

Draft Decision of the Competition Council

No. 163 of 31.08.2005

concerning the notification regarding the financial support to be granted to Regia Autonoma de Interes Local Hunedoara

Competition Council,

Having regard the Decree No.57/2004 on the appointment of the Competition Council members,

Having regard the provisions of the Competition Law no.21/1996, republished in Official Journal, Part. I, no. 742, 16 August 2005,

Based on the provisions of the Law no. 43/1999 on State aid, republished in the Official Journal of Romania, Part. I, no. 744 on 26 August 2005,

Taking into account the provisions of European Agreement establishing an association between Romania and European Communities on one side, and the Member States of those, on the other side, approved by Law no. 20/1993, published in the Official Journal of Romania, Part I, no. 73 on 12th of April 1993,

Taking into account the provisions of the Regulation on state aid in the form of compensations granted to certain undertakings entrusted with services of general economic interest, published in the Official Journal of Romania, Part I, no. 1048 on 12th of November 2004,

On the followings grounds,

1. PROCEDURE

(1) By address no. 4151/23.06.2005, registered at the Competition Council with no. RS-AS/56/27.06.2005, S.C. FDFEE ELECTRICA BANAT S.A. notified to the Competition Council under Art. 15 of the Law no. 143/1999 on State aid, republished, the financial support for Regia Autonoma de Interes Local Hunedoara (RAIL Hunedoara).

(2) Since the data presented in the submitted notification was not complete, supplementary information was requested by addresses no. DAAS 922/05.07.2005. The notification became affective on the date the information were complete, namely on 01.08.2005.

2. DESCRIPTION OF THE FINANCIAL MEASURES

2.1 Legal basis for granting the financial support

(3) The legal basis for granting the financial support is represented by the *Emergency Government Ordinance no. 37/2004 regarding certain measures for reducing the arrears in the economy.*

2.2. The beneficiary of the financial support measure

(4) The beneficiary of the notified support measure is RAIL Hunedoara.

(5) The company was set up on in 1995, according to the Romanian Law, as local interest company, by the Decision of the Local Council of Hunedoara no. 11/1995. The company's registered capital amounts to ROL 37,698,081 thousand, whose sole shareholder is the Local Council of Hunedoara City. The company has its registered office in the Hunedoara and it has been registered in the Commercial Register under no J20/896/95, having the unique identification code R 2665280.

(6) The company's main activity consists in the following: transport and distribution of heating energy under the form of hot water to the population, institutions and companies in the city of Hunedoara. As secondary activity, the company also operates the collection and depositing garbage and drinking water supplying and sewerage.

(7) The economic and financial results of the total activity of the company, as shown in the balance sheets for 1999-2002, are presented in Table no. 1.

Table no. 1 – Economic and financial results of the company between 1999-2002

-thou ROL-				
Index	1999	2000	2001	2002
Total turnover on the Romanian market	66,131,414	86,501,192	103,581,075	100,299,833
Profit/loss	-6,361,253	+4,155,574	-3,598,496	-14,388,324

Source: Notification form

From the data in the above table it can be seen that the company registers losses between 1999-2002.

(8) The company delivers heating energy under the form of hot water and for heating to population, budgetary institutions and companies.

(9) The company RAIL has been entrusted with the delivery of public services of transport and distribution of heating energy by the licenses granted by the National Authority for Regulation in the Energy Field (A.N.R.E.). This service cannot be supplied by companies in normal market conditions because the companies are imposed mandatory conditions related to the supply of such services.

(10) According to the *Law of public management no. 326/2001*, the public services must fulfill some essential conditions, as follows:

- a) continuity both in quality and quantity, according to the conditions stipulated in the contract;
- b) adaptability to consumers' requests;
- c) equal access to the public service, in the conditions stipulated in the contract;
- d) ensuring the public health and life quality.

(11) The supply of heating energy for preparing the hot water for consumption is achieved by the heating network of the Hunedoara City. This system has been entrusted to the company by the Decision of Local Council of Hunedoara City.

2.3. The market affected by the financial support granted to the company

(12) The market affected by the granting of financial support assessed in the present decision is the market of the public service of supply and distribution of heating energy. These services represent 48% from RAIL HUNEDOARA total activity and the financial support measures granted by the State and notified by S.C. FDEE ELECTRICA Banat S.A. aim to insure the performance of the public service of supply and distribution of heating energy.

