



EUROPEAN COMMISSION

Brussels, 25.IX.2007  
C (2007) 4319 final

<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>PUBLIC VERSION</p> <p>This document is made available for information purposes only.</p>
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**COMMISSION DECISION**  
**on the 25.09.2007**  
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**awarded by Poland**  
**as part of Power Purchase Agreements**  
**and the state aid**  
**which Poland is planning to award**  
**concerning compensation for the voluntary termination**  
**of Power Purchase Agreements**

(Only the Polish text is authentic)

(Text with EEA relevance)

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*(notified as document number C 43/2005)*

(Only the Polish text is authentic)

(Text with EEA relevance)

THE COMMISSION OF THE EUROPEAN COMMUNITIES,

Having regard to the Treaty establishing the European Community, and in particular the first subparagraph of Article 88(2) thereof,

Having regard to the Agreement on the European Economic Area, and in particular Article 62(1)(a) thereof,

Having called on interested parties to submit their comments pursuant to the provisions cited above<sup>1</sup> and having regard to their comments,

Whereas:

**1. PROCEDURE**

- (1) By letter dated 1 March 2005, ref. WEH/1023/6-54/05, registered on 3 March 2005 (SG/2005/A/226), Poland gave notification to the European Commission, under Article 88(3) of the EC Treaty, of a bill on “the rules governing the covering of costs incurred by enterprises in connection with the early termination of Power Purchase Agreements” (“the Bill”).

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<sup>1</sup> OJ C 52, 2 March 2006, p. 8.

- (2) Following a preliminary assessment, the Commission found the notification to be incomplete and, by letter of 27 April 2005, asked Poland to provide additional information on the measure.
- (3) By letter of 1 June 2005, registered on 2 June 2005, Poland submitted some of the additional information requested; the remaining information was provided by letter of 24 June 2005, registered on 28 June 2005.
- (4) On 28 and 29 June 2005, at Poland's request, a technical meeting was organised to discuss the notification. The meeting identified the remaining aspects still to be clarified in writing by Poland in order to provide the Commission with comprehensive information for its assessment.
- (5) In the absence of a comprehensive reply, the Commission reminded the Polish authorities by letter of 28 July 2005 (D/55776) of the clarifications requested at the meeting of 28 June 2005 and asked Poland to provide the requested information.
- (6) By letter of 7 September 2005, registered on 9 September 2005, Poland informed the Commission that work on the Bill had been halted as the parliamentary term had ended.
- (7) By letter dated 23 November 2005, the Commission informed Poland that it had decided to initiate the procedure laid down in Article 88(2) of the EC Treaty in respect of the Bill and in respect of Power Purchase Agreements ("PPAs") in the Polish electricity sector.
- (8) The Commission decision to initiate the procedure was published in the Official Journal of the European Union.<sup>2</sup> The Commission called on interested parties to submit their comments.
- (9) By letter of 16 December 2005 the Polish authorities requested that certain information contained in the decision to initiate the procedure not be disclosed to third parties. The Commission replied to the request and, by letter of 25 January 2006, presented its proposal for the non-confidential version of the decision, which was accepted by the Polish authorities by email of 16 February 2006 registered on the same day.
- (10) Poland provided the Commission with the first part of its comments on the initiation of the procedure in connection with the Bill on the early termination of Power Purchase Agreements by letter dated 28 December 2005, registered by the Commission on 4 January 2006, which described the action taken to allay the concerns expressed by the Commission on the Bill. Second, following a request for a deadline extension which was accepted by the Commission on 12 January 2006, the Polish authorities provided their comments on the Commission's assessment of the PPAs by letter dated 23 January 2006, registered by the Commission on 26 January 2006.
- (11) As a supplement to their letter of 23 December 2005, the Polish authorities provided by letter of 5 April 2006, registered on 6 April 2006, a further description of the

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<sup>2</sup> See footnote 1.

planned changes to the Bill on the early termination of Power Purchase Agreements in order to bring it in line with the relevant state aid rules. The annexes to that letter were provided by letter of 6 April 2006, registered on 10 April 2006.

- (12) The Commission received comments from interested parties. By letter dated 20 June 2006 the Commission forwarded these comments to Poland, which was given the opportunity to react.
- (13) The decision to open the procedure was challenged by one of the interested parties before the Court of First Instance by way of an application lodged on 12 May 2006 and was assigned reference number T-142/06.
- (14) Following a request by the Polish authorities dated 7 July 2006, registered on 12 July 2006, most of the comments were translated into Polish and transmitted to the Polish authorities by letter of 23 February 2007. In reply to that letter, by letter dated 12 March 2007, registered on the same day, the Polish authorities informed the Commission that it was no longer necessary to translate the remaining comments.
- (15) The Polish authorities subsequently submitted an opinion on the interested parties' comments by letter dated 28 March 2007, registered by the Commission on the same day.
- (16) In reply to the Commission's letter dated 28 April 2006, the Polish authorities submitted additional information on the measure by letter of 6 June 2006 registered on 8 June 2006. By letter of 13 July 2006, registered on 17 July 2006, the Polish authorities submitted copies of the PPAs with the corresponding annexes and appendices (609 documents in total) in paper format.
- (17) By letter registered on 4 May 2007 the Polish authorities requested an interpretation of one of the points of the Commission Communication relating to the methodology for analysing state aid linked to stranded costs ("the Stranded Costs Methodology").<sup>3</sup>
- (18) By letter of 27 September 2006 the Commission sent the Polish authorities a list of points which were of crucial importance for the drafting of the Bill on the early termination of Power Purchase Agreements.
- (19) Different versions of the Bill on the early termination of Power Purchase Agreements at different stages of the legislative procedure in Poland were submitted by letters registered on 17 August 2006, 5 January 2007 and 28 May 2007 and by email registered on 29 May 2007 (English version of the Bill).
- (20) In the course of the procedure, Poland provided additional information on the measure by letters registered on 31 January 2007 and 4 April 2007, by emails dated 2, 4, 7 and 11 May 2007 and by letter registered on 6 June 2007.
- (21) By letter dated 3 April 2007 the Commission asked the Polish authorities about progress with legislative work on the Bill on the early termination of Power Purchase Agreements and about the action taken by Poland further to earlier discussions with the Commission.

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<sup>3</sup> Adopted by the Commission on 26 July 2001.

- (22) In addition, within the framework of the investigation procedure, meetings were held with the Polish authorities on 5 April 2006, 7 September 2006, 26 October 2006, 2 February 2007, 22 February 2007, 26 April 2007, 2 May 2007 and 14 May 2007.
- (23) By letter of 9 July 2007 Poland submitted the final version of the Early Termination of Purchase Power Agreements Act, which was adopted by the Polish Parliament and entered into force on 4 August 2007. On 18 July 2007 Poland submitted the English translation of the Act and a list of the changes made to the Act by the Upper Chamber of Parliament, the Senate, together with an explanatory memorandum.

## **2. DESCRIPTION OF THE AID**

### **2.1. Power Purchase Agreements**

- (24) In the mid-90s the Polish government decided to launch a programme designed to modernise the Polish electricity sector and bring it into line with the technical and environmental standards of Western Europe.
- (25) In order to implement this programme, Poland launched a tender procedure with a view to selecting projects for new or modernised electricity generation plants. These projects would be awarded long-term PPAs for their generation capacity. The decision to launch the tendering procedure was taken by the Ministry of Trade and Industry. The procedure was organised under the aegis of the Ministry by Polskie Sieci Elektroenergetyczne S.A. ("PSE"), the publicly owned Polish electricity network operator.
- (26) Technical documents and specifications for the tendering procedure were published in August and September 1994. The documents indicated three objectives to be met by the projects: procurement of cheap electricity, maintenance of a reasonable level of security of supply and improvement of environmental standards / prevention of environmental deterioration, taking into account the requirements of integration between Poland and Western Europe.
- (27) Various criteria were used to evaluate the bids, including: the project's efficiency, the volume of capital expenditure, pro-environmental action and the use of proven technologies and stable and secure sources of fuel.
- (28) The deadline for submitting bids was 5 January 1995. 44 bids were received. The least attractive bids were eliminated. Direct negotiations were undertaken with the remaining bidders. These negotiations led to the conclusion of PPAs with several companies or groups of companies.
- (29) The PPAs were signed between 1996 and 1998, with the exception of one of seven PPAs with Południowy Koncern Energetyczny S.A. group ("PKE"), which was signed on 12 April 1995, and the PPA with Elektrownia Turów, which was signed on 26 August 1994.. The PPA with Elektrownia Turów was not covered by the

decision to initiate the procedure<sup>4</sup> and is therefore not covered by this Decision. The following table lists the companies concerned.

**Table – PPAs in Poland**

No	Name of recipient
1	<b>BOT Górnictwo i Energetyka S.A.</b>
2	<b>Południowy Koncern Energetyczny S.A.</b>
3	<b>Elektrownia Kozienice S.A.</b>
4	<b>Zespół Elektrowni Dolna Odra S.A.</b>
5	<b>Zespół Elektrowni Pątnów-Adamów-Konin Pątnów II</b>
6	<b>Electrabel Połaniec S.A.</b>
7	<b>Elektrociepłownia Kraków S.A.</b> <sup>5</sup>
8	<b>Dalkia Poznań Zespół Elektrociepłowni S.A.</b>
9	<b>Elektrociepłownia Rzeszów S.A.</b>
10	<b>Elektrociepłownia Nowa Sarzyna Sp. z o.o.</b>
11	<b>Elektrociepłownia Lublin Wrotków Sp. z o.o.</b>
12	<b>Elektrociepłownia Chorzów "ELCHO" S.A.</b>
13	<b>Żarnowiecka Elektrownia Gazowa Sp. z o.o.</b>
14	<b>Elektrociepłownia Zielona Góra S.A.</b>

Source: Decision to initiate the procedure.

(30) The duration of PPAs ranges from 7 to 20 years, calculated from the date on which the power plant starts operating; most of them have been concluded for a period of more than 15 years. The last PPA expires in 2027.

(31) All PPAs are underpinned by the same basic principles:

power generators undertake to create new capacity, to modernise equipment and to supply PSE with a fixed minimum volume of electricity from the plant in question;

PSE undertakes to purchase at least that minimum volume of electricity;

<sup>4</sup> In the light of Annex IV to the Act concerning the conditions of accession of the Czech Republic, the Republic of Estonia, the Republic of Cyprus, the Republic of Latvia, the Republic of Lithuania, the Republic of Hungary, the Republic of Malta, the Republic of Poland, the Republic of Slovenia and the Slovak Republic, and the amendments to the Treaties on which the European Union is founded (“the Accession Act”), which forms an integral part of the Treaty of Accession of the Czech Republic, the Republic of Estonia, the Republic of Cyprus, the Republic of Latvia, the Republic of Lithuania, the Republic of Hungary, the Republic of Malta, the Republic of Poland, the Republic of Slovenia and the Slovak Republic to the European Union (“the Accession Treaty”) (OJ L 236 of 23 September 2003), aid awarded before 10 December 1994 is regarded as existing aid.

<sup>5</sup> This PPA was not signed as the result of the tendering procedure.

the electricity purchase price is based on passing costs on to the consumer; power generators charge PSE an amount equivalent to all their fixed and variable costs, plus a profit margin.

However, since the final content of PPAs is the result of an individual set of negotiations for each project, they are not completely identical and the details may differ.

(32) Some PPAs have been amended, some several times, since they were signed. These amendments changed certain aspects of the contract, but the main principles described above were always respected.

## **2.2. Bill on the early termination of PPAs in respect of which the decision to initiate the procedure was taken**

(33) The Bill in respect of which the decision to initiate the procedure was taken provided for the power generators listed in Table 1 to voluntarily terminate PPAs concluded with PSE. The power generators that opt in to the system would be entitled to compensation under the conditions laid down in the Bill.

(34) Compensation may cover the difference between the costs incurred by a company for the purpose of discharging a PPA and the share of the revenue generated by the sale of electricity that the company can use to cover these costs. This difference is hereinafter referred to as “the compensatable difference”. These costs also include costs directly linked to the termination of the PPA, such as costs associated with early loan repayments.

(35) Compensation takes the form of an initial payment, followed by annual adjustments until 2016 and a final adjustment in that year.

(36) The initial payment is equal to the compensatable difference from 2006 to 2025 or to the year in which the PPA in question was originally to expire, whichever is earlier, based on forecast trends in prices and market shares over that period.

(37) During the period from the entry into force of the Bill to 2014, the amount of the compensatable difference will be recalculated annually on the basis of actual economic data and compared against the amount originally calculated on the basis of the forecast. If the actual value differs from the forecast, an adjustment will be made which may be positive or negative and will give rise either to a further payment to the recipient or to reimbursement by the recipient, as appropriate. For practical reasons, in particular the time needed to collect and compile all data, computation of adjustments will actually take place two calendar years after the year to which the economic data refer.

(38) In 2016 a new forecast will be established for trends in prices and market shares covering the period from 2015 to 2025 or the year in which the PPA in question was originally to expire, whichever is earlier (“the remaining period”). The amount of the compensatable difference over the remaining period, determined on the basis of this forecast, will be compared against the value calculated using the original forecast. If these amounts are different, a final adjustment will be made which will cover the whole remaining period. Like the previous adjustments, the final adjustment may be

positive or negative and will give rise either to a further payment to the recipient or to reimbursement by the recipient, as appropriate.

- (39) The total compensation paid, including adjustments, may not exceed the following maximum amount. This maximum amount is determined for individual companies or, where companies belong to a single group, for the group:<sup>6</sup>

**Table 2 – Maximum compensation provided for in the version of the Bill analysed in the decision to initiate the procedure**

	<b>Name of recipient</b>	<b>Maximum compensation (PLN thousand)</b>
1	<b>BOT Górnictwo i Energetyka S.A.</b>	7 554 899
2	<b>Południowy Koncern Energetyczny S.A.</b>	5 085 101
3	<b>Elektrownia Koziencice S.A.</b>	1 610 729
4	<b>Zespół Elektrowni Dolna Odra S.A.</b>	1 106 014
5	<b>Zespół Elektrowni Pątnów-Adamów-Konin Pątnów II</b>	2 173 335
6	<b>Electrabel Polaniec S.A.</b>	1 204 454
7	<b>Elektrociepłownia Kraków S.A.</b>	84 656
8	<b>Dalkia Poznań Zespół Elektrociepłowni S.A.</b>	132 773
9	<b>Elektrociepłownia Rzeszów S.A.</b>	302 684
10	<b>Elektrociepłownia Nowa Sarzyna Sp. z o.o.</b>	641 453
11	<b>Elektrociepłownia Lublin Wrotków Sp. z o.o.</b>	508 176
12	<b>Elektrociepłownia Chorzów "ELCHO" S.A.</b>	1 338 272
13	<b>Żarnowiecka Elektrownia Gazowa Sp. z o.o.</b>	1 013 081
14	<b>Elektrociepłownia Zielona Góra S.A.</b>	540 323
	<b>TOTAL</b>	<b>22 755 627</b>

Source: Decision to initiate the procedure.

- (40) This maximum amount is equal to the compensatable difference as calculated from 2006 to 2025 on the basis of the hypothesis that prices on the electricity market will increase steadily but slowly from a level even lower than at present to the levels recorded in Western Europe. In this scenario, average electricity prices start around €22/MWh in 2006, increase slowly to €30/MWh in 2015, then rise more steeply to

<sup>6</sup> N.B.: this table is based on the documentation provided by the Polish authorities in Appendix 1 to their letter of 2 June 2005, which contains more information than the original notification of the Bill.



around €40 /MWh in 2018 and stabilize around this amount, with some upward and downward fluctuations, until the end of the reference period in 2025.

- (41) Compensation will be paid by PSE or a fully state-owned subsidiary, and financed by the introduction of a levy on consumers proportionate to their subscription to the electricity grid. In order to finance the large initial payment, PSE and/or its subsidiary will securitize revenue from the levy.

### **3. GROUNDS FOR INITIATING THE PROCEDURE**

- (42) In its decision to initiate the procedure, with a view to assessing the notified Bill, the Commission examined both the state aid element of the PPAs themselves and the state aid element of the compensation paid in the event of termination of the PPAs. As explained in point 3 of the decision to initiate the procedure, these two measures were closely connected.

- (43) The doubts raised in the decision to initiate the procedure are summarised in points 3.1 and 3.2. below. For a more detailed assessment, the Commission refers to point 3 of the decision to initiate the procedure.

#### **3.1. Power Purchase Agreements**

- (44) In its preliminary analysis, the Commission took the view that the PPAs were likely to provide a competitive advantage to the contracting power generators, which would distort competition and affect trade between Member States.

- (45) The Commission expressed the view that PPAs did not constitute existing aid as - on the basis of the Accession Treaty - none of the PPAs was eligible for one of the three categories of aid that were regarded, as of accession, as existing aid within the meaning of Article 88(1) of the EC Treaty.<sup>7</sup>

- (46) In particular, first, none of the PPAs (with the exception of the one signed with Elektrociepłownia Turów) had entered into force before 10 December 1994. Second, the Commission had not been given notice of the PPAs under the so-called “interim procedure” and, third, none of the PPAs had been indicated on the existing aid list annexed to the Accession Treaty.

