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Why State Aid schemes prepared by the Polish government for hard coal mining are harmful from a legal, economic and climate point of view.

This open briefing was developed with inputs from policy experts at ClientEarth Poland, Instrat Foundation, CAN Europe and Greenpeace Poland.

Introduction

This information note presents concerns regarding the hard coal mining closure scheme prepared in Poland, including the prenotification process on State Aid. The authors of the note are members of the NGO sector working on coal.

Context:

By summer 2020, the economic situation of major Polish hard coal mining companies became unsustainable due to the accumulation of long-standing problems with competitiveness combined with the COVID shock. While initially the Polish government was expected to launch a new wave of sectoral restructuring (including mine closures), trade unions' opposition resulted in abandoning this approach and the launch of negotiations between the government and trade unions on the future of the sector. As a result, after months of negotiations, in May 2021 the so-called "Social Agreement" was struck between state representatives and union leaders. The Social Agreement is not a legally binding document but it has a very significant symbolic meaning - for the first time in Polish history the end of hard coal mining has been tabled (with end date of 2049). The Agreement covers, among others[1]: list of social provisions for the retiring workforce, rules of relocating remaining workforce in active mines, the schedule of closing of currently operating 18 hard coal mines. According to the document, all the points are to be achieved through state aid, which is a key condition. Given the financial situation of the sector, which continues in 2021, without state support the closure would happen much faster. The Agreement does not cover coking coal mines, lignite mines, nor power sector (for the latter, separate Agreement is being negotiated). Some hard coal companies who have signed the Agreement, do not apply for State Aid, described below (Siltech, Ekoplus, PG Silesia/Bumech, Bogdanka).

Two different support schemes for hard coal mining are currently being discussed with the European Commission.

First one (referred further as Scheme 1) refers to so-called "exceptional costs" related to coal mine closures - based on *COUNCIL DECISION of 10 December 2010 on State aid to facilitate the closure of uncompetitive coal mines (2010/787/EU)*. This is an existing support that has been used by Poland throughout the years 2010-2018. At the moment, the Council Decision greenlights the support for Polish mines with closure plans no later than 2018 as per dedicated EC decision issued by the Commission in 2018[2] . This decision grants the possibility to cover those costs by Poland until 2023 as State Aid, under the condition that the mines in question are closed by 2018. According to publicly accessible information[3], the Polish government will apply again for a dedicated permission to extend the conditions of this aid until 2027. A prenotification procedure on such

1 Its key elements are: 1) financial support scheme for the operations of hard coal mining companies, 2) list of planned investments in so-called 'clean coal technologies', 3) decision to establish a special Fund for the Transformation of Silesia coal region, 4) promise of employment guarantee and wage indexation for hard coal mining workers, 5) a schedule for hard coal mines closures to end in 2049 and social provisions for employees of liquidated coal production units.

2 https://ec.europa.eu/competition/state_aid/cases/271369/271369_1969693_92_2.pdf

3 https://www.sejm.gov.pl/Sejm9.nsf/biuletyn.xsp?skrnr=ESK-44

intention[4] was started in May 2021 by the government. The beneficiary of such a State Aid scheme so far was a dedicated Mine Closure Company.

Second one (referred further as Scheme 2) aims at granting financial support to finance the operations of chosen hard coal mining companies (Polska Grupa Górnicza S.A., Tauron Wydobycie S.A., Węglokoks S.A.), covering the operating losses. **This is a new state aid scheme not used for hard coal mining before.** It is being developed by the Polish government as a response to the unprofitability of companies in question. The construction of the scheme assumes direct subsidies for coal production and covering the debts. Hard coal mining in Poland has not been viable financially for many years, with 2020 marking almost 1 billion EUR of net financial loss in the sector[5]. A prenotification procedure on the intention to grant such aid was started in May 2021 by the government, together with the first one[6].

This document explains how granting described schemes would be harmful from a legal, economic and climate point of view.

