

## COMMISSION DECISION

of 4 June 2008

on the State aid C 41/05 awarded by Hungary through Power Purchase Agreements

(notified under document C(2008) 2223)

(Only the Hungarian text is authentic)

(Text with EEA relevance)

(2009/609/EC)

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 those comments,

Whereas

## 1. PROCEDURE

- (1) By letter dated 31 March 2004, registered on the same day, the Hungarian authorities notified the Commission of Government Decree 183/2002 (VIII.23) <sup>(2)</sup> under the procedure referred to in Annex IV, paragraph 3, subparagraph 1(c) to the Treaty of Accession of the Czech Republic, Estonia, Cyprus, Latvia, Lithuania, Hungary, Malta, Poland, Slovenia and Slovakia to the European Union (interim procedure). The notified Decree provides for a system of compensation of the costs borne by the State-owned electricity wholesaler (*közüzemi nagykereskedelmi engedélyes*), the company Magyar Villamos Művek Zrt. (hereinafter referred to as MVM). The Commission registered the notification under State aid case number HU 1/04.
- (2) A number of official letters were exchanged between the Hungarian authorities and the Commission concerning the measure <sup>(3)</sup>. The Commission also received comments from third parties <sup>(4)</sup>. In the course of the interim procedure, the Commission discovered that the Hungarian electricity wholesale market was essentially structured around long-term Power Purchase Agreements (hereinafter referred to as PPAs) between MVM and

certain power generators. Based on the information available to it at that time, the Commission suspected that the PPAs contained unlawful State aid elements.

- (3) By letter dated 13 April 2005, registered on 15 April 2005, the Hungarian authorities withdrew the notification of Government Decree 183/2002. On 4 May 2005, in line with 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>(5)</sup>, (hereinafter the 'Procedural Regulation') the Commission registered a State aid file on its own initiative (case number NN 49/05) concerning the PPAs.
- (4) By letter dated 24 May 2005 (D/54013), the Commission requested additional information from the Hungarian authorities. The reply, dated 20 July 2005, was registered by the Commission on 25 July 2005. Further information was provided by the Hungarian authorities by letter dated 28 September 2005, registered on 30 September 2005.
- (5) By letter dated 9 November 2005, the Commission informed Hungary that it had decided to open the procedure laid down in Article 88(2) of the EC Treaty in respect of the PPAs (hereinafter referred to as the 'Opening Decision'). The Opening Decision was published in the *Official Journal of the European Union* <sup>(6)</sup>.
- (6) In the Opening Decision, the Commission expressed its doubts as to the compatibility of the PPAs with the common market and called on interested parties to submit their comments.
- (7) Following a request for an extension of the deadline for comments, accepted by the Commission <sup>(7)</sup>, Hungary submitted its comments on the Opening Decision on 31 January 2006, registered by the Commission on 1 February 2006.

<sup>(1)</sup> OJ C 324, 21.12.2005, p. 12.

<sup>(2)</sup> Government Decree 183/2002 (VIII.23) on the detailed rules for the definition and management of stranded costs.

<sup>(3)</sup> Letters of the Hungarian authorities dated 4 June 2004, registered on the same day and 20 October 2004, registered on 21 October 2004.

<sup>(4)</sup> Letter dated 21 December 2004 from the power generator AES-Tisza Erőmű Kft.

<sup>(5)</sup> OJ L 83, 27.3.1999, p. 1.

<sup>(6)</sup> OJ C 324, 21.12.2005, p. 12.

<sup>(7)</sup> Request of 14 December 2005 accepted by the Commission on 20 December 2005.

- (8) Following a number of requests for an extension of the deadline for comments, accepted by the Commission<sup>(8)</sup>, the comments of third parties were registered by the Commission as follows: comments submitted by MVM on 11 January 2006; by a third party that requested its identity to be withheld on 20 January 2006; by Marta power plant on 20 January and 6 March 2006; by the bank [...] on 10 February 2006; by AES-Tisza power plant on 13 and 14 February 2006; by the bank [...] on 13 February 2006; by Electrabel S.A. and its subsidiary Dunament power plant on 14 February 2006; by Budapest power plant on 21 February 2006; and by Csepel power plant on 21 February 2006.
- (9) Following confirmation by the Hungarian authorities of the confidential treatment of information provided by third parties in the context of this procedure<sup>(9)</sup>, the Commission forwarded the above comments to Hungary by letter of 25 April 2006.
- (10) The Hungarian authorities submitted the first part of their observations on the third parties' comments by letter of 28 June 2006, registered on 29 June 2006, and the second part by letter of 24 July 2006, registered on 25 July 2006.
- (11) Aware of the planned legislative changes in the energy sector in Hungary, Commissioner Kroes sent a letter to Minister Kóka on 17 October 2006 urging the Hungarian Government to settle in the new legislation the question of the PPAs and potential compensatory measures in line with EU law.
- (12) The company AES-Tisza submitted further comments complaining about several aspects of the Commission's procedure on 19 December 2006.
- (13) By letters of 21 November 2006 (registered on 23 November 2006) and 15 January 2007 (registered on the same day) and at meetings on 18 December 2006 and 8 March 2007 with the Commission, the Hungarian authorities confirmed their intention of making legislative amendments in connection with the liberalisation of the energy sector and thereby also changing the existing situation on the wholesale electricity market.
- (14) The Commission sent a request for further information on 23 April 2007. Hungary replied on 5 June 2007 and sent additional information on 6 August 2007.
- (15) By letter dated 4 May 2007 the Hungarian authorities informed the Commission that it was setting up a working committee to conduct negotiations with all the generators concerned regarding the termination or substantial amendment of the PPAs. Accordingly, on 11 May 2007 the government adopted Decision No 2080/2007 (V.11) on the long-term power purchase agreements in the energy sector<sup>(10)</sup>, thereby establishing the aforementioned working committee (governed by the Prime Minister's Office) with a view to resolving without delay the matter of the PPAs in accordance with EU State aid rules and ordering the opening of official negotiations in this regard with the power generators concerned. By letter of 3 July 2007 the Hungarian Government informed the Commission of the outcome of the first negotiations that took place in June 2007.
- (16) In the context of the liberalisation process, the new Act on Electric Energy<sup>(11)</sup> was published on 2 July 2007 and entered into force partially on 15 October 2007 and partially on 1 January 2008. By letter of 25 July 2007, the Hungarian Government informed the Commission of the achievements of the new Electricity Act as regards the opening up of the Hungarian electricity market. However, the new Act did not alter the PPAs themselves, which remained in force, unchanged, between MVM and the power generators listed in the Opening Decision.
- (17) By letter dated 26 July 2007, the Commission put further questions to the Hungarian authorities.
- (18) On 7 September 2007, the Commission registered a letter from the Hungarian Government requesting more time to bring the negotiations with the generators to a successful conclusion.
- (19) On 24 September and 31 October 2007 the Commission registered Hungary's replies to its questions of 26 July 2007.
- (20) On 14 December 2007, pursuant to Article 5(2) of Regulation (EC) No 659/1999, the Commission sent a reminder to the Hungarian authorities listing the questions for which the information provided was still incomplete. The Hungarian authorities replied by letter dated 16 January 2008.
- (21) As the companies Dunament and AES-Tisza did not provide the requested data, the Hungarian authorities argued they were not able to furnish a complete answer to the Commission's questions.

<sup>(8)</sup> Requests registered on 9 January 2006 (Budapesti Erőmű), 16 January 2006 (AES-Tisza, [...])<sup>(\*)</sup>, 17 January 2006 (Electrabel), 19 January 2006 [...] and 20 January 2006 (Csepeli Erőmű), accepted by the Commission in letters dated 13, 18, 20, 24 January and 27 February 2006.

<sup>(\*)</sup> Data covered by the obligation of professional secrecy is indicated in the text of the Decision by a [...] sign.

<sup>(9)</sup> Letter registered on 3 April 2006.

<sup>(10)</sup> 2080/2007 (V.11) Korm. Határozat a villamos energia iparban kötött hosszú távú szerződések rendezéséről.

<sup>(11)</sup> Act LXXXVI of 2007.

- (22) Accordingly, on 15 February 2008, the Commission adopted an information injunction enjoining Hungary to supply the data listed in the decision within a period of fifteen days.
- (23) On 27 February, Dunament power plant sent to the Commission a copy of its reply to the Hungarian authorities' questions and explained the reasons why it could not answer the questions put to it. The Hungarian authorities replied on 4 and 13 March 2008. In response to Dunament power plant's explicit request, the Hungarian authorities attached to their reply letters sent by Dunament to the Ministry of Finance and to the Hungarian Energy Office dated 14 May 2007, 21 August 2007, 13 September 2007, 7 December 2007, 14 January 2008 and 20 February 2008. The Hungarian authorities had not forwarded a copy of these letters to the Commission at an earlier stage<sup>(12)</sup>; however, in their replies to the Commission's questions throughout the procedure they had included the information they found relevant.
- (24) It appears from the Hungarian authorities' replies that AES-Tisza did not give Hungary any reply. By fax dated 10 March 2008, AES-Tisza sent a letter to Commissioner Kroes expressing its view that the Hungarian authorities were already in possession of all the data that had been requested by the Commission.
- (25) In their answer dated 13 March 2008, on the basis of the information available to them the Hungarian authorities provided the Commission with the relevant data for questions (1)(a) to (d) of Chapter III of the information injunction. However, they did not give any additional data relating to the question asked under point (1)(e) of Chapter III of the information injunction concerning the investments of the two abovementioned power generators.
- (26) A substantial part of the information exchanged since the registration of case HU 1/04 concerned the interpretation and concrete application of the Commission Communication relating to the methodology for analysing State aid linked to stranded costs (the Stranded Costs Methodology)<sup>(13)</sup>. On the basis of the documents submitted in the present procedure, it seemed that the Hungarian authorities planned to introduce a system of stranded cost compensations, the assessment of which could have been included in this Decision. Consequently, substantial discussions took place throughout the present procedure between the Commission and the Hungarian authorities on the details of a compensation system which Hungary could adopt in order for such a system to meet the criteria of the Methodology.
- (27) Notwithstanding the technical discussions about a potential future compensation mechanism, the Hungarian authorities, until the date of this Decision, have not submitted to the Commission a comprehensive compensation mechanism officially confirmed by the Hungarian Government. In their letter of 13 March 2008, the Hungarian authorities explicitly confirmed that, at present, they did not wish to grant stranded costs compensation; however, they reserved their right to grant such compensation to certain power generators at a later stage.
- (28) The Commission asked for the confirmation of certain data by the Hungarian Government in a letter dated 7 April 2008. The Hungarian authorities provided the requested information by letter registered on 22 April 2008.
- (29) In their letter of 20 May 2008, the Hungarian authorities informed the Commission that the PPA of the Paks power plant had been terminated by the parties on 31 March 2008. Although the Csepel and Pannon power plants signed termination agreements in April 2008, the entry into force of the agreements is, at the date of this Decision, still dependent on approval by shareholders and banking institutions.

#### ***Other connected procedures pending***

- (30) The Opening Decision was challenged by Budapest power plant before the Court of First Instance by way of an application lodged on 3 March 2006 and registered as case T-80/06. On 6 June 2006, Csepel power plant requested leave to intervene in the procedure in support of Budapest power plant and this was granted by an order of the Court dated 11 March 2008.
- (31) Furthermore, two international arbitration procedures are pending before the International Centre for the Settlement of Investment Disputes in Washington, D.C, launched against the Republic of Hungary by the electricity generation companies [...] and [...], both shareholders of power plants under PPA in Hungary. The proceedings are based on the investment protection provisions contained in the Energy Charter Treaty.

## **2. DESCRIPTION OF THE MEASURE**

### **Historical background to the PPAs**

- (32) From 31 December 1991 to 31 December 2002 the Hungarian electricity market was structured around a 'Single Buyer', the company Magyar Villamos Művek (MVM). MVM is a 99,9 % State-owned entity whose activities comprise power generation, wholesale, transmission and retail. Under the 'Single Buyer' model, the

<sup>(12)</sup> With the exception of the letters of 7 December 2007 and 14 January 2008.

<sup>(13)</sup> Adopted by the Commission on 26 July 2001. The Methodology is available on the Commission's website: [http://ec.europa.eu/comm/competition/state\\_aid/legislation/specific\\_rules.html](http://ec.europa.eu/comm/competition/state_aid/legislation/specific_rules.html)

power generators could supply energy directly to MVM only (unless MVM cancelled the regional distribution companies' contracts) and MVM was the only company authorised to supply electricity to the regional distribution companies. Under Act XLVIII of 1994 on Electric Energy (Energy Act I), MVM was required to ensure security of energy supply in Hungary at the lowest possible cost.

- (33) Act CX of 2001 on Electric Energy ('Energy Act II', replacing Energy Act I) entered into force on 1 January 2003. It established a dual model of the Hungarian electricity market which remained in force until 1 January 2008, when Act LXXXVI of 2007 on Electric Energy ('Energy Act III', replacing Energy Act II) entered into force. Under this dual model there was a public utility segment and a competitive segment, and eligible customers (the scope of which gradually enlarged) were allowed to switch to the competitive segment. On the public utility segment, MVM remained the only wholesaler, whereas in the free market segment other traders appeared. Energy Act III put an end to the existence of the public utility segment but nevertheless kept household customers and some commercial customers – as permitted by the second Electricity Directive<sup>(14)</sup> – under a universal service obligation.
- (34) Energy Act I required MVM to assess the country's total energy demand and to prepare, every two years, a National Power Plant Construction Plan (*Országos Erőműépítési Terv*). This Plan had then to be submitted to and accepted by the Hungarian Government and the Parliament.
- (35) It appears from Energy Act I and from the submissions of the Hungarian government<sup>(15)</sup> that the most urgent objectives on the Hungarian energy market in the mid-1990s were security of supply at the lowest possible cost, modernisation of the infrastructure with particular regard to the prevailing standards of environmental protection, and the necessary restructuring of the power sector. With a view to achieving these general objectives, long-term power purchase agreements were proposed to foreign investors that would undertake to invest in the construction and modernisation of power plants in Hungary. The PPAs were signed by the power generators on the one hand and by the company MVM on the other hand.

### The PPAs

- (36) The PPAs entered into between MVM and individual power plants<sup>(16)</sup> established a balanced production portfolio enabling MVM to meet its obligation of ensuring security of supply. They allow MVM to satisfy both base load demand (with lignite-fired and nuclear power stations) and peak load demand (with gas-fired power plants).
- (37) The PPAs require the power generators to duly maintain and operate their generation facilities. They reserve all or the bulk of the power plants' generation capacities (MW) for MVM. This capacity allocation is independent of the actual use of the power plant. Beyond the reserved capacities, the PPA requires MVM to purchase a specific minimum quantity of electricity (MWh) from each power plant.
- (38) Some PPAs include so-called 'system services'<sup>(17)</sup> in the case of power plants technically capable of providing them, which MVM provides to the system operator, MAVIR.
- (39) The PPAs signed in 1995-1996 (seven of the ten PPAs under assessment) were awarded in view of the privatisation of the power plants. These PPAs followed a model agreement drafted by an international law firm at the Hungarian Government's request. There was no tendering procedure for the signature of these PPAs. There was, however, a tendering procedure for the privatisation of the power plants. The PPAs (signed before privatisation) formed part of the privatisation package. Some of these agreements (mainly the Mátra, Tisza and Dunament agreements) were partially amended by the parties after privatisation.
- (40) The PPA of Csepel power plant was signed in 1997 and followed a somewhat different model. However, there was no tendering procedure in this case either and the signature of the PPA was similarly linked to the power plant's privatisation.
- (41) The PPA of Ujpest power plant (one of the three plants of Budapest power plant) was signed with Budapest power plant in 1997, likewise without a specific tendering procedure.
- (42) Only the PPA of the Kispest plant (another – aging – plant of Budapest power plant which was essentially rebuilt at the time) was signed in 2001 as a result of an open tendering procedure.

<sup>(14)</sup> 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 (OJ L 176, 15.7.2003, p. 37).

<sup>(15)</sup> Submissions of 20 July 2005, registered on 25 July 2005.

<sup>(16)</sup> In some cases there were separate PPAs for the power plants' different production blocks, such as for Mátra and Dunament.

<sup>(17)</sup> Such as balancing power, tertiary reserves, black start capability, etc.

- (43) From 2000 to 2004, the capacities reserved by the PPAs covered approximately 80 % of total Hungarian electricity demand (MW). From 2005 to the date of this Decision, the share has been around 60-70 %. It was expected that this would gradually decrease in the period between 2011 and 2024 <sup>(18)</sup>.
- (44) Of the nearly twenty PPAs signed between 1995 and 2001, ten were still in force at the date of Hungary's accession to the EU (1 May 2004).
- (45) This Decision concerns only those PPAs that were in force on 1 May 2004. It does not cover PPAs that ended before that date. Although some PPAs (see

recital 28 above) were ended by the parties in April 2008, this Decision covers these and assesses their State aid nature and compatibility with the common market in the period between 1 May 2004 and their end date (April 2008).

**The power plants under PPA and the duration of the PPAs**

- (46) The power plants under PPA covered by this Decision are listed in the table below. The duration shown refers to the initially scheduled end date of the PPAs as established in the PPAs themselves.

Table 1

**Overview of the generation companies under PPA, the main shareholders and the duration of the PPAs**

Name of generation company	Majority shareholder group	Power plant under PPA	Duration of PPA
Budapesti Erőmű Rt.	EDF	Kelenföldi Erőmű	1996-2011
		Újpesti Erőmű	1997-2021
		Kispesti Erőmű	2001-2024
Dunamenti Erőmű Rt.	Electrabel	Dunament F blocks	1995-2010 (signed in 1995, entered into force in 1996)
		Dunament G2 block	1995-2015 (signed in 1995, entered into force in 1996)
Mátrai Erőmű Rt.	RWE	Mátrai Erőmű	1995-2022 (initial duration until 2015, extended to 2022 in 2005)
AES-Tisza Erőmű Kft.	AES	Tisza II Erőmű	1995-2016 (signed in 1995, entered into force in 1996) ([...])
Csepeli Áramtermelő Kft.	ATEL	Csepel II Erőmű	1997-2020 (signed in 1997, entered into force in 2000)
Paksi Atomerőmű Rt.	MVM	Paksi Atomerőmű	1995-2017 (*) (signed in 1995, entered into force in 1996)
Pannonpower Holding Rt.	Dalkia	Pécsi Erőmű	1995-2010 (signed in 1995, entered into force in 1996)

(\*) Terminated by common agreement in March 2008.

<sup>(18)</sup> These rates are based on the calculation of generation capacity reservations (MW) and not on the volume of electricity sale (MWh). They were submitted to the Commission by the Hungarian authorities by letter of 4 June 2004. The same figures appear in the report on the study of the Hungarian electricity market carried out by the Hungarian Competition Authority (15 May 2006).

**Prices**

- (47) In Government Decree 1074/1995 (VIII.4) on electricity price regulation, the government made a commitment that, as of 1 January 1997 (the beginning of the so-called first price regulation cycle), 'in addition to covering the justified operating costs, wholesale and retail prices shall ensure 8 % return on equity'. The government thereby guaranteed an 8 % rate of return on capital to the power plants under PPA.
- (48) As of 1 January 2001 (the beginning of the second price regulation cycle), the official prices included 9,8 % profit on assets (*eszközarányos megtérülés*) for the power plants. The increase in percentage did not necessarily mean a change in actual amounts, as the bases of the two rates of return were different (the first one was calculated on equity while the second one was calculated on assets). The prices reflected changes in inflation.
- (49) The regulated prices remained in place for the power plants until 31 December 2003.
- (50) During this period of price regulation, the Hungarian Energy Office analysed the cost structure of each power plant and fixed the price for the purchase of electricity by MVM at a value that ensured guaranteed profitability.
- (51) The list of costs covered by this price-setting mechanism included the following main cost items<sup>(19)</sup>:
- fixed costs: depreciation, insurance, certain fixed maintenance and operating costs, loan interest [*'hitelkamatok'*], decommissioning [*'rekultivációs költségek'*], fiscal costs (taxes), personnel expenditure [*'személyi jellegű költségek'*], environmental protection costs, expenditures to the Central Nuclear Fund [*'Központi Nukleáris Alap befizetések'*] for the nuclear power plant and extraordinary expenses [*'rendkívüli ráfordítások'*];
  - variable costs: fuel costs.
- (52) The Hungarian Energy Office had the task of ensuring that the costs covered were reasonable and necessary.
- (53) The official price overwrote the price established by the PPAs.
- (54) As of 1 January 2004, the prices were determined on the basis of the PPAs' price formulae. The exact meaning of the formulae was clarified in the context of the yearly price negotiations between MVM and the power generators.
- (55) The price formulae applied in the PPAs are extremely complex; however, they follow the same principles as the methodology applied by the Hungarian Energy Office before January 2004. According to the submissions of the Hungarian authorities<sup>(20)</sup>, the annex to the PPAs concerning price definition was drawn up using the formulae and definitions of the above-mentioned Government Decree 1074/1995 on electricity price regulation. (According to the submission, 'the agreements copied in the formulae and definitions contained in the decree'.) Consequently, the price-fixing principles of the PPAs are based, similarly to the mechanism used for setting regulated prices, on the justified cost categories.
- (56) Each PPA contains two main types of fee components: the *capacity fee* (or *fee for making capacity available*) for the reserved capacities (MW) covering fixed costs + profit (cost of capital), and the electricity fee covering variable costs. The different PPAs provide for different additional charges. Depending on the PPAs, these additional fees can be bonus/malus fees applied as an incentive for the power generators to operate in accordance with the lowest cost principle, and supplementary fees for maintaining generating reserves, rescheduling maintenance at MVM's request, increasing load in peak periods and minimising load below that contracted during the minimum demand period, etc. The periodical (annual, quarterly, monthly) changes of capacity fees depend on a number of factors: activation of implemented retrofit projects, various interest categories, foreign exchange rates, inflation indices, etc. The capacity fee and the supplementary fees also cover the system services (covered by the PPA). Essentially, electricity fees are related to fuel costs and specific fuel heat utilisations (*fajlagos tüzelőhő felhasználása*). They are calculated on the basis of the principle of *pass-through* of the variable costs.
- (57) It must be noted that the definition of the covered cost categories was not necessarily identical in the price regulation before 1 January 2004 and in the PPAs. Hungary's submissions<sup>(21)</sup> show that, for example, the capacity fee of [...] and Dunament power plants were higher in their PPA than under price regulation. This was because these PPAs took retrofitting into account, thereby leading to higher fixed costs. These higher fixed costs appeared gradually (following the gradual retrofitting) in higher capacity fees under the PPAs than under price regulation. Other differences due to bilateral negotiations between MVM and the generators could also be observed between regulated prices and PPA prices.

<sup>(19)</sup> List based on information provided by the Hungarian authorities on 20 October 2004 and on the guidelines of the Hungarian Energy Office for the implementation of a cost review with a view to the price setting of January 2001 (*A Magyar Energia Hivatal irányelve a 2001. januári ármegállapítás előkészítését célzó költség-felülvizsgálat végzéséhez*).