- (47) The Commission stated that, since the PPAs had not been notified to it under Article 88(3) of the EC Treaty, they constituted unlawful aid within the meaning of Article 1(f) 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.<sup>8</sup>

- (48) The Commission expressed the view that the terms and conditions of the PPAs put power generators which were parties to a PPA in a more advantageous economic situation than other power generators that were not parties to a PPA and companies in other, comparable sectors in which such long-term agreements had not even been

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<sup>7</sup> Point 3(1)(i) of the decision to initiate the procedure.

<sup>8</sup> OJ L 83, 27 March 1999, p.1

offered to market players. The measure was therefore found, on a preliminary basis, to confer a selective advantage to those power generators.

- (49) The Commission also noted that the electricity markets had been opened to competition and that electricity had been traded between Member States at least since the entry into force of Directive 96/92/EC of the European Parliament and of the Council of 19 December 1996 concerning common rules for the internal market in electricity.<sup>9</sup> Measures that favour companies in the energy sector in one Member State were therefore regarded as potentially impeding the scope for companies from other Member States to export electricity to that Member State, or favouring exports of electricity to the second group of Member States.
- (50) The Commission also expressed the view that this advantage entailed the use of state resources, because the decision to sign the PPAs was a consequence of state policy implemented via the network operator PSE, which was fully state-owned. Under the case law of the Court of Justice of the European Communities (“Court of Justice”), when a state owned company uses its funds in a way that can be deemed to constitute state action, then these funds should be regarded as state resources within the meaning of Article 87(1) of the EC Treaty.<sup>10</sup>
- (51) The Commission therefore concluded that the PPAs probably constituted state aid to the power generators within the meaning of Article 87(1) of the EC Treaty.
- (52) The Commission went on to state that the Stranded Costs Methodology should be used to analyse the state aid received by the power generators. On the basis of the documents in its possession at the time, the Commission had doubts as to the PPAs’ compatibility with the criteria set out in the Stranded Costs Methodology.
- (53) First, the Commission had doubts that the very rules governing a PPA which foreclosed a significant part of the market could be deemed compatible with the fundamental objectives of the Stranded Costs Methodology, i.e. to increase the pace of liberalisation of the sector by granting adequate compensation to incumbents facing unfair competition.
- (54) Second, the Commission doubted that the aid element included in PPAs would be compatible with the detailed criteria of the Stranded Costs Methodology as regards the calculation of eligible stranded costs and the attribution of adequate compensation.

### **3.2. Compensation in the event of early termination of PPAs**

- (55) In the decision to initiate the procedure the Commission used the same reasoning as the one explained above to determine whether the PPAs contained aid elements. It subsequently concluded, on a provisional basis, that aid elements were also present in cases of compensation for the early termination of PPAs.<sup>11</sup>

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<sup>9</sup> OJ L 27, 30 January 1997, p. 20.

<sup>10</sup> Case C-482/99 *French Republic v Commission of the European Communities* [2002] ECR I-04397.

<sup>11</sup> See point 3 (1) (ii) of the decision to initiate the procedure.

(56) The Commission then analysed the compatibility of the aid element of compensation with the criteria set out in the Stranded Costs Methodology.

(57) The Commission doubted that the compensation was compatible with the detailed criteria of the Stranded Costs Methodology as regards the calculation of eligible stranded costs and the awarding of adequate compensation.

#### 4. COMMENTS FROM INTERESTED PARTIES

(58) Following the publication of the decision to initiate the procedure, and within the relevant deadline or, in a few cases, following a deadline extension requested by the interested parties, the Commission received comments from:

the following electricity generators: Elektrociepłownia Rzeszów S.A. (“Elektrociepłownia Rzeszów”), Electrabel SA and Electrabel Połaniec S.A. (collectively referred to as “Electrabel”), Zespół Elektrowni Pątnów – Adamów – Konin S.A. and Elektrownia Pątnów II Sp. z o.o. (collectively referred to as “PAK”), BOT Górnictwo i Energetyka S.A., BOT Elektrownia Opole S.A. and BOT Elektrownia Turów (collectively referred to as “BOT”), Elektrociepłownia Chorzów „ELCHO” Sp. z o.o. Elektrociepłownia Kraków S.A (“ECK”), Elektrociepłownia Zielona Góra S.A. (“ECZG”) and Elektrociepłownia Nowa Sarzyna Sp. z o.o. (“ENS”);

the following banking institutions that provided financing to the electricity generators: Dresdner Bank AG London Branch, Bank Pekao S.A., WestLB AG London Branch<sup>12</sup> and WestLB AG (collectively referred to as “the Banks”);

PSE.

(59) The comments submitted to the Commission by the parties are very similar, sometimes virtually identical. For that reason, instead of describing the comments of each interested party separately, the Commission has grouped them into general categories (see below).

##### 4.1. Comments on the PPAs

###### *Applicability after accession*<sup>13</sup>

(60) The interested parties argue that PPAs should not be regarded as “still applicable after accession” within the meaning of Annex IV, paragraph 3, subparagraph 1(c) to the Accession Act.<sup>14</sup>

(61) The interested parties argue that measures that were established in accordance with the law prior to accession should not be reviewed by the Commission after

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<sup>12</sup> In the context of its request for a meeting with the Commission, West LB AG London Branch also submitted some additional comments by letter dated 27 December 2006 (see footnote 39 below) on the Bill on the early termination of PPAs which was adopted by the Polish Cabinet in December 2006. A meeting with representatives of West LB AG London Branch and the Office of the Polish Permanent Representative to the EU took place on 14 March 2007.

<sup>13</sup> Comment submitted by BOT, ENS, ECZG, ECK, ELCHO and PAK.

<sup>14</sup> See footnote 3 above.

accession. This is in line with the general principle of non-retroactivity. The Community state aid rules were not supposed to apply until accession.

- (62) The interested parties refer to previous Commission decisions<sup>15</sup> in which the Commission stated that aid systems which, in their view, were similar to the PPAs, did not apply after accession.
- (63) In their opinion, any aid under PPAs would have been awarded prior to accession. Annual payments would still have to be effected but should not be regarded as constituting new aid.
- (64) PPAs fixed the volume of electricity to be purchased by PSE and the purchase price for the electricity over the period in question. In the case of certain items at least, prices were calculated in such a way that they could not exceed a level previously agreed between the parties or fluctuations would be limited to a reasonable amount as compared to specified market prices, i.e. the most objective standard possible. Actual prices were sometimes even lower, in particular because the Polish regulator kept indirect control over them. As such, the state's maximum exposure was also clearly determined by the PPAs prior to accession.

*Existing aid*<sup>16</sup>

- (65) The interested parties argue that, even if one was to admit that the PPAs constitute state aid within the meaning of Article 87(1) of the EC Treaty, this state aid should be regarded as existing aid within the meaning of Article 1(b) of Council Regulation (EC) No 659/1999 of 22 March 1999.
- (66) The interested parties take the view that a decision determining whether aid awarded prior to accession and continued after accession should be regarded as “new aid” or “existing aid” should not be based solely on Annex IV to the Accession Act. According to the interested parties, if such aid does not qualify as existing aid under Annex IV of the Accession Act, it should still be examined in the light of Article 1(b)(ii) to (v) of Council Regulation (EC) No 659/1999.
- (67) The interested parties argue that Article 1(b)(v) of Council Regulation (EC) No 659/1999 applies to the PPAs, and that therefore the PPAs constitute “existing aid”.
- (68) The interested parties go on to state that the last sentence of Article 1(b)(v) of Council Regulation (EC) No 659/1999 does not apply to the PPAs for three reasons.
- (69) First, in the *Alzetta Mauro* judgment,<sup>17</sup> the Court ruled that aid that existed in a certain market which was initially closed to competition before its liberalisation is to be regarded as existing aid from the time of liberalisation. According to the interested parties, this judgment is based directly on an interpretation of Article 88(1)

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<sup>15</sup> Commission decisions CZ 52/2003 (Universal Banka), CZ 58/2003 (Evrobanka), CZ 46/2003 (Investicni a postovni banka).

<sup>16</sup> Comment submitted by ECZG, ECK and the Banks.

<sup>17</sup> Judgement of the Court of First Instance of 15 June 2000 in Joined Cases T-298/97, T-312/97, T-313/97, T-315/97, T-600/97 to T-607/97, T-1/98, T-3/98 to T-6/98 and T-23/98.

of the EC Treaty, and therefore takes precedence over Council Regulation (EC) No 659/1999.

- (70) Second, in any event, given that Council Regulation (EC) No 659/1999 had not yet entered into force when the electricity market was liberalised under Directive 96/92/EC or when the PPAs were signed, the rules as set out in the *Alzetta Mauro* judgment applied, not Council Regulation (EC) No 659/1999.
- (71) Third, a comparison of the wording of the different categories in Article 1(b) of Council Regulation (EC) No 659/1999 leads to the conclusion that Article 1(b)(v) applies only to state aid schemes, since individual aid was not explicitly mentioned.
- (72) In support of this contention, the interested parties also point to the fact that the PPAs were private-law agreements as opposed to state measures. According to the interested parties, it would be a perverse outcome if a contract legally and validly concluded before Poland's accession to the EU and liberalisation were to become illegal after accession. The interested parties take the view that this would be an expansive and retroactive interpretation of the EC Treaty state aid rules which is incompatible with the internationally recognised principles of legal certainty and legitimate expectations.

#### *Imputability of measures to the state*

- (73) The following comments were submitted by the Banks.
- (74) The Banks argue that the measure cannot be imputed to the State, but to PSE. Bearing in mind the state of the Polish electricity sector when the PPAs were signed, PSE's only option was to conclude long-term contracts. This would also have been the case if PSE had been a privately-owned market operator. It was therefore in the interest of both the state and the parties to the agreements for the PPAs to be concluded, rather than a case of the state imposing a policy decision on PSE.

#### *Economic advantage<sup>18</sup>*

- (75) Most of the interested parties argue that the PPAs do not confer any economic advantage.
- (76) The interested parties criticise the Commission's preliminary finding that the prices established under the PPAs are higher than wholesale market prices. According to the interested parties, the Commission did not make it clear in the decision to initiate the procedure which market and which prices the decision referred to. In particular, the Polish Power Exchange was not opened until December 1999, by which time many PPAs had already been concluded. In the opinion of the interested parties, the interconnectors between Poland and other countries were congested at the time. The Commission wrongly referred to a price recorded in Greece in 2003, i.e. in a totally different geographical and temporal context.

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<sup>18</sup> Comments submitted by BOT, ENS, ECZG, ECK, ELCHO, Rzeszów, the Banks, PAK, Electrabel and PSE.

- (77) Energy sold under PPAs cannot be compared with energy sold outside PPAs, even in Poland. The former respect modern environmental standards, while the latter is produced by less environmentally friendly units, which “dump”<sup>19</sup> their surplus capacity at marginal costs, under various mechanisms, none of which ensures prices that cover both fixed and variable costs. Power generators operating outside PPAs were also subsidised and were not required to modernise their equipment, unlike power generators under the PPAs. They were in any event not able to produce enough electricity to cover total demand in Poland, in particular in 1997-1998.
- (78) According to the interested parties, PPAs should be analysed in the light of the circumstances prevailing at the time when they were concluded, i.e. a centralised, regulated electricity system with a single customer, rather than a liberalised system with a wholesale market.
- (79) PPAs were the only way to secure investments which met the requirements for the electricity sector in Poland (in particular, modernisation of the whole system, environmental protection and security of supply). The Banks required PPAs to serve as collateral for their loans. Applying the private investor principle meant taking account of these requirements, and the only way of meeting them was PPAs. The interested parties note that PPAs impose investment and availability obligations on power generators.
- (80) The interested parties argue that PSE’s behaviour in signing PPAs should not be analysed in terms of whether it achieved short-term profits but whether it ensured the profitability of long-term investments and - from a network operator’s perspective – whether it ensured stable security of supply and discharged its general public service duties. The interested parties state that the PPAs were concluded by way of a transparent and open tender procedure, which was conducted in a non-discriminatory way and led to the lowest possible price. According to the interested parties, it follows from Court of Justice case-law that this is in itself sufficient for the granting of an economic advantage to be ruled out.<sup>20</sup> Before launching the tender procedure for the PPAs, a lowest cost analysis was undertaken to determine a list of investment priorities in the sector.
- (81) The interested parties also argue that since PSE was operating in a regulated electricity system, its behaviour cannot be compared with the behaviour of companies operating under normal market conditions. Accordingly, PSE's behaviour should be assessed with reference to objective and verifiable elements which, according to the interested parties, are constituted by the costs incurred by power generators.<sup>21</sup> PSE's behaviour is compatible with the private investor principle because PPAs cover nothing other than fixed costs plus variable costs and a reasonable margin of profit.

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<sup>19</sup> Wording used by the interested parties.

<sup>20</sup> Reference to the judgment of the Court of First Instance in Joined Cases *P&O European Ferries (Vizcaya), SA (T-116/01) and Diputación Foral de Vizcaya (T-118/01) v Commission of the European Communities* [2003] ECR II-02957, point 118.

<sup>21</sup> Reference is made to the Court judgments in cases C-83/1 P, C-93/1 P and C-64/01 P *Chronopost and others v Ufex and others* [2003] ECR I-06993, paragraphs 38 and 39.

- (82) It is said to be generally accepted practice for operators in the sector to conclude long-term contracts like PPAs. This, it is argued, is a normal form of risk-sharing between the power generator and the buyer. The long duration of a contract should not be construed as an advantage per se. The interested parties cite a number of examples: a contract between Electricité de France and Péchiney in France, two contracts between Redes Energéticas Nacionais and Turbogás and Electricidade De Portugal and Pego in Portugal, and contracts concluded by Northern Ireland Electricity in the United Kingdom. The interested parties also refer to an "IASB" contract, but the references provided were incorrect and the Commission was unable to find the document.<sup>22</sup> The interested parties claim that the Commission did not express reservations about the duration of these contracts, even though it amounted to at least 15 years. The interested parties state that long-term contracts are also a generally accepted practice in the USA, but fail to provide any specific examples.
- (83) The interested parties also claim that PPAs do not guarantee return on investment. PSE and regulatory authorities have retained the legal means to limit return on investment. In particular, the regulatory authorities can review prices and reject excessive or unjustified charges. PSE did not always use power plants' full capacity, and incorporated gains resulting from efficiency improvements when calculating electricity prices in the contracts. Power generators also bear a number of risks relating e.g. to financing, construction, operating and maintenance.
- (84) Since the PPAs do not provide any economic advantage, it is argued, they do not constitute state aid within the meaning of Article 87(1) of the EC Treaty.
- (85) Interested parties that are privately owned also argue that, even if the PPAs did contain some economic advantage, the value of this economic advantage would have been reflected in the sale price agreed at the time of the privatisation of the power plant. PPAs were necessary in order to carry out privatisation, being one of the basic preconditions of the privatisation agreements for these plants. The interested parties argue that, further to the *Banks*<sup>23</sup> and *Falck* judgments of the Court of Justice, the circumstances referred to above rule out any element of economic advantage from the PPAs.

*Services of general economic interest*<sup>24</sup>

- (86) The interested parties argue that the power generators that are parties to the PPAs provide services of general economic interest ("SGEIs").
- (87) state aid under the PPAs, if any, meets the four cumulative criteria laid down by the Court in its judgment in case C-280/00 ("the Altmark judgment").<sup>25</sup>

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<sup>22</sup> The Polish authorities did not maintain this argument in their comments.

<sup>23</sup> Case C-390/98 *H.J. Banks & Co. Ltd v The Coal Authority and Secretary of State for Trade and Industry* [2001] ECR I-06117 and joined cases C-74/00 P and C-75/00 P *Falck SpA and Acciaierie di Bolzano SpA v Commission of the European Communities* [2002] ECR I-07869.

<sup>24</sup> Comments submitted by BOT, ENS, ACZG, ECK, ELCHO, PAK and PSE.

<sup>25</sup> Case C-280/00 *Altmark Trans GmbH and Regierungspräsidium Magdeburg v Nahverkehrsgesellschaft Altmark GmbH, and Oberbundesanwalt beim Bundesverwaltungsgericht* [2003] ECR I-07747.

