EUROPEAN COMMISSION

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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 […].	**PUBLIC VERSION** **WORKING LANGUAGE** **This document is made available for information purposes only.**

Subject: **State aid N 660/2009 - Poland**

Aid to PGNiG for underground gas storage

Excellency,

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

I. PROCEDURE

1. By electronic notification of 26 November 2009, the Republic of Poland notified the above-mentioned measure. The Commission asked additional information by a letter of 25 January. The Polish authorities submitted the requested information by letters registered on 23 February, 22 March 2010 and 23 April 2010.

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II. DESCRIPTION OF THE MEASURE

Description and objectives of the investment projects

2. The notification covers individual projects to be implemented in line with the provisions of Council Regulation (EC) No 1083/2006 of 11 July 2006 laying down general provisions on the European Regional Development Fund, the European Social Fund and the Cohesion Fund and repealing Regulation (EC) No 1260/1999[1], planned for implementation in the framework of the 2007-2013 Environment and Infrastructure Operational Programme (EIOP). Individual projects are investment undertakings with strategic importance for the implementation of the operational programme.

3. The measure concerns the following four investment projects in expansion of existing or in construction of new of underground natural gas storage (UGS) facilities, aimed at improving the security of gas supply in Poland :

   – "UGS Strachocina" - expansion of an existing UGS from 150 million m^3 to 330 million m3 i.e. by 180 million m^3.

   – "UGS Wierzchowice" - expansion of an existing gas storage from 575 million m3 up to 1 200 million m3 i.e. by 625 million m^3

   – "UGS Mogilno" – expansion of existing underground gas storage in salt caverns from the current capacity of 370 million m^3 to 492 million m^3 i.e. by 122 million m^3.

   – "UGS Kosakowo" - construction of new underground gas storage in salt caverns i.e. construction of four caverns with a total capacity of 100 million m^3.

4. Once the aforementioned projects are completed, the natural gas storage capacity in Poland will increase by about one billion $m^{3,}$ from 1.6 billion m^3 to 2.6 billion m^3. The aid aims, according to the Polish authorities, at significantly improving the energy security of Poland in case of disruption. In that respect, the infrastructure is also viewed as necessary from the perspective of the EU security of supply strategy and the development of a more competitive gas market. In particular the broad aims of the investments, according to the Polish authorities, are:

   – protection of consumers against the effects of interruptions in the supply of gas or a reduced amount of gas in the transmission system (e.g. technical failure or interruption of pipeline in the supply of the import contracts);

   – coverage of increased demand for natural gas (collected during the autumn-winter);

   – ability to respond to sudden and short-term (several days) changes in demand (quick pick-cavern gas storage facilities);

   – enabling stable level of gas production during the year, which allows effective management of resources of natural gas;

   – creating strategic reserves of gas in accordance with the relevant applicable national laws and, allegedly, EU law.

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[1] OJ L 210, 31.7.2006

5. The Polish authorities also claim that the implementation of the project will make possible to offer higher gas storage capacities to companies willing to enter the Polish gas market thereby improving the functioning of the market. Notwithstanding this claim concerning storage in Poland, as further shown below, the provisions of national law regarding reserves and obliging companies to store a percentage of gas imports in storage facilities located on the Polish territory ("territoriality clause") are the subject matter of an ongoing infringement procedure because of violation of the EU legislation.

6. An additional distributional and social effect of the provision of public co-financing sought by Poland is the fact that the cost of the investments will not be passed on to the consumers in the form of increased tariffs. According to the available calculations, the (regulated) gas price for households (in purchasing power standards per GJ) would need to increase by 1% in the absence of aid. Prices for industrial consumers in nominal and not purchasing power standards terms are the fourth lowest in the EU[2]. The Polish regulator has recently issued an approval for a 3,3 % average price rise[3]. Given that gas prices for households in Poland are already among the eight-highest in the EU[4], Poland considers that price increases due to financing of storage facilities would have a high impact on consumers.

Activities of the beneficiary

7. The single beneficiary of the aid is the Storage System Operator (SSO) Division which operates all gas storage facilities in Poland and which belongs in 100% to the incumbent gas company – Polskie Gornictwo Naftowe i Gazownictwo S.A. ("PGNiG"). PGNiG which is in 84.75% state-owned, is active and has a quasi-monopolistic position[5] on the markets of production, import, distribution, wholesale and retail sales of gas. The PGNiG SSO does not have any other activities then gas storage. Distribution of gas is operated by six separate gas distribution companies fully owned by but legally unbundled from PGNiG. Since 31 December 2008, the SSO in Poland is functionally unbundled from its single owner the PGNiG i.e. it is separated organisationally and has separate accounts.

Rules applicable to gas storage in Poland

8. Poland imposes on energy companies conducting business of foreign trading in natural gas and entities importing natural gas an obligation to hold stocks of natural gas. According to the requirements of the Energy Law, obligatory stocks of natural gas are held exclusively on the territory of Poland in storage installations connected to the gas system, the technical parameters of which assure the ability to supply the whole of the obliged quantity to the gas system within a period of no longer than 40 days.

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2 Eurostat data as used in the Technical Annex of the Report on the progress in creating the Internal Electricity and Gas Market, page 21, http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=SEC:2010:0251:FIN:EN:PDF

3 ICIS Heren European Gas Markets, EGM17.10, 27 May 2010, page 10.

4 Eurostat data "Environment and energy" issue 49/2009

5 There are 19 other undertakings holding licences for gas trade. However, only few of them sell on the market and their market share is marginal (not exceeding 0.3% for each of them)

9. From 1 October 2009 to 30 September 2010, energy companies conducting business activities of natural gas trading and entities importing natural gas are obliged to hold stocks of natural gas of a quantity reflecting at least 15 days with respect to their average daily imports. In the following years, i.e. from 1 October 2010 to 30 September 2012, this amount is to reflect 20 days of the average daily imports of natural gas and from 1 October 2012, it is to be equal to the level of 30 days of the average daily imports of gas.

