THE “MUNICIPAL WASTE MANAGEMENT PROGRAM IN KRAKOW”: A CASE STUDY ON THE EXEMPTION OF STATE AID NOTIFICATION UNDER THE EU SGEI DECISION

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1. Introduction

The “Municipal Waste management program in Krakow” was included in the JASPERS Action Plan with the number 2007 039 PL SWE SLW. JASPERS therefore supported the Beneficiary during the project preparation by reviewing and commenting the documentation regarding the application for Cohesion Fund co-financing.

This project provides an example of an application in practice of the Services of General Economic Interest (SGEI) exemption from notification for State aid clearance of an EU co-financed infrastructure project.

The main component of the project is the construction of a Waste Incineration Plant for residual mixed municipal waste in Krakow with a total capacity of incineration of 220 000 tons per year and its total cost is EUR 169.9 million. The beneficiary and plant operator is Krakowski Holding Komunalny SA (KHK SA, Krakow Municipal Holding, a joint-stock company). All shares (100%) belong to the City of Krakow. The infrastructure to be built within the project would be owned, operated and monitored by the beneficiary.

From the outset, it is worthwhile stressing, first, that the project was assessed under the Decision 2005/842/EC of 28 November 2005 on the application of Article 86(2) of the EC Treaty to State aid in the form of public service compensation granted to certain undertakings entrusted with the operation of SGEIs ¹ (the 2005 SGEI Decision), replaced since by the Commission Decision 2012/21/EU of 20 December 2011 on the application of Article 106(2) of the TFEU to State aid in the form of public service compensation granted to certain undertakings entrusted with the operation of services of general economic interest² (the 2012 SGEI Decision). They both are however almost identical and thus the authors will refer indistinctly to both of them. Yet, any relevant modification in the 2012 SGEI Decision with regard to its predecessor will be duly highlighted.

Second, this project was not submitted to the DG Competition of the European Commission for its assessment under the State aid rules. Indeed, any public financing measure which complies with the applicable conditions to SGEI compensation established in the SGEI Decision is exempted from this notification. Notwithstanding, State aid was one of the elements examined by DG Regional Policy of the European Commission, since the application for EU co-financing for major projects like the one at issue includes a specific section on the compliance with the EU’s State aid rules.

Finally, before analyzing the conditions of applicability and the requirements for exempting of the notification fixed in the SGEI Decisions of 2005 and 2012, it has to be established whether the service financed by means of public funds is indeed of general economic interest.

¹ OJ L 312, 29.11.2005, p.4
² OJ L 7, 11.1.2012, p.3
2. Waste management as a potential service of general economic interest

According to the Court of Justice, Member States have wide discretion to define what they regard as an SGEI. Thus, the definition of such services or tasks by a Member State can be questioned by the Commission only in the event of a manifest error.\(^3\) This allegedly wide definition of SGEI is however restricted in practice and there is no presumption that a given service constitutes an SGEI.

On the opposite, for an activity to be considered as an SGEI, it should exhibit special characteristics as compared with ordinary economic activities which contribute to the development of certain economic activities or economic areas as foreseen in Article 107 (3) (c) TFEU.

According to the Communication from the Commission on the application of the EU State aid rules to compensation granted for the provision of SGEI, “the services to be classified as SGEIs must be addressed to citizens or be in the interest of society as a whole”\(^4\) and “the entrustment with a ‘particular public service task’ implies the supply of services which, if it were considering its own commercial interest, an undertaking would not assume or would not assume to the same extent or under the same conditions”.\(^5\) More precisely, the 2003 Green Paper on SGEI, states that the “existing Community legislation on services of general economic interest contains a number of common elements that can be drawn on to define a useful Community concept of services of general economic interest. These elements include in particular: universal service, continuity, quality of service, affordability, as well as user and consumer protection”.\(^6\) Thus, the Commission demands that the activities are not provided satisfactorily and under conditions such as price, objective quality characteristics, continuity and access to the service, consistent with the public interest as defined by the State, by undertakings operating under normal market conditions.

The question whether waste management fulfils these conditions is not a settled issue. In the Municipal Waste management program in Krakow project DG REGIO sent an interruption letter to the Polish authorities, raising this issue. More precisely, it asked for clarifications on the reasons which had led the Polish authorities to qualify the activities of waste management as being of general economic interest.