<sup>(20)</sup> Letter dated 20 July 2005, registered on 25 July 2005.

<sup>(21)</sup> Letter of 28 June 2006, registered on 29 June 2006.

- (58) Notwithstanding such differences, in Hungary's submissions of 20 October 2004 and 20 July 2005 each power plant under PPA confirmed that the price calculation method as well as the cost categories applied after the end of price regulation were largely similar to those applied by the Hungarian Energy Office before that date.
- (59) The prices under the PPAs applied after 1 January 2004 thus remained based on the calculation of justified (fixed and variable) costs + profit.
- (60) It follows from the above that although price regulation ended on 31 December 2003, prices were not genuinely liberalised as the wholesale pricing of electricity remained driven by the principle of return on investments enshrined in the PPAs <sup>(22)</sup>.
- (61) On 6 February 2006, the Hungarian Parliament adopted Act XXXV of 2006 <sup>(23)</sup> which reinstated governmental price regulation for the electricity sold to MVM under the PPAs. The first new price decree entered into force on 9 December 2006. As of that date, the price regulation of the PPAs was again overwritten by the governmental price formula for a period of approximately one year (until 31 December 2007).
- (62) As of 1 January 2008, in the context of the liberalisation of the market, Energy Act III put an end to the regulated generation prices as well as to the existence of the dual public utility and free market segments.
- (63) Consequently, as of 1 January 2008 the price of the electricity sold by the power generators to MVM under the PPAs is again defined by the price formulae of the PPAs. The underlying principles of these formulae have not been altered since their last application: they thus follow the same principles as in the period between 1 January 2004 and 8 December 2006 (see recitals 54 to 59 above).
- (64) Accordingly, pricing under PPA remains driven by the principle of return on investment.

#### **Reserved capacities**

- (65) The PPAs reserve for MVM all or a substantial part of the capacities of the generating units under PPA.

Table 2

#### **Hungary's domestic generation capacity <sup>(24)</sup>**

Capacity	2004	2005	2006	2007
Installed total generation capacity <sup>(1)</sup>	8 777	8 595	8 691	8 986
Gross available capacity <sup>(2)</sup>	8 117	8 189	8 097	8 391
Net available capacity <sup>(3)</sup>	7 252	7 792	7 186	7 945
Peak load of the Hungarian electricity system	6 356	6 409	6 432	6 605

(MW)

<sup>(1)</sup> Installed total generation capacity (*Beépített teljesítőképesség*): the nominal generation capacity in MW of the machinery in the Hungarian power plants. Can change only with expansion or removal.

<sup>(2)</sup> Gross available capacity (*Rendelkezésre álló állandó teljesítőképesség*): the power plant's actual available capacity taking into account permanent permissible overload and permanent shortfalls. Installed capacity after deductions for reasons of a permanent nature and after addition of permissible overloads.

<sup>(3)</sup> Net available capacity (*Igénybe vehető teljesítőképesség*): the capacities actually available after deduction of planned maintenance works.

<sup>(22)</sup> See also the report on the study of the Hungarian electricity sector carried out by the Hungarian Competition Authority (15 May 2006).

<sup>(23)</sup> A villamos energia árszabályozását érintő egyes törvények módosításáról szóló 2006. évi XXXV. törvény (Act XXXV of 2006 on amendments concerning the price regulation of electricity).

<sup>(24)</sup> The figures of the table are based on the statistics published in the Statistical Yearbook for Electricity (*Villamosenergia Statisztikai Évkönyv*). See also the letter of the Hungarian authorities submitted on 21 April 2008.

Table 3

Generation capacity of the power plants under PPA <sup>(25)</sup>

Power plant	Capacity	(MW)			
		2004	2005	2006	2007
Kelenföld	Net available capacity	90,1	97,6	97,2	78,0
	Contracted capacity <sup>(1)</sup>	83,3	89,8	89,4	71,9
Ujpest	Net available capacity	106,3	106,1	106,2	106,0
	Contracted capacity	99	98,8	98,9	98,7
Kispest	Net available capacity	46,1	110,2	110,2	109,6
	Contracted capacity	43	102,6	102,6	102,3
Dunament F	Net available capacity	1 020	1 020	1 020	1 020
	Contracted capacity	928,2	923,1	923,1	923,1
Dunament G2	Net available capacity	187,6	223,1	223,1	223,7
	Contracted capacity	178,4	212,4	212,4	213
AES-Tisza	Net available capacity	638,0	824,7	824,7	824,7
	Contracted capacity	[...] <sup>(e)</sup>	[...] <sup>(f)</sup>	[...] <sup>(f)</sup>	[...] <sup>(f)</sup>
Csepel	Net available capacity	348,9	331	355	349,5
	Contracted capacity	323	307	329	324
Pannon	Net available capacity	25,9	25,9	25,9	25,9
	Contracted capacity	20,1	20,1	20,1	20,1
Mátra	Net available capacity	593	552	552	552
	Contracted capacity	496	460	460	460
Paks	Net available capacity	1 597	1 596	1 596	1 596
	Contracted capacity	1 486	1 486	1 485	1 485
Total net available capacity of the power plants under PPA		4 652,0	4 886,6	4 910,3	4 885,4
Total contracted capacity		[...] <sup>(e)</sup>	[...] <sup>(d)</sup>	[...] <sup>(e)</sup>	[...] <sup>(f)</sup>

<sup>(1)</sup> Average available capacity contracted (*Rendelkezésre álló átlag teljesítőképesség szerződött értéke*).

<sup>(a)</sup> Between 400 and 700 MW (footnotes indicated by small letters do not appear in the authentic version of the Decision but have been included in the public version to indicate a range of magnitude of certain data covered by the obligation of professional secrecy).

<sup>(b)</sup> Between 600 and 900 MW.

<sup>(c)</sup> Between 4 057 and 4 357 MW.

<sup>(d)</sup> Between 4 725,9 and 5 025,9 MW.

<sup>(e)</sup> Between 4 749,6 and 5 049,6 MW.

<sup>(f)</sup> Between 4 724,7 and 5 024,7 MW.

(66) The above figures show that in the period under assessment, around 60 % of Hungarian net available generation capacity is contracted by MVM under PPAs. If the actually available capacities of the power plants (*Ténylegesen igénybevehető teljesítőképesség*) minus their own consumption (*Önfogyasztás*) are taken into account, the ratio is higher than the above.

(67) The above tables also show that the capacity reserved under the PPAs for MVM cover all or the bulk of the respective plants' available capacities.

<sup>(25)</sup> The figures of the table are based on the PPAs as submitted to the Commission by the Hungarian authorities. See also the letter of the Hungarian authorities registered on 21 April 2008.



- (68) MVM pays a capacity fee for these capacity reservations (recital 56 above), irrespective of the actual use of the plant.
- (69) Import capacity in Hungary is around 1 000-1 300 MW. Around 600 MW of this import capacity is reserved for MVM under other long-term agreements.

#### **Sold quantities**

- (70) When MVM actually makes use of its reserved capacity and buys electricity from the power plant, it then pays the energy fee for the off-taken electricity (see recital 56 above).
- (71) There is a certain minimum off-take guaranteed by the PPAs for each power plant.
- (72) The overall domestic electricity production in Hungary is between 32 and 36 TWh (= 32 – 36 000 000 GWh) a year.

Table 4

#### **Electricity produced under PPAs <sup>(26)</sup>**

Power plant	Produced electricity	(GWh)			
		2004	2005	2006	2007
Budapest (including Kelenföld, Újpest and Kispest)	Total generated electricity	1 228	1 510	1 643	1 742
	Own consumption	87	89	91	84
	Minimum guaranteed off-take	Kelenföld: [...] Újpest: [...] Kispest: [...]	Kelenföld: [...] Újpest: [...] Kispest: [...]	Kelenföld: [...] Újpest: [...] Kispest: [...]	Kelenföld: [...] Újpest: [...] Kispest: [...]
	Actual off-take	939	1 302	1 451	1 538
Dunament (*) (F + G2)	Total generated electricity	4 622	3 842	3 450	4 300
	Own consumption	174	148	147	188
	Minimum guaranteed off-take	F: [...] G2: [...]	F: [...] G2: [...]	F: [...] G2: [...]	F: [...] G2: [...]
	Actual off-take	4 232	2 888	2 495	3 296
AES-Tisza	Total generated electricity	1 621	1 504	1 913	2 100
	Own consumption	96	97	117	116
	Minimum guaranteed off-take	[...]	[...]	[...]	[...]
	Actual off-take	1 525	1 407	1 796	1 984
Csepel	Total generated electricity	1 711	1 764	1 710	2 220
	Own consumption	48	49	48	53
	Minimum guaranteed off-take	[...]	[...]	[...]	[...]
	Actual off-take	1 662	1 715	1 661	2 166
Pannon (*)	Total generated electricity	673	266	237	232
	Own consumption	116	52	34	29
	Minimum guaranteed off-take	[...]	[...]	[...]	[...]
	Actual off-take	361	206	203	203

<sup>(26)</sup> The figures of the table are based on the PPAs as submitted by the Hungarian authorities, the statistics published by the Hungarian Energy Office on its website: [www.eh.gov.hu](http://www.eh.gov.hu), and the letter of the Hungarian authorities dated 21 April 2008. The quantities of guaranteed off-take stipulated in the yearly commercial agreements may differ somewhat from the quantities provided for in the PPAs themselves. The actual off-take figures cover all the sales of the power plant concerned to MVM.

Power plant	Produced electricity	(GWh)			
		2004	2005	2006	2007
Mátra (*)	Total generated electricity	5 688	5 698	5 621	6 170
	Own consumption	675	670	667	710
	Minimum guaranteed off-take	[...]	[...]	[...]	[...]
	Actual off-take	3 730	3 762	3 587	4 082
Paks	Total generated electricity	11 915	13 833	13 460	14 677
	Own consumption of the plant	750	821	800	848
	Minimum guaranteed off-take	[...]	[...]	[...]	[...]
	Actual off-take	11 112	13 012	12 661	13 828

(\*) The total generated electricity and own consumption data also cover the blocks of these plants which are not under PPA.

(73) The minimum guaranteed off-take is the quantity MVM is required to purchase irrespective of market demand. Should MVM not purchase the fixed minimum quantities, it still has to pay for the fuel costs incurred (Dunament, Kelenfold, Pécs and [...]), all costs or compensation incurred by the generator on the basis of its Fuel Supply Agreement (Csepel), and all justified costs (Kispest and Ujpest).

### 3. GROUNDS FOR INITIATING THE PROCEDURE

#### 3.1. The PPAs

(74) In its Opening Decision, the Commission reached the preliminary conclusion that the PPAs constituted State aid within the meaning of Article 87(1) of the EC Treaty to the power generators parties to a PPA with MVM.

(75) It expressed the view that PPAs were applicable after accession within the meaning of Annex IV, paragraph 3, subparagraph 1(c) to the Accession Act<sup>(27)</sup> and that they did not constitute existing aid, since they do not come under the aid categories that were regarded, as of accession, as existing aid within the meaning of Article 88(1) of the EC Treaty.

(76) Firstly, none of the PPAs entered into force before 10 December 1994. Secondly, none of the PPAs had been included on the existing aid list annexed to Annex IV to the Accession Act. Thirdly, the Commission had not been given notice of the PPAs under the so-called 'interim procedure'.

<sup>(27)</sup> 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 adjustments to the Treaties on which the European Union is founded; OJ L 236, 23.9.2003.

#### *Existence of State aid*

(77) The Commission expressed the view that the guaranteed return on investment and the high purchase price secured by the PPAs put power generators operating under a PPA in a more advantageous economic situation than other power generators not parties to a PPA, including possible new entrants on the market and companies in other, comparable sectors in which such long-term agreements have not even been offered to market players. The measure was therefore found, on a preliminary basis, to confer a selective advantage on those power generators.

(78) 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>(28)</sup>. Measures favouring particular 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 from that Member State to other Member States.

(79) The Commission also expressed the view that this advantage stemmed from the use of state resources, because the decision to sign the PPAs was a consequence of state policy implemented via the State-owned public utility wholesaler MVM. 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 is imputable to the State, these funds should be regarded as State resources within the meaning of Article 87(1) of the EC Treaty<sup>(29)</sup>.

<sup>(28)</sup> OJ L 27, 30.1.1997, p. 20.

<sup>(29)</sup> Case C-482/99 *French Republic v Commission* [2002] ECR I-04397. Decision of 16 May 2002.

(80) The Commission therefore came to the preliminary conclusion that the PPAs constituted State aid to the power generators within the meaning of Article 87(1) of the EC Treaty, such aid being 'still applicable after' within the meaning of Annex IV, paragraph 3, subparagraph 1(c) to the Accession Act.

#### ***Compatibility of the PPAs with the EC Treaty***

(81) 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 of the Opening Decision, the Commission had doubts as to the PPAs' compatibility with the criteria set out in the Methodology.

(82) Firstly, the Commission had doubts that the very principles governing a PPA which create a barrier to free competition on the market could be deemed compatible with the fundamental objective of the Methodology, i.e. to assist by means of State aid the liberalisation of the sector by granting adequate compensation to incumbents facing new conditions of competition.

(83) Secondly, the Commission doubted that the State aid element included in the PPAs was compatible with the detailed criteria of the Methodology as regards the calculation of eligible stranded costs and the determination of adequate compensation.

#### **3.2. Government Decree No 183/2002 (VIII.23) on stranded costs**

(84) In order to enable MVM to honour its PPAs and, at the same time, keep the resale prices on the public utility segment approximately at the level of the free market price, Government Decree 183/2002 (VIII.23) provided for the payment of State compensation to MVM in certain circumstances.

(85) In their initial notification of case HU 1/04 (withdrawn on 13 April 2005), the Hungarian authorities considered that this compensation constituted State aid to MVM.

(86) In its Opening Decision, however, the Commission concluded that the compensation payments did not constitute State aid to MVM, but that the amount received under Government Decree 183/2002 (VIII.23) formed part of the purchase price paid by MVM to the power stations under PPA and thus constituted part of the advantage the generators received from the PPAs.

(87) Consequently, the Opening Decision opens the formal investigation procedure on the PPAs only and not on Government Decree 183/2002 (VIII.23).

#### **4. COMMENTS BY HUNGARY ON THE OPENING DECISION**

(88) Hungary expresses its view that individual assessment of the PPAs would seem to be justified given the differences in their exact terms and conditions.

(89) With regard to the opening of the Hungarian electricity market, Hungary takes the view that it was successful (i.e. in line with the European average) in terms of the number of consumers switching to the free market. Hungary concludes that the PPAs did not create a barrier for consumers to switch to the free market. Such a barrier would be much more likely to be constituted by Hungary's limited cross-border capacities and the consequently high prices.

(90) Hungary furthermore considers that the long-term nature of the PPAs cannot in itself constitute a competitive advantage to generators as such long-term contracts are widespread in the electricity sector both in Europe and on other continents.

(91) With regard to the reference price referred to in the Opening Decision, the Hungarian authorities suggest that the Commission should take into account the regional specificities of Hungary and the recent increase in fuel prices when establishing a reference price.

(92) With regard to new entrants on the electricity market, Hungary informs the Commission that there have been none since 1 May 2004 (the date Hungary joined the EU and the date the energy market was liberalised). The Hungarian authorities point to the time-consuming nature of any such investment and, as a result, to the unlikelihood of any investment being operational before 2011.

(93) Finally, in response to the Commission's doubts as to the compatibility of the PPAs with point 4.6 of the Methodology, Hungary confirms that it will grant no State aid for the rescue and restructuring of the companies benefiting from the PPAs under assessment.

#### **5. COMMENTS FROM INTERESTED PARTIES**

(94) Following the publication of the decision to initiate the procedure (21 December 2005), and within the relevant deadline (in most cases following a deadline extension requested by the interested parties and accepted by the Commission), the Commission received comments from:

— the following electricity generating companies: AES-Tisza Erőmű Rt., Budapesti Erőmű Zrt., Csepeli Áramtermelő Rt., Dunamenti Erőmű Zrt. and its main shareholder, Electrabel S.A., and Mátrai Erőmű Rt.,

- the following banks that provided financing to the electricity generators: [...] Bank, acting as Facilities Agent on behalf of twelve banks, lenders to Csepeli Áramtermelő Kft. and [...] Bank acting as Facilities Agent on behalf of nine banking institutions, lenders to AES-Tisza Erőmű Kft. and
- MVM and,
- a third party that requested its identity to be withheld.

(95) Most of the comments submitted to the Commission by the parties follow very similar lines of argument. For that reason, instead of describing the comments of each interested party separately, the Commission has grouped them into general categories (see points 5.1 to 5.7 below).

#### 5.1. Comments on the individual assessment of the PPAs

(96) The Mátra power plant and another interested party that requested its identity to be withheld expressed the view that the PPAs should be assessed individually by the Commission given the differences that exist between their exact content. Other power generators implicitly requested individual assessment of their PPA by giving the Commission details of the specific terms and conditions of their own PPA.

#### 5.2. Comments on the existence of State aid

##### *The relevant time of assessment*

(97) AES-Tisza Erőmű, Budapesti Erőmű, Csepeli Áramtermelő and Dunamenti Erőmű argue that the criteria for the existence of State aid at the time of the conclusion of the PPAs should be assessed in the context of the market conditions that prevailed at that time. Some of the comments state this requirement explicitly, while others imply it by referring to the circumstances of the conclusion of the PPAs in their assessment of the existence of State aid. Reference is made to the Court's case law in this regard<sup>(30)</sup>.

##### *No economic advantage*

###### *(i) Wrong reference price/No advantageous prices*

(98) All the power generators argue that the PPAs do not confer any economic advantage.

(99) They criticise the Commission's preliminary finding that the prices established under the PPAs are higher than generators' market prices.

(100) They argue that the reference price of EUR 36/MWh used in other decisions and referred to in the Opening Decision is inappropriate in this procedure as it originates from a completely different geographical and temporal context. They argue that the price assessment should take into account the circumstances that prevailed at the time of conclusion of the PPAs. They also stress that prices under any long-term agreement will always be lower than spot market prices. Moreover, generators that provide MVM with mainly peak load electricity also argue that their prices cannot be compared to base load prices. Most of them suggest that the Commission should take into account the substantial increase in fuel prices in recent years.

(101) Many of the generators argue that their actual rate of return was below the rates mentioned in the Opening Decision.

(102) The generators also emphasize that they do bear important risks (contrary to what is suggested in the Opening Decision), in particular construction, regulatory, environmental, maintenance and fiscal/financial risks. Price regulation was mentioned as one of the principal categories of regulatory risks. Generators also consider that the reservation of a significant share of their generation capacities by MVM constitutes a disadvantage, as it prevents them from using these capacities to produce energy for other potential customers. Moreover, the PPAs provide for clear obligations on the generators which, if the generators do not meet them, lead to lower payments or to damage claims.

(103) [...] maintained that one of the advantages gained by Hungary as a result of the PPAs were the reliable balancing services which could only be offered by itself and Dunamenti Erőmű. This generator argued that it would not have entered the market and offered these services without a PPA.

(104) The Mátra power plant argues that it has cheap mining costs because it has its own coal mine, enabling it to offer very competitive prices. It argues that its prices are even below MVM's resale prices, contrary to other PPA prices.

###### *(ii) Privatisation price*

(105) The Dunament power plant argues that it obtained no advantage from the PPA as it paid the market value for the privatisation of the power plants and the purchase price took into account its rights and obligations under the PPA. Consequently, it paid for the PPA (and for any advantage it might confer on it) in the privatisation price.

<sup>(30)</sup> Reference is made to Case T-366/00, Scott S.A.

(iii) *Market investor principle*

(106) The Budapest, AES-Tisza, Mátra and Csepel power plants argue that the PPAs reflect market conditions at the time of their conclusion, both for MVM and for the generators. With regard to MVM, they argue that any private operator in MVM's position (legal obligation of security of supply as single buyer, etc.) would have chosen to enter into the PPAs. With regard to the generators themselves, they argue that their 'advantage' from the PPAs does not go beyond what should be considered as normal commercial advantage for any party in any commercial agreement. At the time of their conclusion, in the sector concerned, the PPAs reflected normal market conditions. Furthermore, PPAs represent normal commercial business methods and a standard form of risk allocation and management.

(107) The PPAs were the only way to secure investments which met the requirements of the electricity sector in Hungary (in particular, modernisation of the whole system, environmental protection and security of supply). Applying the private investor principle should lead to take account of those requirements, and the only way of meeting the requirements was PPAs. The interested parties note that PPAs impose investment and availability obligations on power generators.

(iv) *Service of general economic interest*

(108) The Budapest and Csepel power plants argue that generators party to PPAs provide services of general economic interest (SGEI). In their view, the PPAs serve as a tool for MVM to meet its obligation of security of supply and therefore fulfil a public service obligation. Budapest power plant argues that it can also be considered that it is actually the Budapest power plant itself that has to discharge a public service obligation imposed on it by its PPAs. Both interested parties refer to the Commission's decision of 16 December 2003 in State aid case N 475/03 (Ireland)<sup>(31)</sup> whereby the Commission accepted that the construction of new generation capacity to ensure security of supply could be considered a service of general economic interest.

(109) The interested parties are of the opinion that, as in to the Irish case, State aid under the PPAs – if it exists – meets the four cumulative criteria laid down by the Court in its

judgment in case C-280/00 (the Altmark judgment)<sup>(32)</sup>. They argue as follows.

(110) Firstly, it followed from the Hungarian Energy Acts that MVM had several public service obligations, such as security of supply at the lowest possible cost, environmental protection and efficiency. MVM's public service obligations are thus clearly defined by law and the power generators parties to the PPAs are entrusted with providing the SGEI.

(111) Secondly, the compensations were set in advance by the government price decrees and by the price formulae of the PPAs. The compensations could thus be calculated on the basis of objective and transparent parameters.

(112) Thirdly, the compensation paid on the basis of PPAs does not exceed the costs of the SGEI provided. PPAs are strictly cost-based and the profit margins do not exceed usual profit margins on the market. This is ensured by the fact that, as Budapest power plant argues, its PPAs were openly and transparently tendered (see below). The power plants were sold to the tenderer with the highest bid and the best business plan. It follows from the tendering procedure that the compensation under the PPAs cannot exceed what is necessary to cover all costs incurred in the discharge of the public service obligation and a reasonable profit margin.

(113) Fourthly, Budapest power plant argues that its PPAs were all openly and transparently tendered, either as an essential part of the privatisation package or separately. Csepel power plant argues that although the plant was not chosen on the basis of a public tender, it still receives a compensation that is limited to cover costs and a reasonable profit margin. The pricing mechanisms ensure that overcompensation is avoided.

(114) 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 do not therefore constitute aid within the meaning of Article 87(1) of the EC Treaty.

<sup>(31)</sup> OJ C 34, 7.2.2004, p. 8.