10. The Commission has opened infringement proceedings against the rules on territoriality of storage as a violation of EU law (Infringement Number 2006/4918). In order to diminish the barriers of entry on the Polish gas market, and with respect to the ongoing infringement procedure, the Polish authorities committed in a letter to the Commission to introduce several changes in the obligation to store gas imposed on companies and presented the draft law. However, the Commission does for the time being not consider these measures as sufficient to alleviate all concerns with respect to the territoriality clause. A concrete draft law as well as a date for adoption will have to be awaited (see below).

11. Gas storage in Poland is regulated by concessions granted by the Energy Regulator Office (ERO). Any company owning gas storage facilities and having a concession for gas storage can be appointed as SSO on the basis of the decision of ERO and for the duration of the concession. The PGNiG SSO Division was designated as SSO on the 31 December 2008. The concessions can be annulled basically in cases when the operator is breaking the conditions of the concession or in cases of bankruptcy, division or mergers of the company. The concessions cannot be transferred to third parties by the concession holder.

12. The concession obliges companies to store gas in line with the rules specified in the Energy Law of 10 April 1997[6]. The PGNiG SSO is required, inter alia, to grant Third Party Access (TPA) to the storage capacities to other companies which require storing gas.

13. The TPA to storage facilities operated by the SSO is implemented through the Rules for Storage Services and the Tariff for storage which require approval of the ERO. Before its implementation, the Rules and the Tariff where consulted in a process of market screening carried out in April 2009, to which five companies responded, and consulted with market participants and the public in May 2009, where four companies commented. The Rules and the Tariff have been published on 1 July 2009 and apply since then.

14. The Rules foresee that the storage services will be offered to all parties by allocating the released capacities in an open call. In case the demand for capacities would be bigger as available capacities, the allocation will be made in proportion to the requests. Pursuant to the Rules, the duration for which storage services can be provided on the basis of signed service agreement is one year as a minimum and four years as a maximum.

15. Furthermore, Poland provides for the ability to apply for an exemption from the obligation to hold stocks of natural gas. According to the provisions of the Energy

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6 Journal of Laws 2006 No 89

Law, such exemption can be obtained if the number of companies' customers is no greater than 100 thousand and the imports of natural gas do not exceed 50 million m^3 during the year. The minister responsible for the economy issues the exemption by means of a decision on the request of the interested entity. According to the Polish authorities, these provisions are susceptible to be modified in the future, with less demanding requirements.

Current and future allocation of storage capacities in Poland

16. The first allocation of storage capacities took place from the 1 July to 31 July 2009. The total capacity of active storage installations of 627 million m³ was made available, that is:

    – 302 bundled units in the storage installation of UGS Mogilno under firm service;

    – 264 bundled units under firm service in UGS Wierzchowice and UGS Husów together with additional withdrawal capacity of 248 thousand m3/h;

    – 61 bundled units under interruptible service at the storage installations UGS Wierzchowice and UGS Husów together with additional withdrawal capacity of 8.54 thousand m3/h.

17. However, within the period during which interested entities could have requested making gas storage services available, the Polish authorities state that only one application for such services from PGNiG S.A Gas Trading Division was received. Gas storage capacities were preliminarily allocated by 14 August 2009, in accordance with adopted Storage Service Rules. All capacity, namely 627 million m3 of active capacity of storage installations, was allocated to PGNiG S.A. Gas Trading Division for the period:

    – until 31 March 2013 in the case of UGS Mogilno;

    – until 31 March 2014 in the case of virtual installation based on operations of UGS Wierzchowice and UGS Husów.

18. In the opinion of the President of ERO (national regulator), the minimal interest in the use of storage services, despite interests expressed in the market screening procedure organised by PGNiG before offering capacities for TPA, stemmed from several reasons:

    – Problem with the transit of gas across the Ukraine following the 2009 gas crisis.

    – Lack of entities required by their business of foreign trade in gas to hold obligatory stocks of gas fuels in 2009.

    – Economic crisis, the effect of which is the decline in the requirement for gas and the relatively unclear forecasts of the level of demand in future years. Due to these factors, business entities have not taken a risk related to incurring charges for storage services without being certain that they will manage to achieve a level of sales in future years which implies the need to hold the obligatory stocks.

    – Publication of a tariff containing the rates of charges for the storage service after the market screening procedure was closed. PGNiG's earlier tariffs did not include charges for the provision of access to gas storage facilities therefore companies expressing interest during market screening procedure made declarations regarding the intention to conclude a storage agreement without knowledge of the tariff.

19. According to the Polish authorities, remaining storage capacities were not included in storage installations and were used for the purposes of domestic production (905 million m³) and Transmission System Operator for gas […].

20. At the same time, it appears that, in relation to investment activities carried out, the SSO expects making additional gas storage services available in accordance with the following adopted time schedule : as of 2011, at UGS Strachocina, as of 2012 at UGS Wierzchowice and as of 2014 at UGSs Kosakowo and Mogilno. As a result, the following capacities per site appear to be available to third parties from 2010 until 2020, so that there will be a significant increase of capacity (Table 1).

Table 1 : Storage capacity 2010-2020

UGS	2010	2011	2012	2013	2014	2015	2020
	million m^3						
Kosakowo	0	0	0	50	100	100	250
Wierzchowice**	175	175	800	800	800	800	1 600
Brzeźnica**	0	0	0	0	0	0	35
Swarzów**	0	0	0	0	0	0	0
Strachocina**	0	180	180	180	180	180	180
Husów**	150	150	150	150	150	150	300
Mogilno*	302	330	328	325	373	492	800
Total:	**627**	**835**	**1 458**	**1 505**	**1 603**	**1 722**	**3 165**

The capacity of CUGS Mogilno was reduced by the demand of the Transmission System Operator (TSO) and Storage System Operator (SSO).