The elements applied for considering waste management as a particular public service task, and therefore, potentially as of general economic interest, are the following:

First, the Commission itself in its staff working paper on *The application of EU State aid rules on SGEI since 2005 and the outcome of the Public Consultation* has identified waste management services as a potential SGEI:

> *The provision of water supply and water and waste management services is often a responsibility of local public authorities which have an obligation to ensure that such services are satisfactorily provided within their geographic area of competence. This responsibility is often discharged directly by public administrative entities and enterprises or by the entrustment of a public service concession to a private enterprise, which performs the services under conditions and for a duration specified in the concession contract… Where services are provided by public undertakings, public financial support may take the form of increases in share capital or other financial contributions by the public authorities/shareholders. Such financial support would, unless it met the conditions of the market investor principle, constitute a de facto SGEI compensation*. [emphasis added]

The Court of Justice and the Commission have had the occasion to pronounce itself on a related, yet not identical, activity: the management of particular waste. In this case, the Court of Justice has acknowledged that it can potentially constitute a service of general economic interest:

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\(^5\) Ibid., para.47

"The management of particular waste may properly be considered to be capable of forming the subject of a service of general economic interest, particularly where the service is designed to deal with an environmental problem." [emphasis added]

In another case, the management of hazardous, and thus as well particular, waste has also been considered by DG COMP as an SGEI. It is worthwhile quoting the Commission’s way of reasoning:

“(79) First, there is an obvious public interest in appropriate treatment when hazardous waste is disposed of. There is as well a public and Community interest in ensuring the availability of sufficient domestic capacity for such disposal. In accordance with the objective laid down in Article 5(1) of Directive 75/442/EC, Member States should strive to become self-sufficient in the disposal of waste.

(80) Second, public intervention was necessary to safeguard this public interest. Since the RDFs were operated at a loss, without the aid AVR would have closed the RDFs and the C2 depot at the end of 2001.

(81) Third, the public interest was real. Between 2002 and 2004 significant quantities of RDF and C2 waste produced in the Netherlands were disposed of... The interested parties may have been right in maintaining that all hazardous waste produced in the Netherlands during that period could have been disposed of or recovered within the country or abroad even without AVR’s RDFs. They failed, however, to demonstrate that without AVR’s RDFs no exports of waste for disposal abroad would have been necessary at all because of the absence of sufficient capacity. It is precisely in this connection that the Netherlands could legitimately base its policy on the desire to defend the public interest, in line with the objective of Article 5(1) of Directive 75/442/EC.

(82) Fourth, the measures do not infringe the ‘polluter pays’ principle. As concluded in point 72, the suppliers of waste are not spared the costs that should normally be included in their budget.

(83) Fifth, classification as an SGEI does not circumvent the rules that normally apply. The measure seeks to protect the environment since it ensured appropriate treatment of hazardous waste at a location near its source. ...

(84) Sixth, by nature, the bulk of the RDF and C2 waste is supplied by companies, but collection systems exist for the safe and easy disposal of any hazardous waste from households. Some of the hazardous waste collected can then be disposed of in the RDFs. So the service for which the aid was granted was general in character and did not favour a limited number of users.

Most of these arguments could be applied to the disposal and management of any type of waste, and were indeed applicable to the project in question. The Polish authorities underlined for instance the lack of sufficient supply of waste incinerators in the area, waste being disposed in landfills.

Moreover, such a significant investment as the one needed for the construction of a new waste incinerator, if it was to be financed without public funds, would demand a significant increase in the tariffs charged to the end-users of the infrastructure (i.e. the population served by the waste management plant). This increase would be unacceptable from a social point of view according to the national authorities. In this sense, as mentioned above, the Commission demands that any activity in order to be qualified as an SGEI cannot be provided satisfactorily and under conditions such as price, objective quality characteristics, continuity and access to the service, consistent with the public interest as defined by the State, by undertakings operating under normal market conditions. The fact that the funding of the infrastructure by means of the beneficiary’s own resources would entail that waste management services would no longer be provided under acceptable pricing conditions for the population is a further argument in favour of qualifying waste management in this case as a potential SGEI.

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7 Case C-209/98 Entreprenørforeningens Affalds/Miljøsektion (FFAD) v Københavns Kommune (‘Sydhavnens Sten&Co’) [2000] ECR 3743, paragraph 75.
The Polish authorities also put forward the internal regulation of the waste management services in Poland to show that it entails special characteristics as compared with ordinary economic activities which contribute to the development of certain economic activities or economic areas:

According to the Polish Local Government Act (A.7.1.3 ustawy o samorządzie gminnym, Dz. U. z 2001 r., Nr 142, poz. 1591, z późn. zm.) and the Act on the maintenance of cleanliness and order in the municipalities (A.3 ustawy o utrzymaniu czystości i porządku w gminach, Dz. U. z 2005 r., Nr 236, poz. 2008, z późn. zm.) waste management counts among the responsibilities that municipalities are to provide in order to meet the collective needs of the community and is therefore a mandatory charge for these entities.

Moreover, under Article 16a of the Act on Waste (ustawy o odpadach, t.j. Dz. U. z 2010 r., Nr 185, poz. 1243, z późn. zm.) among the mandatory tasks of the municipalities regarding waste management counts the construction, maintenance and operation of their own or of shared installations and equipment for the recovery and disposal of waste or the provision of the necessary means to guarantee the provision of these installations and equipment by external companies.

The identification of the provision of waste management services as an SGEI by means of an internal act having binding legal force, besides being a relevant element for classifying this service as of general economic interest, will also be necessary to meet the first Altmark criteria, i.e. the entrustment condition (cf. infra).