- (88) First, the power generators that are parties to the PPAs will be entrusted with providing SGEIs. This follows from Article 1(2) of the 1997 Polish Energy Act, which states that the state must secure a continuous and uninterrupted supply of energy to end-users in a manner that is technically and economically justifiable, with due regard for the requirements of environmental protection. The interested parties also consider diversification of fuel supply and reduction of nitrogen oxide emissions close to urban areas as SGEIs which they are bound to provide. Member States have a wide margin of discretion to determine which services constitute SGEIs. More precisely, Directive 96/92/EC makes it possible for security of supply to be regarded as an SGEI, which is confirmed by the Commission's decision-making practice. Environmental protection, including energy efficiency and climate protection, was also recognised as an SGEI in Directive 2003/54/EC of the European Parliament and of the Council of 26 June 2003 concerning common rules for the internal market in electricity and repealing Directive 96/92/EC ("Directive 2003/54/EC").<sup>26</sup> As such, the PPAs are regarded as a legal instrument used by the State to entrust power generators with the aforementioned SGEIs, as confirmed by the bid assessment criteria.
- (89) Second, the PPAs, including annexes, lay down precise rules governing compensation for the costs of the SGEIs from the outset. This is a part of the negotiations for the PPAs. Certain PPAs were amended several times, even after Poland's accession to the European Union, but this did not have a significant impact on the compensation rules or the amounts involved.
- (90) Third, the compensation paid on the basis of PPAs does not exceed the costs of the SGEIs provided. PPAs solely cover the costs of generating the electricity purchased (e.g. construction costs, capital costs, fixed and variable operating and maintenance costs, overheads) and a reasonable margin of profit.
- (91) Fourth, the SGEIs were entrusted to companies selected by way of an open, competitive and non-discriminatory tender procedure for the conclusion of the PPAs.
- (92) In the light of the above, the interested parties conclude that the PPAs fulfil the four cumulative criteria referred to in the Altmark judgment and should be regarded as not constituting aid within the meaning of Article 87(1) of the EC Treaty.
- (93) The interested parties also argue that even if PPAs were deemed not to fulfil the four cumulative criteria of the Altmark judgment, they could still be declared compatible with the common market under Article 86(2) of the EC Treaty.
- (94) As indicated in recital 88, the PPAs entrusted power generators with SGEIs, the nature of which is laid down in Polish law. PPAs are regarded as a necessary means to guarantee provision of SGEIs; otherwise, appropriate sources of financing for the plants' development could not have been found. Aid under PPAs is proportionate to the objective of obtaining the SGEIs since it does not cover more than the full costs of electricity generation, plus a reasonable margin of profit. In short, in view of the very limited number of interconnections between Poland's electricity network and other electricity networks in the European Union, the aid could not affect the

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<sup>26</sup> OJ L 176, 15 July 2003, p. 37.



development of trade between Member States to an extent contrary to the common interest.

*Selectivity*<sup>27</sup>

- (95) The interested parties consider that the PPA system does not comprise elements of selectivity.
- (96) According to the interested parties, it cannot be automatically assumed that a measure that favours only one sector of the economy is selective. The interested parties argue that the Commission should always define the relevant geographical and product market. The Commission should then identify the competitors of the aid measure's recipients in this market so as to determine whether the measure is selective. In this specific case, the tender procedure for the selection of parties to the PPAs was open, transparent and non-discriminatory, which means that no selectivity was involved.
- (97) The interested parties also argue that sector-specific measures may be non-selective if they are purely the result of market forces. The measures examined by the Court in the *Van der Kooy* judgment<sup>28</sup> are a typical example of non-selective measures of this type.
- (98) The interested parties also point out that the decision to conclude PPAs was taken not by the state, but by PSE. The selectivity criterion should be replaced by the private investor principle.

*Distortion of competition and impact on trade between Member States*<sup>29</sup>

- (99) The interested parties argue that the Commission should have examined whether the PPAs distorted competition or affected trade between Member States at the time when they were concluded.
- (100) The PPAs were signed at a time when there was no competition on the Polish electricity market. Directive 96/92/EC was not applicable to Poland at that time. Poland was at a very early stage of its EU membership negotiations – there was not even a definitive timeline for accession. Prices at the time were fully regulated, including prices for electricity generators which were not parties to PPAs. So PPAs could not be seen as distorting competition at that time.
- (101) The interested parties also note that Poland was not a Member State of the European Union at the time the PPAs were signed. Furthermore, connection capacity between Poland and its neighbours was limited, and the electricity generated under the PPAs was more expensive than electricity generated outside the PPAs. As such, it cannot be argued that the PPAs affected trade between Member States at the time when they were concluded.

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<sup>27</sup> Comments submitted by BOT, ENS, ECZG, ELCHO and the Banks.

<sup>28</sup> Judgment of the Court of 2 February 1988, joined cases 67, 68 and 70/85 *Van der Kooy BV and others v Commission* [1988] ECR 00219.

<sup>29</sup> Comments submitted by BOT, ENS, ECK, ELCHO, the Banks and PAK.

*Compatibility within the meaning of Article 87(3)(a) of the EC Treaty*<sup>30</sup>

- (102) The interested parties argue that, if the PPAs were state aid, they could be declared compatible with the common market pursuant to Article 87(3)(a) of the EC Treaty.
- (103) The interested parties argue that the PPAs cannot be regarded as operating aid. Operating aid (as opposed to investment aid) is “aid that is intended to relieve an undertaking of the expenses that it would normally have to bear in its day-to-day management or its usual activities.” Payments under the PPAs cannot be regarded as constituting such aid. They constitute the price payable for goods or services supplied under a business contract. Besides, the purpose of PPAs is to enable implementation of an investment project, which demonstrates that they are investment (as opposed to operating) measures.
- (104) The interested parties also take the view that the Commission should recognise the existence of exceptional circumstances that could result in the operating aid being authorised in this case. Due consideration should be given to the state of the Polish electricity sector in the 1990s. Clearly, Poland could be treated as one of the regions referred to in Article 87(3)(a) of the EC Treaty. Some of the power generators in question were located in areas where closure would have a very significant impact on the community as a whole. PPAs also promoted the development of the electricity sector in Poland and of the economy as a whole, given the importance of this sector.

*Compatibility within the meaning of Article 87(3)(b) of the EC Treaty*<sup>31</sup>

- (105) The interested parties argue that, if the PPAs were state aid, they could be declared compatible with the common market pursuant to Article 87(3)(b) of the EC Treaty.
- (106) According to the interested parties, when the PPAs were signed the state of the Polish electricity sector was creating serious disruption in the Polish economy. PPAs, it is argued, were a way of remedying this serious disruption.

*Compatibility within the meaning of Article 87(3)(c) of the EC Treaty*<sup>32</sup>

- (107) The interested parties argue that, if the PPAs were state aid, they could be declared compatible with the common market pursuant to Article 87(3)(c) of the EC Treaty.
- (108) In that respect, the interested parties take the view that PPAs should not be analysed in the light of the Stranded Costs Methodology, since they were not designed to compensate for these costs. PPAs should instead be analysed directly in the light of Article 87(3)(c).

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<sup>30</sup> Comments submitted by BOT, ENS, ELCHO and PAK.

<sup>31</sup> Comments submitted by ELCHO, PAK and PSE.

<sup>32</sup> Comments submitted by BOT, ENS, ELCHO, PAK and PSE.

- (109) The interested parties claim that PPAs were designed to enable the development of the Polish energy sector by attracting foreign investment in modern, environmentally friendly power plants. As such, PPAs were intended to “facilitate the development of certain economic activities.”
- (110) The interested parties also claim that PPAs had little impact on trade in electricity between Member States. For technical reasons, interconnections between Poland and other countries were limited. Imports faced technical barriers and full use had already been made of the scope for exports, so it cannot be claimed that PPAs introduced restrictions in this area. According to the interested parties, in its initial report on the energy market,<sup>33</sup> the Commission did not identify PPAs as an obstacle to integration of the European energy markets. The interested parties conclude that the PPAs had “no adverse effect on trading conditions to an extent contrary to the common interest.”
- (111) The interested parties also argue that the PPAs should have been analysed in the light of the Community guidelines on state aid for environmental protection,<sup>34</sup> bearing in mind the fact that PPAs were specifically designed to bring power generators in Poland into line with the requirements of Directive 2001/80/EC of the European Parliament and of the Council of 23 October 2001 on the limitation of emissions of certain pollutants into the air from large combustion plants.<sup>35</sup>

*The PPAs should have been examined under the interim mechanism referred to in the Accession Treaty<sup>36</sup>*

- (112) The interested parties argue that PPAs should be examined under state aid procedure No PL 1/03,<sup>37</sup> which was initiated by the Commission in application of the interim mechanism provided for in the Accession Treaty.
- (113) Case No PL 1/2003 dealt with the notification by Poland of the initial version of the bill for the abolition of PPAs. The interested parties consider that, when it examined the notification, the Commission probably reached the same conclusion on the link between the PPAs and the initial bill as on the link between the PPAs and the Bill, namely that the PPAs and the bill are “closely linked.”
- (114) According to the interested parties, the logical conclusion is that the Commission should have analysed the PPAs by way of the same procedure that it used to analyse the initial bill, i.e. procedure No PL 1/2003, just as it did in the present case.
- (115) The interested parties note that the decision to initiate the procedure also repeals the Commission decision concerning case PL 1/2003. The Commission justified this repealing decision on the grounds that Poland had failed to implement the initial bill prior to accession and that therefore the procedures laid down in the Accession Treaty did not apply to it. The interested parties argue that this ignores the intrinsic relationship between the initial bill and the PPAs. Contrary to the initial bill, the

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<sup>33</sup> [http://europa.eu/comm/competition/antitrust/others/sector\\_inquiries/energy/po\\_1.pdf](http://europa.eu/comm/competition/antitrust/others/sector_inquiries/energy/po_1.pdf)

<sup>34</sup> OJ L 309, 27 November 2001, p. 1.

<sup>35</sup> OJ C 37, 3 February 2001, p. 3.

<sup>36</sup> Comments submitted by ELCHO, the Banks and PAK.

<sup>37</sup> Commission Decision of 3 February 2004 in state aid case PL 1/03 – Poland – Compensations of stranded costs in Poland. Letter C(2004)167fin dated 3 February 2004.

PPAs would have remained within the scope of the procedures laid down in the Accession Treaty. The Commission should have continued to analyse the PPAs by way of procedure No PL 1/2003, i.e. under the procedures of the Accession Treaty, and should not have initiated a new procedure under the EC Treaty.

*Deprivation of rights*<sup>38</sup>

(116) The interested parties argue that termination of the PPAs means that they are deprived of their rights<sup>39</sup> (without adequate compensation).<sup>40</sup>

**4.2. Comments on the Bill**

(117) Only ELCHO, the Banks and PAK submitted comments on the Bill.

(118) The interested parties reiterate their viewpoint that the PPAs do not constitute an economic advantage (see above). They argue that, as a consequence, the payment of fair compensation for termination cannot constitute an advantage either. The interested parties refer to the *Asteris* judgement.<sup>41</sup> Compensation paid under the Bill is, they argue, akin to compensatory damages, and in addition is guaranteed under private international law and Article 10 of the Energy Charter Treaty.

(119) The interested parties also argue that the Bill does not involve state resources in so far as the parafiscal levy that will fund it does not go through PSE, but through one or more private operators or companies.

(120) The interested parties also argue that the Bill can be regarded as compatible with the EC Treaty in the light of Articles 87(3)(a)-(c) and 86(2). In this respect, the interested parties are invoking the same arguments as the ones used when discussing the compatibility of PPAs with these Treaty provisions.

(121) Regarding the Bill's compatibility with the Stranded Costs Methodology, the Banks argue that this method was conceived and adopted in a totally different context. The objective of the Stranded Costs Methodology was to resolve the problem of how to recover sunk costs following liberalisation. The Bill, by contrast, took account of the circumstances prevailing in Poland when the PPAs were signed. The Banks criticise the fact that, in its decision to initiate the procedure, the

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<sup>38</sup> Comments submitted by Rzeszów and West LB AG London Branch

<sup>39</sup> Rzeszów failed to substantiate this argument in greater detail. However, in its additional comments, West LB AG London Branch (cf. footnote 11) states that; although the bill on the early termination of PPAs provides for PPAs to be terminated voluntarily, in practice the Act will make such termination mandatory. In addition, as a result of liquidation of the adjustment component of the system charges, PSE will no longer receive funds to discharge its obligations under the PPAs after the Act enters into force – which is likely to result in PSE having significant difficulties in discharging its obligations under the PPAs. Therefore, if power generators fail to terminate the contract voluntarily, the risk of not receiving the total amount of funding for contract implementation is greatly increased.

<sup>40</sup> According to West LB AG London Branch, the way in which the compensation for stranded costs is calculated and paid practically deprives financial institutions of the source of repayment of loans negotiated under the PPAs. Financial institutions would be deprived of their rights without compensation. West LB argues that the bill should therefore – as a minimum – provide for sufficient compensation to ensure that financial institutions can obtain immediate repayment of all funding granted to power generators.

<sup>41</sup> Judgment of the Court of 27 September 1988 in joined cases C-106 to 120/87 *Asteris AE and others v Hellenic Republic and European Economic Community* [1988] ECR 05515, paragraphs 23 and 24.

Commission qualified certain power plants in Poland as “inefficient” and sought to analyse whether the Draft Law would result in the level of income guaranteed before liberalisation being maintained. According to the Banks, this logic would result in any power plants constructed before the accession of a new Member State to the European Union being deemed inefficient, with the consequence that any contracts concluded with these power plants would automatically be regarded as including state aid. In turn, this would lead to the far-reaching conclusion that all contracts would have to be terminated at the date of accession and then renegotiated. This would make no legal or economic sense. The Banks add that the Commission has failed to provide any convincing or tangible evidence that the power plants are inefficient.

(122) In short, according to the Banks, the Commission made a wrong distinction between power plants that had been completed, or nearly completed, at the time of accession, and the others. In so doing, the Commission overlooked the fact that compensation must be calculated with reference to the established rules of domestic and international law. According to the Banks, the price which a new player is prepared to pay to enter the market is irrelevant to these calculations.

## **5. COMMENTS FROM POLAND ON THE DECISION TO INITIATE THE PROCEDURE**

### **5.1. Comments on the PPAs**

(123) Poland takes the view that the state has a duty to ensure energy security, which includes securing energy supplies, with due account for environmental requirements.

(124) Poland argues that PPAs were the only way of discharging this duty in Poland at the time when the agreements were signed. Significant investment was necessary to modernise the Polish electricity market, and the energy companies themselves had very limited resources. The Banks made the granting of loans contingent on a certain level of income being guaranteed for a specified period. PPAs were regarded as collateral for these loans.

(125) PSE was the only entity that was capable of implementing the PPAs. When analysing this company’s behaviour, it should be borne in mind that the main motive of the state is not to generate profit but to discharge its duties in the general interest.

(126) Poland argues that, since the PPAs were concluded by way of an open, transparent and non-discriminatory tender procedure, the state’s participation in them should be seen as representing the market price for discharging the duty in the public interest, which leads to the conclusion that there is no state aid element involved. This is compatible with the concept of public-private partnership, which is promoted by the Commission.

(127) According to Poland, the PPAs were concluded under market terms and their form reflected in particular the credit terms offered by the banks to power generators.

(128) Furthermore, Poland argues that, since the concepts of SGEIs and public-private partnership always refer to a specific sector, the PPAs cannot be viewed as instruments which are abnormally sector-specific.

- (129) Poland also argues that, in cases where power plants were privatised, the sales price took account of the value of the PPA. This therefore rules out any element of economic advantage, which is one of the cumulative elements for defining state aid.
- (130) Poland also takes the view that the PPAs do not constitute aid which is still applicable after accession. Poland regards PPAs as individual aid, and states that their implementation, even after accession, is nothing more than the transfer of aid awarded before accession. The PPAs also clearly indicate the state's maximum exposure.
- (131) Poland states in its opinion that the Stranded Costs Methodology cannot be applied to the PPAs themselves. It is applicable only after the PPAs have been terminated.
- (132) In conclusion, the Polish authorities dispute the statement that the PPAs guarantee a certain price for the electricity over a specified period. Poland argues that instead the PPAs ensure that the costs of generating electricity are covered and allow for a small profit margin to the extent necessary to repay the debt. According to Poland, in accordance with market economy principles, the price of a product or service should always reflect the costs of the capital obtained to finance the investment.

## **5.2. Comments on the Bill**

- (133) Poland responded to the Commission's doubts on the Bill as expressed in the decision to initiate the procedure by proposing an amended version of the Bill. The Bill entered into force on 4 August 2007 and is therefore referred to hereinafter as "the Act".
- (134) As regards state aid, a description is given below of the points in which the new version of the Act differs from the original version as described in section 2.2.
- (135) The list of aid recipients and the maximum amount of compensation have been amended. The new list of stranded costs compensation amounts for potential recipients is as follows:

**Table 3 – Compensation levels in the amended Act**

<b>Name of recipient</b>	<b>Maximum compensation (PLN thousand)</b>
BOT Górnictwo i Energetyka S.A.	<b>4 536 851</b>
Południowy Koncern Energetyczny S.A.	<b>1 479 745</b>
Elektrownia Koźienice S.A.	<b>623 612</b>
Zespół Elektrowni Dolna Odra S.A.	<b>633 496</b>
Zespół Elektrowni Pątnów-Adamów-Konin Pątnów II	<b>1 377 880</b>
Elektrociepłownia Kraków S.A.	<b>0</b>
Elektrociepłownia Rzeszów S.A.	<b>297 415</b>
Elektrociepłownia Nowa Sarzyna Sp. z o.o.	<b>777 535</b>
Elektrociepłownia Lublin Wrotków Sp. z o.o.	<b>425 263</b>
Elektrociepłownia Chorzów „ELCHO” S.A.	<b>888 581</b>

Elektrociepłownia Zielona Góra S.A.	464 297
Elektrociepłownia Gorzów S.A.	72 755
<b>Total</b>	<b>11 577 430</b>

Source: Appendix 2 to the Act as submitted by Poland.

(136) As compared against the list in Table 2, the amended list of recipients:

- a) no longer includes Electrabel Połaniec S.A. and Dalkia Poznań Zespół Elektrociepłowni S.A., because their PPAs have expired in the meantime;

no longer includes Żarnowiecka Elektrownia Gazowa Sp. z o.o., because the PPA for this power plant was terminated before construction of the plant had been completed;

now includes Elektrociepłownia Gorzów S.A., which became eligible for payments under the Bill.