* According to the TSO, the purposes of maintaining security of operations of the gas transmission system using the capacity of […] is necessary and the active capacity of 18 million m3 is allocated out of available bundled units on standard terms (differences in temperature after compression).

** These storage installations would provide services to the national gas production sector, taking into account the whole or a part of active capacities of these storage installations (905 million m3 in total).

21. Moreover, for the purposes of illustration, Poland submitted as well data concerning the forecast of natural gas consumption, volume of domestic output, volume of natural gas deliveries from Russia, volume of mandatory reserves, and anticipated volumes of available natural gas storage capacities in Poland up to 2030 (Table 2)

Table 2: Forecast of consumption and volume of mandatory reserves

Years	Consumption forecast	Natural gas output in Poland assumed in the model	Maximum volume of gas deliveries from Russia	Minimum volume of gas deliveries from Russia	Expected natural gas storage capacity in Poland
	billion m^3				
2010	[…]	[…]	[…]	[…]	[…]
2015	[…]	[…]	[…]	[…]	[…]
2020	[…]	[…]	[…]	[…]	[…]
2025	[…]	[…]	[…]	[…]	[…]
2030	[…]	[…]	[…]	[…]	[…]

Aid amount, intensity and duration

22. The total amount of aid is 1 539 920 200 Polish Zloty (PLN) which is approximately EUR 390.5 million. The aid will be granted from the approval of the Commission until June 2015. Granting of the aid is based on a co-financing agreement which is signed with the beneficiary following a positive conclusion of evaluation of the application for co-financing and its annexes in line with the method for selection of individual projects laid down in Article 21(1) of the Act of 6 December 2006 on the development policy[7]. The agreement contains a clause whereby payment of the funds is conditional upon the nature of the State aid decision of the European Commission. Any provisions related to the decision must be incorporated into the agreement and when the funding is paid to the beneficiary

23. According to the information provided by Polish authorities, the cost of the individual tasks and the co-financing sought by the beneficiary are as follows:

Table 3: Aid intensity

UGS	Total costs (VAT excl.)	Eligible costs	**Aid**	Aid intensity
	1000 PLN			%
Strachocina	451 749.00	451 374.00	**231 329.18**	51.25
Wierzchowice	1 603 675.56	1 603 272.96	**894 626.31**	55.80
Kosakowo	546 958.61	546 264.40	**311 370.71**	57.00
Mogilno	180 623.81	179 989.48	**102 594.00**	57.00
Total	2 743 953.32	2 780 900.84	**1 539 920.20**	**55.37**

Costs of the projects and the aid foreseen (calculations of 15 September 2009)

24. In order to calculate the aid amount for each of the projects, Poland applied strictly a method of no-overcompensation in line with the Guidelines of the Minister of Regional Development regarding selected issue related to preparation of investment projects, including revenue-generating projects of 15 January 2009[8]. Poland submitted data showing the Internal Rate of Return (IRR) and the Net Present Value (NPV) of the project over the lifetime of the installation, including all costs and incomes from the project. The calculations illustrate the IRR and the NPV calculated separately for the cases i) when aid is granted where the returns are calculated for own capital engaged by the operator[9] and ii) when no aid is granted and the investment is financed exclusively by the operator.

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7 Journal of Laws No 227, entry 1658, as subsequently amended

8 http://www.mrr.gov.pl/fundusze/wytyczne_mrr/obowiazujace/horyzontalne/strony/lista.aspx

9 As stated above the aid is not treated as engaged capital and therefore it will not generate any profits for the operator in financial terms

Table 4: Return on the investment with/without aid

UGS	Without the aid		With the aid	
	IRR	NPV	IRR	NPV
Strachocina	[…]	[…]	[…]	[…]
Wierzchowice	[…]	[…]	[…]	[…]
Kosakowo	[…]	[…]	[…]	[…]
Mogilno	[…]	[…]	[…]	[…]

Tab. IRR and NPV with and without the aid, based on 8% discount and 25 years lifetime

25. In line with those Guidelines, the financial IRR on the own capital engaged in a project financed from the Structural Funds, shall not be higher than 8%, which has been agreed with the European Commission as a level above which it is considered that the burden on the European Union tax payer is too high[10]. The amount of public funding is therefore calculated so as to bring the IRR from the low values without support (<2%) portrayed in the table above to the higher values but still below 8% planned for the beneficiary. Poland submits on the basis of these calculations that the aid strikes the balance between the minimum requirement of the return on capital of WACC of 6% and the maximum return of 8% above which the return would be considered to overburden the EU taxpayer. Furthermore Poland points that the maximum share of co-financing of a project under the EIOP measure in terms of eligible expenditure was established in the detailed description of EIOP priorities and may not exceed 57% of eligible costs of EIOP projects.

26. The operation of the publicly financed storage facilities will generate revenues from gas tariffs. The tariff for storage capacities operated by the beneficiary of the aid applies as of 1 July 2009. These are tariffs designed in line with the rules established by the ERO, which follow the Regulation of the Minister of Economics of 6 February 2008 for detailed rules on establishing and calculation of tariffs in trade with gas[11]. They cover two types of costs, firstly all substantiated costs of storage including costs

[10] In its Guidance On The Methodology For Carrying Out Cost-Benefit Analysis of 08/2006, the Commission recommends that a 5% financial discount rate in real terms is used as an indicative benchmark for public investment projects co-financed by the Funds. It stresses however that values differing from the 5% benchmark may, however, be justified on the grounds of: the Member State's specific macroeconomic conditions; the nature of the investor: for instance, the discount rate can be higher for PPP projects, where the inclusion of private funds may increase the opportunity cost of capital or the sector concerned (e.g., transport, environment, energy, etc.). Furthermore in the documents prepared within the JASER initiative it has been stated that the long term inflation rate expected for Poland can be expected to be 3%. Therefore, it has been stated that the nominal real discount rate used for costs benefits analysis for investments supported from the EU Funds in Poland shall be 8%. For details see: http://ec.europa.eu/regional_policy/sources/docoffic/2007/working/wd4_cost_en.pdf and http://www.mrr.gov.pl/fundusze/wytyczne_mrr/obowiazujace/horyzontalne/Documents/

[11] Journal of Laws No 28, entry 165

of depreciation, maintenance, taxes, wages etc and, secondly, the return on capital. The tariffs need annual approval of ERO.