All in all, there were sufficient elements to consider that waste management, in this particular case, fulfilled the applicable conditions in order to be qualified as an SGEI.
3. The application of the Commission Decision on SGEI compensation

Once it is established that the services, in this case the waste management services, might potentially be considered as being of general economic interest, some further conditions have to be met in order to consider that the public funding measure in question does not involve State aid in the sense of Article 108 (1) TFEU or can be deemed as compatible with the internal market and is therefore not subject to the notification to the European Commission under Article 108 (3) TFEU.

Whether the SGEI compensation does not constitute State aid or whether it is to be considered as State aid, yet compatible with the internal market and exempted from notification to the European Commission, will depend on the fulfillment of the so-called Altmark criteria:

1. If the public funding meets all four criteria established by the European Court of Justice in the Altmark case, then the SGEI compensation will not be considered as State aid. Consequently, the measure will not have to be notified.
2. If the public funding measure does not fulfill all four Altmark criteria, granting a selective advantage to the beneficiary and affecting trade and competition at EU level, it will be considered as State aid but will be also exempted from notification to the European Commission, provided it meets the compatibility criteria established in the SGEI Decision.

The 2012 SGEI Decision thus lays down the conditions under which State aid in the form of compensation for an SGEI is not subject to the prior notification requirement of Article 108 (3) TFEU as it can be deemed compatible with Article 106 (2) TFEU:

“Undertakings entrusted with the operation of services of general economic interest or having the character of a revenue-producing monopoly shall be subject to the rules contained in the Treaties, in particular to the rules on competition, in so far as the application of such rules does not obstruct the performance, in law or in fact, of the particular tasks assigned to them. The development of trade must not be affected to such an extent as would be contrary to the interests of the Union”.\(^9\)

In this case, the public financing has the aim to compensate for the discharge of public service obligations by the recipient undertaking and is necessary for allowing these services to operate on the basis of adequate principles and conditions enabling them to fulfill their public service mission. This is the reason why the aid granted with this purpose, if it complies with the conditions established in the SGEI Decision, will be deemed compatible with the internal market without requiring a prior notification and clearance by the Commission:

“State aid in the form of public service compensation that meets the conditions laid down in this Decision shall be compatible with the internal market and shall be exempt from the prior notification obligation”.

The scope of the 2005 and 2012 SGEI decisions are fixed in their respective Articles 2, which establish different applicability conditions (cf. infra).

The remaining articles of the decision develop three of the four cumulative conditions established by the European Court of Justice in the Altmark case in order to consider that a public service compensation does not constitute State aid. The SGEI Decision deals with those cases in which the fourth Altmark criteria (selection of the beneficiary by means of a public procurement procedure or level of compensation based on the costs that a typical undertaking, well run, would have incurred in discharging the SGEI) is not complied with. The remaining three conditions which have to be met in order to deem the aid as compatible with the internal market are the following:

1) The beneficiary of a State funding mechanism for a service of general economic interest must be formally entrusted with the provision and discharge of the service, the obligations of which must be clearly defined:

\(^9\) Article 106 (2) TFEU
2) The parameters for calculating the compensation must be established beforehand in an objective and transparent manner, to avoid it conferring an economic advantage which may favour the recipient undertaking over competing undertakings.

3) The compensation cannot exceed what is necessary to cover all or part of the costs incurred in the discharge of public service obligations, taking into account a reasonable profit for discharging those obligations.

As mentioned above, although at the time the applicable legislative instrument was the 2005 SGEI Decision, subsequently replaced by the 2012 SGEI Decision, the differences between the two are minor ones and the assessment made under the 2005 Decision is essentially applicable at present under the 2012 Decision.

3.1. Scope and applicability of the 2012 SGEI Decision

The 2012 SGEI Decision, on its scope, establishes a general rule and some particular sectorial exceptions applicable to the provision of SGEI in the maritime and air transport sector, the health care sector and SGEIs meeting other social needs regarding for instance childcare. According to Article 2.1 (a) the Decision applies to State aid in the form of public service compensation, when the latter does not exceed an annual amount of EUR 15 million for the provision of SGEIs in areas other than transport and transport infrastructure.

One of the differences between the 2005 and the 2012 Decision affects the criteria applied to fix its scope. The 2005 Decision covered “public service compensation granted to undertakings with an average annual turnover before tax, all activities included, of less than EUR 100 million during the two financial years preceding that in which the (SGEI) was assigned, which receive annual compensation for the service in question of less than EUR 30 million”.

The project meets those requirements and thus fell within the scope of the Decision:

The total amount of aid in form of compensation for public service is EUR 103 million over a period of 20 years (2011-2030). The distribution over this period will be however uneven. The disbursement of the European Cohesion funds, in particular, will be concentrated in the implementation period (2011 - 2015). Therefore, the aid amount in some of these years will be well above the compensation threshold set out in Article 2(1)a of the 2005 Decision. However, the average amount for the whole duration of the project, which should be taken as the relevant figure, lies far below the EUR 30 million threshold.