<sup>(32)</sup> Case C-280/00 *Altmark Trans GmbH and Regierungspräsidium Magdeburg v Nahverkehrsgesellschaft Altmark GmbH, and Oberbundesanwalt beim Bundesverwaltungsgericht* [2003] ECR I-07747.

(115) The Budapest power plant also argues 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. The interested party expresses its view that the impact of its PPAs on the alleged foreclosure of the Hungarian electricity market is negligible, since they cover only 3 % of Hungarian electricity consumption. Moreover, for technical reasons, an increase in electricity imports was impossible at the time the PPAs were concluded. Consequently, its PPAs would not have any adverse effect on trade. The interested party also stresses in its comments the importance of its cogeneration technology for district heating, which meets the objectives of EU energy and environmental policy.

(116) The Mátra power plant argues that it was required to reserve a certain minimum capacity for MVM in order to secure the energy supply in the Hungarian market using indigenous coal resources. It argues that, in line with Article 11(4) of the Electricity Directive<sup>(33)</sup>, State aid should be considered as compatible with the common market when, for reasons of security of supply, it finances the generation of electricity from indigenous coal.

(v) *No advantage in long duration*

(117) Csepel, Mátra and Budapest power plants argue that the long duration of a contract should not be construed as an advantage per se. The Csepel power plant argues that in a long-term agreement both parties pay a price for the certainty the long term offers. The power generators agree to offer a lower price than the spot market price and to be bound by the agreed price, whatever the spot prices are. They also agree to reserve their capacities for one company for the entire duration of the agreement. It is argued that long-term agreements therefore represent a balancing of economic risks and opportunities for both parties and cannot be seen as a pure advantage.

(118) On the basis of the above arguments, all power generators conclude that the PPAs do not provide them with an economic advantage and that consequently they do not constitute State aid within the meaning of Article 87(1) of the EC Treaty.

### **Selectivity**

(119) AES-Tisza argues that the PPAs do not provide a selective advantage. The interested party refers to the existence of long-term agreements in the entire electricity sector, not only between the generators and MVM but also between

MVM and the distribution companies and between fuel suppliers and electricity generators, as well as for the import of electricity. As far as the generators are concerned, the Energy Act I (from 1994) and Government Decree 34/1995 explicitly required generators to conclude a power purchase agreement with MVM in order to obtain a construction and operation licence. Consequently, all generators had agreements with MVM and only renewable and cogeneration plants could have shorter term agreements, as these generators have different legal guarantees (e.g. mandatory off-take).

### **Transfer of State resources**

(120) Mátra power plant submits that only the price can be considered State aid in the PPAs. The duration of the PPAs and the guaranteed sales volumes cannot be viewed as State aid because even if they confer an advantage, they do not lead to the transfer of State resources. The third party concludes that given Mátra power plant's very competitive prices (see (i) above), there is no State aid element whatsoever in its PPA.

### **Imputability to the State**

(121) The company AES-Tisza argues that the PPA prices are imputable not to the State but to the parties to the PPAs. AES-Tisza criticises the imputability assessment of the Opening Decision in that it concentrates only on the imputability to the State of the actual conclusion of the PPAs and not on the imputability of the price setting, whereas at the same time the Commission argues that the unfair advantage is secured by the advantageous prices. After the period of central price setting (i.e. after January 2004, and with the exception of 2007), the prices were negotiated between MVM and the power generators and cannot be attributed to the State.

### **Distortion of competition and impact on trade between Member States**

(122) AES-Tisza, Budapest and Csepel power plants contest the distorting effects of the PPAs and their potential to impact trade between Member States.

(123) Firstly, the power plants in question submit that this criterion should also be assessed in the light of the time the PPAs were concluded. At that time Hungary was not part of the EU and its electricity market was not liberalised. Consequently, it is argued that the PPAs could not by definition distort competition in the common market.

<sup>(33)</sup> Directive 2003/54/EC.

(124) Secondly, they argue that competition and trade between Member States are influenced by factors other than the PPAs. Specifically, they contend that Hungary's cross-border capacities are the main factor influencing trade between Hungary and other countries. These cross-border capacities are used at their maximum. Clearly, then, trade in electricity is limited because of Hungary's restricted cross-border capacities and not because of the PPAs. Legislation is argued to be the other factor influencing trade between Member States. Under Hungarian legislation, the power generators were in any event not authorised to sell electricity abroad directly.

(125) Csepel power plant argues that in any event it sells electricity in Hungary only, so its PPA cannot have any *de facto* effect on trade between Member States.

(126) It is also argued that the Hungarian electricity market has been gradually opened up to competition in line with EU obligations. A significant percentage of consumers had switched to the free market segment within a short time. New players would be deterred from entering the Hungarian electricity market or extending their presence in that market by the unpredictability of returns, not the existence of the PPAs. Csepel power plant argues that in recent years power stations have been built in Hungary only when the State has offered some form of stability and predictability of project returns through long-term agreements or in the form of compulsory off-take, or where the use of new capacities was guaranteed by demand for the vertically integrated distribution activity. In any event, the existing PPAs were not a factor deterring new entry.

(127) It is furthermore argued that there is no market demand in Hungary for additional capacities. This is evidenced by the fact that at electricity auctions by MVM a huge majority of the capacities offered for sale remained unsold.

### 5.3. Applicability after accession

(128) This observation was submitted by Budapest power plant.

(129) Budapest power plant argues that the PPAs cannot be regarded as 'still applicable after accession' within the meaning of Annex IV, paragraph 3, subparagraph 1(c) to the Accession Act.

(130) The interested party argues that in line with the general principle of non-retroactivity, measures that were established in accordance with the law prior to accession should not be reviewed by the Commission after

accession. As Community State aid rules apply only from the date of accession, only aid measures that provide an additional benefit after accession can be defined as applicable after accession. They argue that the PPAs do not provide any additional benefit after accession as their price formulae were defined before accession, and consequently the State's financial exposure was entirely known prior to accession.

### 5.4. Existing aid

(131) This argument was submitted by Budapest, Csepel, AES-Tisza and Mátra power plants and by [...] Bank.

(132) The interested parties argue that even if one were to accept that the PPAs constituted State aid within the meaning of Article 87(1) of the EC Treaty, such State aid should be regarded as existing aid within the meaning of Annex IV, paragraph 3, subparagraph 1(c) to the Accession Act. They are of the view that the Commission did not object to the measure within the period of 3 months required by the Accession Act. The Hungarian authorities notified the measure on 31 March 2004. After an exchange of information, the Commission did not, the parties claim, react to Hungary's letter of 19 October 2004 within a period of 3 months, thereby ruling out classification of the measure as 'new aid'.

(133) Budapest power plant also takes 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 Budapest power plant, if such aid does not qualify as existing aid under Annex IV to the Accession Act, it should still be examined in the light of Article 1(b)(ii)-(v) of Regulation (EC) No 659/1999.

(134) Budapest power plant further argues that Article 1(b)(v) of Regulation (EC) No 659/1999 applies to the PPAs and that the PPAs therefore constitute 'existing aid'. In its view, the last sentence of Article 1(b)(v) of Regulation (EC) No 659/1999 referring to new aid does not apply to the PPAs for three reasons.

(135) First, in the *Alzetta Mauro* judgment<sup>(34)</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 party, this judgment is based directly on an interpretation of Article 88(1) of the EC Treaty, and therefore takes precedence over Regulation (EC) No 659/1999.

<sup>(34)</sup> Judgment 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.

- (136) Second, in any event, given that 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 Regulation (EC) No 659/1999.
- (137) Third, a comparison of the wording of the different categories in Article 1(b) of Regulation (EC) No 659/1999 leads to the conclusion that Article 1(b)(v) applies only to State aid schemes, since individual aid is not explicitly mentioned.
- (138) Conversely, AES-Tisza argues that if the PPAs were to be classified as new aid, then such classification should be based on Article 1(b)(v) of Regulation (EC) No 659/1999.
- (143) Conversely, [...] Bank argues with regard to the Csepel PPA that the consideration paid under the PPA is limited to covering costs that are actually eligible under the Methodology (i.e. fixed costs, variable costs and a reasonable profit margin). It maintains that the Csepel PPA does not provide for compensation exceeding eligible stranded costs.
- (144) Csepel furthermore argues that the PPAs fulfil the criteria of Article 87(3) of the EC Treaty in that they significantly contribute to the security of electricity supply in Hungary and, more generally, to the overall development of the Hungarian economy.
- (145) The company AES-Tisza suggests (without giving detailed reasons) that the PPAs should be regarded as securing investment in an Article 87(3)(a) region.

**5.5. Validly concluded private agreements cannot be ended by the Commission (*pacta sunt servanda*) — Legal uncertainty**

- (139) These arguments were submitted by Budapest and AES-Tisza power plants and [...] Bank.
- (140) The parties stress that they entered into the PPAs in good faith in the market circumstances that prevailed at the time. They accepted major investment obligations borne by credit institutions through financing agreements. In their view, the Commission's investigations lead to significant legal uncertainty which should be avoided. AES-Tisza questions the Commission's right to terminate, on the basis of the State aid rules and, more generally, the EC Treaty's competition rules, validly concluded commercial agreements <sup>(35)</sup>.
- (146) Moreover, AES-Tisza notes the Opening Decision's lack of clarity with regard to the 'benchmark' market price to be used, the meaning of 'inefficient investment' and the economic scenarios and time periods applied for the Commission's assessment of compatibility with the common market.

**6. REPLY FROM HUNGARY ON COMMENTS FROM INTERESTED PARTIES**

- (147) In reaction to the comments of Csepel power plant, Hungary submits that, contrary to what might be inferred from Csepel's comments, its PPA also contains guaranteed minimum off-take quantities.
- (148) As regards Dunament's argument that it cannot refuse generation under conditions dictated by MVM even to the detriment of Dunament's free market sales, the Hungarian authorities point out that in 2006, MVM initiated the termination of the PPAs with regard to 4 F blocks which, as a result, could have competed directly on the free market for system services. However, Dunament refused to take this opportunity.
- (149) On the comments of AES-Tisza whereby generators without PPA mainly invested if they fell under the guarantee of mandatory off-take, the Hungarian authorities submit that important power plants and power plant blocks sell electricity on the free market without both PPAs and mandatory off-take (for instance the Dunament G1 block, the Vértes power plant and the Mátra I-II blocks).
- (150) Hungary also stresses that, contrary to AES-Tisza's comments, MVM's negotiating position is also limited by the PPAs themselves (price formulae and guaranteed off-take quantities).

**5.6. Proportionality**

- (141) The AES-Tisza power plant expresses its concerns regarding the proportionality of the Commission's request to terminate the PPAs and refers to the possibility of renegotiation of the agreements by the parties.

**5.7. Comments on the compatibility of PPAs with the common market**

- (142) The companies Csepel and AES-Tisza submit that the PPAs were not designed to be a compensation scheme and it is therefore inappropriate to compare them to the Stranded Costs Methodology. At the time of their conclusion, the PPAs could not be construed as a stranded cost compensation as the Methodology did not even exist at that time. In their view, the use of the Methodology is only appropriate in a situation where the PPAs were ended previously.

<sup>(35)</sup> Letter registered on 19 December 2006.



## 7. ASSESSMENT BY THE COMMISSION

### 7.1. Unlawful aid

- (151) The aid contained in the PPAs was not notified to the Commission in accordance with the State aid procedural rules. The aid thus constitutes unlawful aid.

### 7.2. General comment on the individual assessment of the PPAs

- (152) In their comments, certain interested parties and the Hungarian authorities suggested that the PPAs should be assessed individually given the differences in their exact terms and conditions.

- (153) This Decision covers all PPAs between MVM and power generators that were in force when Hungary joined the EU (see recitals 44 and 45 above). The Commission considers that the governing principles of the PPAs present similarities which, in a State aid procedure, justify their common assessment. As shown below, the Commission is of the view that the main advantage flowing from the PPAs is common to all of them, and that the decision on their conclusion in the period 1995-2001 followed the same policy objectives and the same type of solution. In concrete terms, they all provide for a purchase obligation on the part of MVM – for a duration covering a substantial part of the lifetime of the assets – of reserved capacities and a guaranteed quantity, with a pricing mechanism allowing the generators to cover their fixed and variable costs. Furthermore, the other criteria for the existence of State aid also present similarities that justify their common assessment. Their selectivity is based on the same principles; the question of whether the PPAs lead to a transfer of State resources requires largely the same assessment for each of them; and their affect on competition and trade also follows the same economic assessment and must also take into account the coexistence of the PPAs on the Hungarian market. The Commission is thus of the view that in order for this State aid decision to accurately reflect the reality of the Hungarian power generation market, the PPAs must be assessed jointly, with a single decision closing the procedure.

- (154) This comprehensive approach does not prevent the Commission from taking into account the differences that indeed exist between the PPAs in question. This Decision thus sets out the differences between the PPAs where such differences are relevant for the purpose of this Decision.

### 7.3. Existence of State aid within the meaning of Article 87(1) of the EC Treaty

- (155) 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.

### *The relevant time of assessment*

- (156) In their comments, the interested parties argued (with reference to several assessment criteria) that the Commission should consider only the situation that prevailed when the PPAs were signed. The findings of this analysis should then extend to the whole duration of the PPAs. In this regard, Budapest power plant refers to the Commission notice on the determination of the applicable rules for the assessment of unlawful State aid <sup>(36)</sup>.

- (157) In establishing the relevant time of assessment, the Commission must first take into account the Accession Act of Hungary to the EU, the Procedural Regulation and the Court's case law.

- (158) The relevant part of Annex IV to the Accession Act reads as follows:

'ANNEX IV

### **List referred to in Article 22 of the Act of Accession**

[...]

#### 3. Competition policy

1. The following aid schemes and individual aid put into effect in a new Member State before the date of accession and still applicable after that date shall be regarded upon accession as existing aid within the meaning of Article 88(1) of the EC Treaty:

(a) aid measures put into effect before 10 December 1994;

(b) aid measures listed in the Appendix to this Annex;

(c) aid measures which prior to the date of accession were assessed by the State aid monitoring authority of the new Member State and found to be compatible with the acquis, and to which the Commission did not raise an objection on the ground of serious doubts as to the compatibility of the measure with the common market, pursuant to the procedure set out in paragraph 2.

All measures still applicable after the date of accession which constitute State aid and which do not fulfil the conditions set out above shall be considered as new aid upon accession for the purpose of the application of Article 88(3) of the EC Treaty.

<sup>(36)</sup> OJ C 119, 22.5.2002, p. 22.

The above provisions do not apply to aid to the transport sector, nor to activities linked to the production, processing or marketing of products listed in Annex I to the EC Treaty with the exception of fisheries products and products derived thereof.

The above provisions shall also be without prejudice to the transitional measures regarding Competition Policy set out in this Act.

(159) The relevant part of Article 1 of the Procedural Regulation reads as follows:

'(b) "existing aid" shall mean:

[...]

(v) aid which is deemed to be an existing aid because it can be established that at the time it was put into effect it did not constitute an aid, and subsequently became an aid due to the evolution of the common market and without having been altered by the Member State. Where certain measures become aid following the liberalisation of an activity by Community law, such measures shall not be considered as existing aid after the date fixed for liberalisation.

(c) "new aid" shall mean all aid, that is to say, aid schemes and individual aid, which is not existing aid, including alterations to existing aid'.

(160) It follows from the above provisions that measures which did not constitute State aid at the time they were granted can, in certain circumstances, become State aid measures within the meaning of Article 87 of the EC Treaty. This is without prejudice to the classification of the measure becoming State aid as existing or new aid.

(161) Although it is true that, in analysing the existence of State aid in a specific case, the Commission must assess the situation prevailing at the time the measure entered into force, this does not mean that the assessment of the four criteria in the definition of State aid should in all circumstances be limited only to the time at which the aid was granted.

(162) From Article 1(b)(v) of the Procedural Regulation, it clearly appears that there are exceptional circumstances, such as the evolution of the common market or the

liberalisation of a sector, where substantial economic and legal changes take place in a sector or several sectors of the economy and where, owing to these changes, a measure that initially did not come within the scope of Article 87 of the Treaty may fall under State aid control. When liberalising a sector of the economy, to keep all measures which did not qualify as State aid owing to the substantially different market conditions at the time they were granted, but which as of liberalisation meet all the criteria of State aid, would *de facto* perpetuate a large part of the pre-competitive market circumstances. This would go against the precise intention of putting an end to such an uncompetitive situation on a market, i.e. the decision of the Member States to liberalise the given sector. The purpose of special provisions whereby a measure can become State aid is to avoid prolonging any measures which, although not constituting aid under previous economic and legal circumstances, might harm the interests of players in the new market conditions <sup>(37)</sup>.

(163) The question of whether such State aid is to be classified as existing or new aid should be assessed separately once the Commission has established the existence or otherwise of State aid.

(164) Hungary's economy underwent a drastic change in the 1990s. The country took the decision to join the European Union, becoming a full Member State on 1 May 2004. It was well aware of its obligation to bring its existing measures into line with the competition rules of the internal market it wished to join, since the Europe Agreement <sup>(38)</sup>, signed by Hungary in 1991, explicitly refers to that obligation.

(165) In joining the European Union, Hungary also joined the liberalised internal energy market. The competition rules of the Accession Act do not provide for any exception as regards the Hungarian energy market. In the light of this, contrary to the interested parties' comments, the Commission is of the view that the PPAs, entered into in substantially different economic conditions (as recognised by the interested parties) before accession to the liberalised internal energy market, may very well become State aid in the new legal and economic circumstances. To establish the existence of such aid, the four criteria of the existence of State aid within the measure should be assessed under the new economic and legal circumstances.

<sup>(37)</sup> The judgment of the Court of First Instance of 15 June 2000 in the *Alzetta Mauro* case referred to by Budapest power plant also confirms that the measure needs to be assessed in the light of the new market circumstances after liberalisation when recognising that the measure which may not have constituted State aid before liberalisation becomes (existing or new) aid.

<sup>(38)</sup> Europe Agreement establishing an association between the European Communities and their Member States, of the one part, and the Republic of Hungary, of the other part, signed on 16 December 1991.

- (166) The question of the relevant time of assessment should furthermore be assessed in the light of the Accession Act. Unlike in previous accessions, the Member States agreed to introduce specific provisions to the Accession Act whereby all aid measures applicable after accession and concluded after 10 December 1994 were to be notified to the Commission before accession and reviewed by it on the basis of the *acquis communautaire*.
- (167) The vast majority of the countries that joined the EU on 1 May 2004 had, for historical reasons, a strong tradition of State interventionism. However, there may be measures that could not fulfil the four criteria of State aid before accession owing to the very different market conditions then prevailing. However, with the new legal and economic conditions of post-accession, these conditions may very well become fulfilled.
- (168) The relevant articles of the Accession Act aim at ensuring undistorted competition on the internal market for the period after the date of entry into force of the Treaty. Consequently, the purpose of the relevant articles of the Accession Act is to avoid distortions of competition on the common market due to incompatible State aid measures after accession. In this regard, it is irrelevant whether in the 1990s when the measure was granted, it actually fulfilled all the criteria of State aid or not. Consequently, the relevant time for the assessment of the criteria for the existence of aid as to be the time period following the date Hungary joined the EU and the liberalised internal energy market.
- (169) Any other approach would lead to a situation where the economic conditions of the pre-accession and pre-liberalisation period (corresponding, in the case of most new Member States, to a transition period following the communist regime) could be perpetuated long after the country's accession to the European Union. Measures which might not have constituted State aid before accession could be maintained and even prolonged as long as the Member State wished, even if they constituted State aid under post-accession conditions, as they would not fall under the Commission's State aid control.
- (170) This is precisely the intention of the interested parties' comments in this regard. All the interested parties' arguments concerning the relevant time of assessment aim to show that the economic and legal assessment of the PPAs in the context of the present State aid procedure should be based only on the circumstances that prevailed at the time of the signature of the PPAs (i.e. between 1995 and 2001), and to lead to the conclusion that the PPAs, because of those legal and economic circumstances, do not constitute State aid. They argue that the market economy operator test and the criteria of distortion of competition and effect on trade should be analysed in the economic context of the mid-1990s, that the Commission should take into account MVM's obligations at that time (security of supply) and the model of the energy sector prevailing at that time ('Single Buyer' model, etc.). In their view, the result of the assessment under these circumstances should prevail until the end date of the PPAs (2024 for the longest contract), irrespective of such changes as Hungary's accession to the EU and the subsequent mandatory liberalisation of the energy market.
- (171) The Commission cannot agree with this line of argument. The Commission is of the view that the relevant articles of the Accession Act aim precisely at avoiding such situations, by requiring the immediate application of State aid rules to the players of the economy. The Accession Act does provide for exceptions for certain sectors of the economy (e.g. provisions on transport), but no exception whatsoever is provided for operators on the electricity market. The *acquis communautaire*, including Directive 96/92/EC, thus applies to all contractual conditions of the Hungarian electricity market immediately as of accession.
- (172) In its assessment of the PPAs, the Commission thus takes the view that, by joining the liberalised internal energy market, Hungary agreed to apply the principles of that market's economy to all the players on its existing market, including all existing commercial relations.
- (173) The Commission must therefore assess whether, as of the day on which Hungary joined the European Union, the measure meets the criteria for the existence of State aid.
- Advantage**
- (174) As an introduction to the assessment of the existence of an advantage, it is useful to note that most of the power generators acknowledged in their comments that they could not have invested in those plants without the guarantees offered by the PPAs. [...] power plant argues in its comments that 'The PPAs are an important element for the banks to agree to finance the investment and pre-finance the operating costs on a continuous basis. [...] On [...], [...] asked for the consortium's [i.e. the financial institutions'] view on a potential amendment of the PPAs. However, the banks refused the decrease of both the reserved capacities and the guaranteed off-take' <sup>(39)</sup>.

<sup>(39)</sup> Quotation from point 3 of the generator's comments.

(175) In this regard, [...] (as facility agent for the twelve banks, lenders of nearly [...] to Csepel power plant) argues that 'The view of the Banks is that the PPA is part of a package of closely related commercial agreements that secured and still secure the Facility Agreement that provides the financing for the project at market conditions. Thus, any change of the PPAs would automatically affect the Banks and, owing to the contractual mechanisms available to the Banks to protect their financial interests, in turn endanger the Csepel II Project as a whole'.

(176) [...] (as facility agent for the nine banks, lenders of nearly [...] to AES-Tisza) argues that 'The principal basis for this financing was the existence of the PPA along with the other pertinent project documents (e.g. the Fuel Supply Agreement). [...] The PPAs provide stability to demand risk (volume of electricity sold and pricing).' 'The demand stability feature [...] is critical in giving banks the necessary security to provide long-term financing in an immature market'.

(177) In order to assess the existence of an advantage under the PPAs, the Commission first carried out a preliminary analysis to determine what line of reasoning to follow in the assessment. As a result of the preliminary analysis, outlined in recitals 180 to 190, the Commission concluded that in order to establish whether an advantage existed, it should be ascertained whether under the conditions prevailing when Hungary joined the European Union, a market operator would have granted the generators a similar guarantee as that enshrined in the PPAs, namely a purchase obligation on the part of MVM of the capacities reserved in the PPAs (corresponding to a substantial proportion and, in many cases, to all the power plant's available capacities), a guaranteed minimum quantity of generated power over a period of 15 to 27 years corresponding to the typical expected lifetime of the assets concerned or their depreciation, at a price covering the plant's fixed and variable costs (including fuel costs) <sup>(40)</sup>.