27. Tariffs cover a justified return on engaged capital of the operators which is the profit of the SSO. In order to calculate such return on capital ERO applies in respect to the SSO a calculation method where the Weighted Average Cost of Capital (WACC)[12] is multiplied by the sum of net engaged capital and of the liquidity. The WACC for gas storage is regulated by the Energy Law and shall be at the level of 6%. On the basis of the principles of the Regulation, Poland approved detailed guidelines on how the funding needs to be calculated in respect to the aid under the measure.

28. In their notification, the Polish authorities explained the planned aid is by Law not treated as own engaged capital and therefore it will have no impact on the return from capital. Hence it will not increase the profits of the beneficiary, compared to the situation where it would built the storages without public funding. Although Poland expects that the tariff will increase because part of the investments will be financed by the operator itself, the increase will remain lower than if the aid would not be granted and still in keeping with the distributional and social aims of the public financing.

Eligible expenditure

29. In accordance with the Guidelines of the Minister of Regional Development with regard to eligibility of expenses under EIOP[13], the following costs have been accepted as eligible expenditures:

    - project preparation (project documentation, technical documentation, tender documentation, environmental impact assessment, fees related to the acquisition of necessary administrative decisions);
    - acquisition of real estate (purchase of an undeveloped property);
    - building work and assembly (ground-level and underground building work, including: performing operating boreholes, injection of buffer gas);
    - necessary fees and other charges (gas and power network connection charges and insurance related to construction for contracts compliant with the provisions of “FIDIC general contract terms” or similar);
    - plant and equipment (the entire technological equipment);
    - project management (Project Engineer).

30. PGNiG applied for the aid for all projects in the year 2006, when the list of strategic individual projects was assembled by Poland, and therefore before the date when any

[12] The interest rates use for calculation reflect the market typical interest rates

[13] http://www.mrr.gov.pl/fundusze/wytyczne_mrr/obowiazujace/szczegolowe/pois/Documents/20090903_wytyczne_kwalifikowanie_POIiS.pdf

eligible expenditures were incurred. The eligible expenditures incurred for the implementation of those projects during the period of 2007–2009 are the following:

Table 5: Eligible expenditure

Project	Period of project implementation	Financial conclusion of project	Categories of costs incurred in 2007–2009	Eligible expenditures incurred in 2007–2009 [PLN ’000]
Strachocina	05.2007–06.2011	12.2011	1. Project preparation	[…]
			2. Building work	[…]
			3. Plant and equipment	[…]
			Total	[…]
Wierzchowice	01.2007–12.2011	06.2012	1. Project preparation	[…]
			2. Project management	[…]
			3. Building work	[…]
			4. Plant and equipment	[…]
			5. Necessary fees and other charges	[…]
			Total	[…]
Kosakowo	02.2007–12.2014	06.2015	1. Project preparation	[…]
			2. Project management	[…]
			3. Acquisition of real estate	[…]
			4. Building work	[…]
			5. Plant and equipment	[…]
			6. Necessary fees and other charges	[…]
			Total	[…]
Mogilno	02.2008–12.2014	06.2015	1. Building work	[…]
			2. Plant and equipment	[…]
			Total	[…]
Total costs incurred:				[…]

Tab. List of costs incurred for project implementation in the years 2007–2009

III. ASSESSMENT

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

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

32. The aid is granted from State resources within the meaning of Article 107(1) of the TFEU because the structural funds resources are paid to the Member State before being paid by the latter to the beneficiary of the State aid. Therefore, the money is at the control of the Member Sate at the moment of payment to the beneficiary and constitute State resources. The choice of the projects at hand and the transfer of Structural Funds resources from the EU budget are imputable to a decision and request of Poland.

Selective economic advantage to the storage system operator and PGNiG

33. The underground storage of gas is regulated in Poland by the public authorities i.e. independent ERO which grants concession contracts and appoints storage system operators. The PGNiG SSO Division has been assigned as an SSO on 31 December 2008 and is subject to the rules applicable to an SSO and regulated by the ERO, notably as to tariffs.

34. The subsidy will reduce the amount of capital that PGNiG SSO Division would need in order to finance the planned investment without State support. In addition, the gas storage facilities belong to PGNiG. PGNiG will therefore become owner of assets which it would be able to use e.g. as a collateral to obtain credits from the banks.

35. Moreover, the method to calculate the tariff ensures that the investment subsidy will not qualify as engaged capital, so that there would be no tariff increase yielding additional revenues in consideration of the amount of capital engaged for the publicly financed part of the investment. However, since depreciation of the partly publicly financed new storages enters as an operating cost in the tariff calculation, the revenues of the SSO shall further increase in proportion to the increase in the operating costs, because more revenues are generated from more storage facilities being operated by the beneficiary.

36. Since Poland implements functional unbundling from the SSO's single owner, the PGNiG, in that the SSO is only separated organisationally and has separate accounts, advantages resulting from the aid granted to the SSO will also benefit its mother company the PGNiG.