Legal concerns

1. Illegality

As pointed out by ClientEarth Poland[7], Scheme 2, prolonging the operation of the hard coal mining industry is inconsistent with the current EU competition law. EU State Aid law provides a specific legal basis to eligibility and granting aid to the coal mining industry – currently the only legal basis is the Council Decision 2010/787/EU on State aid to facilitate the closure of uncompetitive coal mines.

On Scheme 1: Decision 2010/787/EU provides for a very narrow range of possibilities to grant aid to the mining industry. Such aid can only be granted to cover closing of mines, on the condition that the definitive closure had taken place by the end of 2018 at the latest, and to cover exceptional costs not related to current production (such as costs of social protection payments, job-to-job transition costs, or mining damage). In practical terms, the above means that mines set for closure after 31 December 2018 should cover closure costs by themselves, on market terms. Polish hard coal companies and authorities have had a chance to apply for closure aid for the unprofitable mines in accordance with the provisions of the Council's decision, and they have not done it, even if the very bad economic condition of the domestic mining industry was well predictable.

Based on the information provided by the Secretary of State[8], the legal basis for the Scheme 2 prenotification submission is the Article 107 of the Treaty on the Functioning of the European Union[9], paragraph 3 b), pointing that aid will remedy a serious disturbance in the economy of a Member State. According to the Secretary of State statement, such a legal procedure has not been used before in the EU to support hard coal mining, which means that Poland is proposing a legal precedent.

2. Unfair approach to other Member States

The "Social Agreement" provides for subsidies to coal production in unprofitable mines until 2049 (Scheme 2). This is clearly contradictory to the conditions provided for in the Decision 2010/787/EU, which is still in force. All other EU Member States have complied with the aforementioned deadline of 31 December 2018 to obtain state aid for hard coal closure. Therefore, approving such State aid would be unfair to other countries that have decided to decarbonise their economies faster. It would also set a dangerous legal precedent encouraging other Member States to apply for State aid approval, ignoring binding secondary legislation.

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[4] https://www.teraz-srodowisko.pl/aktualnosci/wniosek-prenotyfikacyjny-liktidacja-gornictwa-10383.html

[5] https://wysokienapiecie.pl/36605-gornictwo-przynioslo-43-mld-zl-strat-w-2020-roku/

[6] https://www.teraz-srodowisko.pl/aktualnosci/wniosek-prenotyfikacyjny-liktidacja-gornictwa-10383.html

[7] https://www.documents.clientearth.org/wp-content/uploads/library/2021-03-10-niewykonalna-umowa-spoleczna-ce-pl.pdf

[8] https://www.sejm.gov.pl/Sejm9.nsf/biuletyn.xsp?skrnr=ESK-44

[9] https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex%3A12012E%2FTXT

3. Non-compliance with EU Green Deal

The pre notified measures are clearly contradictory to decarbonisation objectives resulting from the EU Green Deal. The proposed aid to cover production losses of coal poses an obstacle to energy transformation of Poland and it is very likely to slow it down, as compared to a business as usual scenario (i.e. when such aid is not granted). Poland is currently the fourth largest GHG emitter in the EU, and the Polish power and heating sectors are responsible for as much as almost half of national emissions. Poland should rather finance a clean energy transition in power production, because coal-based generation becomes unprofitable, then subsidise coal for which demand will decline quite soon. In recent communications around the changing EU competition policies[10], the Commission has once again confirmed that now the Union should facilitate the phasing out of subsidies for fossil fuels. Approving new State aid for coal mines in operation would be against such unequivocal stances.

Economic concerns

1. Not solving structural problems of hard coal in Poland and creating risk of wasting taxpayers money

Due to high labour costs, depletion of easily accessible deposits and low productivity the hard coal mining in Poland is not profitable and lacks competitiveness. The current crisis is a continuation of the long-term trend of domestic mining decline, which is similar to processes which occurred in Western Europe before. Proposed schemes do not address these problems, even if some commitment is made that productivity of productions will rise. The market dynamics for thermal coal use in power and industry are showing a downward trend. Previous hard coal mining reform introduced in 2015, which resulted in the creation of Polish Mining Group (PGG), was proven to be inefficient as pointed out by Polish Supreme Audit Office[11] report. This means that there is little chance that the current attempt will be successful, given even less favorable market conditions for coal production and sale. In fact, while the previous restructuring started in 2015 was presented as a process which should result in the long-term financial stability and self-sufficiency of PGG, this time the government openly admits that operating subsidies will be required to prolong the lifetime of the mines in line with the "Social Agreement".