(13) The market of heating energy is a regulated market. The National Agency for Regulating the Public Services of Town's Administration (ANRSC), establishes the delivering prices for heating energy towards population and companies. These consumers are captive, as they don't have the possibility to choose their heating energy supplier.

(14) The productions and supply of heating energy function as a centralized system and are organized under the coordination and control of local public administration, based on the local autonomy principle.

(15) The geographical market is the City of Hunedoara, which is a local interest market.

(16) RAIL HUNEDOARA is the only heating energy supplier in the area it serves. From the total heating energy produced, 89% is sold to the population and 11% to companies and budgetary institutions.

2.4. The financial support measures

(17) The financial support measure notified by S.C. FDEE ELECTRICA BANAT S.A. represents the write-off of the interests, increases and penalties in the amount of ROL 25,191,350,448 due by RAIL HUNEDOARA to the supplier.

(18) According to the notification, RAIL HUNEDOARA benefited from subsidies as follows:

Table no. 2 – Financial support granted between 1999 – 2002

-ROL thou-					
Financial support	1999	2000	2001	2002	TOTAL
Subsidy for covering the difference between the national reference price ¹ and the local delivery price of heating energy ²	6,648,436	2,502,359	4,602,201	1,717,440	15,470,437

Source: Notification form

¹ National reference price is defined at subchapter 2.6.1.

² Local delivery price of heating energy is defined at subchapter 2.6.2

2.5 Costs deriving from the delivery of the service of general economic interest

(19) The public service of supplying heating energy is regulated by ANRSC. In order to perform this service, the company incurs raw materials cost, personnel costs, environmental costs, repairing costs, and maintenance and investments costs, etc.

(20) According to the provisions of art. 20 (5) of the Law of public management no. 326/2001 which delivers public services must keep a separate accounting for all the activities, such as it can be easy to evaluate, monitor and control.

(21) RAIL HUNEDOARA keeps a managing accountancy where the company's activities are registered separately. The activity of heating energy production and supply, which represents the public service obligation, is presented separately from its other activities. Its results are presented in Table no. 3.

Table no.3 The evolution of the main economical-financial indicators
- ROL thou -

	1999	2000	2001	2002	Total
Revenues from the transport, distribution and supply of heating energy as hot water (public service) ³	27,233,212	33,378,969	28,212,209	16,302,457	105,126,847
Costs from the producing, transport and distribution and supply of heating energy as hot water (public service)	45,352,064	41,450,035	36,682,058	23,005,674	146,489,831
Gross result from the producing, transport and distribution and supply of heating energy as hot water (public service)	-18,118,852	-8,071,066	-8,469,849	-6,703,217	-41,362,984

Source: Supplementary information

(22) From the above data from the table it can be seen that between 1999-2002, the result from the delivering the public general interest service is negative, due to the high costs incurred from selling at regulated prices. The main cause of the high exploiting costs is the technological losses in the transport and distribution system due to the worn out transport and distribution network.

2.6. The difference between the national reference price and the local delivery price for the heating energy

(23) As mentioned in point (13) the heating energy market is a regulated one. There are two reference prices, respectively the national reference price and the local delivery price.

2.6.1. The national reference price

(24) The national reference price was established by EGO no.162/1999 for heating energy supplied to the population in centralized systems, aiming to provide house heating and for hot water preparation.

³ Subsidies for covering the difference between the national reference price and the local delivery price of heating energy are not included in the revenues amount.

(25) This national reference price is a regulated one from social protection reasons. Thus, if the local delivery price is higher than the national reference price, the population will pay the last one.

(26) The national reference price is established, for achieving equilibrium between the degree in which the population can support it, and the subsidies possibilities from the state budget. As regard the social aspect, in establishing this price it is taken into account the proportion of the cost of heating energy from the budget of a family with medium income.

(27) The level of the national reference price for heating energy is established in advance, by ANRE, as an average between the local prices of the producers using the same type of fuel, added to the related delivery tariffs, taking into account the possibility to be subsidized from the State's budget.