(137) Elektrociepłownia Kraków S.A. remains eligible for payments under the Act, but with a maximum level of compensation equivalent to zero.

(138) The main rules governing the calculation of the maximum amount of stranded cost compensation listed in Table 3 above are laid down in Article 27 of the Act.

(139) The maximum amounts of compensation were calculated as the difference between:

- (a) undepreciated investment costs as of 2007 not covered by investment aid, and
- (b) the part of its cash flow that the company will be able to use to recoup its investment costs.

Investment costs are the net book value of fixed assets as per Article 27(1) of the Act. Undepreciated investment costs are the book value of fixed assets after deduction of their depreciated value.

The following are subsequently deducted from this amount:

- a) - the residual book value of the power plant as at the day on which the PPA was originally scheduled to end (if any), and
- the total amount of the grants and write-offs relating to the assets.

This maximum amount was calculated from 2007 until expiry of the PPA for each power plant.

(140) When the compensation amounts were calculated, only those investments that had been completed or were on the point of completion as of the date of Poland's accession to the European Union were taken into consideration. "Investments on the point of completion" means investments which it was more economic to complete and operate rather than stopping construction. The assessment was carried out as at the date of Poland's accession to the European Union.

- (141) Future cash flows were calculated on the basis of the same type of market forecasts as the ones described in the decision to initiate the procedure. The Polish authorities substantiated their forecasts.
- (142) The Act no longer provides for a large initial payment; instead, there are annual instalments with a system of advances which, in particular, take account of the power generator's debt. The mechanism designed to adapt compensation amounts to actual changes in electricity prices was extended until the originally planned termination of each PPA. It corresponds to the period referred to in recital 139 used to calculate the maximum amount of compensation for each company.
- (143) The Act states that recipients of compensation will not receive rescue or restructuring aid for a period of ten years after the last stranded costs compensation payment provided for by the Act.
- (144) The Act also provides for a new category of stranded costs for the power generators listed in Table 3 which have concluded a long-term gas supply contract containing a take or pay clause relating to the plants' operation under their PPA. Long-term take or pay contracts are contracts in which the buyer undertakes to take a certain quantity of gas for each year of the contract at a price set by a formula and is liable to a fine if it fails to purchase the quantity in question.
- (145) The maximum compensation for these categories of stranded costs is equivalent to the maximum volume of electricity that the generator in question can produce from the gas contracted under take or pay conditions, multiplied by the estimated difference between the price per unit of energy of this gas and the average price per unit of energy of the coal needed to produce the same amount of electricity, and by a coefficient reflecting the ratio between the average cost per unit of energy of gas from Polish gas fields and the average cost per unit of energy of the gas used by generators not using gas from Polish gas fields (if the generator concerned does not use Polish gas).
- (146) The following table indicates the maximum payments for compensation linked to take or pay contracts under the Act:

**Table 4 – Maximum compensation for stranded costs linked to take or pay contracts**

<b>Generator</b>	<b>Maximum compensation (PLN thousand)</b>
Elektrociepłownia Rzeszów S.A.	124 395
Elektrociepłownia Lublin Wrotków Sp. z o.o.	191 480
Elektrociepłownia Nowa Sarzyna Sp. z o.o.	340 655
Elektrociepłownia Zielona Góra S.A.	313 477
Elektrociepłownia Gorzów S.A.	35 273
<b>Total</b>	<b>1 005 280</b>



Source: Appendix 2 to the Act as submitted by Poland.

(147) A mechanism has been put in place to update the actual compensation granted each year to each of these generators for stranded costs linked to take or pay contracts.

(148) Actual compensation in a given year comprises two items:

a) first, an amount equivalent to the actual quantity of electricity produced in a given year by the generator in question from the gas obtained under his take or pay contract, multiplied by the difference between the actual price per unit of energy of the gas purchased under the take or pay contract and the actual average price per unit of energy of the quantity of coal necessary to produce the same amount of electricity in that year, minus the difference between the average sales price per unit of energy of the electricity charged by the generator concerned in that year and the average sales price per unit of energy of electricity charged by coal-fired generators in that year (when this difference is negative it is not taken into account in the calculations). The coefficient reflecting the ratio between the average cost per unit of energy of gas from Polish gas fields and the average cost per unit of energy of the gas used by generators not using gas from Polish gas fields (if the generator concerned does not use Polish gas) is also applied;

a) second, an amount equivalent to the actual fines paid by the generator in question in that year for gas contracted under take or pay provisions and not taken.

(149) For each power generator, the sum of actual annual compensation as calculated in accordance with the methodology laid down in recital 148 may not exceed the maximum amount of compensation provided for in Table 4. All payments for the compensation of stranded costs linked to take or pay contracts cease when this maximum amount is exceeded. In any event, payments cease at the latest when the terminated PPA was originally scheduled to expire.

(150) The above-mentioned provisions apply only to quantities of gas acquired under take or pay contracts that had already been concluded at the time of Poland's accession to the European Union. Additional quantities of gas contracted under take or pay provisions by the same power generator after accession do not qualify for compensation. Furthermore, if the quantity of gas acquired under the take or pay provisions is reduced after accession, then this reduction is reflected in compensation payments.

## **6. REPLY FROM POLAND ON COMMENTS FROM INTERESTED PARTIES**

(151) Poland takes the view that PPAs should not be regarded as state aid by the Commission. However, if they were to be deemed as constituting state aid, they should be treated as aid not applicable after accession.

(152) Poland notes that the exemption from the obligation to submit tariffs to the President of the Office for Energy Regulation for approval was intended to

encourage power generators to behave like market operators and limit energy generation costs.

(153) Poland emphasises that the conclusion of PPAs was preceded by a tender procedure which was open and non-discriminatory and addressed to all generators (public and private alike). The Commission is also requested to note that some PPAs were linked to privatisation and that the price of the privatised enterprise reflected the fact that a PPA had been concluded.

(154) Should the Commission deem PPAs to constitute state aid, Poland considers that the aid should not be qualified as operating aid, as in practice it was linked to the discharge of the public duties vested in the power generators. PPAs were designed to ensure security of supply.

(155) Poland once again reiterated its standpoint that PPAs should not be assessed in the light of the Stranded Costs Methodology; the Methodology should be used only for costs arising when a Member State fails to discharge its obligations and guarantees vis-à-vis generators.

## **7. ASSESSMENT BY THE COMMISSION**

(156) As mentioned in recital 133, the Polish authorities have submitted the Act to the Commission as part of the present procedure for it to be assessed under the state aid rules. The Act provides for compensation linked to early termination of PPAs and cannot therefore be dissociated from the PPAs themselves. In its decision to initiate the procedure, the Commission expressed doubts about possible state aid elements and PPAs' compatibility with state aid legislation. The PPAs are still in force at the date of the present Decision.. Therefore the Commission has a duty to assess the PPAs listed in Appendix 1 to the Act.

### **7.1. With regard to PPAs**

#### *7.1.1. Existence of state aid within the meaning of Article 87(1) of the EC Treaty*

(157) Below the Commission analyses each of the four cumulative criteria which comprise the definition of state aid within the meaning of Article 87(1) of the EC Treaty: the involvement of state resources, the existence of an economic advantage, the selectivity of the advantage and the impact on trade.

(158) It is important that this analysis should determine the time at which these criteria are examined and which will, as a result, be taken into account for the state aid assessment of the PPAs.

(159) In their comments, the interested parties argued (with reference to several assessment criteria) that the Commission should consider only the situation prevailing when the PPAs were signed. The findings of this analysis would then extend to the whole duration of each PPA, at least until it was substantially amended.

- (160) It is true that, when carrying out an analysis to determine the existence of aid in a specific case, the Commission must examine the situation prevailing at the time when the measure entered into force.
- (161) However, that does not mean that the assessment of the four criteria in the definition of state aid should be limited to the precise time at which the aid was granted. If, from the outset, the aid was granted for a long duration in the form of successive payments - as opposed to a one-off payment - the Commission must determine whether the criteria were met over the whole planned duration of the measure.
- (162) In the present case, the Commission has reached the conclusion that the assessment findings were identical irrespective of whether the PPAs were deemed to constitute state aid when they were concluded. If the Commission were to take the view that the four criteria for aid were present when the PPAs were concluded, the measure should be assessed in accordance with the Accession Treaty. As a result of this assessment (point 7.1.2 below), the measure would constitute new aid as of 1 May 2004 and its compatibility with the common market should be assessed as of that date. Should it be concluded, however, that the PPAs did not constitute state aid when they were signed, the Commission is of the view that they became state aid at the time of accession – at the latest on the date of accession of Poland to the EU (point 7.1.2 below). On the basis of the Accession Treaty and in accordance with Article 1(b)(v) of Council Regulation (EC) No 659/1999, the Commission would conclude that the measure constitutes new aid as of 1 May 2004 and its compatibility with the state aid rules is to be assessed as of that date (point 7.1.2 below).
- (163) Therefore the Commission is assessing whether, as of the day on which Poland acceded to the European Union and since that date, the measure meets all the criteria for the existence of state aid.
- (164) In this regard, the Commission wishes to respond to comments submitted by the interested parties to the effect that private-law contracts cannot automatically become void as a result of accession and liberalisation, as this outcome would, according to the interested parties, go against the principles of legal certainty and legitimate expectations.
- (165) The Commission rejects this argument. The Europe Agreement establishing an association between the European Communities and their Member States, of the one part, and the Republic of Poland, of the other part, which paved the way for accession, was signed on 16 December 1991. At the time when the parties concluded these agreements, it was clear that Poland would accede to the EU and, for most of them, it was also clear that this would take place before the end date of the PPA.
- (166) The Republic of Poland signed the Accession Treaty on 16 April 2003. The Accession Treaty entered into force on 1 May 2004. From the date of accession, the provisions of the original Treaties and those of the secondary legislation became binding in Poland, in line with Article 2 of the Accession Act.<sup>42</sup> Consequently, the so-called *acquis communautaire* applies to all contractual relations in the new Member States, and any exceptions to this rule can stem only from the Accession

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<sup>42</sup> See footnote 3 above.

Treaty itself. The Accession Act annexed to the Treaty and its Annexes do not provide for any exception under the state aid rules that would exempt the PPAs or the energy sector in general from the direct application of EU state aid legislation.

(167) The Commission is duty bound to apply EU competition law to Poland in the same way as it does to all other Member States as regards the energy sector and all other sectors of the Polish economy. The Commission notes that the form of aid (private-law contract as in the case of the PPAs) is not relevant from the state aid viewpoint; only the effect of the measure is relevant to the Commission's analysis. The Commission therefore found no valid arguments in the interested parties' comments to explain why this procedure is incompatible with the principles of legal certainty or legitimate expectations.

*State resources and imputability to the state*

(168) The guarantee of profitability, which is the basis of the PPAs, manifests itself in practice in the obligation for PSE to purchase electricity at a price which covers investment and operating costs plus a certain margin of profit. The purchase price is borne in full by PSE, a company which is entirely owned and controlled by the Treasury.

(169) The interested parties have argued that the decision to conclude the PPAs was made by PSE

(170) As far as state resources are concerned, the Commission has also considered the application of the *PreussenElektra* judgment,<sup>43</sup> in which the Court of Justice examined a mechanism whereby privately owned companies were compelled by the state to purchase electricity from specific producers at a price fixed by the state which was higher than the market price. The Court ruled that, in this case, there was no transfer of public resources, and therefore no state aid.

(171) The Polish situation is significantly different from the system examined by the Court in the aforementioned ruling. In particular, the difference lies in the ownership structure of the companies to which the obligation to purchase the electricity applies.

(172) In the *PreussenElektra* case, the company which the State required to purchase the electricity was privately owned, whereas PSE is entirely owned and controlled by the state. PSE is under state control in accordance with the definition set out in 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.<sup>44</sup> The resources used therefore belong to a fully state-owned company.

(173) In the *PreussenElektra* case, when the funds are traced from the recipient back to the source, it emerges that at no time were they under the direct or indirect control of the state.

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<sup>43</sup> Case C-379/98 *PreussenElektra AG v Schleswag AG* [2001] ECR I-02099.

<sup>44</sup> OJ L 318, 17 November 2006, p. 17.

- (174) In contrast to the situation described in the *PreussenElektra* judgment, in the Polish case the funds are under state control because they are transferred to a public company (i.e. PSE) and will therefore be regarded as state resources.
- (175) On the basis of the assessment of the measure and in the light of the aforementioned judgment, the Commission concludes that the PPAs do comprise state resources.
- (176) As far as imputability is concerned, in the *Stardust* judgment,<sup>45</sup> the Court stated that resources allocated to companies that are under the control of the state are state resources. However, the Court added that it is also necessary to examine whether the use of such resources is imputable to the state in a concrete manner.
- (177) According to the *Stardust* judgment of the Court of Justice, when a publicly owned company uses its funds in a way which is imputable to the state, then these funds should be regarded as state resources within the meaning of Article 87(1) of the EC Treaty.
- (178) It clearly appears from the comments submitted by Poland and interested parties that the decision to launch a programme to attract investors to the power generation sector was designed to promote the sector's modernisation, update power plants so as to bring them into line with EU standards and ensure that energy supplies fully covered demand. This demonstrates that the PPAs were concluded by PSE not for commercial purposes but, as acknowledged by the Polish authorities themselves, in order to implement a number of important policy objectives.
- (179) The state's control over the award of PPAs is evidenced in the fact that the invitations to submit tenders were sent to participants by the Polish Ministry of Industry and Trade. Moreover, under the Polish Commercial Code, the Minister of the Treasury has the full authority of the General Assembly of Shareholders.
- (180) The core principle underpinning the prices provided for in the PPAs was that they should cover investment and operating costs and ensure a certain profit margin. This framework is designed to ensure the necessary investments and also reflects a decision by the state authorities implemented via PSE.
- (181) In the light of the above assessment, the Commission considers that the above elements constitute a set of indicators which, according to the criteria laid down by the Court of Justice in the *Stardust* judgment, lead to the conclusion that the use of PSE's funds in the PPAs is imputable to the state and that therefore, in view of the arguments set out, the PPAs should be considered, for the purposes of the assessment, as being financed from state resources.
- (182) It seems clear to the Commission that the state was involved in concluding the PPAs and in defining the basic rules governing these agreements.

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<sup>45</sup> Judgment of the Court of 16 May 2002 in case C-482/99 *French Republic v Commission of the European Communities* [2002] ECR I-04397.

### *Economic advantage*

- (183) The legal form of a PPA is a contract concluded between two parties: PSE and the power generators. As explained in recital 172, PSE is a fully state-owned company.
- (184) To determine whether the PPAs provide an economic advantage to power generators, the Commission must assess whether, via the PPAs, generators obtain economic advantages that they would not obtain from the market.
- (185) PPAs provide eligible generators with an advantage if the parties to these agreements are placed in a better economic position than other companies.
- (186) Even though the details of individual PPAs may vary, all PPAs are structured around a core invariable principle: the mandatory purchase by PSE of most (sometimes all) of the electricity generated by the companies concerned, at a price reviewed periodically in accordance with the principle that the total costs (fixed and variable) of generating electricity, plus a profit margin, are passed on to the consumer.
- (187) The Polish electricity regulator, URE, indirectly retains the right to check whether the costs charged to PSE are justified and reasonable, but in practice URE uses this power only to check that the costs were actually linked to electricity generation. Furthermore, URE's checks are only indirect since their purpose is to verify the cost structure of PSE with a view to defining PSE's income from captive customers. In the unlikely circumstance of some of the PPA-related costs charged to PSE being deemed unjustified by URE, it can only prohibit PSE from passing these costs on to its captive customers. This might make it more difficult for PSE to discharge its obligations under the PPAs, but it would not mean they had been legally annulled.
- (188) The core principle described above is applied for the whole duration of the PPA, which lasts from 7 years to 20 years from the beginning of operation of the plants, i.e. from 10 to 31 years following the conclusion of the PPAs and, in the majority of cases, more than 15 years.
- (189) This means that, during this period, the commercial risk associated with operating the power plants is borne by the buyer of the electricity, i.e. PSE. This includes the risk associated with fluctuations in electricity generation costs and, in particular, fuel costs, the risk associated with fluctuations in end-user electricity prices, and the risk associated with fluctuation in end-user electricity demand. These are the typical risks that any power generator without a PPA would bear itself.
- (190) This means that power plants which have concluded PPAs (provided that they are properly managed from a technical perspective) have guaranteed profits extending over a very significant period equivalent to the typical expected lifetime of the assets concerned or their depreciation. The longer the period is, the greater the value of the guarantee, since it protects against a risk whose occurrence is increasingly unpredictable.
- (191) The Commission considers that this guarantee, which is the core of the PPAs, places the beneficiaries in a better economic situation than other companies on the market and therefore provides an advantage to the relevant power plants.

