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YEARBOOK
of ANTITRUST
and REGULATORY
STUDIES

Antitrust and Regulation in the Energy Sector

Edited by

BARTŁOMIEJ NOWAK and TADEUSZ SKOCZNY

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**YEARBOOK OF ANTITRUST AND REGULATORY STUDIES
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Contents

From the Editors	5
Foreword from the President of the European Parliament.....	7
GUEST ARTICLES	
MARIUSZ SWORA, Smart Grids after the Third Liberalization Package: Current Developments and Future Challenges for Regulatory Policy in the Electricity Sector.....	9
KRZYSZTOF ŻMIJEWSKI, MACIEJ M. SOKOŁOWSKI, The Main Frameworks of the National Programme for the Reduction of Emissions: Towards the National Programme for Low-Emission Economic Development. The Public Board's Role	23
ARTICLES	
BARTŁOMIEJ NOWAK, PAWEŁ GRZEJSZCZAK, Poland's Energy Security in the Context of the EU's Common Energy Policy. The Case of the Gas Sector	41
MARIA MORDWA, The Obligation of Strategic Gas Storage Introduced in Poland as an Example of a Public Service Obligation Relating to Supply Security: A Question of Compliance with European Law	57
JANUSZ LEWANDOWSKI, Cutting Emissions in the Energy Sector: a Technological and Regulatory Perspective	83
MARCIN STOCZKIEWICZ, The Emission Trading Scheme in Polish Law. Selected Problems Related to the Scope of Derogation from the General Rule for Auctioning in Poland	95

ALEKSANDER STAWICKI, The Autonomy of Sector-Specific Regulation – Is It Still Worth Protecting? Further Thoughts on the Parallel Application of Competition Law and Regulatory Instruments	115
FILIP M. ELŻANOWSKI, The Duties of the President of the Polish Energy Regulatory Office in the Context of the Implementing the Third Energy Package	135
MARZENA CZARNECKA, TOMASZ OGŁÓDEK, The Energy Tariff System and Development of Competition in the Scope of Polish Energy Law	151
TADEUSZ SKOCZNY, Consolidation of the Polish Electricity Sector. The Merger Law Perspective	169
ANDRZEJ T. SZABLEWSKI, The Need for Revaluation of the Model Structure for Electricity Liberalization	201

CASE COMMENTS

Which authority is competent to decide when a power company is abusing monopolistic power: the President of the UOKiK or the President of the URE? Case comment to the judgement of the Supreme Court of April 2, 2009 – <i>ENION S.A.</i> Commented by ALEKSANDER MAZIARZ.....	225
Are the rights and obligations arising from a license transferable under Article 40 of the Privatization and Commercialization Act? Case comment to the judgement of the Supreme Court of November 20, 2008 (Ref. No. III SK 13/08) Commented by ILONA BANKIEWICZ AND URSZULA ANTONOWICZ.....	231

BOOK REVIEW

Bożena Borkowska, <i>Regulacja monopolu naturalnego w teorii i praktyce</i> [<i>Regulation of a natural monopoly in theory and practice</i>], Wydawnictwo Wrocławskiego Uniwersytetu Ekonomicznego, [Publishing House of the Wrocław University of Economics], Wrocław 2009, 229 pp. Reviewed by ANNA FORNALCZYK.....	239
--	-----

BIBLIOGRAPHY 2007–2010

Compiled by AGATA JURKOWSKA-GOMUŁKA and BARTŁOMIEJ NOWAK.....	245
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From the Editors

The editorial board is pleased to present the forth volume of the **Yearbook of Antitrust and Regulatory Studies (YARS 2011, 4(4))**, dedicated solely to competition protection and regulation in the energy sector in Poland.

As was the case in our previous issues, we hope that this time, too, our Yearbook will be interesting for our foreign readers. Thus, all the research papers published here are dedicated to the major developments currently underway in the Polish energy sector – an economic sector which for years has been dependent on and under the control of the government. Because of this, recent liberalization and the opening of the energy market in Poland, driven by European Union legislation, cannot bear full fruit all at once. Liberalization of the energy market demands time. It involves a complicated decision-making process, the passage of sector-specific legislation, and massive investments together with various market adaptations, as Professor Buzek aptly observes in his foreword. Moreover, it should be clear that the necessary political involvement does not end with the decision to liberalize or with the completion of the legislative work required to establish a market framework. Indeed, continued political and business involvement is required to create a competitive energy industry in Poland as well as to monitor and regulate the exercise of monopoly powers by independent national regulators. This is why the complexity of market liberalization is of paramount interest to policy makers, and also why the former President of the Energy Regulatory Authority (M. Swora) accepted our invitation to write a guest article on development in the energy sector. His choice was wise and proper: smart grids and smart metering. The second guest article was prepared by representatives of the Public Board of the National Programme for Reduction of Emissions – K. Zmijewski and M. Sokołowski. These experts highlight the key tasks of the Board with regard to the reduction of greenhouse gas emissions in the energy sector, along with its role in the overall process of CO₂ reduction in Poland. We are very grateful for these guest articles and their authors' efforts.

The papers submitted and accepted for publication in this volume of the Yearbook of Antitrust and Regulatory Studies discuss truly major concerns and issues regarding liberalization of the energy market in Poland. Our authors pay special attention to matters such as: energy security, reduction of CO₂ emissions,

renewable energies, and independent regulation and competition on the energy market. Each of these aspects has an important influence on the competitiveness of the Polish energy sector vis-à-vis other EU Member States. We believe that this alone places our publication in the mainstream of the discussions pursued by Europe's academics and professionals in the energy and regulatory law field.

The present volume opens with articles on energy policy and the legal aspects of energy security in the natural gas sector – specifically, the lack of cooperation among Member States and infrastructural obstacles to a common energy policy for Europe (B. Nowak and P. Grzejszczak) as well as gas storage problems (M. Mordwa). Later on our authors focus on the reduction of greenhouse gas emissions in the energy sector through technological innovations and developments in heat and electricity generators (J. Lewandowski) and through the emission trading scheme and newly established (by EU directives) auctioning general rule (M. Stoczkiewicz). The next section of YARS deals with regulatory, institutional, and jurisdictional concerns. A. Stawicki focuses his research on the autonomy of sector-specific regulation and the relation between energy law and competition law. F. Elżanowski discusses the duties of the 'Energy Regulator' in light of the third energy package, and M. Czarnecka and T. Ogiódek focus on tariff creation as a regulatory tool, and its impact on competition. Last but not least, this section of YARS ends with research papers on competition liberalization and successive changes in the Polish electricity sector from the legal perspective (T. Skoczny) and the economic perspective (A. Szablewski) as well.

Aside from these research papers, this volume of YARS also contains two case comments concerning the energy field. Our case commentators present judgements wherein the Supreme Court tackled the question (i) which authority is competent to decide when a power company is abusing monopolistic power: the President of UOKiK or the President of URE? (A. Maziarz), and (ii) whether the rights and obligations arising from a license are transferable under Article 40 of the Privatization and Commercialization Act (I. Bankiewicz, U. Antonowicz)

Finally, this year's volume of YARS ends with a book review of Bożena Borkowska's *Regulacja monopolu naturalnego w teorii i praktyce* [Regulation of a natural monopoly in theory and practice. The reviewer (A. Fornalczyk) recommends the book not only to theoreticians, but also to practitioners engaged in natural monopoly sectors.

The Editorial Board hopes that YARS will become an integral part of legal and economic libraries concerning energy and regulatory issues, and one that will prove especially valued in that it will continue to provide its readers with up-to-date insights into the workings of energy and regulation in Poland.

Warsaw, June 2011.

Bartłomiej Nowak

Tadeusz Skoczny

Foreword from the President of the European Parliament

EU energy policy needs to be at the forefront of all our thinking. Although the Community has legislated in the area of energy policy for many years, and evolved out of the founding Treaties themselves, the concept of introducing a comprehensive European energy policy for all Member States is fairly new. Europeans may not understand all the fine details of geo-politics, but they understand when the gas is cut off – and they understand that now is the time for a full European energy policy.

Not surprisingly, it is only recently that the segmented European energy markets are legally being combined together under the name of the internal energy market as a large part of the EU's energy policy. Although Europe is on the right track, the process of unification is still far from completion. The creation of a solid energy policy and a common energy market (one that would take into consideration all the different views of the Member States) cannot occur all at once, but only over time. This is because it not only has involved a complicated process of political negotiations, decision-making, and the passage of concrete legislation, but also massive market adaptations and investments. Both the European Commission and the European Parliament were strong enthusiasts and supporters of inserting into the Lisbon Treaty an energy article – specifically, one which shall be seen as the main legal basis for action in the sphere of EU energy policy.

The fundamental question that policy makers – both at the EU and national level – shall now be trying to answer is whether an agreement can be reached regarding the need to develop a common European energy policy and whether both internal issues (competitiveness and the EU energy market) as well as external ones (energy security, relations with third countries) should be the core principles underpinning this policy. The answer is 'yes', although such a process is difficult and lengthy. Well-functioning energy markets which ensure secure and sustainable energy supplies at competitive prices are fundamental to both economic growth and consumer benefit in the EU.

There is no alternative to an Internal Energy Market. First, an integrated energy market is essential for enhancing trade in energy products between the EU Member States. Second, it is important for diversifying and integrating the

different domestic energy markets and thus for securing supplies across the EU. Third, the EU's dependence on external primary energy sources such as gas or oil has been steadily growing – and it will continue to do so. It is clear, therefore, that if the present situation is not tackled within the framework of the Internal Energy Market, this external dependence will have profoundly negative economic and social consequences for the whole of the European Union. Fourth, only a single competitive domestic market (as envisaged within the third energy legislative package) generates the right investment signals, offers fair network access for all potential investors, and thus provides effective incentives to both system operators and generators to invest billions of Euros in infrastructure. Fifth, a competitive and efficient energy market is a precondition for tackling climate change. A well-functioning market will support an effective emission trading mechanism and a renewable energy industry.

The Yearbook of Antitrust and Regulatory Studies (YARS), edited by the Centre for Antitrust and Regulatory Studies (CARS), University of Warsaw, provides a platform for a broader presentation and analysis of the problems and achievements of the Polish antitrust and sector-specific regulations. This special issue of YARS, which focuses on energy policy and regulation, is dedicated to an international audience: as such it is a significant element of the present discussion regarding the development and integration of energy markets in the European Union.

Jerzy Buzek

President of the European Parliament

**Smart Grids after the Third Liberalization Package:
Current Developments and Future Challenges for Regulatory Policy
in the Electricity Sector**

Mariusz Swora *

CONTENTS

- I. Introduction
- II. Smart performance of buildings
- III. The regulatory framework for smart grids – towards a new model of regulation
- IV. Conclusion

Abstract

The smart grid is a concept for the development of power distribution grids that offers great promise for the realization of the ambitious objectives of European Energy Policy. In its Third Energy Liberalization Package, European energy law has introduced the concept of intelligent grids and intelligent metering systems. A new directive of EPBD (energy performance of buildings) is to press ahead with this trend. At the same time work is underway at the European Commission and with European Regulators concerning standardization and the new shape of regulatory policy in the implementation stage. The EU legislation and regulatory policy of the National Regulatory Authorities will have to take into consideration the current trends in the modernization of the networks. Among other things, this means revising the existing regulatory model, and that will have to take into account the performance and output of industry networks.

Résumé

Smart Grid est le concept du développement des réseaux de la distribution de l'électricité, qui donne la chance de réaliser des objectifs de grande importance

* Dr. Mariusz Swora, PhD in Law, assistant at Adam Mickiewicz University in Poznań; attorney-at-law.

de la perspective des Politiques Européennes de l'Énergie. Le droit européen de l'énergie a introduit, dans son troisième paquet de libéralisation, le concept des réseaux intelligents et des systèmes de compteurs intelligents. La nouvelle directive sur la performance énergétique des bâtiments (EPBD) constitue une continuation de cette tendance. Au même temps, les travaux de la Commission Européenne et des Régulateurs Européens concernant la standardisation et la nouvelle forme des politiques de régulation, sont réalisés. La législation de l'UE et la politique de régulation des autorités réglementaires, doivent prendre en considération les tendances contemporaines de la modernisation des réseaux. Cela signifie, entre autre, une révision du modèle de régulation existant, qui doit prendre en considération la performance et les effets des réseaux de l'industrie.

Classifications and key words: smart grids, smart metering, energy regulation, output-based regulation.

I. Introduction

In European law today there is no better concept than the smart grid for serving to demonstrate European energy policy in the areas of ensuring security of supply, sustainable development, and promotion of competition¹. The development of Smart Grids legislation in the EU up to the adoption of the Third Energy Liberalization Package² has been extensively discussed in the literature; this article will review the recent developments in this area³. In particular, I will present two important areas of the new legislative and regulatory landscape that was formed following the adoption of the Third Energy Liberalization Package, which includes the energy performance of buildings and regulatory effort seeking to adapt the regulatory policy to the

¹ J. Vasconcelos, 'Survey of Regulatory and Technological Developments Concerning Smart Metering in the European Union Electricity Market' (2008) 1 *RSCAS Policy Papers* 1.

² Directive 2009/73/EC of the European Parliament and of the Council of 13 July 2009 concerning common rules for the internal market in natural gas and repealing Directive 2003/55/EC, OJ [1994] L 211/94 (hereafter, new gas directive); Directive 2009/72/EC of the European Parliament and of the Council of 13 July 2009 concerning common rules for the internal market in electricity and repealing Directive 2003/54/EC, OJ [2009] L 211/55 (hereafter, new electricity directive); Regulation (EC) No. 715/2009 of the European Parliament and of the Council of 13 July 2009 on conditions for access to the natural gas transmission networks and repealing Regulation (EC) No. 1775/2005, OJ [2009] L 211/36; Regulation (EC) No. 714/2009 of 13 July 2009 on conditions for access to the network for cross-border exchanges in electricity and repealing Regulation (EC) 1228/2003, OJ [2009] L 211/15; Regulation (EC) No. 713/2009 of 13 July 2009 establishing an Agency for the Cooperation of Energy Regulators, OJ [2009] L 211/1.

³ M. Swora, 'The intelligent grid: unfinished regulation in the Third EU Energy Package' (2010) 4 *Journal of Energy & Natural Resources Law* (forthcoming).

requirements posed by the concept of the smart grid. I will go on to argue that, despite the maturity of the smart grid concept, EU legislation still treats smart grid obligations in a quite soft manner. Thus, further development of the smart grid concept needs strong regulatory effort to adopt a new model of regulation – namely, output-based regulation.

II. Smart performance of buildings

The introduction of intelligent grid and intelligent metering systems in the Third Liberalization can be seen as a top-down process, where the European legislator put certain obligations (albeit in very vague language) on Member States. In the directive on the energy performance of buildings (hereafter, EPBD)⁴, which will be the subject of our analysis in this part of the article, a different approach was presented, one that can be described as a bottom-up approach aimed at stimulating the introduction of intelligent metering systems in places where they should be installed.

A great portion of energy in the EU is consumed by buildings, which are responsible for 40% of energy consumption and 36% of the EU's CO₂ emissions. Taking this into account the EU made the energy performance of buildings a key to achieving its climate and energy objectives (20% reduction of greenhouse gas emissions by 2020 and 20% energy savings by 2020). One of the areas to improve the energy performance of buildings is to empower their ICT (Information and Communication Technologies) – i.e., their Home Area Network (HAN) infrastructure which enables interactions between home appliances and the grid. In a broader perspective this also involves opening the market for new players from the ICT sector, aggregators, ESCOs (Energy Savings Companies) and for the provision of new services for customers (demand response, net metering, etc.). Development of ICTs for energy-smart buildings and districts and integration of renewable energy systems in buildings seem to be one of the main European R&D Objectives in the area of energy efficiency within the European Economic Recovery Plan 2010–2013⁵. It is worth noting that support instruments have also been sharply focused on this purpose in the plans aimed at combating the economic crisis in other Western economies⁶. Given the contribution of ICT-HAN technologies

⁴ Directive 2010/31/EU of the European Parliament and of the Council of 19 May 2010 on the energy performance of buildings, OJ [2010] L 153/13.

⁵ http://ec.europa.eu/research/industrial_technologies/lists/energy-efficient-buildings_en.html#3

⁶ S. Ferrey, 'Restructuring a Green Grid: Legal Challenges to Accommodate New Renewable Energy Infrastructure' (2009) 39 *Environmental Law* 983.

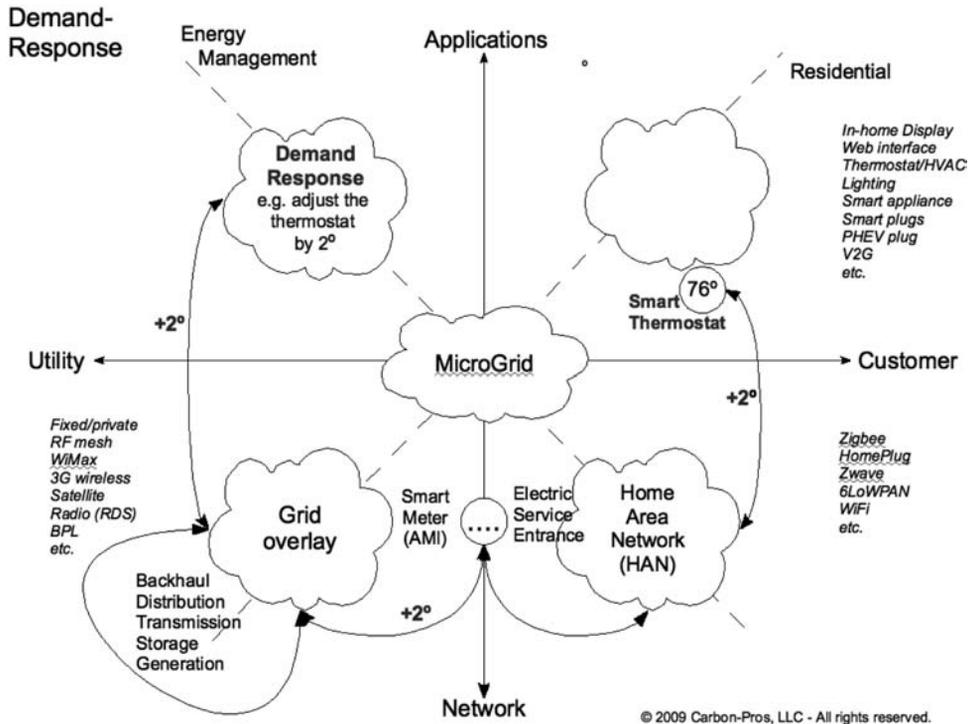
in improving the energy performance of buildings, European legislators included smart metering in the EPBD. A combination of energy efficiency and ICT seems to be very promising in achieving the goals of the EPBD, however, broad introduction of ICT appears to be very difficult considering the different technical condition and age of buildings and uncertainty as to the universal acceptance of this kind of technology in newly constructed buildings and buildings undergoing major renovations. Indeed, this was at the basis of the EPBD's new regulations, which provide for the rather cautious evolution towards energy-efficient buildings with a complex internal structure of ICT, based on a two-way communication system (hereafter, smart homes), which are a part of the smart grid ecosystem (see Figure 1 below).

Article 8(2) EPBD referred to intelligent metering systems obliging the Member States to “encourage” introduction of such systems whenever a building is constructed or undergoes major renovation. While the word “encourage” in reference to intelligent systems is quite clear, the softer stipulation in this article *in fine* refers to the installation of active control systems such as automation, control and monitoring systems that aim to save energy, and which the Member States shall encourage only “where appropriate”. Forms of such “encouragement” may include, in particular, free or subsidized technical assistance and advice, direct subsidies, loan schemes or low interest loans, grant schemes, and loan guarantee schemes. EPBD does not constitute a complete list of all possible measures of encouragement. It may be argued how much more effective strictly fiscal instruments like tax relief might be, especially in the case of deploying intelligent metering systems. According to Article 8(2) this bottom-up approach adopted by the EPBD should be in line with the top-down obligations in Directive 2009/72/EC of the European Parliament and of the Council from July 13, 2009 concerning common rules for the internal market in electricity. It is not entirely clear why European Law did not adopt the similar solutions of Directive 2009/73/EC of the European Parliament and of the Council from July 13, 2009 concerning common rules for the internal market in natural gas. Looking for cross-references it is also advisable to refer to Directive 2006/32/EC, which in Article 13(1) imposes on Member States a conditional and (again) softly expressed condition to ensure that final customers are provided with “individual meters that accurately reflect the final customer’s actual energy consumption and that provide information on actual time of use”⁷. Directive 2006/32/EC refers to final customers of electricity, natural gas, district heating and/or cooling and domestic hot water, which may lead to the assumption that Member States

⁷ Directive 2006/32/EC of the European Parliament and of the Council of 5 April 2006 on energy end-use efficiency and energy services and repealing Council Directive 93/76/EC, OJ [2006] L 114/64.

should encourage provision of meters for such media. It is worth noting that the directive counts final customers in the context of metering, but it does not resolve the problem of integrating metering systems.

Figure 1. Smart grid ecosystem



Source: http://carbon-pros.com/blog1/2009/07/smart_grid_smart_house.html

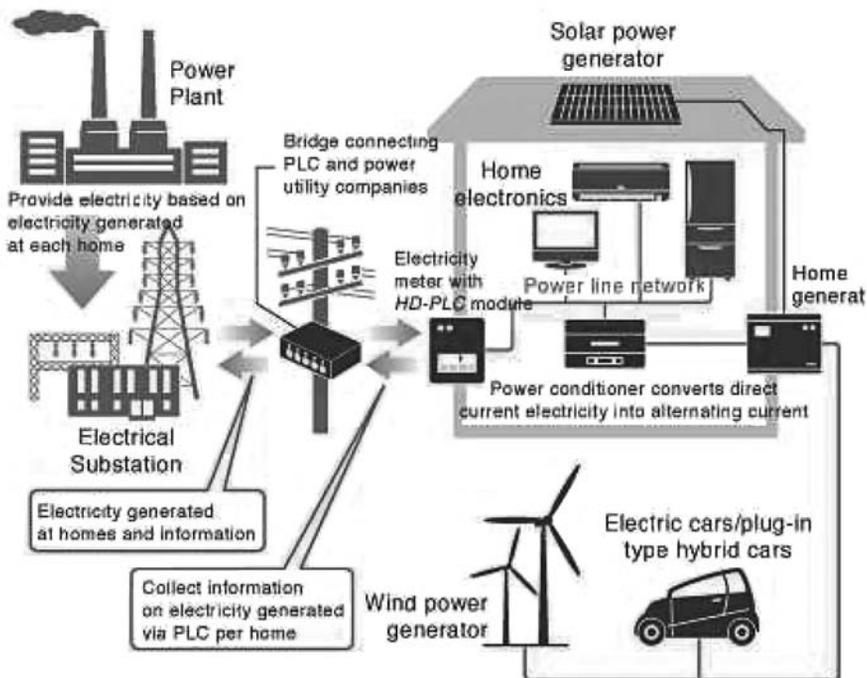
According to Article 8(1) of the Directive 2006/32/EC *in fine*, when a new connection is made in a new building or a building that is undergoing major renovations, as set out in Directive 2002/91/EC (a predecessor of the EPBD), such individual meters shall always be provided⁸.

With reference to the EPBD, it has to be noted that the term “individual meters” is no longer used in this directive, but it borrows its language from new liberalization directives. Although the EPBD counts only “intelligent metering systems”, it may be argued that some of its provisions refer to

⁸ Directive 2002/91/EC of the European Parliament and of the Council of 16 December 2002 on the energy performance of buildings, OJ [2003] L 1/65.

the broader concept of “intelligent grid”⁹. Article 6 EPBD opens the way for micro-generation in new buildings, namely for such high efficiency systems as: (a) decentralized energy supply systems based on energy from renewable sources; (b) cogeneration; (c) district or block heating or cooling, particularly where it is based entirely or partially on energy from renewable sources; (d) heat pumps. According to the above Article for new buildings, Member States shall ensure that, before construction starts, the technical, environmental, and economic feasibility of such high-efficiency alternative systems, if available, be considered and taken into account. Also in this case the language of EPBD is somewhat vague, referring to “availability” as well as technical, environmental, and economic considerations.

Figure 2. Smart home in a smart grid model



Source: <http://hd-plcmag.com/en/feature/smartgrid01.html>

It may be argued that European legislation in the EPBD is not conclusive about intelligent metering systems and the intelligent grid. On the other hand, it is difficult to expect strong obligations imposed on the Member States to roll-out existing meters in all types of buildings or to integrate metering of

⁹ M. Swora, ‘The intelligent grid: unfinished...’.

different media regarding the techno-economic maturity of ICT solutions in this area, privacy concerns, propriety of meters, and other factors. One thing is certain, in the name of energy efficiency the obligation imposed on the Member States is to encourage deployment of intelligent metering systems, allowing them to draw the appropriate measures to fulfill this obligation.

III. The regulatory framework for smart grids – towards a new model of regulation

In addition to the adoption of new solutions by European legislation, national regulators gathered in the European Regulators' Group for Energy and Gas (ERGEG) adopted their own framework regarding smart metering and smart grid implementation¹⁰. Regulatory effort should be considered a part of the process of implementing liberalization directives and other EU legislation concerning intelligent grids and intelligent metering systems. The work of regulators is carried out alongside intensive standardization work, which aims at the creation of European standards that will enable the interoperability of utility meters (water, gas, electricity, heat) which can raise final customers' awareness of their actual consumption¹¹. These issues are high on the agenda of European energy regulators primarily because intelligent grid/intelligent metering is the core activity of regulated grid operators. The smart grid is an idea which is a good starting point in changing the regulatory model, but also a change in the network utilities model. This change is well exemplified by J.P. Tomain, who has said: "The traditional model of utility regulation must be replaced with a smarter version – the *iUtility*. Where the old model encouraged consumption, the new model must encourage conservation. Where the old model fostered economic inefficiency, the new model must foster the efficient use of electricity. Where the old model was content with capital-intensive, centralized power production, the new model must promote distributed, small-scale power production. Where the old model was satisfied with burning dirty fossil fuels, the new model must expand the development,

¹⁰ Smart grid issues are also on the agenda of other regional and international organizations like the Energy Regulators' Regional Association and International Confederation of Energy Regulators, e.g. 'A Description of Current Regulatory Practices for the Promotion of Energy Efficiency', ICER, 21 June 2010, Ref. I10-CC-02-04.

¹¹ 'Standardization mandate to CEN, CENELEC and ETSI in the field of measuring instruments for the development of an open architecture for utility meters involving communication protocols enabling interoperability M/441', European Commission M/441/EN, Brussels, 12 March 2009.

production, and consumption of alternative and renewable resources”¹². It is obvious that such changes to the ‘DNA’ of the electricity grid need a regulatory response.

The activity of the European regulators towards smart grids should significantly influence the change in the model of regulation. European regulators do not have legislative power, but their advisory voice is heard through their expertise and knowledge about the regulated industry. So far, two main regulatory developments on the European stage are particularly worth noting: consultations on smart grids and on smart metering¹³. One of the implications arising from the consultation documents, being of utmost importance from the perspective of regulatory policy, is to change the regulation model associated with the change of priorities in the development of the grid operators. According to the ERGEG, output-based regulation of grid industries (hereafter, OBR) shall focus on smart grid benefits and can be done in two ways: 1) by direct regulation, i.e., minimum requirements for certain parameters, and/or 2) by performance-based incentive regulation providing penalties and rewards related to certain criteria and performance indicators¹⁴. This concept of regulation goes beyond the traditionally functioning cost-based or incentive-based regulation models. A key element of such a model of regulation is to define the outputs, which are part of the very definition of the efficiency-based and customer-focused element of the smart grid. An important factor that adds an element of uncertainty to such a model is the degree of innovation of solutions defining the performance of network operators.

The OBR model focuses on the performance of operators, which is evaluated by performance indicators. While selecting the indicators it should be ensured that they are objectively verifiable. The following are outputs and indicators that have been proposed by ERGEG.

This list of benefits and indicators is a proposal of the European Regulators and currently has no normative value – rather, it is an example of good practice promoted by ERGEG. However, this is the first serious approach to the development of a regulation model that takes into account the concept of the intelligent grid. In analyzing the benefit groups presented by ERGEG it has to be noted that they relate in part to the transnational electricity market and transmission system operators (TSOs). This area is a natural point of

¹² J. P. Tomain, ‘Steel in the Ground’: Greening the Grid with the iUtility’ (2009) 39 *Environmental Law* 951.

¹³ ERGEG Conclusion Paper on Smart Grid’, Ref: E10-EQS-38-05, ‘An ERGEG Public Consultation Paper on Draft Guidelines of Good Practice on Regulatory Aspects of Smart Metering for Electricity and Gas’, Ref: E10-RMF-23-03, 10 June 2010.

¹⁴ ERGEG Conclusion Paper on Smart Grid, p. 10

Table 1. Effects/benefits of smartness and list of potential performance indicators by ERGEG

Effects/benefits	Potential performance indicators
(1) Increased sustainability	Quantified reduction of carbon emissions Environmental impact of electricity grid infrastructure
(2) Adequate capacity of transmission and distribution grids for “collecting” and bringing electricity to consumers	Hosting capacity for distributed energy resources (‘DER hosting capacity’) in distribution grids Allowable maximum injection of power without congestion risks in transmission networks Energy not withdrawn from renewable sources due to congestion and/or security risks
(3) Adequate grid connection and access for all kind of grid services	Benefit (3) could be partly assessed by: – first connection charges for generators, consumers, and those that do both – grid tariffs for generators, consumers, and those that do both – methods adopted to calculate charges and tariffs – time to connect a new user
(4) Satisfactory levels of security and quality of supply	Ratio of reliably available generation capacity and peak demand Share of electrical energy produced by renewable sources Measured satisfaction of grid users for the ‘grid’ services they receive Power system stability performance Duration and frequency of interruptions per customer Voltage quality performance of electricity grids (e.g. voltage dips, voltage and frequency deviations)
(5) Enhanced efficiency and better service in electricity supply and grid operation	Level of losses in transmission and in distribution networks (absolute or percentage) Ratio between minimum and maximum electricity demand within a defined time period (e.g. one day, one week) Percentage utilization (i.e., average loading) of electricity grid elements Availability of network components (related to planned and unplanned maintenance) and its impact on network performances Actual availability of network capacity with respect to its standard value (e.g., net transfer capacity in transmission grids, DER hosting capacity in distribution grids)

Effects/benefits	Potential performance indicators
(6) Effective support of trans-national electricity markets	Ratio between interconnection capacity of one country/region and its electricity demand Exploitation of interconnection capacity (ratio between mono-directional energy transfers and net transfer capacity), particularly related to maximization of capacity according to the Regulation on electricity cross-border exchanges and the congestion management guidelines Congestion rents across interconnections
(7) Coordinated grid development through common European, regional and local grid planning to optimize transmission grid infrastructure	Benefit (7) could be partly assessed by: – impact of congestion on outcomes and prices of national/regional markets – societal benefit/cost ratio of a proposed infrastructure investment – overall welfare increase, i.e. always running the cheapest generators to supply the actual demand): this is also an indicator for benefit (6) above – time for licensing/authorization of a new electricity transmission infrastructure – time for construction (i.e. after authorization) of a new electricity transmission infrastructure
(8) Enhanced consumer awareness and participation in the market by new players	Demand side participation in electricity markets and in energy efficiency measures Percentage of consumers on (volunteer) time-of-use / critical peak / real time dynamic pricing Measured modifications of electricity consumption patterns after new (volunteer) pricing schemes Percentage of users available to behave as interruptible load. Percentage of load demand participating in market-like schemes for demand flexibility Percentage participation of users connected to lower voltage levels to ancillary services

Source: ERGEG Conclusion Paper on Smart Grid, Ref: E10-EQS-38-05.

reference at the European level and will certainly be of interest to the newly established agency – the Agency for the Cooperation of Energy Regulators (ACER). The problem of implementation of smart grids lies predominantly not at the level of TSOs, but rather at the level of distribution system operators (DSOs). For the national regulatory authorities the ERGEG position can be an important reference point, but it is not binding. It is still too early to demand the adoption of new laws, but once the OBR model becomes everyday practice in the activities of regulators, it should find place in the provisions of the liberalization directives.

Some national regulatory authorities are already developing new methods of regulation. So far, the new model of price control, RIIO (Revenue = Innovation + Incentives + Outputs), has been proposed by British Ofgem. The RIIO is based on the previous price control regime used by Ofgem (RPI-X), but according to its authors better meets the investment and innovation challenge by placing much more emphasis on incentives to drive the innovation needed to deliver the required outputs in terms of improved customer service and smarter grids¹⁵. According to Ofgem key features of the RIIO model include:

- Much greater say for network customers in setting out what network companies need to deliver, i.e., renewable developers might want faster connections
- Fast track price controls will be introduced for companies who innovate, deliver good service, and produce well-documented plans setting out how they will invest efficiently for the future. They will be rewarded with higher returns
- Poorly performing companies will face much more intrusive regulation and will face lower returns
- Lengthening price controls from five to eight years will provide more stability
- A stronger incentive regime to encourage more efficient investment and innovation
- The additional option of giving new network companies a greater role in delivering certain large-scale projects where this does not delay delivery. This could open up new sources of finance and encourage innovation
- Expansion of the current low carbon networks fund to encourage greater innovation across gas and electricity networks¹⁶.

¹⁵ ‘Ofgem reengineers network price controls to meet £32 billion low carbon investment challenge’ – press release of July 26, 2010; available at: <http://www.ofgem.gov.uk/Media/PressRel/Documents1/JULY%20RPI%20PRESS%20NOTICE.pdf>

¹⁶ Ibidem.

The British model of price control is certainly an interesting proposal, taking into account the requirements of the smart grid concept. At the moment there is no one common regulatory model which would be a ready-to-use product adoptable by all the European Regulatory Authorities. The Member States are free to choose a regulatory model which best suits local conditions, but they must take into account the current trend in network development, with its focus on the smart grid concept.

In analyzing the ERGEG document on the smart grid, regulators stress the importance of one more priority which should be included when drafting the regulatory policy. The smart grid concept is not only about the energy sector, as it requires the involvement of various stakeholders from the ICT sector, consumer organizations, the construction industry, renewable energy sector, etc. Regulators should therefore play an active role in favouring cooperation among those stakeholders to achieve the targets set for the various smart grid concepts, innovations, and solutions. According to ERGEG the role of regulators should be to facilitate smart grid discussions, hammering out common views, and cooperation among all stakeholders. ERGEG stresses the fact that such cooperation should be “especially devoted to agreeing which smart grid concepts will provide clear and greater net benefits (i.e., the benefits minus any possible additional costs) to network users and to the whole society, to identifying the possible presence of regulatory barriers to such smart grid concepts and to finding the best solutions to remove them”¹⁷. Consequently, in the process of implementing the smart grid, regulators must go far beyond their erstwhile relationship with the energy sector, and try to bring together as many smart grid actors as possible. For herein depends the success of a holistic vision for modernizing the electricity grid.

¹⁷ ERGEG Conclusion Paper on Smart Grid, p. 11.; networking strategy of Polish energy regulator can serve as an example of this type of action, which: 1) commissioned preparation of feasibility study on smart metering and initiated a discussion on that subject, 2) finalized signing of *Declaration concerning the introduction of smart grid into the Polish power system*, together with consumer organizations, National Energy Conservation Agency; which won support of several ministries, professional organizations, scientific institutions and other public bodies (http://www.ure.gov.pl/portal/en/1/21/Polish_Regulator_and_consumers_urge_the_energy_sector_to_implement_smart_grid.html), 3) initiated creation of smart metering platform (<http://www.piio.pl/>), 4) organized several conferences and meetings, whose purpose was to, e.g. gather interest of members of parliament in smart grid (http://www.ure.gov.pl/portal/en/1/71/Prospects_for_the_development_of_smart_grids_technological_breakthrough_in_the_.html), 5) initiated press releases, 6) built interest of industry in creating smart economic zones 7) activated dialogue with energy sector, ICT industry, self – government bodies, scientific organizations on smart grid, including creation of a common definition of outputs of smart grid solutions (http://www.ure.gov.pl/portal/en/1/86/Towards_Smart_Grids_in_Poland_smart_UTILITIES_2010_Conference_Wroclaw_27__28_Ma.html; http://www.ure.gov.pl/portal/en/1/77/Intelligent_networks_intelligent_control_Forum_Energy_Effect_Environment.html).

In closing it should be pointed out that the idea of changing the regulatory model is in fact not a purely European phenomenon. The developmental direction of modern industry networks towards smart grids is being widely adopted in many industrialized economies¹⁸. One good example is the United States, where the shift in regulatory policy toward taking into consideration the smart grid is described in terms of a transition towards a new regulatory model described as “regulation 3G”, which: “affects the development of the smart grid in many ways. The smart grid requires innovation, collaboration, and technological investment. It promises efficiency, reliability, and smoother working electricity markets. It also promises to transform the industry from sellers of electricity to providers of energy services and products. Regulation 3G also promises to revamp the old regulatory structure into one that is more flexible, market-based, and less prone to capture”¹⁹.

IV. Conclusion

Due to the user-centric approach and focus on energy efficiency and sustainable development, the approach to the network industry is changing: a new axiology for grids is being added in the form of sustainable development, security of supply, and promotion of competition. European energy law and policy describes this shift in terms of intelligent metering systems and intelligent grids. Neither concepts are ready-made products, but rather determinants of the direction of future network development, indicating the axiology of the desired changes with the use of modern ICT solutions. At the same time these concepts ought to be regarded as offering the most promising vision of the objectives of European Energy Policy.

This direction has already been reflected in Directive 2006/32/EC and more explicitly in the liberalization package directives. In the post-package legal environment the directive is represented in the bottom-up approach of the EPBD, but once more the obligations regulated in this directive are rather soft. According to Directive 2006/32/EC, one clear obligation of the Member States is to encourage deployment of intelligent metering systems, but countries are free to choose their own proper measures. It should be clear that the EU shall adopt harder measures in the future legislation aimed at the effectiveness of smart grid deployment. The provisions of the Directive 2006/32/EC will have

¹⁸ W. Breuer, D. Povh, D. Retzman, Ch. Urbanke, M. Weinhold, ‘Prospects of Smart Grid Technologies for a Sustainable and Secure Power Supply, available at: <http://www.worldenergy.org/documents/p001546.pdf>

¹⁹ J.P. Tomain, ‘Steel in the Ground’..., p. 976.

to change in the future towards clarification of obligations that which this directive put on energy firms in the area of informing customers and frequency of information delivery.

Along with legislation and European Commission efforts focused on standardization, regulators have begun the process of adapting to a new model for the functioning of network industries. One of the important outcomes of these efforts is to propose a new model of regulation based on outputs. The smart grid sets new tasks for regulators, who will have to play a leading role in the introduction of new solutions, offering within their regulatory tools price control models that define performance indicators and measure and reward outputs of regulated industries. This is to significantly include innovation and changes in the management of the modern industry grid. This task requires moving beyond the established model of economic regulation. Success will be achieved if “smart regulators” meet “smart industry” in regulatory policy.

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The Main Frameworks of the National Programme for the Reduction of Emissions: Towards the National Programme for Low-Emission Economic Development. The Public Board's Role

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CONTENTS

- I. Introduction
- II. The Public Board of the National Programme for the Reduction of Emissions
- III. The Board's tasks
- IV. The Board's structure
- V. Strategic documents
- VI. An era of sustainable development
- VII. 2011 objectives
- VIII. Policy recommendations and results

Abstract

European climate and energy policy will have a great impact on the European and Polish energy markets. Moreover, it will have an influence on broad realms of social and economic activity. This raises the necessity of taking concrete strategic measures, especially on the governmental level. EU climate and energy policy also entails sizeable investment requirements and places important demands on the modernization programme for the energy sector. This spells the need to develop broad dialogue between the government and society.

The above gives the background behind the appointment of the biggest Polish think tank in 2009 – namely, the Public Board of the National Programme for the Reduction of Emissions. In the Polish context the authors herein analyze the European climate and energy package, European Union policy regarding the reduction of emissions, and the Polish efforts taken in this field. The authors also

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describe the role of the Public Board of the National Programme for the Reduction of Emissions and its tasks. In conclusion they present policy recommendations and results in the area of fulfilling European obligations and conducting an infrastructural modernization programme in Poland.

Résumé

Les politiques énergie-climat européennes auront un grand impact sur le marché de l'énergie européen et polonais. En plus, elles auront une influence sur les différentes sphères de l'activité sociale et économique. D'ici, la nécessité de réaliser des actions stratégiques spécifiques, surtout au niveau gouvernemental. Les politiques énergie-climat influencent aussi les besoins d'investissement et le périmètre du programme de modernisation dans le secteur de l'énergie. Il est alors nécessaire de promouvoir un vaste dialogue entre le gouvernement et la société.

Les résultats indiqués constituent un arrière-plan pour l'établissement du plus grand "think tank" polonais en 2009 – le Conseil Public du Programme National de Réduction des Émissions. Dans le contexte polonais, les auteurs analyseront le packet énergie-climat, les politiques de réduction des émissions de l'UE et les actions polonaises réalisées dans ce domaine. Les auteurs décriront aussi le rôle et les tâches du Conseil Public du Programme National de Réduction des Émissions. Dans la conclusion, ils présenteront les recommandations et les résultats dans le domaine de l'accomplissement des obligations européennes et de l'implantation du programme de modernisation d'infrastructure en Pologne.