(178) As a second step, the Commission analysed the answer to this question in the light of standard commercial practices on European electricity markets.

(179) Finally, the Commission briefly assessed the impact of the PPAs on the market in the period following Hungary's accession to the European Union. Although this analysis is not necessary to determine the existence or otherwise of an economic advantage within the PPAs, it is useful in order to duly address certain comments submitted by interested parties.

(1) *Preliminary analysis: the reasoning that should be followed in order to assess the existence or otherwise of an advantage*

(180) In the comments submitted in the course of the procedure, third parties analysed the existence or otherwise of an advantage in the light of the conditions under which the PPAs were signed in the mid-1990s. In essence, they concluded that in that period, and in the context of the privatisation of the generating companies, an average market operator would have granted similar guarantees to the generators as those enshrined in the PPAs in order to attract investors and thereby ensure security of supply in Hungary.

(181) The Commission analysed the merits of this approach and came to the conclusion that it was inappropriate for two reasons. First, it does not take into consideration the actual beneficiaries of the measure under assessment. Second, the period considered under the approach is not relevant in assessing the existence of an advantage.

#### *The beneficiaries of the potential advantage*

(182) The Dunament power plant argues that it received no advantage through its PPA as it paid the market value for the privatisation of its power plants, and the purchase price took into account its rights and obligations under the PPA. Consequently, it paid for any advantage the PPA may have conferred on it in the privatisation price.

(183) The Commission considers that this reasoning is unsound in the present case. In the case at issue, the beneficiaries of the aid are the privatised power plants (for those which were indeed privatised) and not the shareholders of those plants. The privatisation of the power plants took the form of share deals.

(184) The Court of Justice has analysed how a change in the ownership of a company during a share deal affects the existence of unlawful aid granted to the company and its recipient. It ruled that the unlawful aid remains with the company that benefited from the aid, despite the change in its ownership <sup>(41)</sup>. The transfer of shares at the market price merely ensures that the buyer itself does not benefit from State aid. However, this does not affect the existence of an advantage for the activity of the beneficiary power plant.

(185) In the case under assessment, the beneficiaries of the aid are the Hungarian companies that operate the power plants and signed the PPAs, and not the shareholders of the power plants. Furthermore, the change in the

<sup>(40)</sup> Irrespective of whether the price is based on the price formula contained in the PPAs or on pricing decrees, given that both are based on principles similar to pricing regulation.

<sup>(41)</sup> Joined cases C-328/99 and C-399/00 *Italy and SIM 2 Multimedia v Commission* [2003] ECR I-4035, paragraph 83.

ownership of the power plants occurred before the date from which the existence of State aid is to be assessed and is of no relevance in assessing the existence of State aid to the companies operating the power plant. The companies that signed the PPAs thus benefited from the advantages contained in the PPAs regardless of their ownership structure.

***Period to be considered for the assessment of the existence of an advantage***

- (186) The Commission is aware that in the market circumstances of the mid-1990s in Hungary, the governing principle of the PPAs, that is the guarantee of the return on investment, was the essential condition under which the necessary investments could take place.
- (187) The fact that, owing to the characteristics of the generation sector and the political and economic context of that period in Hungary, there was the need for the State to intervene in the common interest and the best solution was to award PPAs to a number of generators, does not in any way contradict the fact that the PPAs do confer an advantage on the generators.
- (188) Most generators argue that the PPAs do not confer any advantage on the generators as they correspond to the normal market behaviour of any market economy operator in both MVM's and the generators' position. They argue that any private actor in the position of MVM (with legal obligation of security of supply, as a single buyer) would have chosen to enter into the PPAs, and that the economic advantage from the PPAs does not go beyond what, in the circumstances of the immature energy market of the 1990s in Hungary, was a normal commercial advantage for the parties. Moreover, generators had the legal obligation to enter into an agreement with MVM in order to obtain their operating licence. The generators argue that applying the private investor principle should lead the Commission to take account of the legal requirements and economic reality of the time of conclusion of the PPAs.
- (189) With regard to the interested parties' arguments on the private investor principle, the Commission refers to the recitals of this Decision concerning the time to be established as relevant for the assessment of the existence or otherwise of State aid under the PPAs. The Commission reiterates that it does not intend to call into question the fact that it was necessary to enter into PPAs in the circumstances prevailing at the time those agreements were concluded. However, as explained above, this does not in any way mean that the PPAs did not confer an advantage on the generators. The interested parties in fact argue only that these agreements corresponded to the market conditions prevailing at the time of their conclusion. None of the interested parties argues that they correspond to current market conditions on the internal market.

***Conclusion of the preliminary analysis***

- (190) The Commission concludes that in order to assess the existence of an advantage within the PPAs, it should be ascertained whether, under the conditions prevailing when Hungary joined the European Union, the average market operator would have granted generating companies a similar guarantee to that enshrined in the PPAs, as described in recital 177.
- (2) *Assessment of the existence of an advantage to the power generators when Hungary joined the European Union*
- (191) To answer the question referred to in the previous recital, the Commission identified the main practices of commercial operators on European electricity markets that are relevant for the purpose of this analysis, and assessed whether PPAs are in line with these practices or provide generators with guarantees that a buyer would not accept if it acted on purely commercial grounds.
- (192) As a preliminary remark, it is useful to note that traditionally, electricity markets are divided into four markets: (i) generation/import and wholesale supply, (ii) transmission/distribution, (iii) retail, and (iv) balancing services. The relevant markets for the assessment of the PPAs are the first and fourth category, as MVM purchases electricity from domestic generators, imports electricity and sells it to regional distribution companies and commercial suppliers (suppliers on the retail market). MVM also provides reserved capacities to the Transmission System Operator in order to ensure the balancing of the system.
- (193) In Hungary, the retail market is divided into two segments in the period under assessment: (i) a public-utility segment where regional distribution companies supply power at regulated prices to non-eligible consumers and consumers that do not make use of their eligibility; (ii) a free market segment where commercial suppliers provide power to eligible consumers at prices resulting from market mechanisms. Under the regime introduced by Energy Act III, the public utility segment is limited to the household and commercial consumers that are covered by a universal supply obligation.
- (194) In the period of assessment, MVM supplied power to both the regional distribution companies (suppliers on the public utility segment) and to suppliers on the free market segment. However, as outlined in recitals 221 to 231, MVM's sales to suppliers on the free segment were only intended to release the surplus quantities purchased under the PPAs and not needed by the public utility segment. It is a consequence of the PPAs themselves rather than an autonomous commercial activity.

Therefore, the existence of an advantage must be analysed against the primary objective assigned to MVM, which was to supply enough power to the regional distribution companies to fulfil the needs of the public utility segment. Consequently, what needs to be verified is whether, in the absence of PPAs, a market operator entrusted with supplying the regional distribution companies with sufficient amounts of electricity, and acting on purely commercial grounds, would have offered the same guarantee as that enshrined in the PPAs. This assessment has to be carried out in the light of the operation of competitive wholesale markets. The recitals below provide first, an overview of typical commercial practices relevant for this analysis and second, a comparison between the PPAs and these practices. Finally, in the light of this comparison the Commission analysed the consequences of the PPAs that the public authorities could expect when Hungary joined the European Union, and whether they could have expected a better balance between positive and negative consequences from other types of agreements.

(2)(a) Short description of commercial practices on European electricity markets relevant for the assessment of the existence of an advantage within the PPAs

(195) In its Sector Inquiry on electricity markets in Europe <sup>(42)</sup>, the Commission examined in detail the conditions governing trade in electricity on European wholesale markets.

(196) Depending on the delivery period, bulk electricity can be traded on spot and forward markets. Spot markets are mainly day-ahead markets, on which electricity is traded one day before physical delivery takes place. Trade in power on spot market exchanges is always based on marginal pricing, which guarantees only that short-run marginal costs are covered <sup>(43)</sup>.

(197) On forward markets, power is traded for delivery further ahead in time. Forward products include weekly, monthly, quarterly and yearly products. Both spot and forward products can be traded on power exchanges or

over-the-counter (OTC) markets. As a result of continuous arbitrages, prices of identical products on power exchanges and OTC markets tend to converge. Therefore, power exchanges tend to set reference prices for all spot and forward products, and therefore for the entire wholesale market.

(198) Furthermore, the price of forward products results from the expectations of market players with regard to future price development on spot markets. Since market players engage in forward contracts because they prefer price certainty to unknown spot prices in the future, forward prices also include a risk element. In practice, prices of forward products include a central element which reflects market players' expectations with regard to the development of spot prices and, depending on whether they attach a high value to price certainty, a risk premium or discount, though in practice it often appears to be a premium. Consequently, spot prices constitute references for all electricity prices. If a spot market exchange is in place, prices on that exchange constitute references for the whole market. In many wholesale markets, buyers usually try to cover a large share of their expected needs with forward contracts in order to have visibility over their costs. The needs additional to those met with forward contracts are covered by purchases on spot markets.

(199) The Energy Sector Inquiry noted that apart from standardised exchange and OTC trading there are also 'bespoke bilateral transactions'. These contracts can be very different in terms of products delivered or services and the prices of such transactions are usually not reported. However, in competitive market conditions, the existence of standardised power exchanges and OTC trading necessarily influence such transactions, as a generator or importer would not agree to engage in a bespoke bilateral contract that would offer clearly worse conditions than a standardised spot or forward contract. Therefore, standardised spot and forward contracts on European wholesale markets constitute a relevant basis for comparison in assessing the existence of an advantage conferred on generators by PPAs.

(200) On forward markets the longest delivery period is one year. The longest duration between the conclusion of the contract and the beginning of the actual delivery period is 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. A standardised forward contract places on the supplier the obligation to provide a certain amount of energy at a price agreed in advance, over a maximum period of one year starting within at maximum 6 years of the conclusion of the contract.

<sup>(42)</sup> In June 2005 the Commission opened an inquiry into the operation of the European gas and electricity markets. The final report of this Energy Sector Inquiry, which was issued on 10 January 2007, is used in this Decision as a source of information concerning main commercial trends and practices on European electricity markets which were already prevailing when Hungary joined the European Union on 1 May 2004. The report is available at [http://ec.europa.eu/comm/competition/antitrust/others/sector\\_inquiries/energy/](http://ec.europa.eu/comm/competition/antitrust/others/sector_inquiries/energy/)

<sup>(43)</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 are primarily driven by fuel costs.

The order of magnitude of these timeframes is significantly below the usual depreciation and lifetime of any power generation station. Consequently, in normal market conditions and even if they trade most of their output in the form of forward contracts, generators have no visibility on prices and sales volumes over the depreciation and lifetime of power generation assets. Furthermore, as prices are fixed in advance, generators run the risk that their costs will exceed the agreed prices. This risk is not negligible, owing in particular to the volatility of fuel costs, which is for most generation technologies the main component of variable costs. Furthermore, generators are faced with competitive pressure as they have to renew their forward contracts a significant number of times during the lifetime of their generation assets, and therefore adapt their offers to evolving competitive conditions.

(201) Contracts involving the reservation of generation capacities may also be encountered on wholesale markets in the form of 'drawing rights', which are therefore worth comparing with the PPAs. Acquiring drawing rights consists in reserving part of the generation capacities of a given power plant, usually for the expected lifetime of the power station, and paying a 'capacity fee' to the plant operator, corresponding to the capital and fixed costs linked to the reserved capacities. The technical risks are borne by the operator of the plant. The holder of the drawing rights can decide on the level of use of the reserved capacities and pays to the power plant operator a price corresponding to the variable costs incurred for the energy generated from the reserved capacities.

(202) In order to further assess the existence or otherwise of an advantage within the PPAs, it is also useful to consider the situation of large business or industrial end-consumers, even though they act not on wholesale markets but on retail (downstream) markets. As generators sometimes directly supply power to large business or industrial consumers, the comparison with the PPAs is relevant.

(203) The Energy Sector Inquiry has shown that it was common practice for electricity suppliers to sign fixed-price contracts with large business or industrial consumers. The duration of such contracts is usually limited to one to two years. They usually provide for a delivery schedule based on historical consumption. The price is derived from wholesale prices on forward markets and contains other cost components such as expected costs of balancing or the supplier's margin. Deviation from the delivery schedule entails the application of a 'take or pay' clause, which compels the buyer to pay for energy which it does not need, or to pay an excess charge. In this respect, such contracts may

be regarded as based on a minimum guaranteed off-take combined with the reservation of capacity<sup>(44)</sup>.

(204) Another type of agreement has to be considered for the purpose of assessing the advantage within the PPAs, namely contracts concluded for the provision of balancing services to the Transmission System Operators (TSOs). As electricity cannot be stored, demand and supply must be matched at each point in time. If demand or supply deviate from forecasts and result in a need for additional generation, it is the responsibility of the Transmission System Operator to call on certain generators to increase production at short notice. In order to ensure the availability of generation capacities to face such situations, TSOs reserve capacities in generation units which are capable of modifying their production level at short notice. In Hungary, as there is no pump storage plant, natural gas fired plants have the most appropriate technical characteristics to provide these services.

(205) The Energy Sector Inquiry has provided an overview of European TSOs' practice with respect to capacity reservation contracts for the provision of balancing services. This overview shows that capacities are reserved by means of tenders. One year may be regarded as a standard duration, which grants flexibility to TSOs to adjust the amounts of reserved capacities to their actual needs. The contracts generally specify the technical characteristics of the required service, the reserved capacity and a price either for the energy provided or for both energy and capacity.

#### (2)(b) Comparison of the PPAs with standard commercial practices

(206) The Commission has compared the purchase obligation enshrined in the PPAs with the main features of standard forward and spot contracts, 'drawing rights' contracts, long-term contracts concluded by large end-consumers, and contracts concluded between generators and TSOs for the provision of balancing services.

#### *Standard spot and forward contracts*

(207) It follows from the description presented in recitals 195 to 200 that the combination of long-term capacity reservation, a minimum guaranteed off-take and price-setting mechanisms covering variable, fixed and capital costs do not correspond to usual contracts on European wholesale markets and that they shield generators from more risks than standard forward and spot contracts.

<sup>(44)</sup> The fact that the supplier commits to deliver the quantity set in the contract may be regarded as equivalent to capacity reservation.

(208) Trade in power on spot-market exchanges is always based on marginal pricing, which guarantees only that short-run marginal costs, and not all fixed and capital costs are covered. Furthermore, on spot markets, a power generating company has no assurance as regards the level of utilisation of its generating capacities. This risk is much higher than for most manufacturing sectors and is due to the fact that it is impossible to store electricity economically, a very specific feature of that industry. If at a given point in time enough power to meet demand is offered at lower prices than those offered by a given generator for one of its power generation units, that unit will not be despatched, which means that its generation capacities will be lost for the concerned period of time.

(209) Therefore, sales on spot markets entail a significant degree of uncertainty concerning the remuneration of fixed and capital costs and the level of utilisation of generation capacities.

(210) Nor do forward markets, whose prices are derived from spot prices, provide assurance to generators that all their fixed and capital costs are covered by their sales, because prices are fixed in advance. If fuel costs increase unexpectedly over the period of delivery, the costs of producing electricity may exceed the price set in advance. On forward markets, the risk concerning the use of the production capacities is lower than in the case of spot products owing to the longer time horizon of forward contracts. However, even if a generator is able to sell most of its output through forward contracts, it enjoys visibility over the utilisation rate of its power generation units over a limited period of time compared to their lifetime.

(211) Interested parties emphasize that the generators do bear important risks under their PPAs, in particular constructional, regulatory, environmental, maintenance and fiscal/financial risks. The Commission recognises that the PPAs do not eliminate all risks linked to the operation of a power plant. Indeed, these risk elements listed by the generators in their comments are certainly borne by the generators themselves. However, this corresponds to normal risks any market player on the electricity generation market would need to bear, including in the case of sales in the form of standard spot or forward markets. However, the commercial risks 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 are born by MVM on a substantial part (or entirety) of the lifetime of the assets under PPA.

(212) Interested parties also argued in their comments that the reservation of capacities for MVM entailed a disadvantage for them, because they could not use these capacities for

other purposes than for sales to MVM. However, the system of guaranteed minimum off-take mitigates that constraint to a large extent. The system of minimum guaranteed off-take should be regarded as a guarantee for generators that they will not be prevented from using their capacities for energy production and sale should MVM not make use of its reserved capacities. As a matter of fact, as shown by the following table, the minimum guaranteed off-take corresponded to a utilisation rate of the reserved capacities exceeding the average utilisation rate of the total available capacities in Hungary.

Table 5

#### Minimum guaranteed off-take and reserved capacities

	2004	2005	2006
Guaranteed off-take (GWh)	23 234	23 528	23 516
Reserved capacities (MW)	4 242	4 460	4 481
Ratio between minimum guaranteed off-take and reserved capacities (number of hours per year)	5 477	5 275	5 248
Ratio between net electricity generation and net available generation capacities for all Hungarian power generation units (number of hours per year)	4 272	4 225	4 601

(213) Therefore, spot and forward contracts entail a much higher level of risk for generators than the PPAs, which provide certainty both as regards the remuneration of fixed and capital costs and the level of use of the generation capacities.

#### Drawing rights

(214) As regards drawing rights, the main difference between this form of agreement and the PPAs is that drawing rights are normally not associated with minimum guaranteed off-take. The holder of the drawing rights bears commercial risks linked to the sale of the energy produced out of the reserved capacities. However, it has the assurance that it will be able to sell all that energy at prices covering at least variable costs, because it can decide not to generate energy if prices fall below variable costs. That assurance is not provided by the PPAs to MVM, owing to the existence of the minimum off-take obligations on MVM for the benefit of the generators.

#### Long-term purchase contracts concluded by large consumers

(215) As regards standard long-term purchase contracts concluded by large consumers, it is clear that they are much more advantageous for the buyer than the PPAs are to MVM because the price, which is usually fixed for



the whole duration of the contract, is normally not indexed on parameters such as fuel costs whose development over the duration of the contract is unpredictable, and is not designed in such a way as to cover fixed and capital costs, as it depends on price quotations on wholesale markets. Indeed, buyers have an interest in concluding long-term contracts only if these contracts provide them with 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. Furthermore, these contracts are usually concluded for much shorter periods than the PPAs and therefore give buyers the option to change suppliers if better prices are offered by competitors. In order to obtain the lowest prices possible, buyers often use tendering procedures.

#### **Balancing services contracts**

(216) Balancing services contracts are relevant to the assessment of the existence of an advantage between the PPAs because a minor part of the capacities reserved under PPAs is assigned by MVM for the provision of balancing services to the TSO<sup>(45)</sup>. In practice, MVM sells capacities to the TSO on an annual basis as a package and uses part of the capacities reserved under the PPAs for that purpose. In practice, it means that the generators do not bear the risk attached to the annual tenders<sup>(46)</sup> and to the uncertainty concerning the amount of energy that they will provide. From their point of view, the contractual conditions governing the provision of balancing services are those of the PPAs. However, as shown in recital 204, the specifications of the PPAs, especially their long duration and the existence of minimum guaranteed off-take, cannot be justified on commercial grounds even for the provision of balancing services. The Commission recognises that in Hungary, few generation units may be able to provide the necessary balancing services to the TSO, as claimed by interested parties, but has come to the conclusion that even in such circumstances the conditions offered by the PPAs go further than what a TSO may consider acceptable on commercial grounds.

#### **Conclusion on the comparison between PPAs and standard commercial practices**

(217) This comparison shows that PPAs structurally provide more guarantees to generators than standard commercial

contracts. The generators are thus in a more advantageous situation than the one they would face on the free market without their PPA. In order to complete the assessment of the existence of an advantage, it is necessary to assess the positive and negative effects that the public authorities could expect from the PPAs when Hungary joined the European Union and to verify whether they could have expected a better balance between the positive and negative effects from other approaches based on standard commercial practices.

(2)(c) Foreseeable consequences of the PPAs for the public authorities in the light of the comparison with buyers' standard commercial practices on European electricity markets

(218) The public authorities could expect from the PPAs that MVM would be able to find enough energy to fulfil the needs of the public utility market over a long period of time.

(219) However, they had no assurance concerning the level of price that would have to be paid by MVM over that same period because the PPAs do not provide hedging against risks of price fluctuations, which are due in particular to fluctuation in fuel costs.

(220) Furthermore, the combination of long-term capacity reservation and the associated minimum guaranteed off-take deprives the public authorities of the possibility of benefiting from more attractive prices offered by other generators and importers. The capacities and minimum guaranteed off-take of the PPAs, the long-term import contracts concluded by MVM and the quantities purchased by it under the mandatory off-take system<sup>(47)</sup> were sufficient to cover its needs. MVM could thus not diversify its supply portfolio, although alternative generation capacities were available. In 2004, several power generators were not engaged in long-term power purchase agreements. The PPAs of two power plants accounting for 470 MW of installed capacity expired at the end of 2003, which significantly increased the supply capacity outside PPAs. Around 700 MW of import capacities are not covered by long-term import contracts and could have been used by MVM to import electricity if it had not been bound by the system of reserved capacities and minimum guaranteed off-take.

<sup>(45)</sup> 15 % of contracted capacities in 2005.

<sup>(46)</sup> Owing to the annual tenders, the amount of capacity that can be offered to the TSO and the price obtained vary on an annual basis and may decrease if the TSO's needs decrease and/or if lower prices or larger amounts are offered by other suppliers.

<sup>(47)</sup> The Hungarian legislation requires MVM and the regional distribution companies to buy the electricity produced in cogeneration or from waste or renewable energy sources at regulated prices.

(221) As shown in the following recitals, it was clear when Hungary joined the European Union in 2003 and 2004 that the system of reserved capacities and minimum guaranteed off-take, which was designed under a Single Buyer Model whereby all electricity consumed in Hungary transited through MVM, entailed significant risks that the PPAs would require MVM to purchase energy beyond its needs.

(222) An important element to be taken into consideration in this respect is the partial opening of the electricity market in 2003. On 18 December 2001 the Hungarian Parliament adopted Energy Act II, which allowed large consumers, defined as those which consumed more than 6,5 GW/year, to become 'eligible consumers' and therefore be allowed to choose their supplier of electricity. This legislative measure, which came into force on 1 January 2003, led to the creation, alongside the pre-existing public utility segment, of a free market where prices resulted from the confrontation of supply and demand. The foreseeable effect of that measure was to reduce the quantities needed by MVM for supply to the regional distribution companies for the fulfilment of demand on the public utility segment. The following table shows the continuous increase in quantities actually sold on the free market between 2003 and 2006 and the corresponding decrease in quantities actually sold on the public utility segment through regional distribution companies.