37. In the view of the direct benefits to PGNiG SSO Division and its mother company the PGNiG in form of additional capital finance and revenues , the aid will give a direct economic advantage to the beneficiary. As the financing of the planned gas storage infrastructure by State resources under the control of Poland confers an economic advantage which is only granted to PGNiG and PGNiG SSO Division, that

advantage favours certain undertakings within the meaning of Article 107(1) of the TFEU.

Distortion of competition and affectation of trade between Member States

38. The gas market in Poland on which PGNiG is active is in principle open to competition. The legal framework applicable to gas supplies in Poland requires that companies importing or trading gas secure certain amounts of gas storage in proportion to their supplies, unless specific derogations apply. Storage-related costs are therefore a normal cost in the budget of a company active on that market. The selective economic advantage to the beneficiary in the form of reduced capital finance needs and increased revenues it would not obtain without the State aid gives therefore the beneficiary a competitive advantage to operate on that market, which distorts or threatens to distort competition thereon.

39. Moreover, the planned subsidies may deter other companies operating in the EU to invest themselves in new gas storage facilities in Poland or in Member States interconnected to Poland and may therefore distort competition as to the construction and operation of gas storage capacities.

40. As the Polish gas market is currently suffering a lack of competition which is partially due to the lack of available storage capacity enabling in principle that companies trading with gas fulfil the requirements of storing obligatory gas reserves, it is likely that the new investments will attract new suppliers of gas from other EU and non-EU States to request access to and use these storages to enter the gas market and operate in Poland. Therefore constructing the new underground storages will give some suppliers of gas indirect benefits of increased sales to the new customers, in particular once the current barriers hampering the smooth functioning of the internal energy market are lifted. Therefore on this count, the aid is also likely to affect competition on the downstream markets of gas in Poland to the benefit of the new entries to the market, under the same conditions.

41. As gas is traded between Member States in the EU and the new storages are, in the above circumstances, likely to attract gas trading companies to sell gas in Poland and discourage competitors from investing in alternative storage capacities, the planned aid is likely to affect trade between Member States.

Conclusion on existence of the aid

42. In the light of the above considerations, the Commission concludes that the measure involves State aid within the meaning of Article 107 (1) of the TFEU.

Lawfulness of the aid

43. Poland confirmed to the Commission that the payment of the aid is subject to the approval by the European Commission. Therefore Poland has fulfilled its obligation according to Article 108(3) of the TFEU by notifying the aid measure before its implementation.

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

44. The Commission notes that the measure primarily aims to increase gas storage capacities in Poland with no prospect for these investments on regular commercial

conditions i.e. financed from the company funds and recouped from tariffs, in the near and medium term. The Commission also notes that the measure does not fall under one of the existing frameworks and guidelines. In particular, aid for such projects of gas storage infrastructure does not fall within the scope of the 2008 Environmental Aid Guidelines[14].

45. Likewise, although the areas covered by the measure are eligible under the European Regional Development Fund, as well as Article 107 (3) (a) TFEU assisted areas within the meaning of the Guidelines on national regional aid for 2007-2013 (hereafter Regional Aid Guidelines (RAG))[15], the aid is not primarily designed to contribute to regional development by supporting investment and job creation through the expansion and diversification of the economic activities located in the less-favoured regions, in particular by encouraging firms to set up new establishments there. Three of the four projects concerned involved concern the expansion of existing capacities. In the case at hand neither job creation nor setting up new establishment are the main objective of the aid.

46. As stated by Polish authorities and as assessed below, the main objective of the aid is the development of the Polish system for the storage of natural gas and in this way contributing to the creation of the basic infrastructure for the operation of the internal market in natural gas and increased energy security in Poland .

47. The Commission considers that the assessment of the compatibility of the measure with the internal market requires an assessment as to whether the measure contributes to the development of the European Union market for gas and to the security of supply of the European Union, based directly on Article 107(3)(c) TFEU which states that: "*aid to facilitate the development of certain economic activities or of certain economic areas, where such aid does not adversely affect trading conditions to an extent contrary to the common interest*" may be considered to be compatible with the internal market.

48. In order to be compatible under Article 107(3)(c) TFEU, an aid must pursue an objective of common interest in a necessary and proportionate way. In this regard, the Commission considers it appropriate to assess the following questions:

    (1) Is the aid measure aimed at a well-defined objective of common interest (i.e. does the proposed aid address a market failure or another objective of common interest)?

    (2) Is the aid well designed to deliver the objective of common interest? In particular:

        (a) Is the aid measure an appropriate instrument, i.e. are there other, better-placed instruments?

        (b) Is there an incentive effect, i.e. does the aid change the behavior of firms?

        (c) Is the aid measure proportional, i.e. could the same change in behavior be obtained with less aid?

[14] OJ C 82 of 01.04.2008
[15] OJ C 54, 4.3.2006, p. 13

(3) Are the distortions of competition and the effect on trade limited, so that the overall balance is positive?

Objective of Common Interest

49. An objective of common interest is an objective which has been recognised by the EU as being in the common interest of the EU Member States. As further documented below, the aid measure has to aim at a well-defined objective of common interest.

50. Underground gas storage facilities supported in the framework of the Environment and Infrastructure Operational Programme contribute to the development of the Polish system for storage of natural gas. The supported gas storage facilities will allow stabilising supply of gas and reacting to changes in demand of gas and therefore are likely to increase the security of supply of consumers. Changes in supply may be a consequence of seasonal changes (higher demand in autumn and winter), daily or weekly picks and unforeseen interruptions of gas supply such as the Russian-Ukrainian gas crisis of 2009.

51. Underground gas storages, in particular, where the legislation on their location is in line with EU law, make a key contribution to increased energy security and the creation of the basic infrastructure for the operation of the internal market in natural gas, thereby promoting the wider interest of the European Union, beyond the specific interest of Poland. This has been confirmed in following documents issued by the European institutions.