Classifications and key words: Emission Trading System, energy, reduction of emissions, energy market, energy policy, climate and energy package.

I. Introduction

The National Programme for the Reduction of Emissions ("the National Programme") in its investment aspect is a legal remedy which will shape the structure of the Polish energy market in the field of energy sources. The National Programme will allow Poland to carry out the European "3x20" climate and energy package. The National Programme is to be submitted by the Polish government to the European Commission not later than by the end of September 2011, and is to show ways for achieving a reduction of CO₂ emissions by 21% by 2020 in the Emission Trading System area, and of limiting growth by 14% in the non-Emission Trading System area. This also means a 15% increase in the participation of Renewable Energy Sources in the final energy balance and a 20% reduction of energy use through the rise

of energy efficiency in the years leading up to 2020. According to assessments carried out by the Ministry of the Economy, the budget for these investment activities is 100 billion Euro by 2030, which fact required that the National Programme and related activities be initiated immediately.

It should be mentioned that although the name of the National Programme was altered from the National Programme for the Reduction of Emissions to the National Programme for Low-Emission Economic Development, the role of the Programme was not changed. It is still a document in which there will be set a primary rules for government activity in the area of meeting European Union climate obligations. Therefore in this article the authors will use “National Programme” both in the context of the National Programme for the Reduction of Emissions (NPRE) and the National Programme for Low-Emission Economic Development (NPLEED).

The National Programme and its proper implementation and realization will require high-scale investments. Their extent and type is presented on the tables below:

Table 1. The Polish Investment Programme

billions €		sector
90	100	Electric energy
15	20	Gas
~80	100	Heating and buildings
~80	100	Transport
265	320	by 2030
13.5 per year	16 per year	Annually

This effort should be compared with the famous Marshall Plan, which was ever so crucial for the European economy, and which embraced many countries for a period of 3.5 years.

Table 2. A New Marshall Plan

Marshall Plan	
<i>13.5 billion \$1948</i>	<i>90 billion €2009 22.5 billion € per year</i>
Modernization and Emissions Reduction Plan	
265 ÷ 320 billion €	
13.5 ÷ 16 billion €	

The current and predicted situation of the Polish economy suggests that by 2030 Poland will have to face an enormous undertaking in respect of investments that – to a significant degree – will have to be financed from individual funds. This of course does not mean that there will be no scope for the involvement of foreign investors. However, it indicates that it is necessary to realize that these investors will expect a decent return on the capital they have put in (which is generally higher than the costs of instruments such as loans). In other words, as we demonstrate below, Poland needs a huge infrastructure modernization programme.

Meanwhile European Union obligations mean that this programme must simultaneously be a National Programme. As in any great undertaking, a proper diagnosis of the situation must precede any later activities. In this case, the priority is knowledge of the degree of technical depreciation of fixed assets, i.e., knowledge of the degree of the technical exploitation of Poland's infrastructure. This task can be carried out in four phases:

Firstly, it is necessary to define the primary value of each of the components of the infrastructure in question;

Secondly, we must define (and adopt) a maximum life-span for a given facility; for example, in the case of a coal-based condensation power plant this is 40 years, and these 40 years yield a rate of technical depreciation of

$$\frac{1}{40} \cdot 100\% , \text{ i.e. } 2.5\% \text{ p.a.};$$

Thirdly, 2.5% of the primary value must be added per year; the sum obtained after this is done reflects the actual value of technical depreciation;

Fourthly, all current redemptions should be identified and divided by the sum of the primary values of all of the elements of constant assets in a given company, sector, or the economy.

The end result arising out of these calculations illustrates the percentile rate of technical exploitation of infrastructure. If the result is equal to 0% then the infrastructure is new, if it is 100% then it is completely exploited – i.e., there is no guarantee that it will continue to work properly. The algorithm is very simple insofar as a set of assets is inventorized and technical depreciation is calculated and added on a regular basis¹.

The fundamental problem that Poland faces is that such inventorization has not been officially carried out. As a result, we are unable to precisely define the level of technical depreciation of the country's infrastructure. Thus, the need to elaborate and conduct an exacting National Inventorization Programme is exigent.

¹ See more M. Kleiber, J. Steinhoff, K. Żmijewski, *Manifest desperatów*, "Rzeczpospolita", 8.X.2010.

II. The Public Board of the National Programme for the Reduction of Emissions

The Public Board of the National Programme for the Reduction of Emissions (“the Board”) was announced by the Deputy Prime Minister, Minister of the Economy Waldemar Pawlak on April 23, 2009. It is to support the endeavours of the Polish government in relation to the creation and execution of the National Programme for the Reduction of Emissions.

The Public Board is chaired by the Presidium of the Board and has seventeen Task Forces. Each Task Force has a Chairman, Vice-chairman, and a Secretary. The members of the Task Forces are distinguished authorities in the area of science and technology. They are supported by independent experts: professional consultants and reputable people from the business world. The Presidium of the Board and the Presidents of the Task Forces were nominated on October 28, 2009:

- Prof. Jerzy Buzek – Chairman (President of European Parliament);
- Prof. Michał Kleiber – Vice-chairman (President of the Polish Academy of Science);
- Janusz Steinhoff PhD – Vice-Chairman (former Deputy Prime Minister);
- Prof. Krzysztof Źmijewski – Secretary General.

The legal basis for the Board’s operation is the Act of August 8, 1996 on the Council of Ministers² and Order No. 28 of the Minister of the Economy of October 21, 2009 (“Order No. 28”). According to these regulations the Board is an advisory body to the Minister of the Economy.

The role of the Board’s work is indicated in the rationale for Order No. 28, according to which the Board’s objective is to materially support the Minister of the Economy in his or her activities connected with the development and implementation of the National Emission Reduction Programme. The Board’s activities are expected to lead to effective implementation in Poland of the European Union climate and energy package and of the Industrial Emissions Directive currently under preparation. The budget for investment activities under the programme (continuing until 2030) is estimated by the Ministry of the Economy at € 100 billion, which requires prompt commencement of the Board’s activities. The Board is composed of a voluntary team of outstanding specialists representing science and technology, supported by nongovernmental voluntary advisors (outstanding representatives of the business world), which means that it is the biggest think tank of any quasi-governmental organization. The issue of emission reduction has not only environmental, energy-related and economic dimensions, but also a significant social dimension.

² Journal of Laws 2003 No 4, item 199 with amendments.

III. The Board's tasks

The Board's tasks are regulated in § 2 of Order No. 28, and they are as follows: to develop proposals and concepts for systemic solutions aimed at reducing Poland's greenhouse gas emissions into the atmosphere, taking into account relevant international commitments of the Republic of Poland as well as European Union legislation, and to participate in the development and appraisal of relevant draft documents. This shall lead to an improvement of economic efficiency, development of low-emission industrial technologies, development of renewable energy sources, and the general directions of the energy sector's development. These tasks are underlined by the broad range of the Board's activity, which gives it the opportunity to influence numerous branches of the economy both directly and indirectly in terms of the reduction of emissions in Poland.

The basic tasks set before the Board include:

- a) elaboration of road-maps for specific programmes encompassed by the NPRE,
- b) elaboration or appraisal of *terms of reference* for projects prepared and carried out by the government and aimed at reducing emissions,
- c) appraisal of the compliance of the aforementioned projects with their *terms of reference* and appraisal of the execution of these projects,
- d) preparing opinions of the strategic intentions of the government in respect to reducing emissions,
- e) elaboration of strategic solutions for reducing of emissions.

The mission of the Board is to provide the Deputy Prime Minister responsible for development of the Polish economy with competent, independent, and comprehensive strategic knowledge permitting the constitutional principle of sustainable development to be upheld³. The main aim is optimization of the process to reduce emissions as a basic tool for climate protection. An additional aim is to convince society of the relevance of optimal measures aimed at climate protection. The vision of the Board is to lead to zero-energy development in Poland – pursuant to the guidelines of the Energy Policy.

As its name suggests, the Board is above all to be an advisory body. The fact that it gathers together people from outside the political divides, people who have the highest competences and moral authority, generates synergy and

³ Article 5 of the Constitution of the Republic of Poland: "The Republic of Poland shall safeguard the independence and integrity of its territory and ensure the freedoms and rights of persons and citizens, the security of the citizens, safeguard the national heritage and shall ensure the protection of the natural environment pursuant to the principles of sustainable development".

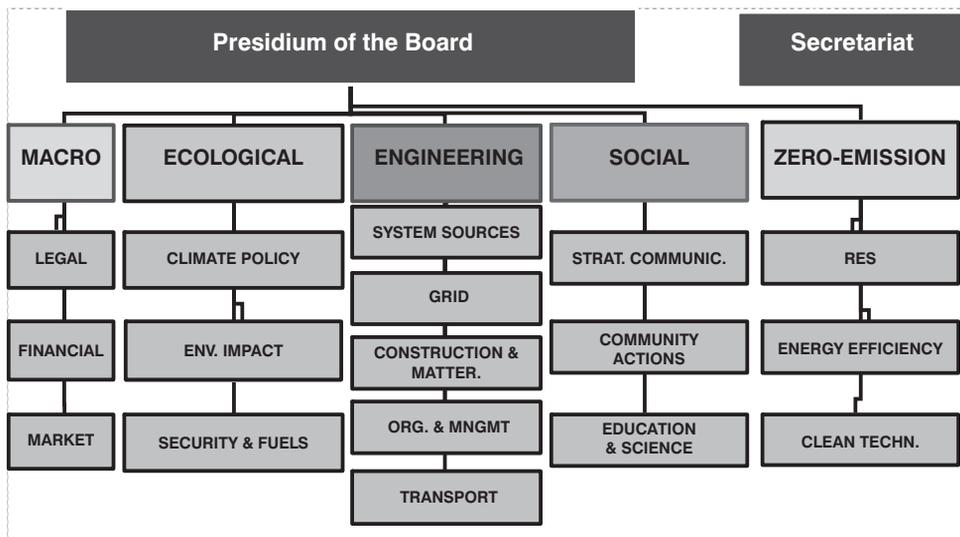
a collective authority with enormous potential in respect to influencing the public – and therefore the decisions made by the government, as well. The second vital function of the Board is to persuade society and politicians to carry out efforts aimed at reducing emissions and ensuring climate protection.

The main aim of the Board is to execute its action plan and thereby assist the government in executing the NPRE/NPLEED. A broader aim is to optimize actions undertaken as part of the NPRE/NPLEED.

IV. The Board’s structure

The issue of reducing emissions not only has an ecological, energy-related, and economical dimension, but also a clear social dimension. This is why the Board will also focus its work on non-technical matters, as reflected in the Board’s structure:

Chart 1. The Board’s structure⁴



The functioning of the Board is based on the tried-and-tested model of separation of the competences and activities for which the Presidium of the Board (the Chairman of the Board and Chairs of the Working Groups) is responsible from the competences and activities for which the Secretary

⁴ www.rada-npre.pl.

General, Secretaries of the Working Groups, and Secretariat of the Board are responsible. This model has been tested in the first phase of Board's operation and proved successfully.

The Board consists of the Presidium and the 17 listed Working Groups. They are supported by the Secretary of the Board and the Ministry of the Economy's Department of Energy and Department of Economy Development. The members of the Working Groups are independent experts and authorities from scientific and technical spheres⁵. As stated in § 3 of Order No. 28, the Board's members are appointed by the Minister of the Economy from among scientists, entrepreneurs, and representatives of opinion-making circles connected with the energy sector.

The Board is also supported by independent voluntary consultants who formally are not Board members, but are invited by the Chairman to cooperate with the Board when their knowledge and experience may be useful in the fulfillment of the Board's tasks. They may also participate in the proceedings of the Board. Such non-members shall include in particular: representatives of the public authorities, experts in the fields covered by the Board in its work, and representatives of scientific institutions.

The Board's activities are mainly carried out by Internet (via emailing) and it is supported by quarterly meetings of the Working Groups. Moreover, cooperation in the Board is complemented by members' meetings during conferences, debates, and joint discussions. Virtual cooperation with experts acting as consultants is very useful. This is the simplest, cheapest, and most efficient form of cooperation for preparing source materials – reports, policies, White and Green Papers, and above all relevant legislation (ideas and forms of reference).

As underlined in Order No. 28 the Board shall act as a collegial body. In connection with the above-described scope of the Board's tasks, the Board shall adopt resolutions regarding issues coming within its scope of work. The Board's resolutions shall be passed by consensus. The Chairman shall direct the proceedings of the Board and shall chair the Board's sessions. If unanimity cannot be reached, the Chairman may put the issue to a vote; in such a case, the Board resolution shall be taken by a majority of the votes cast by the present and voting members of the Board. In the case of a tie, the Chairman's vote shall be decisive.

The Board benefits from logistic support provided by the Ministry of the Economy. This support is provided by two departments: the Department of Economic Development and the Department of Energy. Moreover, the Board will try to extend its cooperation with the Polish government by strengthening

⁵ M.M. Sokołowski, 'Społeczne wsparcie Rządu, czyli głos ekspertów w kwestii redukcji emisji' (2010) 3 *Nowa energia.com.pl*.

cooperation with the Ministry of the Environment and other governmental agendas.

The Board is also supported by an interior body – the Secretariat of the Board, which provides logistics support for the Board's activity, without which the Board would not be able to operate and fulfill its tasks. The practical experience of the functioning of the Board in 2009–2010 indicates that the Secretariat ensures proper communication between the Board's members as well as enables consultation of documents. Together this leads to the achievement of goals. The Secretariat also ensures that the Board's members can present the results of their activity at conferences, meetings, and seminars. They assure promotion of the Board's activity.

The Board collaborates with numerous non-governmental organizations on an everyday basis. This cooperation and necessary communication occupies a considerable part of the Secretariat's work. In this way the Board develops its pro-public activity by encouraging these organizations to cooperate and publically express their opinions during debates and conferences organized with the Board's help or under the Board's patronage. The Board plans to develop this cooperation, especially in the context of elaborating the Polish Climate Change Act. Study visits in various countries with similar activities will be a great advantage for Polish concepts and ideas.

Finally, the Board is currently carrying out activities aimed at gaining the support of foreign members of the Board acting on a voluntary basis. We are open to every form of cooperation with foreign experts: secondments of experts, for example from the Task Force in Holland, would be a great advantage. In a similar way the support of foreign experts active in Poland would be of great advantage (as was the case with the Energy Restructuring Group in Poland in the 1990s). The Board also plans to develop its cooperation with European professional expert organizations.

V. Strategic documents

All of the Board's aims and tasks result in the preparation of a set of analytical documents which thereby assist the government in executing the National Programme. The effects of this activity should create a background suitable for optimizing efforts undertaken as part of the National Programme. These strategic documents includes Green Papers (problems and barriers), White Papers (concepts and solutions), Road Maps (terms and measures), and Principles and Terms of References of the National Programme.

Specific issues of the experts' analytical activity includes: the scale and means for financing the programme for modernization of the electric energy sector; the means for carrying through the required 15% share of energy from renewable energy sources in the final energy balance (taking into account the heating sub-sector); and the means for limiting growth in CO₂ emissions in the transport sector, in order to ensure that the limit of 14% growth in the non-ETS area is not exceeded. It also includes introduction of legislation allowing for timely execution of the National Programme – to wit, the Energy Efficiency Act, the Nuclear Law Act, and the Act on Execution of Strategic Infrastructure Investments of Particular Significance to the Development of the Country. In details it covers issues such as: acceleration of the development of renewable energy sources; liquidation of investment barriers; improvement of the renewable energy sources motivation system; preparation of Poland's comprehensive position in the face of the challenges posed by the European climate policy; elaboration of underlying guidelines for a national campaign aimed at increasing energy awareness, basic guidelines for a programme aimed at education and development of science (including in particular nuclear and energy efficiency issues), and guidelines for the Clean Coal Technologies Programme.

These issues are described in the above-mentioned catalogue of strategic documentation. The 230-page Green Paper of the National Programme for the Reduction of Emissions is the first example of the Board's analytical activity⁶. The Green Paper was elaborated in 2010 and was delivered to the Polish government and its agendas.

The main aims of the Green Paper are defined as identification of problems requiring resolution and tasks requiring execution, together with inventorization of issues for discussion. Additionally, the Green Paper also elaborates the means of achieving the aims in question. For example, it may involve controlling energy demand, changes in respect of sources of energy, and/or technological developments.

The basis for seeking solutions is that of the aim to achieve balance in respect to the basic triad of the following components: economic development (competitiveness), sustainable development (environment), and stable development (security). This context is a vital background for all of the Green Papers chapters, which are gathered in three main areas: “Problems requiring resolution – programmes”, “Tasks to be executed”, “Issues for discussion”. Their frameworks indicate such issues as: preparation of tools for law, finance, and regulation; tariffs and organization; procedures and structures; problems, development of technologies (renewable energy sources, clean coal sources,

⁶ ‘Green Paper for Reduction of Greenhouse Gas Emissions’, www.rada-npre.pl.

nuclear energy, power grid, gas networks, heating networks, sources – system-based and local – energy efficiency, low emissions transport, promotion of innovation); protection of the environment; emissions planning (emissions budget); reduction of emissions; control of emissions; creation of social awareness; ensuring security; diversification of supply (liquefied natural gas, Trans-European Energy Networks, Trans-European Gas Networks); and finally integration of the European markets of emissions, energy, efficiency, and others markets.

Another subject of activity is the creation of social awareness in respect to the issue of demand for energy and means of satisfying the indicated needs, e.g., by means of changes in social behaviour and lifestyle. Such problems are described in the Green Paper in the chapters “Education”, “Information”, “Promotion”, “Dialogue (social consultations)”, “Cooperation” and “Co-responsibility”.

The Board also suggests conducting efforts in the field of concrete campaigns. These are means of executing tasks resulting from European Union energy policy and its obligatory aims. Among these campaigns shall be: re-electrification of rural areas; gasification of the country; sensitization and education of the network; intelligent networks; smart metering; cogeneration and heating; restitution of power; construction of new sources and modernization of existing sources; thermo-refurbishment and certification of buildings; passivization of buildings; decarbonization of transport; and reorganization of transport. These campaigns are correlated with issues for discussion – e.g., the level of Poland’s gasification; the future of coal; directions and areas of development of RES; types of technologies; cooperation with classical energy; road law; green heat – low-emissions heating; the future of nuclear energy; types of technology; management of fuels and waste; organization of the energy efficiency market; organization of the biomass market; certification of “colourful” energy; financing of energy-efficient and zero-emissions investments; and reorganization of passenger and freight transport.

This highlights the challenges and barriers in the area of elaborating and realizing the National Programme. Thus, another of the Board’s fields of interest should be strengthened. This refers to finding solutions and a general concept for the needs of the Programme. For instance, the efforts above include solutions and consequences of the EU-ETS directive, the effort sharing decision (non-Emission Trading System), the Integrated Pollution Prevention and Control directive (integrated permits), and the Energy Efficiency directive.

The material set out in the chapters was analyzed by reference to the barriers and problems that it breaks down into the area of law, finances, technology, education, institutions and organizations, and promotion. Proposals for specific solutions, programmes, tools, and decisions will be the subject of a subsequent

report – the White Paper, which is now in progress and will be elaborated in mid-2011.

VI. An era of sustainable development

The Board supports the Polish government in the realization of the European Presidency Action Plan. Hence, the Board elaborated a vital proposal in the area of energy for the Polish Presidency, extending over the second half of 2011. The document is called “Theses for the Polish Presidency”. The authors will present its most important provisions.

The main idea of the “Theses” is the possibility of making avail of the Presidency to change the dark vision of Poland to a green one, so as to ensure that the priority of energy security that has been adopted by Poland is received in a positive manner by the general public in the EU for the duration of the Presidency.

Nevertheless it should be emphasized that for less developed countries, optimization of the process of reducing emissions means minimizing the costs of such reduction. These were in fact the primary assumptions of the package – to protect the climate in the cheapest possible manner. For Poland, a country that has a high-emissions industrial sector, as well as for other countries in a similar position – both from within the European Union and from developing regions – the limitation of emissions costs is a critical issue. For this reason, it is vital that support be given for initiatives such as:

- *domestic offset* – controlled “transfer” (not necessarily 100%) of emission from the non-ETS sector (construction and transport) to the Emission Trading System sector (mainly energy). In European legislation, this solution is known as a *Community level project*⁷. Unfortunately, it has been blocked as executive legislation has been put in place, which defines the conditions under which such projects can be used. Poland could remove this barrier and therefore effectively lower the costs of carrying out the climate and energy package.
- *carbon label* – a carbon label based on the carbon footprint, to be used as a tool controlling the emissivity of products and services (including those imported from outside the European Union). There are tens of such projects in Europe and throughout the world. The Polish Presidency could undertake to coordinate these efforts. Countries such as Sweden could be valuable partners in this respect.

⁷ See Article 24a of the Directive 2009/29/EC of the European Parliament and the Council <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CONSLEG:2003L0087:20090625:PL:PDF>

- *smart grid* – intelligent networks are composed of three basic elements (*smart metering* – intelligent metering allowing for duplex communication, and in effect *active demand side management*, *smart sensing* – monitoring of the technical state of the network in *quasi real time*, which allows for the burden to be increased in the summer and the formation of ice layers to be combated in the winter, *virtual power plant* – management of dispersed energy sources connected “beyond the horizon” of the Transmission System Operator).

The Board’s experts believe that the development of this technology requires establishing a certain standard, mainly in respect of the definition of data exchanges – the so-called open protocol allowing for cooperation between the equipment of various producers. Poland can take the initiative in this respect.

- *efficiency drivers* – tools supporting efficiency (*white certificates* – supporting investments relating to energy efficiency; *voluntary agreements* – in which factories or sectors make obligations in respect of energy savings and reduction of emissions; *tax credit* – a system for providing tax-based support for energy-saving investments made by small end-users (households and small companies); *performance contracts* relating to the achievement of energy efficiency (known as: Energy Saving Company, Third Party Financing, Public–Private Partnership), in which the investor is a third party and investment costs are paid off from savings (energy efficiency leasing; *efficiency funds* – support funds aiding the financing of energy-saving investments such as the Thermorenovation Fund, National Fund for Environmental Protection and Water Management, etc.

Without enlisting these tools, neither Poland nor Europe would be able to execute the aims of the climate and energy package. Contrary to common European opinion, Poland has already put in place several interesting solutions in the above area. Potential partners include Italy (*white certificates*), Holland, and Ireland (*voluntary agreements*), Italy and the UK (*tax credit*), the UK (*performance contracts*), Bulgaria, Portugal, Spain, and Austria (*efficiency funds*).

These initiatives are beneficial for Poland and other highly carbonized countries. In some of these countries, interesting solutions have been elaborated that now require dissemination, whilst in others preliminary concepts that require development and implementation have been prepared. Poland also has its own solutions and concepts which we Poles could develop, thereby joining the leaders of efficient reduction of emissions in Europe.

VII. 2011 objectives

In 2011 the Board will focus its activity on these fields:

- continuing support for the government in elaboration of the National Programme for Low-Emission Economic Development;
- elaborating and publishing the White Paper;
- supporting the Ministry of the Economy in the field of passing the Energy Efficiency Act through the Parliament (done);
- elaborating the draft of the Terms of References for the Polish Climate Change Act;
- creating solutions for its low-emission development in cooperation with the Ministry of the Economy and Ministry of the Environment;
- pro-consumer legislation package.

The Board will be engaged in the process of elaborating the National Programme for Low-emission Economic Development. The role of the Board as an expert advisory body in preparation of the National Programme for the Reduction of Emissions has been underlined in the new version of the *Terms of References*. Moreover, the Board will provide Deputy Prime Minister Pawlak, the Minister of the Economy, with competent, independent, and comprehensive strategic knowledge allowing Poland to meet the constitutional principle of sustainable development. The Board will also support the Polish government by elaborating Terms of References of the Polish Climate Change Act (draft version).

Thanks to the legal basis of the Board its operation is stable and it guarantees the Board's development and proper functioning. Furthermore, it indicates the broad scope of the Board's activity and underlines the importance of the Board's role in Poland. It also enables the Board to establish its plans for 2011, which shall highlight:

- developing cooperation with the Ministry of the Environment, which should enable the Board's participation in a governmental panel strictly responsible for the National Programme for Low-Emission Economic Development;
- preparing opinions for the government in respect to strategic plans of the government regarding the reduction of emissions;
- developing or establishing cooperation with foreign advisory bodies responsible for climate change and reduction of emissions, the aim of which is the creation of a European Climate Change Convent.

It is necessary to stress that the Board is engaged in strategic issues and is not involved in day-to-day support of the government. As a result, the Board is in contact with the Ministry of the Economy and the Ministry of the

Environment and participates in the dialogue concerning the enlargement of the National Programme for the Reduction of Emissions into the National Programme for Low-emission Economic Development. Both Ministers have stated that the Board will be engaged in this Programme (which was also stated at the Presidium meeting on October 1, 2010).

VIII. Policy recommendations and results

The Board has suggested the following policy steps:

- altering the renewable energy sources support system;
- intensifying the renewable energy sources connection to the grid⁸;
- grid stabilization;
- promoting energy efficiency;
- developing energy efficiency drivers;
- effective reduction of emissions;
- altering the tariff system⁹;
- promoting a low-emission economy;
- pro-consumer legislation package.
- educating society about reducing emissions.

The main aim of the Board is to execute the Action Plan and thereby assist the government in executing the National Programme for Low-emission Economic Development. A broader aim is to optimize the efforts undertaken as a part of the National Programme for Low-emission Economic Development. The following results should be achievable through the Board's efforts:

- elaboration of documentation (Summary of a White Paper, Executive Summary, Popular Version, Popular Short Version), White Paper for Reduction of Greenhouse Gas Emissions / the part of the White Paper of the National Programme of the Low-emission Economy Development (final version) – concepts and solutions for the National Programme in Poland, Terms of References of the Polish Climate Change Act (draft version), Road Maps for Transport, Power Grid, Innovative Energy Technologies accompanied by Atlases in respect of programmes encompassed by the National Programme, along with other materials in

⁸ K. Żmijewski, M.M. Sokołowski, 'Identyfikacja barier i problemów związanych z polską energetyką odnawialną jako wybór relewantnej informacji dla rządu, społeczeństwa i gospodarki' [in:] B. Sitek, R. Trzaskalik (ed.), *Zarządzanie informacją i energią w systemie bezpieczeństwa Unii Europejskiej*, Józefów 2010.

⁹ See more K.Żmijewski, M.M. Sokołowski 'Analiza zapisów Mapy Drogowej Efektywności. Efektywnie o gospodarce (cz. 2)' (2010) 9 *Energia i budynek*.

accordance with the needs of the Ministry of the Economy and other government bodies;

- supporting government in the realization of: the European Presidency Action Plan and Energy Efficiency Action Plan 2011,
- public debates and conferences with the participation of Board members, independent experts, decision makers, politicians, representatives of science, the media, and the public.

Indirect results:

Specific indirect results include:

- elaboration of reports relating to issues discussed by Working Groups, the Presidium, and other bodies functioning within the Board;
- elaboration of publications, opinions, reports and analyses by members of the Board and bodies functioning within the Board, or commissioning of elaboration of such documents in accordance with the Board's needs;
- reports relating to media activities (strategic communication) carried out by the Board or with the participation of its members;
- reports concerning study visits and international cooperation.

“Soft” results:

- an increase in public awareness;
- an increase of the participation of government representatives in the aforementioned;
- wider presence of climate package topics in the media. Higher public acceptance for the necessary infrastructure investments aimed at increasing efficiency and reducing emissions;
- introducing energy efficiency as a priority for the Polish Presidency in the European Union, July 1 to December 31, 2011.

Potential threats and barriers:

- Economic – lack of sufficient funds for full-scale financing of the Board's activity;
- Political – lack of strong influence on actions undertaken by the government could be de-motivating for members of the Board (thus far, this threat has not been very likely due to the high level of involvement of the Deputy Prime Minister and Minister of the Economy, moreover the Minister of the Environment also strongly supports the Board);

- Cultural – initial problems with application of modern tools for working in a virtual environment;
- Institutional – weak cooperation between different Ministries, lack of proper understanding of the priorities of the Polish economy on all levels of ministerial staff, lack of coherent message from the government to the public, and last but not least – lack of a strategic programme centre with proper tools for necessary analysis.

Opportunities

- The Board is the only institution except the government formally and materially responsible for preparation of the National Programme for Low-emission Economic Development in Poland;
- The Board is the largest and hence a well-recognized Polish think-tank;
- The Board gathers experts from various spheres and business milieux, which means that it is a full-scale platform for dialogue in the area of sustainable development and a low-carbon economy;
- The Board develops international cooperation with similar advisory bodies, the Board arranges multinational collaboration and establishes a European coalition for climate – this ensures international understanding of the problems faced by countries with highly carbonized economies;
- The actions of the Board are focused on innovative tasks realized with the use of new technologies;
- The Board creates structural documents, which support the Polish government in the key decision making process;
- An extensive contact database as well as knowledge database necessary to educate the public guarantees full use of the results of the project;
- The high level of competences and authority of the members of the Board, combined with its non-political nature, guarantees that the Board has an influence on public opinion. On the other hand, the style of functioning of the Board guarantees its pro-democracy and pro-market nature.

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A R T I C L E S

Poland's Energy Security in the Context of the EU's Common Energy Policy. The Case of the Gas Sector

Bartłomiej Nowak*, Paweł Grzejszczak**

CONTENT

- I. Introduction
- II. The security of the gas sector
- III. Poland and its gas concerns
- IV. Conclusions

Abstract

The concept of energy security can be rather difficult to precisely define. In fact, the scope of energy security includes a somewhat different set of issues in the gas sector than in the electricity sector. After all, electricity can be produced in every country of the European Union, but gas extraction is possible only in some. Natural gas is a commodity which constitutes a significant component of the export policy of only a few countries. As a result, the scarcity of gas in the EU makes it a very desirable resource for many countries, some of which are taking important energy-related decisions without consulting or assessing their impact on other Member States. This hampers the coordination of energy policy and the setting of common objectives with regard to energy security for the EU as a whole. The lack of cooperation among Member States has a clearly more negative impact on Poland and the other new Member States (which depend on a single gas supplier) than on the old EU-15, whose gas supply is generally well diversified. Moreover, the lack of proper infrastructure and cross-border connections puts in question the creation of a solid energy policy at the EU level in the gas sector.

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Résumé

Le concept de sécurité énergétique est assez difficile à préciser. En fait dans le champ d'application de la sécurité énergétique, différentes sont les données dans le secteur du gaz par rapport celui de l'électricité. Tant que l'électricité peut être produite dans tous les pays de l'Union européenne, l'extraction du gaz n'est pas possible partout. Le gaz naturel est un produit qui constitue une composante importante de la politique d'exportation de quelques pays seulement. En raison de la pénurie de gaz dans l'UE, il est une des ressources très souhaitable par de nombreux pays, qui prennent des décisions importantes concernant l'énergie, sans consulter ni évaluer leur impact sur les autres Etats membres. Ce l'autre côté entrave la coordination de la politique énergétique et la fixation d'objectifs communs en matière de sécurité énergétique de l'UE dans son ensemble. De toute évidence, le manque de coopération entre les Etats membres a un impact plus négatif sur la Pologne et les nouveaux États membres qui dépendent d'un seul fournisseur de gaz dans l'ancienne UE-15, dont les sources d'approvisionnement sont en général bien diversifiées. Aussi le manque d'infrastructures adéquates et de connexions transfrontalières met en question la solidité de la politique énergétique au niveau de l'UE dans le secteur du gaz.

Classifications and key words: energy security, natural gas, common energy policy

I. Introduction

Energy security is a broad concept and one that can be quite a challenge to define. Despite the fact that the gas sector, along with the electricity and oil sectors, have a common denominator (namely in the need for diversification of sources and energy carriers, supply continuity, modernization and expansion of infrastructure), the European Union's Member States evince differing circumstances as far as their domestic energy security is concerned. This is a result of many factors, including the historical relationships with suppliers, divergent standards of energy consumption, energy mixes, access to natural resources, dependence on imports (including from just one source), political pursuits, etc. Both these differences and the current practice of Member States, which neither consult nor analyze the impact of their decisions regarding energy on the remaining states of the European Union, hinder implementation of a common energy policy at the EU level. This results in the lack of a shared position as far as energy security matters are concerned.

The clearest example of the lack of cooperation among Member States is in the gas sector. Obviously, such lack of cooperation has a more disadvantageous

influence on Poland and the other new Member States which depend on a single supplier, than on the old EU-15. Furthermore, Poland (as several other new Member States likewise dependent on foreign energy supplies) faces additional challenges stemming from its proximity to and relationship with Russia, the EU's main gas partner. Important differences can be seen in several areas: the structure of energy use (energy mix), energy dependence, infrastructure, and the politicization of the issue.¹ The first important difference between the energy situation of Poland and that of the Western European countries has to do with the fact that the Central and Eastern European (CEE) countries in general have a much higher level of energy dependence on a single source – namely, Russia – than do other European countries. While in Western European countries the level of dependency on a single source hardly exceeds 30%, the CEE countries' level of energy dependency on Russian gas ranges from 50 to 100%. For Poland it is around 65%.² The difference between CEE and Western Europe is marked by further disparity in the effectiveness and quality of infrastructure and facilities, as well as the role energy plays in politics. For many decision-makers in the CEE countries the legacy of relations with the former Soviet Union casts a shadow over trade with today's Russia. For Poland and other CEE states, mistrust and fear spoil the perception of their relationship with their main gas supplier. This is an element that is not present in the relationship between other European states and their suppliers, be it Norway, Algeria, or Russia.

This article presents legal, economic, and political aspects of regulating Poland's energy security within the context of EU energy policy in light of the challenges that remain. These challenges include differing standards of energy consumption, differing energy mixes and access to natural resources, along with dependence on imports, infrastructural obstacles, and political initiatives both at the EU and domestic level. Finally, this article attempts to answer whether a common European energy policy at the current stage of EU integration is possible and what the potential is for further progress in this field.

¹ For more on this see A. Rulska, *The European Union Energy Policy: An Initiative in Progress*. Paper presented at the Conference in April 2006 at the Central and East European International Studies Association – University of Tartu, Estonia.

² B. Nowak, 'Forging the External Dimension of the Energy Policy of the European Union' (2010) 23 *The Electricity Journal*, pp. 57–67.

II. The security of the gas sector

The term ‘energy security’ is interpreted a bit differently in the gas sector than in the electricity sector. The reason for this is quite simple: whereas electricity can be produced in every country of the EU, gas extraction is possible only in a few. Natural gas is a commodity which constitutes an important component of the export policy of some countries: as such it enters the game of global trends of supply and demand³.

Therefore the question of the security of gas supplies should be considered with respect to two areas:⁴

- a) short-term security of supply – which depends on particular Member States that are obliged to undertake all possible and proper regulatory measures to determine their security aims and define the range of competence and responsibilities among market participants according to those security aims;
- b) long-term security of supply – which must include various strategic and geopolitical matters, both on the domestic and the EU level, concerned with ensuring the proper diversification of supply and investments in infrastructure, in order to enable meeting the growing demand for gas, especially in the face of more and more powerful dependence on supply from Russia.

The political conditions of Poland’s energy security are undoubtedly more visible in the gas sector than in the electricity or oil sector. Among others reasons, this results from the fact that Poland cannot satisfy internal demand for gas from its own sources (which cover around one-third of domestic demand), thus it is forced to import. Currently Poland extracts from its own mineral deposits – via Polish Oil and Gas Company S.A. (PGNiG S.A.) (hereinafter PGNiG) – around 3.9 bln m³/ a year of gas and imports from Russia around 9.5 bln m³/ a year⁵. It is worth emphasizing that Russia, which has gas reserves estimated at 48 trillion cubic meters⁶ (approximately 35% of

³ There are obviously some other questions which could and even should be considered while discussing demand and supply for gas, e.g., long-term contracts for supplies and contracts of take or pay types. This topic however is far too broad for the present work.

⁴ For more on this topic see also: ‘Provisions on supply security in gas sector’, available at http://ec.europa.eu/energy/electricity/legislation/doc/notes_for_implementation_2004/security_of_gas_supply_en.pdf

⁵ B. Nowak, *Energy Policy of the EU. Chosen legal and political aspects and their implications for Poland*, WAIp, Warsaw 2009, p. 103.

⁶ The International Comparative Legal Guide to: Gas Regulation 2007. A practical insight to cross-border Gas regulation work – Russia. Global Legal Group, p. 197. See also M. Kaczmarek M., *Bezpieczeństwo energetyczne w Unii Europejskiej*, WAIp, Warszawa 2010.

world resources), is the main gas player in the EU, which possesses only 4% of world resources of natural gas⁷. Thus, Russia's enormous gas resources, coupled with great demand and the high price of this resource, enables Russia to use gas as a tool of political pressure, especially towards countries which do not possess sufficient resources and whose sources of acquiring gas are not diversified. Among those who purchase Russian gas such behaviour prompts them to ensure energy security, e.g., through diversification of gas supplies. Such diversification, however, is not only a problem for Poland or a few other Member States, but of the EU as a whole. Therefore, the diversification of sources of acquiring energy carriers should be treated from the EU perspective, or at least in terms of the internal energy market as far as gas supply go. The internal European gas market, in turn, favours diversification of sources of supply thanks to the closer integration and cooperation of domestic gas markets.

Additionally, the greater power and negotiating position of energy companies in the EU is an asset of an integrated market, which is important for ensuring for themselves energy sources on world markets, as results from a bigger choice of delivery systems and easier access to final users. This is particularly important in the case of the EU's strong dependence on one importer. Whereas in 2001 outside supply covered 31% of the EU's demand for natural gas, by 2025 the EU's import needs for gas will have grown to an estimated 60% of its consumption⁸. Besides all this, competitive markets favour achieving diversification because they are able to react more flexibly to changes of supply and demand on world markets. However, we need remember that there are still serious problems which impede the proper functioning of the integrated European gas market. This includes the lack of cross-border connections (interconnections) and the lack of proper LNG (Liquefied Natural Gas) infrastructure in countries having access to the sea.

Apart from infrastructure, another fundamental problem is the lack of a common position among the Member States as far as gas supplies are concerned, as this significantly hinders the formation of a consistent policy at the EU level. Some EU Member States negotiate long-term contracts, especially with Gazprom, being motivated rather more by domestic political reasons than the aim of taking care of supply security seen from the overall European perspective. From the point of view of Gazprom, the situation is obviously altogether convenient. It is clear that no highly liberalized market

⁷ N. Cornwall, 'International trade in gas and prospects for UK gas supplies' [in:] Robins C. (ed) *Regulating Utilities and Promoting Competition. Lessons for the Future*, Edward Elgar, 2006, p. 46.

⁸ *Ibidem.*, p. 45

in Europe would appeal to Gazprom business strategy, as Gazprom wishes to guarantee itself long-term contracts with large, dominant companies and does not opt for liquid markets, where smaller entities, placed lower in the chain of supply, will compete to buy energy resources from it. This understanding seems to have been confirmed by Sergey Korovin, Deputy Head of Gazprom's Foreign Economic Relations Department, in an interview with in *Gas Matters*⁹, when he said *Gazprom would rather negotiate with its old customers and stick to long-term contracts. Since that works, why change things?*

It is obvious that it is far easier for Gazprom to enter the European market through cooperation with large, dominant players instead of through developing contacts with small and scattered entities. Besides, the high prices of gas maintain Gazprom's strong position as a main actor on the European upstream market and possibly on the downstream market in the future, too. Among the methods for loosening the tight straitjacket imposed by Gazprom and diminishing the risk of lack of gas supplies for European industry (especially for the power industry) are the development of nuclear power, carbon capture storage technology, and renewable sources.

But even so, electricity generated from renewable sources does not diminish the risk of Europe gas supply being cut off, as gas is used for other aims than the production of electricity – namely, for heating, kitchen usage, and the nitrogen and petrochemical industries. As a matter of fact, the EU is now in quite a difficult situation., for the lack of solidarity and joint policy at the EU level gives Gazprom broader possibilities to negotiate upstream contracts with individual Member States. Unfortunately, one has to admit that the EU is partially responsible for this state of affairs. For instance, having signed the Energy Charter Treaty, the EU then lost its impetus in attending to its gas and oil negotiations with Russia at the end of the 90s. At that time the price of gas was relatively low and Russia direly needed the influx of foreign investment. For the gas companies of the EU this constituted a perfect opportunity for safeguarding their interests in supply and for starting cooperation with the state-owned Russian companies. Today, the price of gas is high and demand is constantly growing. Therefore, Russia is able to either develop its own technologies or buy them from independent partners without disposing of its own resources in favour of foreign companies. As a result, the future of the international agreements like the Energy Charter Treaty (which binds the countries which ratified it to open their energy markets for foreign companies) looks rather gloomy, at least for as long as the prices of gas stay high.

⁹ The dominant European entities resist the division of property, *Gas Matters* March 2007 p. 20.

