EUROPEAN COMMISSION
Competition DG

Market and Cases I: Energy and Environment
The Director

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Permanent Representation of Croatia to the
European Union
Avenue des Arts 50
B-1000 Brussels

Subject: SA.42188 2014/PN – Plomin C Power Station

Dear Sir, Madam,

On 17 June 2015, your authorities pre-notified to the Commission a measure to support the construction of a new coal-fired power plant in Croatia. You sent further information on the case on 9 and 15 July 2015, and 5 and 28 August 2015. On 29 September 2015, the Commission services sent you a letter laying out their preliminary assessment of the pre-notified measure. You sent further information on the case on 28 October 2015, 25 November 2015, 18 January 2016, and 1 March 2016.

The measure includes a tender by the 100% state owned utility Hrvatska Elektroprivreda d.d. (HEP) for a sponsor to enter into a special purpose vehicle (SPV). The sponsor will provide 50% of the required equity (and take a 50% share) in the SPV. HEP will take the other 50% share and contribute the other 50% required equity. The SPV will design and construct a 515 MW coal-fired power station at the Plomin site (Plomin C) and maintain and operate the plant for 20 years. The SPV will also raise the debt financing required to undertake the project. Through a 20 year power purchase agreement (PPA) HEP will acquire 100% drawing rights over the plant (meaning HEP chooses when the plant runs and the SPV cannot independently choose to run the plant). In return, the SPV will be paid an availability credit (EUR/MW) by HEP sufficient to cover all financing and debt service costs related to the construction of the plant. For any hours in which HEP instructs the plant to run and generate electricity, the SPV will receive an energy payment (EUR/MWh) which covers the variable costs associated with running the plant.

The original proposal included, effectively, a State guarantee. In October 2015 this was removed and instead the parties proposed a change in control clause which would require HEP to buy 100% of Marubeni's shares in the SPV at a pre-agreed price if at any point HEP ceases to be majority state-owned.

On 18 July 2012 HEP published the tender notice in the Official Journal. On 2 September 2014 Marubeni Corporation was selected as the preferred applicant to be the project sponsor.

Your authorities submit that the measure does not constitute State aid because HEP, although publicly owned, is acting independently from the Government, and because HEP and

Marubeni Corporation are acting as market investors so there is no advantage to either party in the deal. Your authorities further state that even if the measure constituted State aid, it would be compatible with the Guidelines on State aid for environmental protection and energy 2014-2020 (EEAG).

On the basis of the information available, the Directorate General for Competition has come to the following preliminary assessment.

Existence of aid

Despite the changes to the project which removed the State guarantee, the Commission services still have several indications that the present measure might constitute State aid within the meaning of Article 107(1) of the Treaty on the Functioning of the European Union (TFEU).

In terms of imputability, HEP's supervisory board represents the interests of the Croatian Government as shareholder. Six of the seven members of the supervisory board are appointed by the government. The supervisory board then appoints a management board to manage HEP's day to day business. You have explained that it was the management board, not the supervisory board, that took the decision to invest in Plomin C, and that under Croatian company law the management board has responsibility to act in the best interests of the company, and that this demonstrates that the Government was not involved in HEP's decision to invest in Plomin C.

However, although you have provided minutes that show that the management board agreed to the timing and content of the tender documents for the Plomin C project, no documents have been provided that show the basis on which a decision to invest in the project was taken, nor which individuals or which board took the investment decision.

In September 2012 the then Croatian Prime Minister was quoted in the press saying that the project was important for Croatia, including because it would reduce the need to rely on 'wasteful' electricity imports[1]. The Croatian Government also recognised the Plomin C project as a 'strategic investment project' under the Act on the Strategic Investment Projects of the Republic of Croatia (the SIP Act) on 15 May 2014, and initially offered a State guarantee to support the project. This points to a degree of Government influence on the decision related to this project.

Finally, the potentially low or negative rate of returns to HEP associated with the project (see below) also raise doubts as to whether the project is actually in HEP's interest to pursue, and therefore whether its board would be considered to be acting in the best interests of the company in choosing to make the investment.

Taken together these indicators demonstrate that HEP's decision to invest in Plomin C was unlikely to have been taken independently from Government.

On the question of advantage and the market economy investor principle (MEIP), you have argued that HEP expects to achieve a reasonable rate of return on its investment in Plomin C,

[1] Poslovni dnevnik, 'Milanović: TPP Plomin C will work with cleaner technology', 14 September 2012, 16:20. http://www.poslovni.hr/vijesti/milanovic-te-plomin-c-ce-raditi-s-ciscom-tehnologijom-215815

and that although this rate of return is expected to be lower than Marubeni Corporation's this is justifiable because Marubeni Corporation takes on some risks that HEP does not bear, since it must design and build the plant, and must raise the debt financing for the project. You have also argued that it is 'normal financial logic for incumbent players to target lower returns for single investment projects in their geography, because they can optimise their geographic asset base and because they know the market, whilst new players who don't know the market, and have only a single project to implement (like Marubeni) will price the risk of entering a new market with no existing assets to leverage higher, and include such risk in their cost of equity'. Finally, you have argued that 'when the Plomin C transaction is analysed as part of HEP's overall business, the downside risks are mitigated by savings made from retiring less efficient plants'. You have not quantified these potential advantages to HEP, but have stated as a point of comparison that HEP's average return on equity for 2010-2014 has been 5.1%.

However, the business plans submitted as part of the draft notification show that HEP expects to make a pre-tax internal rate of return of between minus 3.6% and 12% depending on future coal, carbon and electricity prices. Marubeni Corporation will earn a pre-tax internal rate of return on its equity investment of 12.5% regardless of these future uncertain prices. To support an argument that HEP is acting as a market economy operator, there would need to be strong arguments to justify the lower rate of return to HEP, particularly since HEP faces the risk of marketing the electricity from the plant and there is inevitably high uncertainty about future commodity prices looking 25 years ahead.

Overall, the rate of return scenarios presented in the draft notification suggest that the deal is significantly more attractive for Marubeni Corporation than for HEP. You have suggested that of the rate of return scenarios presented, the (by far most optimistic) 12% rate of return scenario is the most likely. However, this is based on arguments that the International Energy Agency (IEA)'s estimates of future coal and carbon prices are a less reliable benchmark than estimates by HEP which take today's coal and carbon prices and inflate them by 2.4% a year. If the IEA's estimates for coal and carbon prices are used, the project is loss-making for HEP.

The fact that Marubeni benefits from a potentially much higher rate of return than HEP, combined with lower risks, indicates the possible existence of an advantage conferred directly on the SPV through the PPA, and indirectly on Marubeni Corporation.

As concluded in related case-practice[2] the electricity generation market in which HEP and Marubeni Corporation are active is open to competition throughout Europe. Any advantage from State resources to any undertaking in that sector has the potential to affect intra-Union trade and to distort competition.

The Commission services therefore consider that, based on the available information, the Plomin C project is likely to constitute State aid within the meaning of the TFEU.

[2] Cf. for instance case SA.35980 (2014/N-2) – United Kingdom Electricity market reform – Capacity market, recital 114