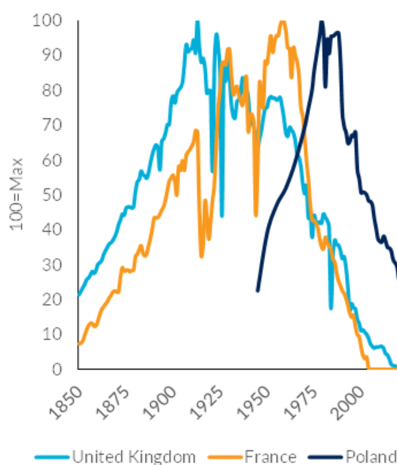


Figure 1. **Hard coal production dynamics:** long-term trends in Poland are similar to Western Europe and are driven by stagnating extraction productivity and growing wages. The domestic coal mining decline had started long before the EU energy and climate policy was introduced in Poland.

Source: WiseEuropa based on national statistics and Eurostat data

10 https://ec.europa.eu/competition-policy/green-gazette/competition-policy_en

11 https://www.nik.gov.pl/aktualnosci/slabe-efekty-restrukturyzacji.html

2. Another support to declining industry

According to the report of the Polish Audit Supreme Office (NIK) on the State Aid granted to the hard coal mining sector in years 2007-2015[12], the industry received numerous forms of support. As NIK points out, the frequently quoted data on the official State Aid support reported by the Office of Competition and Consumer Protection (UOKIK data, first row in the legend on the chart below)[13] does not include other various forms of support the industry is receiving, such as debt relief resulting in the net deficit in the payments to the Social Security Institution (ZUS).

If the subsidy to ZUS was to be taken into account, the support to the coal industry would be up to 10 times larger than the official UOKIK data shows. The chart below shows the breakdown of the support measures between 2007 and 2015 as reported by NIK.

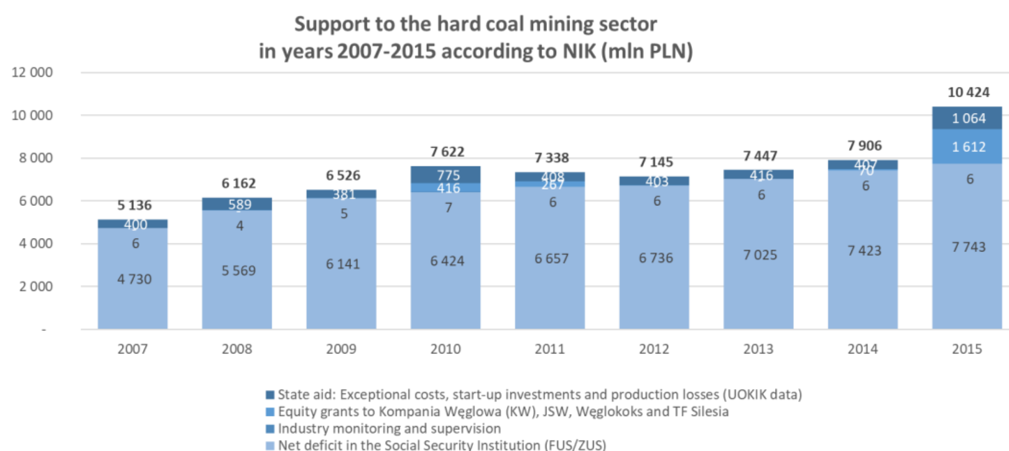


Figure 4. Source: Instrat based on the Polish Supreme Audit Office.