Table 6

**Sales on the retail market (regulated segment and free segment)**

	(GWh)			
	2003	2004	2005	2006
Total consumption	33 584	33 836	34 596	35 223
Sales on the free segment	3 883	7 212	11 685	13 057
Sales on the regulated segment	29 701	26 624	22 911	22 166

Source: Statistical data of the Hungarian power system, 2006 <sup>(1)</sup>.  
<sup>(1)</sup> See amongst others the website <http://www.mvm.hu>

(223) Between 2003 and 2006 the quantities sold on the public utility segment, which correspond to MVM's actual purchase needs, decreased by 25 %. The decrease of MVM's needs was largely foreseeable at the time when Hungary joined the European Union, particularly in the light of the significant difference between the official prices on the public utility segment (prices paid by consumers to regional distribution companies) and the prices observed on the free segment in 2003 and 2004.

Table 7

**Price differences between the regulated segment and the free segment on the retail market in 2003 and 2004**

	(HUF/kWh)	
	2003	2004
Average price on the free market	11,1	12,7
Average prices on the public utility sector <sup>(1)</sup>	19	21,1

Source: Statistical data on the Hungarian power system, 2006

<sup>(1)</sup> Resulting from the regulated tariffs, which depend on the level of consumption.

(224) Prices on the free market indeed constituted clear incentives for eligible consumers to make use of their eligibility rights. It was also well known in 2003 and 2004 that the forthcoming accession of Hungary to the European Union would entail the entry into force of the Second Electricity Directive <sup>(48)</sup>, and consequently the rights of all consumers to become eligible as from 1 July 2007, which would lead to a further reduction of MVM's needs over a much shorter period of time than the remaining validity of the PPAs.

(225) Consequently, it was clear in 2003 and 2004 that the PPAs, which had been designed in the context of a Single Buyer Model whereby all electricity needed by the Hungarian market transited through MVM, would not only prevent MVM from diversifying its supply portfolio and obtaining more favourable prices by fostering competition between its suppliers, but was also likely to result in the obligation on MVM to purchase more energy than it actually needed.

(226) This risk had actually been identified by the public authorities. In 2002, the Hungarian Government issued a Decree <sup>(49)</sup> which required MVM to initiate a renegotiation of the PPAs with all generators with a view to adjusting the amount of reserved capacity. Although that Decree did not require the termination of the PPAs, it is in itself a clear indication that the amounts of capacity reserved under the PPAs (and subsequently, the minimum guaranteed off-take) were too high in the light of the gradual liberalisation of the retail market. That Decree also introduced the possibility for MVM, in the event of failure to complete negotiations with generators, to sell capacities and energy which prove to be in excess of the amounts actually needed to supply the regulated segment, through three 'release mechanisms': capacity auctions, capacity tenders and sales on a virtual Internet-based trading platform called 'the Marketplace' (*Piactér*). Although the form of these three mechanisms vary, all three of them in essence

<sup>(48)</sup> 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, OJ L 176, p. 37-55.

<sup>(49)</sup> Governmental Decree 183/2002.

consist in MVM offering for sale on the free market, in the form of a variety of forward delivery products, the surplus energy that it does not need to supply the public utility sector but that it has to purchase in accordance with the terms of the PPAs.

- (227) The following table displays data concerning the first three auctions carried out by MVM. It shows that the prices received by MVM for the energy sold through the release mechanisms were significantly below the prices paid for that same energy under the PPAs.

Table 8

**MVM's three first auctions**

	First auction June 2003	Second auction December 2003	Third auction June 2004
Baseload products			
Quantities of electricity sold (GWh)	375	240	133
Sale prices on auctions (HUF/kWh)	8,02	9,5	8,4
Off-peak load products			
Quantities of electricity sold (GWh)		259	421
Sale price on auctions		5,6	3,5
Average annual PPA prices			
	2003	2004	
	11,3	11,7	

- (228) The Hungarian legislation had actually anticipated that effect and provided for a compensation to be paid by the Hungarian State to MVM for the losses incurred owing to the difference between the price paid for the quantities released through capacity auctions and the sales prices obtained on the market. The compensation paid to MVM amounted to 3,8 billion HUF in 2003<sup>(50)</sup>. According to MVM's annual report for 2004, the compensation increased by HUF 2,4 billion in 2004.
- (229) From the point of view of the public authorities, it is clear that such a system cannot be justified on commercial grounds as it amounts to subsidising the sales of generators for supply to the free market segment.
- (230) The following table shows the total quantities of energy sold by MVM through the release channels between 2003 and 2004 on the basis of the information provided by Hungary on 24 September 2007 and 21 April 2008.

<sup>(50)</sup> See the letter of the Hungarian authorities registered on 4 June 2004.

Table 9

**Quantities sold by MVM through the release mechanisms**

	(TWh)			
Year	2003	2004	2005	2006
Total sales by MVM through the release mechanisms <sup>(1)</sup>	0,6	1,9	6,5	6,5

<sup>(1)</sup> Capacity auctions, capacity tenders and MVM Marketplace.

- (231) It is clear that under normal market circumstances buyers do not engage in contracts which entail a significant risk of being compelled to buy more electricity than needed and incurring substantial losses when reselling that energy. This risk is theoretically present in forward contracts and long-term contracts concluded by large end-consumers, but to a much lower degree.
- (232) The duration of forward contracts is significantly less than that of the PPAs. The buyer has a much better overview of its needs for such timeframes than for a period ranging from 15 to 27 years. Furthermore, buyers tend to cover only part of their expected needs with forward contracts, buying any additional quantities needed on spot markets.
- (233) Long-term contracts concluded by large end-consumers also entail only a limited risk of excess purchase because of their limited duration, and also because the consumption of large industrial and business end-consumers entering into such contracts is as a rule stable and predictable, which is not the case for MVM for the reasons outlined above.

- (234) Furthermore, it is useful to recall that under forward contracts or long-term purchase contracts concluded by end-consumers, buyers commit to buying a certain amount of energy several months or years before actual delivery takes place because their purchase contract provides hedging against price fluctuations. This benefit is not present in the PPAs because prices cover variable costs, which owing to variation in fuel costs may increase in unpredictable proportions.

**Conclusion on the existence of an advantage**

- (235) The Commission concludes that the benefits obtained by the public authorities from the PPAs do not provide the hedging on energy prices that the average market operator would expect from a long-term contract and entail significant risks of being compelled to purchase energy in excess of actual needs and incurring losses when reselling the surplus quantities. These risks were

well known by the Hungarian authorities when Hungary joined the European Union. The comparison between PPAs and standard commercial practices on European electricity markets shows that a buyer acting on purely commercial grounds would not have accepted such detrimental effects and would have adopted other purchase strategies and entered into different types of agreements in line with standard commercial practice.

- (236) In the light of the above, the Commission concludes that the core principles of the PPAs entail an advantage to the power generators beyond normal commercial advantage. In this respect, it is essential to stress that the main principles of the PPAs, i.e. the long-time capacity reservation, minimum guaranteed off-take and pricing mechanisms based on a capacity fee and an energy fee to cover fixed, variable and capital costs, cannot be isolated and assessed separately. The existence of an advantage lies in the combination of these elements. As shown above, the long duration of the PPAs contributes to a great extent to the existence of an advantage.

(3) *The impact of the PPAs on the market in the period following Hungary's accession to the European Union*

- (237) Interested parties argue in their comments that the prices applied under the PPAs are not higher than wholesale market prices. The Mátra power plant especially stresses that its prices are competitive because it has its own coal mine, so it has low mining costs. Consequently, they conclude that they do not benefit from any advantage.

- (238) The Commission cannot agree with this line of argument.

- (239) First, as discussed in detail above, the price actually paid under the PPAs is one consequence of the PPAs but it does not constitute the core of the advantage entailed in them. The comments by the banking institutions referred to above (see in particular recitals 175 and 176) also confirm that all the elements of the PPAs guaranteeing the generating units the return on the investment of the assets and shielding the generators from the commercial risks of their operation constitute together the core of the advantage of these agreements.

- (240) Second, the price difference compared to market prices depends on a great number of factors linked to market evolution which are independent of the PPAs and can only be assessed *a posteriori*. The PPA prices are unit prices at a certain point in time; they do not take into consideration the advantage flowing from all other elements of the PPAs, such as the capacities and quantities which the generators could have sold if their sales depended on market demand. As discussed above,

the Commission is of the view that there is an economic advantage for generators inherent to all PPAs under assessment, whether or not they actually lead, at a given period of time, to prices above market prices.

- (241) For the sake of completeness of the Commission's answers to the comments received and to better understand the consequences of the PPAs in this regard, the Commission nevertheless compared the PPA prices actually applied with prices achieved on the part of the wholesale market not covered by PPAs.

- (242) In this comparison, the Commission does not take into account 2007 prices as in that year (more precisely, from 9 December 2006 to 31 December 2007) the PPA prices were overwritten by official prices. Accordingly, the applied prices do not necessarily reflect the exact prices to which the application of the PPA price formulae would have led.

- (243) Consequently, the Commission compared the applied PPA prices with free market prices for 2004 to 2006.

Table 10

**The average price of electricity sold to MVM under the PPAs <sup>(51)</sup>**

Power plant under PPA	HUF/kWh		
	2004	2005	2006
Dunament F blocks	[...]	[...]	[...]
Dunament G2 block	[...]	[...]	[...]
Tisza II	[...]	[...]	[...]
Pécs	[...]	[...]	[...]
Csepel II	[...]	[...]	[...]
Kelenföld	[...]	[...]	[...]
Újpest	[...]	[...]	[...]
Kispest	[...]	[...]	[...]
Mátra	[...]	[...]	[...]
Paks	[...]	[...]	[...]

- <sup>(51)</sup> The figures in the table are based on the letters from the Hungarian authorities registered on 24 September 2007 and 16 January 2008. There are certain minor differences (of less than 5 %) between the figures provided in the two information letters with regard to the prices for 2006. This Decision is based on the most recent information (letter of 16 January 2008).

Table 11

**The quantity and average price of electricity sold by domestic generators without PPA to the free market <sup>(52)</sup>**

Power plant	2004		2005		2006	
	Quantity (MWh)	Price (HUF/kWh)	Quantity (MWh)	Price (HUF/kWh)	Quantity (MWh)	Price (HUF/kWh)
Mátra ([...] blocks)	989 097	8,15	972 813	8,33	1 082 699	9,26
Vértes	157 701	8,02	942 999	8,79	1 213 622	10,51
Dunamenti [...] block	215 647	8,57	805 381	9,85	814 702	13,29
EMA	133 439	11,07	129 252	11,83	101 607	12,92
AES Borsod	[...]	[...]	18 301	11,25	n.a. (*)	
AES Tiszapalkonya	364 869	12,76	86 673	9,87	119 218	14,27

(\*) The quantities sold are below 1 000 MWh. The Commission considers that the price for such limited quantities does not constitute an adequate basis for comparison with PPA prices.

Table 12

**The quantity and average price of electricity imports purchased by MVM <sup>(53)</sup>**

Import	2004		2005		2006	
	Quantity (MWh)	Price (HUF/kWh)	Quantity (MWh)	Price (HUF/kWh)	Quantity (MWh)	Price (HUF/kWh)
Ukraine through Slovakia ([...] (*))	1 715 200	[...] (**)	1 525 600	[...] (**)	1 311 400	[...] (**)
Switzerland through Slovakia ([...] (*))	1 768 100	[...] (**)	1 761 700	[...] (**)	1 709 200	[...] (**)
Switzerland ([...] (*))	631 700	[...] (**)	629 500	[...] (**)	626 200	[...] (**)

(\*) Name of import partner company.

(\*\*) The average weighted price of all electricity imports covered in this table was 9,14 HUF/kWh in 2004, 10,41 HUF/kWh in 2005, and 11,49 HUF/kWh in 2006.

(244) Since 2003, in line with Energy Act II <sup>(54)</sup>, MVM has been releasing surplus power (i.e. power in excess of what it needed for the public utility segment) for supply to the competitive market through three release channels: (i) public generation capacity auctions, (ii) capacity tenders and (iii) its virtual on-line trading platform, the 'Piactér'. The table below presents the average prices achieved at these sales:

<sup>(52)</sup> Information based on the letter from the Hungarian authorities registered on 24 September 2007. The company E.ON DKCE also sold electricity to the free market in 2005 and 2006. However, according to information provided by the Hungarian authorities by letter registered on 22 April 2008, the quantities sold were minor, so the Hungarian authorities did not have the corresponding price data.

<sup>(53)</sup> Information based on the letters of the Hungarian authorities registered on 24 September 2007 and 16 January 2008. There are minor differences (of less than 2 %) between the figures provided in the two information letters. This Decision is based on the most recent information (letter of 16 January 2008). The imports by MVM are also based on long-term agreements; those agreements are not covered by the present procedure.

<sup>(54)</sup> See recital 32 of this Decision.

Table 13

Average price achieved by MVM capacity auctions, tenders and Marketplace <sup>(55)</sup>

Year of delivery of auctioned product (*)	Weighted average price at capacity auctions (HUF/kWh)	Year of Tenders and Marketplace sales	Average price at tenders and Marketplace (HUF/kWh)
2004	4,7	2004	6,5
Auction of 17 June 2004	Off peak: 3,48 Base: 8,4		
2005	5,4	2005	8,1
Auction of 9 December 2004	Off peak: 4,54 Base: 8,32		
Auction of 10 June 2005	Off peak: 4,6 Base: 8,5		
Auction of 21 July 2005	Base: 9,3 Peak: 10,42		
2006	9,9	2006	9,1
Auction of 9 November 2005	Off peak: 6,02 Base: 9,74 Peak: 11,76		
Auction of 31 May 2006	Base: 11,33		

(\*) The quantities sold are between 25 000 and 2 000 000 MWh per type of product (off-peak/base/peak).

(245) The above figures show that the average prices at which electricity was sold in Hungary on the competitive sector in 2004 at the wholesale level varied between 4,7 and 12,76 HUF/kWh. Of the generators with PPAs, the Paks nuclear power plant and Mátra sold to MVM at prices in that range. Dunament [...] sold its electricity under PPA at [...], the highest price ([...]) achieved without PPA. All other generators charged MVM an average price between 13,86 and 25,46 HUF/kWh. This pricing is 10 % to 100 % higher than the *highest* free market price.

(246) In 2005, the prices of sales outside the PPAs under assessment varied between 5,4 and 12,91 HUF/kWh. Of the generators with PPA, only the Paks and Mátra power plants sold electricity under their PPAs within this price range. All other generators charged their electricity under PPA at an average price between 13,99 and 25,64 HUF/kWh. This pricing is between 10 and 100 % higher than the *highest* free market price.

(247) In 2006, sales prices outside the PPAs in question varied between 9,1 and 14,27 HUF/kWh. Of the generators with PPA, only the Paks and Mátra power plants sold electricity under their PPAs within this price range (in the case of Paks, actually below the lowest free market price). All other generators charged their electricity under PPA at an average price between 16,67 and 33,49 HUF/kWh. This is between 15 % and 135 % higher than the *highest* free market price.

(248) The above calculations are based on *average* price figures, i.e. they do not calculate separately with off peak, base or peak prices. Generators that would mainly sell peak load products in the absence of PPAs <sup>(56)</sup> argue that their prices should not be compared to base load prices. Indeed, the Commission recognises that peak electricity prices are normally higher than those of base load electricity. When comparing those prices with free market sales (for instance, at the electricity auctions by MVM), peak products show an average price level around 10-30 % above base load prices.

<sup>(56)</sup> According to the Hungarian authorities, in the absence of PPAs the various generators currently under PPAs would achieve maximum profit in the following way: the Paks and Pécs power plants would sell 100 % of their production in the form of base load products, the Mátra, Dunament G2, Kelenfold, Ujpest and Kispest power plants would sell approximately 50 % of their produced electricity as base and 50 % as peak products, while the Csepel, Dunament F block and Tisza II power plants would sell mostly peak electricity (approximately 70 %).

<sup>(55)</sup> The average prices represent indicative weighted prices.

- (249) However, when comparing the prices of Csepel, Dunament F and [...] with peak prices achieved at the capacity auctions, it can be seen that their prices were higher than the price of any peak product obtained at the auctions during these years. Moreover, amongst the generators selling electricity without PPA to the free market and listed in Table 11 above, there are some (for instance the EMA plant) which also sold mainly peak products.
- (250) The above comparison shows that the PPA prices of the generators under PPA in years 2004 to 2006, with the exception of the Paks and Máttra power plants, were actually higher than the highest free market prices.
- (251) Accordingly, the Commission disagrees with the arguments of interested parties that their PPA prices were not higher than free market prices.
- (252) As far as the Paks and Máttra power plants are concerned, the above tables show that their prices were below the highest price achieved on the free market. Máttra plant's prices were in the higher range of free market prices. Although its prices are indeed likely to be more competitive than most PPA prices, the Commission cannot exclude that it could not have achieved at least the same prices without its PPA. The Commission notes that the prices Máttra achieved from sales of its blocks without PPA were significantly below its PPA prices.
- (253) The Commission is aware that the prices achieved in the free market sector (without PPAs) cannot be considered as corresponding to the exact market price the generators would have achieved without PPAs if the PPAs had not existed in the period in question. PPAs covering approximately 60 % of the generation market undoubtedly impact prices on the rest of the market. However, this comparison gives an indication of the order of magnitude of the difference between the PPA and the actually observed 'non-PPA' prices.
- (254) The Commission has analysed these arguments and cannot agree with them for the following reasons.
- (255) Under Community legislation, Member States have a certain margin of discretion to define services they consider to be SGELs. Defining the scope of SGELs in a Member State is, within the limits defined by Community legislation, a prerogative of the State itself and it is not for the beneficiaries of aid measures to qualify their own service as a public service.
- (256) In the course of the present procedure, however, the Hungarian authorities never submitted the argument that any of the generators provided an SGEL, nor did they support the generators' arguments to that effect.
- (257) The Commission also considers that the PPAs do not fulfil all the criteria laid down in the *Altmark* judgment.
- (258) First, under the *Altmark* judgment, the recipient undertaking is actually required to discharge a public service and the obligations connected with that service are to have been clearly defined by the Member State.
- (259) MVM did have an obligation of security of supply under Hungarian legislation in the time period under assessment, but this obligation was a general obligation whereby the Single Buyer at the time had to ensure the necessary supply of energy to cover total demand; however, it does not entrust any specific generator with a defined SGEL.
- (260) The objective of security of supply is of a very general nature. To some extent, the view could be taken that any generator in the electricity sector contributes towards achieving this objective. The interested parties failed to submit any official document of the Hungarian State clearly defining an SGEL and entrusting a specific generator (or generators) with providing that specific service.
- (261) The PPAs themselves are similar in this respect: they fix the obligations of the parties but do not define a specific public service obligation. The fact that all of the ten power plants under PPAs have to reserve their capacities to MVM does not in itself mean that they are specifically entrusted with a public service obligation. Again, such an approach could lead to the conclusion that the whole power generation sector fulfils an SGEL – which would clearly be in breach of the spirit Community legislation and practice means to give to the concept.
- (262)

#### ***Service of general economic interest (SGEI)***

- (254) The Budapest and Csepel power plants have argued that the PPAs should be regarded as implementing SGELs for the purpose of securing electricity supplies. They considered that they fulfil the criteria laid down in the *Altmark* judgment, which means that their PPAs do not constitute State aid within the meaning of Article 87(1) of the EC Treaty.

- (263) In the present case, the alleged public service obligations have not been clearly defined and there is no specific generator required to discharge any such concretely defined public service obligation.
- (264) The interested parties argue that PPAs are documents that entrust generators with SGEIs. But PPAs do not contain any specific definition of SGEIs and do not refer to these obligations or to legal provisions that would be a basis for the State to entrust SGEIs to other entities.
- (265) In its decisions to date<sup>(57)</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), i.e. provided that the generators concerned use indigenous primary energy fuel sources to produce energy 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.
- (266) The only generator that submitted that it used indigenous primary energy fuel was Mátra power plant. However, Mátra power plant did not produce any official documents showing that the Hungarian State had specifically entrusted it with a clearly defined SGEI.
- (267) In the light of the above, the Commission must reject the claim that the PPAs discharge a public service obligation in the field of security of supply.
- (268) Second, the parameters on the basis of which the compensation is calculated should 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>(58)</sup>.
- (269) In the absence of a clear definition of the SGEIs to be provided, in particular one making a clear distinction between the services 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.
- (270) 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.
- (271) Third, where the company which is to discharge public service obligations has not been selected via 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.
- (272) Nine of the ten PPAs were signed without tendering procedures. Even in the one tendering procedure for Kispeszt power plant, no specific objective for the SGEIs was defined. This makes it difficult to assess what exact part of the power plant's activities would correspond to the SGEI and thus what the level of compensation would be that would not exceed what is necessary to cover the costs incurred in the discharge of the public service obligation.
- (273) Furthermore, neither the Hungarian authorities nor the interested parties provided an analysis of the costs of the generators in question to support the contention that they correspond to the costs incurred by a typical undertaking.
- (274) Finally, the Commission notes that, with the exception of the Kispeszt PPA, all of the other PPAs under assessment were signed without a tender procedure.
- (275) The PPAs thus do not fulfil the criteria of the *Altmark* judgment.
- (276) The interested parties 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. The compatibility of the measure with Article 86(2) of the EC Treaty is assessed under point 7.7 of this Decision.

<sup>(57)</sup> See Commission decisions in cases N 34/99 (OJ C 5, 8.1.2002, p. 2), NN 49/99 (OJ C 268, 22.9.2001, p. 7), N 6/A/2001 (OJ C 77, 28.3.2002, p. 25) and C 7/05 (not yet published).

<sup>(58)</sup> These are actually the second and third criteria of the *Altmark* judgment.



**Selectivity**

- (277) The PPAs were concluded with a number of companies in a certain sector of the economy. The companies benefiting from the PPAs at stake are listed in Table 1 above.
- (278) AES-Tisza argues that the PPAs are not selective as long-term agreements exist in the entire electricity sector: between MVM and the generators, between MVM and the distribution companies, and for the import of electricity. They argue that, as a result of the legislative measures at that time in Hungary, all generators had agreements with MVM and only renewable and cogeneration plants had shorter term agreements.
- (279) The Hungarian authorities observe in their submissions relating to the interested parties' comments that important power plants and blocks of power plants sell electricity on the free market without PPAs and mandatory off-take (e.g. the Dunament G1 block, the Vértes power plant and the Mátra I-II blocks).
- (280) Indeed, there are important power plants and blocks which operate without PPAs (see the examples provided by the Hungarian authorities). The company AES itself owns two power plants which do not operate under PPAs.
- (281) The Commission notes that the fact that an aid measure is not aimed at one or more specific recipients defined in advance, but that the beneficiaries are identified on the basis of a number of objective criteria, does not mean that this measure does not confer a selective advantage on its beneficiaries. The procedure for identifying beneficiaries does not affect the State aid nature of the measure <sup>(59)</sup>.
- (282) Furthermore, it is also confirmed by the case law of the Court that even a measure that would favour an entire sector compared to other sectors of the economy in a comparable situation must be considered as conferring a selective advantage on that sector <sup>(60)</sup>.
- (283) In the light of the above considerations, the Commission concludes that the PPAs constitute a selective measure.