(28) The standard methodology to calculate this price is established by ANRE' Order. The factors influencing the national reference price modification are: the natural gases price, the energy's price, the modifying of the consumer price index, the modification of the exchange rate (ROL/USD or, after case, ROL/EURO).

2.6.2. Local delivery price for the heating energy

(29) The local delivery price for heating energy is established by ANRSC, both for the population as well as for the undertakings. The methodology for establishing the local delivery price is applied by ANRSC to all producers which do not produce heating energy in co-generation. The undertaking has the obligation to present to ANRSC, at the end of each year, the justifying documents from which to come forth the real costs related to the public service performed in that year and the quantities of heating energy produced and sold each month.

(30) Starting from these entering data the standard methodology is applied and the costs for the producing, transport, distribution and supplying heating energy is determined. Funding the prices is made separately for each activity/ service, the local delivery price being the result of adding the price for the production activity, the tariff for the transport service and the price for the service of delivery and supply.

(31) The local delivery prices are established at the beginning of each year and adjusted at the beginning of the second semester of the year. The steps are the following:

- identifying the regulating activities and services;
- identifying the sources for producing heating energy (separate sources and/or co-generation);
- estimating the quantities delivered to the final customers, based on the undertaking's accomplishments in the previous years, taking into account the losses in the transport network and the quantities produced as well as the power plants' own consumption;
- allocating the costs with technological fuel;
- allocation of direct costs, exclusively those with the fuel, on activities/services and production sources;
- allocating the indirect costs and the general management costs, on services, proportionally with the value of the direct costs, exclusively the fuel;
- establishing the total costs for producing heating energy under the form of hot water and steam;

- establishing the unit costs;
- re-distribution on activities of the costs related to the own consumption;
- allocation of the financial costs on regulated services;
- establishing the total costs for regulated services.

(32) According to EGO no.162/1999, if the local price of gigacalory is higher than the national reference price, the difference is subsidized as follows:

- a) from the state budget, within the limits approved by the budgetary law, differentiated with this destination;
- b) from local budgets, for the uncovered part.

(33) During 1999-2002, the national reference price was lower then the heating energy's local delivery price established for RAIL HUNEDOARA. In order to cover the difference between them, the company receives, in accordance with EGO no.162/1999, subsidies in amount of ROL 15,470,437 thousand (see Table no 4).

Table no. 4 *The evolution of the quantities delivered to the population and the value of the subsidies granted for covering the difference between the national reference price and the local delivery price during 1999-2002*

Period	Quantities delivered to the population (G cal)	Subsidy (ROL thousand)
Total year 1999	166,884.98	6,648,436
Total year 2000	116,777.43	2,502,359
Total year 2001	38,949.35	4,602,201
Total year 2002	12,243.03	1,717,440
Total		15,470,437

Source: Supplementary information

The subsidy in amount of ROL 15,470,437 thousand covers exclusively the company's losses determined by the difference between the national reference price and the local delivery price, taking into account the total quantities of heating energy delivered to the population.

2.7. Costs higher than the local delivery price for the heating energy due to the public service obligation

(34) When analyzing the measures of support for RAIL HUNEDOARA, one must also consider that, for the services of production and supply of heating energy, the company registers costs higher than the local price for supplying heating energy established by ANRSC.

(35) The unitary exploiting cost has been calculated based on the expenses registered each year in the analyzed period, respectively the costs with raw materials, employment, environment,

repairing and investments, countering and others and the real production of heating energy delivered in the respective year.

(36) Actually, the local delivery price established by ANRSC does not cover all costs due to the fact that fuel price increase estimates are not considered. Subsequent to the fuel price increase during the year, ANRSC is adjusting the energy price only when the increase is more than 5% and the adjustment refers only to the fuel, without taking into account the raw materials and materials' prices that increase chain effect. This increase is not considered when adjusting but only when prices are reviewed, once a year. Thus, there is a gap during the year between the costs of the energy operator and the local delivery price.