The main obstacle for the Russian authorities, which did not ratify the Energy Charter Treaty, is the Energy Charter Transit Protocol, according to which the admission of foreign companies to national transport infrastructure is provided under internal tariffs. As a result countries such as Azerbaijan, Georgia, Kazakhstan, Turkmenistan, and Uzbekistan – having large oil and gas resources and desiring to transport them to the EU on favorable terms through the territory of Russia – would be able to do so under the umbrella of a legally binding Treaty. In fact, all these countries have signed and ratified the Energy Charter Treaty and are directly interested in Russia's ratification of the Energy Charter Treaty. Russia, on the other hand, is afraid that ratifying the Energy Charter Treaty will increase the influence of the Central Asian and Caspian countries on the world gas and oil market, and thus decrease Russia's control over commodity streams on the world market along with its dominant influence on political decisions in the region.¹⁰ Russian apprehensions are confirmed by the fact that the cost of gas in the Caspian countries is below the average in Russia. Therefore it is rather clear that Russia's ratification of the Energy Charter Treaty would increase deliveries of gas from Central Asia and the Caspian countries to the EU markets, thus potentially decreasing the flow of Russian gas to the EU.¹¹ From the EU perspective a wider spectrum of choices as to gas sources would not only increase the security of supply, but also reduce the price of gas delivered to Europe in general.

Lastly, it is of course true that Europe is dependent on gas from Russia. But the converse is also true: the EU is Russia's largest client. If Russia loses credibility as a reliable supplier of gas, it stands to lose future revenues. However, two main issues seem to hamper a healthy relationship between the EU and Russia when it comes to supplies of energy: Russia's refusal to ratify the European Energy Charter, and the liberalizing energy networks within Russia without granting to it access to the EU.¹²

Finally, taking into consideration the strong position of Russia on the energy resources market and their use as an element of foreign policy, it seems that the need to work out a common policy concerning the security of gas supplies to the EU is an issue of a great importance on the present stage of European integration.

¹⁰ For more on this see B. Nowak, *Energy Policy of the EU...*, p. 106.

¹¹ See for instance M. Nowacki's point of view, *Prawne aspekty bezpieczeństwa energetycznego w UE*, Wolters Kluwer, Warszawa 2010, p. 365.

¹² For more on this see "The EU's energy dilemma: with or without Russia?" *EU Business*, March 22, 2006. Available at: <http://www.eubusiness.com/Energy/russia.2006-03-22>.

III. Poland and its gas concerns

The problem with a joint energy policy, one that takes into account European dependence on gas imports (especially dependence on Russia), rests also on the disparity in perceptions toward Russia between new Member States and the old Member States. Poland, supported by the Baltic States, envisaged the European Union as an organization that would move quickly to reduce its energy dependence on Russia, and that the EU itself would adopt a much tougher and collective position in relations with Russia. But Germany and France did not seem to fathom the legacy of difficult relations with the Soviet Union for the CEE countries, and thus stated they were unwilling to isolate Russia, preferring instead to engage in a long-term energy relationship beneficial to both sides. For France and Germany, where imports of gas from Russia constitute around 30% of all imported gas, cooperation with Russia is not perceived as deeply threatening to the domestic security of supply. For Poland and other CEE countries, in turn, where dependence on Russian gas ranges between 60% and 100%, close cooperation with the former regional hegemon is politically hard to accept. Nevertheless, one has to remember that, apart from the political baggage, Russia is an important trading partner for Poland.

From the Polish perspective, a certain safeguarding of the continuity of gas supply and energy security *sensu largo* is seen in a section of the Lisbon Treaty, which deals in particular with energy solidarity among EU countries in the case of crisis in the supply of energy resources. Article 194 section 1 of the Treaty stipulates:

‘In the context of the establishment and functioning of the internal market and with regard for the need to preserve and improve the environment, Union policy on energy shall aim, in a spirit of solidarity between Member States, to: (...) b) ensure security of energy supply in the Union;’

The Treaty’s idea for security of supply and energy solidarity in the EU can only be safeguarded by properly functioning domestic energy systems. To achieve this the European Union supports the Member States in modernizing the old and building new elements of energy infrastructure system by secondary and soft law acts. In the Communication of the European Commission on the Report on progress in creating the internal gas and electricity market¹³, the Commission stated the following: ‘Access to new gas sources usually requires the construction of new transport infrastructure, pipelines or liquefied natural

¹³ The Communication of the European Commission to the Council and the European Parliament about the Report on progress in creating the internal gas and electricity market, {SEC(2005) 1448 p. 14.

gas (LNG) facilities. In this respect the EU will need to give increasing focus on the strategic dimension of its energy relations with third countries, particularly suppliers, and how their deepening can contribute to the functioning of the EU's energy markets. The recent decisions taken by investors to launch a number of new LNG terminal projects in the EU constitute progress in this respect. Other pipeline and LNG projects need to follow and the dialogue with gas-producing countries must be intensified. LNG imports from new producing regions are already becoming a competitive alternative in some cases.'

The Treaty's idea for energy solidarity among the EU Member States, however, deals with the situation where Member State X is in need and where Member State Y has appropriate resources and infrastructure to help. Now, Poland in the case of a general crisis in gas supplies to the EU would be altogether in need. The lack of underground storage and supply infrastructure alternative to pipelines such as LNG terminals, not only puts Poland in a bad situation in the case of supply disruptions through gas pipelines, but also weakens and limits its active participation in making key decisions for the functioning of the EU's gas market.

Here it is worth noting that Poland reacted suspiciously to the matter of including a separate energy chapter into the Lisbon Treaty. Poland's Euro-sceptic government at that time claimed that it would accept new articles on climate change and energy as long as doing so did not mean more powers for the EU. Ironically, at that very same time Poland was the most enthusiastic supporter of inserting into the Treaty an energy solidarity clause in the case of serious supply problems, thus undermining its own policy on the energy article. It seems that this position was a result of a certain lack of preparation with regard to energy issues.

In fact the inclusion of energy into the Treaty of Lisbon as an area of shared competencies should be perceived as an attempt to establish a 'special cooperation *modus operandi* between the Community and national governments in the interest of greater transparency with respect to energy markets. Transferring some of the energy competencies from the control of national governments to the EU level shall accelerate necessary changes in further liberalization of the electricity and gas markets.

The question of diversification of supply sources itself (meaning the security of supply and energy solidarity) is a particularly hot political issue in Poland – and in other countries of Central and Eastern Europe, as well. The difficult geographic and geopolitical location of these countries and strong dependence upon Russian resources (gas and oil) enhances the fact that Russia, to a great extent, particularly in the case of the Baltic countries, considers this part of the EU to be an area of its traditional influence. In connection with this, the

clause on energy solidarity in the case of crises in resource supplies (especially from the eastern direction) is perceived by the CEE countries' leaders as a protective device against Russian ambitions¹⁴. Additionally, Poland (as the other new EU Member States) is far more dependent on one source of gas supply – Russia – than are the old Member States. As a matter of fact, the difficult historical relations between Russia and the Central and Eastern Europe countries and the current policy of Russia towards the Baltic countries have a negative influence on the new Member States' perception of Russia as a main gas trade partner of the EU.

Hence, the close cooperation between Germany and Russia (as far as gas goes) is difficult to accept for decision-makers in Poland and the Baltic countries, which are afraid of Russia regaining domination in the region. Therefore the matter of diversification of gas supply sources became even more fiery after the German government strengthened relations with Russia and formed a consortium responsible for building Nord Stream (the Northern pipeline) along the bottom of the Baltic Sea. This project is perceived by political decision makers in the Central and Eastern Europe countries as an offence and as an instance of German selfishness in solving a problem that in fact concerns the EU as a whole. Poland, having been omitted from the project, feels its energy security is thereby imperiled. Moreover, the fact that Germany (more than others) has staked its bets on strengthening relations with Russia, allows us to speak of special or strategic relations between Russia and Germany. Such a special relation with regard to energy sources, especially between those two countries, is difficult to accept for the new Member States, and especially the Baltic countries.¹⁵

Some experts argue¹⁶ that the realization of this project will detach Polish and Western European security of supply, thus undermining European solidarity and the prospects for the emergence of a common external energy policy at the EU level. However this seems fairly unlikely especially in the case where the Nord Stream project is perceived by the European Commission as a strategic investment for European energy (gas) security. From the point view of Poland, the most negative element of the pipeline construction is

¹⁴ More on this topic – see also B. Nowak, *Bezpieczeństwo energetyczne Polski a bezpieczeństwa energetyczne Unii Europejskiej*, Krytyka Prawa. Niezależne Studia nad Prawem, Vol. 2 – *Bezpieczeństwo* red. Wojciech Sokolewicz, WAiP, Warszawa 2010.

¹⁵ For more on this see A. Rahr, *Germany and Russia: A special Relationship*. The Center for Strategic and International Studies and the Massachusetts Institute of Technology, 2007, p. 1. See also A. Gusev, *Energy Relations between the European Union and Russia: content, problems, prospects*. Institut European des Hautes Etudes Internationales, Nice 2008, pp. 68–74. Available at: <http://www.iehei.org/bibliotheque/memoires2008/Gusev.pdf>.

¹⁶ E. Wyciszkievicz, 'One for All – All for One – The Polish Perspective on External European Energy Policy' (2007) 8 *Foreign Policy in Dialogue* 20, pp. 34–44.

the fact that Poland will lose out considerably as a transit country: after all, that status has been essential in negotiation policy towards the Russian partner. Paradoxically, the recent conclusion of Polish-Russian negotiations regarding the Jamal gas contract might also provide some complications for Polish energy policy. Namely, the Russian national champion – Gazprom – in the course of negotiations gave up its moderate control over gas transit on Polish territory to Germany (Gazprom is using around 75% of the Jamal pipeline capacity by sending yearly 34 billion cubic meters to Germany and around 9.5 billion cubic meters to PGNiG SA). EuRoPol Gaz¹⁷, which so far has been the system operator for the Jamal pipeline, was replaced by the Gaz-System (Polish state-owned transmission system operator). This may be considered a very sophisticated move, whereby with Gazprom giving up control over transit, it seeks to relocate in the future its gas delivery to German to the newly constructed pipeline Nord Stream, slowly downgrading transit through the Jamal. This of course would further and significantly diminish the role of Poland as a transit country. From the Russian perspective, omitting transit countries (thus avoiding transit fees) shall be considered an important factor behind the decision to construct Nord Stream. It seems that Poland now has nothing to do but to join the already begun investment into Nord Stream and quickly finish construction of its LNG terminal, which will partially diversify the sources of gas supply. Germany might be a very good example here. It acquires gas from four sources: (i) from home, (ii) from the North Sea, (iii) from Russia, and (iv) from import of liquefied gas (LNG) from the Arab countries. Such diversification – 20–30% from each direction – makes Germany independent of sundry political and economic turbulences. What is more important, it enables Germany to maintain a flexible and economically rational gas policy.

In the case of Poland a certain complement to import by gas pipelines and to an LNG terminal might be the extraction of shale gas. One should remember, however, that this is a complicated, expensive process which for the time being does not guarantee the safeguarding of Poland's gas interest. Thus, Poland should invest in new technologies, but not resign from already accepted and functioning solutions. Moreover, the long-term contract signed by Poland (excluding Gazprom) with the companies Statoil (Norway) and DONG (Denmark) to import gas seem to be a rational solution to diversify the supply of this resource.

¹⁷ EuRoPol Gaz Transit Pipeline System was incorporated as a joint stock company on September 23, 1993. The company consisted of three shareholders: PGNiG SA (48% of shares), Gazprom (48% of shares), and Gas-Trading (4% of shares). Gas-Trading conducts business in the field of investment, manufacturing, trade, and services – as well as foreign trade. EuRoPol Gaz was mainly responsible for the operation and maintenance of the Jamal gas pipeline.

We should bear in mind, however, that diversification of sources of gas supply must run parallel to the development of infrastructure, which means modernization and development of transmission pipelines, interconnections with neighbouring countries, and gas underground storage facilities. In Poland's case this is even more important, because the majority of Polish gas pipelines run from east to west. Thus, to make maximum use of the contracts with the Scandinavian countries, a transmission network from the north to the south, connected with the east-west network, is needed. Interconnections with Germany, the Czech Republic, and Slovakia (which are slated for construction), would in fact have a double impact on Polish energy security. On the one hand, cross-border connections would significantly improve the security of supply, since in the event of any disruption in supply from the east, Poland could receive gas supplies from the west. On the other hand, it would increase competition on the domestic market, since there would be more gas on the Polish market which is not shipped and delivered by the national champion (PGNiG S.A.).

In Poland, where gas is imported mainly from the east, and through the territory of several countries, we see the problem of relations with countries of unstable political and economic systems (e.g., Belarus, less so Ukraine), what with their inclinations to make use of their own infrastructure as a factor in achieving their own objectives in regional policy. Any breaks in supply continuity inevitably have a negative impact on Polish industry, and at the same time on the country's energy security.

The strategic element of gas infrastructure that far more strengthens the security of gas supplies and the independence of the directions of supplies is the LNG terminal. Recent events regarding the problems of gas supplies to the EU clearly indicate the necessity to possess expanded infrastructure.

The European Community, aware of the uncertainty which dominates the energy resources markets, in 2004 issued a directive of the Council 2004/67/EC¹⁸ concerning measures to safeguard the security of natural gas supplies. This directive was recently repealed by regulation No 994/2010 of October 20, 2010 concerning measures to safeguard the security of gas supplies¹⁹. The aim of the 2004/67/EC directive, as well as regulation no. 994/2010, was to ensure an adequate level of security of gas supplies to Member States, which contributes to the proper functioning of the internal gas market expressed in directive 2003/55/EC (repealed by directive 2009/73/EC) dealing with the

¹⁸ Council Directive 2004/67/EC of 26 April 2004 concerning measures to safeguard security of natural gas supply, OJ [2004] L 127/92.

¹⁹ Regulation No 994/2010 of the European Parliament and Council of 20 October 2010 concerning measures to safeguard security of gas supply, OJ [2010] L 295/1.

common rules for creating an internal gas market²⁰. Due to the principle of subsidiary, directive 2004/67/EC did not impose on Member States strictly defined means for achieving the aim of the secure functioning of the domestic gas systems, but only suggests certain measures which are intended to lead to that aim. One of the main devices for implementing the policy of supply security indicated in the directive is nothing other than an LNG terminal. Regulation no. 994/2010 also points out LNG terminals as an important tool for securing gas supplies. In fact, regulation no. 994/2010 also supports regional cooperation involving natural gas enterprises, Member States, and national regulatory authorities designed to enhance the security of supply and the integration of the internal energy market. This includes the three regional gas markets under the Gas Regional Initiative: (i) the Gas Platform, (ii) the High Level Group of the Baltic Energy Market Interconnection Plan, and (iii) the Security of Supply Coordination Group of the Energy Community. Poland's integration with neighbouring countries through interconnections shall be seen as an important step toward securing gas supplies.

Returning to the LNG terminal, it should be pointed out that all the biggest EU countries (Germany, France, Great Britain, Italy, and Spain) possess at least one LNG terminal. If Poland (with the same population as Spain) wishes to matter in the game and be a partner in gas dialogue with the biggest countries and Russia, it must have an infrastructure which is complementary (if not alternative) to the pipeline infrastructure. In other words, Poland's lack of an LNG terminal is a great obstacle to pursuing a viable policy of diversifying energy sources. One example of such a viable policy of diversification is the Polish oil sector. For although almost 90% of the oil used in Poland comes from import – almost all of it from Russia – it is gas, not oil, which is the bigger problem today.

Poland has the possibilities of oil import in an amount satisfying the country's needs – by the pipeline *Przyjaźń* (*Friendship*) and by sea through Naftoport in connection with the points in the North Harbour in Gdańsk. The trans-ship capacity of Naftoport is now 23 mln tons²¹. Together with the trans-ship capacity of the points in the Northern Harbour in Gdańsk this gives around 34 mln tons a year, with domestic demand for oil in 2008 being around 18.5 mln tons.²² Moreover, the last modernization of Naftoport (above all the basin enlargement, which introduced tankers to Naftoport with a displacement

²⁰ Directive 2003/55/EC of the European Parliament and of the Council of 26 June 2003 concerning common rules for the internal market in natural gas, OJ [2003] L 176/57, as amended by the directive 2009/73/EC of the European Parliament and of the Council of July 13 2009 concerning common rules for the internal market in natural gas, OJ [2009] L 211/94.

²¹ <http://www.naftoport.pl/index.php?n=16>.

²² www.pern.com.pl.

of over 300 thousand tons), enables the transit of Russian oil through the territory of Poland in two new directions: to the US and to China.

The transit of a volume of 10 mln tons does not only considerably increase the rank of Naftoport on the Baltic sea, but above all positively impacts Poland's energy security. This is because on the territory of Poland there is more oil (in transit) that could (in a crisis situation) be redirected to the needs of the Polish refining industry. Nothing prevents similar solutions from being adopted in the gas sector.

The building of an LNG terminal is a long and expensive process. Moreover, the world LNG market (due to a great increase of demand) is now the producer's market and it is the latter that decides about the attractiveness and the risk of a given project. In connection with this it is advisable to find a strategic partner who could manage a minority block of shares in the investment. This should be a partner who not only has experience in LNG technology, but also a wide network of contacts with LNG producers. It could also be an LNG producer. What is more, the rule of buying capacity in different terminals to sell gas where it is the most advantageous has become popular among the producers.

IV. Conclusions

The present practice of individual Member States to take important energy-related decisions without consulting or assessing their impact on other Member States hampers the coordination of energy policy and the establishment of common objectives for the EU as a whole. Another important issue is the endowment of Member States with natural resources. Some of the countries are producers (such as the UK and the Netherlands), while the majority are energy-importing countries. As a result there is a great variation in the level of import dependence among EU countries, which fact, apart from the disparity in relations with Russia among Member States, creates a rather difficult obstacle to energy market integration. Other significant reasons impeding a joint approach in energy policy include differences in the energy mixes of the Member States and the divergent structure of national energy sectors. This predetermines different national energy priorities and sets the pattern for respective energy policies such as protectionism. Protectionist trends are most visible in France and Poland. The first fears that in an open market it could lose its national champions, and the second that its energy sector will end up under Russian control, giving rise to energy insecurity. Finally, additional infrastructure must be built to strengthen the existing networks and ensure the development of cross-border markets, as these measures would likely improve

the security of supply, guarantee a high level of public service, and maximize the benefits expected by consumers.

To overcome the domination of national interests, the EU does not only have to work out a common energy policy, but EU institutions together with Member States have to create a competitive internal European energy market and a system of energy solidarity in the case of supply crisis to the EU. Possible cooperation would involve: diversification of resource supplies and sources and types of energy carrier; building elements of market cooperation between energy sectors; and creating stable conditions for investments. The EU Reform Treaty (The Lisbon Treaty) in its provisions concerning energy should constitute an impulse to act in the area of common energy policy. It should also be the basis for issuing a range of legal acts pertaining to the energy solidarity expected by Poland and other new EU Member States. However, to put theory into practice, the EU as a whole will not only have to create proper rules of the game, e.g., anti-crisis plans, but also support the investment process in expanding energy infrastructure involving LNG terminals, underground storage facilities, pipelines, and interconnections between systems. The role of the particular Member State is to establish the political and legal frameworks needed for the network to be developed, in particular by promoting major gas supply infrastructure projects especially within the European Union, but outside it, too. For then those solutions, in connection with the European internal energy market, will allow the Member States to possess comparable energy mixes and import dependencies in line with their similar interests and expectations towards a common energy policy.

Finally, since economic indicators show that the current demand for energy services greatly exceeds the available supply, Poland's growing energy needs will require both domestic and foreign direct investment. The opening of the energy sector to private investment as a mean of alleviating energy shortages in Poland's transition economy is not an option but a necessity that over the years has become increasingly urgent. Poland suffers from a long-standing lack of investments in production capacity and infrastructure (re: transmission pipelines, underground storage, LNG terminals). In order to attract potential strategic investors, the Polish government must reduce the risk that its current policies pose: it must significantly enhance transparency in government institutions and create a governmental climate favourable to economic growth. Rapid increases in energy demand require solutions that attract domestic and foreign capital. The Polish government needs a policy that reflects the interest of investors and consumers who in the long run will pay for the necessary investments in energy security.

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The Obligation of Strategic Gas Storage Introduced in Poland as an Example of a Public Service Obligation Relating to Supply Security: A Question of Compliance with European Law

Maria Mordwa *

CONTENTS

- I. Introduction
- II. The EU legal framework of public service obligations in the gas sector
- III. Compliance with the gas strategic storage obligation, as set out in the Act on Fuel Reserves and the Proposal of November 3, 2010 with EU law
 - 1. Compliance with the provisions of Article 3(1) of Directive 2003/55/C
 - 2. Compliance with the requirement of justifiability of intervention in the general economic interest
 - 3. Compliance with the requirement that public service obligations must be clearly defined, transparent, non-discriminatory, and verifiable
 - 4. Compliance with the principle of proportionality and the “interest of the Union” principle
- IV. Conclusions

Abstract

This paper presents the system for the strategic storage of gas imposed by the Act on Fuel Reserves and evaluates its compliance with the relevant provisions of EU law, in particular the so-called 2nd and 3rd Internal Energy Market Packages. Unlike the case of legislation on strategic oil stocks, EU legislation on gas does not impose on Member States any obligation to maintain strategic reserves of gas. Furthermore, Member States are obliged to implement common rules establishing an internal market in natural gas including Third Party Access (TPA) to storage facilities. However, Member States are allowed to impose on undertakings operating in the gas sector, in the general economic interest, public service obligations which may relate to supply security, and EU law recognizes the contribution of gas storage to the security of supply. Thus, the objective of this article is to evaluate

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whether the Act on Fuel Reserves as well as the amendments to it proposed by the Polish Ministry of the Economy are in line with the relevant provisions of EU law. The analysis includes the position of the Court of Justice presented in several judgements as regards the concept of public service obligations.

Résumé

Ce document présente le système de stockage stratégique de gaz imposé par la loi sur les réserves en essence et évalue la conformité de ce système avec les provisions de la loi européenne et plus particulièrement les 2ème et 3ème paquets sur le marché intérieur de l'énergie. Contrairement à certaines législations sur les stocks pétroliers stratégiques, la législation européenne pour le gaz n'impose pas aux États membres une obligation de maintenir un stock stratégique en gaz. En outre, les États membres sont obligés d'appliquer des règles communes établissant un marché interne du gaz comprenant de l'accès des tiers aux installations de stockage. Cependant, ils sont autorisés à imposer aux entreprises opérant dans le secteur du gaz, dans l'intérêt économique général, des obligations de service public qui peuvent porter sur la sécurité d'approvisionnement et les lois européennes reconnaissent les installations de stockage comme un moyen essentiel, entre autres, de mettre en oeuvre les obligations de service public telle que la sécurité des approvisionnements. Donc l'objectif de cet article est d'évaluer si la loi sur les réserves en fuel et ses amendements proposés par le ministère de l'économie polonaise sont en accord avec les lois européennes correspondante. Cette analyse inclus notamment plusieurs jugements de Cour de justice concernant les obligations de service public.

Classifications and key words: public services obligations, security of supply of natural gas, obligation of strategic gas storage, TPA to storage facilities.

I. Introduction

The access to gas storage facilities in Poland is regulated by the Act of 10 April 1997 – the Energy Law (hereafter, the Energy Law)¹. Starting from 2004 it has been evolving in order to comply with EU energy law, including implementation of Directive 2003/55/EC². It will be amended further in order to implement Directive 2009/73/EC³. It provides for designation of a Storage

¹ Consolidated text: Journal of Laws 2006 No. 89, item 625, as amended.

² Directive 2003/55/EC of the European Parliament and of the Council of 26 June 2003 concerning common rules for the internal market in natural gas and repealing Directive 98/30/EC, OJ [2003] L 176/57.

³ Directive 2009/73/EC of the European Parliament and of the Council of 13 July 2009 concerning common rules for the internal market in natural gas and repealing Directive 2003/55/

System Operator (hereafter, SSO) for gas storage facilities located on Polish territory, and also requires the SSO to comply with numerous obligations⁴, including offering storage services to all system users on a non-discriminatory basis. The Energy Law provides for regulated access to all storage facilities located on Polish territory, as well as for the organization of access to ancillary services⁵. Therefore, the SSO is obliged to offer storage as well as ancillary services to system users on the basis of published tariffs, provided that none of the conditions for refusing access to the system is fulfilled⁶.

The demand for storage services in Poland is driven by two factors. The first regards the daily and seasonal variations of natural gas demand as is natural in every Member State. In particular, seasonal storages are used to manage the increase of demand in winter and the decrease of demand in summer. Small-scale storage facilities (salt caverns), which have a lesser volume of gas and

EC, OJ [2009] L 211/94. Directive 2009/73/EC introduces significant amendments to Directive 2003/55/EC and to Regulation (EC) No. 1775/2003 of the European Parliament and of the Council of 28 September 2005 on conditions for access to the natural gas transmission networks (OJ [2005] L 189/1) with regard to third-party access to storage. However, Directive 2009/73/EC does not introduce substantial changes to the organization of public service obligation (which will be analyzed in the following sections of the Paper). In particular, Articles 3(1) and 3(2) of Directive 2003/55/EC remained unchanged (Articles 3(1) and 3(2) of Directive 2009/73/EC have the same wording as the relevant Articles of Directive 2003/55/EC). Directive 2009/73/EC is to be implemented by March 3, 2011.

⁴ Provided for in Article 9c of the Energy Law Act and in line with Article 8 of Directive 2003/55/EC.

⁵ Storage facilities are defined in Article 2(9) of Directive 2003/55/EC, nevertheless the legal position of natural gas storage in Directive 2003/55/EC is unclear. First, Directive 2003/55/EC provides definitions for five types of storage facilities: storage used for production operations, storage used for excluding facilities reserved exclusively for transmission system operators in carrying out their functions, a facility used for the stocking of natural gas (natural gas storage), the part of LNG facilities or LNG terminals used for storage, temporary storage necessary for the re-gasification process and subsequent delivery to the transmission system (temporary LNG storage). However, only natural gas and liquefied natural gas (LNG) storages are subject to the TPA regime for gas storage under Directive 2003/55/EC. Second, Directive 2003/55 provides for two different perceptions about the legal position of TPA Storage in different Articles of Directive 2003/55/EC, as the concept of 'available capacity' in Article 21 is not the same as the capacity of TPA storage under the 'TPA Necessity Condition' in Article 19 [...]. The problem was, at least to some extent, addressed in Directive 2009/73/EC. According to Article 33 of Directive 2009/73/EC, the portion of storage facilities falling under the access to storage rule is further delimited. In particular, Member States that limit application of the TPA rule only to the storage facilities and linepack when 'technically and/or economically necessary for providing efficient access to the system for the supply of customers, as well as for the organization of access to ancillary services' are obliged to define and publish criteria according to which the access regime applicable to storage facilities and linepack may be determined

⁶ For more information refer to: A. Falecki, M. Mordwa, 'Komentarz do art. 4c' [in:] M. Swora, Z. Muras (eds.), *Prawo energetyczne. Komentarz*, Warszawa 2010, pp. 338–348.

higher output capacity, are to provide short-term flexibility during cold snaps. In Poland the seasonal and daily swing of gas consumption is a relatively important factor due to climate conditions and the vast share of natural gas supply being consumed for households and heating purposes⁷. According to the Commission's working document, Member States from the Baltic Region have the highest heating degree days, and therefore the highest demand for heating in the EU (Poland was the eighth country on the list)⁸. The second factor for demand for storage in Poland stems from the need to comply with requirements imposed on undertakings – namely, the legal obligation of maintaining strategic storage of natural gas on Polish territory. Mandatory gas stocks and mandatory use of gas from gas stocks for households was also introduced in Hungary (45 days of gas demand) and Portugal (15–20 days of gas demand), Spain (20 days of consumption – 10 days as strategic, and 10 days as commercial storage)⁹.

According to the Act on Fuel Reserves¹⁰ every undertaking which is shipping natural gas to Poland or supplying customers on Polish territory with natural gas not originating from domestic production is obliged to keep strategic storage of gas on Polish territory. The amount of natural gas to be stored shall equal the volume of natural gas shipped to Poland by the undertaking during an average 30 days of its operation. Nonetheless, the level of 30-days reserve of natural gas will be required from October 1, 2012 and the Act on Fuel Reserves provides for the progressive timetable of achieving this target starting from the level of an 11-day reserve of natural gas from the day of implementation of the Act on Fuel Reserves¹¹. Undertakings that are shipping to Poland less than 50 million cubic meters of natural gas and supplying fewer than 100,000 customers may receive an exemption from this obligation from the Minister of the Economy. Such exemption is valid for one year.

In Poland all underground gas storage facilities belong to the Polish Oil and Gas Company S.A. (hereafter, PGNiG). In 2009 and 2010 the company

⁷ 'National Report from the President of the Energy Regulatory Office in Poland', July 2008, p. 72 (available at: http://www.ure.gov.pl/portal/en/17/67/Activity_Report.html). The demand for gas is highly seasonal in the countries where a large part of the demand for gas stems from household temperature-dependant gas consumption and at the same time the share of imported gas to a country is substantial ('Study on natural gas storage in the EU (draft final report)' (2008) 10 *Ramboll*; see: IEA – Gas Trade Flows in Europe; available at: <http://www.iea.org/gtf/index.asp>).

⁸ Commission staff working document, accompanying document to the proposal for a regulation of the European Parliament and of the Council concerning measures to safeguard security of gas supply and repealing Directive 2004/67/EC. Assessment report of directive 2004/67/EC on security of gas supply, SEC (2009) 978, Table: Winter Comparison, p. 18.

⁹ *Ibidem*, p. 23.

¹⁰ Articles 24 and 25 of the Act of 16 February 2007 on Reserves of Oil, Oil Products, Natural Gas and on Procedures in Case of Emergency in Security of Fuel Supply and Disturbance on Oil Market (*Journal of Laws* 2007, No. 52, item 343, as amended).

¹¹ Article 74 of the Act on Fuel Reserves.

operated underground gas storage facilities of a total working capacity equal to 1.630 billion m³ and covered from 30 to 50 days (12%) of domestic gas consumption depending on climate conditions¹². PGNiG made 50 million m³ of storage capacity available to OGP Gaz-System SA in connection with its transmission system operator function. The remaining storage capacity, including capacities offered on the basis of Third Party Access (TPA) requirements, was used for PGNiG's needs¹³.

PGNiG uses storage facilities not only in order to ensure the continuity of gas supply to its customers, but also to fulfill the strategic storage of gas obligation imposed by the Act on Fuel Reserves. On May 30, 2009 the strategic reserves kept by PGNiG totaled 296 million m³ of gas. In 2009 seventeen undertakings holding a license to ship gas to Poland did not keep a strategic gas reserve. Thirteen of them were not subject to the strategic storage of gas obligation as they had not begun the activity of shipping gas to Poland (Elcom, PKN Orlen, Pol Aqua, Megagaz, Gas Trading, Energia Trading, ZA Puławy, Ekoenergia, Bartimpex, Emfesz, ZA Anwil, Polenergia, Petro Wigor) and the four remaining received exemption from the Minister of the Economy (Handen, KRI, CP Energia, EWE energia)¹⁴.

The impact of the Act on Fuel Reserves on competition on the gas market in Poland is undeniably negative. The President of the Energy Regulatory Office (*Prezes Urzędu Regulacji Energetyki*; hereafter, the URE President) identified the strategic storage obligation as one of the impediments to the development of a competitive gas market in Poland¹⁵. In 2006 and 2007, the URE President initiated two dispute settlement proceedings regarding PGNiG's refusal to

¹² 'Monitoring report of security of gas supply issues from Minister of the Economy from 1 January 2009 to 31 December 2009', p. 31 (available at: <http://www.mg.gov.pl/Gospodarka/Ropa+i+gaz/Sprawozdania>).

¹³ PGNiG-Storage System Operator Division operates: 1) five underground storage facilities located in the depleted fields (UGS Wierzchowice, UGS Husów, UGS Strachocina, UGS Swarzów, UGS Brzeźnia) – used as seasonal storages serving to cope with seasonal demand as well as to fulfil strategic storage obligation; 2) one smaller scale storage facility located salt caverns (UGS Mogilno); 3) three remaining storage facilities used for production operations (UGS Daszewo, UGS Bonikowo, UGS Kosakowo) and thus excluded from the scope of the definition of 'storage facility' (refer to <http://www.pgnig.pl/osm/magazyny>). According to the PGNiG – Storage System Operator Division, the Storage service rules, from May 17, 2010, storage service are provided through the storage installations: a) CUGS Mogilno, b) Virtual Storage Installation consisting of UGS Husów and UGS Wierzchowice a) CUGS Mogilno, b) Virtual Storage Installation consisting of UGS Husów and UGS Wierzchowice (document available at: <http://www.pgnig.pl/osm/uslugi/zasady/18482>).

¹⁴ 'Annual Activity Report from the President of the Energy Regulatory Office in 2009', March 2010, p. 92 (available at <http://www.ure.gov.pl/porta1/pl/423/2916/Sprawozdania.html>).

¹⁵ The URE President pointed out that in 2007 PGNiG didn't offer any storage services to system users and only used storage capacities for its own use in order to ensure continuous gas

provide storage services to two enterprises: Emfesz NG Polska sp. z o.o. and Media Odra Warta sp. z o.o.¹⁶ PGNiG justified refusal to grant access to storage facilities on the grounds of a lack of available capacity. Moreover, in January 2009, the URE President denied PGNiG an exemption from Third Party Access (TPA) to storage requirements on the grounds of Take-or-Pay obligations.

Simultaneously to the proceedings carried out by the URE President, on November 28, 2007, the European Commission initiated infringement proceedings against Poland in order to verify whether the provisions regarding storage facilities included in the Act on Fuel Reserves and the Energy Law were infringing Directive 2003/55/EC (Directive 2009/73/EC), as along with Directive 2004/67/EC (Regulation 994/2010)¹⁷. The European Commission pointed out that there was no SSO for storage facilities located in Poland and that storage services were not provided to third parties, as well as that the provisions on strategic storage obligation were infringing competition on Polish, as well as on EU markets¹⁸. Subsequently, on December 31, 2008 the PGNiG Storage System Operator Division was designated by the URE President as an SSO for the period from January 1, 2009 to December 31, 2025 and implemented TPA to storage¹⁹. In July 2009 the SSO conducted an open season procedure in order to allocate available storage capacity to the market participants²⁰. Eventually, in the Act of January 8, 2010 introducing amendments to the Energy Law Act, the Polish Parliament adopted provisions strengthening the competences of the URE President in the procedure for

supply to the customers ('National Report from President of the Energy Regulatory Office in Poland', July 2008, p. 50).

¹⁶ The proceeding was initiated on the basis of Article 8(1) of the Energy Law (replay from March 2008 of W. Pawlak, Minister of Energy to MP interpellation No. 753, available at: <http://orka2.sejm.gov.pl/IZ6.nsf/INTop/00753?OpenDocument>).

¹⁷ Council Directive 2004/67/EC of 26 April 2004 concerning measures to safeguard security of natural gas supply, OJ [2004] L 127/92.

¹⁸ The infringement proceeding initiated by the Commission against Poland (Infringement No 2006/4918) originally was to verify that the provisions regarding storage facilities included in the Act on Fuel Reserves and the Energy Law Act are not in compliance with Art. 3(1), 7, 8(1)(b) and (d) and Art. 19 of Directive 2003/55/C as well as Article 3(2) of Directive 2004/67/EC (M. Nowacki, *Prawne aspekty bezpieczeństwa energetycznego w UE*, Warszawa 2010, p. 136).

¹⁹ SSO adopted on May 17, 2010 Storage Service Rules (Storage Services Code), received on 16 June 2009 a approval from the URE President of Gas Storage Services Tariff No. 1/2010 (effective from July 1, 2009); documents available at <http://www.osm.pgnig.pl/osm>.

²⁰ However, the only undertaking that applied for available storage capacity was PGNiG ('National Report to the European Commission from the President of the Energy Regulatory Office in Poland', July 2010, p. 62; available at http://www.ure.gov.pl/portal/en/17/67/Activity_Report.html). This raises concerns as to whether the Storage Services Code together with conducted allocation procedure were in line with Directive 2003/55/EC especially as regards requirements of competitiveness and non-discrimination.

designating a system operator and thus ensured compliance of the Energy Law with the provisions of Directive 2003/55/EC. Therefore, the European Commission limited its further investigation to the issue of compliance of the provisions on strategic storage of gas with EU law²¹.

In order to adjust the provisions on strategic storage of gas with EU law, as well as to address concerns raised by the European Commission, the Ministry of the Economy on June 2, 2010 launched public consultations on a proposal of the Act amending the Act on Fuel Reserves (hereafter, the Proposal of November 3, 2010)²². According to the Proposal of November 3, 2010 the obligation to maintain strategic storage of gas imposed by the Act on Fuel Reserves will be sustained. Nevertheless, it contains several provisions mitigating the negative impact of the strategic storage obligation to competition on the gas market. As a result the Proposal of November 3, 2010:

- 1) limits the categories of undertakings being subject to the strategic storage obligation – at present the obligation is imposed on every undertaking shipping natural gas to Poland or supplying customers on Polish territory with natural gas not originating from domestic production. According to the Proposal of November 3, 2010 only undertakings performing the activity of supplying customers on Polish territory with natural gas not originating from domestic production will be subject to the strategic storage obligation, thus undertakings that perform only the activity of shipping natural gas to Poland in particular in order to use it for their own consumption will be exempted from this obligation;
- 2) increases the limits for an undertaking to be eligible to receive an exemption from the obligation of strategic storage – at present exemption from this obligation may be issued by the Minister of the Economy only to undertakings shipping to Poland less than 50 million cubic meters of natural gas and supplying less than 100,000 customers. According to the Proposal of November 3, 2010 these limits will be 100 million cubic meters of natural gas and 100,000 customers;
- 3) entitles newcomers to apply to the Minister of the Economy for exemption from strategic storage obligation – at present the Minister of the Economy denies an exemption from strategic storage obligation to undertakings interested in shipping gas to the Polish market on the grounds that Article 24 of the Act on Fuel Reserves provides only for

²¹ Commission Press release No. IP/10/945, Brussels, July 14, 2010.

²² The Proposal of November 3, 2010 of the Act on amendment of the Act on Reserves of Oil, Oil Products, Natural Gas and on Procedures In Case of Emergency In Security of Fuel Supply and Disturbance on Oil Market and of the Energy Law Act, version 1.0015. The Proposal of November 3, 2010 incorporates comments given by stakeholders during consultation process (documents available at: <http://bip.mg.gov.pl/node/11962>).

- exemption of undertakings that are already active on the Polish Market²³, according to the Proposal of November 3, 2010 also undertakings that received from the President of the ERO pre-license for trading natural gas with other countries are entitled to apply to the Minister of the Economy for exemption;
- 4) enables undertakings to use gas storages in another Member State, provided that: i) storage facilities located in another Member State are directly connected to the gas system²⁴; ii) technical parameters of storage facilities and of the grids to which these storage facilities are connected are such that they guarantee possible injection of all the gas kept in order to comply with the strategic storage obligation to the Polish transmission system within no more than 40 days; and iii) the undertaking receives consent from the Minister of the Economy to keep strategic gas reserves outside Polish territory based on the opinion of the transmission system operator that the shipper has presented substantiated proof that gas will be physically injected into the Polish transmission system within 40 days.

II. The EU legal framework of public service obligations in the gas sector

Both Directive 2003/55/EC as well as Directive 2009/73/EC seek to complete the internal market in natural gas and to speed up liberalization in this sector with a view to achieving a fully operational internal market. Pursuant to Recital 1 of Directive 2009/73 ‘the internal market in natural gas, which has been progressively implemented throughout the Community since 1999, aims to deliver real choice for all consumers of the European Union, be they citizens or businesses, new business opportunities and more cross-border trade, so as to achieve efficiency gains, competitive prices, and higher standards of service, and to contribute to security of supply and sustainability.’ Consequently, Article 3(1) of Directive 2003/55/EC (Directive 2009/73/EC) imposes on Member States the obligation to ensure that ‘natural gas undertakings are operated in accordance with the principles of this Directive with a view to achieving a competitive, secure and environmentally sustainable

²³ ‘Activity Report of the President of the Energy Regulatory Office’, July 2008, p. 74.

²⁴ According to Article 24a(1) of the Proposal of November 3, 2010 the strategic storages of gas may be kept in storage facilities on the territory of another Member State directly connected to the ‘gas system’. In Article 2(24) of the Act on Fuel Reserves ‘gas system’ is defined as ‘gas grids together with connected to them facilities and installations cooperating with the grids, as well as installations located on Polish territory used for introduction of gas to Polish territory and distribution of it on Polish territory’.

market in natural gas, and shall not discriminate between these undertakings as regards either rights or obligations.’ The implementation of the internal market in natural gas is strengthened further by Article 3(5) of Directive 2009/73/EC imposing on Member States the obligation to ensure that ‘all customers connected to the gas network are entitled to have their gas provided by a supplier, subject to the supplier’s agreement, regardless of the Member State in which the supplier is registered, as long as the supplier follows the applicable trading and balancing rules and is subject to security of supply requirements. In this regard, Member States shall take all measures necessary to ensure that administrative procedures do not constitute a barrier for supply undertakings already registered in another Member State.’