**State resources and imputability to the State**

- (284) The Commission needs to assess whether the PPAs involve the transfer of State resources.

<sup>(59)</sup> Case T-55/99 of the Court of First Instance of 29 September 2000, *CETM v Commission*, paragraphs 40 and 52.

<sup>(60)</sup> Case 203/82 of the Court of 14 July 1983, *Commission v Italy*, paragraph 4.  
Case 173/73 of the Court of 2 July 1973, *Italy v Commission*, paragraph 18.

(285) The core principle of all the PPAs under assessment is the purchase obligation by MVM of a fixed generation capacity and fixed minimum quantities of generated power at a price covering the fixed and variable costs of the power plant, over a duration of 15 to 27 years. In economic terms, this purchase obligation creates a continuous obligation for MVM to pay a certain price for a certain capacity (capacity fee) and a certain quantity of energy (energy fee) to the power generators over the entire duration of the contract. Further financial obligations of MVM are laid down in the individual PPAs, as described under Chapter 2 above. This ongoing transfer of financial resources to the generators and the payment of the fees referred to is inherent in all the PPAs and is present for the entire duration of the contracts. Naturally, the longer the duration of the PPA, the higher the amount of resources transferred.

(286) In order to establish whether the resources transferred by MVM to the generators constitute State resources, the Commission has assessed the measure on the basis of the following considerations in particular:

**Existence of State resources — the PreussenElektra ruling <sup>(61)</sup>**

- (287) In its PreussenElektra ruling, the Court of Justice examined a mechanism under which privately owned companies were compelled by the State to purchase electricity from specific electricity producers at a price fixed by the State and higher than the market price. The Court ruled that, in such a case, there was no transfer of public resources and therefore no State aid.
- (288) The Commission considers that the Hungarian scheme is significantly different from the system examined by the Court in the aforementioned ruling, owing in particular to the difference in the ownership structure of the companies under a purchase obligation.
- (289) The company on which the State imposed the purchase obligation was privately owned in the PreussenElektra case, while MVM is entirely State-owned. The resources used are therefore resources belonging to and controlled by a fully State-owned company.

(290) In the PreussenElektra case, when tracing the monies from the beneficiary back to their origin it transpired that they never came under the direct or indirect control of the State. However, in the present case they do come under State control since, in tracing them back to their origin, it can be seen that they go to a state company.

<sup>(61)</sup> Case C-379/98 of the Court of Justice of 13 March 2001.

**Imputability to the State: the Stardust ruling** <sup>(62)</sup>

- (291) The Commission also considers that the behaviour of MVM is imputable to the Hungarian State. It must be added that the Hungarian authorities never argued during the present procedure that the PPAs were not imputable to the State and thus did not involve the transfer of State resources.
- (292) The underlying principle of MVM's purchase obligation designed to guarantee the viability of the power plants concerned is imputable to the Hungarian State. As this core principle governing the PPAs throughout their entire duration was established when the PPAs were entered into, the Commission needs to examine the conditions of the signing of the PPAs (i.e. the circumstances of the establishment of this core principle) in order to clarify whether it is imputable to the Hungarian State.
- (293) In its assessment of the imputability question, the Commission took into consideration, in particular, the following circumstances.
- (294) At the time the PPAs were entered into, under Energy Act I MVM had the legal obligation to ensure security of supply in Hungary at the lowest possible cost.
- (295) The same Energy Act I required MVM to assess electric energy demands and initiate the extension of production capacities based on the prognosis resulting from the assessment. MVM had to prepare a National Power Plant Construction Plan (*Országos Erőműépítési Terv*) which then had to be submitted to the Government and the Parliament for approval.
- (296) The Hungarian Government and all interested parties agreed in their comments that at the time of their conclusion the PPAs constituted the tool identified by the Hungarian Government to ensure security of supply and other governmental objectives, such as the modernisation of the energy sector with particular regard to the prevailing standards of environmental protection, and the necessary restructuring of the sector <sup>(63)</sup>. As Csepel power plant states in its comments: 'The PPA must thus be assessed as what it is: an integral part of the Hungarian State's attempt through MVM to build a diversified generation portfolio at a time when the State did not have the financial means to achieve this on its own' <sup>(64)</sup>.
- (297) The Hungarian authorities informed the Commission <sup>(65)</sup> that preparation for the signature of the PPAs had started in the context of the privatisation procedure for the power plants, on the basis of Governmental Decree 1114/1994 (XII.7). The entire procedure of drawing up the PPAs and privatisation was characterised by strong cooperation between the Hungarian Energy Office (the regulator), the Ministry of Industry and Trade, the Ministry of Finance, the 'Allami Vagyonügynökség Rt' i.e. the governmental body responsible for the privatisations, MVM, and a number of international advisors.
- (298) A working committee was set up in this context with representatives from the above bodies, which adopted guidelines on the drafting of, *inter alia*, the PPAs and the pricing methods.
- (299) At the request of the Hungarian Government, a standard PPA was drafted by an international law firm. The Hungarian authorities confirmed that the PPAs were based on this standard model. They also confirmed that the price setting mechanism of the PPAs had been prepared on the basis of the Government Decision of 1074/1995 (III.4) on the price regulation of electric energy, which included detailed rules on the calculation of regulated electricity prices. The PPAs took over the formulae and definitions of the Government Decision <sup>(66)</sup>.
- (300) The decision on the signature of the PPAs was taken by the Board of Directors of MVM, both in the context of the privatisation and after. The members of the Board of Directors are elected by the General Meeting. According to the information received from the Hungarian authorities <sup>(67)</sup>, 'as MVM is more than 99 % State-owned, the members of the Board of Directors are appointed, elected and recalled as seen fit by the State'.
- (301) Under Government Decree 34/1995 (IV.5) on the implementation of Energy Act I, MVM was required to organise a call for tenders within ninety days following the approval of the Power Plant Construction Plan.
- (302) The PPA of Kispest power plant was signed following a tendering procedure in accordance with the legal procedure set out below
- (303) Joint Guidelines of the responsible Ministry and the Hungarian Energy Office were issued in 1997 on the authorisation procedure for power plant construction and the general rules of the tender procedure.

<sup>(62)</sup> Case C-482/99 of 16 May 2002 of the Court of Justice.

<sup>(63)</sup> See e.g. the letter of the Hungarian authorities registered on 25 July 2005.

<sup>(64)</sup> Page 5 of the comments.

<sup>(65)</sup> Letter registered on 25 July 2005.

<sup>(66)</sup> 'A szerződés mintegy áttemelte a Kormányhatározatban szereplő képleteket, meghatározásokat.' Letter of the Hungarian authorities registered on 25 July 2005.

<sup>(67)</sup> Letter dated 20 July 2005 registered on 25 July 2005.

- (304) The Joint Guidelines set out the main reasons for the need to transform the ownership structure and establish new power generation capacities. It clearly identifies the targets: security of supply at the lowest possible cost, modernisation to meet environmental protection standards, diversification of the primary energy sources, more flexible power plant park possessing the necessary reserve and able to cooperate with the western European electricity system. It also stresses that the operation of the future power plant park 'shall allow profitable operation and maintenance, at a development of prices being in accordance with the provisions of the law' <sup>(68)</sup>.
- (305) Under point 2, the Joint Guidelines of the Ministry and the Hungarian Energy Office also add that the implementation of the above targets should result in 'a modern electricity system satisfying the requirements of environment protection, guaranteeing the European cooperation, the return of justified investments and the costs assumed by efficiently operating license holders, as well as prices containing a profit necessary for a durable operation. All the above aims shall be achieved in a way guaranteeing ...the safety of the primary energy supply, enable those intending to invest in this area to feel their investments, the return on investments in safety, ..., the fulfilment of the declared government intentions in safety.'
- (306) The Joint Guidelines then regulate the competition procedure relating to the establishment of power plant capacities.
- (307) A Principal Evaluating Committee (Értékelő Főbizottság) made the final proposal to the winner of the tender. The members of this Committee were the representatives of the Ministry of Economy, the Ministry of Environment, the Hungarian Energy Office, MVM and the ERSTE Bank. The final decision was taken by the Board of Directors of MVM. Under the Joint Guidelines, the official result of the tender was to be published (exclusively) in the official bulletin of the Ministry.
- (308) Energy Act II was constructed in a way as to presuppose the existence of the PPAs. This Parliamentary Act that is the main legal framework for the operation of the Hungarian energy market in the period under assessment refers numerous times to the long-term purchase obligations of MVM.
- (309) Article 5(2) of Government Decree No 183/2002 (VIII.23) on stranded costs lays down an obligation for MVM to initiate the renegotiation of the PPAs in order to decrease the purchased capacities. The decree thus obliges MVM to propose the amendment of the PPAs.
- (310) AES-Tisza argued in its observations that the prices under the PPAs were not imputable to the State after the period of price regulation (i.e. after 1 January 2004, with the exception of new price regulation in 2007), but were the result of negotiations between the power plant and MVM.
- (311) The Commission acknowledges that the exact amount of resources transferred to the beneficiaries does not solely depend on the clauses contained in the PPAs, which are imputable to the State, but also to periodic bilateral negotiations conducted by MVM with the generators. In fact, PPAs offer a certain latitude to the parties to negotiate the quantities of electricity actually purchased by MVM as well as certain components of the price, notably with respect to the calculation of the capacity fees, which as indicated in recital 356 depend on a number of factors and necessitate periodic adjustments. However, the negotiations on purchased quantities can never lead to quantities below the minimum guaranteed off-take level established in the PPAs. Similarly, negotiations on prices can only be conducted in the framework of the price-setting mechanisms enshrined in the PPAs, which are imputable to the State. The price negotiations thus did not call into question the principle of purchase obligation covering justified costs and a level of profit necessary for the operation of the power plant.
- (312) Furthermore, the fact that the PPAs provide for the reservation of the bulk of the capacities of the power plants under PPAs and a payment for these capacities entails in itself a transfer of State resources to the beneficiaries, independently of periodic negotiations between MVM and the generators.
- (313) In their comments <sup>(69)</sup>, the interested parties all agreed that the main formulae and definitions applied on the basis of the PPAs after 1 January 2004 followed the main rules of price regulation. [...] <sup>(70)</sup> itself explains both in its abovementioned comments and in its comments on the Opening Decision that the price negotiations 'clarified' the application of the pricing formulae and 'interpreted' its content (\*). It recognises that the PPA prices have always been cost based, covering justified costs, and that from the beginning they largely took into account the price calculation method applied by the price decrees.
- (314) [...] furthermore explains that the price formulae of the [...] amendment to its PPA are also based on government decrees: 'The formula in the [...] Amendment (Schedule [...] Annex [...]) for the calculation of the availability fee is the same as that

<sup>(68)</sup> The text of the Joint Guidelines was submitted to the Commission in English only.

<sup>(69)</sup> Forwarded to the Commission by the Hungarian authorities on 20 October 2004 and, in respect of Dunament, on 25 July 2005.

<sup>(70)</sup> Annex 3 to [...]s submissions.

(\*) Name of power generator.

included in the applicable Decrees (footnote reference to Decree 55/1996 of the Minister of Industry, Trade and Tourism (IKIM) and Decree 46/2000 of the Minister of Economic Affairs (GM), and the last applicable one (re generators) before 1 January 2004 was Decree 60/2002 of the Minister of Economic Affairs and Transportation (GKM)) setting out the maximum availability (= capacity) and energy fees for generators listed therein'.

- (315) The above shows that neither the price negotiations nor the amendments to the PPAs affected the core principle of the PPAs as established in the circumstances described, when the PPAs were signed. The same principle of a purchase obligation in order to ensure return on investment governs the PPAs today.
- (316) It is apparent from the above circumstances that the existence of MVM's purchase obligation vis-à-vis the power generators, with the principle of covering justified fixed and variable costs, is imputable to the Hungarian State.
- (317) Furthermore, it is settled case law that a measure does not constitute State aid only when an advantage is conferred on undertakings by way of a direct and clear mobilisation of State resources, but also when the granting of the advantage may, if certain conditions are fulfilled in the future, entail an additional financial burden for the public authorities which they would not have had to bear if the advantage had not been granted<sup>(71)</sup>. In 2004, it was clear that MVM would bear such an additional burden in the likely event that power generators and importers not engaged in PPAs offered lower prices than the PPA prices, because the development of such offers would create incentives for MVM to modify its supply portfolio and consequently reduce the quantities purchased from the power generators actually under PPAs and obtain price reductions from them. However, owing to its obligations stemming from the PPAs, MVM cannot make such decisions because, as shown above, MVM cannot reduce the quantities purchased from generators operating under PPAs below a minimum level (the guaranteed off-take quantity) and cannot negotiate prices on the basis of alternative offers provided by competing generators, but only within the cost-based price formation mechanism enshrined in the PPAs. This fact, together with the conclusion reached in recitals 315 and 316, leads the Commission to conclude that the condition of transfer of State resources has been present in the PPAs since 1 May 2004 and will be present as long as they are valid, independently of actual market conditions, because they prevent MVM from carrying out the arbitrages that might prove appropriate to minimise the amounts of resources spent for the purchase of the electricity necessary to fulfil its needs.
- (318) It follows from the above considerations that the PPAs lead to the transfer of State resources.

<sup>(71)</sup> See in particular the judgement of the Court of First Instance of 13 June 2000 in Joint Cases T-204/97 and T-270/97 *EPAC v Commission* [2000] ECR II-02267.

### ***Distortion of competition and impact on trade between Member States***

- (319) The electricity markets have been opened to competition and electricity has been traded between Member States in particular 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>(72)</sup>.
- (320) Measures that favour undertakings in the energy sector in one Member State may therefore impede the ability of undertakings from other Member States to export electricity to that State, or favour the export of electricity from that State to the other Member State. This is particularly true for Hungary, which owing to its central location in Europe is connected or can easily connect to the networks of numerous present or future Member States.
- (321) This is particularly true for Hungary, which is a centrally located country in Europe surrounded by seven countries, four of which belong to the EU. Of the EU Member States, it has interconnectors with Slovakia, Austria and Romania. In 2004 it imported nearly 14 000 GWh and exported 6 300 GWh. From 2005, imports increased to above 15 000 GWh and exports to between 8 000 and 10 000 GWh.
- (322) In the years following Hungary's accession to the EU, approximately 60 % of Hungarian generation capacity was contracted by MVM under PPAs. The PPAs expire between the end of 2010 and the end of 2024. The above conditions of MVM's purchase obligation will remain unchanged until the end of the agreements.
- (323) The first step of the opening up of the market in Hungary took place on 1 July 2004, when all non-household consumers became eligible to switch to the free market. On 1 January 2008 the public utility segment ceased to exist and accordingly all customers became 'eligible'.
- (324) Notwithstanding the market opening since 2004, a sizable proportion of eligible customers did not choose the free market segment. The Report of the Office of Economic Competition on the sectoral investigation on the Hungarian energy market<sup>(73)</sup> explicitly concluded that the lack of available capacities on the free market due to the substantial volumes of capacities reserved under the PPAs creates a serious obstacle to choosing the free market. Through the PPAs, around 60 % of Hungarian generation capacities were tied to the public utility sector, to MVM only, and only the remaining capacities could in reality compete for new customers.

<sup>(72)</sup> OJ L 27, 30.1.1997, p. 20.

<sup>(73)</sup> Published on 15 May 2006.

- (325) The reserved capacities, i.e. the guaranteed quantities over a long duration also create a barrier to the entry of new generators on the wholesale market, as 60 % of all capacities is linked to one (State-owned) company with a purchase guarantee.
- (326) In this regard, the Commission also took into account the results of the sectoral investigation by the Hungarian Office of Economic Competition, which explicitly concluded that the PPAs lead to foreclosure of the competitive market by limiting the *de facto* possibility of eligible consumers to switch to that free market and deterring potential wholesalers from entering the market <sup>(74)</sup>.
- (327) The scarcity of capacities available outside the PPAs furthermore lead to an increase of prices on the competitive market. The substantial volume of capacities and quantities of energy reserved by the PPAs affect prices also on the free market.
- (328) According to a quantitative study by the Regional Centre for Energy Policy Research on the impact of the PPAs on wholesale electricity prices in Hungary <sup>(75)</sup>, the PPAs lead to higher prices on the wholesale market than could be achieved without PPAs. More generally, this study also argues that the PPAs constitute one of the major factors which lead to a market structure that is '*incompatible with the principles of a free competitive market*' <sup>(76)</sup>. This study actually proposes the termination of the PPAs as a solution to achieve free competition on the Hungarian electricity wholesale market.
- (329) In its Energy Sector Inquiry <sup>(77)</sup> the Commission also assesses the effects of PPAs on competition and trade. In recitals 467 to 473, it concludes that 'Long-term power purchase agreements (PPAs) are another factor which may affect the volumes that are traded on a regular basis on wholesale markets.' With regard to the PPAs in Poland, it argues that 'they may well constitute a significant barrier to the development of the Polish wholesale market.' It then goes on to say that 'A similar situation exists in Hungary, where Magyar Villamos Művek (MVM) is the public utility wholesaler and acquires electricity by means of long-term PPAs that is subsequently sold to the local retailers. The Hungarian PPAs cover the vast majority of that Member State's electricity needs, which may have effects on wholesale trading similar to, or even going further than, those described above in the context of the Polish wholesale market'.
- (330) The various studies referred to above thus all conclude that the PPAs distort competition and may affect trade between Member States.
- (331) Interested parties argue further that it is untrue that the scarcity of available free capacities leads to the distortion of competition, as the capacity auctions of MVM show that it could not even sell all of its proposed electricity products.
- (332) A comparison between the proposed quantities and successfully auctioned products <sup>(78)</sup>, however, shows that MVM sold all proposed products at nearly each auction. Indeed, in most cases it even needed to use the 10 % maximum additional products it is legally allowed to propose.
- (333) The interested parties also submitted comments to emphasize that many other factors affected trade and influenced the success of the development of free competition on the wholesale energy market in Hungary. The Commission obviously agrees that the PPAs are not the sole factor influencing competition and trade. All the above-mentioned studies also recognize that a great number of other elements (legislation, limited access to cross-border capacities, significant influence of price evolution on international energy markets, etc.) equally affect the overall success of market opening and the actual price levels. However, all the studies submitted to the Commission in the course of the present procedure and otherwise available to it, except the one submitted by AES-Tisza and commissioned by it <sup>(79)</sup>, clearly recognise that the PPAs do have a significant effect on competition and trade.
- (334) The reserved capacities, the guaranteed off-take and the pricing mechanism provided for by the PPAs shield the power generators under PPA, for the entire duration of the PPA, from the commercial risk associated with operating the power plants. As indicated under recital 211 above, 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. As these risks are the typical risks that power generators without a PPA would have to bear, the PPAs create an obstacle for a level playing field in the power generation sector and distort competition based on merit.

<sup>(74)</sup> Point 24 of the Conclusions (Összefoglalás) of the Report.

<sup>(75)</sup> Published in November 2006. The original title is 'A hosszú távú áramvásárlási szerződések megszűnésének hatása a villamos energia nagykereskedelmi árára'.

<sup>(76)</sup> Quotation from point 2 of the Study: 'összegegyeztetetlen a versenypiaci működés elveivel'.

<sup>(77)</sup> 10 January 2007; [http://ec.europa.eu/comm/competition/antitrust/others/sector\\_inquiries/energy/](http://ec.europa.eu/comm/competition/antitrust/others/sector_inquiries/energy/)

<sup>(78)</sup> The information is available on the website of the Hungarian Energy Office: [www.eh.gov.hu](http://www.eh.gov.hu)

<sup>(79)</sup> Study by Dr Theon van Dijk, March 2006.

- (335) The Commission also notes that most generators benefiting from the PPAs belong to major international groups that are present in several Member States. Conferring a competitive advantage on those groups indubitably has an effect on trade and the potential to distort competition on the common market.
- (336) The majority of the interested parties' assessments of the criteria for impact on trade and distortion of competition refer to market circumstances at the time of conclusion of the PPAs and, in any case, to market circumstances before Hungary's accession to the EU. The Commission cannot accept this line of argument and refers in this regard to recitals 156 to 172 above.
- (337) Certain interested parties also argue that their PPA, viewed individually, does not affect trade as the generation capacity of their power plant is minor compared to the country's overall generation capacities. As the core principle of the PPAs is the same for all of them (obligation to purchase a certain minimum quantity of generated electricity, reservation of generation capacities, a price covering the justified fixed and variable costs over a duration of 15 to 27 years), each PPA has an impact on the market. However, by definition, the extent of the effect is multiplied by the co-existence of the ten PPAs on the Hungarian market. The more capacities covered by PPA, the greater the above effects are.
- (338) In the light of the above, the Commission concludes that the terms and conditions of the PPAs described above have an effect on trade and the potential to distort competition.
- (339) In point 3.1 of its Opening Decision, the Commission expressed its doubts as to the State aid character of Paks power plant owing to differences that may exist between the PPA of this plant and the other PPAs with regard to its governing principles. However, as a result of its investigations the Commission concludes that the above assessment of the State aid criteria applies equally to Paks PPA, as the same core principles are present in it with the specific features set out under the relevant criteria.
- (340) On the basis of the above assessment, the Commission takes the view that the main terms and conditions of the purchase obligation enshrined in the PPAs, i.e. the capacity reservations and guaranteed off-take by MVM under such conditions as to ensure the return on investment of the power plants by shielding them from the commercial risks of the operation of their plant, constitute State aid within the meaning of Article 87(1) of the EC Treaty. This State aid is achieved by the combination of the capacity reservations, the minimum guaranteed off-take, the pricing mechanism based on a capacity fee and an energy fee to cover fixed, variable and capital costs, over a long duration beyond normal commercial practice.
- #### 7.4. Applicability of the PPAs after accession
- (341) The interested parties argue that in accordance with the general principle of non-retroactivity, measures that were established in accordance with the law prior to accession should not be reviewed by the Commission after accession.
- (342) The Commission cannot agree with this argument. All measures, irrespective of their legality under national rules before accession, become subject to the rules of the *acquis communautaire* at the date of accession. The specific rules for State aid measures set forth in Annex IV to the Accession Act do apply to aid measures, even if they were otherwise established in accordance with national legal rules prior to accession.
- (343) Annex IV.3(1) to the Act of Accession defines as existing aid only three categories of measures: (i) those put into effect before 10 December 1994; (ii) those that – having been examined by the Commission – were included in the list in Annex IV to the Treaty of Accession; and (iii) those approved by the Commission under the so-called interim mechanism. All the measures still applicable after the date of accession, which constitute State aid and do not fall within one of these three categories, are considered as new aid upon accession; the Commission therefore has full powers to prohibit these measures if they are incompatible with the common market. This application of State aid rules to the future effects of measures still applicable after accession does not entail any retroactive application of the EC State aid rules and is in any event mandated by the Act of Accession.
- (344) Annex IV.3(2) to the Act of Accession defines the 'interim mechanism'. It provides a legal framework for the assessment of aid schemes and individual aid measures put into effect in a new Member State before the date of accession and still applicable after accession.
- (345) The interested parties argue that, as Community State aid rules apply only from the date of accession, only aid measures that provide an additional benefit after accession could be defined as applicable after accession. They argue that the PPAs do not produce any additional benefit after accession, as their price formulae were defined before accession and, consequently, the State's financial exposure was entirely known prior to accession.