More detailed information about Polish hard coal mining sector support measures covering a wider time period (1990-2020) will be published in the upcoming Instrat brief (expected publication date mid December 2021). Please visit the link provided in the footnote.[14]

3. Creating false demand for coal

The commitment to maintain hard coal production by 2049, resulting from the "Agreement" is not supported by demand scenarios. Based on the recent study by Jagiellonian Institute and the Polish Academy of Sciences the coal supply will exceed the demand from heat and power sectors in Poland[15].

The results of the modelling show that the oversupply of coal in Poland is existing already in 2025 (see low coal demand variant in the chart below) and by 2040 the levels of oversupply can reach 15-20 mln tonnes. Implementation of the schedule of mine closure presented in the Social Agreement and extending the lifetime of mines to 2049 will result in the following average oversupply volumes: 1.6 million mg / year (s_wys_Por_kra J_imP), 11.4 million mg/year (s_nis_Por_kra J_imP) and 16.2 million mg / year (s_min_Por_kra J_imP) - in the entire analysis period (2022-40) - says the report. There is

12 Informacja o wynikach kontroli NIK, LKA.410.038.2015, Nr ewid. 209/2016/P/15/074/LKA, Delegatura w Katowicach, Funkcjonowanie górnictwa węgla kamiennego w latach 2007-2015 na tle założeń programu rządowego „Program działalności górnictwa węgla kamiennego w Polsce w latach 2007–2015". https://www.nik.gov.pl/plik/id,13913,vp,16351.pdf page 62

13 Office of Competition and Consumer Protection, https://sudop.uokik.gov.pl/home

14 To be published in December 2021 under this link https://blog.energy.instrat.pl/en/pl-coal-mining-state-aid-net-giver

15 https://jagiellonski.pl/files/other/HARD_COAL_E_BOOK.pdf page 37

no rationale behind the plan for mines as there will be no sufficient demand to keep production after 2031 - if transition is aligned to market conditions.

FIG. 20. SUPPLY-DEMAND BALANCES IN THE DOMESTIC SUPPLY AND IMPORTS VARIANT (W_KRAJ_IMP)

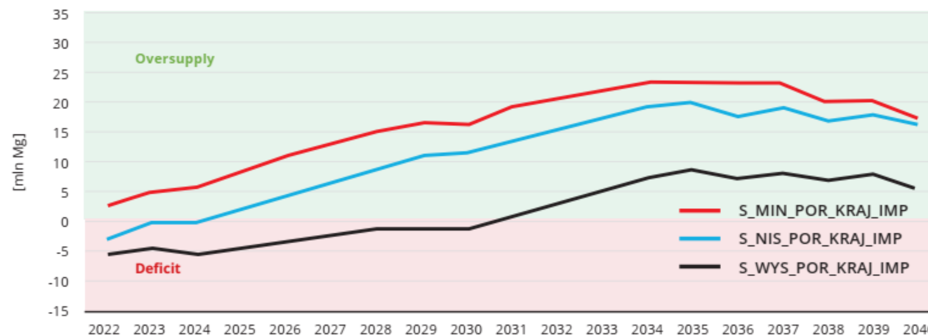


Figure 5. Supply -demand balances for power and heating in three scenarios representing different assumptions for the demand for hard coal (see below). This chart shows the projections for deposits exploitation according to the "Social Agreement" schedule, assuming that coal will be also imported.

1. "High Demand" (S_WYS) (Fig. 14), where demand drops from 54 million Mg in 2022 to 23 million Mg in 2040
2. "Low Demand" (S_NIS) (Fig. 15), where demand drops from 51 million Mg in 2022 to 12 million Mg in 2040
3. "Minimum Demand" (S_MIN) (Fig. 16), where demand drops from 46 million Mg in 2022 to 11 million Mg in 2040.

Even the national energy strategy (PEP2040) assumes a 54% reduction of hard coal demand in the power sector by 2030. In 2040, the coal demand in the PEP2040 scenario can be covered by the Bogdanka mine alone (below 10 mln tonnes, from 32.2 in 2020) - mine which is not applying for State Aid. Implementing the 2049 schedule would mean that power plants would be kept alive beyond economically viable dates to artificially create demand for hard coal.