However, the foregoing provision of Article 3(1) of Directive 2003/55/EC (Directive 2009/73/EC) is ‘without prejudice to paragraph 2’ of this Article which provides that ‘having full regard to the relevant provisions of the Treaty, in particular (Article 106 of Treaty on the Functioning of the European Union (hereafter, TFEU), Member States may impose on undertakings operating in the gas sector, in the general economic interest, public service obligations (PSO)²⁵ which may relate to security, including security of supply (...). Such obligations shall be clearly defined, transparent, non-discriminatory, verifiable and shall guarantee equality of access for EU gas companies to national consumers.’ As stated in Recital 27 of Directive 2003/55/EC compliance with public service requirements ‘is a fundamental requirement of this Directive, and it is important that common minimum standards, respected by all Member States, are specified in this Directive, which take into account the objectives of (...) security of supply and equivalent levels of competition in all Member States. It is important that the public service requirements could be interpreted on a national basis, taking into account national circumstances and subject to the observance of Community law.’ The power of Member States to impose PSO is subject to verification by the European Commission, since according to Article 3(6) of Directive 2003/55/EC (Article 3(11) of Directive 2009/73/EC) Member States are obliged to inform the European Commission of all measures adopted to fulfill public service obligations and their possible effect on national and international competition.

The above-mentioned provisions apply equally to undertakings performing the activity of storage of natural gas in storage facilities. According, to Recital 6 of Directive 2003/55 ‘the main obstacles in arriving at a fully operational

²⁵ Directive 2003/55 does not define the term ‘public service obligations’. However, under EU law, Article 2 of Council Regulation No. 1191/69 of June 26, 1969 concerning PSOs in inland transport (OJ [1969] L 156) defines PSOs as ‘obligations which the undertaking ..., if it were considering its own commercial interests, would not assume or would not assume to the same extent or under the same conditions’.

and competitive internal market relate to, amongst other things, issues of (...) access to storage (...)’²⁶. The core provision, as far as the regulatory framework for operating storage facilities is concerned, constitutes Article 19 of Directive 2003/55/EC (Article 33 of Directive 2009/73/EC) which imposes on Member States the obligation to choose either or both of the procedures for the organization of access to storage facilities and linepack (negotiated or regulated access regime) and ensure that the TPA system is operated in accordance with objective, transparent, and non-discriminatory criteria. Furthermore, according to Article 21 of Directive 2003/55/EC access to storage facilities can be refused on the grounds of lack of capacity, PSO, and take-or-pay (ToP) problems²⁷.

As stated above, PSO, including these imposed on an SSO, may relate to security, including security of supply. Directive 2003/55/EC recognizes the fundamental role that storage facilities can perform in the Member States’ security of energy supply policy. In Recital 21 of Directive 2003/55/EC it is stated that ‘storage facilities are essential means, amongst other things of implementing public service obligations such as security of supply’. However, ‘this should not lead to distortion of competition or discrimination in the access to storage.’ The European Commission is of the position that ‘a clear and transparent definition of Public Service Obligations, as required by Article 3(2) of Directive 2003/55/EC (Article 3(2) of Directive 2009/73/EC), in terms of storage capacities is considered an indispensable prerequisite for refusal of access to storage facilities on the grounds of PSOs. If PSOs are not in line with the requirements of Article 3(2) of Directive 2003/55/EC, as well as (Regulation 2010/994²⁸), they cannot constitute grounds for refusing access to storage’²⁹.

²⁶ The same logic was followed in Directive 2009/73/EC introducing obligation of legal and functional unbundling of OSM as well as strengthening the transparency requirements in respect of the storage capacity that is offered to third parties.

²⁷ For more see: B. Nowak, *Wewnętrzny rynek energii w Unii Europejskiej*, Warszawa 2009, pp. 102–123.

²⁸ Regulation (EU) No. 994/2010 of the European Parliament and of the Council of 20 October 2010 concerning measures to safeguard security of gas supply and repealing Council Directive 2004/67/EC (OJ [2010] L 295/1); Regulation 994/2010 repeals from December 2, 2010 Directive 2004/67/EC with the exception of Article 4(1) and (2) of that Directive which shall apply until the Member State concerned has defined protected customers in accordance with Article 2(1) of this Regulation and has identified the natural gas undertakings in accordance with Article 8(1) of this Regulation. Nonetheless, Article 4(1) and (2) of Directive 2004/67/EC shall no longer apply after June 3, 2012.

²⁹ Note of DG Energy & Transport on Directives 2003/54/EC and 2003/55/EC on the internal market in electricity and natural gas, third party access to storage facilities, 16.1.2004, p. 9; ‘Commission staff working paper: interpretative note on Directive 2009/73/EC concerning common rules for the internal market in natural gas third-party access to storage facilities’, 22 January 2010, p. 15 (both documents are available at: http://ec.europa.eu/energy/gas_electricity/interpretative_notes/interpretative_note_en.htm).

Further requirements for PSO related to security of supply are laid down in Directive 2004/67/EC and in Regulation 2010/994 repealing Directive 2004/67/EC. According to Article 3(2) of Directive 2004/67/EC Member States are obliged to ensure that the measures to safeguard security of natural gas supply adopted on the basis thereof do not place an unreasonable and disproportionate burden on gas market players and thus distort competition, and are compatible with the requirements of a competitive internal gas market, i.e., are not discriminatory³⁰. The Annex of Directive 2004/67/EC presents a non-exhaustive list of instruments which should enhance the security of gas supply. One of the instruments mentioned therein consists of working gas in storage capacity, and withdrawal capacity in gas storage. The Annex to Directive 2004/67/EC does not provide any further specifications or details of the suggested instruments, their importance, nor any relation between them, their impact on the security of gas supply, nor any preferences towards a particular measure. Although the Directive does not mandate any gas storage targets, it puts a strong emphasis on this instrument, as it is the only instrument facilitating security of supply which is specifically addressed in Directive 2004/67/EC. According to Recital 7 of Directive 2004/67 'indicative minimum targets for gas storage could be set either at the national level or by industry'. Those indicative targets, if set, 'should not create any additional investment obligations'. Furthermore, according to Article 4(6) of Directive 2004/67 such minimum storage targets should be published for transparency reasons.

Also, the Annexes of Regulation 2010/994 provide a non-exhaustive list of security of gas supply measures to be used by Member States. Usage of strategic gas storage may be introduced only as a non-market based measure applied in the event of an emergency. Therefore, neither Directive 2004/67/EC nor Regulation 994/2010 introduced an EU-level obligation as regards strategic storage of gas. The European Commission strongly encourages all Member States to support the development of commercial storages, but does not propose an EU-level obligation as regards strategic stocks. This is due to the fact that Member States have different levels of exposure to risks and hence different gas supply security requirements. A country with diversified gas import or a high share of own production, good level of interconnections with neighbours, developed market and high fuel switching possibilities (high share of industry or power generation consumption) may be less exposed to risks and may develop less expensive measures than strategic stocks to deal efficiently with supply shortages. Furthermore, geological conditions in certain areas may

³⁰ The requirements for PSO introduced in Article 3(2) of Directive 2004/67/EC are sustained in Article 3(6) of Regulation 994/2010. Furthermore, Article 3(6) of Regulation 994/2010 requires that the measures to ensure the security of supply do not endanger the security of gas supply of other Member States or of the Union as a whole.

also limit the development of gas storage facilities. Moreover, according to European Commission estimations stockpiling of natural gas is several times more expensive when compared to oil stocks³¹. Therefore, the European Commission is of the opinion that strategic stocks might be the preferable or midterm solution only for countries with single-source dependence and a high share of uninterrupted demand. The European Commission also pointed out that if a Member State chooses strategic gas stocks as a national measure, 'the use of strategic stocks has to be carefully regulated to avoid market distortions: strategic stocks should not be released in non-crisis situations to influence the value of storage and other flexibility instruments that are developed under competitive market conditions'³². According to the European Commission strategic storages of gas are 'still considered a storage facility under the definition of the Gas Directive', as Directive 2003/55/EC (and Directive 2009/73/EC) 'does not provide for special treatment of such storages, but it allows Member States to take such measures under Article 3(2) Gas Directive under strict conditions, requiring a notification to the European Commission under Article 3(11) Gas Directive'³³.

III. Compliance with the gas strategic storage obligation as set out in the Act on Fuel Reserves and the Proposal of November 3, 2010 with EU law

1. Compliance with the provisions of Article 3(1) of Directive 2003/55/EC

The provision on strategic storage provided by the Act on Fuel Reserves is designated as a measure to safeguard an adequate level for the security of gas supply. According to the Polish government's Statement of Reasons

³¹ The cost per unit of energy for gas is approximately 16.7 MEUR per PJ, compared to 3.33 for oil. Commission staff working document, accompanying document to the proposal for a regulation of the European Parliament and of the Council concerning measures to safeguard security of gas supply and repealing Directive 2004/67/EC. 'Assessment report of directive 2004/67/EC on security of gas supply', SEC (2009) 978, Table: Winter Comparison, p. 24.

³² Communication from November 13, 2008 from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of Regions on the Directive 2004/67/EC of 26 April 2004 concerning measures to safeguard security of natural gas supply, COM(2008) 769 final.

³³ 'Commission staff working paper: interpretative note on Directive 2009/73/EC concerning common rules for the internal market in natural gas third-party access to storage facilities', January 22, 2010, p. 14.

for the Act on Fuel Reserves³⁴, the Act on Fuel Reserves implements into Polish law Directive 2004/67/EC. According to Article 24(1) of the Act on Fuel Reserves, the stockpiling of natural gas is destined to be used exclusively in emergency situations; therefore natural gas is inaccessible under normal market conditions.

The measure obviously restricts competition, as it imposes a burden on enterprises shipping natural gas to Poland or supplying customers on Polish territory with natural gas originating not from domestic production, in the form of obligatory strategic storage of gas on Polish territory. Thus the gas strategic storage obligation is not in line with Article 3(1) of Directive 2003/55/EC (Directive 2009/73/EC).

As mentioned above, however, Article 3(2) of Directive 2003/55 (Directive 2009/73/EC) allows Member States to derogate from general provisions on compliance with common gas market principle of Article 3(1) of Directive 2003/55/EC (Directive 2009/73/EC) when introducing public service obligations. The term 'services of general economic interest' is specific to EU law³⁵. Moreover, neither EU Treaties, nor the EU energy acts analyzed above give definition of that expression. As provided for in the TFEU, in particular Articles 14 and 106 thereof and as confirmed in Protocol No. 26 on services of general interest, annexed to the Treaty on European Union and to the Treaty on the Functioning of the European Union, Member States are primarily responsible for defining what they regard as services of general economic interest on the basis of the specific features of the activities³⁶. However, this definition can be subject to control by the European Commission for 'manifest error'³⁷. A 'manifest error' would occur when the measure employed

³⁴ Sejm RP of V term, document No: 1238, available at: <http://www.sejm.gov.pl>.

³⁵ M. Stoczkiewicz, *Pomoc państwa dla przedsiębiorstw energetycznych w prawie UE*, Warszawa 2011, p. 205.

³⁶ Protocol No. 26 on services of general interest, annexed to the Treaty on European Union and to the Treaty on the Functioning of the European Union specifies that '[t]he shared values of the Union in respect of services of general economic interest within the meaning of Article 14 of the Treaty on the Functioning of the European Union include in particular: the essential role and the wide discretion of national, regional and local authorities in providing, commissioning and organising services of general economic interest as closely as possible to the needs of the users; the diversity between various services of general economic interest and the differences in the needs and preferences of users that may result from different geographical, social or cultural situations; a high level of quality, safety and affordability, equal treatment and the promotion of universal access and of user rights', OJ [2008] C 115/308.

³⁷ Refer to European Commission in Communication from 20 September 2000 on Services of General Interest in Europe Brussels, COM(2000) 580 final, paragraph 22.

is incompatible with EU law or with criteria established by the European Court of Justice³⁸.

In order to be in line with EU law it is indispensable for public service obligations in the gas sector to ensure their compliance with the requirements defined in Article 3(2) of Directive 2003/55/EC (Directive 2009/73/EC) and in Article 3(2) of Directive 2004/67/EC (Article 3(6) of Regulation 994/2010). It follows from the wording of these EU legislative acts that for a PSO to be introduced it must: be in the general economic interest, be clearly defined, transparent, non-discriminatory, verifiable, guarantee equality of access for UE gas companies to national consumers and thus do not distort competition, as well as have full regard to the relevant provisions of the TFEU, in particular Article 106 thereof.

Hence, it is necessary to analyze the compatibility of the stockpiling of natural gas measure introduced in the Act on Fuel Reserves with the conditions set out in above-mentioned provisions.

2. Compliance with the requirement of justifiability of intervention in the general economic interest

Article 3(2) of Directive 2003/55/EC incorporates the concept of the PSO into the list of measures for the organization of the gas sector and permits Member States to impose certain burdens on undertakings operating in the gas sector. Thus, the provision allows Member States wide discretion in assessing whether, in the general economic interest, it is necessary to impose public service obligations on undertakings operating in the gas sector in order, in particular, to ensure the security of gas supply to final consumers. Nevertheless, it follows from Article 3(2) of Directive 2003/55/EC that in each case when creating a PSO the Member State is obliged to examine whether a task of general economic interest exists.

As regards the issue of justifiability of intervention in the general economic interest there is no definition of that expression in Directive 2003/55/EC, but the reference in Article 3(2) of Directive 2003/55/EC both to that condition and to Article 106 TFEU, which concerns undertakings entrusted with the management of a service of general economic interest, implies that the

³⁸ Refer to E. Gromnicka, 'Komentarz do art. 16 Traktatu ustanawiającego Wspólnotę Europejską' [in:] A. Wróbel, D. Miąsik, N. Półtorak (eds.), *Traktat ustanawiający Wspólnotę Europejską. Komentarz, Tom 1*, Warszawa 2008, p. 430, as well as M. Szydło, 'Komentarz do art. 86 Traktatu ustanawiającego Wspólnotę Europejską' [in:] A. Wróbel, K. Kowalik-Bańczyk, M. Szwarc-Kuczer (eds.), *Traktat ustanawiający Wspólnotę Europejską. Komentarz, Tom 2*, Warszawa 2009, p. 518.

condition should be interpreted in light of the latter provision of the TFEU³⁹. The Court of Justice has specifically addressed the formula of public service obligation provided for in Article 106(2) TFEU. It has stated that Article 106(2) of TFEU, in allowing, in certain circumstances, derogations from the general rules of the Treaty seeks to reconcile the Member States' interest in using certain undertakings, in particular in the public sector, as an instrument of economic or fiscal policy with the Community's interest in ensuring compliance with the rules on competition and preservation of the unity of the common market. Therefore, Member States cannot be precluded, when determining the services of general economic interest which they entrust to certain undertakings, from taking account of objectives pertaining to their national policy or from endeavouring to attain them by means of obligations and constraints which they impose on such undertakings⁴⁰.

The Court of Justice has held a large and varied group of services to be of general economic interest. In case C-393/92 *Municipality of Almelo and Others*, the Court of Justice accepted, with respect to a regional undertaking entrusted with electricity distribution, that the uninterrupted supply of electricity throughout the territory in respect of which the concession is granted to all consumers, whether local distributors or end-users, in sufficient quantities to meet demand at any given time, at uniform tariff rates and on terms which may not vary save in accordance with objective criteria applicable to all customers, is a task of general economic interest within the meaning of Article 106(2) of TFEU⁴¹. In case C-159/94 *European Commission v French Republic*, the Court of Justice recognized as public service obligations, the obligations of gas supply, continuity of gas supply, and equal treatment between customers or consumers⁴². Advocate General Ruiz-Jarabo Colomer in his opinion delivered in Case C- 265/08 *Federutility* enumerates the conditions for the provision of services of general economic interest – namely, that the service should be: uninterrupted (continuity); for the benefit of all consumers throughout the

³⁹ Opinion of Advocate General Ruiz-Jarabo Colomer delivered on October 20, 2009 C-265/08 *Federutility, Assogas, Libarna Gas SpA, Collino Commercio SpA, Sadori gas SpA, Egea Commerciale, E.On Vendita srl, Sorgenia SpA v Autorità per l'energia elettrica e il gas* (not yet reported), para. 40–46.

⁴⁰ Judgements of the European Court of Justice: 202/88 *France v Commission* ECR [1991] I-1223, para. 12; C-157/94 *Commission v Netherlands* ECR [1997] I-5699, para. 39, 40; Case C-67/96 *Albany International BV v Stichting Bedrijfspensioenfonds Textielindustrie* ECR [1999] I-05751, para. 103, 104; C-265/08 *Federutility, Assogas, Libarna Gas SpA, Collino Commercio SpA, Sadori Gas Srl, Egea Commerciale Srl, E.On Vendita Srl, Sorgenia SpA v Autorità per l'energia elettrica e il gas*, para. 28, 29.

⁴¹ C-393/92 *Municipality of Almelo and others v NV Energiebedrijf Ijsselmij* ECR [1994] I-01477, para. 48.

⁴² C-159/94 *Commission v French Republic* ECR [1997] I-5815, para. 89, 96.

relevant territory (universality); at uniform tariff rates and of similar quality, irrespective of specific situations or of the degree of economic profitability of each separate transaction (equality); and transparent and affordable⁴³.

The security of gas supplies raises serious concerns. The primary supply instruments are measures like diversifying the risk of disruption and financing pipeline construction, and long-term contracts with producers. Other instruments to provide security of supply include measures to increase system flexibility (e.g., fuel switching, interruptible contracts, cross-border pipeline capacity and liquid spot markets). However, these mechanisms have a limited capacity to absorb shocks that would endanger all the Member States at the same time, similar in scale to the gas supply disruptions in the EU that have occurred on several occasions (the most significant in January 2006 and 2009 with respect to gas supplies from Russia through Ukraine). To ensure uninterrupted services in the short-medium term, precautionary gas storage is indispensable⁴⁴. Against this background and taking into account that both Directive 2004/67/EC as well as Regulation 994/2010 allow for using gas strategic storage as a non-market based security of gas supply measure to be applied only in the event of an emergency, the objective of ensuring continuity of gas supply to final consumers in case of disruption of gas supply constitutes grounds for ‘general economic interest’ and justifies public intervention designed as the gas strategic storage obligation⁴⁵.

Nevertheless, it is indispensable that the other conditions of Directives 2003/55/EC and 2004/67/EC be met.

3. Compliance with the requirement that public service obligations must be clearly defined, transparent, non-discriminatory, and verifiable

As mentioned above, from Article 3(2) of Directive 2003/55/EC (Directive 2009/73/EC) and from Article 3(2) of Directive 2004/67/EC (Article 3(6) of Regulation 994/2010) it follows that measures designed as a PSO must be: clearly defined, transparent, non-discriminatory, verifiable, and must guarantee equality of access for UE gas companies to national consumers.

In particular, a measure would be discriminatory if in reality intervention were to lead to imposing the burden arising from the intervention only on

⁴³ See the Opinion of Advocate General Ruiz-Jarabo Colomer in case C-265/08 *Federutility*, para. 54, 55.

⁴⁴ The dependency on storage and its flexibility was clearly demonstrated in January 2009 when most MS doubled the gas supply from their storages in comparison to January 2008 [...]

⁴⁵ In Poland disruptions of gas supplies occurred in 2004, 2006 and 2010, refer to the Polish governments Statement of Reasons of the Act on Fuel Reserves, point 1 (The aim of the Act).

some of the undertakings active in the gas market. The requirement thus seeks to ensure that PSO binds all of the undertakings equally, so as to prevent the lack of competition from becoming worse⁴⁶. The European Commission states that ‘in determining the storage needs for fulfilling PSOs, there must be no discrimination against newcomers, i.e., new market entrants taking PSOs must be given the same right and their storage needs for PSOs must be taken into account in the same manner as for the incumbent companies’⁴⁷. The European Commission is of the opinion that the only way to effectively guarantee non-discrimination is to use a competitive tendering process to carry out public service obligation.

According to the European Commission and in line with established Court of Justice case-law the criterion of transparency is met when the public service task is assigned in the way of an official public instrument ‘that may take the form of a legislative or regulatory instrument or a contract or instruction’. Furthermore, the European Commission states that “this official instrument must specify: the nature of the public service obligations, the undertakings and territory concerned, the responsibility for determining the undertaking’s selling prices and the conditions for reviewing such prices, the nature of any exclusive or special rights assigned to the undertakings, the amount of any compensation granted to the undertakings and any revision clauses, as well as the period covered by these obligations.”⁴⁸

As regards the criterion of verifiability, the European Commission, in the note on public services obligations from 2004, states that it will be assured when the measure chosen is the least restrictive possible for competition and trade between Member States. Moreover, according to the European Commission the burden of proof lies with the public authorities which impose the measure or with the undertaking if, in the context of the internal subsidiary of the Member State, it can choose the measure to fulfill the objective imposed on it⁴⁹.

As far as the issue of non-discrimination is concerned it must be noted that the strategic storage obligation as framed in the Act on Fuel Reserves is imposed on every undertaking that ships natural gas to Poland or supplies

⁴⁶ See the Opinion of Advocate General Ruiz-Jarabo Colomer in case C-265/08 *Federutility*, para. 81.

⁴⁷ ‘Commission staff working paper: interpretative note on Directive 2009/73/EC concerning common rules for the internal market in natural gas third-party access to storage facilities’, 22 January 2010, p. 15; available at: http://ec.europa.eu/energy/gas_electricity/interpretative_notes/interpretative_note_en.htm.

⁴⁸ Note of DG Energy & Transport on Directives 2003/54/EC and 2003/55/EC on the internal market in electricity and natural gas, public services obligations, 16.01.2004, p. 5 (available at: http://ec.europa.eu/energy/gas_electricity/interpretative_notes/interpretative_note_en.htm).

⁴⁹ *Ibidem*, pp. 6–8.

customers on Polish territory with natural gas not originating from domestic production. Therefore, it does not apply to the undertakings performing the activity of gas production from domestic sources⁵⁰. Neither does the Act on Fuel Reserves provide the possibility of exempting from the strategic storage obligation those undertakings interested in commencing the shipment of gas to the Polish market, as it only allows for exemption of undertakings that are already active on the Polish market and fulfill the conditions introduced in Article 24 of the Act on Fuel Reserves⁵¹. Moreover, the Act on Fuel Reserves includes the territorial clause, as the strategic storages of gas must be kept in storage facilities located on Polish territory. It can be seen from the above that the measure on strategic gas storage from the Act on Fuel Reserves infringes EU law as it is not compatible with the requirement of non-discrimination. The Proposal of November 3, 2010 introduces several changes (presented in the first section of the Paper) in order to adjust the Act on Fuel Reserves to the requirement of non-discrimination. Nevertheless, it must be pointed out that even after the Proposal of November 3, 2010 enters into force, still this criterion will not be met, as the Proposal does not impose the PSO on domestic production.

Regarding the second criterion, the obligation to maintain strategic storages of gas is imposed on undertakings by the official instrument – namely, the Act on Fuel Reserves, which is of a general nature. Also, the Act on Fuel Reserves specifies most of the details for implementing the PSOs enumerated by the European Commission. A separate issue is whether the provisions on the stockpiling of natural gas are accurately and exhaustively designed. As far as the issue of compensation granted to the enterprises, the Act on Fuel Reserves provides that the costs of keeping the strategic storage of gas are to be treated as justified costs and thus can be reimbursed through the tariffs for gas sold on Polish territory (Article 28(1) and 2 of Act on Fuel Reserves). Moreover, according to Article 45(1) of the Energy Act, undertakings investing in or maintaining storage facilities are ensured that the tariffs cover the justified costs of such investment but also the rate of return of not less

⁵⁰ In Poland, domestic production provides an important part of gas mix as it satisfies almost 31% of domestic demand; however, the provision can be justified on the grounds that domestic production doesn't involve the same risks as imports, therefore there is no need to impose security measures on undertakings performing this activity. Nevertheless it should be noted that PGNiG has an almost 100% share in domestic production subsector ('National Report to the European Commission from the President of the Energy Regulatory Office in Poland', July 2010, p. 8, 14, 65) is subject to the obligation of maintaining strategic gas storages due to its gas import activity.

⁵¹ 'National Report from the President of the Energy Regulatory Office in Poland', July 2008, p. 74.

than 6%⁵². Therefore, it can be evaluated that this criterion is in principle met. Nevertheless, the revision clause should be introduced to the Act on Fuel Reserves.

As far as the criterion of verifiability is concerned, it is worth remembering that the Court of Justice in Case C-159/94 *European Commission v French Republic* stated that ‘it is not necessary, in order for the conditions for the application of Article 106(2) of the TFUE to be fulfilled, that the economic viability of the undertaking entrusted with the operation of a service of general economic interest should be threatened. It is sufficient that, in the absence of the rights at issue, it would not be possible for the undertaking to perform the particular tasks entrusted to it, defined by reference to its public-service obligations. (...) Whilst it is true that it is incumbent upon a Member State which invokes Article 106(2) of the TFUE to demonstrate that the conditions laid down in that provision are met, that burden of proof cannot be so extensive as to require the Member State, when setting out in detail the reasons for which, in the event of elimination of the contested measures, the performance of the tasks of general economic interest under economically acceptable conditions would, in its view, be jeopardized, to go even further and prove, positively, that no other conceivable measure, which by definition would be hypothetical, could enable those tasks to be performed under the same conditions’⁵³. Therefore, the position of the European Commission appears to be very restrictive and does not take into account the position of the Court of Justice, which agreed that the measure should be the least restrictive possible but placed the burden of proof on the European Commission. Moreover, it should be noted that the scope of verifiability criterion, as defined by the European Commission in the note on public services obligations from 2004, is similar to the criterion of proportionality and the ‘interest of the Union’ introduced by the Court of Justice and thus will be discussed in the next section.

⁵² The latter provision seems to be designated in principle as a measure to promote investment in the new storage facilities, as it limits the risk for the investor as regard costs recovery. Investment in the storage facilities, in particular seasonal storages are considered to be of high risk. These risks are the uncertainty over overall costs of the investment (storage facilities are not only capital-intensive but also the costs of cushion gas are not precisely known upfront), as well as uncertainty over future flow of income (for more information see: M.-K. Codognet, J.-M. Glachant, ‘Weak investment incentives in new gas storage in the United Kingdom?’, p. 10, available at: <http://www.grjm.net/documents/M-K-Codognet/CodognetGlachantUKstorage.pdf>).

⁵³ C-159/94 *Commission v French Republic* ECR [1997] I-5815, para. 89, 96, 101.

4. Compliance with the principle of proportionality and the “interest of the Union” principle

As mentioned above, it follows from Article 3(2) of Directive 2003/55/EC (Directive 2009/73/EC) that the measures designed as a PSO must be adopted in a manner having full regard for the relevant provisions of the TFEU, in particular Article 106 thereof. The Article provides, first, that undertakings entrusted with the operation of services of general economic interest are subject to the rules on competition insofar as the application of such rules does not obstruct the performance, in law or in fact, of the particular tasks assigned to them, and, secondly, that the development of trade must not be affected to such an extent as would be contrary to the interests of the Union.

The first part of Article 106(2) TFEU establishes the so-called proportionality test. Thus, the foregoing provisions do not preclude the freedom of Member States to impose a gas strategic storage obligation, provided the measure is designed so as to fulfill the requirement of proportionality. The Court of Justice provides in case-law all the necessary indications for that purpose in regard to the law of the Union. In case C-265/08 *Federutility*, the Court of Justice applied the proportionality test in order to evaluate the compliance with EU law of the measure whereby *Autorità per l'energia elettrica e il gas* of Italy defined “reference prices” for the supply of natural gas⁵⁴.

First, the measure must be of a temporary nature. As a PSO is an exception to the rules of the internal market⁵⁵ ‘it must be limited in duration to what is strictly necessary’. The Court of Justice states that ‘the mere fact that the national law in question labels the intervention as temporary is not in itself sufficient for a finding that it is proportionate from the point of view of its duration’. Moreover, relevant national law should require the administration to ‘make a periodic re-examination, at close intervals, of the need for it to intervene in the gas sector and the manner of its doing so, having regard to the development of that sector’.

Secondly, ‘the method of intervention used must not go beyond what is necessary to achieve the objective which is being pursued in the general economic interest’.

Thirdly, the measure, in order to be proportional, must limit the beneficiaries of the state measure: in particular, the level of protection for final consumers should be higher than that of the commercial users, since the situation of

⁵⁴ C-265/08 *Federutility, Assogas, Libarna Gas SpA, Collino Commercio SpA, Sadori gas SpA, Egea Commerciale, E.On Vendita srl, Sorgenia SpA v Autorità per l'energia elettrica e il gas*, para. 33–43.

⁵⁵ This can be derived from the fact that Article 3(2) of Directive 2003/55/EC, providing a legal basis of the PSO, is an exception to the provisions of Article 3(1) of Directive 2003/55/EC.

undertakings is different from that of domestic consumers – moreover, there are objective differences between the undertakings themselves, according to their size⁵⁶.

In considering the above, it should be noted that the requirement does not prevent Member States to impose a gas strategic storage obligation, provided it is well designed. In this regard it should be noted that neither the Act on Fuel Reserves nor the Proposal of November 3, 2010 provides for a temporary nature of the strategic storage obligation. On the contrary, according to Article 74 of Act on Fuel Reserves, undertakings subject to this obligation will in time be obliged to increase the strategic storages of gas in order to achieve the required level of 30-days reserve of natural gas. Also, the foregoing provisions do not require the administration to make a periodic re-examination at close intervals in order to adapt the PSO to changing situation. Thus, neither the Act on Fuel Reserves nor the Proposal of November 3, 2010 allow taking into account the result of investments currently developed in Poland that would involve substantial changes in the way the gas industry is run in Poland. As several times underlined in this paper, storage services are not the unique flexibility source for gas supplies. Flexible production fields, flexible importing contracts together with a sufficient portfolio of interruptible contracts with industrial customers, as well as access to spot market for gas may constitute a substitute for gas storage. These tools will become more available to the smaller undertakings when the above-mentioned investments will be accomplished.

As far as the second requirement is concerned, it is obvious that the strategic storage of gas obligation is a strong intervention into the market. In that respect, it should be evaluated whether this is the most effective measure and if the objective of ensuring the security of gas supply could be achieved by using other instruments. It is to be noted that the Act on Fuel Reserves introduces two instruments to enhance security of gas supply: gas strategic storage obligation and limitation of gas supply to non-protected consumers, i.e., consumers to whom more than 417 m³/hour of gas is supplied from the exit point of the gas network to which they are connected⁵⁷. Meanwhile, in Annex A to Directive 2004/67/EC there is a much wider non-exhaustive list of instruments which may be used in order to achieve the security of supply standards⁵⁸. Moreover, the European Commission, in the Communication

⁵⁶ C-265/08 *Federutility, Assogas, Libarna Gas SpA, Collino Commercio SpA, Sadori Gas Srl, Egea Commerciale Srl, E.On Vendita Srl, Sorgenia SpA v Autorità per l'energia elettrica e il gas*, para. 35–42.

⁵⁷ For more information refer to footnote 66.

⁵⁸ These instruments are: working gas in storage capacity, withdrawal capacity in gas storage, provision of pipeline capacity enabling diversion of gas supplies to affected areas, liquid tradable gas markets, system flexibility, development of interruptible demand, use of alternative back-up

‘Second Strategic Energy Review’⁵⁹, supported by the European Council in March 2009⁶⁰, pointed that, ‘there is insufficient evidence at this stage for the EU to decide upon obligatory strategic gas stocks. Strategic gas stocks cost at least five times more than oil stocks. A more effective approach is to promote the development and effective transparent operation of commercial storages, diverse supply connections enabling flexible sourcing from LNG or neighbouring providers within the EU internal market, and rapid demand reduction through interruptible contracts and fuel switching especially in electricity generation’. This philosophy of supporting the tools increasing the flexibility of the gas market, like demand-side measures, combined with a focus on stronger integration of the internal market is also reflected in Regulation 2010/994. Also, the Study on natural gas storage in the EU shows that gas storages are not the only tool of flexibility on the supply side that can cover swing demand as this purpose can be also achieved by indigenous production and natural gas imports⁶¹. These instruments are however positively correlated with market shares and are more available to the incumbent than to new entrants. Therefore, in practice a new entrant has no flexibility tools available but storage. Moreover, even if the duplication of storage is considered economically viable by new entrants, it would require suitable sites and a long time span to carry out investment. The discussed measure on strategic storage not only doesn’t support competition on the gas market but enables to the incumbent company prevent the follower from extending its market shares by hoarding storage capacity.⁶² In this regard and having taken into account that the availability and distribution of market storage resources are considered among the causes of market foreclosure in Europe and the access to existing storage remains a regulatory issue, the lack of profound economic

fuels in industrial and power generation plants, cross-border capacities, cooperation between transmission system operators of neighbouring Member States for coordinated dispatching, coordinated dispatching activities between distribution and transmission system operators, domestic production of gas, production flexibility, import flexibility, diversification of sources of gas supply, long term contracts, investments in infrastructure for gas import via re-gasification terminals and pipelines.

⁵⁹ In the Communication from November 19, 2008, from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions, Second Strategic Energy Review, An EU energy security and solidarity action plan, COM (2008) 781, p. 12.

⁶⁰ European Council Conclusions from March 19/20, 2009, point 24 (available at: <http://www.consilium.europa.eu>).

⁶¹ ‘Study on natural gas storage in the EU, Draft Final Report by Ramboll Oil & Gas from October 2008’, p. 49.

⁶² P. Bertolotti, A. Cavaliere, A. Tordi, ‘The Regulation of Access to Gas Storage with Capacity Constraints’, First Draft, 7 February 2008, available at: www.economia.unipv.it/pagp/pagine_personali/pberto/papers/StorageBCT3.pdf.

analysis of other measures to ensure PSO for security of supply in the Polish government's Statement of Reasons for the Act on Fuel Reserves (as well as the Polish government's Statement of Reasons for the Proposal of 3 November 2010) raises doubts as regards the conformity of the measure with Article 106 of TFUE.

As for the third requirement, i.e., the limited scope of beneficiaries of the state measure, it must be pointed out that neither the Act on Fuel Reserves nor the Proposal of November 3, 2010 differentiate the scope of beneficiaries of the strategic storage obligation. In particular, every undertaking which is shipping natural gas to Poland or supplying customers on Polish territory with natural gas originating from other than domestic production is obliged to keep strategic storage of gas in Poland, regardless of to whom the gas is being delivered. However, the Council of Ministers Regulation on the introduction of limitation to the gas supply leaves small consumers outside the group of consumers who may suffer limitation of gas supply in the case of gas supply disruption.⁶³ In this way it differentiates the beneficiaries of the PSO, although there is no difference between the level of protection of households and other small consumers. Thus, the provision will have to be modified, in order to be in line with Regulation 2010/994 and the definition of protected customers.

Without prejudice to the proportionality test, the second part of Article 106(2) TFEU seeks to ensure that the measure adopted does not affect the development of trade to such an extent 'as would be contrary to the interests of the Union'. Advocate General Ruiz-Jarabo Colomer in his opinion delivered in case C-265/08 *Federutility* states that, even though the Court of Justice stated in its case-law⁶⁴ that it was incumbent on the European Commission to define the interest of the Union, these statements can be explained by the rules governing the burden of proof in infringement proceedings. Thus, 'in order to find that there is a detrimental effect on intra-community trade within the meaning of Article 106(2) of TFEU, unlike the classic concept of measures having an effect equivalent to a quantitative restriction, proof would be required that the measure in issue has substantially disrupted the operation of the internal market'⁶⁵. According to Article 3(6) of Directive 2003/55/EC (Article 3(11) of Directive 2009/73/EC) Member States are obliged to

⁶³ According to paragraph 4 of the Council of Ministers Regulation of September 19, 2007 on the introduction of limitation to the gas supply (Journal of Laws 2007, No. 178, item 1252), limitation of gas supply cannot be imposed on consumers if less than 417 m³/hour of gas is supplied from the exit point of the gas network to which they are connected.

⁶⁴ See the following judgements of the Court of Justice: C-157/94 *Commission v Netherlands* ECR [1997] I-5699; C-158/94 *Commission v Italy* ECR [1997] I-5789; C-159/94 *Commission v French Republic* ECR [1997] I-5815; C-160/94 *Commission v Spain* ECR [1997] I-5851.

⁶⁵ Opinion of Advocate General Ruiz-Jarabo Colomer in case C-265/08 *Federutility*, para. 78.

inform the European Commission of all measures adopted to fulfill public service obligations and their possible effect on national and international competition. Thus, the provision allows the European Commission to verify whether a measure established by a Member State, in accordance with the principle of subsidiary, on the basis of Article 3(2) of Directive 2003/55/EC (Directive 2009/73/EC) is in the interest of the Union and does not affect the developments of trade to such an extent contrary to the interests of the Union. The European Commission stated that ‘from 1 July 2007, the Community interest will include compliance with full competition’⁶⁶.

IV. Conclusions

The provision on strategic storage is introduced as a measure to safeguard an adequate level of security of gas supply, according to the Polish government’s Statement of Reasons for the Act on Fuel Reserves. The measure obviously restricts competition and thus is not in line with Article 3(1) of Directive 2003/55/EC (Directive 2009/73/EC). It might however be justified on the basis of Public Service Obligation in line with Article 3(2) of Directive 2003/55/EC (Directive 2009/73/EC) and Article 3(2) of Directive 2004/67/EC (Article 3(6) of Regulation 994/2010). Both Directive 2004/67/EC and Regulation 994/2010 allow for using strategic gas storage as a non-market based security of gas supply measure to be applied only in the event of an emergency, and gas storage is recognized as the most flexible tool to ensure uninterrupted services in the short-medium term. Therefore, the objective of ensuring continuity of gas supply to final consumers, even in the case of disruption of gas supply, does justify public intervention designed as the strategic storage of gas obligation. Nevertheless, it is indispensable that the other conditions of Directives 2003/55/EC and 2004/67/EC be met.

In this regard it must be evaluated that the measure on strategic gas storage provided in the Act on Fuel Reserves, even after being amended by the Proposal of November 3, 2010 will not fully comply with EU legislation. In particular, the Polish provisions on strategic storage do not fully heed the proportionality principle. First of all, the measures are not of a temporary nature, nor do they require the administration to make a periodic re-examination, at close intervals, of the need for it to intervene in the gas sector and of the manner of its doing so, in regard to the development of that sector. On the contrary, according to Article 74 of the Act on Fuel Reserves enterprises subject to this obligation

⁶⁶ Note of DG Energy & Transport on Directives 2003/54/EC and 2003/55/EC on the internal market in electricity and natural gas, public services obligations, 16.01.2004.

will in time be obliged to increase the strategic storage of gas. Secondly, the discussed provision does not introduce an alternative to the strategic storage flexibility tools. As a result the measure on strategic storage not only does not support the availability of gas storages for smaller enterprises, but enables the incumbent company to prevent the follower from extending its market shares by hoarding storage capacity. Thirdly, the measure on strategic gas storage provided in the Act on Fuel Reserves is not compatible with the non-discrimination clause. The Proposal of November 3, 2010 introduces several changes (presented in the first section of the Article) in order to adjust the Act on Fuel Reserves to the requirement of non-discrimination. However, even after the Proposal of November 3, 2010 enters into force, this criterion will still not be met as the Proposal does not impose the PSO on domestic production. Also, the scope of the beneficiaries of the state measure should be redefined in order to ensure compliance with EU law, in particular Regulation 994/2010. In conclusion, the amendments included in the Proposal of November 3, 2010 appear to go in the right direction to ensure the compliance of Polish law with EU law. Nevertheless, the measure of strategic gas storage to be provided in Polish law still seems to infringe EU law. Thus the aim of the amendment, as declared in the Polish government's Statement of Reasons for the Proposal of November 3, 2010, i.e., to avert the action being brought by the European Commission against Poland to the Court of Justice, might not be achieved.

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Cutting Emissions in the Energy Sector: a Technological and Regulatory Perspective

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CONTENTS

- I. Introduction
- II. Historical background
- III. A glance toward the future
- IV. Directives and the competitive market
- V. Conclusions

Abstract

The generation of utilizable forms of energy, mainly electricity and heat, carries an environmental impact – as does any human industrial activity. In the case of the power industry based on fossil fuels, this impact is connected with the emission of technological by-products, not necessarily of a material character. It is obvious that the Polish point of view on this problem is connected with the unique degree of dependence of the national power industry on coal. Two aspects of the emission reduction problem are analyzed in this article: the technological, connected with the permanent development of flue-gas cleaning; and the administrative, connected with limiting the permissible pollutant concentration in flue gases. It is shown that during the development of the power industry to date, those relations led to an effectiveness (efficiency) of flue-gas cleaning installations which seemed impossible at the moment of its implementation. The main goal of this work is to demonstrate that the regulations being introduced by the European Commission strongly disturb the present relations between technical capabilities and administrative requirements.