The aid was made up of the grant requested from the Cohesion Fund (EUR 92 382 339) and a subsidized loan amounting an estimated EUR 11 131 766, which represents the difference between the amount resulting from the application of the preferential and the non-preferential reference rate. Article 5.2 of the Executive agreement signed between the Municipality of Krakow and the beneficiary (cf. infra section on entrustment) furthermore codified this EUR 30 million limit in order to guarantee that it would also be respected after the disbursement of the public funds.

Regarding the average annual turnover before tax during the two financial years preceding that in which the SGEI was assigned, KHK SA did not exceed the EUR 100 million of the 2005 Decision either. It was indeed lower than EUR 500.000 for each of the two years. This EUR 100 million limit was as well included as a condition precedent for the disbursement of the aid in Article 3.11 of the Executive agreement.

Therefore, the 2005 SGEI Decision was applicable. Moreover, if the 2012 Decision had been applied to the project, the latter would have met the applicability condition of the former’s Article 2.1(a) as well.

10 Article 2.1 (a) Decision 2005/842/EC of 28 November 2005 on the application of Article 86(2) of the EC Treaty to State aid in the form of public service compensation granted to certain undertakings entrusted with the operation of SGEIs, OJ L 312, 29.11.2005, p.4
3.2. Formal entrustment

The first Altmark condition demands the formal entrustment of the beneficiary with the discharge of the SGEI. According to Article 4 of the 2011 SGEI Decision, "[o]peration of the service of general economic interest shall be entrusted to the undertaking concerned by way of one or more acts, the form of which may be determined by each Member State" with the restriction that it must entail "binding legal force under national law. The specific form of the act (or acts) may be determined by each Member State, depending among other things on its political and/or administrative organisation".

Moreover, the act shall include:

a) The content and duration of the public service obligations;
b) The undertaking and, where applicable, the territory concerned;
c) The nature of any exclusive or special rights assigned to the undertaking by the granting authority;
d) A description of the compensation mechanisms and the parameters for calculating, controlling and reviewing the compensation;
e) The arrangements for avoiding and recovering any overcompensation; and
f) A reference to this Decision.

In the Municipal Waste management program in Krakow project, the entrustment was made by means of a resolution of the Krakow City Council of 5 November 2008, which modified the resolution establishing the joint-stock KHK SA and an Executive agreement signed between both on April 4th 2011.

According to Article 1.2 (b) of the Resolution, in its activities, KHK SA, acting on behalf of the Municipality of Krakow, has to carry out, among other tasks, the disposal of municipal waste. Further, Article 2.1 of the Resolution entrusted KHK SA with the preparation, construction and operation of a waste incineration plant in Krakow, a project which had been submitted for funding by the EU Regional Funds and included in the Operational Program Infrastructure and Environment under OPI 2.1.3.

Article 2.3 of the Resolution provides a more detailed description of the entrustment tasks, namely:

1. Conducting a consultation among the community on the acceptance as well as promotional and educative activities related to the project.
2. Determine the location of the plant
3. Issue a preliminary architectural and construction design of the plant
4. Arrange a detailed work plan
5. Acquire land for the purpose of the project
6. Raise funds to build the waste incineration plant, including EU aid, in order to minimize the need of own financial resources
7. The construction and refinement of the plant
8. Operation of the plant

The Executive agreement signed between the Municipality of Krakow and KHK SA reminds, at its Article 2.5, that the construction and operation of the waste management plant is a task to be performed by KHK SA on

11 Similarly, Article 4 of the 2005 Decision stated “In order for this Decision to apply, responsibility for operation of the service of general economic interest shall be entrusted to the undertaking concerned by way of one or more official acts, the form of which may be determined by each Member State.”

Decision 2005/842/EC of 28 November 2005 on the application of Article 86(2) of the EC Treaty to State aid in the form of public service compensation granted to certain undertakings entrusted with the operation of SGEIs, OJ L 312, 29.11.2005, p.4

12 COMMISSION STAFF WORKING DOCUMENT Guide to the application of the European Union rules on state aid, public procurement and the internal market to services of general economic interest, and in particular to social services of general interest, Point 3.4.2, p.38 http://ec.europa.eu/services_general_interest/docs/guide_eu_rules_procurement_en.pdf

13 Similarly, Article 4 of the 2005 Decision required that “the act or acts shall specify, in particular:

a) The nature and the duration of the public service obligations;
b) The undertaking and territory concerned;
c) The nature of any exclusive or special rights assigned to the undertaking;
d) The parameters for calculating, controlling and reviewing the compensation;
e) The arrangements for avoiding and repaying any overcompensation”

Decision 2005/842/EC of 28 November 2005 on the application of Article 86(2) of the EC Treaty to State aid in the form of public service compensation granted to certain undertakings entrusted with the operation of SGEIs, OJ L 312, 29.11.2005, p.4

14 https://www.bip.krakow.pl/?dok_id=167&sub_dok_id=167&sub=uchwala&query=id%3D17557%26typ%3DU
behalf of the Municipality and qualifies it as a service of general interest (usług świadczonych w ogólnym interesie gospodarczym).