(37) The high operating costs of RAIL Hunedoara are due mainly to the following causes:

- the high level of losses from the heating energy transport and distribution system, due to the worn out networks;
- the forecast of the increases in the fuel price are not taken into consideration. As mentioned in point (36), the regulating authority adjust the price for the energy only if the increase represents more than 5% and the adjustment refers strictly to the fuel; it is also known that the price of materials and raw material are linked to one each other;
- although the technologies are worn out, in the price structure approved by ANRSC it is not included the developing quota for upgrading these technologies. Thus, the undertaking carries on investments, repairing and upgrading activities in the energetic system and these expenses are not always reflected in the local delivery price;
- the population pays a national reference price, approved by Government Decision and established mainly according to the purchasing power of the population, the difference between this and the production and distribution costs of heating energy being subsidized. This subsidy hardly reaches to the producer, because the Local Council's budget which ensures a significant percentage of it does not have the liquidities required to pay in due time. In this way the real value of the subsidies is strongly diminished by the inflation rate; it results that a part of the real costs remains uncovered;
- another cause of the difference between the local delivery price and the real cost is due to the obligation of RAIL, as an operator of public service, to not cease the supply in Hunedoara. This leads to high losses because the network is over dimensioned and the related costs are very high.

(38) In table no. 5 are described both the evolutions of the local delivery price for heating energy under the form of hot water and its real cost of supply between 1999-2002.

Table no. 5 – *Losses evolution registered by the company between 1999-2002 due to the difference between the local delivery price and the real cost of supply of heating energy under the form of hot water*

PERIOD	Total delivered quantities (Gcal)	Total revenues (ROL thousand)	Total costs (ROL thousand)	Uncovered losses (ROL thousand)
Total 1999	189,244.43	33,881,648	45,352,064	11,470,416
Total 2000	132,099.74	35,881,328	41,450,035	5,568,707

Total 2001	73,609.90	32,814,410	36,682,058	3,867,648
Total 2002	27,426.43	18,019,897	23,005,674	4,985,778
TOTAL	422,380.5	120,597,283	146,489,831	25,892,548

Source: Supplementary information

As it can be seen, in the analyzed period, the exploiting costs are higher than the local delivery price, established by ANRSC, both for population and undertakings.

(39) As a consequence, the difference between the real cost and the local delivery price is of ROL 25,892,548 thousand for the delivering the public interest service

3. ANALYSIS OF THE STATE SUPPORT MEASURES

3.1. Object of the decision

(40) On the basis of the notification to the Competition Council by S.C. FDFEE ELECTRICA S.A. Banat, the object of the present decision is the financial support measures granted under the form of subsidy for covering the price difference for the delivered heating energy to population and interest, increases and penalties write-off due by RAIL HUNEDOARA to the electricity supplier.

(41) The financial aid measures shall be analyzed in the context of fulfillment by RAIL Hunedoara of the obligation to discharge a service of public interest.

3.2. Obligation of service of general economic interest

(42) The financial support granted to a company entrusted with a service of general economic interest is not considered state aid for the purposes of Art. 2 of *Law 143/1999 on state aid with subsequent amendments and completions*, if the following conditions are cumulatively met:

- the obligation to discharge a service of general economic interest is entrusted through a normative/administrative act and is clearly defined;
- the parameters based on which the compensation is calculated must be established in advance, in an objective and transparent way, in order to avoid granting an economic advantage to the beneficiary;
- the compensation must not exceed the amount necessary to totally or partially cover the costs incurred through the service of general economic interest, taking in consideration the relevant incomes and a reasonable profit in performing these obligations;
- if the undertaking entrusted with the service of general economic interest was not selected through open public tender which would have allowed the selection of a bidder able to discharge this public service at the lowest costs, then the level of compensation must be set based on a comparative analysis of the company's costs and the costs of well-managed and profitable enterprise which meets all the

conditions set for the performance of the particular public service, given the relevant incomes and a reasonable profit from the meeting of the service of general economic interest obligations.

3.3. The condition from par. 3.2. a):

(43) RAIL Hunedoara is entrusted with the production, transport, distribution and supply of heating energy for the population, institutions and undertakings, under the ANRE licenses no. 193/2000, 194/2000 and 195/2000. In these licenses are mentioned, among other things, the obligations specific for the undertakings performing a service of general economic interest, namely: continuity in supplying heating energy, ensuring access to heating networks for new customers, achieving performance standards. Also, by EGO no.162/1999, producers and suppliers of heating energy are under the obligation to sell heating energy to the population at a regulated price which regularly is lower than the costs incurred by the discharge of the service (national reference price).