Strategically, the proposed subsidy scheme shifts the focus of stakeholders interested in maintaining the hard coal mining from the supply side (i.e. tackling high costs, low productivity) to the demand side (maintaining energy sector demand for the subsidised fuel). Thus, introducing the subsidy scheme for domestic hard coal mines will result in additional pressure on the government to maintain high volumes of electricity production from coal. This will negatively affect the parallel restructuring process in the energy sector and further increase the costs for Polish citizens. The alternative is maintaining current legal framework, closing down unproductive mines, increasing the pace of coal phase out in energy sector to avoid increasing import dependency, and utilising the available European funds to support just transition in affected communities

Lack of transparency and control mechanisms

1. Lack of process transparency, access to information, stakeholder engagement and reference to national strategies

The 10 month process of negotiating the so -called "Social Agreement" was not inclusive, reserved only for the government and trade union leaders. Mining companies were made part of the negotiations at the last stage. Local and regional authorities, civil society were excluded, which is in

stark contradiction to just transition principles, that recommend preparing the phase out strategies in the dialogue with all concerned stakeholders (it is worth to underline that the Social Agreement has not been linked in any way with the territorial just transition plans prepared by six coal regions in Poland). The process also ignored all existing structures responsible for the social dialogue. The content of the negotiated Agreement was not published nor consulted. It was leaked to the press only upon signing by the negotiating parties. The leaked text lacks technical details and feasibility assessment. The content of the proposed Schemes, which the Polish government pre-notified DG Competition for, is now classified.

There is no transparency on how the new State Aid corresponds to already adopted national climate and energy strategies (PEP2040) and how the alignment with updated EU 2030 targets will be assured (as well with revision of NECP in 2023).

The Social Agreement contains a paragraph that in case the requested State Aid is granted the hard coal phase out schedule might supersede the one adopted in Polish Energy Strategy 2040 (PEP2040).

2. Challenge on cost transparency and control mechanism

The Scheme 1 assumes that the beneficiaries of the support will be mining companies. So far the only beneficiary of *State aid to facilitate the closure of uncompetitive coal mines* was the Coal Closure Company (SRK). Changing this will mean that tracking the accounting of Exceptional costs will become very difficult in the books of mining companies, as well as separating them from any other aid.

In order to prepare a basis for Scheme 2, an extraction reduction program is planned for each mine, including efficiency KPIs. Based on the dedicated cost reduction program for each mine the amount of maximal AID will be calculated according to the algorithm: production cost of 1 ton of coal (including the debt of the company and other allocated costs like remunerations) – revenue that should be obtained according to market prices = aid. Basically it means that if the mine (production unit) fails to have zero net result on production the state will cover the diff. The real revenue is supposed to be deducted from the aid but the documents are not specifying how.

In such complex accounting mechanisms, the risk of not meeting KPIs related to costs and extraction levels by mining companies using Scheme 2 is high. The leaked documents do not specify what bodies will be responsible for auditing and control measures. If the independence of the auditing bodies is not assured, the risk of data manipulation is high. Mine companies and unions know the details of the support scheme, the rest of society is not informed, including the information on the estimated costs for the country budget, the assumed period of the financial support, the debt element in the proposed support to be covered with public funds, eligible costs and monitoring process.