The Executive agreement also fixes the duration of the entrustment of the public service tasks: In accordance with this agreement, the provision of public services would end on the 31st December 2030 (Points 1.1 and 12.9 of the executive agreement and Article 14 of the annex to the Executive agreement).

The territory covered by the SGEI is specified in Article 1.1 of the Executive Agreement, according to which Public services are to be understood as the services provided by the Contractor (KHK SA) in the general economic interest and consisting of the disposal of municipal waste through treatment of municipal waste from the area of the City of Krakow.

The exclusive or special rights granted to the beneficiary are also mentioned in the entrustment acts, more precisely in the executive agreement. Its Article 3.3 states that the Municipality of Krakow will apply its constituent and control powers resulting from generally applicable laws and local laws, in order to guarantee that companies applying for permissions for the collection and transportation of urban waste in the area of the City of Krakow, will deliver the waste to the beneficiary within the limit of 220 000Mg/year.

The compensation mechanisms and the parameters for calculating, controlling and reviewing the compensation and recovering any overcompensation figure as well in the two entrustment acts (cf. infra).

Therefore, the two entrustment documents contain all the information demanded by the applicable EU regulations and soft law.

3.3 Compensation established beforehand and absence of overcompensation

The compensation granted to the undertaking entrusted with the delivery of the SGEI should not exceed what is necessary to cover the net costs incurred in discharging the public service obligations, including a reasonable profit.15

As seen in the previous section, the design of the compensation mechanism is a part of the mandatory content to be included in the act of entrustment (“A description of the compensation mechanisms and the parameters for calculating, controlling and reviewing the compensation” and “[t]he arrangements for avoiding and recovering any overcompensation”). It will thus be automatically established beforehand in the, or one of the, entrustment act or acts.

Moreover, the guidelines included in the SGEI decision, either in the 2005 one or, currently, in the 2012 Decision, for calculating the costs and revenues of the service have to be respected:

“The costs to be taken into consideration shall comprise all the costs incurred in operating the service of general economic interest:

(a) where the activities of the undertaking in question are confined to the service of general economic interest, all its costs may be taken into consideration;

(b) where the undertaking also carries out activities falling outside the scope of the service of general economic interest, only the costs related to the service of general economic interest shall be taken into consideration;

15 Article 5 SGEI Decision 2012. The 2005 SGEI Decision expressed this condition on a slightly different manner: “The amount of compensation shall not exceed what is necessary to cover the costs incurred in discharging the public service obligations, taking into account the relevant receipts and a reasonable profit on any own capital necessary for discharging those obligations. The compensation must be actually used for the operation of the [SGEI] concerned, without prejudice to the undertaking’s ability to enjoy a reasonable profit.” Commission Decision 2012/21/EU of 20 December 2011 on the application of Article 106(2) of the TFEU to State aid in the form of public service compensation granted to certain undertakings entrusted with the operation of services of general economic interest, OJ L 7, 11.1.2012, p.3
(c) the costs allocated to the service of general economic interest may cover all the direct costs incurred in operating the service of general economic interest and an appropriate contribution to costs common to both the service of general economic interest and other activities;

(d) the costs linked with investments, notably concerning infrastructure, may be taken into account when necessary for the operation of the service of general economic interest”.16

In the Municipal Waste management program in Krakow project the undertaking entrusted with the SGEI will carry out activities falling outside the scope of the SGEI besides those which qualify as of general economic interest.

KHK SA is thus obliged, according to Article 3.5 of the Executive agreement, to have separate accounting of incomes and expenses related to each of its activities, fulfilling thus the condition established in Article 5.9 of the 2012 SGEI Decision:

“Where an undertaking carries out activities falling both inside and outside the scope of the [SGEI], the internal accounts shall show separately the costs and receipts associated with the [SGEI] and those of other services, as well as the parameters for allocating costs and revenues. The costs linked to any activities outside the scope of the [SGEI] shall cover all direct costs, an appropriate contribution to the common costs and an adequate return on capital. No compensation shall be granted in respect of these costs”.17

- Costs

The Executive agreement signed between the beneficiary and the Municipality of Krakow establishes that costs related to non-SGEI activities as defined in the entrustment act are not eligible for public financing. On the other hand, incomes derived from those non-SGEI activities shall not be used to finance SGEI services, although both the 2005 and the 2012 SGEI Decisions allow it.18 They are therefore not taken into account when calculating the compensation (cf. infra). A cross-subsidization of activities which do not pertain to the SGEI is prevented expressly in Article 4.8 of the Executive agreement, according to which the receipts stemming from public services are not to be employed for financing other services.