(346) The Commission makes the following observations. The PPAs expire between 2010 and 2024, i.e. after accession. Only in very exceptional circumstances has the Commission considered that an aid measure still in force after accession does not constitute aid applicable after accession within the meaning of the Accession Act. Such exceptional practice should nevertheless, as all exceptions in law, be interpreted *stricto sensu* to avoid removing from the Commission's State aid control measures that the signatories of the Accession Act intended to be under such control.

(347) In this context, the Commission has indeed considered in its practice<sup>(80)</sup> that aid measures for which the State's exact economic exposure was precisely known before accession were not applicable after accession within the meaning of Annex IV to the Accession Act.

#### ***The 'exact economic exposure of the State'***

(348) The PPAs do not cap at a maximum amount the State's financial exposure, nor could it be precisely calculated before accession for the entire duration of the PPAs.

(349) On the contrary, the State's economic exposure under the PPAs depends on parameters whose future evolution 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.

(350) In particular, the fact that the State's exposure under the PPAs was not known on the date of accession and that the PPAs imposed obligations on the State after accession is demonstrated by the following circumstances.

(351) First, the exact energy prices at which the power generators sell electricity to MVM are 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.

(352) The price formulae of the PPAs include a capacity fee and an electricity fee, with other different supplementary fees depending on the generators.

(353) The formulae define only the admissible costs and charges under each category of fees and the importance of that category of fees in the price.

(354) The generators themselves as well as MVM recognised in their observations that the exact meaning of certain categories of fees must have been further clarified in negotiations with MVM.

(355) A great number of cost categories recognised by the PPAs are variable and cannot have been precisely known prior to accession. For instance:

#### (356) *Capacity fee*

This cost category takes into account both the guaranteed capacities and the capacities actually used for MVM. This cost category depends, amongst others, on yearly, monthly and weekly planning. Each of the PPAs refers to the rules of the periodical planning, and the exact final price depends in each PPA of the yearly, monthly and weekly plans. By definition, these cost categories cannot be precisely defined in advance. The parties can for instance foresee 'overcapacities' for a given period in their plans. The overall price to be paid by MVM will necessarily depend on other parameters, e.g. the weather, influencing electricity demand.

This cost category also depends on the exchange rates of HUF.

#### (357) *Energy fee*

This cost category depends primarily on fuel costs. These costs fluctuate according to market rules outside the control of the parties. The costs linked to the future price evolution of fuel are not subject to any concrete cap in the PPAs.

The exact amount of the energy fees payable over a certain period of time furthermore naturally depends on the exact quantity of sales to MVM, which can only be calculated *a posteriori*.

#### (358) *Supplementary fees (where applicable)*

Certain PPAs provide for a supplementary fee for capacities that were reserved but in the end not used. Its exact amount cannot, by definition, be specified in advance.

(359) In most PPAs there is a system of bonus/malus whereby generators are entitled to a bonus if they operate more capacities in peak periods than provided for in the PPA, or generate more electricity. A malus is provided for if a generator provides less capacity than forecast by the PPA and the yearly/monthly plans.

(360) These calculations, like the others listed above, are based on periodic operating plans and depend also on the generator's own behaviour. They can under no circumstances be defined in advance.

<sup>(80)</sup> E.g. see the Commission decision of 28 January 2004 on State aid, CZ 14/2003 – Czech Republic 'Česka spořitelna, a.s.'.

- (361) All the above shows that fixing the exact final price for the purchase of electricity for contracts of a duration of 15 to 27 years is technically impossible. The exact price takes into account periodic production plans and depends on electricity demand, the behaviour of the parties to the contract, fuel prices, etc.
- (362) Even if not all of these arguments apply to all PPAs (as the admissible cost categories vary to a certain extent depending on the PPAs), all PPAs contain price elements which it is impossible to define with exactitude in advance.
- (363) 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 changing parameters in the formula makes it impossible to determine the future level of the State's exposure with sufficient precision.
- (364) As a subsidiary argument, MVM'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 MVM can generate by selling the electricity. However, the price at which MVM sells its electricity cannot be predicted. It depends on the exact revenues generated by MVM's sales under its agreements with the regional distributors, the outcome of its auctions, tenders and its sales at the 'Marketplace' (Piactér). These prices are also influenced by periodic official price regulation and fluctuation of market demand. This increases the unpredictability of the State's exposure under PPAs. It may even be the case that the guaranteed off-take provided for in the PPAs is increasingly in excess of real MVM needs, in particular after full liberalisation of the energy market in January 2008. The electricity surplus may lead to even higher unknown costs, increasing the unpredictability of the State's exact exposure under PPAs still further.
- (365) Therefore MVM's payments to the power generators after accession are not the mere disbursement of tranches within an overall fixed cap established before accession.
- (366) Consequently, the PPAs under assessment in this Decision are applicable after Accession within the meaning of point 3 of Annex IV to the Accession Act.
- (367) According to point 3 of Annex IV to the Accession Act, 'if the Commission does not object to the existing aid measure on the ground of serious doubts as to the compatibility of the measure with the common market, within 3 months of receipt of complete information on that measure or of receipt of the statement of the new Member State in which it informs the Commission that it considers the information provided to be complete because the additional information requested is not available or has been already provided, the Commission shall be deemed not to have raised an objection.'
- (368) Based on this article, certain interested parties argue that the Commission missed the three months' deadline after Hungary's notification of 31 March 2004 and thereby implicitly approved the measure under the interim procedure.
- (369) In this regard, the Commission points out that the subject of the notification of 31 March 2004 under the interim procedure was a decree on compensations granted to MVM, and not the PPAs. The notification was withdrawn by Hungary and an NN case was later opened by the Commission on the PPAs themselves (see Chapter 1 above).
- (370) It should also be noted that, as shown by the Table below, the Commission did not in fact miss the three-month deadline referred to by the interested parties:

Event	Date	Deadline after receipt of information
Notification by Hungary	31.3.2004	
Questions by the Commission	29.4.2004	29 days
Answers by Hungary	4.6.2004	
Questions by the Commission	10.8.2004	2 months and 6 days
Answers by Hungary	21.10.2004	
Questions by the Commission	17.1.2005	2 months and 27 days
Answers by Hungary	7.4.2005	
Withdrawal of the notification by Hungary	15.4.2005	8 days

#### 7.5. PPAs as 'new aid' as opposed to 'existing aid'

- (367) According to point 3 of Annex IV to the Accession Act, 'if the Commission does not object to the existing aid measure on the ground of serious doubts as to the compatibility of the measure with the common market, within 3 months of receipt of complete information on that measure or of receipt of the statement of the new Member State in which it informs the Commission that it considers the information provided to be complete because the additional information requested is not available or has been already provided, the Commission shall be deemed not to have raised an objection.'
- (371) In addition to the above written correspondence, personal meetings took place between the Commission and the Hungarian authorities on 15 July 2004, 30 November 2004 and 12 January 2005.



- (372) As far as the present procedure is concerned, the Commission hereunder assesses whether the PPAs contain existing or new aid on the basis of the provision of the Accession Act and the Procedural Regulation.
- (373) In accordance with Chapter 3 of Annex IV to the Accession Act, all State aid measures that entered into force before accession, are still applicable after that date and do not fall under one of the categories of existing aid listed below shall be regarded, as of accession, as new aid within the meaning of Article 88(3) of the EC Treaty.
- (374) The PPAs concerned by this Decision entered into force between 1995 and 2001, i.e. before Hungary joined the EU on 1 May 2004. This Decision concerns only the PPAs that were in force at the date of accession. It does not cover any PPA that ended before that date. For all additional reasons mentioned under point 7.4 above, the measure is applicable after accession within the meaning of the Accession Act.
- (375) The three categories of existing aid referred to in the Accession Act comprise:
1. Aid measures put into effect before 10 December 1994.  
  
All the PPAs were signed and entered into force after 10 December 1994.
  2. Aid measures which were included in the list of existing State aid measures attached to the Accession Act.  
  
Neither the PPAs in general nor any of the individual PPAs were included in the Appendix to Annex IV to the Accession Act referred to in point 1(b), Chapter 3, Annex IV, which contains the list of existing aid measures.
  3. Aid measures which prior to the date of accession had been assessed by the State aid authority of the Member State 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 Act, the so-called 'interim procedure' (cf. second paragraph, Chapter 3 of Annex IV to the Accession Act).  
  
No PPAs were submitted to the Commission under the so-called interim procedure.
- (376) As the PPAs do not belong to any of the categories of existing aid enumerated in the Accession Act, they constitute new aid as of the date of accession.
- (377) The Commission notes that this categorisation is also in line with the last sentence of Article 1(b)(v) of the Procedural Regulation. 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 Hungary when it joined the European Union), such measures are not deemed to be existing aid after the date fixed for liberalisation, i.e. they must be treated as new aid.
- (378) Budapest power plant argues that this last sentence of Article 1(b)(v) of the Procedural Regulation should not apply. The plant invokes the *Alzetta Mauro* judgment<sup>(81)</sup>, arguing that aid awarded in a market that was closed to competition before its liberalisation is to be regarded as existing aid from the date of liberalisation.
- (379) The Commission cannot accept this argument. As already discussed above, the Commission takes the view that the purpose of the State aid provisions contained in the Accession Act was precisely to ensure that all measures which might distort competition between Member States as of the date of accession were reviewed by the Commission. In contrast to the accession treaties prior to 1 May 2004, the Accession Act entered into on 1 May 2004 is designed to restrict measures deemed to constitute existing aid to the three specific cases described above. The *Alzetta Mauro* judgment does not concern a measure under the scope of the Accession Act and cannot therefore be deemed applicable in this regard to the PPAs under assessment. Furthermore, the *Alzetta Mauro* judgment concerns a situation prior to the entry into force of Regulation (EC) No 659/1999.
- (380) Budapest power plant also argues that Article 1(b)(v) is not applicable to individual aid measures 'since individual aid measures are not explicitly mentioned'. The Commission cannot accept this submission. There is no reason why the reference to 'aid' and to 'certain measures' should not refer to both individual aid and aid schemes. Article 4 of Regulation (CE) No 659/1999 consistently refers to notified 'measures', but the Commission presumes that the interested party would not argue that Article 4 exclusively governs the preliminary examination of notified aid schemes.
- (381) Therefore, on the basis of the Accession Act and the Procedural Regulation, the Commission concludes that the PPAs constitute new aid.

<sup>(81)</sup> See footnote 32.

**7.6. Validly concluded private agreements cannot be ended by the Commission (pacta sunt servanda) — Legal uncertainty — Proportionality**

- (382) The Commission wishes to respond to comments submitted by the interested parties to the effect that private-law contracts cannot be ended by the Commission, as this outcome would, according to the interested parties, go against State aid rules of the EC Treaty, the principle of legal certainty and the requirement of proportionality.
- (383) The Commission rejects these arguments. The form of aid (private-law contract 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. Should the terms and conditions of a private law contract give rise to unlawful and incompatible State aid to one of the parties, such terms and conditions must be ended by the Member State. The termination of the illegal and incompatible State aid measure must be ordered by the Commission, even if the State aid constitutes such an essential part of the agreement that its termination will actually affect the validity of the agreement itself.
- (384) As far as legal certainty is concerned, the Commission makes the following observations. The Europe Agreement establishing an association between the European Communities and their Member States, of the one part, and the Republic of Hungary, of the other part, which paved the way for accession, was signed on 16 December 1991 and entered into force on 1 February 1994, i.e. before the conclusion of the PPAs. Hungary officially applied for accession on 31 March 1994. At the time when the parties concluded the PPAs (1995 to 2001), in line with Article 62 of the Europe Agreement Hungary was already required to bring the rules of competition into line with the EC Treaty. It was also clear that the PPAs were signed for such a long duration that they would not end before Hungary's accession to the EU.
- (385) The Republic of Hungary signed the Accession Treaty on 16 April 2003<sup>(82)</sup>. The Accession Treaty entered into force on 1 May 2004. From the date of accession, the provisions of the original basic Treaties and those of the secondary legislation became binding in Hungary, in line with Article 2 of the Accession Act. 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 Act 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.

- (386) The Commission is thus bound to apply EU competition law to Hungary in the same way as it does to all other Member States as regards the energy sector. Contrary to the arguments of interested parties, the Commission is of the view that it is in fact the non-application of State aid rules to the PPAs that would introduce legal uncertainty on the common energy market. The accession of a Member States may indeed give rise to situations whereby a measure not infringing any domestic legislation before accession qualifies as State aid as of accession and, as such, falls under the Commission's State aid control.
- (387) The Commission therefore found no valid arguments in the interested parties' comments as to why the present procedure is incompatible with the principle of legal certainty.

**7.7. Compatibility assessment**

- (388) Article 87(1) of the EC Treaty provides for the general prohibition of State aid within the Community.
- (389) 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).
- (390) The exemptions in Article 87(2) of the EC Treaty do not apply in the present case because the measure does not have a social character, was not awarded to individual consumers, is not designed to make good damage caused by natural disasters or exceptional occurrences and was not awarded to the economy of certain areas of the Federal Republic of Germany affected by the division of that country.
- (391) Further exemptions are provided for in Article 87(3) of the EC Treaty.
- (392) 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 under-employment' may be declared compatible with the common market. Hungary's entire territory could be regarded as such an area at the time of accession and most of its regions can still benefit from such aid<sup>(83)</sup>.

<sup>(82)</sup> OJ L 236, 23.9.2003.

<sup>(83)</sup> Regional aid map of Hungary, approved by the Commission on 13 September 2006 and published in OJ C 256, 24.10.2006, p. 7.

- (393) The Commission adopted guidelines for the assessment of such aid. When Hungary joined the EU the guidelines on national regional aid<sup>(84)</sup> (the previous Regional Aid 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. For the period after 1 January 2007, new guidelines on regional aid were adopted by the Commission<sup>(85)</sup> (the new Regional Aid Guidelines).
- (394) Under both Regional Aid Guidelines, State aid could in principle be authorised only for investment costs<sup>(86)</sup>. According to both Guidelines:
- (395) 'Regional aid aimed at reducing a firm's current expenses (operating aid) is normally prohibited. Exceptionally, however, such aid may be granted in regions eligible under the derogation in Article 87(3)(a) provided that (i) it is justified in terms of its contribution to regional development and its nature and (ii) its level is proportional to the handicaps it seeks to alleviate. It is for the Member State to demonstrate the existence and importance of any handicaps'<sup>(87)</sup>.
- (396) The aid cannot be regarded as investment aid. Investment aid is defined using a list of potential eligible costs which are indicated in both the Regional Aid Guidelines. Payments under the PPAs clearly cover other costs as well. The most obvious 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 eligible for investment aid. On the contrary, they come under the operator's current expenses and as such must be included in operating costs as defined by both Regional Aid Guidelines.
- (397) As far as operating aid is concerned, during the procedure neither the Hungarian authorities nor the interested parties demonstrated any regional handicaps relating to specific regions targeted by the PPAs, nor did they show the proportionality of the aid level to such handicaps.
- (398) Moreover, both Regional Aid Guidelines provide that operating aid should in any case be progressively reduced and limited in time. The aid granted through the PPAs is not reduced progressively and the duration of 15 to 27 years goes far beyond what can be allowed under both Guidelines. Nor do the PPAs come under any specific exemption in the Regional Aid Guidelines and neither the Hungarian authorities nor the interested parties ever argued to that effect.
- (399) In the light 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.
- (400) 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.
- (401) The Commission notes that the aid in question is not designed to promote the execution of an important project of common European interest.
- (402) Nor has the Commission found any evidence that the aid is designed to remedy a serious disturbance in the Hungarian 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 Hungary in the 1990s.
- (403) 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 and cannot be applied to agreements providing for normal electricity supply. Moreover, the Commission notes that this concept entails an aspect of urgency that is incompatible with the PPAs.
- (404) Neither the Hungarian authorities nor the interested parties argued that the PPAs were compatible with Article 87(3)(b) of the EC Treaty.
- (405) 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.
- (406) 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 if 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.
- (407) Article 87(3)(c) provides for the authorisation of aid to facilitate the development of certain economic activities or 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 the derogation contained in this Article is to apply.

<sup>(84)</sup> OJ C 74, 10.3.1998, p. 9.

<sup>(85)</sup> OJ C 54, 4.3.2006, p. 13.

<sup>(86)</sup> Point 4.15 of the old and point 5 of the new Regional Aid Guidelines.

<sup>(87)</sup> The quotation is from point 5 of the new Regional Aid Guidelines.

- (408) As far as both the old and the new Regional Aid Guidelines are concerned, the PPAs' incompatibility with those Guidelines is shown in recitals 393 to 398 above.
- (409) The Commission notes that the Environmental Guidelines applicable at the time of Hungary's accession to the EU <sup>(88)</sup>, 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.
- (410) The fourth and last type of operating aid that can be authorised is aid for the combined production of power and heat, hereinafter referred to as 'cogeneration' (section E.3.4). Some of the generators concerned produce heat and power. However, the conditions of point 66 and hence the conditions of the options under points 58 to 65 of the Environmental Guidelines were not met by the PPAs. One of the conditions set out in point 66 is that the support measure is beneficial in terms of the protection of the environment because the conversion efficiency is particularly high, because the measure will allow energy consumption to be reduced or because the production process will be less damaging to the environment. Nothing in the information available to the Commission indicates that this condition is met.
- (411) The three options that Member States may use to grant operating aid for cogeneration are the following:
- option 1: aid to compensate for the difference between the production costs of the cogeneration plant and the market price of the energy produced,
  - option 2: introduction of market mechanisms such as green certificates or tenders,
  - option 3: aid to compensate for the external costs avoided, which are the environmental costs that society would have to bear if the same quantity of energy was not produced by cogeneration,
  - option 4: aid limited to 5 years, either digressive or limited to 50 % of the eligible costs.
- (412) It is obvious that the PPAs do not fulfil the conditions of option 2 and option 3. The conditions of option 1 are not fulfilled either, as the market price of the energy produced is not used to calculate the amount of aid. The amounts of aid transferred under a given PPA depend not on the prices offered by any other power generator, but solely on the investment and operating costs incurred by the generator in question.
- (413) Furthermore, neither Hungary nor any of the producers concerned has actually argued compatibility on the basis of these articles or ever demonstrated that the plants meet the criteria of the Environmental Guidelines for operating aid to cogeneration.
- (414) On 23 January 2008, the Commission adopted new guidelines on State aid for environmental protection <sup>(89)</sup>. These new Guidelines also allow operating aid only in the cases of energy saving, cogeneration, the use of renewable energy sources and tax reductions and exemptions. As mentioned above, none of these apply to the PPAs.
- (415) As far as cogeneration is concerned, there are three options Member States can choose from when granting such aid:
- option 1: aid to compensate for the difference between the production costs of the cogeneration plant and the market price of the energy produced,
  - option 2: introduction of market mechanisms like green certificates or tenders,
  - option 3: aid limited to 5 years, either digressive or limited to 50 % of the eligible costs,
- None of the conditions of these options are fulfilled by the PPAs. Neither the Hungarian authorities nor the power generators provided evidence of any kind on the fulfilment of these criteria of the new Environmental Guidelines.
- (416) Of the guidelines and communications the Commission developed to explain how exactly it will apply the derogation contained in Article 87(3)(c), the only one which could apply in the present case is the Stranded Costs Methodology (see recital 26 above).

<sup>(88)</sup> Community guidelines on State aid for environmental protection, OJ C 37, 3.2.2001, p. 3.

<sup>(89)</sup> OJ C 82, 1.4.2008, p. 1.

- (417) The Stranded Costs Methodology concerns aid granted to incumbent companies that invested in power plants prior to liberalisation of the electricity sector and that may have difficulties in recouping their investment costs in a liberalised market. Since one of the essential features of the PPAs is to allow certain companies which invested in power generation assets before the liberalisation of the electricity sector to continue to benefit from a guarantee of revenues which secures a return on investment, the Methodology is to be regarded as a relevant basis for the assessment of the compatibility of the PPAs.
- (418) The Commission notes that neither the Hungarian authorities nor any of the power generators concerned argued in their comments that the PPAs were themselves compatible with the criteria of the Methodology. Most generators actually conclude that the PPAs are commercial agreements established well before the existence of the Methodology, and the criteria of a compensation mechanism are simply inadequate to assess the PPAs.
- (419) The main purpose of the Stranded Costs Methodology is to help the transition of the energy sector to a liberalised market by allowing the incumbent electricity undertakings to adapt to the introduction of competition<sup>(90)</sup>.
- (420) The Methodology outlines the principles applied by the Commission in assessing aid measures designed to compensate for the costs of commitments or guarantees that it might no longer be possible to honour on account of the liberalisation of the electricity market. Such commitments or guarantees are referred to as 'stranded costs' and can take a variety of forms, notably investments undertaken with an implicit or explicit guarantee of sale.
- (421) Since the PPAs themselves constitute an explicit guarantee of sale pre-dating liberalisation, the power plants under PPAs may be regarded as falling within the scope of the Methodology.
- (422) However, the Commission notes that several elements of the main principles constituting the PPAs do not meet the conditions laid down in section 4 of the Methodology. First, they do not meet the condition set out in paragraph 4.2 of the Methodology, which requires that the arrangements for paying the aid must take account of future development in competition. The price-setting mechanisms of the PPAs are designed in such a way as to take into consideration only specific parameters of the power plant concerned to establish the price. Prices offered by competing generators and their generation capacities do not have to be taken into account.
- (423) According to point 4.9 of the Methodology, the Commission has the most serious misgivings when the amount of aid is not likely to be adjusted to take due account of the differences between the economic and market assumptions initially made when estimating stranded costs and real changes in them over time. The PPAs fall within this category, as no market assumption has been used to design the aid measure. Furthermore, the fact that the core principles of the PPAs have remained unchanged in spite of the gradual opening of the electricity market and therefore entail the obligation on MVM to purchase energy in excess of its needs and to release it on the free market, clearly shows that the PPAs take no account of actual market developments.
- (424) Furthermore, as shown under Chapter 3 above, one of the main advantages of the PPAs for the power generators is the purchase obligation by MVM of fixed capacities and guaranteed quantities at a price covering fixed, variable and capital costs, over a duration corresponding approximately to the lifetime or depreciation time of the assets. As a consequence, PPAs have the effect of obliging one of the parties to purchase its electricity from the other party, irrespective of the actual development of offers by competitors.
- (425) Several Member States have put in place compensation mechanisms whereby a maximum aid amount is set in advance on the basis of an analysis of the future competitive market and in particular of future market prices resulting from the confrontation of supply and demand. If actual revenues obtained by the generators concerned turn out higher than forecast, the actual grants are recalculated and set at a lower level than the maximum amount. The impact of the compensation on the market is therefore limited to the minimum, notably because it does not secure a minimum level of production and sale to the beneficiaries.
- (426) In this respect, instead of helping transition to a competitive market, the PPAs in fact create an obstacle to the development of real competition on a substantial part of the power generation market. Therefore, the arrangements for paying the aid do not allow account to be taken of future development in competition and the amount of aid is not conditional on the development of genuine competition.
- (427) As a consequence, they also contradict the principles laid down in Section 5 of the Methodology whereby the financing arrangements must not conflict with the Community interest, notably competition. Under Section 5, the financing arrangements must not have the effect of deterring outside undertakings or new players from entering certain national or regional markets. However, as highlighted, *inter alia*, in recital 220, the system of capacity reservation and capacity fee tends to deter MVM – which is by far the largest buyer on the wholesale market – from shifting to producers other than those under PPAs. Furthermore,

<sup>(90)</sup> See the introductory provisions of the Methodology.

the opening of the market and the conditions set out in the PPAs compel MVM to purchase more electricity than it needs and lead it to resell that electricity on the free market through release mechanisms. This in itself hampers new entries on the wholesale market. Finally, the Commission considers that the PPAs entail distortions of competition on the Hungarian wholesale electricity market over a period largely exceeding the time necessary for a reasonable transition to a competitive market.