Unrealistic 2049 schedule

1. Unrealistic in terms of market conditions and permitting (mining licences)

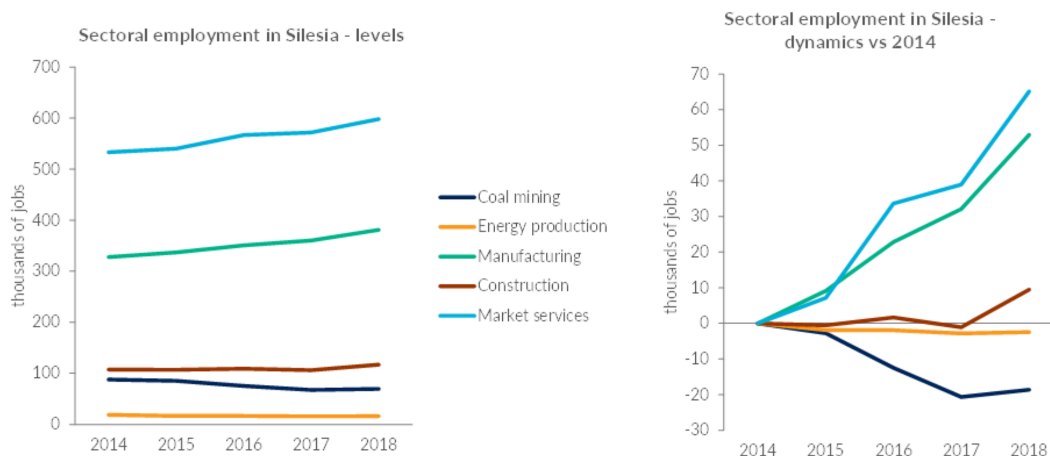
Most mines listed in the schedule will close down much sooner due to economic pressure, high costs and declining demand for coal. Few ones that are profitable now and set to work longer, like Bogdanka (indicated date - 2049) or privately owned Silesia (outside of Social Agreement) will need some additional incentive to close. Still, implementation of the 2049 schedule would require extension of at least 5 mining licenses for hard coal mines and will postpone energy transformation in Poland for the next decades.

2. Contradiction with EU climate targets and just transition agenda

The unambitious schedule of hard coal phase-out, with an end date of 2049, is not aligned with EU climate targets for 2030 and stands in sharp contradiction with the EU's commitment to the Paris Climate Agreement. A Paris-aligned plan for coal in Europe means all power production based on this fuel must end by 2030 at the latest and most EU countries already apply this to their phase out decisions (except for five European countries). In the planned 2049 schedule, only four hard coal

mines -out of eighteen located in Poland- would get closed by 2030. This is not compatible with Paris Climate Agreement commitments, as well as the European Commission's projections. Moreover the 2049 schedule and non-transparent formula of its preparation create risk for coal regions of Silesia and Western Małopolska. Their Territorial Just Transition Plans need to include a timeline for ceasing or scaling down coal mining by 2030. Małopolska mines are predicted to close in 2049, which means the region is not meeting the requirement to access Just Transition Fund. Since mine closure timelines are decided at the national level, coal regions in Poland are not in control of their just transition strategies. In case current assumptions are changed before the mid-term review of JTF planned for 2023, Silesia needs to amend its TJTP which in turn can cause delays in access to the Just Transition Fund.

Figure 3. Sectoral employment in Silesia. During previous restructuring in Silesia, the biggest hard coal region in the EU, regional employment growth in other sectors was several times greater than the declines in coal mining sector impacts of restructuring. Securing just transition is crucial for local communities and affected workers, but the **coal mining sector is no longer a foundation of the regional economy.** Past experiences of the region do not support claims that maintaining coal subsidies for the next 30 years is necessary to avoid serious economic disturbances at the regional (let alone national) level.



Source: WiseEuropa based on GUS data

3. No real national "plan B"

The Polish government assumes that the prenotification process will finalize with a green light from the Commission to grant state aid, and an official notification will follow. If this does not happen, the only alternative presented by the Secretary of State, Government Plenipotentiary for Transformation of Energy Companies and Coal Mining (responsible for the process) includes continuation of the Scheme 1. No real national "plan B" for Scheme 2 is prepared, in case the European Commission raises objections. No alternative coal phase-out schedule is available either.