According to paragraph 6.1.5 of the Executive agreement, the costs that are considered for calculating the SGEI compensation in the project are all costs and expenses directly linked to the public service, the corresponding share of the fixed costs of the beneficiary and the expenses in infrastructures needed for performing the SGEI.19

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16 Article 5.3 Commission Decision 2012/21/EU of 20 December 2011 on the application of Article 106(2) of the TFEU to State aid in the form of public service compensation granted to certain undertakings entrusted with the operation of services of general economic interest, OJ L 7, 11.1.2012, p.3. The 2005 SGEI Decision has an almost identical provision at its Article 5.2. Decision 2005/842/EC of 28 November 2005 on the application of Article 86(2) of the EC Treaty to State aid in the form of public service compensation granted to certain undertakings entrusted with the operation of SGEIs, OJ L 312, 29.11.2005, p.4
17 Article 5.9 Commission Decision 2012/21/EU of 20 December 2011 on the application of Article 106(2) of the TFEU to State aid in the form of public service compensation granted to certain undertakings entrusted with the operation of services of general economic interest, OJ L 7, 11.1.2012, p.3. Cf. as well Article 5.5 Decision 2005/842/EC of 28 November 2005 on the application of Article 86(2) of the EC Treaty to State aid in the form of public service compensation granted to certain undertakings entrusted with the operation of SGEIs, OJ L 312, 29.11.2005, p.4 and 5.4 of Commission Decision 2012/21/EU of 20 December 2011 on the application of Article 106(2) of the TFEU to State aid in the form of public service compensation granted to certain undertakings entrusted with the operation of services of general economic interest, OJ L 7, 11.1.2012, p.3.
18 “The Member State concerned may decide that the profits accruing from other activities outside the scope of the [SGEI] are to be assigned in whole or in part to the financing of the [SGEI]”. Article 5.3 of Decision 2005/842/EC of 28 November 2005 on the application of Article 86(2) of the EC Treaty to State aid in the form of public service compensation granted to certain undertakings entrusted with the operation of SGEIs, OJ L 312, 29.11.2005, p.4
19 "6.1.5 Całość kosztów i wydatków planowanych do poniesienia w związku ze świadczeniem Usług publicznych, które do koszty i wydatki wyodrębnione i ewidencjonowane są zgodnie z postanowieniami powyższych 3.5, 3.6 oraz odpowiedni udział w kosztach stałych Wykonawcy związanych z prowadzeniem Usług publicznych i inna działalnością Wykonawcy, a także wydatki inwestycyjne związane z infrastruktura, konieczne do odpowiedniego wykonywania Usług publicznych (symbol wskaźnika Wkd (n)"
Revenues

On the other hand, regarding the relevant revenues for calculating the net costs of the SGEI provision and subsequently the level of compensation, these comprise, according to the SGEI Decisions, “at least the entire revenue earned from the [SGEI], regardless of whether the revenue is classified as State aid… If the undertaking in question holds special or exclusive rights linked to activities other than the [SGEI] for which the aid is granted, that generate profits in excess of the reasonable profit, or benefits from other advantages granted by the State, these shall be included in its revenue”. 20

In the “Municipal Waste management program in Krakow” project the special rights were granted to the beneficiary consisted in the guarantee by the Municipality of Krakow that it would apply its constituent and control powers resulting from generally applicable laws and local laws, in order to guarantee that the companies applying for permissions for the collection and transportation of urban waste in the area of the City of Krakow, would deliver the waste to the beneficiary within the limit of 220 000 Mg/year. These special rights are thus linked to the SGEI and do not have to be taken into account autonomously.

The executive agreement, in its paragraph 6, lists in detail the incomes which are to be taken into account when calculating the compensation: The annual revenue from waste treatment, the sale of green certificates, heat and electricity generated during the process of incineration of municipal waste and the sale of recycled materials.

Reasonable profit

Both the 2005 and 2012 SGEI Decisions allow the SGEI provider to perceive a reasonable profit on top of the reimbursement of the costs incurred in the provision of the public service. The 2012 SGEI Decision gives a more detailed guidance than its predecessor:

1. The amount of compensation shall not exceed what is necessary to cover the net cost incurred in discharging the public service obligations, including a reasonable profit...

5. For the purposes of this Decision, ‘reasonable profit’ means the rate of return on capital that would be required by a typical undertaking considering whether or not to provide the [SGEI] for the whole period of entrustment, taking into account the level of risk. The ‘rate of return on capital’ means the internal rate of return that the undertaking makes on its invested capital over the duration of the period of entrustment. The level of risk depends on the sector concerned, the type of service and the characteristics of the compensation.

6. In determining what constitutes a reasonable profit, Member States may introduce incentive criteria relating, in particular, to the quality of service provided and gains in productive efficiency...