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Résumé

La production de toutes formes d'énergie et tout particulièrement d'électricité et de chauffage a son impact sur l'environnement aussi bien que chaque type d'activité industrielle de l'homme. Dans le cas de l'industrie énergétique qui utilise des carburants organiques, cet impact est lié aux émissions de la poussière d'oxyde de soufre, d'oxyde nitrique, de monoxyde et de dioxyde de carbone. La position de la Pologne concernant ce problème est affectée par la forte dépendance de son industrie énergétique de l'exploitation du carbone. Dans cet article nous avons analysé deux problèmes de réduction de l'émission de pollutions: technologique, lié au développement de la technologie de la purification des gaz d'échappement et législatif, lié aux réductions de niveaux de pollution autorisés. Il a été démontré que au fur et à mesure de développement de l'industrie énergétique, la corrélation entre ces deux aspects (technologique et législatif) a permis d'arriver à un niveau d'efficacité des installations de purification qui n'avait jamais été envisageable au moment de leur implantation. L'intérêt majeur de cette publication est de démontrer que les réglementations introduites par la Commission Européenne déséquilibrent fortement les relations entre les capacités techniques et les exigences administratives.

Classifications and key words: power industry, emission reduction, development of technology of flue-gas cleaning , low regulation on industrial emission

I. Introduction

Just like any human industrial activity, the generation of useful energy forms, primarily electricity and heat, leaves an environmental footprint. In the case of the power industry, based as it is on fossil fuels, this footprint includes various emissions occurring as by-products that are not necessarily of a material character. These can include noise or electromagnetic wave emissions, but also particulates, sulphur dioxide, nitrogen oxides, carbon monoxide, and carbon dioxide discharges. Process by-products include ash, slag, and effluents. The word 'emissions' is typically taken to mean the products released directly into the ambient air. Not so long ago the substances in question were limited to carbon monoxide, particulates, sulphur dioxide, and nitrogen oxides, while carbon dioxide was believed to have no impact on the environment. In recent years, however, the attitude toward CO₂ has changed drastically. CO₂ emissions have been declared the main driver of climate change, and cutting CO₂ emissions has been declared one of the greatest challenges facing humankind in the upcoming decades.

The Polish outlook as regards the issue of emissions in the power industry is obviously driven by the dependency of the country's power sector on coal.

The magnitude of dependency is higher than elsewhere in Europe. Hence, this study will be primarily focused on analyzing the impact of emission limitations on the development of coal-based power technologies while still referring to the traditional 'dirty' pollutants, i.e., particulates, sulphur dioxide, and nitrogen oxides.

II. Historical background

In terms of ambient air pollution the development of the coal-based sector can be divided into four stages. The first stage was the time when the emission issue had not yet been identified, mainly due to a lack of observable environmental changes. This situation continued until large urban areas found themselves covered by smog. It was easy to find the cause – particulate emissions. Technology for particulate emission abatement was not a problem. Power stations and other industrial plants were equipped with cyclone dust separators or electrostatic precipitators. Small-scale sources used for individual residential heating, however, proved to be a bigger problem. In this case gas or electricity were adopted as energy sources and domestic coal fires were banned by law in certain areas.

From the technical point of view the problem of smog was largely solved, and that seemed to be the end of the matter until it became evident that some forests were withering. The diagnosis proved simple: acid rain caused by the emission of sulphur dioxide and nitrogen oxides. The sulphur content in the combusted coal – and hence in flue-gas – was high, leading to the introduction of a new requirement: sulphur dioxide emission abatement. The technology was ready and flue-gas desulphurization (FGD) systems appeared at power plants, soon followed by NO_x abatement systems.

The fourth stage can be observed today. This is a period when the main challenge is to limit carbon dioxide emissions, an issue that will be discussed further on in this study.

When investigating the history of limiting the emission of traditional pollutants, two aspects need to be highlighted: the technical and the legal. Of course, the key devices used in cutting particulate emissions are electrostatic precipitators (ESPs). The ESP concept can be traced back to the 19th century, when in 1821 M. Hohlfeld precipitated smoke in an earthed tube¹. Further important steps were taken in 1911 and 1982. The former saw installation of the first electrostatic precipitator with a system of plate electrodes, the latter the commissioning of the first ESP with a joint electrode area of 100,000 m².

¹ See J. Kucowski, D. Laudyn, M. Przekwas, *Energia i środowisko*, WNT, Warszawa 1997.

The breakthrough in flue-gas desulphurization (FGD) technology was the installation of scrubbers at the Battersea power station in London in the early 1930s². The 1950s and 60s saw intensive research into new desulphurization techniques involving lime or limestone, and this resulted in commercial application of the now common wet scrubbing technology. By 1982 in the United States alone this technology had been installed in power plants with a total capacity exceeding 28,000 MW, and new ones were under construction at plants with a total capacity over 14,000 MW³.

When discussing technical aspects of curbing traditional emissions we must not forget the Dürnröhr power station in Austria, commissioned in 1986, which was equipped with⁴:

- Preliminary single field electrostatic precipitators with 90% efficiency and main four-field ESPs with 99.9% efficiency
- Semi-dry FGD system with 90% efficiency
- SCR NO_x abatement system with 80% efficiency.

Therefore by the mid-1980s technologies to minimize emissions of the particulates, sulphur dioxide, and nitrogen oxides had not only become commercially available, they were in wide use.

Technical progress in flue-gas cleaning systems was accompanied by the introduction of legal restrictions on permissible emission levels. This process commenced in 1979 when the Convention on Long-Range Transboundary Air Pollution was signed in Geneva. In order to implement its stipulations developed countries started to enact local regulations determining permissible levels of pollutants – mainly particulates, sulphur dioxide, nitrogen oxides, and carbon monoxide – in flue gas. Hitherto, most countries had only regulated locally on emission levels, with resulting localized effects. For instance, in 1983 Germany introduced harsh limits on sulphur dioxide emissions, e.g., for systems with a fuel input power exceeding 300 MW the maximum allowed level was 400 mg/m³, while for 100 to 300 MW plants the reduction efficiency had to be at least 60%⁵.

The first regulation determining maximum permitted emission levels was issued in Poland in 1990 (designated as PL'90 in Fig. 1)⁶. It has been amended many times since – in 1998 (PL'98)⁷, 2001 (PL'01)⁸, 2003 (PL'03)⁹ and 2005

² Ibidem.

³ Ibidem.

⁴ Ibidem.

⁵ Ibidem.

⁶ Journal of Laws 1990 No. 15, item 92.

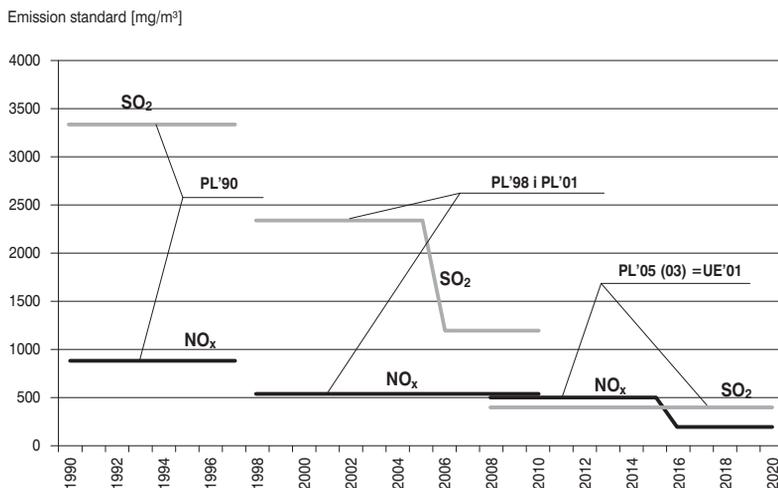
⁷ Journal of Laws 1998 No 121, item 793.

⁸ Journal of Laws 2001 No 87, item 957.

⁹ Journal of Laws 2003 No 163, item 1584.

(PL05)¹⁰. The history of the limits is presented in Fig. 1. The last two editions of the regulation relate to the implementation of EU Directive 2001/80/EC¹¹ (the LCP Directive – UE'01).

Fig. 1. Changes in SO₂ and NO_x emission standards for large combustion plants (power P > 500 MW) fired with hard coal for which a building permit had been issued prior to July 1, 1987.



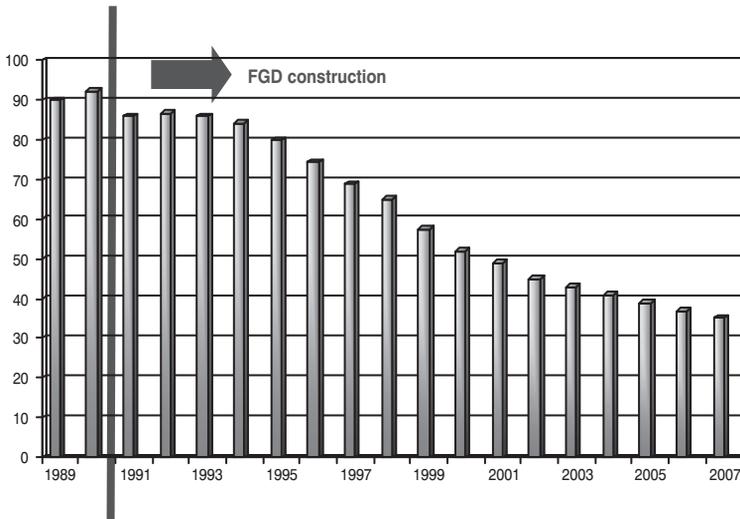
Poland's 1990 regulation for plants that were already operating was of a purely symbolic character, although it did presage a significant standard tightening in 1998 to a level similar to that imposed by the 1998 regulation. With this prospect looming, most large Polish power sector boilers had their burners replaced with low-emission models equipped with over-fire air (OFA) systems during the 1990s. This allowed restriction of NO_x emissions to approximately 500 mg/m³. Construction of FGD systems, mainly of the wet scrubbing variety, also commenced at plants with a fuel input exceeding 500 MW. The results of those investment projects are presented in Fig. 2.

This historical discussion illustrates that while mature flue-gas cleaning technologies preceded the related legal regulations in developed countries, the introduction of thorough flue-gas treatment systems in Poland was enforced by the enactment of emissions standards. In no case did the new

¹⁰ Journal of Laws No. 260, item 2181.

¹¹ Directive 2001/80/EU of the European Parliament and of the Council of 23 October 2001 on the limitation of emissions of certain pollutants into the air from large combustion plants, OJ [2001] L 309/1.

Fig. 2. Actual-to-theoretical emission ratio for large combustion plants (LCPs) in 1989–2007.



restrictions cause any noticeable alterations in the main electricity or heat generation process, such as for example a change of fuel from coal to natural gas and resulting process change from the steam cycle into a combined cycle. While some combined cycle CHPs have actually appeared since 2002, it is hard to see any real connection between those few projects and the emission regulations.

It also needs to be pointed out that due to the interdependency between technical development and legal regulations discussed above, the flue-gas treatment systems have reached efficiency levels which had seemed impossible when they were first invented. Modern electrostatic precipitators can achieve an efficiency of 99.9%, wet FGD units – 99%, and SCR NO_x abatement more than 90%.

Emission regulations in the early years of the new century have been primarily marked by the Kyoto Protocol and the European Union Emission Trading Scheme for CO₂ allowances, a tool designed to achieve the Protocol's objectives in EU member states. The system has been stirring a lot of excitement. The combination of caps on emission allowances distributed among plant operators and a market in allowances together were supposed to drive allowance prices to a level which would on the one hand eliminate those systems with the highest emission levels from the market, and on the other precipitate the development of low-emission technologies. Nonetheless, the first ETS phase between 2005 and 2007 ended in failure.

Too large a pool of assigned allowances resulted in erratic price variability, which is shown in Fig. 4¹². In late 2007 the allowance price dropped to EUR 0.01/Mg. The second ETS phase, *in situ* at the time of writing, runs from 2008 until 2012. Thus far the allowance price has proved much more stable than during phase one, ranging between EUR 8 and EUR 16/Mg. Nonetheless, this does not alter the cost balance sufficiently to affect the feasibility of commonly used power generation technologies. It does however increase the feasible efficiency of a power generation system – a fact which had not been taken into account during development of the newest Polish power generation units (Pałnów II, Łagisza II, Bełchatów II).

Fig. 4. CO₂ allowance price in 2005–2007 [9].



III. A glance toward the future

It seems very probable that the future of the power industry, including the selection of technologies, will be determined by the latest European Union legal regulations, primarily the new Directive on the CO₂ emission trading scheme¹³ which has already been adopted, and the new Industrial Emissions Directive or IED¹⁴. According to the former document, eventually there will

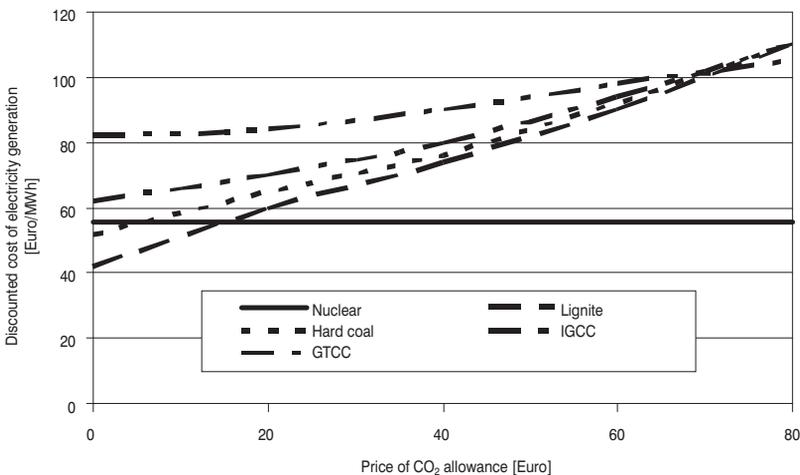
¹² K. Badyda, J. Lewandowski, 'Determinants of energy development in Poland using coal' (2008) 3 *Energetyka*.

¹³ Directive 2009/29/EU of the European Parliament and of the Council of 23 April 2009 amending Directive 2003/87/EU so as to improve and extend the greenhouse gas emission allowance trading scheme of the Community, OJ [2009] L 140/63.

¹⁴ Directive 2010/75/EU of 24 November 2010 on industrial emissions (integrated pollution prevention and control), OJ [2010] L 334/17.

be no free-of-charge distribution of CO₂ emission allowances for power and heat generators. Rather, plant operators will need to purchase their allowances at auctions. The assumption at play is that the emission allowance price should reach a level which would make carbon capture and storage (CCS) systems feasible. It is estimated that for this purpose the allowance price should reach approximately EUR 60/Mg. The relationship between emission allowance prices and electricity generation costs is presented in Fig. 5¹⁵. A glance at this figure immediately begs the question of whether high allowance prices will drive CCS development, or rather lead to a renaissance in nuclear power.

Fig. 5. Discounted electricity generation cost as a function of the CO₂ emission allowance price with assumed plant operation for 6500 h/a (baseload plant) [11].



It also needs to be pointed out that at this emission allowance price level it will no longer be feasible to generate heat at coal-fired boiler plants. For the increase in the generation cost caused by the emission allowance purchase obligation will exceed PLN 20/GJ, which means that it will almost double current operating costs. In comparison, the rise in the cost of natural gas-based heat generation will be a mere PLN 10. We therefore need to hope that the emissions issue will result in a change of fuel, and a further spread in CHP technologies – not a return to domestic heating sources, as they are not affected by the emission trading scheme.

¹⁵ ‘Prognoza zapotrzebowania na paliwa i energię do 2030 r.’, Agencja Rynku Energii S.A., Warszawa, luty 2009.

Fig. 6. Comparison of the SO₂ emission limits for lignite and hard coal [mg/m³] from 2016 on, as per the Regulation of the Minister of the Environment of December 20, 2005 [5] and the Industrial Emissions Directive for “existing” plants.

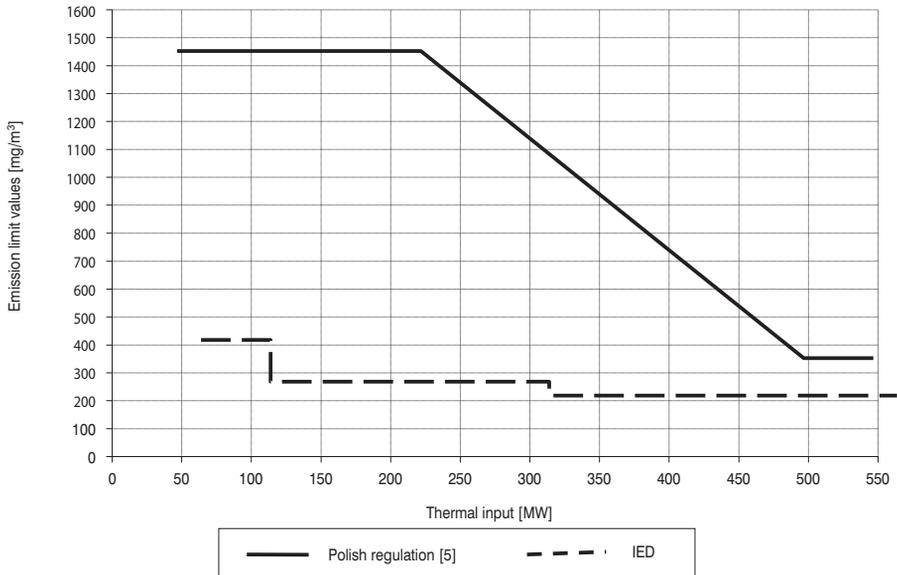


Fig. 7. Comparison of the NO_x emission limits for lignite and hard coal [mg/m³] from 2016 on, as per the Regulation of the Minister of the Environment of December 20, 2005 [5] and the Industrial Emissions Directive for “existing” plants”

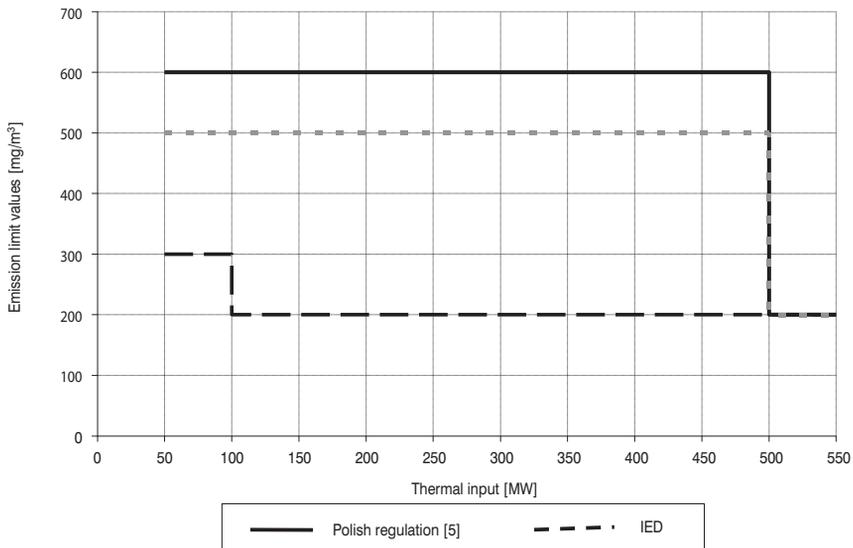


Table 1. Cost of investments required to construct new capacities if the IED is implemented in 2016 with a definition “combustion plant = stack” [14].

Variant	Without IED		IED implemented in 2016	
	Installed capacity	Investment cost	Installed capacity	Investment cost
New combined heat and power plants	3,036	12,751	6,211	26,086
New condensing power plants	1,338	7,359	5,429	29,860
New peakload power plants	2,347	3,638	2,163	3,353
Total cost of the new plants	6,721	23,748	13,803	59,298

Fig. 8. Comparison of the particulates emission limits for lignite and hard coal [mg/m³] from 2016 on, as per the Regulation of the Minister of the Environment of December 20, 2005 [5] and the Industrial Emissions Directive for “existing” plants

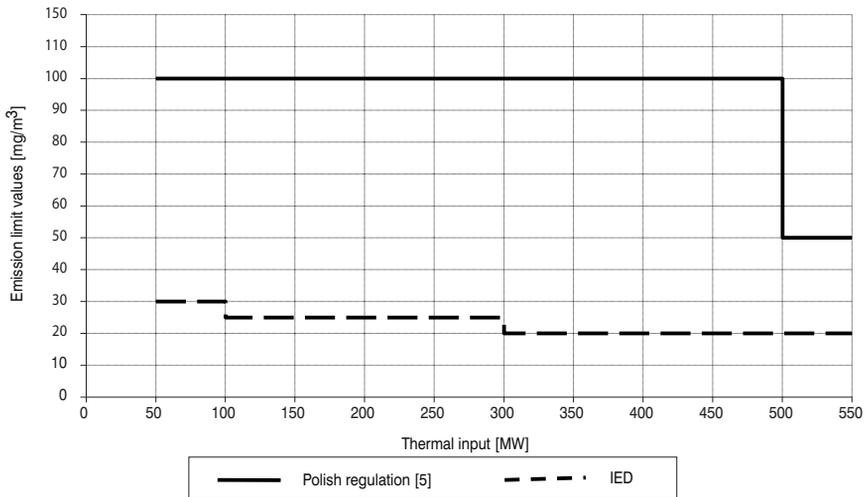
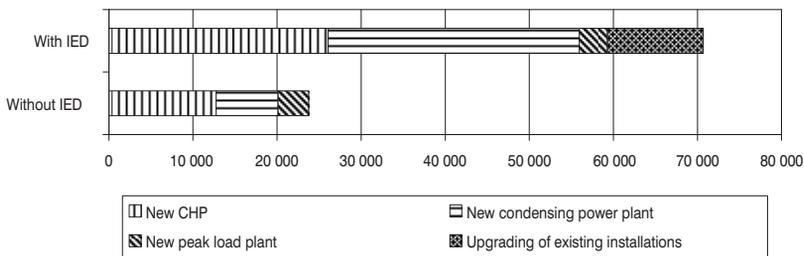


Fig. 9. Total cost of investments in the Polish power industry in variants with and without IED implementation [14].



IV. Directives and the competitive market

The IED in its current form with the gradual introduction of very stringent requirements will result in major changes in the competitiveness of individual firms. It will create a situation in which one company with four boilers such as WR-10 (thermal input > 50 MW, but each of the boilers <15 MW) will not have to equip the high exhaust gas cleansing systems, but a company with such two boilers WR -25 and one WR-5 will. IED significantly differentiates between the conditions of business and splits companies into 7 groups:

1. Plants with a capacity < 20 MW and boilers <5 MW – no restrictions emission.
2. Plants with a capacity < 20 MW of power boilers > 5MW – to reduce emissions of sulphur dioxide, nitrogen oxides and particulates in accordance with Regulation of the Minister of Environmental Protection of December 20, 2005¹⁶.
3. Plants with a thermal input > 20 MW, boilers <5 MW – reducing CO₂ emissions through the trading scheme (ETS).
4. Plants with a thermal input > 20 MW and boilers > 5 MW – reducing CO₂ emissions through the trading scheme (ETS) and emissions of sulphur dioxide, nitrogen oxides and particulates in accordance with Regulation of the Minister of Environmental Protection of December 20, 2005¹⁷.
5. Plants with a thermal input of common stack > 50 MW, but without boilers > 15 MW reduction in CO₂ emissions through the trading scheme (ETS) Regulation of the Minister of Environmental Protection of December 20, 2005¹⁸.
6. Plants of new installations (after 1987) > 50 MW (“born too late”), and boilers > 15 MW, even if thermal input on the common stack < 50 MW – are subject to trading and the new IED.
7. Plants in a thermal input of common stack > 50 MW and boilers > 15 MW – are subject to trading and the new IED.

¹⁶ See above the note No. 10.

¹⁷ Ibidem.

¹⁸ Ibidem.

V. Conclusions

The history of limiting pollution emissions from power and heat generation plants has been that of an improvised but seemingly orderly interplay of technological development and legal regulations setting permissible levels. This resulted in the emergence of extremely effective flue-gas treatment systems without an excessive increase in operating costs. Unfortunately, there is a threat that the regulations defined by the new directives – ETS¹⁹ and IED²⁰ – will increase generation costs to such an extent that the operators will run short of funds for technological development.

The increase in the cost of electricity and heat generation caused by the directives ETS and IED apply to medium and large installations. They are in a much worse market position than small plants. This mainly applies to the cost of heating buildings. Meanwhile, small heating installations generate “low emissions”, which in fact are usually more burdensome for the environment than large systems. Application of regulations similar to those in the directives ETS and IED to such small installations is not possible in Poland, mainly for social reasons – and therefore for political reasons, too.

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¹⁹ Directive 2010/75/EU of 24 November 2010 on industrial emissions (integrated pollution prevention and control), OJ [2010] L 334/17.

²⁰ ‘Prognoza zapotrzebowania na paliwa i energię do 2030 r.’, Agencja Rynku Energii S.A., Warszawa, luty 2009.

The Emission Trading Scheme in Polish Law. Selected Problems Related to the Scope of Derogation from the General Rule for Auctioning in Poland

Marcin Stoczkiewicz*

CONTENTS

- I. Introduction
- II. Transposition of EU law into the Polish legal system
 - 1. Legal framework
 - 2. Scope of application
 - 3. Greenhouse emission permit
 - 4. Allocation of allowances
 - 5. Administration of allowances
 - 6. Emissions allowance trading
 - 7. Charges related to participation in the Polish emission trading system
 - 8. Monitoring and sanctions
- III. Selected key problems related to the implementation of Phase 3 of the ETS Directive in Poland in terms of the electricity sector
 - 1. Derogation from the auctioning principle
 - 2. Obtaining emission permits by 30 June 2011 as one of the derogation conditions
 - 3. Meaning of the phrase “*investment process physically initiated*”
 - 4. Free allocation of emission allowances and State aid
 - A. Tradable emission permits and State aid
 - B. Imputability to the Member State
 - C. The resources of the Member State
 - D. Selective advantage
 - E. Effect on trade between Member States and distortion of competition.
 - F. Consequences
- IV. Conclusion

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Abstract

The subject matter of this article is the implementation in Poland of Directive 2003/87/EC on the emissions trading scheme for greenhouse gases in the Community. The first part of the article focuses on the presentation of the legislation and institutional arrangements which transpose the obligations contained in Directive 2003/87/EC into Polish law. On the basis of this, the article then presents some problems regarding the implementation in Poland of important changes introduced into Directive 2003/87/EC by Directive 2009/29/EC. This part of the article contains an analysis of Article 50 of the new Act on the System of Greenhouse Emission Trading, which introduces specific rules for licensing bodies that undertake investment in terms of compliance with the provisions of Directive 2009/29/EC. Secondly, this paper also presents a preliminary assessment of the proposed free allocation of greenhouse gas emissions allowances in Poland to electricity production enterprises. This is examined from the viewpoint of the possibility of State aid in the meaning of Article 107(1) of the Treaty on the Functioning of the European Union.

Résumé

L'article traite de l'application en Pologne de la directive n° 2003/87/CE établissant un système d'échange de quotas d'émission de gaz à effet de serre dans la Communauté. La première partie de l'article présente les actes juridiques ainsi que les solutions institutionnelles nécessaires à la transposition de l'ensemble du contenu normatif de la directive n° 2003/87/CE en Pologne. Par la suite, l'article explicite certains problèmes liés à l'application en Pologne de modifications significatives de la directive n° 2003/87/CE introduites par la directive n° 2009/29/CE. Cette partie de l'article contient l'analyse de l'art. 50 de loi relatif au système d'échange de droits d'émission de gaz à effet de serre, lequel introduit des règles spécifiques concernant le système d'octroi de permis aux sujets entreprenant la réalisation d'un investissement, du point de vue de sa conformité avec les dispositions de la directive n° 2009/29/CE. L'auteur donne aussi une estimation préliminaire du plan d'allocation de quotas d'émission de gaz à effet de serre gratuits en Pologne aux entreprises de production de l'électricité sous l'aspect d'éventuelle aide d'Etat au sens de l'article 107 alinéa 1 du *Traité sur le fonctionnement* de l'Union européenne.

Classifications and key words: environmental law, directive 2003/87/EC, emission trading, auctioning, free allocation, State aid.

I. Introduction

The concept of using tradable emissions permits in environmental policy is not a new idea. It was first proposed by J.H. Dales¹ more than 40 years ago, and received much attention in economic literature in the latter part of the 20th century.² The international discussion around emissions trading has gained new momentum due to its inclusion as a policy tool in efforts to protect the global climate. In 2003, the EU created an internal emissions trading scheme to assist the European Union and its then 15 Member States in achieving their commitments to reduce greenhouse gas emissions under the Kyoto Protocol in a cost-effective manner.³ The EU Emissions Trading Scheme (EU ETS) is based on the recognition that creating a price for carbon offers the most cost-effective way to achieve the deep reductions in global greenhouse gas emissions that are needed to prevent climate change from reaching dangerous levels. Since January 1, 2005, greenhouse gas emissions in the EU, up to that point virtually unregulated, have been subject to limitations. At the same time these limitations became tradable in the EU.⁴

According to the European Commission the EU ETS is being implemented in distinct phases or ‘trading periods’.

Phase 1, from January 1, 2005 to December 31, 2007, was a three-year pilot phase of ‘learning by doing’ in preparation for the crucial Phase 2. It successfully established a price for carbon, free trade in emission allowances across the EU, and the necessary infrastructure for monitoring, reporting and verifying actual emissions from the businesses covered. The generation of verified annual emissions data filled an important information gap and created a solid basis for setting the caps on national allocations of allowances for Phase 2.

Phase 2, running from January 1, 2008 to December 31, 2012, coincides with the ‘first commitment period’ of the Kyoto Protocol – the five-year period during which the EU and its Member States must comply with their emission targets under the Protocol. The 2005–2007 pilot phase was necessary to ensure

¹ J.H. Dales, *Pollution, Property and Prices*. Toronto 1968.

² See: W.J. Baumol and W.E. Oates *The Theory of Environmental Policy*. Second Edition. Cambridge 1988; N. Hanley, J.F. Shogren, B. White, *Environmental Economics in Theory and Practice*. London 1997.

³ The European Union had 15 Member States when the Kyoto Protocol was agreed. On May 1, 2004, EU membership increased to 25 with the accession of Cyprus, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Malta, Slovakia and Slovenia. On January 1, 2007, Romania and Bulgaria joined the EU.

⁴ U. Ellinghaus, P. Ebsen, H. Schloemann, ‘The EU Emissions Trading Scheme (EU ETS): a Status Report’ (2004) 1 *Journal for European Environmental & Planning Law*, p. 3.

that the EU ETS contribute fully to the achievement of these targets by functioning effectively during Phase 2. On the basis of the verified emissions reported during Phase 1, the Commission has cut the volume of emission allowances permitted in Phase 2 to 6.5% below the 2005 level, thus ensuring that real emission reductions will take place.

Phase 3 will run for eight years, from January 1, 2013 to December 31, 2020. This longer trading period will contribute to the greater predictability necessary for encouraging long-term investment in emission reductions. The EU ETS will be substantially strengthened and extended from 2013, enabling it to play a central role in the achievement of the EU's climate and energy targets for 2020.⁵

The EU ETS is built on three main legal instruments, established for Phase 1 and accordingly amended and enlarged for Phase 2 and Phase 3. The first instrument is the Emissions Trading Directive (ETS Directive)⁶, which establishes the 'cap and trade' system itself, including key requirements on e.g., covered installations, allocation of allowances, monitoring, and trading. The second is the so-called Linking Directive⁷, which allows for, and regulates, the introduction into the emissions trading scheme of emission reduction credits generated through specific projects abroad that lead to emissions reductions. The third is the Registries Regulation⁸, which provide rules for

⁵ See: European Commission, *EU action against climate change. The EU Emission Trading Scheme*, edition 2009, p. 8; M.J. Mace, J. Anderson, 'Legal and design issues arising in linking the EU ETS with existing and emerging emissions trading schemes' (2009) 6.2. *Journal for European Environmental & Planning Law*, pp. 197–232.

⁶ Directive 2003/87/EC of the European Parliament and of the Council of 13 October 2003 establishing a scheme for greenhouse gas emission allowance trading within the Community and amending Council Directive 96/61/EC, OJ [2003] L 275/32; Directive 2008/101/EC of the European Parliament and of the Council of 19 November 2008 amending Directive 2003/87/EC so as to include aviation activities in the scheme for greenhouse gas emission allowance trading within the Community, OJ [2008] L 8/3; Directive 2009/29/EC of the European Parliament and of the Council of 23 April 2009 amending Directive 2003/87/EC so as to improve and extend the greenhouse gas emission allowance trading scheme of the Community, OJ [2009] L 140/63.

⁷ Directive 2004/101/EC of the European Parliament and of the Council of 27 October 2004 amending Directive 2003/87/EC establishing a scheme for greenhouse gas emission allowance trading within the Community, in respect of the Kyoto Protocol's project mechanisms, OJ [2004] L 338/18.

⁸ Commission Regulation (EC) No 2216/2004 of 21 December 2004 for standardised and secured system of registers pursuant to Directive 2003/87/EC of the European Parliament and of the Council and Decision No 280/2004/EC of the European Parliament and of the Council, OJ [2004] L 386/1; Commission Regulation (EC) No 916/2007 of 31 July 2007 amending Regulation (EC) No 2216/2004 for standardised and secured system of registries pursuant to Directive 2003/87/EC of the European Parliament and of the Council and Decision No 280/2004/EC of the European Parliament and of the Council, OJ [2007] L 200/5; Commission Regulation (EC) No 994/2008 of 8 October 2008 for standardized and secured system of registries pursuant

the establishment and operation of national electronic registers for the EU system's emission allowances in the Member States.

The main subject matter of this article is a presentation of a general overview of the transposition of EU ETS law into the Polish legal system. As a result I will investigate selected key problems related to the implementation of Phase 3 of the EU ETS in Poland, especially within the scope of derogation from the general rule for auctioning in Poland. I will analyze Article 50 of the new Act on the System of Greenhouse Emission Trading, which introduces specific rules for licensing bodies that undertake investment, in terms of compliance with the provisions of Directive 2009/29/EC. I will also present a preliminary assessment of the free-of-charge allocation of greenhouse gases emissions allowances in Poland to electricity production enterprises from the viewpoint of the possibility of the existence of State aid.

II. Transposition of EU law into the Polish legal system

1. Legal framework

EU ETS law was originally transposed into the Polish legal system by the Act of 22 December 2004 on greenhouse gases (GHG) and allowances trading in the emission of other substances (Emission Trading Act)⁹ and the Act of 17 July 2009 on the management of emissions of GHG and other substances (Emission Management Act)¹⁰.

The Emission Trading Act sets out the general framework for the Polish emission trading system and provides for the necessary procedures and the administrative structure to make emission trading operational in Poland. It regulated e.g. which installations and GHGs fall within its scope, the permit procedure for emission of GHGs, the procedure for issuing allowances, the design of a national emission trading registry, as well as provisions on the transfer of allowances and compliance instruments.

to Directive 2003/87/EC of the European Parliament and of the Council and Decision No 280/2004/EC of the European Parliament and of the Council, OJ [2008] L 271/3.

⁹ Journal of Laws 2004 No 281, item 2784 and 2008 No 199, item 1227.

¹⁰ Journal of Laws 2009 No 130, item 1070. This Act is focused on monitoring and management of the Kyoto units and is not a subject for analysis in this article.

2. Scope of application

The Emission Trading Act established an emission trading system in Poland. This system includes two sub-systems: 1) a community emission trading system and 2) a national emission trading system.¹¹ The system covers GHGs and other substances. GHGs are described in Annex II to the ETS Directive as: carbon dioxide (CO₂), methane (CH₄), nitrous oxide (N₂O), hydrofluorocarbons (HFCs), perfluorocarbons (PFCs), and sulphur hexafluoride (SF₆).¹² ‘Other substances’ covered by the system are sulphur dioxide (SO₂), nitrogen oxides (NO_x) and dusts.¹³ The community emission trading system covers GHGs. The national emission trading system covers the emission of ‘other substances’ into the air. The system covers emissions from installations. The concept of ‘installation’ is defined in Article 3(6) of the Act of 27 April 2001 on Environmental Protection Law¹⁴. The most important part is the definition of an ‘installation covered by the system’. Installations covered by the system are described currently in the Regulation of the Ministry of the Environment of 27 July 2009 on installations covered by the community emission trading system.¹⁵ This Regulation transposes into the Polish law Annex I of the ETS Directive.

3. Greenhouse emission permit

The Emission Trading Act in Articles 33–36 transposed Articles 4–6 of the ETS Directive in terms of greenhouse emissions permits. The operator of an installation covered by the system has an obligation to obtain a “permit”. This permit should be understood as a “greenhouse emission permit” in the light of Article 4 of the ETS Directive. This permit is issued by the authority competent for issuing integrated pollution prevention and control permits for a period of 10 years.

4. Allocation of allowances

The allocation of allowances ensures the effectiveness of emission trading as an environmental policy instrument. It determines the overall budget of allowances allocated to the participants in the system. Operators of

¹¹ Article 5(1) ETA.

¹² Article 3 (5) ETA.

¹³ Article 3 (14) ETA.

¹⁴ Journal of Laws 2001 No 62, item 627 with amendments.

¹⁵ Journal of Laws 2009 No 136, item 1120.

installations who exceed their allowance budget will either need to reduce emissions themselves or buy allowances on the market. In general, allowances in Phase 2 of EU ETS can be auctioned or allocated free-of-charge, depending on the respective political decision. The ETS Directive states that for the three-year period beginning January 1, 2008, Member States shall allocate at least 90% of the allowances free-of-charge. Therefore it is possible to auction up to 10% of allowances in this period.

In Poland the allocation of allowances in Phase 2 of EU ETS is organized as follows: the National Administrator of the Emission Trading System (KASHUE) prepares a draft of the National Allocation Plan (NAP).¹⁶ The process for preparation of the NAP is open for public participation.¹⁷ Pursuant to the ETS Directive, the European Commission examines the NAPs and can require amendments and subsequently reject them. This provision is transposed into ETA in Article 18(1). According to this provision of ETA the NAP is accepted by the European Commission and next adopted by the Government in the form of regulation.¹⁸ The acceptance of the Polish NAPs by the European Commission was beset by long procedural disputes, including proceedings before the Court of First Instance of the European Community.¹⁹ The NAP which is currently in force was accepted by the Regulation of the Council of Ministers of July 1, 2008.²⁰ In Phase 2 of the EU ETS Poland has allocated all allowances free-of-charge. Allowances are in principle allocated to operators of existing installations on the basis of the average absolute emissions of the respective individual installation during the last five years (grandfathering system).²¹ Allocations are in principle granted for each installation in the content of the NAP.²²

5. Administration of allowances

The competent authority in terms of the administration of the system is the National Administrator of the Emission Trading System (NAETS). The main task of the NAETS is hosting the emission trading registry²³ pursuant to the Registry Regulation of the European Commission which provides for

¹⁶ Article 14(4) ETA.

¹⁷ Article 17 ETA.

¹⁸ Article 18(2) ETA.

¹⁹ Poland won the case T-183/07 [ECR] 2009, 23.09.2009. Commentary onto this case significantly transcends the scope of this paper. See: J. de Cedra de Larragan, 'Case note: Republic of Poland v. Commission' (2000) 1 *Climate Law*, pp. 199–206.

²⁰ Journal of Laws 2008 No 202, item 1248.

²¹ Article 16(4)(2) ETA.

²² Article 22(2) ETA.

²³ Article 9(2)(1) ETA.

a purely electronic emission trading system in which allowances exist solely electronically.²⁴

6. Emissions allowance trading

The determination of the contract provisions governing the transfer of allowances, due to the lack of EU-wide regulations, is subject to the law of the Member State. According to Article 26(1) of the ETA, allowances granted to each installation can be used for its own needs related to real emission from the installation or can be traded or used in the next reporting years of the next reporting period. In principle, the relevant provisions of the Polish Civil Code²⁵ are applicable to the purchase of an emission allowance.²⁶

7. Charges related to participation in the Polish emission trading system

Costs of participation in the system include *inter alia*: a) a charge for the first entry into the National Emission Allowances Register (NEAR) in the reporting period; b) a charge for the granting of an emission allowance. That charge for the first entry into the NEAR is set as a constant charge of 450 PLN.²⁷ Both charges, due to a lack of EU regulations on this subject, are regulated by Polish law only.

8. Monitoring and sanctions

ETS Directive in Article 14 (Monitoring and reporting of emissions) and in Article 15 (Verification and accreditation) has established the obligations of the Member State to ensure that emissions are monitored and reported, and that the reports submitted by operators are verified independently. These requirements are implemented in Section 7 of ETA. Each operator of an installation who has been granted allowances has an obligation to monitor

²⁴ See: Commission Regulation (EC) No 2216/2004 of 21 December 2004 for standardised and secured system of registers pursuant to Directive 2003/87/EC of the European Parliament and of the Council and Decision No 280/2004/EC of the European Parliament and of the Council, OJ [2004] L 386/1.

²⁵ Journal of Laws No 16, item 93 with amendments.

²⁶ Article 26(4) ETA.