- (192) According to both the Polish authorities and the interested parties, the banks required the PPAs to be signed as a precondition for awarding loans to finance the assets. Electrabel states that “Financial institutions were not ready to finance new investments in the Polish power sector without benefiting from a special guarantee that the borrower will achieve a certain turnover during the period of reimbursement of the loan.”<sup>46</sup> It follows from these requirements on the part of banks that the guarantees awarded as part of the PPAs had a positive market value. The financial institutions’ agreement to finance the investments was therefore contingent on the PPA.
- (193) It follows from the above considerations that PPAs are not a traditional form of guarantee but simply provide for payment by the State-owned and State-controlled PSE of the investment costs and the most important (if not all) operating costs of the power plants which are parties to the agreements. In practice, this “guarantee” means that, over more or less the full depreciation period or planned lifetime of the plant, and irrespective of any changes in the conditions obtaining on the market, PSE buys a fixed quantity of electricity at a price that must ensure the power plant’s viability.
- (194) With a view to determining whether an advantage exists, the Commission analyses several other aspects in the following paragraphs.
- (195) First, the Commission notes that in Poland PPAs were concluded only with selected power generators. At the time they were concluded, there were other electricity generators that did not benefit from the PPA rules. More were set up in later years, and new investments are currently under way without PPA support.
- (196) In the first years of the PPAs, power generators without a PPA could sell their electricity at prices controlled by the State via URE. On 28 June 2001 a start was made on eliminating this mechanism and these power generators started selling their electricity at free, market-based prices.
- (197) As the interested parties have indicated, none of these mechanisms (price controlled by the state or free, market-based price) enabled generators without PPAs to cover all their costs. They sell their electricity at a price corresponding to marginal costs, i.e. a price which only ensures that their variable costs are covered.
- (198) The interested parties have suggested that electricity produced by power generators without PPAs is not as environmentally friendly as electricity generated by beneficiaries of PPAs, and that this would justify the former receiving a lower price for their electricity. The Commission rejects this argument. First, it is not certain that all power plants without PPAs generate “dirty” electricity. The newest plants in Poland (without PPAs) produce electricity using state-of-the-art technology. In addition, there is no economic reason why less environmentally friendly electricity would have a lower market value than more environmentally friendly electricity. The electricity produced is completely substitutable (it is not even possible to distinguish

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<sup>46</sup> Electrabel’s comments on the procedure, point 45, fourth sentence.

physically between the two types), and its value for the customer is exactly the same.<sup>47</sup>

(199) The Polish Power Exchange started operating in 1999. Since 2001 the average price of electricity on the Polish Power Exchange has remained stable and has fluctuated within a range of 110 to 125 PLN/MWh.<sup>48</sup> In 2004, the average price on the market fluctuated around 115 PLN/MWh; in 2005 around 115 – 120 PLN/MWh; in 2006 it was rather stable at around 125 and in 2007 (to 31 July 2007) it fluctuated between 110 and 122 PLN/MWh. By way of comparison, the information provided by Poland allowed the Commission to estimate the full costs incurred in 2005 by the power plants entitled to compensation under the Act as follows:

**Table 5 – Estimated total costs of generating electricity in power plants which concluded PPAs in 2005**

Generator		Average generation costs in 2005 (PLN/MWh)
Elektrownia Opole (part of BOT)	–	[...] <sup>#</sup>
Elektrownia Turów (part of BOT)	–	[...]
Południowy Energetyczny S.A. Koncern	–	[...]
Elektrownia Kozienice S.A.	–	[...]
Zespół Elektrowni Dolna Odra S.A.	–	[...]
Państw II	–	[...]
Elektrociepłownia Kraków S.A.	–	[...]
Elektrociepłownia Rzeszów S.A.	–	[...]
Elektrociepłownia Nowa Sarzyna Sp. z o.o.	–	[...]
Elektrociepłownia Wrotków Sp. z o.o. Lublin	–	[...]
Elektrociepłownia „ELCHO” S.A. Chorzów	–	[...]
Elektrociepłownia Zielona Góra S.A.	–	[...]

– *Average price on the Polish Power Exchange* 115-120 PLN/MWh

<sup>47</sup> Green electricity may be a limited exception since some customers may be prepared to pay more for electricity which is certified to have been generated from renewable energy sources. However, none of the power plants benefiting from PPAs uses these energy sources.

<sup>48</sup> Source: Polish Power Exchange statistics.

<sup>#</sup> Confidential information



**Source:** Commission estimates based on data provided by Poland. For Państw II, the value is for 2008, the first year in which the plant should be operational.

- (200) The figures in Table 5 above show how unlikely it is that market prices – i.e. the price that generators without PPAs are paid for their electricity on the market – would suffice to provide the same type of profit guarantee as the one PPAs offer.
- (201) The example of the Polish Power Exchange is not an isolated one. Other Member States have also liberalised their electricity markets and established power exchanges in which buyers and sellers trade electricity under market conditions.
- (202) In its Sector Enquiry on electricity markets in Europe,<sup>49</sup> the Commission examined in detail the conditions governing trade in electricity in European wholesale markets. The data gathered as part of this enquiry shows that no liberalised market provides a guarantee to generators that they will cover all their costs in the long-term. As a matter of fact, most transactions take place within a horizon of three years.
- (203) Trade in electricity on power exchanges is always based on marginal pricing, which guarantees only that short-run marginal costs are covered.<sup>50</sup> Furthermore, the time horizon for contracts on these markets is shorter than for PPAs. For instance, at present the longest contracts have been concluded for: four years in NordPool (Scandinavian countries), three years in Powernext (France), five years in UKPX (United Kingdom) and six years in EEX (Germany). On some exchanges, like OMEL in Spain, no forward contracts are concluded. Since 1 April 2006 no forward contracts have been concluded on the Polish Power Exchange either.
- (204) In liberalised markets, electricity can also be traded via bilateral contracts (“over the counter” or OTC market). An energy enquiry showed that, because of the possibility of arbitrage between power exchanges and bilateral contracts, trading conditions (in particular price and duration of contracts) on the OTC market are similar to those prevailing on power exchanges.
- (205) In the PPAs, PSE undertook to purchase a fixed minimum volume of electricity from power generators at a price covering their full costs until 2007 for the shortest PPAs and until 2027 for the longest ones.
- (206) This decision was imposed on PSE by the Polish Government. As ELCHO indicates in its comments, “the Polish Minister for Trade and Industry implemented the policy objectives of ensuring security of supply and improving environmental standards of power generation through PSE.”<sup>51</sup>

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<sup>49</sup> [http://ec.europa.eu/comm/competition/antitrust/others/sector\\_inquiries/energy/](http://ec.europa.eu/comm/competition/antitrust/others/sector_inquiries/energy/)

<sup>50</sup> Short-run marginal costs are the costs that power generators can avoid by choosing to stop generating electricity in the short term. These costs are more or less equal to variable costs, since both notions are primarily driven by fuel costs.

<sup>51</sup> ELCHO's comments on the procedure, paragraph 1.4.1, third sentence.

- (207) The very fact that the Polish Government had to decide in PSE's place that new investments would take place and would benefit from PPAs clearly shows that this decision was mainly based on criteria other than market investor considerations.
- (208) There are two main reasons why PSE would not have had an economic interest in taking this decision without government intervention.
- (209) First, PSE purchased a quantity of energy that it already knew might be surplus to its requirements.
- (210) By awarding the PPAs, PSE undertook to purchase a fixed and significant quantity of electricity (around 50% of Polish electricity production in 2005,<sup>52</sup> and up to 70% in the period in question).
- (211) At the very beginning (the first few years of the PPAs) PSE was the only supplier in the Polish electricity system, so it could sell all this electricity to its end users. However, from the very outset, it was clear that PSE would soon cease to be the sole electricity supplier in Poland. The PPAs were signed between 1996 and 1998, with the exception of one of the six PKE PPAs, which was signed on 12 April 1995. It was already clear at the time that Poland was likely to accede to the Union during the life of most if not all of the PPAs (in reality, accession occurred before the end of the first one and 23 years before the end of the last one). In particular, during the pre-accession process, in December 1991, the Polish government had signed the Europe Agreement which constituted an association partnership between the EC and the Republic of Poland. Later, in 1994, Poland lodged its official application for EU membership. Accession negotiations started in 1998 and ended in 2002 when the Copenhagen European Council found that Poland fulfilled the accession criteria.
- (212) As a matter of fact, the interested parties even indicated that one of the aims of the PPAs was to ensure that Polish power generators complied with certain EU directives on air pollution and, in particular, with the directives on emissions of large combustion plants,<sup>53</sup> which is further evidence that these parties were aware that Poland would soon accede to the European Union.
- (213) It was known that Poland's accession to the European Union would entail integration into the internal electricity market, liberalisation of which started with the adoption of Directive 96/92/EC.<sup>54</sup> This meant the opening-up of the market to other suppliers competing with PSE, and, accordingly, that PSE might not need all the electricity provided for in the PPAs in the light of changes on the electricity market.
- (214) The liberalisation plans were implemented very rapidly in Poland, with the first customers benefiting from the opening-up of the market in 1999. The Polish Power Exchange opened in the same year. Further changes occurred when Directive

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<sup>52</sup> Source: URE. Message from the President of the Energy Regulatory Office in the 2005 Annual Report. Second paragraph. [http://www.ure.gov.pl/index\\_eng.php?dzial=1&id=6](http://www.ure.gov.pl/index_eng.php?dzial=1&id=6).

<sup>53</sup> The latest version of this Directive is Directive 2001/80/EC of the European Parliament and of the Council of 23 October 2001 on the limitation of emissions of certain pollutants into the air from large combustion plants, OJ L 309 of 27 November 2001, p.1.

<sup>54</sup> The directive was adopted on 19 December 1996 and had been under discussion since the presentation by the Commission of its draft proposal on 14 March 1992.

2003/54/EC was adopted on 26 June 2003. This Directive provides for the liberalisation of the market for all professional consumers by 1 July 2004 and for all consumers by 1 July 2007, thus gradually reducing PSE's captive market share to zero.

- (215) Second, even for the share of electricity which PSE actually needed, it made no sense for PSE, as the buyer, to undertake to pay the power plants the full costs of generating power, plus a profit margin established such a long time in advance even though it was already known that liberalisation would allow it to choose between different technologies and prices, including those offered by new market entrants using more efficient technologies.
- (216) Buyers have an interest in concluding long-term contracts only if these contracts provide them some hedging against fluctuations in the electricity market, and in particular against changes linked to fluctuations in fuel costs. For this reason a buyer would have an economic interest in a long-term contract of this type only if the seller offered to take part of the risk associated with fluctuations in fuel costs or if the generating technology ensured stable fuel costs, as is the case with hydropower plants, and, in certain conditions, nuclear plants.
- (217) This economic logic is confirmed by the fact that there does not seem to be any example of private buyers taking long-term contracts without state intervention with plants using fossil fuel and covering all production costs for the same duration as the PPAs (more than 10 years). The Commission found none in its energy sector enquiry, and, despite their claims to the contrary, none of the interested parties submitted an example of such a contract to the Commission, despite the fact that some of them belong to very large groups with activities in several countries.
- (218) The only examples quoted by the interested parties are not adequate for the reasons indicated below:
- a) the contracts in Portugal between Redes Energéticas Nacionais on the one hand and Turbogás, Electricidade De Portugal and Pego on the other hand, were concluded by a publicly owned company (Redes Energéticas Nacionais). It should be noted that the Commission did not regard these contracts as compatible with the state aid rules, despite attempts by the interested parties to prove that they were. The Commission only issued a decision concerning their compatibility with Article 81 of the EC Treaty. In a state aid decision concerning the compulsory annulment by Portugal of these contracts and the awarding of compensation for annulment, the Commission noted that they constituted an advantage for the power generators;<sup>55</sup>
  - b) the contracts concluded by Northern Ireland Electricity in the United Kingdom were awarded at a time when Northern Ireland Electricity was still a publicly owned company, at the request of the state. Northern Ireland

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<sup>55</sup> Commission decision in state aid case N 161/04 – Portugal – Stranded costs in Portugal. OJ C 250, 8 October 2005, p. 9.

Electricity was subsequently privatised and the UK Government had to put in place a support scheme to compensate Northern Ireland Electricity for the non-economic burden associated with these contracts;

- (c) the contract between Electricité de France and Pêcheiney in France covers only Electricité de France's variable nuclear plant costs. Many other contracts of that type were concluded in France in the 1990s. They are all based on the principle that the generator undertakes to deliver electricity to the buyer over a long period at a price which only covers its marginal costs.

(219) Lastly, the Commission notes that, despite the interested parties' claims to the contrary, it is not true that the fact that PPAs were concluded following a competitive procedure suffices for them to be deemed as not constituting aid. This reasoning applies when a Member State purchases goods or services for its own use. In the case at issue, the purpose of the competitive procedure was to serve policy objectives such as promotion of foreign investment in Poland, environmental protection and improvements in security of supply, rather than to purchase goods and services required by the state. In such cases, the fact that a competitive procedure was followed may lead only to the conclusion that the aid is limited to the minimum necessary to achieve the policy objectives; it does not suffice to rule out the presence of state aid.

(220) Power generators belonging to privately owned groups have argued that any state aid under the PPAs would have been eliminated by the privatisation process because the price paid by the companies that purchased the power plants would have taken account of the value of the PPAs.

(221) The Commission considers that this reasoning does not apply in the present case. In the case at issue, privatisation of the power plants took the form of share deals.

(222) The Court of Justice has analysed how a change in the ownership of a company during a share deal affects the existence of aid and the recipient of unlawful aid granted to the company. It ruled that the unlawful aid remains and stays with the company that benefited from the aid, despite the change in its ownership.<sup>56</sup> The transfer of shares at the market price merely ensures that the buyer did not benefit from state aid either.

(223) In the case at issue, this means that the change in the ownership of the power plants that benefited from the PPAs did not alter the fact that the PPAs constitute state aid to these power plants. In reality, the power plants benefited from the advantages contained in the PPAs, irrespective of their ownership structure.

(224) All the above-mentioned elements of the economic advantage and the arguments developed above concern the time of accession of Poland to the EU and remain applicable as at the date of this Decision (in the case of PPAs which terminated before the date of this Decision, until the date on which they terminated).

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<sup>56</sup> Joined cases C-328/99 and C-399/00 *Italy and SIM 2 Multimedia v Commission* [2003] ECR I-4035, paragraph 83.

(225) In view of the above, the Commission concludes that the PPAs provide an advantage to the beneficiaries.

#### 7.1.2. *Service of general economic interest*

(226) The interested parties have argued that the PPAs should be regarded as implementing SGEIs for the purpose of securing electricity supplies and environmental protection. They are said to fulfil the criteria laid down in the *Altmark* judgment, which means that they do not constitute aid within the meaning of Article 87(1) of the EC Treaty.

(227) The Commission has analysed these arguments and cannot agree with them for the following reasons:

(228) Member States have a wide margin of discretion to define the scope of SGEIs. However, the existence of this wide margin of discretion does not mean that just any state intervention with a policy motivation can be characterised as an SGEI. For instance, in the *Merci convenzionali porto di Genova* judgment,<sup>57</sup> the Court rejected the application of Article 86(2) of the EC Treaty because “it does not appear [...] that [dock] work is of a general economic interest exhibiting special characteristics as compared with the general economic interest of other economic activities.” The Commission also considers that the Member States' wide margin of discretion in defining the scope of SGEIs is restricted in fields where Community legislation exists.

(229) The interested parties have invoked environmental protection as one of the SGEIs to be implemented by the PPAs. More precisely, the PPAs were supposed to support investment designed to allow Polish plants to adapt to EU environmental standards.

(230) The Commission considers that the requirement to fulfil environmental standards does not exhibit any special characteristics as compared with the constraints imposed on all companies active in an industrial sector. Furthermore, considering the fulfilment of environmental standards as an SGEI would go directly against the polluter pays principle which is one of the core principles of Community environmental law, enshrined in primary legislation by Article 174(2) of the EC Treaty.

(231) The Commission notes the interested parties' argument that environmental protection is quoted as one of the possible areas for public service obligations in Article 3 of Directive 96/92/EC. However, the Commission takes the view that this does not undermine the position set out above. The fact that the Directive states that there may be public service obligations in the field of environmental protection does not mean that there are no requirements as to the actual content of these public service obligations. In particular, these obligations must exhibit special characteristics as compared with the normal business environment of companies in the sector, and may not be incompatible with the principles on which Community environmental protection policy is based (e.g. the polluter pays principle).

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<sup>57</sup> Judgment of the Court of 10 December 1991 in Case C-179/90 *Merci convenzionali porto di Genova SpA v Siderurgica Gabrielli SpA* [1991] ECR I-05889, paragraph 27.