52. In the Communication from the Commission to the European Council and the European Parliament "An Energy Policy for Europe"[16], security of supply is recognized as one of the pillars of the European energy policy and it is recognised that gas storage contributes to security of supply and it needs to be further developed.

53. Working gas in storage capacity is expressly mentioned among the instruments to enhance the security of gas supply in Council Directive 2004/67/EC of 26 April 2004 concerning measures to safeguard security of natural gas supply[17]. Gas storage is also an instrument allowing realisation of the Decision No 1364/2006/EC of the European Parliament and of the Council of 6 September 2006 laying down guidelines for trans-European energy networks and repealing Decision 96/391/EC and Decision No 1229/2003/EC[18].

54. In particular, Decision No 1364/2006/EC, which applies among others to underground storage facilities connected to high-pressure gas pipelines, lists explicitly in its Annex III, the extension and/or development of the UGSs Wierzchowice and Kosakowo, which are part of the notified scheme, among projects being in the common interest of the Union. Furthermore in Annex I of this decision, the development of gas storage in the Baltic Sea region has also been identified as a priority project of European interest.

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16 COM/2007/0001 final

17 OJ L 127, 29.4.2004

18 OJ L 262, 22.9.2006

55. The planned investments were included in the list pursuant to the procedures in force in the framework of the 2007-2013 Environment and Infrastructure Operational Programme, cofinanced by ERDF and the Cohesion Fund and are in line with the strategy for the relevant priority axis. Given that they are major projects, Poland plans to submit applications to the Commission in line with the provisions of Council Regulation (EC) No 1083/2006 of 11 July laying down general provisions on the European Regional Development Fund and the Cohesion Fund. Major projects are investment undertakings with strategic importance for the implementation of the operational programme.

56. In view of the importance of the planned investments for security of supply, as expressly recognised in the above legal acts concerning energy policy, and in view of the possible positive impact of the new storage capacities on competition in Polish gas market, it can be concluded that the Polish scheme aims at a well-defined objective of common interest.

Appropriate Instrument

57. Directive 2004/67/EC includes in its annex a non exhaustive list of instruments to enhance security of supply, which includes gas storage. Gas storage is indeed one of the most used instruments for security of gas supply by Member States, which is furthermore the only instrument which is specifically addressed in the Directive (Article 4(4)).

58. As indicated by the Commission, all Member States where it is possible to do so have recourse to gas storage, which highlights the significance of gas storage for security of supply purposes, so that, at present, 21 Member States use gas storage as an instrument to increase security of gas supply. For instance, Italy, Germany and France use the gas storage as main tool to cover the seasonality of gas demand. Beyond normal supply and demand peak/non-peak or seasonal conditions, gas storage has also proved its value in more unpredictable and sudden supply crisis such as the Russian-Ukrainian crisis in January 2009. As indicated by the Commission: "*the dependence on storage and its flexibility was clearly demonstrated in January 2009, where most Member States doubled the gas supply from their storages in comparison to January 2008*"[19].

59. When completed, the increase of 1 bm^3 brought about by the planned projects in the gas storage capacity of Poland (1.6 bm^3) will be below 1% of the total storage capacity EU-wide. The capacity increase planned to be financed with state aid for the four sites at hand, combined with current storage capacities in Poland is forecasted to amount to, respectively, 17%, 15% and 13% of planned demand in Poland by 2015, 2020 and 2025, thereby bringing Poland closer to the current EU average of 14% of annual gas consumption[20].

60. Moreover, not only is gas storage a widely used instrument and recognised in EU law as appropriate for the purposes of guaranteeing security of supply. Gas storage can

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[19] Commission Staff working document: "Assessment report of Directive 2004/67/EC on security of gas supply (SEC(2009)978 accompanying COM(2009)363), p.22 to 26.

[20] Commission Staff working document: "Assessment report of Directive 2004/67/EC on security of gas supply (SEC(2009)978 accompanying COM(2009)363), p. 22. The estimate of the storage capacity of 19 Member States is 100 bcm, representing 14% of EU annual gas consumption.

also be used in conjunction with other instruments to achieve the intended aim, including the non exhaustive list in annex to Directive 2004/67/EC.

61. Specifically in the case of Poland, it appears that the planned increase of storage capacities is not the only measure relied upon to improve security of supply. As shown by the Commission review of "Member States use of security of gas supply instruments", among the nine instruments reviewed, Poland has recourse to at least seven other instruments, in addition to gas storage, such as diversity of sources and mixes, flexibility of production and imports, interruptible contracts, cross-border capacity plans etc[21].

62. As the Commission recognised in its report on Directive 2004/67/EC: "*The different structure of national gas markets, governs the mix and the balance between various instruments. The most frequently used measures are gas storages, long term supply contracts, production and import flexibilities and diversifications of gas supply*"[22]. It follows that the planned project appears to be appropriate and also part of a wider policy-mix of regulatory or commercial instruments weighted by the Polish authorities according to the specific structure of the market.

63. With regard to the present measure, the Polish authorities pointed out that the SSO is constrained in its investment decisions by the capital available. In order to fulfil its obligations in storing gas, it can postpone the investments necessary from the perspective of national and EU policy interests, to the future. Imposing any legal obligation to realise the investments at hand could only be financed via an increase in tariffs for gas transmission as any investments in infrastructure realised by a network operator can only be financed from tariffs. This would in turn further increase prices for gas for consumers, which has been considered to be socially difficult to justify.

64. Financing of construction of 1.027 m^3 gas storage would require increase in tariffs for storage of gas which would result in an increase of gas prices by 1% and has an impact on inflation of 0.024%. Polish authorities argue that, at present, such increase in tariffs is uneasy from the social point of view in particular as, according to Poland, the gas prices in Poland are among the highest within the EU i.e. Poland has the eight highest prices for household consumers in purchase power parity terms in the EU [23]. Moreover, the Polish regulator has recently issued an approval for a 3,3 % average price rise.