²⁷ Article 12(1) ETA.

and report the emissions from that installation during each calendar year.²⁸ The Ministry of the Environment has described specific rules regarding the monitoring of emissions in the Regulation of September 12, 2008 on monitoring of emissions covered by the EU ETS.²⁹

III. Selected key problems related to the implementation of Phase 3 of the ETS Directive in Poland in terms of the electricity sector

1. Derogation from the auctioning principle

The legal framework for Phase 3 of EU ETS (2013–2020) is established in Directive 2009/29/EC of the European Parliament and of the Council of 23 April 2009 amending Directive 2003/87/EC so as to improve and extend the greenhouse gas emission allowance trading scheme of the Community (Directive 2009/29/EC).³⁰ Member States shall transpose and implement this Directive by December 31, 2012. However, they shall publish and submit to the Commission, by September 30, 2011, a list of installations covered by this Directive and any free allocation to each installation in their respective territories.³¹

In terms of the energy sector, Directive 2009/29/EC sets up a general rule for the auctioning of emission allowances from 2013.³² Pursuant to Article 10(1) of Directive 2003/87/EC as amended by Directive 2009/29/EC ('amended ETS directive') from 2013 onwards, Member States shall auction all allowances which are not free-of-charge in accordance with Articles 10a and 10c. Article 10c was included in the package of elements of the final compromise for the adoption of the amended ETS Directive. This Article establishes the option for a transitional free allocation for the modernization of electricity generation on the basis of an authorization by the Commission. According to Article 10c (1) of the amended ETS Directive by derogation from Article 10a(1–5), a Member State may give a transitional free allocation to installations for electricity production in operation by December 31, 2008 or installations for electricity production for which the investment process was physically initiated by the same date, provided that described conditions are met. The list of conditions set up in Article 10c for the derogation is too

²⁸ Article 40 ETA.

²⁹ Journal of Laws 2008 No 183, item 1142.

³⁰ OJ [2009] L 140/63.

³¹ Article 2 and Article 11(1) of the Directive 2009/29/EC.

³² Preamble to the Directive 2009/29/EC, recital 19.

long to be described and analyzed in this paper. Selected problems regarding free-of-charge allocation in the case of the Polish electricity sector investments will be highlighted below.

2. Obtaining emission permits by June 30, 2011 as one of the derogation conditions

Article 10 a(7), of the amended ETS Directive provides that ‘No free allocation shall be made in respect of any electricity production by new entrants’. Clearly, one of the purposes of this condition is to limit the scope of the derogation from the general rule for auctioning. It should be taken into consideration that the derogation described in the Article 10c of the amended ETS Directive is not extended to Article 10a(7), but includes only Article 10a(1–5).³³ In terms of the scope of derogation from that perspective, the definition of ‘new entrant’ is crucial. Pursuant to Article 3h of the amended ETS Directive ‘new entrant’ means

- any installation carrying out one or more of the activities indicated in Annex I, which has obtained a greenhouse gas emissions permit for the first time after 30 June 2011,
- any installation carrying out an activity which is included in the Community scheme pursuant to Article 24(1) or (2) for the first time, or
- any installation carrying out one or more of the activities indicated in Annex I or an activity which is included in the Community scheme pursuant to Article 24(1) or (2), which has had a significant extension after June 30, 2011, only in so far as this extension is concerned.’

It follows from Articles 10a(7) and Article 3h that the amended ETS Directive requires installations benefiting from free allowances under Article 10c to have their emissions permits by the end of June 2011.

The end of June 2011 as the final term for obtaining an emissions permit is an unrealistic timescale for almost all the new power generators which are being planned by the Polish government to receive free allocations under Article 10c derogation.³⁴ Polish legislators have realized that this is a real problem and have prepared a solution in the new Act on the System of Greenhouse Emission Trading (‘New ETS Act’).³⁵ One of the main purposes of the new act is the

³³ See M. Ballesteros, ‘Transitional free allocation of allowances to the power sector’ (2010) 3 *ClientEarth*, p. 3.

³⁴ See M. Głowacki, *Why can't new investments in Polish power generators benefit from derogation laid down in Article 10 c of the Directive EU ETS*, 2009, www.emissions-euets.com, p. 1.

³⁵ See: [http://orka.sejm.gov.pl/opinie6.nsf/nazwa/3887_u/\\$file/3887_u.pdf](http://orka.sejm.gov.pl/opinie6.nsf/nazwa/3887_u/$file/3887_u.pdf). The legislative procedure hadn't been completed by May 29, 2011. However, the Act needs only to be signed by the President.

transposition into Polish law of amendments to the ETS Directive in the scope of changes made by Directive 2008/101/EC and Directive 2009/29/EC.³⁶ The new ETS Act in Article 50 introduces specific rules for issuing emissions permits to entities which begin the process of realization of an installation. According to Article 50(1) of the new ETS Act, 'The permit is issued upon the application of an entity which begins the realization of a combustion installation, with the exception of installations for incineration of hazardous or municipal waste with the rated thermal input exceeding 20 MW, that will generate electricity to be sold to a third party and that will not be used for activities defined in points 2–29 in the Part B of the Annex to this Act.'³⁷ Pursuant to Article 50(2) of the new ETS Act, 'Commencement of realization of the installation takes place on the day of the actual initiation of the investment process related with this installation (...)'³⁸ The day of the actual initiation of the investment process is described as, 'a day, prior to 31 December 2008, on which preparatory works were started on the installation's construction site'.³⁹ There are two legal problems which result from Article 50 of the new ETS Act.

The first problem concerns the correct transposition of the amended ETS Directive. The Polish legislators intend not to treat as yet non-existent but planned installations as 'new entrants', by granting them emissions permits. The concept of issuing emission permits to installations that haven't been completed on the day of issuing is more than dubious. The declared goal of the regulation of Article 50 of the new ETS Act is implementation of Article 10c of the amended ETS Directive into Polish law in a way that will make free-of-charge allocation to electricity producers possible.⁴⁰ In fact, the regulation of Article 50 of the new ETS Act is intended to limit the effect of Articles 10a (7) and Article 3h. The clear purpose of these Articles is the exclusion of new entrants from the benefit of free-of-charge allocations. As the amended ETS Directive explains in Article 1, it 'provides for the reductions of greenhouse gas emissions to be increased so as to contribute to the levels of reductions that are considered scientifically necessary to avoid dangerous climate change'. It should be obvious that the main purpose of the ETS Directive is to limit greenhouse pollution. The main instrument to achieve this purpose is the auctioning rule established in Article 10(1) of the amended ETS Directive. An unjustifiable extension of derogation from that general rule provided in Article

³⁶ Justification of the draft Act, p. 2, see: http://www.mos.gov.pl/g2/big/2010_08/f79b98d3e6a89f264326bd6fce2ef624.pdf.

³⁷ Author's own translation of Article 50.

³⁸ Author's own translation of Article 50.

³⁹ Author's own translation of Article 50.

⁴⁰ Justification of the draft Act, p. 28, see: http://www.mos.gov.pl/g2/big/2010_08/f79b98d3e6a89f264326bd6fce2ef624.pdf.

48 of the draft ETS Act is contradictory to the main aim of the amended ETS Directive and therefore constitutes an incorrect transposition of this Directive. It should be stressed that the general principle governing the implementation of the directives into national law is the assurance of achievement of the desired result of the directive (*effect utile*).⁴¹

Moreover, Article 3h of the amended ETS Directive provides that ‘new entrant’ means ‘any installation carrying out’ the defined activities under certain conditions. It follows *a fortiori* from this wording that any installation which is not already carrying out the activities must be treated as a ‘new entrant’. In other words, any installation which isn’t carrying out the activities fulfills the definition of ‘new entrant’ in the meaning of Article 3h of the amended ETS Directive. It appears that Article 50 of the new ETS is also in direct contradiction with the wording of Article 3 h of the amended ETS Directive.

3. Meaning of the phrase ‘investment process physically initiated’

The second problem arising from Article 50 of the new ETS Act is related to the meaning of ‘investment process physically initiated’ in Polish law. This phrase is used in the amended EU ETS Directive to describe the scope of derogation from the general rule for auctioning. According to Article 10c ‘By derogation from Article 10a(1–5) Member States may give a transitional free allocation to installations for electricity production in operation by December 31, 2008 or to installations for electricity production for which the investment process was physically initiated by the same date ...’.⁴² Pursuant to Article 50(2) of the new ETS Act ‘Commencement of realization of the installation takes place on the day of the actual initiation of the investment process related with this installation (...)’⁴³ The day of the actual initiation of the investment process is described as ‘a day, prior to 31 December 2008, on which preparatory works were started on the installation’s construction site’.⁴⁴ [underlining added – M.S.]. The crucial problem to be settled while deciding which installations in Poland are entitled to enjoy the derogation as foreseen by Article 10c, is the interpretation of when the investment process for an installation may be regarded as physically initiated – in other words, how the operators shall prove that the investment process of their installation

⁴¹ See: case C-48/75 [ECR] 1976, 497, para 75.

⁴² See also: Communication from the Commission – Guidance document on the optional application of Article 10c of Directive 2003/87/EC, OJ [2011] C 99/9, para 15.

⁴³ Author’s own translation of Article 50.

⁴⁴ Author’s own translation of Article 50.

was *physically initiated* before a given date. Article 50(2) of the new ETS Act transposed the phrase ‘physically initiated’ as ‘actual initiation’. According to M. Bar, as the Directive refers to ‘physical initiation’ and not to the mere ‘authorization’ of commencing the investment process (not the mere possessing relevant permits to start the building), it is legitimate to state that one shall prove that the works on construction the installation have actually started.⁴⁵ In Poland, the requirements concerning construction works are regulated by the Act of 7 July 1994 – Building Law⁴⁶ (Building Law Act), and the draft ETS Act directly refers to ‘preparatory works’. In my opinion this term should be understood according to the Building Law Act. Pursuant to Article 41(1–3):

‘Art. 41.1. The construction commences with undertaking of preparatory works on the construction site.

2. The preparatory works are:

- 1) geodesic marking of objects on the construction site;
- 2) levelling of the construction site;
- 3) management of the site including temporary building objects;
- 4) developing of connections to the technical infrastructure network for construction purposes.

3. The preparatory works may be carried out only on the site encompassed by a construction permit (...).

It is clear that according to the Building Law Act preparatory works may be carried out only on the basis of a construction permit. This interpretation is also presented by the jurisprudence. The Voivodeship Administrative Court in Kielce stated in its verdict of September 11, 2008 that: ‘geodesic marking of objects in the construction site is one of the types of the preparatory works which commence the construction. It is NOT an activity which is to be carried out prior to obtaining a construction permit.’⁴⁷ It follows from Article 41(3) of the Building Law Act that in Poland only installations which had already acquired construction permits by December 31, 2008 are entitled to enjoy derogations as foreseen by Article 10c of the amended ETS Directive. Pursuant to Article 45(1) of the Building Law Act ‘a building diary is an official document confirming the course of a construction (...).’ According to the interpretation of M. Bar the most appropriate proof that ‘the investment process was physically initiated’ is the first entry in the building diary for a given project.⁴⁸ It should be underlined that this conclusion is valid also to ‘actual initiation’ described in Article 50(2) of the new ETS Act, because

⁴⁵ M. Bar, *Legal opinion concerning of the term „physically initiated investment process” as user by Directive 2003/87/EC under Polish law*, 30.09.2010, typescript. p. 2.

⁴⁶ Journal of Laws 2006 No 156, item 1118 with amendments.

⁴⁷ Judgement of VAC Kielce, II SA/Ke 342/08; LEX nr 526502.

⁴⁸ M. Bar, *Legal opinion...*, p. 3.

this article refers to ‘preparatory works’ and this is the term of the Building Law Act.

4. Free allocation of emission allowances and State aid

A. Tradable emission permits and State aid

Poland is planning to allocate free European Union CO₂ Allowances (EUAs) to up to 15,000 MW worth of new power plants. If these plans are realized, it will mean that Poland will hand out around 60 million EUAs to new plants between 2013 and 2020.⁴⁹ The question arises whether this planned free allocation will constitute State aid in the sense set out by Article 107(1) TFEU?⁵⁰

The European Commission has stated in the Community Guidelines on State aid for environmental protection that ‘Tradable permit schemes may involve State aid in various ways, for example, when Member States grant permits and allowances below their market value and this is imputable to Member States.’⁵¹ According to the draft of the Community Guidelines on Certain State Aid Measures Relating to the EU Emission Trading System After 2013 ‘some of the provisions and statement linked to the ETS Directive after 2013 involve State aid in the meaning of Article 107(1) of the TFEU’.⁵² This draft establishes conditions to be fulfilled for a declaration compatible with the Internal Market of State aid involved in the transitional and optional free allocation for modernization of electricity generation in accordance with Article 10c of the ETS Directive.⁵³ The Commission has presented its opinion regarding State aid aspects in transitional free allocation of allowances in Phase 3 of the EU ETS in the Communication ‘Guidance document on the optional application of Article 10c of Directive 2003/87/EC’.⁵⁴ According to the Commission, ‘the free allocation of emission allowances to electricity generators and the financing of correspondent investments required by

⁴⁹ See: B.Garside, *Poland misled investors on free EUAs: WWF*, PointCarbon.com, 18.08.2010.

⁵⁰ According to settled case law the conditions are as follows: First, there must be an intervention by the State or through State resources. Second, the intervention must be liable to affect trade between Member States. Third, it must confer an advantage on the recipient. Fourth, it must distort or threaten to distort competition. See: Case C-280/00, *Altmark Trans*, para 75.

⁵¹ OJ [2008] C 82/1, pp. 55 and 139.

⁵² European Commission, *Community Guidelines on Certain State Aid Measures Relating to the EU Emission Trading System After 2013*, draft dated 2009, para 1.2.

⁵³ *Ibidem*, para 3.1.3.

⁵⁴ Communication from the Commission – *Guidance document on the optional application of Article 10c of Directive 2003/87/EC*, OJ C 99/9, 31.3.2011.

Article 10c of Directive 2003/87/EC would in principle involve State aid in the meaning of Article 107(1) TFUE.⁵⁵ The results of a preliminary examination into whether the free allocation of EUAs in the case of Poland will fall within the constitutive elements of State aid are presented below.

B. Imputability to the Member State

According to the Commission, NAPs may contain elements which distort competition and constitute State aid. Even if the NAP did not contain any ‘over-allocation’, there still might be an element of State aid, having regard to Article 10 of Directive 2003/87. Especially in the case where a Member State allocated **more than 95% of the allowances for the first allocation period free-of-charge**, thereby foregoing public revenue⁵⁶. It should be stressed that Article 10 of Directive 2003/87/EC has been changed by Directive 2009/29/EC, which has established an auction principle. This means the EC law obligation to grant 95% of allowances free-of-charge will be removed starting from 2013. Consequently, the Member State’s decision to use the derogation established in Article 10c and allocate allowances free-of-charge will therefore be imputable to the Member State in Phase 3 of EU ETS?

C. The resources of the Member State

State resources are involved where public authorities of the Member State enjoy or acquire control over the funds which finance the economic advantage granted to an enterprise. According to the Court of First Instance (CFI) ruling in the NO_x case ‘Setting up a scheme which provides for the possibility of trading NO_x emission allowances on the market, the Kingdom of the Netherlands has conferred on them the character of intangible assets which the undertakings concerned are free to sell, even if they are linked to a maximum ceiling applicable to the undertaking concerned. Those assets are put at the disposal of the undertakings concerned free-of-charge, whereas they could have been sold or put up for auction. The Kingdom of the Netherlands has thus forgone State resources.’⁵⁷ Pursuant to Article 10(3) of the amended ETS Directive Member States **shall** determine the use of revenues generated from the auctioning of allowances. At least 50% of the revenues **should** be used for the described purposes (energy efficiency, etc.). It is the Member State that has to determine the use of auctioning revenues.⁵⁸ Revenues from

⁵⁵ Ibidem, para 27.

⁵⁶ See: case T-387/04, para 23.

⁵⁷ Case T-233/04, para 75.

⁵⁸ M. Ballesteros, *Transitional free allocation...*, points 28–29.

auctioning EUAs which would be resigned by the Member State who make allocations free-of-charge are under the control of the Member State.

D. Selective advantage

According to the above referenced CFI ruling in the NO_x case: the tradability of emission allowances provided for by the measure constitutes an advantage for enterprises subject to emission standards.⁵⁹ Poland is planning to grant free-of-charge emission allowances to a selected group of electricity generation enterprises. The concept of ‘selectivity’ established in the jurisdiction of the ECJ is very broad. The ECJ in its *Adria Wien Pipeline* ruling clearly stated that a rebate on an energy tax applying only to the primary and industrial sector was indeed selective, because the measure distinguished between the manufacturing sector and the rest of the economy, including the service sector.⁶⁰ Granting emission allowances free-of-charge only to a certain group of electricity generation enterprises will at least distinguish between their situation and the situation of: a) other electricity generation enterprises, who will not be granted them free-of-charge and b) enterprises of other sectors covered by the EU ETS system, who will have to buy the emission allowances at auction.

E. Effect on trade between Member States and distortion of competition

Electricity generation is a liberalized activity in the European Union’s internal market. The electricity generation market is open for competition. The measure in question could distort competition on several levels, e.g., (i) competition between incumbents and new market entrants, (ii) competition between competing firms within the same Member State, (iii) and competition between beneficiaries and other power plants (e.g. in Poland and beyond).

According to the ECJ ruling in case 730/90, *Philip Morris*, in order to consider that a measure ‘distorts or threatens to distort competition’ and ‘affects trade between Member States’, it is sufficient for the Commission to prove that the measure in question has the potential to do so.⁶¹

F. Consequences

If free allocation of EUAs constitutes State aid in the meaning of Article 107(1) of the TFEU, this will be incompatible with the internal market as a

⁵⁹ Case T-233/04, para 74.

⁶⁰ Case C-143/99, *Adria Wien Pipeline GmbH* ECR [2001] p. I-8365.

⁶¹ Case 730/90, *Philip Morris*, para 11.

general rule and therefore prohibited. State aid in the form of free allocation of EUAs may be considered to be compatible with the internal market (and therefore allowed) on the grounds of Article 107 (3)(c) of the TFEU as ‘aid to facilitate the development of certain economic activities or of certain economic areas, where such aid does not adversely affect trading conditions to an extent contrary to the common interest’.

Nevertheless, pursuant to Article 108(3) of the TFEU, the Commission shall be informed of any plans to grant State aid (an obligation of notification). Directive 2009/29/EC in Article 10c includes two legal basis of obligation of the Member State related to the free-of-charge allowances allocation. First, any Member States that intends to allocate allowances on the basis of this Article shall, by September 30, 2011, submit to the Commission an application containing the proposed allocation methodology and individual allocations.⁶² Second, the Member State concerned shall submit to the Commission a national plan that provides for investment in the retrofitting and upgrading of infrastructure and clean technologies.⁶³ It should be stressed that the notifications referred to above cannot be treated as a formal notification of the State aid measure pursuant to Article 108(3) of the TFEU. This conclusion follows from the CFI ruling in case T-387/04, *EnBW Energie Baden-Württemberg v. Commission*. This case concerned a German NAP which was notified to the Commission according to the obligation under the ETS Directive. The Court sustained the approach presented by the Commission that the decision of acceptance of the NAP was only a provisional assessment in the light of the rules concerning State aid and such a provisional assessment cannot be interpreted as a definitive position in that regard.⁶⁴ This means that the Polish plans concerning the granting of free-of-charge emission units as a State aid measure shall be subject to official notification pursuant to Article 108(2) of the TFEU to the European Commission (DG Competition), additionally to the obligatory notifications established in Directive 2009/29/EC.

IV. Conclusion

1. EU ETS law is transposed into the Polish legal system by the Act of 22 December 2004 on GHG and trading in the emission allowances of other substances and the Act of 17 July 2009 on management of emissions of GHG and other substances and executive regulations to these acts.

⁶² Directive 2009/29/EC, Article 10 c (2), point 2.

⁶³ Directive 2009/29/EC, Article 10 c (5).

⁶⁴ Case T-387/04, *EnBW Energie Baden-Württemberg v. Commission*, para 136.

These acts organize Phase 2 of EU ETS in Poland. Transposition and implementation in Poland of the EU Directives which constitutes the basis of EU ETS in Phase 2 were in general of proper and appropriate quality.

2. On April 28, 2011 the Polish Parliament adopted the new ETS Act. One of the main purposes of the new act is the transposition into Polish law of amendments to the ETS Directive in the scope of changes made by Directive 2008/101/EC and Directive 2009/29/EC. Some important problems derive from the transposition into the Polish legal system of these EU Directives which constitute the legal basis for Phase 3 of EU ETS. In this paper only selected problems, connected with the scope of derogation from the auctioning general rule in Poland, have been examined.

Specific problems are related to Article 50 of the new Act on the System of Greenhouse Emission Trading, which introduces extraordinary rules for issuing emissions permits for entities who commence realization of an installation. Firstly, the fact that Article 50 of the new Act of the System of Greenhouse Emission Trading introduces an unjustifiable extension of derogation from the general rule for auctioning emission allowances provided by the amended ETS Directive is contradictory to the main goal of this Directive and therefore constitutes mistaken transposition of this Directive. Secondly, this mistaken transposition of the scope of derogation from the general rule for auctioning cannot be successful in terms of *ex post* proof of investment, which in fact was not physically initiated by the end of December 2008. The Polish Building Law Act clearly states that preparatory works (“the physical initiation of the investment process”) may be carried out on the basis of a construction permit only.

Different kinds of problems arise from EU State aid rules and assessment of the planned free-of-charge allocation to new power plants from a State aid perspective. According to a preliminary examination of the free allocation of emission allowances in the case of Poland, this free-of-charge allocation will constitute a State aid measure in the meaning of Article 107(1) of the TFUE. As a consequence it will be incompatible with the internal market as a general rule and therefore prohibited. Polish plans concerning the granting of free-of-charge emission units as a State aid measure shall be subject to official notification pursuant to Article 108(2) of the TFEU to the European Commission (DG Competition), additionally to the notification obligations established in the EU ETS Directive. After the Commission’s examination the measure in question may be considered as a State aid measure compatible with the internal market (and therefore allowed) on the grounds of Article 107(3)(c) of the TFEU.

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**The Autonomy of Sector-Specific Regulation –
Is It Still Worth Protecting?
Further Thoughts on the Parallel Application of
Competition Law and Regulatory Instruments**

Aleksander Stawicki*

CONTENTS

- I. Introduction
- II. Supreme Court rulings
- III. Criticism of the Supreme Court's position
 - 1. The Supreme Court's position
 - 2. What is the rationale for the sector-specific legislation?
 - A. The competition community's voice
 - B. The purpose of sector-specific regulation
 - C. The adequacy of regulatory tools to remedy competition problems
 - D. The problem of 'double jeopardy'
 - E. Creating a 'vicious circle'
 - F. No room for autonomous regulatory policy
 - 3. How to interpret the law?
 - A. Looking for the right perspective
 - B. The Deutsche Telekom case should not be directly applied to Polish circumstances
 - C. The need for a strict interpretation of regulatory and antitrust legislation
 - D. The properly defined relationship between the national sector-specific act and national competition law
- IV. Conclusions

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Abstract

This article sets out to contribute to the on-going discussion regarding the relationship between competition law and sector-specific regulation, as well as the parallel application of competition law and regulatory instruments. Thus, this article attempts to provide a systematic outline of arguments which are conclusive for the proposition that sector-specific regulation must remain fully autonomous, while taking a critical stance with respect to the views of both the Supreme Court and academic lawyers who advocate the supremacy of competition law.

Résumé

Le sujet du présent article est la relation entre le droit de la concurrence et le droit des secteurs régulés, ainsi que l'application parallèle des institutions du droit de la concurrence et des instruments réglementaires. Le but de l'article est de présenter les arguments selon lesquelles les réglementations des secteurs doivent rester autonomes. Il est important de polemiquer avec l'avis exprimé par la Cour Supérieure polonaise et par certains juristes qui croient le droit de la concurrence supérieur aux autres réglementations.

Classifications and key words: abuse of dominant position, sector-specific regulation.

I. Introduction

For many years the relationship between competition law and sector-specific regulation has been a focus of discussion among academic lawyers and practitioners¹. It has also been addressed in numerous court decisions, including by Poland's Supreme Court. Despite such broad interest, the issue is still far from being resolved and there is continued uncertainty about how the existence of sector-specific regulation affects the applicability of competition law.

This article sets out to contribute to that on-going discussion, rather than attempting to sum up its current status. Based on the practical experience of

¹ For a distinction between competition law and sector-specific regulation, characteristics of each of these branches of law, and the purposes which they are supposed to serve, etc., see especially T. Skoczny, 'Ochrona konkurencji a prokonkurencyjna regulacja sektorowa' (2004) 3 *Problemy Zarządzania* 7 et seq. Cf. M. Szydło, *Prawo konkurencji a regulacja sektorowa*, Warszawa 2010; 'Stosowanie przez przedsiębiorstwo energetyczne cen w oparciu o taryfę zatwierdzoną przez Prezesa URE a zarzut naruszenia ogólnego prawa antymonopolowego' (2009) 9 *Monitor Prawniczy* and by the same author 'Regulacja sektorowa a ogólne prawo antymonopolowe' (2008) 1 *Problemy Zarządzania* 237 et seq.

representing regulated undertakings in administrative proceedings before the competition authority and regulatory authorities and in the related appeal cases, I am one of those authors who for a long time have advocated the view that sector-specific regulation should be treated as *lex specialis* in relation to competition law and that, therefore, the Polish National Competition Authority (*Prezes Urzędu Ochrony Konkurencji i Konsumentów*; hereafter, UOKiK President) should not have adjudicative power where such power is vested in the relevant National Regulatory Authority (hereafter, NRA)². Until just a few years ago, it seemed that such a view would become more popular, partly because that was where the Supreme Court's case law was apparently headed. But then came the unfortunate decision of the European Commission in *Deutsche Telekom* and things took a complete turnaround³. And I really mean 'unfortunate' not only because I deeply disagree with that decision (as well as with the subsequent affirmative court decisions), but also because these rulings were later eagerly transplanted into the national case law without considering that, for many different reasons (which I will mention later on), they cannot be directly applied in the relations between Polish sector-specific regulation and Polish competition law⁴. In consequence of the

² Cf. especially: J. Baehr, A. Stawicki, 'Prawo energetyczne jako *lex specialis* w stosunku do przepisów ustawy o ochronie konkurencji i konsumentów' [in:] C. Banasiński (ed.), *Prawo konkurencji – stan obecny oraz przewidywane kierunki zmian*, Warszawa 2006, p. 132 et seq., and by the same authors 'Rozważania wokół równoległego stosowania prawa konkurencji i instrumentów regulacyjnych', [in:] C. Banasiński (ed.), *Ochrona konkurencji i konsumentów w Polsce i Unii Europejskiej*, Warszawa 2006, p. 145 et. seq. See also: A. Stawicki, 'Waiting for the Polish *Trinko*', Oil Gas and Energy Law Journal, Special Issue *Antitrust in the Energy Sector (OGEL No. 1/2010)*, A. Stawicki [in:] A. Stawicki, E. Stawicki [ed.], "Act on Protection of Competition and Consumer Interest. Commentary", Warsaw, 2011, p.60 et seq.. A similar view seemed to be agreeable to, inter alia, P. Lissoń, 'Kompetencje organu antymonopolowego a kompetencje organów regulacyjnych w Polsce', [in:] C. Banasiński (ed.), *Aktualne problemy polskiego i europejskiego prawa ochrony konkurencji*, Warszawa 2006, p. 113 et seq. For a critical approach see e.g. C. Banasiński, 'Równoległe stosowanie prawa konkurencji i instrumentów regulacyjnych w Polsce (na przykładzie telekomunikacji i energetyki)' [in:] C. Banasiński (ed.), *Prawo konkurencji...*, p. 93 et seq.

³ Case COMP/C-1/37.451, 37.578, 37.579 – *Deutsche Telekom* (2003) and judgment of the Court of the First Instance T-271/03 *Deutsche Telekom AG v. Commission*, ECR [2008] II-477. For discussions of the Commission's decision in *Deutsche Telekom*, see especially J. Baehr, A. Stawicki, 'Rozważania wokół równoległego stosowania...', p. 146 et seq. or, in foreign literature D. Geradin, R. O'Donoghue, 'The Concurrent Application of Competition Law and Regulation: the Case of Margin Squeeze Abuses in the Telecommunications Sector' (2005) 4 *The Global Competition Law Centre Working Papers Series*; N. Petit, 'The Proliferation of National Regulatory Authorities alongside Competition Authorities: A Source of Jurisdictional Confusion' (2004) 2 *GCLC Working Paper*; C. Veljanovski, 'Margin Squeezes in Telecoms' (2008) 36 *Intermedia*.

⁴ Act of 16 February 2007 on competition and consumer protection (Journal of Laws 2007 No. 50, item 337, as amended), hereafter, Polish Competition Law or PCL. References to 'competition law' are references to the competition law in general.

foregoing recent developments, there is an increasing number of opinions that the applicability of competition law to undertakings from the so-called regulated sectors is not excluded by the fact that their conduct is authorized by (grounded in) specific statutory provisions, as long as the entity in question is left with some sort of 'discretion'. Under those views, the existence of such 'discretion' makes it possible to challenge business conduct as inconsistent with Poland's Competition Law.

The author who takes this view to the extreme is M. Szydło⁵, who argues that regulatory authorities should be 'bound' by the rules of competition law. This proposition has led him to conclude that if a regulated undertaking's conduct (and which is authorized by the regulator or regulatory framework) has consequences that are contrary to competition law, then the competition authority is permitted to question such conduct⁶. This is supposed to hold true even where the undertaking applies rates or prices under a tariff approved by the regulator. M. Szydło further concludes that a regulated company should take its own measures to make sure that its conduct is in compliance with competition law, even when applying approved tariffs, for if the application of an approved tariff leads to anticompetitive effects, the company may become liable under competition law.

Even though not quite as strongly articulated, a similar line of thought can be seen to surface in case law, including the most recent cases where the Supreme Court addressed the matter⁷. The Supreme Court also seems to be increasingly more prepared to hold that the risk of antimonopoly intervention can be avoided only in the case of a very detailed, or even thorough, regulatory framework that does not leave the subject businesses any room for manoeuvre (I will come back to this issue further below).

This reasoning, no doubt heavily inspired by the *Deutsche Telekom* decision and the related case law, and which, unfortunately, seems to be increasingly widespread, commands us to seriously consider if there is still any purpose

⁵ Interestingly, M. Sieradzka, the author of another article published in the same source – *Monitor Prawniczy* (and co-editor of the whole publication), seems to follow a contrary approach when she writes that: 'According to the principle *lex specialis derogat legi generali*, the Energy Law excludes the application of anti-trust law. In many situations, the conduct of a utility company will be lawful even if the Competition Act treats it as anticompetitive'. See M. Sieradzka, 'Praktyczne problemy rozgraniczenia kompetencji pomiędzy Prezesem UOKiK oraz Prezesem URE na podstawie art. 8 PrEnerg' (2009) 9 *Monitor Prawniczy*. The references to 'Energy Law' are references to Act of 10 April 1997 – Energy Law (consolidated text: Journal of Laws 2006 No. 89, item 625, as amended).

⁶ And its intervention may be enabled not only by EU law, but also by the national competition law on an autonomous basis.

⁷ See judgement of the Supreme Court of 15 July 2009, III SK 34/08.

in defending the autonomy of sector-specific regulation⁸. The issue is in fact much more serious and our discussion should basically be about whether defending such autonomy generally is at all worthwhile. If the regulated undertakings (and other undertakings operating on regulated markets) cannot trust regulatory action but must instead take their own measures to check whether they are in compliance with competition law in whatever they do, then maintaining sector-specific regulation tends to have a rather limited justification. Regulation is a solution that is neither simple to use nor cheap to operate. It is thus only logical to ask if we are still better off using instruments whose importance has decreased so dramatically.

Because, despite all the setbacks, I firmly believe that there is a purpose in sector-specific regulation, I will try to outline below certain arguments which in my opinion do not allow us to take for granted the increasingly visible domination of competition law over sector-specific special legislation. My further discussion will first of all turn to the evolution of the Supreme Court's approach (as its decisions will have the greatest impact on the Polish landscape over the next years). In the next section of this paper I will attempt to provide a systematic outline of arguments which I think are conclusive for holding that sector-specific regulation must remain fully autonomous, while taking a critical stance with respect to those views of both the Court and academic lawyers which advocate competition law supremacy⁹.

II. Supreme Court rulings

As has already been mentioned, the existing controversies are reflected in Supreme Court rulings on these issues. Consequently, it is worthwhile having a closer look at the Court's views in this respect. The key decisions here are most certainly: the resolution of the Supreme Court of December 7, 2005, III SZP 3/05; the judgment of the Supreme Court of October 19, 2006, III SK 15/06, and the judgement of the Supreme Court of July 15, 2009, III SK 34/08.

⁸ Whenever in this article the concept of 'autonomy' of the regulatory regime or of the regulator is discussed, this applies not to their formal autonomy or independence, but rather to the autonomy of the decision-making process. The key issue is whether the regulator is free to autonomously shape its own regulatory policy or whether such policy should rather be inferior to the goals of competition law.

⁹ Note also that the discussion below draws heavily from my article 'Waiting for the Polish *Trinko*', published in Oil Gas and Energy Law Journal Special Issue *Antitrust in the Energy Sector* (OGEL No. 1/2010) as well as from the commentary to Art. 3 of the Polish Competition Law published in A. Stawicki, E. Stawicki [ed.], "Act on Protection of Competition and Consumer Interest. Commentary", Warsaw, 2011, p.60 et seq.

All the foregoing verdicts resulted from appeals against the decisions of the Polish Competition Authority¹⁰.

The Supreme Court's resolution comes first in chronological order and is on a path towards finding that to the extent the sector-specific act¹¹ governs matters related to competition on the given market, under the Polish legal system it is of a specific nature (*lex specialis*) in relation to the general competition protection rules applicable under the PCL (*lex generalis*). Therefore the application of sector-specific legislation is an obstacle for the application of the provisions of the Polish Competition Law. Consequently, there is also, according to the Supreme Court, a division of legal powers between two separate central government administration bodies. Each of the two bodies (i.e., the regulator and the competition authority) may only act within its remit and may not interfere with the statutory powers of the other, though they are also required to cooperate with each other while performing their respective tasks.

The Supreme Court seems to have expressed a different view in the decision of October 19, 2006. In this case, as in the previous one, the starting point for the Court's discussion is the partial overlap between the Telecommunications Law and the Polish Competition Law. Still, the Court held that this is not a sufficient reason to find that the relationship between the PCL and the sector-specific acts falls within the ambit of the classic *lex specialis derogat legi generali* rule. The Supreme Court expressed the opinion that the provisions of the Polish Competition Law apply to all markets, including that of telecommunications, unless a specific act generally excludes the application of the Competition Law or compels a form of conduct which should be deemed a restrictive practice from the perspective of the Competition Law's provisions. Thus, save as expressly provided by statutory provisions, Polish Competition Law cannot be disapplied by the mere fact that provisions of another act govern the conduct of entrepreneurs or lay down specific dispute resolution procedures.

The two rulings seem to be going in two different directions. The reason behind this difference may, to a certain extent at least, reflect the facts of the two cases, which were essentially different. In the first case, the one to which the Supreme Court's resolution of 2005 relates, the crux of the dispute and the essence of the practice which was found anticompetitive was the refusal of access to the infrastructure (network) in a specific instance. In the other

¹⁰ The decisions in question referred to the conduct of undertakings preceding EU accession (i.e., prior to 1 May 2004), therefore all three cases had been decided by the Competition Authority and by the Courts solely on the grounds of Polish national law. There was no question of the application of the Community law rules to the potentially abusive conduct.

¹¹ Here – the Act of 16 July 2004 – Telecommunications Law (Journal of Laws 2004 No. 171, item 1800, as amended, hereafter as Telecommunications Law.

case, the one to which the Supreme Court's judgement relates, the practice was not so much a refusal of network access, but evasion of contracts for network access to be made with numerous entities, also in situations where the regulator declared that there was an obligation to enter into such a contract. The Supreme Court found such conduct of the dominant undertaking to be impeding competitors' access to the market. In the context of the foregoing facts of the two cases, an attempt may be made to perceive the Supreme Court's judgment more as an addition to and elaboration upon the points made in the Court's resolution. This is because the Court seems to be highlighting the need to define the practice properly. In particular, the essence of the practice may not be simply defined as 'refusal of access to the network' in a specific instance, as such conduct must be assessed solely on the basis of sector-specific provisions. If it were made possible to assess it also under the Polish Competition Law, this would actually undermine the purpose of sector-specific regulation. Such would also pose a risk of contradictory decisions by state authorities. The Supreme Court's judgement seems therefore to be leading to the conclusion that it is not the refusal of access to the network in a specific instance as such, but the refusal-related conduct which may be penalized, if it meets the conditions to be categorized as abuse of a dominant position. For example, a discriminatory refusal of access may be penalized in a situation where the network undertaking relies on sector-specific regulation to deny access to some of the entities operating on the market and provides access to its infrastructure to some entities in a discriminatory fashion, which adversely affects competition on the related market. Similarly, refusal of network access may be found abusive if it forms part of a broader anticompetitive strategy of deterring access to the market or foreclosing the existing competitors¹².

¹² The following part of the statement of grounds for the Supreme Court judgment is crucial here: 'To the extent governed by the PCL the only purport of Art. 46, Art. 79, Art. 81(4) and Arts. 83–85 of the Telecommunications Law is that – as follows from the Supreme Court resolution of 7 December 2005, III SZP 3/05 – these provisions exclude a claim of abuse of a dominant position by refusal to provide a specific entrepreneur with access to the essential facility. This is because they provide that access to the network may be obtained as a result of interference by the President of RATC [the NRA for the telecoms sector – AS]]; consequently, impossibility to obtain access to the essential facilities, which is one of the prongs of the test required to effectively invoke the essential facilities doctrine, is not met (see US Supreme Court judgment in *Verizon Communications Inc. v. Law Offices of Curtis V. Trinko*, L.L.P. (540 U.S. 398 (2004))). However, this does not disapply Art. 8(1) in conjunction with Art. 8(2)(5) of the Competition Law under the circumstances of the instant case. As mentioned above, it was 'the plaintiff's evasion of cooperation agreements between operators' which was considered to have been a practice of preventing the development of conditions required for competition to arise or grow (the Competition Authority decision of 5 January 2004 [...]). The plaintiff's conduct affected a wide range of market players, thus blocking practically all possible new entrants and harming consumers' interests. This is the difference between the facts of this

Unfortunately, the foregoing ambiguities have not been clarified with the Supreme Court's judgment of July 15, 2009. The vast majority of the Court's reasoning in the statement of grounds seems to show that the Court does not agree with the view according to which the regulatory law (here: Energy Law) could be considered to be *lex specialis* in relation to the Competition Law. This is because, in the Court's opinion, the Energy Law deprives a certain category of entities of a claim for conclusion of a transmission services contract under the sector-specific legislation. This does not mean, in the Supreme Court's opinion, that it is prohibited by the regulatory regime to provide access to transmission infrastructure in circumstances other than those set out in the law; accordingly, there is no reason to disapply antitrust provisions to refusal to provide such service in said circumstances. In some other sections of its reasoning the Court states that, 'other than to the extent arising from third party access rules, network undertakings are not required to provide access to the network under sector-specific legislation. However, this does not mean that it was contrary to the Energy Law to enter into a gas transmission contract for imported or domestic gas with an entity which was not yet entitled to make a transmission contract'. Apparently the Court believes that, if there is no clear prohibition of certain conduct in the sector-specific regulation, a possibility is opened for interference by antitrust authorities. Consequently, the Court's discussion as aforesaid apparently leads to a conclusion that sector-specific legislation in fact does not exclude the possibility to assess the network undertaking's conduct, in light of the competition laws. More specifically, such legislation could exclude the application of the PCL only where it expressly prohibits or compels certain conduct without allowing the network undertaking any discretion. That such understanding of the ruling is correct may be confirmed by another passage from the grounds, where the Court finds that 'the above shows that access to the transmission network has not been regulated comprehensively in the Energy Law, hence the Energy Law was not *lex specialis* with respect to Competition Law during the period which the imported gas transmission related to'. Accordingly, this finding may imply that energy law would be *lex specialis* in relation to Competition Law to the extent the energy law regulations were comprehensive (that is to say, it would not allow any discretion).

At the same time, the Supreme Court in its judgement does not prejudice if the refusal to access the network constituted abuse of the natural monopoly of the network company under the Polish Competition Law. The Court seems to

case and of the one which the Supreme Court's resolution of 7 December 2005 (III SZP 3/05) referred to. Therefore, the telecommunications operator's conduct which involved impeding market entry by independent dial-up Internet access providers may be assessed in terms of the Competition Law'.

accept that the level of (un)development of the gas market, that translated into overall regulations related to the functioning of that sector of the economy on the date of the refusal, could justify the position of the network undertaking. Such refusal could have been therefore objectively justified, which excludes qualifying it as an anticompetitive practice on the basis of the Competition Law¹³.

III. Criticism of the Supreme Court's position

1. The Supreme Court's position

The foregoing views of the Supreme Court, which were – in the last two cases discussed above – inspired by reasoning adopted in the *Deutsche Telekom* case, may suggest that this is the direction that Polish courts will take. This must prompt serious concern since the motives behind the decision of the Court may raise substantial doubts.

