Restructuring Guidelines since it does not show any indications laid down in Section 2.1 Art. 9 of the Rescue and Restructuring Guidelines, which define a company in difficulties as one which is “*unable... to stem losses which would without outside intervention by the public authorities almost certainly condemn it to going out of business...*” The company showed in 2004 a profit of CZK 21 million (€ 700,000). This was mainly a consequence of reduction of provisions

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paragraph 11). For that purpose, it is not necessary for the beneficiary undertaking itself to export its products. Where a Member State grants aid to an undertaking, domestic production may for that reason be maintained or increased with the result that undertakings established in other Member States have less chance of exporting their products to the market in that Member State (judgment in Case 102/87 France v Commission [1988] ECR 4067, paragraph 19).“

<sup>6</sup> Available data from July 2004.

<sup>7</sup> O.J. L 205, 02/08/2002, p. 1-8.

<sup>8</sup> O.J. C 074, 10/03/1998, p. 9-31.

<sup>9</sup> O.J. C 70 of 19/3/2002, p. 8.

(CZK 25 million, i.e. € 833,333) originally envisaged to cover the costs connected with the closure of the mine. Without this operation the company would have ended up with a small loss. Also in 2003 Lignit Hodonín showed a loss. However, these losses were certainly not sufficient to “*condemn the company to go out of business*”. The company has always been able to pay its due debts and does not show in its books any unpaid debts after their maturity. Within the intended closure it would have been able to pay all existing liabilities. Moreover, in the light of Section 2.1 Art. 11 of the Rescue and Restructuring Guidelines, Lignit Hodonín does not show “*the usual signs of a firm in difficulty*” listed there. On the contrary, the present initial investment will enable the continuation of the production of lignite in this assisted area which would otherwise have closed down. The measure will therefore contribute to the regional development of the region for a minimum period of 5 years.

- (28) An application for aid was submitted before work on the investment started in line with point 4.2 of the guidelines. The costs of the project covered by the aid (CZK 155.5 million) are eligible in accordance with point 4.5 of the guidelines as they concern buildings and tangible assets (technical equipment). The investment will be maintained in the region for more than 5 years in accordance with point 4.10 of the guidelines. Finally, the intensity of the notified aid constituting 48% gross (€ 5 million) is not cumulated with any other aid and is below the regional threshold set at 48% net.
- (29) The company is not eligible for receiving the aid under the existing regional aid scheme for the Czech Republic approved by the Commission<sup>10</sup>, since the scheme is limited only to aid for creating new jobs, not maintaining existing ones.
- (30) As the aid is not granted on the basis of the scheme, the compatibility of the measure in question has to be examined from the point of view of Section 2 of the guidelines, which refers particularly to *ad hoc* aid. This type of aid may be especially distortive, while its effects on regional development rather limited. Therefore it can only be justified if the equilibrium between the distortions of competition caused by the aid and the benefits for the regional development is guaranteed.<sup>11</sup> Section 2 of the guidelines stipulates that “*an individual ad hoc aid payment made to a single firm, or aid confined to one area of activity, may have a major impact on competition in the relevant market, and its effects on regional development are likely to be too limited. Such aid generally comes within the ambit of specific or sectoral industrial policies and is often not in keeping with the spirit of regional aid policy as such. The latter must remain neutral towards the allocation of productive resources between the various economic sectors and activities. The Commission considers that, unless it can be shown otherwise, such aid does not fulfil the requirements set out in the preceding paragraph*”.

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<sup>10</sup> N 259/2004.

<sup>11</sup> See (for example) the decision in N492/2004 – NL, Ad hoc regional aid in favour of SABIC.

- (31) It follows from the provided information that the notified aid is in line with the regional development policy in the region which focuses on increase of employment (in terms of safeguarding as well as job creation), support of alternative ways of economic development to agriculture, promotion of entrepreneurial activities in the region, and improvement of the standard of living of the inhabitants.
- (32) Principally, the measure is not contrary to the Czech National energy conception in the sense that the conception supports the self-sufficiency in energy supply of the regions. However, it is not to be considered to reflect the pursuit of a sectoral policy. Since the investment is targeted at maintaining the employment in the region and thus promotes its development, it complies with the regional development policy for the region in question. Moreover, ortho-lignite represents a very marginal energy source in the Czech Republic.
- (33) Taking into account the above arguments, the Commission considers that there exists equilibrium in this case between the distortions of competition caused by the aid and the benefits for the regional development in the sense of point 30. For this assessment the specific situation with a rather limited distortion of competition has to be taken into account. As explained in paragraphs 15 – 17, the company is not exposed to direct competition. Moreover, despite the possibility of substitution of ortho-lignite with meta-lignite from other coal producers, the company's production level is rather insignificant and its existence or closing down does not have a major impact on the situation of the national or even European coal markets. As regards the position of the Hodonín power plant, who is basically the company's sole customer, it can be assumed that this would not be significantly affected by the closing down the mine either, since it would be in a position to replace the lignite by coal from mines belonging to the ČEZ group (ČEZ holds 37% of shares in the North Bohemian mines - Severočeské doly).
- (34) In addition, it must be noted that the investment does not notably add production capacity, since the mine envisages maintaining the same level of production of around 500 thousand tonnes per year.
- (35) According to the information provided by the Czech Republic, as summarised above, the investment to be carried out by Lignit Hodonín has a limited effect on competition but will significantly contribute to the development of the region through promoting the economic activity and in this way will safeguard the jobs that are significant in respect to the size of the region. The Commission therefore considers that the State aid to be granted by the Czech Republic to Lignit Hodonín will promote the economic development of the region, in which the standard of living is abnormally low and which faces serious unemployment.

#### **IV. DECISION**

In view of the above, the Commission considers that the notified aid is compatible with the common market in accordance with Article 87(3)(a) of the EC Treaty.

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://europa.eu.int/comm/secretariat\\_general/sgb/state\\_aids/](http://europa.eu.int/comm/secretariat_general/sgb/state_aids/). Your request should be sent by registered letter or fax to:

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Yours faithfully,  
For the Commission

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