- (428) The rules constituting the PPAs do not meet the criteria set out in paragraph 4.5 of the Methodology, since the maximum amount of aid to be paid to generators between 1 May 2004 and the expiry of the PPAs is not specified in advance.
- (429) Furthermore, point 4.8 of the Methodology indicates that the Commission has 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<sup>(91)</sup>, without taking strictly into account the eligible stranded costs that might result from the opening of the market.
- (430) The fact that the PPAs were maintained when Hungary joined the European Union was designed precisely to safeguard most of the income obtained by the power generators concerned before the entry into force of Directive 96/92/EC. Furthermore, the plants under PPA cover a very important share of the market and for a very long duration, considerably exceeding the time necessary for a reasonable transition to the market.
- (431) Moreover, within the main provisions constituting the PPAs, the Commission cannot isolate a set of elements that it might consider compatible with the common market under the Methodology. In particular, a reduction of the duration of the PPAs would not suffice to make the PPAs compatible, since the financing method, which is based on reserved capacities and guaranteed off-take quantities, would still hamper the development of genuine competition. The price formation mechanisms would also continue to contradict the objective of fostering the emergence of a truly competitive market where prices result from the interplay of supply and demand.
- (432) In the light of the above considerations, the Commission concludes that the PPAs are incompatible with the criteria laid down in the Methodology.

<sup>(91)</sup> The date of liberalisation of the electricity market, which for Hungary was 1 May 2004.

- (433) Certain interested parties have also argued that Article 86(2) of the EC Treaty could apply to the PPAs even where they do not fulfil the criteria of the *Altmark* judgment.
- (434) The Commission takes the view that the considerations set out in recitals 255 to 275 with regard to the criteria of the *Altmark* judgment also lead to the conclusion that Article 86(2) cannot apply to PPAs.
- (435) Article 86(2) can apply only to companies that provide specifically defined services of general economic interest, which is not the case in this particular instance, as demonstrated in recitals 256 to 267 above. Furthermore, compensation for providing the SGEI must be proportionate to the extra costs incurred; in other words, it must be possible to define the scope of the SGEIs in order to calculate the associated costs. This is not the case here, as is demonstrated in recitals 268 to 270 above.
- (436) The aid under assessment thus constitutes incompatible State aid.

### 7.8. Recovery

- (437) According to the EC Treaty and the Court of Justice's established case law, the Commission is competent to decide that the State concerned must abolish or alter aid<sup>(92)</sup> when it has been found to be incompatible with the common market. The Court has also consistently held that the obligation on a State to abolish aid regarded by the Commission as being incompatible with the common market is designed to re-establish the previously existing situation<sup>(93)</sup>. In this context, the Court has established that that objective is attained once the recipient has repaid the amounts granted by way of unlawful aid, thus forfeiting the advantage it enjoyed over its competitors on the market, and the situation prior to the payment of the aid has been restored<sup>(94)</sup>.
- (438) Following that case-law, Article 14 of Regulation (EC) No 659/99 laid down that 'where negative decisions are taken in respect of unlawful aid, the Commission shall decide that the Member State concerned shall take all necessary measures to recover the aid from the beneficiary. The Commission shall not require recovery of the aid if this would be contrary to a general principle of Community law'.

<sup>(92)</sup> Case C-70/72, *Commission v Germany*, [1973] ECR 00813, point 13.

<sup>(93)</sup> Joined Cases C-278/92, C-279/92 and C-280/92 *Spain v Commission*, [1994] ECR I-4103, point 75.

<sup>(94)</sup> Case C-75/97, *Belgium v Commission*, [1999] ECR I-030671 points 64-65.

- (439) Certain interested parties argued that the termination of private law contracts by way of a Commission decision would go against the principle of legal certainty because PPAs are private law contracts which generators entered into in good faith in the market circumstances that prevailed at that time. They also argue that such a decision would conflict with the principle of proportionality. The Commission rejects these arguments for the reasons set out under recitals 382 to 387.
- (440) With regard to proportionality, the Court has held that the recovery of State aid unlawfully granted for the purpose of restoring the situation existing previously cannot in principle be regarded as disproportionate to the objectives of the provisions of the Treaty on State aid <sup>(95)</sup>.
- (441) The Commission therefore considers that there are sufficient grounds to recover the aid granted through the PPAs in order to re-establish the conditions of competition.

#### **Quantification of the aid amount to be recovered**

- (442) It has been shown under recitals 176 to 236 that the advantage flowing from the PPAs goes far beyond any positive difference between the PPA prices and the prices that could have been achieved on the market without PPAs.
- (443) However, the Commission is of the view that the overall value of all the conditions of MVM's long-term purchase obligations, as set out in recitals 174 to 236, for the period between 1 May 2004 and the termination of the PPAs, cannot be calculated with exactitude. Consequently, when ordering the recovery of unlawful aid, the Commission will limit its recovery order to the difference that may have existed between the power generators' revenues under their PPAs and the revenues they could have obtained on the market without PPAs over that time period.
- (444) In determining the amount to be recovered from generators, the Commission acknowledges that accurately calculating the amount of State aid that has actually benefited the beneficiaries is fairly complex, as it depends on what the prices and amounts of energy produced and sold would have been on the Hungarian wholesale market between 1 May 2004 and the date of termination of the PPAs if none of the PPAs have been in force during that period. As PPAs cover the bulk of

Hungarian generation capacities, the market would have been drastically different under the 'counterfactual scenario' <sup>(96)</sup> than it was in reality.

- (445) A specific feature of electricity is that it cannot be stored economically once produced. In order to ensure network stability, electricity supply and demand have to be balanced at all times. Consequently, the amount of energy that power generators and importers can sell on the wholesale market during a certain period and the price that they can obtain for that energy do not depend on the overall amount of energy requested by buyers during that period, but on the amount of power requested at each point in time <sup>(97)</sup>. Furthermore, electricity demand fluctuates significantly during the day and seasonally, which means that the generation and import capacities needed to satisfy demand at each point in time also fluctuate and that certain power generation units only supply energy during periods of high demand <sup>(98)</sup>. Consequently, the operation of the market cannot be assessed with complete accuracy on the basis of the annual consumption, production and price data available to the Commission.

- (446) However, according to the case-law of the Court, no provision of Community law requires the Commission, when ordering the recovery of aid declared incompatible with the common market, to fix the exact amount of the aid to be recovered. It is sufficient for the Commission's decision to include information enabling the recipient to work out the amount itself without too much difficulty <sup>(99)</sup>.

- (447) Accordingly, the Commission provides guidelines on how the recovery amount should be quantified. As mentioned above, the PPAs cover such an important share of the Hungarian generation market that prices without PPAs would have been different from the prices actually observed on the part of the market without PPAs. Consequently, the price generators could have obtained in the absence of PPAs can be calculated on the basis of a market simulation consisting in analysing the operation of the wholesale electricity market under the 'counterfactual scenario'. The purpose of the simulation is to estimate what the sales and prices would have been under the counterfactual scenario with

<sup>(95)</sup> Case C-75/97, *Belgium v Commission*, [1999] ECR I-030671 point 68, Case C-142/87 *Belgium v Commission*, [1990] ECR I-00959 point 66, and Joined Cases C-278/92 to C-280/92 *Spain v Commission*, [1994] ECR I-04103, point 75.

<sup>(96)</sup> Defined as a fictitious scenario whereby no PPA was in force between 1 May 2004 and the date of termination of the PPAs. The 'actual scenario' is what actually happened owing to the existence of the PPAs.

<sup>(97)</sup> This parameter is expressed in MW and is commonly called 'system load'.

<sup>(98)</sup> Periods of high demand are commonly called 'peak load' periods, as opposed to 'base load' periods.

<sup>(99)</sup> See, in particular, Case C-480/98 *Spain v Commission* [2000] ECR I-8717, point 25, and Case C-415/03, *Commission v Greece*, [2005] ECR I-03875, point 39.

a view to establishing reliable estimates of the amounts that MVM would have paid to the generators concerned for the energy purchased from them under that scenario. The simulation must meet the conditions set out in the following recitals.

- (448) First of all, given that electricity has a very low price elasticity demand, the simulation should be carried out under the assumption that at each point in time the system load in the counterfactual scenario is identical to the load actually observed at that time.
- (449) Second, as noted in recital 196, bulk electricity is sold on competitive wholesale markets through spot and forward contracts. The Energy Sector Inquiry showed that the level of forward prices depended on individual expectations with regard to the development of spot market prices. Unlike for spot markets, for which the economic theory suggests that in perfectly competitive conditions the price is at each point in time the highest short run marginal cost of all the generation units necessary to meet demand<sup>(100)</sup>, there is no explicit price benchmark for forward markets that can be estimated using economic theory. Furthermore, it is not possible to simulate the impact of the strategies developed by both sellers and buyers with regard to arbitrage between spot and forward contracts. This fact is illustrated by the wide variety of situations observed on wholesale markets across Europe. The Energy Sector Inquiry has shown that the ratio between volumes traded in the form of spot products and the national electricity consumption varied significantly across Member States<sup>(101)</sup>.
- (450) As outlined in recital 198, spot prices, notably those observed on spot power exchanges, normally set references for the entire wholesale market, including for forward products. The Commission therefore takes the view that in order to establish the aid amounts to be recovered, the wholesale market should be simulated under the assumption that all electricity would be traded through spot contracts, with the exception of the particular elements referred to in recitals 453 to 456.
- (451) The simulation should be carried out on the basis of the short run marginal costs of the generation units
- concerned. Consequently, the simulation should take into account relevant data specific to each power generation unit operated in Hungary<sup>(102)</sup> between 1 May 2004 and the actual date of termination of the PPAs, with respect notably to installed capacity, thermal efficiency, fuel costs and other main components of the variable costs, and periods of planned and forced outages. Moreover, the simulation should be carried out under the fundamental assumption that at each point in time there is one single price on the simulated spot market resulting from supply and demand mechanisms. This single price varies over time owing to variation in demand and variable costs.
- (452) The simulation should take account of the fact that under the counterfactual scenario, MVM would not have to purchase power in excess of what it needs to fulfil the needs of the public utility segment<sup>(103)</sup>. Consequently, the release mechanisms referred to in recital 226 would not exist under the counterfactual scenario and MVM's needs would be limited to the amounts necessary to fulfil demand on the public utility segment.
- (453) The simulation should also take into account certain specific, duly justified situations which may entail deviation from the marginal cost principle underlying the whole simulation. Such specific situations may be encountered by cogeneration units. Depending on their contract or statutory obligations with regard to heat supply, these units may have to sell power at a price lower than their short run marginal cost.
- (454) Such situations may also concern generation units benefiting from a public support scheme on the grounds that they are based on environment-friendly technologies. This is the case in Hungary where the legislation imposes on MVM and regional distribution companies a mandatory off-take of electricity generated in cogeneration or from waste or renewable energy at officially regulated prices usually higher than the prices observed on the competitive sector of the wholesale market. The simulation must take into account that under the counterfactual scenario, this mandatory off-take scheme would have also been in place. Therefore, the quantities purchased by MVM under the mandatory off-take regime and the prices paid for that energy would have been identical to those observed under the actual scenario<sup>(104)</sup>.

<sup>(100)</sup> In perfectly competitive conditions, all the generation units necessary to meet demand at each point in time are those which have the lowest short run marginal costs and are able to supply the network with all the power needed to meet demand. Power generation units can be ranked according to their short run marginal costs. Their access to the market at each point in time depends on their ranking in this 'merit order', on the system load and on the power supplied by the generation units that have a higher ranking in the merit order.

<sup>(101)</sup> E.g. the ratio is 5 % in France, 11 % in the United Kingdom, 44 % in Italy and 84 % in Spain.

<sup>(102)</sup> Whether under PPA or not.

<sup>(103)</sup> Taking due account of the losses on the transmission and distribution networks.

<sup>(104)</sup> The actual scenario corresponds to the market as it has stood since 1 May 2004 with the existence of the PPAs.



- (455) The simulation should also take account of the fact that certain physically available generation capacities are not available for supply of electricity on the wholesale market, since they are reserved for the provision of balancing services to the Transmission System Operator. Under the actual scenario, balancing services were provided both by generators engaged in a PPA and by other generators. The simulation should be carried out under the assumption that under the 'counterfactual scenario' the capacities reserved for the provision of balancing services to the TSO, the energy provided on the basis of these capacities and the price obtained for it were the same as under the actual scenario.
- (456) Under the counterfactual scenario, the quantities of electricity imported and exported and the prices obtained for them may have been different from under the actual scenario. However, it would not be possible to accurately assess that effect without extending the scope of the simulation to the markets of the exporting and importing countries, because market actors' decisions with regard to export or import from one country to another are influenced by the market conditions prevailing in both the exporting and importing country. Considering that the volumes imported into and exported from Hungary are limited compared to those generated and consumed internally and taking into account that one third of total imports are covered by long-term contracts<sup>(105)</sup>, the Commission considers that such an extension of the scope of the simulation may require disproportionate efforts. Hungary may thus consider that under the counterfactual scenario, the quantities imported and exported and the corresponding prices were the same as under the actual scenario.
- (457) The Commission is aware that certain generators not engaged in a PPA with MVM have concluded long or medium term power supply contracts with other customers. However, the Commission takes the view that such contracts should not be taken into account for the purpose of the simulation because the termination of the PPAs at 1 May 2004 or before, which is the basic assumption of the counterfactual scenario, would have necessarily modified the commercial strategies of all generators given the large proportion of installed capacities reserved under the PPAs. As substantiated in recital 449, it is not possible to estimate the proportion of electricity sold in the form of spot and forward products. Therefore, it is reasonable to consider that all generators would sell all their output in the form of spot products, unless they fall in one of the situations referred to in recitals 453 to 456.
- (458) The most accurate way of simulating a wholesale electricity market is to do it on an hourly basis, taking account of all parameters specific to each single hour. However, the Commission will accept that the simulation
- be limited to representative time samples and that the results of the simulations carried out on each representative time sample be extrapolated to the whole period under assessment.
- (459) The simulation should yield reliable estimates of the amount of power supplied by each generation unit and the price obtained for it under the counterfactual scenario. The ratio between the power needed by MVM to fulfil the needs of the regulated segment<sup>(106)</sup> and the overall amount of power supplied on the wholesale market at each point in time should be estimated on the basis of historical data concerning the overall consumption of end-users on the regulated segment and the overall consumption of all end-users under the actual scenario.
- (460) This proportion should be used to estimate the amounts of power that each generator would have sold to MVM at each point in time under the counterfactual scenario. On the basis of these estimates, the overall amounts that MVM would have paid to each generator for the energy purchased to meet demand on the regulated segment under the counterfactual scenario should be estimated over the whole period of assessment<sup>(107)</sup>.
- (461) The final step of the calculation of the recovery amounts should take account of the fact that under the actual scenario, generators did not sell all the output of the generating blocks covered by PPAs to MVM but used their unreserved capacities for sale to customers other than MVM. For each generating block concerned the amount of aid to be recovered should be computed on an annual basis according to the difference between the revenues obtained from the sale of energy to MVM under the PPAs<sup>(108)</sup> under the actual scenario and the amounts that would have been paid by MVM under the counterfactual scenario, as calculated in accordance with the principles outlined above.
- (462) However, the Commission acknowledges that under the counterfactual scenario, the generators concerned may have obtained higher revenues from customers other than MVM than those obtained from those customers under the actual scenario. This is due in particular to the fact that under the counterfactual scenario no

<sup>(105)</sup> Which would have remained in force under the counterfactual scenario.

<sup>(106)</sup> This amount corresponds to the power actually consumed by consumers on the regulated segment and an additional amount needed owing to losses on the transmission and distribution networks.

<sup>(107)</sup> Between 1 May 2004 and the actual termination of the PPAs.

<sup>(108)</sup> These revenues are to be computed on the basis of the prices actually paid by MVM. For the period when regulated prices overrode the price formulae of the PPAs (between 9 December 2006 and 31 December 2007), regulated prices should be taken into account for that calculation.

capacity is reserved by MVM, which offers the generators additional opportunities to sell their output to customers other than MVM. Consequently, Hungary may deduct from the amounts calculated in accordance with recital 461 the difference between the revenues that the generators would have obtained from customers other than MVM under the counterfactual scenario and the revenues that they obtained from customers other than MVM under the actual scenario, if that difference is positive.

(463) The interest to be recovered pursuant to Article 14(2) of Regulation (EC) No 659/1999 should also be calculated on an annual basis.

(464) In order for the Commission to assess the accuracy and reliability of the simulation carried out by Hungary, the latter should provide it with a detailed description of the underlying methodology and of the set of data fed into the simulation.

(465) The Commission is aware of the existence of suitable tools capable of performing the necessary simulation. Such a tool was actually used by the Commission in the context of the Energy Sector Inquiry to assess the structure and performance of six European wholesale markets<sup>(109)</sup>. Such tools are also used by a number of power generators and traders to do long-term electricity forecasting, conduct resource planning studies and optimise generation despatch. Furthermore, as outlined above, the Commission is willing to accept certain simplifications, notably the use of representative time samples instead of a simulation on an hourly basis. Therefore, on the basis of the principle of loyal co-operation set out in Article 10 of the Treaty, Hungary is required to carry out a simulation in accordance with the principles outlined above and to calculate the amount of aid to be recovered on the basis of that simulation within a reasonable timeframe.

### **Implementation of the Decision**

(466) The Court of Justice considers that a Member State encountering unforeseen or unforeseeable difficulties or perceiving consequences overlooked by the Commission may submit those problems for consideration by the Commission together with proposals for suitable amendments. In such a case, the Commission and the Member State concerned must work together in good faith with a view to overcoming the difficulties whilst fully observing the EC Treaty provisions<sup>(110)</sup>.

<sup>(109)</sup> The Member States concerned were Belgium, France, Germany, Italy, the Netherlands, Spain and the United Kingdom, which are among the largest wholesale markets in Europe.

<sup>(110)</sup> See Case C-94/87 *Commission v Germany* [1989] ECR-175, point 9 and Case C-348/93 *Commission v Italy* [1995] ECR-673, point 17.

(467) The Commission therefore invites Hungary to submit to the Commission for consideration any problem that it may meet in implementing this Decision.

### **8. CONCLUSION**

(468) The Commission concludes that the PPAs confer illegal State aid on the power generators within the meaning of Article 87(1) of the EC Treaty and that this State aid is incompatible with the common market.

(469) As explained in point 7.3, the State aid element provided for in the PPAs consists in the purchase obligation by MVM of a certain capacity and a guaranteed minimum quantity of electricity at a price covering capital, fixed and variable costs over a significant part of the lifetime of the generating units, thereby guaranteeing a return on investment.

(470) Since this State aid is incompatible with the EC Treaty, it must be ended,

HAS ADOPTED THIS DECISION:

#### *Article 1*

1. The purchase obligations as set out in the Power Purchase Agreements between Magyar Villamos Művek Rt. and Budapesti Erőmű Rt., Dunamenti Erőmű Rt., Mátrai Erőmű Rt., AES-Tisza Erőmű Kft., Csepeli Áramtermelő Kft., Paksi Atomerőmű Rt. and Pécsi Erőmű Rt. (signatory of the initial PPA and predecessor of Pannon Hőerőmű Rt.)<sup>(111)</sup> constitute State aid within the meaning of Article 87(1) of the EC Treaty to the electricity generators.

2. The State aid referred to in Article 1(1) is incompatible with the common market.

3. Hungary shall refrain from granting the State aid referred to in paragraph 1 within six months following the date of notification of this Decision.

#### *Article 2*

1. Hungary shall recover the aid referred to in Article 1 from the beneficiaries.

2. The sums to be recovered shall bear interest from the date on which they were put at the disposal of the beneficiary until their actual recovery.

<sup>(111)</sup> The company names listed are those that applied at the time of signature of the PPAs.

3. The interest shall be calculated on a compound basis in accordance with Chapter V of Commission Regulation (EC) No 794/2004<sup>(112)</sup> as amended by Regulation (EC) No 271/2008<sup>(113)</sup>.

#### *Article 3*

1. Within two months following notification of this Decision, Hungary shall submit to the Commission information concerning measures already taken and measures planned to comply with this Decision, and notably the steps taken to perform an appropriate simulation of the wholesale market in order to establish the amounts to be recovered, the detailed methodology intended to be applied and a detailed description of the set of data that it intends to use for that purpose.

2. Hungary shall keep the Commission informed of the progress of the national measures taken to implement this Decision until recovery of the aid referred to in Article 1 has been completed. It shall immediately submit, on simple request by the Commission, information on the measures taken and planned in order to comply with this Decision. It shall also provide detailed information concerning the amounts of aid and recovery interest already recovered from the beneficiaries.

#### *Article 4*

1. The exact amount of aid to be recovered should be calculated by Hungary on the basis of an appropriate simulation of the wholesale electricity market as it would have stood if

none of the Power Purchase Agreements referred to in Article 1(1) had been in force since 1 May 2004.

2. Within six months following notification of this Decision, Hungary shall calculate the amounts to be recovered on the basis of the method referred to in paragraph 1 and submit to the Commission all relevant information with regard to the simulation, notably its results, a detailed description of the methodology applied, and the set of data used to carry out the simulation.

#### *Article 5*

Hungary shall ensure that the recovery of the aid referred to in Article 1 is implemented within ten months following the date of notification of this Decision.

#### *Article 6*

This Decision is addressed to the Republic of Hungary.

Done at Brussels, 4 June 2008.

*For the Commission*

Neelie KROES

*Member of the Commission*

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<sup>(112)</sup> OJ L 140, 30.4.2004, p. 1.

<sup>(113)</sup> OJ L 82, 25.3.2008, p. 1.