- (232) The Commission also notes that four of the power plants concerned by the PPAs (in Turów, Pątnów, Bełchatów and Jaworzno) feature on the WWF's list of Europe's thirty most polluting power stations,<sup>58</sup> which further relativises the claims that they fulfil an SGEI in terms of environmental protection.
- (233) The interested parties also invoke security of supply as one of the SGEIs that the PPAs implement.
- (234) In its decision practice,<sup>59</sup> the Commission has taken the view that security of supply could be an SGEI, subject to the restrictions provided for in Article 8(4) of Directive 96/92/EC (which corresponds to Article 11(4) of Directive 2003/54/EC), that is, provided that the generators concerned use indigenous primary energy fuel sources, and that the total volume of energy does not exceed in any calendar year 15% of the total primary energy necessary to produce the electricity consumed in the Member State concerned.
- (235) In the case at issue, the PPAs concern quantities of energy that are largely in excess of the 15% referred to in recital 234. Furthermore, they do not solely concern generators using indigenous primary energy fuel sources.
- (236) The Commission notes that the power plants concerned by the PPAs do not exhibit any special characteristics that would make them particularly well adapted to meet security of supply objectives. In fact, they are just normal plants connected to the network, and therefore contribute to overall security of supply in Poland just like any other power plant in the sector.
- (237) In view of the above, the Commission takes the view that there is no reason to deviate from its usual practice in this field. It must therefore reject the claim that the PPAs implement an SGEI in the field of security of supply. In any event, no SGEI has been defined by Poland in this context to date.
- (238) In view of the above, the Commission concludes that the EC Treaty provisions on SGEIs do not apply to PPAs.
- (239) The Commission also notes that the PPAs would not fulfil all the criteria laid down in the *Altmark* judgment.
- (240) First, under the *Altmark* judgment, the recipient undertaking is actually required to discharge public service obligations and those obligations must have been clearly defined.
- (241) In the case at issue, the alleged public service obligations have not been clearly defined. The interested parties mention environmental protection and security of supply, but these objectives are of a very general nature. In addition, the view could be taken that, to some extent, any generator in the electricity sector contributes to the realisation of these objectives. The interested parties failed to submit any document

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<sup>58</sup> <http://assets.panda.org/downloads/dirty30rankingfinal260905.pdf>.

<sup>59</sup> See Commission decisions in cases N 34/99 (OJ C 5, 8 January 2002, p. 2), NN 49/99 (OJ C 268, 22 September 2001, p. 7), N 6/A/2001 (OJ C 77, 28 March 2002, p. 26) and C 7/2005 (not yet published in the OJ).

providing a more tangible definition of the type of SGEI entrusted to individual generators, let alone a legal document laying down their obligations.

- (242) Article 1(2) of the Polish Energy Act was also invoked.<sup>60</sup> This Article indicates that the state must secure a continuous and uninterrupted supply of energy to end-users in a manner that is technically and economically viable and takes due account of environmental protection requirements. But this Article of the Act does not entrust any specific company with public service obligations. It entrusts duties to the state alone.
- (243) Lastly, the interested parties argue that PPAs are documents that entrust generators with SGEIs. But PPAs do not contain any tangible definition of SGEIs either, nor do they even refer to these obligations or to legal provisions that could be a basis for the state to entrust SGEIs to other entities.
- (244) Second, the parameters on the basis of which the compensation is calculated must have been established beforehand in an objective and transparent manner, and the compensation should not exceed what is necessary to cover all or part of the costs incurred in discharging the public service obligations, taking into account the relevant revenue and a reasonable profit for discharging those obligations.<sup>61</sup>
- (245) In the absence of a clear definition of the SGEIs to be provided, in particular one making a clear distinction between the service to be rendered and the power plants' normal business operations, it is impossible to establish parameters for compensation and/or to determine whether the compensation exceeds the amount necessary to cover the costs incurred in discharging these obligations. It is not even possible to define exactly what the compensation is.
- (246) The existence of certain parameters for establishing the PPA prices is not equivalent to the existence of precise parameters for calculating compensation for SGEIs, since the price is not equal to the compensation. Furthermore, the fact that the price covers only the costs of generating electricity, plus a margin for profit, does not mean that it does not include any excess compensation, since many of the costs of generating electricity may be the normal costs covered by any electricity generator, as opposed to the surplus costs associated with SGEIs.
- (247) Third, where the company which is to discharge public service obligations has not been chosen in a public procurement procedure, the level of compensation needed must be determined on the basis of an analysis of the costs which a typical undertaking, well run and provided with adequate means of production to meet the public service requirements, would have incurred in discharging those obligations, taking into account the associated revenue and a reasonable profit for discharging its obligations.
- (248) The interested parties argue that these criteria should be deemed to be automatically fulfilled because a non-discriminatory and transparent tender procedure was held to award the PPAs. However, the Commission notes that various criteria were applied in the tender procedure, not just price or criteria associated with

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<sup>60</sup> Journal of Laws 1997/54, item 348, as amended.

<sup>61</sup> These are actually the second and third criteria of the *Altmark* Judgement.

the above-mentioned policy objectives (environmental protection, security of supply). The Commission considers that the application of those other criteria not related to the price or the said policy objectives makes it impossible to conclude automatically that the level of compensation is correct. Besides, the fact that many different criteria were used for the purpose of assessing the bids and that no tangible objective for the SGEIs was defined also shows how difficult it is even to assess whether the alleged SGEIs are actually implemented. For instance, mixing price and environmental criteria could result in a bidder proposing to generate electricity for a very low price but with lesser environmental protection being chosen over one proposing to generate electricity of better environmental quality but for a higher price. This raises doubts as to whether the generators actually fulfil an SGEI and, in any event, makes it more difficult to determine the extent of the SGEIs fulfilled.

(249) Furthermore, neither the Polish authorities nor the interested parties provided an analysis of the costs of the generators in question to support the contention that they tally with the costs incurred by a typical undertaking. As a matter of fact, the estimates provided by Poland under the Act for the purpose of calculating compensation to individual power generators show that their costs are significantly higher than those incurred by a typical new entrant in Poland.

(250) Finally, the Commission notes that in the case of the PPA with EC Kraków no tender procedure was organised.

(251) The interested parties have argued that Article 86(2) of the EC Treaty might apply to the PPAs even where they do not fulfil the criteria of the *Altmark* judgment.

(252) The Commission takes the view that the considerations set out above lead to the conclusion that Article 86(2) cannot apply to PPAs.

(253) In particular, Article 86(2) can apply only to companies which have been entrusted with providing genuine SGEIs, which is not the case in this particular instance, as demonstrated in recitals 228 to 238. SGEIs, if any, must be entrusted to specific companies, which is not the case in this instance, as demonstrated in recitals 240 to 243. Lastly, compensation for providing the SGEI must be proportionate to the costs incurred; in other words, it must be possible to carry out an assessment of the scope of the SGEIs in order to calculate the associated costs. This is not the case here as is demonstrated in recitals 245 and 246.

### *Selectivity*

(254) PPAs are obviously selective since they were concluded with a limited number of companies. When these agreements were signed, there were companies in the electricity sector that did not benefit from a PPA.

(255) The interested parties' reference to the imperative of defining the relevant markets is incorrect. The concept of selectivity includes measures that benefit a whole sector, even when they benefit all companies within that sector (which is not the case in this instance since some companies within the sector did not benefit from PPAs).



(256) As for the reference to the *Van der Kooy* judgment, the Commission recalls that in this judgment, the Court did not call into question the selectivity of the aid measure. The assessment referred to by the interested parties in their comments concerns the presence of an advantage but it cannot be established whether the Court of Justice deemed, or would deem, the measure not to meet the selectivity criterion.

(257) Finally, in reply to the interested parties' claim that the selectivity criterion should be replaced by the market investor principle for measures that are not decided by the state, the Commission notes that the market investor principle is a test to check whether an advantage is present, not selectivity.

#### *Distortion of competition and impact on trade*

(258) The interested parties argue that the Commission should have examined whether the PPAs distorted competition or affected trade between Member States at the time when they were concluded. As explained above, the Commission is of the view that whether the PPAs constituted state aid when they were concluded does not influence the outcome of the present procedure. In view of its accession to the EU, Poland opened up its market at an early stage: the first customers became eligible to change electricity supplier in 1999 and the Polish Power Exchange opened in the same year. On 1 May 2004 Poland joined the liberalised internal market. The existence of long-term agreements with the state-owned PSE, including an electricity purchase guarantee issued by that company at a price which covers the power plants' cost plus a profit margin, has the potential to distort competition.

(259) Measures that favour energy-sector companies in one Member State may impede the potential for companies from other Member States to export electricity to that Member State, or favour exports of electricity to the second group of Member States. This is especially true for Poland, which is centrally located in Europe and is connected, or easily connectable to, several current and future Member States.

(260) The electricity market in Poland (Polish Power Exchange) was opened up in 1999; in that same year PSE joined UCTE.<sup>62</sup>

(261) When the PPAs were signed, trade in electricity between Poland and its neighbouring countries was clearly taking place. The transmission capacity of the interconnectors capacity was not large (2000 MW according to the interested parties) but was used in full, mostly for export.

(262) In 2005 Poland exported 14.3 TWh of electricity and imported 3.1 TWh, with domestic consumption levels of 144.8 TWh;<sup>63</sup> however, most trade taking place with the Czech Republic, Germany and Slovakia (interconnectors with Ukraine and Belarus have very small capacity or are out of order).

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<sup>62</sup> Union for the Co-ordination of Transmission of Electricity, an association of transmission system operators cooperating within the interconnected network of continental Europe.

<sup>63</sup> PSE's 2005 Annual Report, available at [http://www.pse-operator.pl/uploads/kontener/Annual\\_Report\\_2005.pdf](http://www.pse-operator.pl/uploads/kontener/Annual_Report_2005.pdf).

(263) It follows from the above that PPAs had the potential to distort competition even before Poland's accession to the EU. However, the criterion of the effect on trade between Member States can be met, by definition, only after accession. As accession and liberalisation of the energy sector in Poland took place on the same date (1 May 2004), the Commission concludes that, by the date of Poland's accession to the EU at the latest, the advantages resulting from the PPAs had the potential to distort competition and affect trade between Member States and has this potential throughout the life of the PPAs.

(264) On the basis of the above, the Commission takes the view that PPAs constitute state aid within the meaning of Article 87(1) of the EC Treaty.

*7.1.3. PPAs as “new aid” as opposed to “existing aid” Unlawfulness of the aid*

*On the applicability of the Accession Treaty to PPAs concluded before accession and still in force after accession*

(265) According to Annex IV, Chapter 3 of the Accession Treaty, the Commission was competent to scrutinise measures (individual aid measures and aid schemes) which entered into force prior to accession, remain applicable after that date and constitute state aid.

(266) First, since the PPAs were signed between 1994 and 1998, i.e. before Poland joined the European Union, they meet the condition of having entered into force prior to accession. In that respect, the Commission notes that the present decision concerns only those PPAs that were in force on the date of Poland's accession to the EU (1 May 2004). It does not cover any PPAs that were terminated before that date.

(267) Second, the PPAs are applicable after accession. They expire between 2006 and 2027 – i.e. after accession. The state's exact exposure by virtue of the PPAs was not known on the date of accession.

(268) In this context, the Commission generally considers the following aid measures to be applicable after accession and to constitute new aid:<sup>64</sup>

- a) any aid schemes that entered into force before the date of accession and on the basis of which, without further implementing measures being required, individual aid may be awarded to the companies indicated in the Act in a general and abstract manner after accession;
- b) aid that is not linked to a specific project and that was awarded before accession to one or more companies for an indefinite period of time and/or an indefinite amount;
- c) individual aid measures for which the state's exact exposure was not known on the date on which the aid was granted.

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<sup>64</sup> See, for example, Commission decision of 28 January 2004 state aid CZ 14/2003 – Czech Republic “Česka spořitelna, a.s.”.

The “exact economic exposure of the state”

- (269) PPAs served to guarantee the power plants’ viability. However, they are not a classic form of guarantee: PPAs provide for a forward-looking return on investment and profitability through a guaranteed purchase of energy at a guaranteed (albeit variable) price for a guaranteed period of time, regardless of market conditions.
- (270) The state’s financial exposure under the PPAs was not capped at a maximum amount before accession and nor was aid to power generators definitively and unconditionally granted in a given amount prior to accession.
- (271) On the contrary, the state's *economic* exposure under the PPAs depends on parameters the future evolution of which was unknown at the time of accession. Moreover, the PPAs guaranteed generators protection from fluctuations in costs which were unrelated to pre-accession transactions or events but concerned future developments and were therefore unknown on the date of accession.
- (272) In particular, the fact that the state’s exposure under the PPAs was not known on the date of accession and that the state remained liable after accession is demonstrated by the following circumstances.
- (273) First, the energy prices at which the power generators sell the electricity to PSE were not laid down in the individual PPAs. The prices are the result of calculations made using a formula comprising a series of parameters that fluctuate in an unforeseeable way.
- (274) For instance, these formulas include parameters such as the Consumer Price indexes in Poland or in the USA, oil or coal prices on world markets, average wages in Poland or the USD/PLN exchange rate. Obviously, fluctuations in all these parameters are not conditioned solely by events that took place before accession. Price calculations and sometimes the formulas themselves change continuously by virtue of a series of annexes to the PPAs, adopted, in some cases, on an annual or even more frequent basis.
- (275) Against this background, the Commission takes the view that the existence of the price-setting formula does not constitute a sufficient cap on the state's *economic* exposure. The very existence of a number of evolving parameters in the formula makes it impossible to determine the potential level of the state’s exposure with sufficient precision.
- (276) Furthermore, unlike classic guarantees, PPAs cover the beneficiaries’ operating costs. They provide for the continuous purchase of a guaranteed quantity of electricity by PSE and for permanent payment of the variable or fixed operating costs as per the price formulas indicated.
- (277) The Commission has also taken into account the fact that, in view of the significant number of parameters which the price formulas comprise, it cannot be excluded that the aid recipient could itself influence the final price (by way of certain operating cost elements, e.g. employees' and managers’ pay).
- (278) As a subsidiary argument, PSE's financial exposure under the PPAs is very much contingent on demand. It is equivalent to the difference between the purchase price

under the PPAs and the revenue PSE can generate by selling the electricity to end-users. The price at which PSE sells its electricity to end-users cannot be predicted. The price of electricity sold on the captive market is set by the state on an annual basis, whereas on the free market prices fluctuate in an unforeseeable way. This increases the unpredictability of the state's exposure under PPAs. It may even be the case that the fixed minimum obligatory purchase of energy volume as provided for in the PPAs will be in excess of real PSE needs, in particular once liberalisation of the energy market is completed in 2007. The electricity surplus may lead to even higher unknown costs, increasing the unpredictability of the state's exposure under PPAs still further.

(279) Therefore PSE's payments to the power generators after accession are not the mere disbursement of tranches within an overall fixed cap established before accession. Moreover, the PPAs had been revised by subsequent annexes on several occasions since the date on which the initial contracts were signed.

(280) The Commission notes that – in the relevant cases – when the assessment of the compatibility of measures with the common market is drawn up, due account should be taken of aid awarded before the Member State joined the European Union and applicable after accession.

*Status of PPAs as new aid*

(281) According to the above-mentioned provisions of the Accession Treaty, all measures which entered into force before accession and are still applicable after that date which constitute state aid and which do not fall under one of the categories listed below shall be regarded, as of accession, as new aid within the meaning of Article 88(3) of the EC Treaty.

(282) The three categories of existing aid referred to in the Accession Treaty comprise:

*1. aid measures which did not enter into force in Poland before 10 December 1994.*

With the exception of one PPA with the generator Turów S.A.<sup>65</sup> the PPAs were signed after 10 December 1994, and as such do not constitute existing aid within the meaning of Article 88(1) of the EC Treaty.

*2. aid measures which were included in the list of existing state aid measures attached to the Accession Treaty.*

Neither the scheme covering PPAs nor any of the individual PPAs were notified to the Commission with a view to inclusion in the list of existing aid schemes annexed to the Accession Treaty and nor were they included in the Appendix to Annex IV of the Accession Treaty referred to in point 1(b), Chapter 3, Annex IV, which contains a list of existing aid measures; as such, they do not constitute existing aid within the meaning of Article 88(1) of the EC Treaty.

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<sup>65</sup> With which the PPA was signed on 26 August 1994, as indicated by BOT in its comments on the procedure.

3. *aid measures which prior to the date of accession had been assessed by the state aid authority in Poland and had been found to be compatible with Community law and which the Commission had not objected to because it had serious doubts regarding compatibility with the common market pursuant to the procedure laid down in the Accession Treaty, the so-called “interim procedure” (cf. second paragraph, Chapter 3 of Annex IV to the Accession Treaty).*

As no PPAs were submitted to the Commission under the so-called interim procedure, they do not constitute existing aid within the meaning of Article 88(1) of the EC Treaty.

- (283) In view of the fact that the individual PPAs do not belong to any of the categories of existing aid enumerated in the Treaty, they constitute new aid as of the date of accession.
- (284) The Commission notes that this categorisation is also in line with the last sentence of Article 1(b)(v) of Council Regulation (EC) No 659/1999. This Article states that where measures become aid following liberalisation under Community law (in this case liberalisation of the energy market pursuant to Directive 96/92/EC, which entered into force in Poland when Poland joined the European Union), such measures are not deemed to be existing aid after the date fixed for liberalisation, i.e. they are treated as new aid.
- (285) With reference to the comments by the interested parties referred to in recital 71, the Commission observes that it treats PPAs as an aid scheme for the reasons set out in recital 31. It also takes account of the fact that a decision by the state offering investors PPAs which guarantee their viability while the agreements remain in force is a common denominator of all PPAs.
- (286) The interested parties argue that the PPAs did not constitute state aid when they were concluded and cannot therefore not be regarded as new aid. They invoke the *Alzetta Mauro* judgment,<sup>66</sup> arguing that aid awarded in a market which was initially closed to competition before its liberalisation is to be regarded as existing aid from the date of liberalisation. Irrespective of the above, Article 1(b)(v) of Council Regulation (EC) No 659/1999 concerns both aid schemes and individual aid measures.
- (287) The Commission rejects this argument. It has been demonstrated that all the criteria governing the existence of state aid were met on the date of Poland’s accession to the EU. In particular, it has been demonstrated that energy was traded between Poland and its neighbouring countries at this time and that the Polish Power Exchange has been operating since 1999. In any case, there were no doubts that, on the date of accession, Poland would immediately join a sector that had been opened to competition. The Commission takes the view that the purpose of the state aid provisions contained in the Accession Treaty was precisely to ensure that measures which might distort competition between Member States as of the date of accession were reviewed. In contrast to the accession treaties prior to 1 May 2004, the Accession Treaty signed by Poland and nine other countries is designed to restrict measures deemed to constitute existing aid to the three specific cases described

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<sup>66</sup> See footnote 17.

above. The *Alzetta Mauro* judgment does not concern a measure caught by the Accession Treaty and cannot therefore be deemed applicable in this regard to the PPAs under assessment. Lastly, the Commission also takes the view that the *Alzetta Mauro* judgment concerns the actual situation as described in the Commission decision dated prior to the entry into force of Council Regulation (EC) No 659/1999.