This issue requires special attention, therefore it is discussed in more detail below, with focus on two major issues. First, the reasoning of the Supreme Court goes against the rationale (*ratio legis*) of the sector-specific legislation and such rationale should always be taken into account when interpreting provisions of law; second, the Court does not follow in a satisfactory way the rules for interpreting legal text that come into play when the provisions of different pieces of legislation are in a conflict with each other.

2. What is the rationale for the sector-specific legislation?

A. The competition community's voice

When we go back in time and observe the reactions of the competition community to the Commission's and CFI's rulings in the *Deutsche Telekom* case, we shall see that many authors expressed concerns that this line of reasoning is undermining the proper functioning of the regulatory regimes. Those comments are undoubtedly also valid for the Polish situation, as the

¹³ The Court seems to ignore in its reasoning the fact that the level of the market's development had already been taken into account by the legislator on the stage of shaping the energy sector regulations. That was the reason why the Energy Law allowed for the refusal of network access in some circumstances. Therefore the provisions of the sector regulation should be perceived rather as 'codified' objective justification for the refusal.

reasoning of the Supreme Court seems to go against the rationale for the existence of the sector-specific legal regimes in the Polish legal system.

B. The purpose of sector-specific regulation

Sector-specific (regulatory) acts are addressed to businesses which either operate in a natural monopoly (network undertakings) or under conditions of limited competition. This is precisely why such entities need to be subjected to the regulatory regimes¹⁴. Accordingly, sector-specific acts are designed to provide a legal framework for the conduct of businesses which operate in a situation of limited competition, frequently including natural monopolists. To put it differently, they are addressed only to undertakings which, given the specificity of their business, remain dominants or monopolies on their markets.

For the foregoing reasons, it is the sector-specific acts which define – in relation to regulated undertakings – how the monopolist is to behave in order to create as much room for competition as possible¹⁵. The extent to which such an undertaking is made subject to competition (within the framework of the regulatory regime) is a result of many various factors and political decisions and therefore it may evolve, depending for example on the stage of market development or the degree of its liberalization.

Given the role it is to play and its individual character, sector-specific legislation is much more detailed than antitrust law. For instance, access to the gas or electricity network is governed both at the statutory level (by numerous provisions of the Energy Law Act) and at the level of secondary legislation (by the so-called system regulations¹⁶) when in the competition law the only basis of the prohibition to abuse the dominant position is Article 9 of the Polish Competition Law, which merely repeats the wording of Article 102 of the Treaty on the Functioning of the European Union (hereafter, TFEU). Therefore, as it is rightly indicated by some authors, ‘the main advantage of ex ante regulation is that it provides a greater degree of certainty to incumbent operators’¹⁷.

¹⁴ See e.g. T. Skoczny, ‘Ochrona konkurencji...’, p. 9 et seq. and M. Szydło, *Prawo konkurencji a regulacja...*, p. 13 et seq. J. Majcher also believes that regulation is a substitute for a competitive market (cf. J. Majcher, ‘Dostęp do urządzeń kluczowych w niezależnych regulacjach sektorowych’ (2004) 3 *Problemy Zarządzania*. Cf. also A. Szablewski, ‘Strukturalny aspekt regulacji prokonkurencyjnej w elektroenergetyce’ (2008) 1 *Problemy Zarządzania* pp. 205–206.

¹⁵ Accord: T. Skoczny, ‘Ochrona konkurencji...’, p. 17.

¹⁶ In Polish: rozporządzenia systemowe.

¹⁷ See D. Geradin, R. O’Donoghue, ‘The Concurrent Application...’.

C. The adequacy of regulatory tools to remedy competition problems

Because of its very nature, the regulatory regime is also better placed to remedy certain competition problems, as the regulatory authorities are usually empowered to apply, on an *ex ante* basis, detailed, tailor-made solutions that are not available for the competition authorities¹⁸. Another problem with the tools of competition law is that the competition watchdogs have neither the supervisory tools and nor resources necessary to safeguard proper implementation of their decisions aimed at remedying the problem in the regulated industry. They may also lack the necessary knowledge of the functioning of the regulated sector, which may result in the adoption of mistaken decisions¹⁹.

D. The problem of 'double jeopardy'

The reasoning adopted by the Supreme Court deviates from the foregoing basic features of sector-specific legislation. In consequence it undermines the legal certainty the regulatory regime is supposed to offer to market participants. This problem has been very well described by C. Veljanovski, who, when commenting on the *Deutsche Telekom* case, stressed that 'a dominant network operator appears now to be subject to 'double jeopardy', even when in full compliance with its regulatory obligations. The case law requires a dominant network operator to ensure that all its regulated margins over which it has some pricing flexibility allow equally efficient competitors to make an adequate return. If this is not done, and the regulator refuses to act, then the operator will infringe competition rules and will be open to fines and possible damage claims (...)'²⁰. This view holds true also in Poland, if the reasoning of the Supreme Court is followed. The simple fact that the regulated undertaking acts within the framework of the sector-specific regulation does not make it immune from the intervention of the competition authority, unless the regulatory regime leaves no room for manoeuvre at all (which is seldom the case). Therefore a 'double test' is required to assess whether its actions are legitimate: first under sector-specific legislation and then under competition law. This means high legal uncertainty²¹.

¹⁸ Cf. T. Skoczny, 'Ochrona konkurencji...', pp. 16–17.

¹⁹ See for example N. Petit, 'Circumscribing the Scope of EC Competition Law in Network Industries? A Comparative Approach to the US Supreme Court Ruling in the *Trinko* Case' (2004) 5(3–4) *Journal of Network Industries*.

²⁰ See C. Veljanovski, 'Margin Squeeze...'. See also discussion of this problem by D. Gerardin and R. O'Donoghue in: 'The Concurrent Application...'. The authors propose some solutions for this problem under Community law. See also N. Petit, 'The Proliferation...'.
²¹ See N. Petit, 'The Proliferation...'. For the relationship between regulation and commercial certainty, see also T. Skoczny, 'Ochrona konkurencji...', p. 17.

E. Creating a 'vicious circle'

The foregoing approach to conflicts between the regulatory regime and competition law may also lead to a 'vicious circle'. This is again precisely put by C. Veljanovski, who indicates that 'the justification of sectoral regulation is the inadequacy of competition law. That is sectoral *ex ante* remedies and price controls are used because (a) *ex post* competition law is claimed to be too slow and uncertain to provide an effective remedy; and (b) it is not a legitimate goal of competition law to regulate prices. (...) The DT decision turns the justification for separate regulation (...) on its head. Regulation which is supposed to fill the gaps arising from inadequate competition rules, is subject to competition law to plug regulatory gaps'²².

F. No room for autonomous regulatory policy

Such reasoning defeats the purpose of any autonomous regulatory policy with respect to undertakings concerned. But, as even those advocating the *Deutsche Telekom* approach admit, regulatory frameworks are informed by other values (and designed to attain other goals) than the 'hard' competition law²³. In particular, liberalization efforts to open the markets to maximum possible competition are just one of the purposes behind regulatory regimes (with other purposes being quite on a par, such as protection of end customers or promotion of environmentally-friendly energy generation methods). Furthermore, sector-specific regulation often incorporates state regulatory policy agendas, which by necessity means that there are interim periods when regulatory authorities must authorize conduct that could otherwise be questionable under competition law (e.g., denial of service to a customer who, under sector-specific legislation, is not yet entitled to use it). If we accept that the competition authority may review regulatory decisions in the sense of being empowered to challenge anti-competitive conduct of regulated undertakings, then we undermine the justification for having any autonomous regulatory policy. That is because, in order not to allow its decisions to be negated by the competition authority, the regulator will have to actually depart from its autonomous policy goals and focus rather on pursuing competition policies (i.e., on ensuring that its decisions conform to the goals of antimonopoly legislation). This strips the regulator of its power and thus places in question whether the

²² See C. Veljanovski, 'Margin Squeeze...'. The problem of price regulation as such and of its influence of the competitiveness of the market in question is outside of the scope of this text.

²³ Cf. especially M. Szydło, 'Regulacja sektorowa...' and by the same author *Prawo konkurencji a regulacja...*. An interesting approach can be seen in U. Böge, who goes so far as to note the existence of 'regulation which restricts competition', see U. Böge, 'Nadzór konkurencji i regulacja sektorowa: podział ról i kooperacja' [in:] C. Banasiński (ed.), *Prawo konkurencji...*, p. 116 et seq.

regulator will in such cases remain autonomous (with autonomy being, after all, one of the fundamental tenets of regulation as such)²⁴.

3. How to interpret the law?

A. Looking for the right perspective

As already indicated, the problem of the relationship of the sector-specific regulatory tools and competition law must be seen not only from the perspective of the *ratio legis* of the regulatory regime, but also in the context of the rules for interpreting the national legislation applied in the Polish legal system, as this exercise sheds a lot of light on the merits of the issue discussed here²⁵.

B. The *Deutsche Telekom* case should not be directly applied to Polish circumstances

First of all, it should be noted that it is not possible simply to use the arguments set forth in the *Deutsche Telekom* case directly in Polish conditions. It is not to be forgotten that the main reason why a ruling such as the one in *Deutsche Telekom* could be passed was that the sector-specific legislation governing the company's conduct derives from directives and national legislation enacted therein. Competition rules, on the other hand, are laid down in the Treaty on the Functioning of the European Union which is the primary EU legislation. Therefore it could be argued that the national legislation may not render provisions of primary legislation, such as Article 102 TFEU ineffective, especially whenever regulatory measures are not used effectively or are insufficient to ensure compliance with Article 102 TFEU. This may provide grounds for the conclusion that EU competition law takes precedence over national legislation. This part of the argument was very clearly emphasized in both the Commission decision and in the CFI ruling²⁶.

²⁴ For regulator autonomy, see especially T. Skoczny, 'Ochrona konkurencji...', p. 19.

²⁵ For the discussion of this issue, see also A. Stawicki in A. Stawicki, E. Stawicki (Ed.), "Act on Protection of Competition..." op. cit., p. 60 et seq.

²⁶ Naturally, this does not resolve the issue of the relationships between EU competition law and sector-specific regulation. The issue is too broad to be discussed here. I will only briefly mention that both the Commission's decision and the subsequent court rulings give rise to substantial doubt. But these decisions and rulings pertain to a specific factual matrix so we should not draw any definitive conclusions until we have more judicial authority on similar cases (e.g. Case COMP/38.784 – *Wanadoo España v. Telefonica* [2007]). Even if the *Deutsche Telekom* reasoning ultimately wins, various authors have proposed certain practical solutions permitting sector-specific regulation to keep its autonomy (cf. e.g. N. Petit, 'The Proliferation...', p. 25 et seq.).

The hierarchy of legal rules underlying the Polish Supreme Court's adjudication is fundamentally different. Sector-specific legislation and the Polish Competition Law are at the same legislative level in national law: these are acts of Parliament, thus having equal status. Thus, there is no reason to believe that the Polish Competition Law is some sort of 'super-legislation' that can make other national legislation ineffective. Losing sight of this fundamental difference is the major sin committed by the proponents of the theories which rely on the *Deutsche Telekom* case ruling.

C. The need for a strict interpretation of regulatory and antitrust legislation

As long as an interpretation of the law (the regulatory and also antimonopoly provisions) applicable to network undertakings may provide a basis for certain imperative provisions or prohibitions, it should be also assumed that both laws must be interpreted strictly and, more specifically, that their liberal interpretation is not acceptable. This is because there are all sorts of penalties, including very large fines, for violation of both pieces of legislation²⁷. Therefore if relevant sector-specific legislation specifies detailed conditions for access to the network, one should rather assume that the regulatory regime is complex (comprehensive) and covers the whole spectrum of possible situations, than assume that there are areas not covered by the regulatory regime and therefore open for competition law intervention.

D. The properly defined relationship between the national sector-specific act and national competition law

What is of crucial importance is that the Supreme Court's ruling leaves aside the issue of the addressees of the Energy Law and the Competition Law. Yet it is crucial for the interpretation process to determine the addressee of such laws, or, more specifically, of the rules of conduct which may be derived from these laws.

As already indicated, sector-specific (regulatory) acts are addressed to businesses which either operate in a natural monopoly (network undertakings) or under conditions of limited competition. This refers in particular to the provisions governing network access: they are addressed to network undertakings and the network business is always carried on in a situation of (network) natural monopoly.

²⁷ Therefore, these provisions are more and more frequently said to be of a criminal (penal) or quasi-penal nature. Such provisions may not be open to doubt, and they also may not be subject to liberal interpretation.

This means that if monopolist's conduct conforms to the regulatory act, that is to say when such conduct is within the framework of the act, it must be considered to be in accordance with the law. Hence, in a purely national context, there is no reason to assess it additionally in the context of the PCL as the lawmakers authorized said conduct and provided the basis for it in the law. If there is some sort of decisional discretion left to the regulated undertaking, this is also because of the decision of the legislator to shape the regulatory regime in this way.

The above argumentation of the Supreme Court may be presented in a simplified form as follows:

Table 1. The reasoning of the Supreme Court

[1] An energy undertaking	[2] may refuse network access as long as the conditions for such refusal under the Energy Law are met	[3] unless the energy undertaking has a dominant position on the market and it is not explicitly prohibited from providing transmission services by the sector-specific act even though the conditions for refusal under the Energy Law are met	[4] as the refusal will then be justified only provided that it is not an abuse of a dominant position on the market
[the starting point of the evaluation of the undertaking's behaviour under of the sector-specific provisions]	[first test – refusal to be justified under sector-specific law]	[the starting point of the evaluation of the undertaking's behaviour under the Polish Competition Law]	[second test – refusal not to violate the Polish Competition Law]

However, the above assumptions fail to take account of the fact that sector-specific legislation relating to network access is addressed solely to natural monopolies (network undertakings). Hence the foregoing table needs to be modified as follows:

Table 2. Potential problems resulting from the reasoning of the Supreme Court

[1] An energy undertaking which is a natural monopolist	[2] may refuse network access as long as the conditions for such refusal under the Energy Law are met	[3] unless the undertaking it is not explicitly prohibited from providing transmission services by the sector-specific act even though the conditions for refusal under the Energy Law are met	[4] as the refusal will then be justified only provided that it is not an abuse of a dominant position on the market
[the starting point of the evaluation of the undertaking's behaviour under the sector-specific provisions]	[first test – refusal to be justified under sector-specific law]	[the need for additional assessment under the Polish Competition Law]	[second test – refusal not to violate the Polish Competition Law]

It would seem the Supreme Court mistakenly assumes that provisions of one piece of legislation may authorize a monopolist to refuse a certain conduct (here: refuse network access) by setting detailed conditions for such refusal in precise terms (and, importantly, penalizing an unjustified refusal to provide the service), while another legal act (the Competition Law) may provide grounds for holding that the refusal – which was justified under the sector-specific legislation – contravened the other act and is thus unlawful. Such a line of reasoning defeats the purpose of sector-specific regulation and is contrary to the principle of a rational legislator. Also, the fundamental rule-of-law principles do not allow for penalizing under one piece of legislation a conduct which is expressly authorized by another legal act of the same status in the legal hierarchy.

Below I present the proper reasoning based on the assumption that a detailed regulation of network access by sector-specific legislation makes it impossible to assess such conduct under Competition Law.

Table 3. The relationship between the Polish Competition Law and the regulatory regime

[1] An energy undertaking	[2] which has a dominant position on the market (is a natural monopolist)	[3] is authorized to refuse network access as long as the conditions for such refusal under the Energy Law are met	[4] such authorized refusal is justified (legitimate) and thus it should not be in any circumstances subject to separate assessment under Competition Law
[the starting of the evaluation of the undertaking's behaviour under the sector-specific regulations]		[the only test – refusal to be justified under sector-specific law]	[possibility for additional test under the Polish Competition Law is excluded]

What stems from the foregoing analysis is that a form of conduct which is authorized by the sector-specific act (and is therefore legitimate) should not be in any circumstances considered as an anticompetitive practice (abuse of a dominant position) under national Competition Law. This is because the sole criterion of its lawfulness is compliance with the sector-specific legislation.

IV. Conclusions

When in 2006, Ulf Böge, at that time the President of German Federal Cartel Office, published his article on the relationship between competition law and sector-specific regulatory regimes, he emphasized the threat of an anticompetitive effect of regulation. He argued that the threat existed because ‘competition does not have its lobby’ in the regulated industries²⁸. Now, nearly five years later, the landscape is entirely different. It is regulation that does not have a sufficiently strong lobby and it is regulation that is at risk of being pushed aside. This is an unavoidable consequence of its increasingly limited autonomy.

As in any issue, here, too, choice is the order of the day. After all, it is not that there is one single prevailing model for relations between competition law and sector-specific regulation, so different systemic solutions are possible in this area as well. However, if we wish to maintain the parallel existence of both sector-specific regulation (with the enforcing regulators) and the ‘general’ competition law, then I believe we should abandon the way to disempowerment of regulation and to making it merely a tool to serve the purposes of competition law. Above all, we cannot allow situations whereby huge and costly regulatory efforts are stripped of their practical meaning in the sense of not being capable of providing the comfort of legal compliance, with regulated undertakings having to continue to analyze their entire conduct anyway, as if in fact no regulation effectively occurred. That would undoubtedly be the worst solution possible. On the one hand, we would have the regulatory wheels in motion (and this gives rise to substantial costs which, one way or another, are finally incurred by end customers), but on the other, this motion would be ‘empty’ in the sense of not being able to give regulated undertakings any point of reference. Undertakings would basically be in the same position as if there were no regulation because, at the end of the day, they must comply with competition law anyway.

Thus, if we decide to maintain the present dualistic system (and I guess no one today would deny that it is sensible), we must strive to keep it meaningful. One condition necessary for that to happen is the real, not sham, autonomy of sector-specific regulation, with the power to pursue autonomous regulatory policies rather than the requirement to use regulatory instruments for competition policy purposes. It therefore seems that there is a clear need to commence lobbying efforts to ensure that regulatory legislation has its proper place in the Polish legal reality.

²⁸ See U. Böge, ‘Nadzór konkurencji i regulacja...’, p. 117.

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The Duties of the President of the Polish Energy Regulatory Office in the Context of Implementing the Third Energy Package

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CONTENTS

- I. Provisions of the Third Energy Package and their influence on the Polish legal system
 1. Aims and provisions of the Third Energy Package
 2. The role and legal position of the national regulatory authorities – the provisions of The Third Energy Package and the state of their implementation
 - A. The duty to guarantee the independence of regulatory authorities
 - B. The duties and powers of national regulatory authorities arising from the establishment of ACER
 - C. Other powers and duties of national regulatory authorities arising from the Third Liberalization Package
- II. New powers of the President of the Energy Regulatory Office
 1. New powers and duties of the President of the Energy Regulatory Office arising from the amendment of the Energy Law
 2. Characteristics of the new powers of the President of the Energy Regulatory Office and their classification in terms of competencies
- III. Conclusions

Abstract

This article presents the duties and powers of the President of the Energy Regulatory Office as the national regulatory authority of Poland within the scope of implementing the Third Energy Package. The article closely examines the changes and omissions connected with implementing the regulations of the Third Liberalization Package. Such implementation has not been fully executed. The biggest shortages are visible in two fields: the realization of the aims of Articles 35

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and 37 of Directive 2009/72/EC. Concerning Article 35 of the Directive, the changes to the legal position of the President of URE (i.e., loosening his ties with the sphere of governmental administration, something strongly advocated by negative developments which have taken place in the legal and constitutional status of the authority over the last six years) have not been implemented.

Résumé

Le Troisième Paquet Énergie contient plusieurs dispositions qui exigent une adaptation au système juridique du pays. Parmi les plus importantes dispositions de la directive 2009/72/CE du Parlement européen et du Conseil du 13 juillet 2009 relative aux règles du marché intérieur de l'électricité se trouvent celles qui concernent le renforcement de la position juridique des autorités de régulation dans les États membres. De plus, aux termes du règlement (CE) n° 713/2009 du Parlement européen et du Conseil du 13 juillet 2009, le Troisième Paquet Énergie a institué une nouvelle autorité – l'Agence de coopération des régulateurs de l'énergie, dont les compétences auront un impact sur le fonctionnement du marché intérieur de l'énergie électrique et l'activité d'autorités de régulation du pays.

Quant à l'adaptation des dispositions mentionnées du Troisième Paquet Énergie au système juridique polonais, il faut faire remarquer que seulement certaines d'entre elles ont été transposées en vertu des derniers amendements de la loi « Droit de l'énergie ». Il faut également souligner que l'adaptation des dispositions de la directive 2009/72/CE renforcera de manière significative la position juridique du Président de l'Autorité de régulation de l'énergie, notamment par le rétablissement du mandat à durée déterminée de sa fonction et le renforcement de son indépendance.

Classification and key words: energy law, national regulatory authority, energy market, EU law, Third Energy Package, President of the Energy Regulatory Office.

I. Provisions of the Third Energy Package and their influence on the Polish legal system

1. Aims and provisions of the Third Energy Package

The Third Energy Package was adopted on July 13, 2009. It consists of the five following legal acts: Directive 2009/72/EU of the European Parliament and of the Council concerning common rules for the internal market in electricity and repealing Directive 2003/54/EU¹; Directive 2009/73/EC of the European Parliament and of the Council concerning common rules for the internal

¹ OJ [2009] L 211/55.

market in natural gas and repealing Directive 2003/55/EC²; Regulation (EC) No 713/2009 of the European Parliament and of the Council establishing an Agency for Cooperation of Energy Regulators³; Regulation (EC) No 714/2009 of the European Parliament and of the Council on conditions for access to the network for cross-border exchanges of electricity and repealing Regulation (EC) No 1228/2003; and Regulation (EC) No 715/2009 of the European Parliament and of the Council on conditions for access to natural gas transmission networks and repealing Regulation (EC) No 1775/2005⁴.

The aims of the Third Energy Package were stressed in the very preambles to the legal acts included in the Third Energy Package. The most important of them are: support for the development and unification of the EU's internal electricity and gas markets; support for intersystem exchange on electricity and gas markets; strengthening and deepening the independence of electricity and gas system operators; deepened harmonization of the rights of Member States' regulatory authorities and strengthening their legal position and independence; strengthening consumer rights and protecting vulnerable customers; increasing energy production from renewable sources; increasing energy efficiency; and the creation of the Agency for Cooperation of Energy Regulators (hereinafter: ACER). Because of the above aims the Third Energy Package is also called the Third Liberalization Package.

All the EU Member States were obliged to implement legal, executive, and administrative regulations necessary for the execution of the directives of the Third Energy Package by March 3, 2011. However, the requisite provisions of the Third Energy Package have not yet been implemented to the Polish legal system, excepting a small part which was implemented to the Act of 10 April 1997 – the Energy Law (hereafter, Energy Law⁵) by the Act of 8 January 2010, which amended the Energy Law⁶. In this context it would be worth scrutinizing those provisions of the package which specially influence the legal position of the President of the Energy Regulatory Office (*Urząd Regulacji Energetyki*; hereafter, URE) and evaluating how well these provisions have been implemented into Polish legislation.

² OJ [2009] L 211/94.

³ OJ [2009] L 211/1.

⁴ OJ [2009] L 211/36 with amendments.

⁵ Journal of Laws 2006 No. 89, item 625, with further amendments.

⁶ Journal of Laws 2010 No. 21, item 104.

2. The role and legal position of the national regulatory authorities – the provisions of the Third Energy Package and their state of implementation

A. The duty to guarantee the independence of regulatory authorities

Directive 2009/72/EC imposes on Member States the duty to guarantee the independence of their energy regulatory authority along with the execution of rights in a neutral and transparent way (Article 35 Para. 4). The directive specifically lists the conditions which must be fulfilled by Member States to meet this obligation. The premises listed in Article 35 are aimed at the ensuring 1) the legal and functional autonomy of the regulatory authority, 2) the functioning of staff independently from market interests and decisions of a political character, 3) budgetary independence and proper human and financial resources, and 4) the terms of offices for members of the managements of the regulatory authority.

According to Article 35 Para. 5 of Directive 2009/72/EC the terms of office should extend over a period of from 5 to 7 years, with the possibility of a single renewal. Moreover, Member States are obliged to ensure a proper system of rotation among the management or top executive positions of the regulatory authority. The members of the management or top executive personnel can be dismissed from their functions during their terms only when they do not fulfill the above-mentioned requirements for independence or when they commit an offence in the meaning of national legislation.

To date the implementation of the provisions of Directive 2009/72/EC into Polish legislation has not been carried out. This requires significant changes to the legal and factual status of the URE President. The URE President is a central authority of the governmental administration (Article 21 Para. 2 of the Energy Law) appointed by the President of the Council of Ministers (i.e., the Prime Minister) on the motion of the minister in charge of the economy. The URE President is subject to the supervision of the minister in charge of the economy, according to Article 9 Para. 3 of the Act on the branches of governmental administration⁷. In the science of administrative law the URE President is called ‘an independent regulatory authority’, but this definition requires more precision. It is pointed out that this does not mean exclusion from the system of public administration. An independent regulatory authority still remains a part of the state administration. The doctrine⁸ explains the ‘independence’ of a regulatory authority as a loose hierarchical submission linking the regulatory authority with other authorities.

⁷ Journal of Laws 1997 No. 141, item 943, with further amendments.

⁸ See M. Swora, ‘Organ do spraw regulacji gospodarki paliwami i energią’ [in:] M. Swora, Z. Muras (eds.), *Prawo energetyczne. Komentarz*, Warszawa 2010, p. 959.

The independence of the regulatory authority – besides the principle of separation of the function of energy policy from regulatory institutions – constitutes a basic principle of the separation of competences applied to different authorities of public administration, proper within the scope of energy politics of the state⁹. Looking at the legal status of the authority of the URE President it must be noted that his formal and factual independence had been limited together with the development of this institution. This authority was established by virtue of the Energy Law which entered into force on October 11, 1997¹⁰. In the initial wording of Article 21 of the Energy Law, the URE President was a central authority of the state administration, appointed by the President of the Council of Ministers for a 5-year term. The cases of his dismissal were listed in Article 21 Para. 3 of the Energy Law, to wit: ‘The President of the Office may be recalled by the Prime Minister prior to the completion of the term of office he has been designated for in case of an illness which permanently prevents him from performing their tasks, a blatant misuse of his competences, committing a crime confirmed by a final and binding court sentence, or as a result of resignation’. The legal status of the URE President created by the initial wording of the Energy Law was clearly the most beneficial regarding the independence of the authority, and was closest to the standards created by the Community sources of the Energy Law. It is possible to state that among all the solutions that have appeared during the 14-year history of the authority, the initial model in the fullest possible way tried to separate the regulator both from regulated subjects as well as from the sphere of governmental intervention and current politics. These principles create *ratio legis* of its existence in the legal system of regulatory authorities. According to Tomasz Kowalak¹¹, the regulatory authority should be maximally independent from current politics in order to counteract attempts to use the energy sector for current interests, should balance the contradictory interests arising between the realm of politics (i.e., interests of the Ministry of the Economy, tax authorities, environmental protection, ownership policy of the State Treasury, and social policy) and the realm of business (i.e., relations between energy entrepreneurs and customers). Unfortunately, the further development of the legal status of the URE President has brought both significant regress and solutions contradictory to Community legal standards for the legal status of independent regulatory authorities¹².

⁹ See F. Elżanowski, ‘Relacje pomiędzy ministrem właściwym do spraw gospodarki a Prezesem Urzędu Regulacji Energetyki w sprawach nadzoru nad sektorem energetycznym’ [in:] M. Wierzbowski, R. Stankiewicz, *Współczesne problemy prawa energetycznego*, Warszawa 2010, p. 61.

¹⁰ Journal of Laws 1997 No. 54, item 348, with further amendments.

¹¹ T. Kowalak, ‘*Tworzenie rynku energii elektrycznej i restrukturyzacja sektora energetycznego – spojrzenie regulatora*’, (2005) *Biuletyn URE* 1, p. 12.

¹² See W. Hoff, *Prawny model regulacji sektorowej*, Warszawa 2008, pp. 200–201.

Article 21 of the Energy Law was for the first time changed as a result of the amendment which entered into force on January 1, 2002¹³. The new provisions provided that the President of the Council of Ministers appoints the President of URE on the motion of the minister in charge of the economy. The disadvantageous trend in changes to the legal status of the URE President began in 2005¹⁴. Implemented by virtue of the Act of July 27, 2005 on conducting competition for executive positions in central offices of the state administration, presidents of state agencies and presidents of state purpose funds, the institution of competition as a stage in the appointment of the URE President ('the President of URE, chosen by the way of competition, is nominated by the Prime Minister upon the request of the minister in charge of the economy'; Article 21 Para. 2a of the Energy Law), the amendment simultaneously overruled the above-listed reasons for recalling the holder of the authority, giving the President of the Council of Ministers (i.e., the Prime Minister) the discretion of making such a decision. This decision played a significant role in limiting the independence of the authority. It made possible easy removal of the URE President for purely political reasons¹⁵. One of the visible results has been that of frequent changes of the holders of the authority since the moment this amendment entered into force. Over the period of 8 years from the day the Energy Law entered into force until the amendment of 2005 the president of the authority did not change. Over the next five years such change occurred 4 times, including once only three months after the office had been taken. The situation worsened after the liquidation of the terms of office of the URE President by virtue of the Act of 4 August 2006 on state cadre reserves and high state positions¹⁶. The current wording of Article 21 of the Energy Law in force was established by the amendment contained in regulations of the Act of November 21, 2008, on the civil service¹⁷. Article 21 Para. 2a states: 'The President of the Office is appointed by the President of the Council of Ministers from people belonging to the state cadre reserves, chosen by way of open and competitive draft, on the motion of the minister in charge of the issues of economy. The President of the Council of Ministers recalls the President of the Office.'¹⁸ The European Commission discerns a connection between the appointment and recalling of the holder of the authority by

¹³ Journal of Laws 2001 No. 154, item 1802.

¹⁴ See M. Swora, 'Status prawnoustrojowy Prezesa URE' [in:] M. Swora, Z. Muras (eds.), *Prawo energetyczne...*, pp. 965–966.

¹⁵ See B. Nowak, 'Niezależny organ regulacyjny na przykładzie sektora energetycznego' (2010) 9 *Przegląd Ustawodawstwa Gospodarczego*, p. 3.

¹⁶ Journal of Laws 2005 No. 62, item 552.

¹⁷ Journal of Laws 2008 No. 227, item 1505, with further amendments.

¹⁸ See M. Nowacki, 'Zakres niezależności Prezesa URE. Uwagi de lege lata i de lege ferenda w świetle wspólnotowych i polskich regulacji prawnych' (2009) *Biuletyn URE* 1, pp. 62–65.

governmental subjects, totally contradictory to the Directive. Thus, it bears repeating¹⁹ that the gradual deprivation of the URE President's prerogatives of constitutional independence meant to secure the running of an effective and impartial regulatory policy is an especially disturbing development, totally at variance with European trends within the area of the constitutional position of independent regulatory bodies.

The implementation of the provisions of Directive 2009/72/EC regarding the terms of office of a regulatory authority should at least entail a return to the wording of the provisions of Article 21 of the Energy Law concerning the execution of his function by the URE President from the original text of the Energy Law. However the following question should be raised: can even the eventual restoration of the previous legal status fulfill the aim of the Directive? Or is more revolutionary reform of the authority – the URE President – required? As Mariusz Swora rightly pointed out, the evolution of the provisions of the European legislation is going in an absolutely different direction than the trends toward limiting the independence of the President of URE in Polish legislation²⁰. It is enough to look at the text of Article 35 Para. 4 of the Directive to notice the significant differences between the Community model for an independent regulator and the Polish legal status of the URE President. First, any regulatory authority should be legally separated and functionally independent from any public or private subject. Today, however, the URE President is appointed by the President of the Council of Ministers (i.e., the Prime Minister) on the motion of the minister in charge of the economy, and can be – at the Prime Minister's discretion – recalled at any moment. This construction deepens the dependence between the holder of the authority and the Prime Minister, being (even in the most 'technical' government) an active politician. It questions the ability of the URE President to undertake (as expected by the provision of Article 35 Para. 5 Point a) 'decisions independent from any political subject'. The strengthening of this independence should be supported by the restoration of the initial norms regarding the legal status of the URE President (lost during the period of the evolution of this institution), as foreseen by the regulation of Article 35 Para. 5 Point b) of the Directive. In details this refers to the restoration of the terms of office (the Directive anticipates a term lasting from 5 to 7 years) and possibility of dismissal only in the case of violating the conditions defined in the Directive or an offence in the meaning of national legislation.

¹⁹ F. Elżanowski, *Polityka energetyczna. Prawne elementy realizacji*, Warszawa 2008, p. 84.

²⁰ M. Swora, 'Status prawnoustrojowy Prezesa URE...', p. 996.

It is worth noting that a similar construction to the Directive is that of Great Britain's independent energy regulator²¹. The regulator in the United Kingdom is the Gas and Electricity Markets Authority, known as Ofgem. This office was established on the basis of Utilities Act of 28 July 2000²². It is a collegial body, consisting of executive members and non-executive members. The non-executive members fulfill advisory functions and originate from among experts – the executive members, in turn, from the executive staff. The management is headed by a Chairman (who is not an executive member) and the Chief Executive. All members are appointed by the Secretary of State (proper minister, now the Secretary of State for Energy and Climate Changes), Of course, the minister is also a politician, but his role is that of appointment (and in exceptional circumstances of withdrawing the right to be a member of the management). At present the members of the management are appointed for individual terms of office not exceeding 5 years and can be dismissed only by virtue of resignation, losing the ability to be a member of the Management, or committing an offence. The present bulletin regarding the implementation within the scope of the Third Liberalization Package in Great Britain points out the necessity of more detailed fulfillment of the aim of the Directive, for instance by changes in the regulations regarding terms of office²³. This model could be the inspiration for changes in the legal status of the Polish regulatory authority, however it must be noted that Great Britain is a country with a significantly different constitutional and legal tradition than exists in Poland and automatic copying of its legal solutions will not automatically be a guarantee of success.

It is worth mentioning Marcin Nowacki's proposition²⁴ to link the URE President with the Parliament. Nowacki justifies his proposal by the fact that the Sejm and the Senate are the highest authority of state authority, executing control over the activity of the Council of Ministers within the scope defined by the provisions of the Constitution and statutes. Moreover he summons the examples of numerous state authorities appointed by the Sejm or the Speaker of the Sejm. These include the Ombudsman, General Inspector of Personal Data, the President of the National Bank of Poland, and the President of the Highest Chamber of State Control. Nowacki recognizes that it would nevertheless be difficult to implement this proposal, due to the necessity of a complete

²¹ For the legal provisions concerning independent energy regulators in France, Germany and Great Britain see B. Nowak, 'Niezależny organ regulacyjny...', pp. 4–6.

²² Utilities Act 2000, c. 27.

²³ DECC – Department of Energy and Climate Change, *Implementation of the EU Third Internal Energy Package. Government Response*, January 2010, document available at: <http://www.decc.gov.uk/Media/viewfile.ashx?FilePath=Consultations/eu-third-package/1163-eu-third-package-gov-response.pdf&filetype=4&minwidth=true>

²⁴ M. Nowacki, 'Zakres niezależności Prezesa URE...', pp. 65–66.

reconstruction of the system for authorities of public administration and identical regulation of the status of other independent regulatory authorities. This proposal was nonetheless positively evaluated by Mariusz Swora²⁵. What is shown by experience is that the practice of appointing authorities reporting to the Sejm by ordinary majority can also contain the risk of too strong a commitment on the part of a person fulfilling the function of the holder of an authority with current party policy. By adopting the possibility of appointing the URE President by the Parliament it should be proper to secure a term longer than a single term of the Sejm and the Senate (which would fulfill the aim of a term of 5–7 years as in the regulation of Article 35 Para. 5 Point b) of Directive 2009/72/EC) and to introduce the principle of qualified majority.

Independently from the choice of a more radical model for changes during the implementation efforts (or, more probably, a more conservative one), the implementation of the resolutions of Article 35 of Directive 2009/72/EC will influence both the functioning of the position of the URE President and the functioning of the whole unit reporting to him – namely, the Energy Regulatory Office. It should be mentioned that carrying out the duties arising from Article 35 of the Directive requires not only the introduction of proper regulations into the Energy Law guaranteeing the independence of the regulatory authority, but also real measures which could be undertaken on the basis of present legal regulation. Previous practice, supported by the process of legislative changes limiting the independence of the URE President, does not permit us to look forward with optimism at the direction of the development of such an important institution for the Polish economy.

B. The duties and powers of national regulatory authorities arising from the establishment of ACER

Directive 2009/72/EC in Article 37 contains a wide catalogue of duties and powers which are entitled to national regulatory authorities. The listed rights and powers partly constitute the achievements of previous regulations within this scope (i.e., the Second Energy Package). They also constitute the basis for the activities of national regulatory authorities, i.e., the URE President. The catalogue from Article 37 of the Directive also contains new resolutions (in result of other resolutions of the Third Energy Package) and determines new roles for national regulatory authorities.

Among the duties mentioned in Article 37 of the Directive significant attention should be paid to the duties arising from the establishment of the Agency for Cooperation of Energy Regulators (ACER) and the competencies

²⁵ M. Swora, 'Status prawnoustrojowy Prezesa URE...', p. 973.

awarded to it. These duties of national regulatory authorities include e.g., cooperation in the realm of cross-border exchange with regulatory authorities of other Member States and with ACER, compliance and implementation of all legally binding decisions of ACER and the Commission, and submitting to the proper authorities of the Member States, ACER, and the Commission annual reports on its activities and the fulfillment of its duties.

The Agency for the Cooperation of Energy Regulators was established by virtue of Regulation (EC) No 713/2009 of the European Parliament and of the Council of 13 July 2009. The Agency was established to support, on the Community level, national independent regulatory authorities aimed at the realization of their duties within the scope of energy regulation and coordination of these activities.

ACER was awarded with far-reaching powers and competencies to issue non-binding acts, and, in defined cases, also ones of a binding character. According to Regulation 713/2009, ACER can issue opinions and recommendations directed to the transmission system operators (TSO) of EU Member States, national regulatory authorities, the European Parliament, Council, and Commission. In cases defined in the Regulation, ACER can issue individual decisions of a binding character. Moreover, ACER monitors the execution of task by ENTSO – the European Network of Transmission System Operators (issuing opinions about the status, regulations, and list of ENTSO members) and presents to the Commission non-binding framework guidelines. Its duty is to secure frameworks for cooperation between national energy regulators. ACER's competencies also include monitoring the internal energy markets of electricity and natural gas, especially the retail prices of electricity and gas, access to networks, including access to energy generated in renewable sources and compliance with consumer rights.

ACER also possesses broad powers regarding electricity network infrastructure. It participates in the elaboration of grid codes, monitors and supervises the implementation of grid codes and guidelines adopted by the Commission, monitors development in the realization of projects aimed at the creation of new capacities for cross-border connections, monitors the implementation of grid development plans of a Community scope, and monitors regional cooperation of transmission system operators. In defined cases ACER is empowered to undertake decisions in regulatory matters which belong to the competencies of national regulatory authorities and which can contain the conditions for access to this infrastructure and the condition of its exploitation safety.

The consequence of integration within the scope of creating the internal energy market is the necessity to establish authorities equipped with powers of a coordinative character supporting cooperation between regulatory

authorities on the Community level. In the longer term it will probably be necessary to establish an authority possessing, in a defined meaning, regulatory rights on the Community level, i.e., referring to the abuse of the principles of the internal market for natural gas and electricity or cross-border cooperation. ACER is not an authority of this type, as its powers do not enter into the competencies of the regulatory authorities of Member States. The issues such as intersystem exchange should no doubt remain within the scope of the authority functioning on the Community level. Thus, the influence on the powers within this scope should be recognized as proper and justified.

The direct effects for the national regulatory authorities, including of course, the President of URE, arising from Regulation 713/2009, entail the duty to cooperate with ACER and the duty to submit reports defined in the Regulation both to ACER and the European Commission. The rights of ACER regarding the regulatory authorities of the Member States were collected in Article 7 of this Regulation and they foresee i.a., the possibility to undertake by ACER individual decisions in technical matters, if such decisions are foreseen in Directive 2009/72/EC, in Directive 2009/73/EC, in Regulation 714/2009, and in Regulation 715/2009. ACER can also issue opinions on decisions handed down by a national regulatory authority. Such an opinion can be issued on the motion of a regulatory authority or the European Commission, and the scope of such an opinion is limited to evaluating the compliance of a decision with the guidelines mentioned in Directive 2009/72/EC, in Directive 2009/73/EC, in Regulation 714/2009, or in Regulation 715/2009 or in other proper provisions of these directives and regulations. The opinion issued by ACER is of a binding character: a national regulatory authority is obliged to comply with it within a period of four months from the day of its reception. If an authority does not comply with the opinion, ACER notifies the European Commission and the given Member State. In the case when a regulatory authority faces difficulties in the application of the provisions of Directive 2009/72/EC, Directive 2009/73/EC, Regulation 714/2009 or Regulation 715/2009, it can submit a motion to ACER asking for an opinion. ACER issues opinions after consultation with the European Commission within a period of three months from the day of reception. It can also issue decisions of a binding character defining conditions of access to the electricity and gas infrastructure connecting at least two Member States.

