

The Kostolac B lignite power plant is currently undergoing environmental improvements, to be followed by the construction of an additional new unit, Kostolac B3 and expansion of the captive mine at Drmno. This process consists of two phases which are both being financed by the China Exim Bank. The report of CEE Bankwatch reveals details of the project.

On December 29, 2011 a contract was signed between the Government of the Republic of Serbia and Chinese Exim Bank, for USD 293 000 000 85% of the cost of the full project Phase 1 - envisaged for reconstruction of blocks B1 and B2 of TE-KO Kostolac, construction of a desulphurization system, building of a landing dock on the Danube and construction of railway infrastructure. In this contract, the Republic of Serbia is the borrower, responsible for paying back the loan amount, while TE-KO Kostolac, part of the state-owned electricity company Elektroprivreda Srbije (EPS) is named as the end-user of the funds. Thus the state takes on all the responsibilities connected with paying back the loan.

On 17 December 2014, a loan agreement was signed by the Minister of Finance on behalf of the Government of Serbia and the China ExIm Bank for USD 608 260 000 for Phase 2 of the Kostolac power plant project, which comprises the construction of unit 3 of the Kostolac B power plant and the expansion of the Drmno mine. This amount makes up 85% of the Engineering, Procurement and Construction signed with Chinese company CMEC in November 2013 to carry out the works. The Law on ratification of the loan agreement was passed by the Serbian parliament on 19 January 2015, and the loan included in the 2015 Serbian budget.

In the 2015 state budget (Article 3) funds are reserved for a guarantee for commercial bank loans for the second phase of the Kostolac project, worth EUR 80 000 000. The description of the project is: JP Elektroprivreda Srbije Participation in the second phase of the TE-KO Kostolac project package (Construction of a new energy unit at the Drmno Kostolac B site phase II and expansion of the capacity of the mine). It is not yet known which commercial bank loans are in question and whether the loan contracts have been signed.

Serbian NGO CRTA in early 2014 wrote a report on the first and second of these points (the loan agreement in the second point had not been signed at that time but it was planned, and money for it had been allocated in the 2014 Serbian budget).

The measures listed in relation with the Kostolac B power plant raise the issue of State aid, but a definitive answer cannot be given. The involvement of the Chinese Exim Bank in itself does not indicate the use of State resources since China is not part of the EU or the Energy Community Treaty. However if the State is the other contracting party and receives the export credit to be used later for the upgrade and extension of the power plant, this changes the status of the measure.

The Serbian State then gains control over the amount of the export credits and with that they become State resources. It has to be noted that infrastructure and ports financing may also fall under State aid rules but they are out of the scope of the Energy Community Treaty.

In general, infrastructure can be financed up to its funding gap under EU State aid rules. As regards the power plant's environmental upgrade and extension with an additional 350 MW unit it has to be first examined, whether the project is viable and profitable under the market economy investor principle.

If the project creates enough revenues to cover costs, including depreciation, payments of the debts and profit above risk free return (normally the yield of State bonds with the tenure close to the project's lifecycle) weighted with the risks of the project, then one can argue the involvement of the State does not lead to advantage which cannot be obtained on the market. Any advantage coming from the Chinese Exim Bank should not be taken into account.

On the other hand, related to the state guarantees for the loans from commercial banks, a market price has to be paid for the State guarantees and the other conditions of the Commission's notice on State guarantees have to be met.

The same approach applies to the extension of the coal mine. For the two economic activities profitability has to be assessed together since the coal mined in the extended mine would be used in the power plant and they form one economic entity. All decisions of the State are interlinked and interdependent.

Therefore by applying the market economy investor principle, the financial exposure in all the measures and the expected return have to be assessed. The desulphurization system in itself may be eligible for environmental aid and its costs if they can be separated.

The main question here is whether the Energy Community acquis requires such a system. If yes, the project can be eligible only to the extent (costs) which it goes beyond these requirements (e.g. ensuring even lower emissions).