7. …[A] rate of return on capital that does not exceed the relevant swap rate plus a premium of 100 basis points shall be regarded as reasonable in any event. The relevant swap rate shall be the swap rate the maturity and currency of which correspond to the duration and currency of the entrustment act. Where the provision of the service of general economic interest is not connected with a substantial commercial or contractual risk, in particular when the net cost incurred in providing the service of general economic interest is essentially compensated ex post in full, the reasonable profit may not exceed the relevant swap rate plus a premium of 100 basis points

8. Where, by reasons of specific circumstances, it is not appropriate to use the rate of return on capital, Member States may rely on profit level indicators other than the rate of return on capital to determine

20 Article 5.4 Commission Decision 2012/21/EU of 20 December 2011 on the application of Article 106(2) of the TFEU to State aid in the form of public service compensation granted to certain undertakings entrusted with the operation of services of general economic interest, OJ L 7, 11.1.2012, p.3 and 5.3 Decision 2005/842/EC of 28 November 2005 on the application of Article 86(2) of the EC Treaty to State aid in the form of public service compensation granted to certain undertakings entrusted with the operation of SGEIs, OJ L 312, 29.11.2005, p.4
what the reasonable profit should be, such as the average return on equity, return on capital employed, return on assets or return on sales ...Whatever indicator is chosen, the Member State shall be able to provide the Commission upon request with evidence that the profit does not exceed what would be required by a typical undertaking considering whether or not to provide the service, for instance by providing references to returns achieved on similar types of contracts awarded under competitive conditions”.

The 2005 SGEI Decision, applied in the project, more briefly states that “‘reasonable profit’ means a rate of return on own capital that takes account of the risk, or absence of risk, incurred by the undertaking by virtue of the intervention by the Member State, particularly if the latter grants exclusive or special rights. This rate shall not normally exceed the average rate for the sector concerned in recent years. In sectors where there is no undertaking comparable to the undertaking entrusted with the operation of the [SGEI], a comparison may be made with undertakings situated in other Member States, or if necessary, in other sectors, provided that the particular characteristics of each sector are taken into account. In determining what constitutes a reasonable profit, the Member States may introduce incentive criteria relating, in particular, to the quality of service provided and gains in productive efficiency”.

The Executive agreement took into account that there was no company carrying out comparable activities at the regional or national level. This prevented the application of a profit rate by analogy with other companies in the sector concerned, which is the first criteria which the 2005 SGEI Decision advises to apply. None of the criteria put forward by this decision are however mandatory. The Municipality and the Holding thus agreed a profit level based on a maximum rate of return on assets (ROA) employed exclusively for the provision of the SGEI.

- Compensation

Once the costs, revenues and the reasonable profit are properly identified, it is possible to fix the maximal amount of compensation which can be earmarked to the beneficiary. As stated above, the amount of compensation shall not exceed what is necessary to cover the net cost incurred in discharging the public service obligations, including a reasonable profit.

The EU grant is one of the components of the compensation.

The Polish authorities, following the national guidelines on the funding under the operational program of entities performing public service obligations in the field of waste management decided that the EU grant should be calculated on the basis of funding gap methodology.

Article 55(6) of the Council Regulation (EC) No 1083/2006 excludes "projects subject to the rules on State aid within the meaning of Article [107] of the Treaty" from the application of the rules set out within that article, regardless of the fact that they meet the other applicability conditions, namely that the projects generate net revenues through charges borne directly by users. The aid in question constituted State aid, more precisely compatible State aid. Therefore, in principle the funding-gap methodology should not have been applied. However, the 2005 SGEI Decision merely requires that no overcompensation is paid to the beneficiaries.
beneficiary. Contrary to other Guidelines and Frameworks, the Commission does not quantify precisely the amount of aid which can be granted to the beneficiary. Thus, the funding-gap method, provided it guarantees that the service is not overcompensated, is a legitimate means to determine the amount of EU funds which can be disbursed. In the “Municipal Waste management program in Krakow” project, the EU grant was calculated at the level of about EUR 92 million.

When calculating the amount of compensation paid for the SGEI, all State resources transferred to the beneficiary, including, but not limited to, the EU funds allocated to the project, shall be taken into account.

In the project the beneficiary was granted besides the EU funds also a preferential loan from the National Fund of Environment Protection and Water Management (NFEPWM), which constituted a public funding measure, and which therefore had to be taken into consideration when deciding on the adequate level of compensation.

In this sense Articles 5.1 and 5.5 of the Executive agreement define the compensation of the SGEI as all benefits and remuneration received by the beneficiary, falling under the category of public funds according to the Public Finance Act, and intended to cover the construction and operation of the waste incineration plant. They include therefore not only the direct grants, namely the EU Cohesion fund grant, but also the preferential loan, as prescribed by the general EU rules on State aid.