(288) Therefore, on the basis of the Accession Treaty, the Commission concludes that the PPAs constitute new aid.

#### *Unlawful aid*

(289) Given that the PPAs were not notified to the Commission in accordance with the state aid procedural rules, the Commission takes the view that they constitute unlawful aid.

#### *7.1.4. Applicable Treaty provisions*

(290) The interested parties have argued that the Commission should have analysed the PPAs in the light of the interim mechanism of the Accession Treaty, together with state aid case PL 1/03.<sup>67</sup>

(291) The Commission rejects this assertion.

(292) Under the Accession Treaty's interim mechanism the Commission's powers were limited to endorsing or objecting to decisions taken by the competition authorities in the accession countries concerning measures had been put into effect and were still applicable after accession. Case PL 1/03 concerned a decision by the Polish competition authority on the draft law on state compensation for the termination of PPAs. It did not cover aid within PPAs themselves and the Polish authorities did not give notification of PPAs under the interim procedure; nor did the relevant decision of the Office for Competition and Consumer Protection cover individual PPAs. The Commission did not have powers to decide unilaterally to extend the scope of the case on the basis of the interim procedure.

(293) In addition, even if the Commission had had powers to extend the scope of the case unilaterally, this would not have been possible in this particular instance because the law reviewed under the interim procedure provided for the mandatory termination of all PPAs before Poland acceded to the EU. Since the Commission review could only address state aid issues still applicable after accession, the PPAs could not have been included within its scope.

(294) As regards the other bilateral treaties or the Energy Charter, the Commission notes that they do not prohibit the termination of such contracts but recommend appropriate compensation which does not alter the state aid nature of PPAs. The purpose of these treaties is to ensure a balance between the objectives of

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<sup>67</sup> PL 1/03 – Stranded costs – Poland, cf. footnote 37.

liberalisation and the obligation to maintain investments. With regard to the interested parties' comments on deprivation of rights, the Commission takes the view that if the PPAs were to constitute unlawful and incompatible state aid, they would be illegal. Accordingly, the termination of these agreements cannot be regarded as constituting deprivation of rights. If such termination is deemed to constitute deprivation of rights, the Commission takes the view that compensation can be awarded and that the conditions laid down in the Methodology will ensure that compensation is fair.

#### 7.1.5. *Compatibility assessment*

(295) Article 87(1) of the EC Treaty provides for the general prohibition of state aid within the Community.

(296) Articles 87(2) and 87(3) of the EC Treaty provide for exemptions to the general rule that such aid is incompatible with the common market as stated in Article 87(1).

(297) The exemptions in Article 87(2) of the EC Treaty do not apply in the present case because this measure does not have a social character, has not been awarded to individual consumers, is not designed to make good damage caused by natural disasters or exceptional occurrences and has not been awarded to the economy of certain areas of the Federal Republic of Germany affected by the division of that country.

(298) Further exemptions are laid out in Article 87(3) of the EC Treaty.

(299) Article 87(3)(a) states that “aid to promote the economic development of areas where the standard of living is abnormally low or where there is serious underemployment” may be declared compatible with the common market. Most if not all of Poland can be regarded as such an area.

(300) The Commission has adopted guidelines for the assessment of such aid. When Poland acceded to the EU the guidelines on national regional aid<sup>68</sup> (“the Regional Guidelines”) were in force. These guidelines also governed the assessment of regional aid in the light of Article 87(3)(c) of the EC Treaty.

(301) Under the Regional Guidelines, state aid could in principle be authorised only for investment costs. Operating aid was normally prohibited (point 4.15 of the Regional Guidelines), but could exceptionally be authorised in specific regions provided it was limited in time, and progressively reduced.<sup>69</sup>

(302) The aid cannot be regarded as investment aid. Investment aid is defined using a list of potential eligible costs which are indicated in points 4.5 and 4.6 of the Regional Guidelines. Payments under the PPAs clearly cover other costs as well. The most striking example is that PPAs guarantee the fuel costs associated with operating the power plants. Staff costs are also covered by the PPAs. Clearly, these costs are not

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<sup>68</sup> OJ C 74, 10 March 1998, p. 9.

<sup>69</sup> An exception to this rule was provided for in point 4.16 of the Regional Guidelines, but only for outermost regions and regions of low population density, which excludes the regions in which the power generators benefiting from PPAs are located.

eligible for investment aid. On the contrary, they correspond to the operator's current expenses and must as such be included in operating costs as defined in point 4.15 of the Regional Guidelines.

- (303) Aid awarded under the PPAs is not subject to a reasonable time framework. PPAs are concluded for very long periods, similar to the expected lifetime of a typical power plant. Furthermore, PPAs do not include any provisions for a gradual reduction in the amount of aid. The guaranteed volumes of purchased electricity are not degressive, and prices are indexed, which means that they increase rather than decrease. The profit guarantee and its scope do not reduce over time either.
- (304) In view of the above, the Commission concludes that the aid is not eligible for the derogation provided for in Article 87(3)(a) of the EC Treaty.
- (305) Article 87(3) (b) of the EC Treaty states that “aid to promote the execution of an important project of common European interest or to remedy a serious disturbance in the economy of a Member State” may be declared compatible with the common market.
- (306) The Commission notes that the aid in question is not designed to promote the execution of an important project of common European interest.
- (307) Nor has the Commission found any evidence that it is designed to remedy a serious disturbance in the Polish economy. The Commission acknowledges that electricity is an important product for any Member State's economy, and that there was a need to modernise this sector in Poland in the 1990s.
- (308) However, the Commission takes the view that the notion of “serious disturbance in the economy of a Member State” refers to much more serious cases. A mere reference to the potential consequences for the economy of a Member State as made by the interested parties is not sufficient for the above-mentioned Treaty provisions to be deemed applicable to a given measure. As a minimum, a more detailed description and analysis of the probability of such disturbance occurring and of the scale of its consequences would be required.
- (309) Lastly, the Commission notes that this concept includes some notion of urgency which is incompatible with the time-consuming cycle of tendering and negotiating the PPAs.
- (310) In view of the above, the Commission concludes that the aid does not qualify for the derogation enshrined in Article 87(3)(b) of the EC Treaty.
- (311) Article 87(3)(d) of the EC Treaty states that aid to promote culture and heritage conservation may be declared compatible with the EC Treaty where such aid does not affect trading conditions and competition in the Community to an extent that is contrary to the common interest. This Article obviously does not apply to the PPAs.
- (312) Article 87(3)(c) provides for the authorisation of state aid to facilitate the development of certain economic activities or of certain economic areas, where such aid does not adversely affect trading conditions to an extent contrary to the common interest. The Commission has developed several guidelines and communications that explain how it will apply the derogation contained in this Article.



- (313) The interested parties have invoked the application of the Regional Guidelines and of the Environmental Guidelines.
- (314) Recitals 300 to 304 indicate the reasons why the aid cannot be deemed compatible with the common market in application of the Regional Guidelines.<sup>70</sup>
- (315) The Commission notes that the Environmental Guidelines, like the Regional Aid Guidelines, primarily allow investment aid. Operating aid is limited to specific objectives. The first is aid for the management of waste and for energy saving (section E.3.1), which is limited to a maximum duration of 5 years. The second is aid in the form of tax reductions or exemptions (section E.3.2). The third is aid for renewable energy sources (section E.3.3). Clearly, none of these provisions apply in the present case.
- (316) The fourth and last type of operating aid that can be authorised is aid for the combined production of power and heat (section E.3.4). Some of the generators concerned produce heat and power. However, neither Poland nor any of the concerned producers has demonstrated that these plants fully meet the efficiency criteria laid down in the Environmental Guidelines. Indeed, Poland has provided the Commission with data showing that only a limited part of the production could be deemed to meet these efficiency criteria. In the Commission's view, this means that aid that covers the whole production of the entities in question cannot be authorised on the basis of these provisions.
- (317) Of the documents referred to in recital 312, the only one which could apply in the present case is the Stranded Costs Methodology. The Stranded Costs Methodology concerns aid granted to incumbents that built power plants prior to liberalisation of the electricity sector and that may have difficulties in operating them in a liberalised market.
- (318) In the decision to initiate the procedure, the Commission raised a number of doubts as to the possibility of PPAs being authorised on the basis of the Stranded Costs Methodology.
- (319) One of these doubts arose from the fact that the Stranded Costs Methodology indicates that the Commission entertains the most serious misgivings regarding aid that is intended to safeguard all or some of the income pre-dating the entry into force of Directive 96/92/EC, without taking strictly into account the eligible stranded costs that might result from the introduction of competition.<sup>71</sup>
- (320) The PPAs were precisely designed to safeguard most of the income pre-dating the entry into force of Directive 96/92/EC obtained by the power generators and the plants concerned. Furthermore, they concerned plants with a very important share of

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<sup>70</sup> The Regional Guidelines are based on both Article 87(3)(a) and Article 87(3)(c) of the EC Treaty. They provide for the same type of assessment for both Articles. The difference in the application of these two Articles is linked to the areas where they apply and the admissible aid intensities.

<sup>71</sup> Point 4.8 of the Stranded Costs Methodology.

the market and for a very long duration, largely exceeding the time necessary for a reasonable transition to the market.

(321) In the light of the above, the Commission concludes that the PPAs are incompatible with the criteria laid down in the Stranded Costs Methodology. They go against its fundamental principles, which were designed to enable a progressive but genuine transition to the market.

(322) The interested parties have argued that the PPAs could be authorised directly under Article 87(3)(c) of the EC Treaty. They indicated that PPAs facilitated the development of the Polish energy sector by attracting foreign investment in modern, environmentally-friendly electricity generation capacity. As such, PPAs were intended to “facilitate the development of certain economic activities.”

(323) The Commission notes that the two policy objectives mentioned above: i.e. attracting investment and promoting environmentally-friendly electricity generation capacity, are precisely the policy objectives referred to in the Regional Guidelines and the Environmental Guidelines. The Commission has analysed the PPAs in the light of these two sets of guidelines and concluded that they are not compatible with these rules. The Commission takes the view that the possibility of invoking Article 87(3)(c) to authorise the PPAs has been exhausted.

(324) In view of the above, the Commission concludes that the PPAs are incompatible with the common market.

#### *7.1.6. The specific case of Żarnowiecka Elektrownia Gazowa Sp. z o.o.*

(325) The PPA with Żarnowiecka Elektrownia Gazowa Sp. z o.o. was terminated by PSE on 17 May 2006, before construction work on the power plant reached the advanced stage.<sup>72</sup> Given that the power plant was not operational at the time, it did not benefit from the PPA. It did not, therefore, benefit from any state aid.

(326) The Commission therefore takes the view that this PPA did not provide any aid to Żarnowiecka Elektrownia Gazowa Sp. z o.o.

### **7.2. With regard to the Act**

(327) The Commission has analysed the four cumulative criteria for the existence of state aid within the meaning of Article 87(1) of the EC Treaty.

#### *State resources and imputability to the State*

(328) The Commission has carried out an analysis to determine the source of the funds to be used for the payments provided for in the Act. It concluded that these funds would be the proceeds of a parafiscal levy established by virtue of the same Act.

(329) The levy is imposed on all consumers (Article 8 of the Act), the amount thereof being contingent on the size and characteristics of their connection to the grid (Articles 10 and 11 of the Act). The amount of the levy is established by the URE (Article 12 of the Act). The proceeds of the levy collected by suppliers are paid into

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<sup>72</sup> Letter from the Polish authorities of 6 June 2007.

an account in the name of Zarządca Rozliczeń S.A. This is a special purpose company, fully owned and controlled by the State, founded under Chapter 7 of the Act. Zarządca Rozliczeń S.A uses the funds to make payments to eligible generators pursuant to Chapter 4 of the Act, under the administrative supervision of URE.

(330) The Commission has analysed the characteristics of this levy in the light of its decision-making practice<sup>73</sup> and Court of Justice case-law.<sup>74</sup> It made the following observations.

(331) First, the levy is a mandatory contribution which is imposed on all consumers by the state.

(332) Second, the proceeds of the levy are paid into an account in the name of Zarządca Rozliczeń S.A. Of the seven members of Zarządca Rozliczeń S.A's supervisory board, four, including the Chairman, are nominated by ministers, two are nominated by presidents of public bodies (URE and the Office for Competition and Consumer Protection) and one is nominated by the General Assembly of Shareholders, i.e. by PSE. The Commission concludes that Zarządca Rozliczeń S.A is fully under state control. This conclusion is reinforced by the fact that Zarządca Rozliczeń S.A operates under the aegis of URE, which is a state body. The proceeds of the levy are therefore managed by a body which is completely controlled by the State.

(333) Third, Zarządca Rozliczeń S.A uses the funds raised to make payments to the benefit of certain generators, in accordance with the provisions adopted by the state in the Act. In accordance with the Act, Zarządca Rozliczeń S.A. disburses the funds to power generators to cover stranded costs in the form of advances for such costs for a given year and in the form of annual adjustments.

(334) From the three observations above, the Commission concludes that the proceeds of the levy constitute state resources.

#### *Economic advantage*

(335) The Act provides for payments to the power plants that opt to apply its mechanism. These power plants will receive the payments in exchange for terminating their PPA with PSE.

(336) Payments under the Act allow the entitled power plants to alleviate the burden of costs incurred. The formula for calculating these payments provides in particular for the state to cover the losses associated with certain types of cost, plus depreciation and fuel costs, if the revenue collected on the market is not sufficient for that purpose, subject to certain conditions which are likely to be fulfilled in a normal economic scenario. This implies that state payments cover the costs normally borne by generators under normal market conditions. These payments therefore constitute an economic advantage.

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<sup>73</sup> See for instance case N 161/04 – Portugal- OJ C 250, 8 October 2005, p. 9.

<sup>74</sup> See for instance the judgment of 2 July 1974 in case C-173/73 *Italian Republic v Commission of the European Communities* [1974] ECR 709 and the judgment of 22 March 1977 in case C-78/76 *Steinike & Weinlig v Federal Republic of Germany* [1977] ECR 595.

(337) The interested parties argue that the payments do not constitute an advantage because they are only fair compensation for the termination of the PPAs. This reasoning is based on the premise that the PPAs themselves do not constitute an economic advantage, which is not the case, as was explained in point 7.1.1.

#### *Selectivity*

(338) Since the beneficiaries of the Act are the same power plants that benefit from the PPAs, the same reasoning as set out in recitals 254 to 257 applies.

#### *Distortion of competition and impact on trade*

(339) The Act provides an advantage to many companies operating on the energy production market. This market is liberalised in the EU. Measures that favour energy-sector companies in one Member State may impede the potential for companies from other Member States to export electricity to that Member State, or favour exports of electricity to the second group of Member States. This is especially true for Poland, which is centrally located in Europe and is connected, or easily connectable to, several Member States.

(340) The competitive advantage resulting from the Act may distort competition and affect trade between Member States

(341) In the light of the above, the Commission takes the view that the compensation system provided for in the Act constitutes state aid.

#### *7.2.1. Award of aid in accordance with the law*

(342) The Act entered into force on 4 August 2007. The Commission takes the view that, under Article 6(1) of the Act, power generators which decide to benefit from the scheme receive funds to cover stranded costs only after the terminating agreement has been concluded. In addition, under Article 22(4) of the Act, the first instalment of the advance to cover stranded costs is paid to the eligible power generators by the fifth day of the month after a period of 120 days has elapsed, starting on the day on which the early termination of the PPAs took place by virtue of the terminating agreements. In the light of the above, the date on which the Act enters into force cannot be deemed to be the date on which aid is granted to the power generators, i.e. the date on which the beneficiary received a legally binding aid authorisation. The Commission therefore does not take the view that the entry into force of the Act prior to the adoption of this Decision constitutes a failure to comply with the obligation referred to in Article 88(3) of the EC Treaty.

#### *7.2.2. Compatibility assessment*

(343) Article 87(1) of the EC Treaty provides for the general prohibition of state aid within the Community.

(344) Article 87(3)(c) provides for the authorisation of state aid to facilitate the development of certain economic sectors, where such aid does not adversely affect trading conditions to an extent contrary to the common interest. The Commission has developed several guidelines and communications that explain how it will apply the derogation contained in this Article.