(44) According to the *Law on town management no. 326/2001*, the supply of heating energy which is centralized produced is a public use service. Organization, operation and functioning of public services must ensure:

- a) meeting the quantity and quality demands of users, according to the contract provisions;
- b) the optimal operation in safety, profitability and economic efficiency conditions of buildings, equipments, installations and all assets, according to the projected technological parameters and in compliance with the requested conditions, operation guidelines and organization and functioning regulations;
- c) protecting the public estate and environment by observing the legal provisions;
- d) Informing and consultation with population in order to protect the health of the population benefiting from the respective service.

(45) The supply of heating energy for preparing the hot water is achieved through the heating network of the town Hunedoara, which is part of the technical infrastructure of the city. The administration of the heating network is entrusted to the company through the Decision of the Local Council.

(46) Given all the above mentioned, the Competition Council concludes that the condition from point 3.2 letter a) regarding the fact that the obligation to discharge a public interest service must be entrusted through a normative/administrative act and must be clearly defined is fulfilled.

3.4. The condition from par. 3.2. b):

(47) According to this criterion the compensation of the public service obligation must be calculated on pre-established objectives, based on transparent parameters and may not grant an economic advantage to the beneficiary.

(48) The two parameters based on which the level of the compensation is calculated are the national reference price, established by ANRE, and the local delivery price established by ANRSC. These parameters are set in advance by Government decision, at the proposal of ANRE. The methodology used to establish the national reference price is based on the following:

- price of fuel used for the production of caloric energy;
- the electric energy price;
- the consumer price index;
- the USD/ROL exchange rate.

The local delivery price is set based on the methodology of establishing regulated prices for purchase/sale, transport and distribution tariffs for heating energy issued by ANRSC.

The producers and suppliers of heating energy submit to the regulatory authority their own price calculation; this contains the costs incurred in the previous 12 months, fixed and variable, as well as estimated costs for the following 12 months of operation. The regulatory authority analyses the variable costs (price of fuel, specific consumptions related to the production of heating energy, losses of heating energy in the transport and distribution networks), as well as fixed costs and approves the local delivery price of the heating energy, resulting different local delivery prices specific to each company.

(49) At the beginning of the financial year RAIL Hunedoara establishes a cost and income budget. Thus, based on the previous year's data it is forecast that the quantities of heating energy (due to the number of consumers and the average yearly consumption per person- at hot water- and per apartment – at heating), the subsidies to be received as well as a volume of the credits necessary for performing the public service in safety conditions. Also, are forecast the expenses incurred by the performance of the public service (with raw materials, the personnel, financial costs).

(50) Thus, the compensation for the service of general economic interest is based on the criteria of *ex-ante* calculation.

3.5. Condition in 3.2. c) :

(51) Condition 3.2.c) requires that the compensation must not exceed the costs incurred through the service of general economic interest.

(52) From Table no. 4 it can be seen that the amounts received by RAIL HUNEDOARA as subsidies, in amount of ROL 15,470,436 thousand covers only the difference between the national reference price and the local delivery price for the heating energy.

(53) Furthermore, from the data in Table no 5 it can be seen that during the analyzed period RAIL HUNEDOARA registered losses of ROL 25,892,548 thousand caused by the difference between the local delivery price established by ANRSC for the heating energy supplied and the real cost for its production and delivery.

(54) Taking into account the total losses of ROL 41,362,984 thousand (see table no 3) that the company incurred due to the performing of the service of general economic interest, it can be seen that the facilities granted to the company under the form of write off amounting to ROL 40,661,984 thousand do not fully cover the company losses. Thus, the financial support granted to the company doesn't exceed the total costs incurred from the performing of the public service.

3.6. Condition in 3.2. d) :

(55) S.C. RAIL HUNEDOARA S.A was not entrusted with the service of general economic interest to produce heating energy following a public tender procedure.

(56) The public service to produce heating energy was entrusted to RAIL HUNEDOARA by a license from ANRE. Thus, in order to establish the compensation level, it is necessary to analyze the costs that another well-run undertaking would have had, in providing the same service. Such a comparison could not be done by the grantor.