65. Indeed the whole territory of Poland, entirely qualifies as an assisted region under the derogation laid down in Article 107(3)(a) of the TFEU, in conformity with the regional aid map for Poland[24] with an Gross Domestic Product per capita in Purchasing Power terms is below 75% of EU average and the average costs of gas in the households budgets amounts to ca 11%. Although the investment would be in line with the EU energy policy, the Polish authorities indicate that currently it can only be achieved with the assistance of aid. That contention is not only justified by social cohesion reasons, but also, inter alia, by the low profitability of the planned

[21] Commission Staff working document: "Assessment report of Directive 2004/67/EC on security of gas supply (SEC(2009)978 accompanying COM(2009)363), p. 22 and Annex 3, p.59. The estimate of the storage capacity of 19 Member States is 100 bcm, representing 14% of EU annual gas consumption.

[22] Communication from the Commission on the Directive 2004/67/EC. COM(2008)769 final of 13.11.2008, p.8.

[23] See Eurostat Data in focus 49/2009

[24] State Aid N 531/2006 – Poland – Regional aid map for 2007-2013.

investment. It is unlikely that any market investor would accept at present a remuneration below 2% of the capital invested, as it would be the case for the projects at hand without the planned aid.

66. Consequently, the Commission considers that State aid is an appropriate instrument to achieve investments in gas storage in Poland for the projects at hand.

Incentive Effect

67. As further shown below, the aid granted for the envisaged measures is capable of providing the necessary incentive effect. State aid provides an incentive effect if the aid changes the recipients' behaviour towards reaching the objective of common interest. It is also apparent that the absence of market forces in Poland may partly explain the absence of sufficiently developed storage capacities to face critical situations. It is therefore unlikely that the planned investments increasing the existing storage capacity would be brought about by market forces alone. The planned aid addresses therefore a well-identified market failure of investing into storage capacity in order to smooth and guarantee supply in the event of unpredictable disruptions.

68. According to the Polish authorities the system of calculating the tariffs for transmission of gas does not provide enough incentives for the PGNiG SSO to invest in extension of the gas storage in the next future. This is because the projects to construct more than one billion m^3 of new storage are a major investment. To finance such investments the SSO would need to increase significantly the engaged capital, far above the "business as usual" maintenance costs.

69. According to the tariff setting mechanism, in order to receive remuneration on such increase engaged capital the tariff would need to increase to a level which is unacceptable for the regulator from social point of view. If the investment were not to be aided but financed only from the company own resources, the IRR would be below 2% i.e. below 6% foreseen by Law as minimum remuneration for engaged capital for gas storage, and would result with very significant negative NPV or each of the storage projects foreseen. Therefore, as the regulator would prevent increase in tariffs to match the costs of investments, the beneficiary would not be able to cover these costs of the investments, at least in the near future. It is therefore unlikely that the investment would be carried out at all or, in any event, at the planned schedule and scope without aid.

70. It follows that in order to achieve the security of supply, the foreseen investments would be carried out at an acceptable, but still modest return, only if partly financed by a support from State resources. Therefore it can be concluded that the State aid will provide for the necessary incentive effect.

Proportionality

71. A State aid measure is proportional if the measure is designed in a way that the aid as such is kept to the minimum and if the beneficiaries are selected in a non-discriminatory, transparent and open process. As regards proportionality of the aid, the amount of the aid will be calculated on the basis of the method warranting that the lifetime financial IRR of the project would be between […] and […] IRR, depending on the UGS concerned. This return is higher than the 6% minimum foreseen by Law but lower than the 8% threshold set by the Commission for

calculations of remuneration from investment projects financed from the Structural Funds in Poland.

72. Poland presented as well the preliminary calculations of the aid intensities of the concrete investment projects. According to the calculations of 23 February 2010, the intensity of co-financing to be applied for by the beneficiary varies from project to project from 51.25% to 57% of the eligible costs. Therefore the maximum aid intensity of the projects of 57% of the "funding gap" foreseen when preparing the measure is not reached. For instance, such contribution of the beneficiary goes beyond the requirements of the standard assessment of the non-applicable Environmental Aid Guidelines which require deducting benefits calculated in the first 5 years only. Furthermore a comprehensive mechanism related to grants from Structural Funds is put in place to ensure that the benefits are properly calculated, surpluses are controlled and recovered if arise unduly.

73. The financial profits for the SSO taking into account investment needs and the tariffs for gas storage are under control of the ERO. Therefore the authorities are able to control the benefits which the beneficiary is receiving when operating gas storages. Furthermore, prices charged to network users are subject to strict regulatory monitoring: regulatory authorities define tariff-setting methodologies and control setting of the tariffs themselves in a way which allows necessary investments to be carried out to ensure the viability of the storage capacities. It follows that the regulation could ensure that no undue or excessive profit accrues to the beneficiary from the operation of the infrastructure.

74. In view of the above it can thus be concluded that the State aid granted for the envisaged measures is proportional.

Distortion of Competition and Balancing Test

75. The market of gas storage is regulated by the State and SSO require to be appointed by the national regulator ERO to be able to operate the storage. So far only PGNiG SSO has been appointed an SSO. It could be argued that other company than PGNiG could be appointed an SSO, at least in the medium term. Therefore the contemplated subsidy, in so far as it contributes to development of existing capacities, might have the effect of deterring operators to invest themselves in new gas storage.

76. However, the impacts on competition on the market for storage of gas are mitigated on the downstream markets, as the beneficiary of the aid is obliged to ensure the third party access to its storage for all suppliers of gas.