- (345) The Stranded Costs Methodology is designed to analyse aid granted to incumbents in the electricity sector in a context where certain decisions taken by these incumbents prior to liberalisation no longer make business sense after liberalisation.
- (346) The first paragraph of section 3 of the Stranded Costs Methodology explains that stranded costs “may, in practice, take a variety of forms: long-term purchase contracts, investments undertaken with an implicit or explicit guarantee of sale, investments undertaken outside the scope of normal activity, etc.” In this particular case, the aid is earmarked for investments in the modernisation or expansion of power plants with the PPAs as an explicit guarantee of sale. It also addresses the consequences of long-term gas purchase contracts concluded by gas-fired generators. The Commission therefore takes the view that the aid falls within the remit of the Stranded Costs Methodology. Accordingly, it analysed the aid in the light of the Methodology.
- (347) The Stranded Costs Methodology provides for a two-stage assessment of aid earmarked for compensation of stranded costs. The first stage, which is referred to in section 3 of the Methodology, concerns the definition of eligible costs, which involves in particular calculating the maximum compensation that can be awarded. The second stage, which is dealt with in section 4 of the Methodology, concerns the mechanism for calculating the actual compensation to be paid for the stranded costs, taking the development of competition on the market into account.
- (348) The Commission first analysed whether the aid met the conditions laid down in 3.1 to 3.12 of the Stranded Costs Methodology.
- (349) Under point 3.1 of the Stranded Costs Methodology, maximum compensation payments take account only of investments completed before the entry into force of Directive 96/92/EC in Poland, i.e. the date on which Poland joined the EU, and of the volume of gas contracted in accordance with the take or pay rule before that date. In exceptional cases, investments contracted before the date of Poland’s accession but which were not yet completed as of accession were also taken into account, but only in so far as Poland could prove to the Commission that completing these investments and generating revenue from them would result in smaller stranded costs than would halting construction work altogether.
- (350) In line with point 3.2 of the Stranded Costs Methodology, there is no doubting the existence and validity of the guarantees granted to the power generators, as they are explicitly mentioned in the PPAs.
- (351) In line with point 3.3 of the Stranded Costs Methodology, the investments involved are very significant and may generate very large losses. This also applies to long-term take or pay contracts. The Commission takes the view that, were these losses not to be compensated in any way, they might, in the light of their size, jeopardise the continued viability of the companies in question. This conclusion is further reinforced by the reaction of the institutions which financed the investments, which informed the Commission that failure to provide proper compensation could be deemed to constitute default under the financing arrangements because of the significant risk of bankruptcy facing the company in question.

- (352) The Commission has also taken account of the fact that the impact of stranded costs is calculated with reference to the consolidated groups. This allows due account to be taken of all the effects of liberalisation, negative or positive, on the group. This mechanism will exclude new investments if they are not clearly replacement investments. The Commission also takes the view that new investment in the sector is vital if the market is to operate properly, and that compensation for stranded costs should not constitute a deterrent.
- (353) In accordance with point 3.4 of the Stranded Costs Methodology, the amounts earmarked by the beneficiaries are committed on an irrevocable basis. There is no other way to recoup the costs of investment in a power plant than to operate it or sell it at a price that cannot exceed the revenue that the power plant generates by selling its electricity on the market. The take or pay contracts may not be revoked unilaterally by the generators either.
- (354) In accordance with point 3.5 of the Methodology, stranded costs associated with investments in power plants are not linked to bilateral agreements. There is therefore no point in checking whether these stranded costs result from guarantees binding two companies within the same group. Stranded costs associated with take or pay contracts do not bind companies belonging to one and the same group.
- (355) In accordance with point 3.6 of the Stranded Costs Methodology, the Polish authorities have provided the Commission with a list of costs to be covered by compensation where a power plant's income is insufficient for that purpose. Having analysed these cost categories, the Commission has come to the conclusion that the compensation will not exceed what is necessary to cover the shortfall in investment return over the lifetime of the new assets, including where necessary a reasonable profit margin. The calculation of the maximum value of the compensation is based on a number of economic assumptions, including in particular a base market price equal to the price that a new entrant in Poland would be prepared to offer. The assumption is that this new entrant's primary source of energy would be coal. The Commission has checked that this assumption regarding the energy source is consistent with present trends in new investments in the sector in Poland, and that Polish coal reserves are sufficient for this trend to continue in the future. If the actual market price is lower than the forecast base market price, the base market price will be taken into account for the purpose of calculating compensation. The Commission takes the view that this formula for calculating stranded costs, which is identical to the formula used in its constant practice,<sup>75</sup> takes account of economic costs that correspond to the actual amounts invested. Compensation for take or pay contracts was calculated on the basis of the actual volumes contracted and the best possible estimate of price trends in the contracts.
- (356) In accordance with point 3.7 of the Stranded Costs Methodology, the method used to calculate compensation takes account of the revenue generated by the assets in question. The maximum amount of compensation is the amount following deduction of the revenue generated by the assets in the past and which is available to cover investment costs and the cash flow of the power plant from 2007 until the expiry date of the PPA which is available to cover investment costs. All this revenue is

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<sup>75</sup> See in particular case NN 49/99 – Stranded costs in Spain. OJ C 268, 22 September 2001, p.7.

taken into account as of the day on which the PPA was concluded, and all state aid received as of 1 May 2004 is included in the deducted amounts.

- (357) In accordance with point 3.8 of the Stranded Costs Methodology, the value of aid awarded in the past for the assets concerned, in particular investment aid, has been deducted from the maximum compensation.
- (358) In accordance with point 3.9 of the Stranded Costs Methodology, the method used to calculate the stranded costs takes due account of real trends in electricity prices. The periodical adjustment in compensation will take account of the difference between the forecast electricity price used to calculate the maximum amount of compensation and the actual electricity price. Compensation payments for take or pay contracts will take into account actual gas use and actual gas prices, but also the actual price at which the electricity generated by the companies was sold.
- (359) In accordance with point 3.10 of the Stranded Costs Methodology, maximum compensation is calculated with reference to costs depreciated before the entry into force of Directive 96/92/EC in Poland.
- (360) In accordance with point 3.11 of the Stranded Costs Methodology, compensation has been calculated on the basis of the least expensive solution for the state. For assets the construction of which started before Poland joined the European Union but which were not completed by accession, Poland has demonstrated that the maximum compensation was calculated on the basis of the cheapest of the two possible scenarios: completing construction and operating the new assets to generate revenue, or halting construction work. The compensation mechanism for stranded costs associated with take or pay contracts was also devised in such a way as to provide an incentive for power generators to actually operate the plant to mitigate the overall stranded costs, rather than stop generation and incur the full penalties, which would result in much higher stranded costs. The Commission analysed several scenarios provided by Poland with a view to determining whether this mechanism helps to reduce the overall amount of compensation. Lastly, should the volume of gas contracted under take or pay agreements be renegotiated and reduced during the compensation scheme, the actual amount of the compensation payments will be decreased accordingly.
- (361) In accordance with point 3.12 of the Stranded Costs Methodology, the payment period for compensation extends until 2027. Point 3.12 of the Stranded Costs Communication states that “costs which some undertakings may have to bear after the time horizon indicated in Article 26 of the Directive (18 February 2006) cannot, as a rule, constitute eligible stranded costs within the meaning of this methodology.” However, in footnote 5 of the Stranded Costs Methodology the Commission states that “it must be understood that investments which cannot be recouped or are not economically viable as a result of the liberalisation of the internal market in electricity may constitute stranded costs within the meaning of this methodology, including in cases where they are, in principle, to extend beyond 2006. Furthermore, commitments or guarantees which must absolutely continue to be honoured after 18 February 2006 because failure to do so might give rise to major risks concerning protection of the environment, public safety, social protection of workers or the security of the electricity network may, if duly justified, constitute eligible stranded costs according to this methodology.”

- (362) The stranded costs referred to in the Act are closely linked to investments in power plants that cannot be recouped as a result of liberalisation of the internal market in electricity. This also applies to take or pay contracts, which were concluded with a view to supplying power plants benefiting from PPAs to an extent consistent with the volume of electricity covered by the PPAs. In view of the aforementioned footnote 5, the Commission may authorise the extension of compensation beyond the deadline if it regards this as justified in the light of the circumstances of the case.
- (363) The Commission notes that the investments in question are investments in power plants. These are particularly long-term investments (from 15 to as much as 30 years), which are very sensitive to electricity price trends that are difficult to predict, in particular during the transition to a fully liberalised market. The costs of these investments cannot be recouped in cases where electricity prices are lower than the prices provided for when the power plants were built.
- (364) Under these circumstances, the Commission takes the view, as it did in previous files concerning Greece<sup>76</sup> and Portugal,<sup>77</sup> that footnote 5 of the Stranded Costs Methodology applies to these specific stranded costs and justifies the award of compensation after 2006 and until the end of the original PPAs.
- (365) In the light of the above, the Commission concludes that the Act complies with the criterion laid down in points 3.1 to 3.12 of the Stranded Costs Methodology. The maximum stranded costs compensation does not exceed the level allowed by the Stranded Costs Methodology. They should therefore be regarded as eligible within the meaning of the Methodology.
- (366) The Commission analysed whether the aid fulfilled the conditions laid down in points 4.1 to 4.6 of the Stranded Costs Methodology.
- (367) In accordance with point 4.1 of the Stranded Costs Methodology, the maximum amounts of compensation were calculated on the basis of clearly defined, individual power plants and take or pay contracts. The compensation actually paid will not exceed these maximum amounts.
- (368) In accordance with point 4.2 of the Stranded Costs Methodology, the compensation actually paid will take account of actual trends in underlying economic data, in particular electricity prices and volumes of gas purchased under take or pay contracts. For instance, should actual electricity prices differ from the base market price referred to in recital 355, the amount of actual compensation will be amended accordingly. The actual amounts of compensation for take or pay contracts will also take account of the actual conditions in which the power generators concerned purchase their gas and sell their electricity on the market.
- (369) In accordance with point 4.3 of the Stranded Costs Methodology, the Polish authorities have undertaken to provide the Commission with an annual report on implementation of the Act.

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<sup>76</sup> state aid case N 133/2001 – Stranded costs in Greece. OJ C 9, 15 January 2003, p.6.

<sup>77</sup> state aid case N 161/04 – Stranded costs in Portugal. OJ C 250, 8 October 2005, p. 9.



- (370) In accordance with point 4.4 of the Stranded Costs Methodology, the base market price considered in recital 355 increases significantly over time, as a result of which the amount of compensation payable will decrease to a certain extent, which the Commission views favourably.
- (371) In accordance with point 4.5 of the Stranded Costs Methodology, the maximum amount of compensation to be paid to a given company is fixed in advance. This takes account of beneficiaries' future profits resulting from productivity gains. The notification of the aid specified in particular how stranded cost calculations will take account of changes in various economic factors (like prices, market shares or other relevant factors indicated by the Member States and listed in the Methodology).
- (372) In accordance with point 4.6 of the Stranded Costs Methodology, the Polish authorities have undertaken not to grant any rescue or restructuring aid to beneficiary companies under the Act for a period of ten years after the last payment to the companies concerned. This period, which extends until 2037 for certain companies, is compatible with the "one time last time" principle as interpreted by the Commission in point 73 of the Community guidelines on state aid for rescuing and restructuring firms in difficulty.<sup>78</sup> The Commission takes the view that this solution also provides sufficient assurance that undue cumulation of aid does not occur within the framework of the Stranded Costs Methodology.
- (373) In the light of the above, the Commission concludes that the Act complies with the criteria laid down in points 4.1 to 4.6 of the Stranded Costs Methodology. The method for disbursing actual stranded cost payments is therefore compatible with the Stranded Costs Methodology.
- (374) In view of the above, the Commission concludes that the Act is compatible with the Stranded Costs Methodology. Aid designed to offset eligible stranded costs complies with the criteria set out in the Methodology and can therefore be declared compatible with the common market.
- (375) Eligible power generators were authorised to receive aid in accordance with the Stranded Costs Methodology as of 1 May 2004. The Act provides for a system of future compensation, but when maximum amounts of compensation are calculated, amounts of aid received by power generators in the past is also taken into account. According to Annex 2 to the Act, the maximum amount of compensation is the amount following deduction of the revenue generated by the assets in the past and which is available to cover investment costs. As pointed out in recital 356, all state aid received as of 1 May 2004 is included in the deducted revenue. In deeming the Act to be compatible with the common market, the Commission also deems the amounts of aid received by beneficiaries as of 1 May 2004 compatible with the common market.

7.2.3. *Specific case of Dalkia Poznań Zespół Elektrociepłowni S.A. and Electrabel Połaniec S.A.*

- (376) The two PPAs concluded with Dalkia Poznań Zespół Elektrociepłowni S.A. and Electrabel Połaniec S.A. elapsed on 31 December 2006. For that reason, these power stations are not covered by the Act. Since neither of these PPAs is covered by the

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<sup>78</sup> OJ C 244, 1 October 2004, p. 2.

Act, they are not caught by the present Decision either and the Commission will issue a separate decision on the two companies concerned.

## 8. CONCLUSION

(377) The Commission concludes that:

the PPAs constitute state aid within the meaning of Article 87(1) of the EC Treaty, with the exception of the PPA with Żarnowiecka Elektrownia Gazowa Sp. z o.o., and that this state aid is incompatible with the common market;

the Act constitutes state aid within the meaning of Article 87(1) of the EC Treaty, and that this state aid is compatible with the common market in application of Article 87(3)(c) of the EC Treaty.

(378) As was explained in point 7.1.1, the state aid element provided for in the PPAs consists principally of the fact that the PPAs guarantee the purchase by PSE of a certain volume of electricity at a price covering all generation costs.

(379) Since the state aid is incompatible with the EC Treaty, it must be ended. Since the guaranteed collection and cost-covering guarantee provisions are the core provisions of the PPAs, the Commission concludes that ending the state aid can only be achieved by ending the PPAs themselves.

(380) The Commission takes the view that ending the PPAs will entail significant work on the part of the parties, particularly as regards agreement on the terms governing the termination of the PPAs. The Commission takes the view that it is necessary to allow a reasonable time for this process to take place in order to ensure that security of electricity supply remains adequate and that the transition to a fully liberalised market in Poland takes place in good conditions. These objectives are also in the interest of the Community.

(381) While drafting the Act within the framework of its national legislative process, Poland consulted all the interested parties on technical matters linked to the voluntary termination of the PPAs. As a result, the deadline laid down in the Act for concluding termination agreements for the PPAs is 150 days as of the entry into force of the Act, i.e. 1 January 2008. The Commission takes the view that this period is also adequate for the purpose of winding up the PPAs as required by this decision. The Commission takes the view that, pursuant to Article 5 of the Act, the PPAs will be actually terminated on the first day of the month after a period of 210 days has elapsed, starting on the day on which the Act entered into force (i.e. 1 April 2008).

(382) Accordingly, as indicated in recitals 356 and 375, amounts of aid received by beneficiaries as of 1 May 2004 are caught by the Act and are therefore deemed compatible with the common market,

(383) In the specific case of Żarnowiecka Elektrownia Gazowa Sp. z o.o. the Commission concludes that the plant did not benefit from any aid under its PPA.

(384) The two PPAs concluded with Dalkia Poznań Zespół Elektrociepłowni S.A. and Electrabel Połaniec S.A. are not caught by the present Decision. The Commission will deal with those two companies in a separate decision,

**HAS ADOPTED THIS DECISION:**

**Article 1**

1. The Power Purchase Agreements between Polskie Sieci Elektroenergetyczne S.A. and the companies indicated in Annex 1 to the Act on the rules governing the covering of costs incurred by enterprises in connection with the early termination of Power Purchase Agreements constitutes state aid within the meaning of Article 87(1) of the EC Treaty to electricity generators.
2. The state aid referred to in Article 1(1) was awarded unlawfully and is incompatible with the common market.

**Article 2**

1. Poland shall terminate the Power Purchase Agreements referred to in Article 1.
2. The termination agreements for the Power Purchase Agreements shall be concluded by 1 January 2008 and shall enter into force not later than 1 April 2008.

**Article 3**

The Power Purchase Agreement between Polskie Sieci Elektroenergetyczne S.A. and Żarnowiecka Elektrownia Gazowa Sp. z o.o. does not constitute state aid within the meaning of Article 87(1) of the EC Treaty.

**Article 4**

1. The compensation provided for in the Act constitutes state aid within the meaning of Article 87(1) of the EC Treaty to the electricity generators listed in Appendix 2 to that Act.
2. The state aid referred to in Article 4(1) is compatible with the common market on the basis of the Stranded Costs Methodology.
3. The maximum amount of compensation provided for in the Act shall be the amount following deduction of the total revenue generated by the assets under the PPAs and which is available to cover investment costs.

**Article 5**

1. The Polish authorities shall inform the Commission by 31 January 2008 of the measures taken by Poland to implement this Decision.
2. The Polish authorities shall submit to the Commission annual reports on implementation of the Act.

## Article 6

This Decision is addressed to the Republic of Poland.

Done at Brussels, [...].

Yours faithfully,  
For the Commission

Neelie Kroes  
Member of the Commission

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N.B.:

If the decision contains confidential information which should not be published, 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 publication of the full text of the decision. Your request specifying the relevant information should be sent by registered letter or fax to:

Commission of the European Communities  
DG Competition, state aid Greffe  
B - 1049 Brussels  
Fax: +32-2-296.1242