(57) Considering the above, one can conclude that the four conditions under point 43 are not met cumulatively, mainly the condition provided at letter (d) was not proved. Therefore, the state support measures for RAIL HUNEDOARA, constitute state aid for the purposes of *art. 2 of Law 143/1999 on State aid*, republished and of the *Regulation on state aid in the form of compensations granted to certain undertakings entrusted with services of general economic interest*.

4. COMPATIBILITY OF THE AID

(58) According to the *Regulation on state aid in the form of compensations granted to certain undertakings entrusted with services of general economic interest* compensations granted in view of discharging the service of general economic interest may constitute state aid compatible with a normal competition environment if the following conditions are met:

- a) the state aid is necessary for discharging a service of general economic interest;
- b) the state aid does not unduly affect the trade between Romania and the EU Member States.

4.1. State aid necessary for discharging a service of general economic interest

(59) The State aid granted to RAIL HUNEDOARA is strictly necessary for appropriate and continuously operating the public service of distribution and supply of heating energy. Where a regulated market exists, the company cannot ask for a price higher than the one necessary to cover the exploiting costs, including a reasonable profit.

(60) This is the main reason for which the company is registering losses every year, and cannot pay its obligations towards the suppliers. We can add to this the low rate of collecting the claims from the population.

(61) The forced execution procedure of these obligations would block the company's activity and will lead to the cease of the public service operation with severe consequences for the population and undertakings in the city of Hunedoara.

4.2. No unduly affect the trade between Romania and the EU Member States

(62) The geographical market affected by the State aid is the city of Hunedoara. Therefore, being a local market, by granting a State aid there will be no unduly distortion on the trade between

Romania and the EU Member States, given the fact that the company is not involved in any export activities.

4.3. There is no over-compensation

(63) The state aid granted under the form of penalties write off due to S.C. F.D.F.E.E. ELECTRICA Banat S.A. and subsidies for covering the price difference does not represent an over-compensation because it does not exceed the costs which are absolutely necessary in order to perform the service of general economic interest.

(64) Thus, the two conditions mentioned at par. (58), conditions provided in the *Regulation on State aid in the form of compensations granted to certain undertakings entrusted with services of general economic interest* are cumulatively met, so we can appreciate that the support measures for RAIL HUNEDOARA, representing compensations for performing the service of general economic interest, are compatible State aid with the normal competitive environment.

(65) From the above mentioned facts it results that the state aid in amount of ROL 40,661,787 thousand, from which ROL 15,470,437 thousand represents subsidies and ROL 25,191,350 thousand represent penalties write off due to S.C. FDFEE ELECTRICA Banat S.A., is compatible with the normal competitive environment.

DECIDES

Art. 1. The analyzed measures of financial support granted to RAIL Hunedoara constitute State aid for the purposes of Art. 2 of *Law 143/1999 on State*, republished.

Art. 2. The notified State aid represents a necessary compensation to achieve, under normal conditions of safety and continuity the service of general economic interest of distribution and supply of heating energy, which does not unduly affect the trade between Romania and the EU Member States.

Art. 3. Pursuant to Art. 21 (2) (b) read in conjunction with Art. 23 (1) (j) of *Law 143/1999 on State aid* republished, it is authorized the State aid for RAIL HUNEDOARA, as State aid due to the delivery under safety and continuity conditions of the general economic interest service.

Art. 4 Pursuant to Art. 32 of *Law 143/1999 on State aid* republished, suppliers shall annually submit to the Competition Council information regarding the State aid granted to RAIL HUNEDOARA in view of its monitoring.

Art. 5 This decision is applicable as of its date of communication.

Art. 6. According to Art. 46 of *Law 143/1999 on State aid* republished, this decision may be appealed by the interested persons before the Bucharest Court of Appeal, the administrative section, within 30 days from its communication.

Art. 7. This Decision shall be communicated by the General Secretariat of the Competition Council to:

- SC Filiala de Distributie si Furnizare a Energiei Electrice ELECTRICA BANAT SA, street Pestalozzi;
- Regia Autonoma de Interes Local, bd. Republicii no. 5, Hunedoara, judet Hunedoara.

Art. 8. The Secretariat-General and the Directorate for State Aid Authorization of the Competition Council shall pursue the fulfillment of the present Decision.

PRESIDENT

MIHAI BERINDE