4. Lack of alignment with power sector restructuring

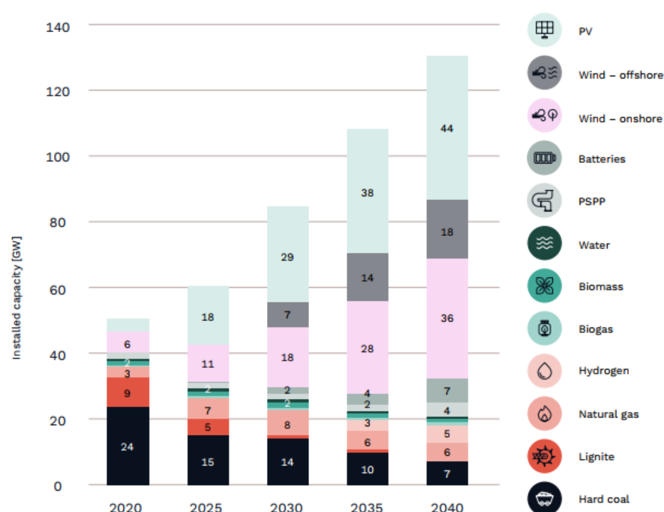
In parallel to hard coal mining closure preparations, the Polish government is discussing a complete restructuring of the power sector. Coal is still responsible for 69.7% of the Polish electricity mix, hard coal electricity production alone had a 45.4% share in 2020. However, already in 2020, about half or Polish coal units were running at negative operating margins. Coal plants, despite receiving the vast majority (around 78%) of capacity market money, are generating losses. Power plant operators are therefore proposing to offload their loss-making coal assets onto the state through a hugely complex

power sector restructuring process. As presented to the public[16], the plans for the power sector and hard coal mining do not appear to be aligned, which raises concerns about the credibility of both. The power sector restructuring plan raises serious doubts, with the early version being incompatible with climate goals, extremely costly and disruptive for energy consumers. The general assumption of power restructuring is to consolidate all coal power plants under one state-owned agency called NABE. However, while several confidential analyses were carried out by the government, only the rough and general version of the plans have been shared with the public without any specifics about the financing, the consequences for energy prices, the coal phase-out schedule.

Keeping the hard coal mines running until 2049 would imply a similar timeline for coal power plants and that would be completely unacceptable in terms of climate targets. According to the EC's GHG55% Impact Assessment[17] and the IEA's latest World Energy Outlook[18], already in 2030 coal electricity production in the EU should be marginal. Also, by 2035 the last coal units in Poland will lose funding from capacity contracts. It is hard to imagine how one could keep coal power plants alive as long as 2049, especially with the power sector needing to decarbonize much faster than the rest of the economy. Poland still doesn't have any official coal phase-out schedule and is the last EU country not even discussing it formally. According to the government's policy[19], in 2030 Poland alone would produce more electricity from coal than the whole EU should.

To ensure Paris Agreement compatibility, the share of coal in the 2030 electricity mix would have to be zero in 2030 and that would mean the closure of hard coal mines by the same date. If Poland was to match the GHG55% trajectory from the EC's Impact Assessment, the coal share in the Polish electricity mix would have to drop to around 12% by 2030. That is achievable and a plan has already been prepared by Instrat. This most comprehensive analysis of Polish RES potentials also shows that the GHG55% compatible path would not require any compromises in terms of social acceptance due to the carefully planned spatial distribution of solar and wind.

Figure 4. Possible installed capacities according to technologies [GW] in Instrat energy transformation scenario, decreasing coal to GW in 2040.



We strongly believe the European Commission should check the alignment between the coal mining state aid scheme and the new power sector restructuring project. Without a credible, climate-compatible phase-out schedule for coal fired power plants, granting the state aid for hard coal mines would mean subsidizing mines that cannot sell coal to anyone except a fully controlled state aid agency, it also creates a risk of hampering the real transformation towards climate neutrality.

16 https://www.gov.pl/web/aktywa-panstwowe/rusza-transformacja-sektora-elektroenergetycznego

17 Which implies that the gross electricity production from coal in the EU is reduced to around 55 TWh in 2030

18 In which the gross electricity production from coal in the EU is 35 TWh in 2030

19 Based on the EC's Impact Assessment and IEA's scenarios