The absence of overcompensation was guaranteed in Article 5.3 of the Executive agreement, which states that the annual compensation may only cover the costs incurred in performing the obligations of public service, assuming an appropriate remuneration for the service including a reasonable profit and under consideration of the principle of the “polluter pays principle”. The beneficiary has, besides, the duty to provide the information requested by the Municipality in order to assess whether there is overcompensation and to submit every year a report with its own assessment on the accuracy of the compensation level received the previous year and another one with its forecasts of incomes and expenditures for the following year. The Municipality will also control every year whether the service was overcompensated (Article 5.6, 5.7 and 9.7 of the executive agreement). In case of overcompensation, the amount in excess will be deducted from the following year’s compensation (Article 9.4 of the executive agreement).

These dispositions fulfill by far the conditions on the control of overcompensation established by the 2005 SGEI Decision and restated by the 2012 SGEI Decision:

“Member States shall ensure that the compensation granted for the operation of the service of general economic interest meets the requirements set out in this Decision and in particular that the undertaking does not receive compensation in excess of the amount determined in accordance with Article 5. They shall provide evidence upon request from the Commission. They shall carry out regular checks, or ensure that such checks are carried out, at least every 3 years during the period of entrustment and at the end of that period.

Where an undertaking has received compensation in excess ..., the Member State shall require the undertaking concerned to repay any overcompensation received. The parameters for the calculation of the compensation shall be updated for the future. Where the amount of overcompensation does not exceed 10 % of the amount of the average annual compensation, such overcompensation may be carried forward to the next period and deducted from the amount of compensation payable in respect of that period.”

Taking into consideration all the facts mentioned above, the public funding of the waste incinerator at issue met the conditions established by the 2005 SGEI Decision and the project was therefore legitimately exempted from the notification duty of Article 108(3) TFEU.

26 Article 6 Commission Decision 2012/21/EU of 20 December 2011 on the application of Article 106(2) of the TFEU to State aid in the form of public service compensation granted to certain undertakings entrusted with the operation of services of general economic interest, OJ L 7, 11.1.2012, p.3 and, mutatis mutandis, Article 6 Decision 2005/842/EC of 28 November 2005 on the application of Article 86(2) of the EC Treaty to State aid in the form of public service compensation granted to certain undertakings entrusted with the operation of SGEIs, OJ L 312, 29.11.2005, p.4
More precisely, the project the applicability conditions of the 2005 SGEI Decision, the beneficiary being properly entrusted with the discharge of the waste management services, which moreover were to be considered as of general economic interest. In addition, the compensation granted was limited to the costs of the service plus a reasonable profit, any overcompensation being prohibited and subject to reimbursement.
**ANNEX**

**COMPLIANCE WITH THE DECISION ON THE EXEMPTION OF STATE AID NOTIFICATION TO PUBLIC FUNDING GRANTED FOR THE COMPENSATION OF SGEI. CHECKLIST**

Decision 2012/21/EU of 20 December 2011 on the application of Article 106(2) of the TFEU to State aid in the form of public service compensation granted to certain undertakings entrusted with the operation of services of general economic interest

(7): “This Decision…lays down the conditions under which State aid in the form of compensation for a SGEI is not subject to the prior notification requirement of Article 108 (3) of the Treaty as it can be deemed compatible with Article 106 (2) of the Treaty”.

**SGEI TEST → FOUR CUMULATIVE CONDITIONS:**

<table>
<thead>
<tr>
<th>Condition</th>
<th>YES □</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Is the service provided a ‘particular public service task’? (i.e. Are the activities not provided satisfactorily and under conditions such as price, objective quality characteristics, continuity and access to the service, consistent with the public interest as defined by the State, by undertakings operating under normal market conditions)?</td>
<td>YES □</td>
</tr>
<tr>
<td>2. Does the project fall within the scope of the 2012 SGEI Decision? (i.e. The compensation does not exceed an annual amount of EUR 15 million for the provision of SGEIs in areas other than transport and transport infrastructure. Special rules on maritime and air transport sector, the health care sector and SGEIs meeting other social needs regarding for instance childcare)?</td>
<td>YES □</td>
</tr>
<tr>
<td>3. Has the SGEI been properly entrusted to the beneficiary? (i.e. Entrustment by means of an act entailing legal binding force and defining a) The content and duration of the public service obligations; b) The undertaking and, where applicable, the territory concerned; c) The nature of any exclusive or special rights assigned to the undertaking by the granting authority; d) A description of the compensation mechanisms and the parameters for calculating, controlling and reviewing the compensation; e) The arrangements for avoiding and recovering any overcompensation; and f) A reference to the Decision)</td>
<td>YES □</td>
</tr>
<tr>
<td>4. Has the compensation for the beneficiary been established beforehand and can overcompensation be ruled out? (i.e. Does the compensation granted to the undertaking entrusted with the delivery of the SGEI not exceed what is necessary to cover the net costs incurred in discharging the public service obligations, including a reasonable profit as defined in Article 5.5 of the SGEI Decision? Do national authorities carry out regular checks in order to control that no overcompensation is granted to the beneficiary? Are there any mechanisms in place guaranteeing that any overcompensation disbursed will be paid back?)</td>
<td>YES □</td>
</tr>
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