77. As explained above, provided the internal market rules will be respected, suppliers of gas may derive benefits from the aid in getting the possibility to enter the gas market in Poland due to the construction of the new storage capacities. New storage capacities may thus increase the possibility of new entries in the gas market due to the legal requirement to store imported gas. Therefore it cannot be excluded that the aid may distort competition on markets where companies distributing and producing or trading gas are active.

78. Pursuant to the Gas Directive (Directive 2003/55/EC), the Member States must ensure access to the gas storage facilities for third parties. In order to fulfil the obligations arising from the Gas Directive with regard to the implementation of the rule of TPA to storage facilities, the Polish authorities appointed the SSO Division of

PGNiG an SSO as of 31 December 2008 and offered access to storage facilities to third parties in the period from 1 July 2009 to 31 July 2009.

79. Altogether, 627 million m^3 of active capacity in storage facilities was made available in total for the purposes of entities interested in such services, and gas fuel storage services available were allocated. Only one company, namely PGNiG applied for access to storage facilities to which active capacities of storage facilities were made available for the next four years of storage. Poland declared that in the case of releasing part of those capacities or increasing the active capacities of storage facilities, they will be made available to the interested entities in accordance with the TPA rule.

80. In that context, the realisation of the supported investments will allow better fulfilment of and increased capacity for TPA to gas storage in Poland thereby facilitating that more companies enter the Polish gas market. For instance, as is shown above, significant amounts of additional storage capacity can be made available as of 2011-2 if the projects at UGS Mogilno and Wierzchowice are implemented.

81. Article 18 of Directive 2003/55/EC imposes on Member States an obligation to ensure access to storage services in accordance with objective, transparent and non-discriminatory criteria, on negotiated or regulated basis. For the Polish SSO, the regulated access model has been adopted. Charges for the gas fuel storage services are applied in accordance with national regulations. In accordance with the provisions of the Energy Law Act, energy companies determine tariffs which are subject to approval by the President of the Energy Regulatory Authority. The principles of access to storage services are specified in the Rules of Provision of Storage Services. The tariff developed and the Rules should normally allow the storage services to be provided in the manner specified in Directive 2003/55/EC.

82. More detailed rules for TPA were enacted in the so called Third Liberalisation Package including Directive 2009/73/EC of the European Parliament and of the Council of 13 July 2009 concerning common rules for the internal market in natural gas and repealing Directive 2003/55/EC (hereinafter "Directive 2009/73/EC")[25], as well as Regulation (EC) No 715/2009 of the European Parliament and of the Council of 13 July 2009 on conditions for access to the natural gas transmission networks and repealing Regulation (EC) No 1775/2005 (hereinafter "Regulation 715/2009")[26].

83. Provisions of the Regulation which are currently been addressed concern, in particular, separation of active storage capacity, injection capacity and off-take capacity from the storage system operator, offering unused capacity of storage facilities at least one day in advance and on interruptible basis, publication of numerical data on the contracted and available capacity of storage facilities and of information about the quantity of gas in each storage facility, quantities of gas injected and taken off and publication of information on calculation methods and

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[25] OJ L 211, 14.8.2009

[26] OJ L 211, 14.8.2009

structure of tariffs under the regulated third-party access. Currently, Poland submitted that intensive works on the adaptation of the operations of the Polish SSO to these provisions are under its way and Poland committed that it will ensure full implementation by 3 March 2011 as required by the Regulation 715/2009.

84. The Commission notes that the new storage capacities to which Poland committed to grant TPA and which will be governed by the TPA rules as described above, are susceptible to improve competition on the gas market in Poland, compared with the status quo, and even more so in the future once the internal market rules will be fully implemented. Access to additional storage capacities will be made available to the companies importing gas when available, whilst improved access to existing capacities in the shorter term shall be possible through the possible transfer or availability upon agreement of unused bundles to other entities.

85. Since appropriate TPA provisions ensure that access to the new storage will be granted in a non-discriminatory and effective manner, on the basis of the above conditions, the measure will ensure the positive effects in terms of security of supply and interpenetration of gas systems, within the internal market. In addition, as the current lack of gas storage capacities in Poland de facto hampers the development of a more competitive gas market in Poland, the aid should enhance such development to the benefit of consumers. Hence, compared to the status quo ante, the negative effects on competition are mitigated to a satisfactory extent by the identifiable positive effects of the aid, given the measures to which Poland commits as to TPA.

86. Therefore, provided such measures are effectively implemented and enforced with respect to existing and new storage capacity, so that there are real possibilities of timely and effective TPA to operators willing to take advantage of such provisions, it can be concluded that the possible distortions of competition and trade resulting from the State aid will be limited and outweighed by the positive effects of flanking measures as to TPA to storage capacity, so that the overall balance with regard to the objective of common interest is positive.

Conclusion

87. The Commission thus concludes that the aid measure is compatible with 107 (3) (c) of the TFEU. This assessment is, however, without prejudice to the compliance of the project and the compliance of the Polish law applicable to the project and to storage obligations with other provisions of EU law, in particular the ongoing infringement proceedings mentioned above with regard to the territoriality requirements for storage (infringement Number 2006/4918) or to any other infringement procedures which the Commission might launch to ensure that Poland correctly implements EU legislation.

IV. CONCLUSION

88. The Commission has accordingly decided not to raise objections to the notified measure, because the aid can be found compatible with the internal market in accordance with Article 107 (3) (c) of the TFEU and Article 61 (3) (c) of the EEA Agreement, since it pursues an objective of common interest in a necessary and proportionate way.

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

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

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

European Commission
Directorate-General of Competition
State Aid Registry
B-1049 BRUSSELS
Telefax nº: + 32-2-296.12.42

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

Yours faithfully,

For the Commission

Joaquin ALMUNIA

Vice-President of the Commission