ACER's duty is also to secure the frames for cooperation for national regulatory authorities and to support cooperation between national regulatory authorities and between regulatory authorities on the regional and Community level and consider the results of this cooperation in the elaboration of opinions, recommendations, and participation on the market in sharing good practices.

Besides the described meaning of the regulations concerning ACER for the harmonization of Community energy law, to date not one regulation of the Package connected with ACER has been implemented into Polish legislation. As Mariusz Swora²⁶ pointed out, a significant mistake is to leave the question of cooperation within the frames of ACER and cooperation with other international authorization without the scope of duties of the URE President, defined in Article 23 Para. 2 of the Energy Law. One consequence of this negligence is the lack of means from the budget for the realization of the duties which the URE President – as the national regulatory authority in the meaning of the regulation of Article 35 Para. 1 of Directive 2009/72/EC – fulfills on the international scene, within the frames of ACER and the European Group of Supervisory Authorities for Electricity and Gas.

C. Other powers and duties of national regulatory authorities arising from the Third Liberalization Package

A significant part of the resolutions of Article 37 of Directive 2009/72/EC will require implementation into Polish legislation. Above all this includes rights connected with cooperation within the scope of cross-border issues with regulatory authorities of Member States and activities of transmission and distribution system operators²⁷ of the Regulation 714/2009, and monitoring the time necessary for transmission and distribution system operators for the execution of connections and repairing. No implementation activities within this scope are underway.

II. New powers of the President of the Energy Regulatory Office

1. New powers and duties of the President of the Energy Regulatory Office arising from the amendment of the Energy Law

The Act of 8 January 2010 on the amendment of the Energy Law and on the amendments of some other acts have introduced a number of new duties and powers of the URE President: they were added to the list contained in the provisions of Article 23 of the Energy Law. As mentioned above, they

²⁶ M. Swora, 'Organ do spraw regulacji gospodarki paliwami i energią...' p. 963.

²⁷ I.e., monitoring investment plans of transmission system operators and placing in an annual report the evaluation of investment plans of transmission system operators within the scope of their compliance with the development plan of the grid of community range, described in Article 8 Para. 1. Point b).

implement these powers only partly. In particular, the provisions arising from the Regulation establishing ACER, awarded rights and duties imposed on Member States, have not been implemented.

The Act on the amendment of the Energy Law and on the amendment of other acts implements Directive 2005/89/EC of the European Parliament and of the Council of 18 January 2006 concerns measures to safeguard electricity supply and infrastructure investment²⁸. This act also contains changes aimed at the application of amendments to the Regulation No. 1228/2003/EC of the European Parliament and of the Council of 26 June 2003 on the conditions for access to the network for cross-border exchanges in electricity²⁹ implemented by the decision of the European Commission of 9 November 2006.³⁰ The powers and duties of the URE President implemented by virtue of the act on the amendment of the Energy Law and on amendments of some other acts with division regarding the subject of these powers will be discussed below.

2. Characteristics of the new powers of the President of the Energy Regulatory Office and their classification in terms of competencies

The widest group of new powers for the URE President regards the functioning of the electricity market at large. They are foremost aimed at supporting competitive conditions on the energy market, supporting its development, and protecting consumer rights.

One of the most important powers awarded to the President of URE by virtue of the amending act concerns controlling the execution of duties arising from Article 49a Paras. 1 and 2 of the Energy Law (Article 23 Para. 4a of the Energy Law). Article 49a of the Energy Law implements a duty to trade a defined percentage of energy generated in a given year by an energy company, publicly, transparently, and openly on the power exchange, on the regulated market, on an Internet trade platform, or in the form of a tender. In connection with the introduction of this duty the URE President was awarded the powers to invalidate, in defined cases, a tender for electricity sales and to grant to generators, in the form of an administrative decision, a release from a duty to sell a defined quantity of energy in the public procedure.

According to Article 23 Para. 2 Point 18 of the Energy Law, the URE President collects and processes information regarding energy companies, calculates and publishes, by March 31 of each year, the average sales price of electricity generated in high-efficiency cogeneration, electricity on the

²⁸ OJ [2006] L 33/22.

²⁹ OJ [2003] L 176/1 with further amendments.

³⁰ OJ [2006] L 312/59.

competitive market and the way of its calculation, and heat generated in generation units which are not cogeneration units and belong to enterprises possessing licenses. Moreover the URE President issues certificates on the origin of electricity from biogas and supervises the fulfillment of the purchase of these certificates by energy companies (Article 9a Para. 1 Point 1 of the Energy Law).

The second group of powers awarded to the URE President consists of those concerning the functioning of electricity and gas systems. Within this scope the URE President was awarded with competencies to approve full Transmission Grid Code and Distribution Grid Code, which, according to Article 9g Para. 12 of the Energy Law, constitute an integral part of a contract for performing transmission and distribution of energy and gaseous fuels or a complex contract. Moreover the URE President was awarded the power to nominate for a period defined via an administrative decision, the transmission system operator, the distribution system operator, the system of storage, the system of natural gas liquefaction and operator of combined system, and to define the area, grid, and installation on which this activity will be performed. The power to nominate system operators was awarded to the URE President also in the former legal status, but in the actual wording of Article 9h of the Energy Law was supplemented by a new procedure for nominating operators (i.e., on the basis of a contract regarding entrusting the operator's functions)

Beyond this, with the implementation of Directive 2005/89/EC concerning measures to safeguard electricity supply and infrastructure investment, the competencies of the URE President were widened to include the rights and duties arising from the Directive mentioned above regarding the security of the national electricity system, i.e., monitoring activities of operators in the case of dangers regarding the security of electricity supplies and elaborating opinions on operators' reports and submitting recommendations to the minister in charge of the economy.

The URE President was also awarded with the power to control the realization (by the electricity transmission system operator or combined electricity transmission system operator and by other participants of the electricity market) of duties arising from Regulation No. 714/2009 of the European Parliament and of the Council of 13 July 2009 on conditions for access to the network for cross-border exchanges of electricity and repealing Regulation (EC) No 1228/2003 and also executing other duties of the regulatory authority arising from this Regulation (Article 23 Para. 2 Point 11 of the Energy Law).

As mentioned above, due to the approval of the Act of 8 January 2010 on the amendment of the Energy Law and on amendments to some other acts,

the legislator executed only partial implementation of the resolutions arising from the Third Energy Package. This Act implemented Directive 2005/89/EC concerning measures to safeguard electricity supply and infrastructure investment and introduced changes supporting the application of changes of Regulation (EC) No 1228/2003 of the European Parliament and of the Council of 26 June 2003 on conditions for access to the network for cross-border exchanges in electricity.

The powers awarded to the URE President by virtue of the Act of 8 January 2010 significantly widened the competencies of the URE President regarding the regulation of the electricity market, but they have not strengthened his legal position satisfactorily. One direct consequence of broadening the catalogue of his powers is that of broadening the catalogue of behaviours of energy companies covered by sanctions due to abuse of provisions of the Energy Law (Article 56 of the Energy Law).

III. Conclusions

The above analysis points out both changes and omissions connected with the implementation of the regulations of the Third Liberalization Package. It must be emphasized that full implementation has not been achieved. The biggest shortcomings are visible in two fields: the realization of the aims of Articles 35 and 37 of Directive 2009/72/EC. Within the scope of the implementation of Article 35 of the Directive the changes to the legal position of the URE President, (i.e., loosening his ties with the sphere of governmental administration, something strongly advocated by negative developments which have taken place in the legal and constitutional status of the authority over the last six years) have not been implemented. One minimal step in the proper direction would be the return of the guarantee of independence which the President of URE possessed at the beginning of his functioning (directly after the establishment of this authority in 1997), along with terms of office, and security from early recall due to reasons beyond current politics, guaranteed by defined reasons for his recall. It would be worth considering a far-reaching redefinition of the presence of the URE President within the structure of governmental administration – for instance, his exclusion from supervision by the minister of the economy, or, as other representatives of the doctrine propose, to subordinate independent regulatory authorities to the Parliament. Subsequently, within the scope of implementing Article 37, we are compelled to negatively evaluate the lack of implementing issues connected with cross-border cooperation with regulatory authorities of the Member States and

connected with the establishment of ACER and the activity of the transmission and distribution system operators. Within this scope, only full implementation of the resolutions of the Directives contained in the Third Energy Package will bring real and far-reaching changes and also will place before the URE President new challenges and newly defined duties. The deadline for the implementation of Directive 2009/72/EC and 2009/73/EC was March 3, 2011.

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The Energy Tariff System and Development of Competition in the Scope of Polish Energy Law

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CONTENTS

- I. Introduction
- II. The tariff issue in Poland: a general depiction
- III. The regulator's role in energy tariff regulation
- IV. Competition in the energy market and price regulation
- V. Conclusions

Abstract

This article presents problems associated with the development of competition on the Polish energy market in the context of tariffs and pricing. National standards are set against the background of European legislation and the activities of the Energy Regulatory Office. The thesis is that the tariffs concerning distribution should be approved by the President of this authority because it is a natural monopoly, something the authors demonstrate in the following part of the article. However, the tariffs concerning selling should be free from confirmation even for households because this is a typical market. The authors do not ignore legal analysis and practical issues.

Résumé

Cet article présente les problèmes associés avec le développement de la concurrence dans le marché de l'énergie en Pologne, dans le contexte des tarifs et des prix. Les standards nationaux sont présentés dans le contexte de la législation européenne

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et des activités de l'autorité de régulation de l'énergie (ERA). La thèse est que les tarifs concernant la distribution devront être acceptées par le Président de l'ERA, parce que c'est un monopole naturel, ce qui sera expliqué par les auteurs dans la partie suivante de l'article, mais les tarifs concernant la vente devront être libre, même pour les ménages, parce que c'est un marché typique. Les auteurs n'ignorent pas l'analyse de la loi et les aspects pratiques.

Classifications and key words: energy law, tariff, energy market.

I. Introduction

The purpose of the article is to present the influence of tariff-setting on the energy market in light of national and community judicial judgements. The authors have not made an economic analysis, and only within the limited extent of this article consider the influence of instruments of an administrative character in the form of tariff approval on the development of competition on the energy market.

Many directives issued within the structure of the European Union (EU) are connected with the liberalization of the energy market. This obviously has a direct effect on national legislation. Energy companies operating on the market aim to maximize their revenues, but they are restricted in doing so by state institutions and legislation. The literature distinguishes various types of regulations and differing motives for its introduction. One may mention regulation for economic reasons concerning the control of prices, the conditions for entry and exit from the sector, type of products, etc. – or regulation connected with social welfare, undertaken in the form of safety, quality, environmental protection, and consumer protection requirements, etc. Among the motives justifying regulation we may mention market inadequacies (ineffectiveness) related to external effects on product markets and production factors, the problem of private and public assets, the problem of natural monopolies, the requirement of supplying ordinary services at sensible prices, and political maneuvering in the conditions of public choice. The process of regulation is used by the state for achieving various functions, such as creating a legal basis for the operation of the market economy. From the times of Adam Smith, the problem of determining the compass of state regulation has been a focus of expert debate¹ as well as legislative efforts. In the scope

¹ A. Zielińska-Głębocka, *Podstawowe założenia teorii konkurencji* [in:] *Konkurencja*, Z. Brodecki [ed.], LexisNexis, Warszawa 2004, pp. 48–49.

of the electricity and natural gas directives², energy companies have been subject to regulation through *unbundling* – in other words, separation of the transmission and distribution activities of a network business from its activities in production and supply.

The main idea of unbundling was to mitigate the incentives for discriminating against competitors, and to increase equality in access to the market and competition. Among others matters, the assumption of the electricity and market directives was also the elimination of discrimination both in the area of defining electricity and gas prices in tariffs³, which shall guarantee nondiscriminatory access to the energy system for all users.

There are two different types of tariffs: (i) distribution tariffs – fee for the energy transfer and (ii) end-user tariffs – currently only for households. Tariffs concerning distribution and transmission should be approved by the President of the Energy Regulatory Office (*Urząd Regulacji Energetyki*; hereafter, URE) because it is a natural monopoly, as we prove in the following part of this article. However, the tariffs concerning price cap for households should be free from the obligation of receiving an approval granted by the URE President. In conclusion, it is our opinion that excessive state interference in the regulation of prices for selling energy and in distribution does not provide improved protection for consumers in the long term.

II. The tariff issue in Poland: a general depiction

In connection with the interference of the state in the energy market the concept of the tariff was introduced to the Act of 10 April 1997 – the Energy Law (hereafter, the Energy Law)⁴. According to Article 3 item 17 of the Energy Law, a tariff is the collection of prices and fee rates, as well as

² Directive of the European Parliament and of the Council 2009/72/EC of 13 July 2009 concerning common rules for the internal market in energy and repealing Directive 2003/54/EC, OJ (2009) L 211/55; Directive of the European Parliament and of the Council 2009/73/EC of 13 July 2009 concerning common rules for the internal natural gas and repealing Directive 2003/55/EC, OJ [2009] L 211/94; Directive 2003/54/WE of the European Parliament and of the Council of the 26 July 2003 concerning common principles in the internal electric energy market and revoking directive 96/92/WE (OJ [2003] L 176/37); Directive 2003/55/WE of the European Parliament and of the Council of the 26 July 2003 concerning common principles in the internal natural gas market and revoking directive 98/30/WE (OJ [2003] L 176/57).

³ B. Nowak, *Wewnętrzny rynek energii w Unii Europejskiej*, C.H. Beck, Warszawa 2009, p. 123 ff.

⁴ Unified text available at http://www.ure.gov.pl/portals/pl/25/17/Ustawa_z_dnia_10_kwietnia_1997_r_Prawo_energetyczne.html.

the conditions of their application, drawn up by the energy enterprise and introduced, as being in force for the recipients specified in them in the manner specified in the Act, that is in the form of administrative decision. These are tariffs which are approved by the URE President, although some of them may not be approved under the provisions of the Energy Law. It is necessary to agree with the position of H. Palarz⁵, that fees are treated in the literature as a public rent collected from subjects in connection with mutual provisions on behalf of those subjects, assuming the form of public services, pursued in principle by enforcement. In the Energy Law the concept of fees is used in another meaning than public legal rents and applies to some of the price components of an energy enterprise. Obviously the question arises as to the legal nature of the establishment of prices. Furthermore, according to the ruling of the Supreme Court of April 11, 2003⁶ the tariff of fuels corresponds to the requirements specified in Article 47 item 1 of the Energy Law and is classified in a standardized contract.⁷ This means that the text of the tariff (with any specific obligations or possibilities) should be an integral part of any agreement.

III. The regulator's role in energy tariff regulation

In our opinion the activity of the URE President, as a substitute for a competitive market, should be obligatory, especially in markets where a natural monopoly exists, such as the energy market. However even here a demarcation line shall be drawn between transmission and distribution which require regulation and supply of energy to customers, and which shall be left to market forces of demand and supply. Otherwise destabilization of the market might ensue.

As confirmed by the URE President in his Statement of June 28, 2001 'The general relief from the duty to approve a tariff issued on electricity generation and electricity trading companies with no electricity distribution activity' ('Statement of June 28, 2001')⁸ was legally effective. Pursuant to

⁵ H. Palarz, *Prawo energetyczne z komentarzem*, Gdańsk 2004, p. 33.

⁶ V CK 38/2002.

⁷ This position was confirmed by the Supreme Court in the ruling of the Civil Division of the Supreme Court that the tariff, approved by the Energy Regulation Authority is not an administrative act, it is within the application of Article 384 of the Polish Civil Code, which does not contain a closed catalogue and is a standard V CK 855/2004 (*Gazeta Prawna* 2005/134 p. 17).

⁸ Stanowisko Prezesa URE w sprawie zwolnienia przedsiębiorstw energetycznych zajmujących się wytwarzaniem i obrotem energią elektryczną z obowiązku przedkładania taryf do zatwierdzenia (28.06.2001), www.ure.gov.pl.

Article 49 item 1 of the Energy Law the URE President is empowered to grant a relief from the duty to submit tariffs, if the market where a particular energy enterprise operates is competitive. The URE President is also empowered to withdraw its relief from the tariff approval duty, provided that the reasons for the earlier issued relief no longer exist. What this means is that that today's energy market cannot be less competitive than in 2001.

It must be noted that pursuant to Article 47 item 1 of the Energy Law the URE President approves tariff (tariff application) submitted by the energy undertaking, but he is not allowed to define the content of the application. The tariff approval procedure includes only two possible outcomes: a decision approving tariff or a decision refusing to approve tariff.

According to Article 47 item 1 of the Energy Law tariffs for natural gas and electric power are subject to approval by the URE President. Energy enterprises prepare tariff application themselves or at the demand of the URE President. Failure to submit an application in the event of a summons by the URE President is subject to a penalty in the procedure of Article 56 item 1 point 5a of the Energy Law. Furthermore according to the judgement of the Supreme Administrative Court (*Naczelny Sąd Administracyjny*; hereafter, NSA) of March 31, 2009⁹ such summons of an energy enterprise to submit tariffs, made by the URE President, is not an act or action within the scope of public administration concerning authorizations or obligations arising from legal regulations and thus is not subject to appeal.

In the tariff application the energy enterprise proposes the period for which the tariff shall be in force. Indication of the validity period of the tariff by the energy enterprise (the applicant) in our opinion should not exceed three years. In the Energy Law the legislator accepted the principle that the period in force not exceeding three years should be dependent upon fulfillment of the premise defined in this regulation. The URE President is authorized to demand changes to tariffs and to the premises (reasons and conditions) applied in the application, e.g., in a situation where a new tariff might lead to the reduction of rates of prices and fees. Undoubtedly the fact remains, as confirmed by the Supreme Court in its judgment of August 5, 2004¹⁰, that the obligation of an energy enterprise to submit to the procedure of tariff verification on the basis of Article 47 of the Energy Law is an obligation of a public-legal nature obliging it to apply prices according to approved tariffs.

The URE President confirms a tariff or refuses its approval in the event that it does not fulfill the requirements as specified in the regulations of the Energy Law. Proceedings in the case of approval of tariffs are subject to the general principles defined in the Code of Administrative Procedure (*Kodeks*

⁹ II GSK 831/08.

¹⁰ III CK 349/03.

Postępowania Administracyjnego; hereafter, CAP), meaning that procedures in such matters should be completed within the period envisaged for arranging matters by the provisions of this Act¹¹. This is explicitly indicated in Article 30 item 1¹² of the Energy Law, which in proceedings conducted before the URE President that orders the application of the provisions of CAP¹³. The URE President in the process of the proceedings for approving tariffs makes an assessment of whether the given tariff has been established in accord with the legal regulations. The boundaries of interference of the Authority in this extent are defined by the provisions of Article 23 item 2 point 2 and 3 in conjunction with Article 47 and 49 of the Energy Law in conjunction with the issues executive ordinances based on Article 46.

According to Article 47 item 2a of the Energy Law the URE President, on the application of energy enterprises, can approve for a period not exceeding 3 years, a tariff containing prices and fee rates whose amount shall not exceed prices and fee rates in force prior to its submission to the URE President, if the following combined conditions are fulfilled, i.e.:

- 1) tariff conditions of application of prices and fee rates have not been subject to change;
- 2) documented (and described in the application) external changes of conditions to the business activity of the energy enterprise, and which concern the tariff, do not justify the reduction of prices and fee rates contained in the tariff;

¹¹ Not completing procedures in one of the periods, referred to in Article 35 of CAP or lack of notification directed to parties according to art. 36 § 1, may result in the resorting by one party to legal measures to combat the inertia of a public authority, including a complaint about inactivity to the Provincial Administrative Court (Article 3 § 1 point 8 of the Act of 30 August 2002 – Law on Procedure before Administration Courts). (...) Additionally it would be necessary to consider, when the situation in which the tariff for various reasons would not be confirmed within the period envisaged in Article 35 CAP, might give rise to responsibility for damages of the party of the President of the Authority. Article 77 of the Constitution of the Republic of Poland states that everyone is entitled to compensation for damages inflicted by the action of a public administrative authority, which contravenes the law. This constitutional principle is codified in the regulations of Article 417–417² of the Act of the 23 April 1964 – Civil Code. According to the wording of Article 417¹ § 3, if damages are inflicted by the failure to issue a ruling or decision, if the obligation to issue them is envisaged in a legal regulation, its remedy may be demanded after confirmation in the appropriate procedure of lack of conformity with the law in the lack of issue of ruling or decision, unless separate regulations determine otherwise. In particular sites damages may arise in the situation, where a new tariff envisaged an increase in prices and fee rates and the President the Office would confirm it with delay....”. For more see: T. Dec, G. Słowiński, ‘Ile potrzeba czasu na zatwierdzenie taryfy?’ (2005) 6 *Biuletyn URE*.

¹² Journal of Laws of 2000 No. 98, item 1071 with amendments.

¹³ B. Adamiak, J. Borkowski, *Kodeks postępowania administracyjnego. Komentarz*, C.H. Beck, Warszawa 2005.

- 3) for the period proposed in the application of the validity of the tariff or part of this period a correction coefficient has not been established, defining the projected correction of the operating efficiency of the energy enterprise and changes in the conditions of the performance by the enterprise of a given type of commercial activity.

In this case two doubts arise: the first concerns the concept of prices and fee rates not exceeding amounts in force prior to the submission of tariffs to the URE President. One must therefore assume that these are prices from the last tariff approved by the URE President. It is obvious that all the premises to define are subject to evaluation by the URE President. According to Article 7 of CAP, during administrative proceedings the administrative authorities such as URE President are guardians of legality and take all steps essential to the precise clarification of facts and to the settlement of the case, which is equitable to the public interest. Before issuing a decision concerning the approval or refusal of a tariff the URE President is obliged to exhaustively collect and examine all material evidence (compare Article 77 § 1 CAP). In the event of documented changes of external conditions in the performance of commercial activity by an energy enterprise the URE President may issue a decision on the correction coefficient, defining the projected improvement in the efficiency of the operation of the energy enterprise and the changes in the conditions of the performance by the enterprise of the given type of commercial activity. This has been approved by the ruling of the Supreme Court of 14 January 2009¹⁴ according to which the decision of approval of electrical energy tariffs may be changed or revoked before the expiry of the period for which the tariff was established.

In such a case the energy enterprise is obliged to apply prices and fee rates from the tariff specified in Article 47 item 2a, until application of a new tariff. The previous tariff shall be applied in two instances, if:

- 1) the decision of the URE President has not been issued or
- 2) appeal proceedings are in progress against the decision of the URE President.

However, this tariff is not applied if the decision of the URE President refusing approval of the tariff is justified by the necessity of prices reduction and fee rates below the prices and fee rates contained in the hitherto binding tariff and results from documented and described changes in external conditions in the performance by the energy enterprise of commercial activity. In such a case the energy enterprise may not apply the tariff and equally may not apply a new tariff, because e.g., appeal proceedings are in progress. In

¹⁴ III SK 23/08.

such a situation the only solution appears to be to desist from the conduct of business activity by the energy enterprise.

According to Article 56 Para. 1 of the Energy Law, an entity which does not observe the obligation to present tariffs to the URE President for approval is subject to an administrative fine. The Supreme Court in its judgement of April 7, 2004¹⁵ approved this position stating that a financial penalty may also be imposed on a person who applies prices and tariffs not approved by the URE President, although already presented for such approval. This means that in such an instance, an energy enterprise may apply neither an unapproved tariff nor a tariff applicable to this time without being in jeopardy of a financial penalty. A possible solution in such a situation would be the legal regulation of such situations in agreements between the energy enterprise and the recipient¹⁶.

According to Article 47 of the Energy Law the URE President announces in the URE Bulletin, at the cost of the energy enterprise, the approved tariffs for fuel gases and electric power. The tariff may be in force not earlier than 14 and not later than 45 days from the date of its publication. This is not a rigidly defined *vacatio legis* of a new tariff, but the legislator has defined the time-frame for the inauguration of the new tariff. Obviously it is to the benefit of the recipients to acquaint themselves with the content of the new tariff. Nevertheless the parties, within the framework of mutual relations, are authorized to indicate another period for the inauguration of a tariff¹⁷. The aforementioned procedure concerns the approval of tariffs. It also raises the basic question of the role of the regulator in the extent of the possibility of non-execution of the obligation to approved tariffs.

The URE President is authorized to free an energy enterprise from the obligation to submit tariffs for approval, if he states that the energy enterprise operates in competitive conditions, on the basis of Article 49 item 1 of the Energy Law.¹⁸ The freeing referred to, may concern a specified part of the

¹⁵ III SK 30/04.

¹⁶ Compare with the judgement of the Supreme Court – Civil Division of October 2, 2003 (V CK 228/2002), which approved and announced in the procedure of the specified Energy Law, the tariff for energy in force from the expiry of the period defined in Article 47 item 4, unless the parties to the sale of energy agreement unless the parties of a power sales agreement defined the other terms of changes in prices and rates, or other means of settlement.

¹⁷ Compare judgement of the Supreme Court – Civil Division of October 2, 2003 (V CK 228/2002). See also: M. Czarnecka, T. Ogłódek *Prawo energetyczne. Komentarz*, C.H. Beck Warszawa 2009; R. Taradejna, Charakter prawny cen i stawek opłat zawartych w taryfie przedsiębiorstw energetycznych, (2003) 1 *Biuletyn URE* www.ure.gov.pl; R. Taradejna, A. Tutak, Problemy i pułapki administracyjno-prawnego zatwierdzenia taryf przedsiębiorstw energetycznych, (2005) 6 *Biuletyn URE* www.ure.gov.pl; D. Nowak, 'Ceny sztywne czy maksymalne?' (1999) 5 *Biuletyn URE*.

¹⁸ The quoted legal standard became the basis for the URE President's statement of December 14, 2000 on recognition of the electric power exchange market as a competitive market, thus releasing energy enterprises selling electric power through the market for goods from the obligation

operations conducted by the energy enterprise, in the extent to which such operations are conducted in a competitive market.¹⁹ With regard to the above, one may accept the interpretation that the release may apply to a specified type of business activity conducted by an energy enterprise and thus may refer to a specified group of tariff recipients or also apply to a specified geographical area. It is characteristic of the legislator to use the definition 'competitive conditions' instead of 'competitive market'. Use of this somewhat less rigorous clause gives the URE President greater possibilities in making use of this authorization.

It must be noted that the URE President still keeps to his stance pending the procedure of tariff approval. This will be actionable and can be challenged with an appeal in the Court for Protection of Competition and Consumers (*Sąd Ochrony Konkurencji i Konsumentów*; hereafter, CCP Court). The CCP Court could include an immediate enforcement clause. If the court judgment is not acceptable for the energy enterprise, it may appeal to the Court of Appeals in Warsaw and finally lodge a cassation procedure to the Supreme Court.

This situation means that provisions for unbundling should clearly indicate that access tariffs for distribution service accepted by the URE President as his domain shall be separated from price caps – tariffs set on prices charged to end-users (consumers). The latter shall remain subject to market conditions, and the role of the URE President shall be reduced to a minimum. Apart from this the division of tariffs set for particular group of consumers is significant – such as for households, small business, or large companies. It cannot be doubted that the intention of the URE President in the areas of natural

of application of tariffs. On the June 28, 2001 the President of the Authority issued the *Statement on release of energy undertaking generating and selling of electricity from the obligation to submit tariffs for confirmation* (Statement of June 18, 2001), on the basis of which he released energy enterprises undertaking production and distribution of electric power from the obligation to submit tariffs for confirmation (with the exception of associated power producers and energy enterprises simultaneously possessing concessions for electric power sale and sending or distributing electric power, that is distribution companies). On September 23, 2004 the URE President issued equally on the basis of Article 49 item 1 of Energy Law, an announcement on the strength of which he released energy enterprises undertaking associated energy production from the obligation of submission of tariffs from January 1, 2005 for electric power for confirmation recognizing that the producers of associated electric power operate in competitive circumstances. On October 31, 2007 the URE President issued the *Statement of URE President concerning the release of energy enterprises possessing a concession for the sale of electric power from the obligation of submission of tariffs for confirmation* (hereinafter, the Statement of 31 October 2007). With reference to the preceding statements, the Statement of 31 October 2007 constituted only the notification of release of all energy enterprises possessing concessions for the sale of electric power from the obligation of submission for confirmation of tariffs for electric power in the sale of electric power.

¹⁹ F. Elżanowski, *Polityka energetyczna. Prawne instrumenty realizacji*, LexisNexis, Warszawa 2008, p. 56 ff.

monopolies and network enterprises should be the restoration of market equilibrium through the prevention of the negative effects of a monopoly. The task performed by the URE President as a substitute for a competitive market shall be that of the requirement to achieve such a regulation of prices as would be established by the market in conditions excluding the existence of monopolies, simultaneously with regard to the principles of energy security and continuity of energy supply.²⁰ However, the natural monopoly in principle primarily concerns network enterprises.²¹

A natural monopoly exists when the supply of product or service is limited to only one enterprise. 'most frequently this exists in the sphere of public utilities, such as electricity supply, (...) It is stated by some that state interference in price-fixing leads to reduced economic efficiency. (...)'²² Whether the given business activity constitutes a natural monopoly depends on the combination of technical conditions, costs and consumer demands. It is generally accepted that the supply of electric power or natural gas by means of a network has the traits of a natural monopoly because the parties, apart from agreements of provision of distribution services, are permanently connected with each other by a permanent (most frequently capital intensive) connection.²³ As a result, the power of the URE President to accept tariffs is logical and required.

IV. Competition in the energy market and price regulation

In case of vertical integration where a competitive business of energy sale is integrated with a regulated business (distribution and transmission of energy) it would seem to be rational to maintain that those energy enterprises undertaking sales of electric power and natural gas should be released from the obligation of tariff approval. This is because this market, in keeping with the principle of third party access (TPA principle), is competitive and the buyer has the right to choose and change its supplier freely.

Generally, this position is supported by the URE President, who has issued the applicable announcements and positions releasing sales enterprises from

²⁰ E. Nojszewska, *Podstawy ekonomii*, Warszawa 1998, p. 134.

²¹ P. Bogusławski, *Taryfowanie ciepła – wymóg urzędniczy czy ekonomiczna konieczność?* (2008) 6 *Biuletyn URE*.

²² M. Nasiłowski, *System rynkowy. Podstawy mikro- i makroekonomii*, Warszawa 1998, p. 14.

²³ A. Dobroczyńska, L. Juchniewicz, *Konkurencyjny rynek energii – czy i komu jest potrzebny?* Biblioteka Regulatora www.ure.gov.pl.

the obligation of approval of tariffs²⁴. Third Part Access (TPA) is a concept which was presented in the Energy Act of 1992 in the United States with relation to the national grid. As a result, the law became the basis for the development of competition in the US wholesale electricity market, with the participation of utilities, manufacturers (with no long-term contracts), as well as new companies trading electricity. Of course, the introduction of TPA to the transmission network in the US did not involve an increase in charges for transmission services in these networks with an additional component in the form of stranded costs because it was associated with the opening of the electricity market for customers. Two representatives, though differing in the cases of the TPA to the distribution networks, are the United Kingdom and California. The difference between these cases are that in the UK the opening of the electricity market to customers was combined with privatization, whereas in California, it followed the opening in existing conditions in privately owned power companies.

As we have already mentioned, the URE President has stated his position in the case of recognizing the electric power exchange market as a competitive market, thus releasing energy enterprises selling electric power through the market for goods from the obligation of the approval of tariffs. On October 31, 2007, the URE President issued a new statement deciding that the market in Poland was sufficiently competitive. He later changed his opinion and took legal action against various energy enterprises to try and force them to gain the authority's approval of their tariffs. Of course all these decisions were issued in flagrant violation of Article 49 1 and 3 of the Energy Law because there was no inquiry on the cessation of the conditions justifying the exemption granted in the Statement of June 28, 2001. Under Article 110 of CAP, the URE President is bound by his Statement of 11 June 2007. However, the withdrawal of the exemption granted in the Statement, even if only partial, requires an analysis of the conditions that justified the amendment made by the Statement of June 28, 2001 and demonstration that those conditions ceased to exist later. No such analysis is a flagrant violation of Article 7, 8, 9, 11 and 77 of CAP. This raises the question about the legitimacy of such proceedings and the issue of the need to respect the principle of deepening trust. Indeed, the principle of explaining the merits of the conditions has been repeatedly the subject of attention both in literature and in the jurisprudence

²⁴ *Mapa drogowa uwolnienia cen dla wszystkich odbiorców energii elektrycznej. W drodze ku prawom odbiorców w sektorze energetycznym.* Document prepared by the URE President, 2008 (http://www.ure.gov.pl/ftp/Biuletyny_URE/2008/2008.03.03-biuletyn_nr2.pdf). See also Komunikat Prezesa URE z dnia 25 lutego 2008 r. w sprawie przesłanek uwolnienia cen energii elektrycznej dla odbiorców w gospodarstwach domowych (http://www.ure.gov.pl/portal/pdb/497/3032/Komunikatw_sprawie_przeslanek_uwolnienia_cen_energii_elektrycznej_dla_odbiorcow_.html).

of administrative law. Implementing the principles of persuasion – in the administrative procedure – should take place through the institution of CAP. ‘This principle should permeate through all activities of the administration in the course of the entire proceedings and the reasons in reaching a decision. Reasons for the decision, written in a proper manner, should be included so that the party can comprehend and if possible to accept the validity of the factual and legal grounds, which led to the authority in dealing with the case issuing a decision’²⁵.

This has a variety of impacts, for example, it should convince all parties that officials dealt fairly with the matter and that no decision was taken in an arbitrary manner, but only after considering all the circumstances. It also serves to show the decision-making mechanism, a description of actions taken and determines the motives of the government. At the same time, reasoning shows that the settlement is fair and beneficial, even if it has been unsuccessful, and that the party should be interested in the voluntary implementation of the imposed obligations.

One of the most important barriers to the development of competition in the market is a lack of proper separation of competitive activities from regulated activities in energy companies. In support of his decisions the URE President raised the problem of the lack of preparation for the actual implementation of the opening of the energy market to the public through free choice of energy supplier granted under Article 4j of the Energy Law,. In fact, the blame for this state of affairs should be laid at the URE President’s door, who by law is required to promote competition (Article 21 of the Energy Law). There is currently no clear information as to the state of the market for participants, neither is there any information regarding the ‘level of readiness of consumers’. Today the market means some kind of agreement between sellers and buyers, in which the supply by sellers, and demand of buyers is the price. The conditions of perfect competition in economic terms are a theoretical model of market and competition, which include assumptions that none of the market participants (consumers, companies, etc.) are able to influence the market price. This state can be achieved when certain important conditions are met, such as a large number of relatively small market participants, excellent portability factor, and full transparency of the market. This is something that economists would call ‘pure and perfect competition, namely, when the set of following four conditions are met by the market: atomization, uniformity, transparency, and liquidity.

²⁵ E. Ochendowski *Postępowania administracyjne i postępowanie przed sądem administracyjnym*, Wyd. Comer, Toruń 1995, p. 58.

However, because of the insufficient preparation of buyers (consumers) and their level of awareness of their rights, as so often indicated by the URE, there is no economic theory relevant for assessing the competitiveness of the market.

It is worth mentioning that the issue of prices, which are set below the cost of purchasing power, has already been noted in foreign literature. Experts have recognized the danger in such tariff regulation stating that if the prices are regulated below-cost this will eventually lead to a situation in which potential competitors are not interested in entering the market – which means that energy companies will not have equal access to customers²⁶.

The European Commission also shares the opinion that the Polish market is not yet free and that there have been infringements of EC law. A memorandum from June 25, 2009²⁷ states that: (i) the regulated end-user price should be the exception and not the principle of a competitive market, (ii) price regulation may lead to the inhibition of the development of the electricity market, (iii) The regulated prices are justified by public service obligations (see the memo regarding the European Commission's allegations against Greece, Lithuania, and Romania). However disputes continuously endure as to whether the obligation of tariff approval for recipients receiving electric power and natural gas for private domestic needs is necessary.

V. Conclusions

In most European countries there are still questions regarding end-user price regulation and whether there has been progress made towards fully deregulated markets. Price regulation is one indicator for market analysis, but of course there are many other relevant indicators which should be taken into account to obtain a complete full.²⁸ As of the January 1, 2010, regulated end-user prices still exist in quite a large proportion of countries in the electricity and natural gas market segments. Between 2008 and 2010, little progress regarding end-user price regulation removal can be seen in the various market

²⁶ C.W. Jones *EU Energy Law, The Internal Energy Market*, Vol 1, Second Edition, Claeys & Casteels, Leuven, 2004, p. 239.

²⁷ MEMO/09/296.

²⁸ ERGEG Draft GGP on indicators for retail market monitoring. Ref: E09-RMF-14-04, 16 April 2010 http://www.energyregulators.eu/portal/page/portal/EER_HOME/EER_CONSULT/OPEN%20PUBLIC%20CONSULTATIONS/GGP%20retail%20market%20monitoring/CD/E09-RMF-14-04_Draft%20GGP-IRMM_PC_16-Apr-10.pdf Status review of End-User Price Regulation as of 1 January 2010.

segments. The small improvements noticed mainly concern the medium to large businesses segment and the energy intensive industry segment.

In most of the countries with end-user regulated prices, the proportion of eligible customers supplied at regulated prices is more than 80%, for each segment considered, indicating a lack of competition in the retail market. This share is close to 100% for the domestic segment. This figure is often smaller for larger customers. The reasons why customers do not switch from regulated prices to free market prices, e.g., lack of competitive offers, lower regulated prices than free market prices, no possibility to switch back to regulated prices, lack of confidence in the market or little information on market functioning, was not covered in the survey. As of January 1, 2010, 5 countries with price regulation have adopted a road-map towards a competitive market without end-user price regulation in electricity; and 1 country in natural gas. It should be noted that these road-maps in most cases do not concern all market segments with end-user regulated prices. In particular, domestic segments are often not covered. In addition, some road-maps do not give a specific removal date and time-schedule for regulated prices.

In more than two-thirds of the EU countries, the regulator sets or approves end-user regulated prices. In approximately one-fifth of the countries for electricity and one-fourth of the countries for natural gas, the decision to remove end-user price regulation lies with the regulator. A general conclusion can be drawn showing that compared to 2008 there has not been much improvement towards competitive energy-markets without price regulation within the EU. This is especially true for the domestic segment where a high proportion of countries still have price regulation. In addition, hardly any road-maps towards the removal of price regulation are in place. This may be because the European Directives leave a lot of room for interpretation regarding price regulation for domestic users. Indeed, a recent judgment of the Court of Justice of the European Union (Case 265/08, 20 April 2010) confirms that end-user price regulation, under certain restrictive conditions, is as a temporary measure, in compliance with the Directives. ERGEG reiterates its call for road-maps to phase out end-user regulated prices in the EU's Member States. ERGEG recognizes that competition also requires careful supervision, to ensure that customers are treated fairly, get the best possible deal available and are enabled to exercise their right to choose in an open market. Regulated prices can not only distort the functioning of the competitive market, but can also hinder the goal of customer protection and participation. Whilst protecting vulnerable customers is also of particular importance, social measures with that aim should be in line with market principles. ERGEG calls on all market participants to promote the efficient functioning of the

European energy markets and to facilitate the development of competition in the energy consumer's interest.

Obviously here one may dispute the notion of competitiveness of the energy market bearing in mind such factors as the appropriate number of participants, position of the enterprise with the specified market share; market entry and exit barriers; homogeneity in trade in goods or services; transparency of structure and operating principles; legal equality and principles of availability of market information to participants; control and supervision preventing cartel development (market fixing); accessibility of highly productive technology.²⁹ However, it is clearly stipulated that a Member State may maintain the procedure of tariff approval, if it supports the implementation of the general commercial interest consisting of maintaining delivery prices of natural gas to final recipients at a realistic level. Member States are obliged to agree among themselves – with regard to the situation of the natural gas sector – objectives in the form of liberalization and also essential end-user protection, as indicated in Directive 2003/55 and the new Directive of the European Parliament and the Council 2009/73/EC concerning common rules for the internal natural gas and repealing Directive 2003/55/EC.

The distribution tariff should be approved by URE President because it is a natural monopoly, but the tariffs concerning end-users should be free from confirmation even for households. In conclusion it is our opinion that excessive state interference in the regulation of prices for selling energy and in the future for distribution in the longer term does not provide improved protection of consumers. It is obvious that what was confirmed in the judgment of ETS is that price regulation primarily concerns households. If it concerns the non-discriminatory nature of the discussed obligation, the task of the URE President should be such a definition of prices so that there could be no accusations of discriminatory activity mostly within the area of distribution. That would always be the case if this type of intervention were to be conducted by the URE President to place the financial burden primarily on commercial enterprises. Obviously price regulation by the approval of tariffs by the URE President is intended to serve the general commercial interest consisting of maintaining prices to end-users at a reasonable level, bearing in mind the fact that EU Member States are obliged to reconcile objectives in the form of liberalization and essential protection of end-users, this being the very objective of the directive. Therefore the role of the national regulatory authority in the area of natural monopoly is the creation of a surrogate competitive market in the field of distribution. On condition of separating the regulatory activity from the activity performed in the competitive market, the task may be performed

²⁹ Raport UOKiK. *Kierunki rozwoju konkurencji i ochrony konsumentów w polskim sektorze elektroenergetycznym*, Warszawa 2010 www.uokik.gov.pl.

by the introduction of direct competition (comparative), where analogous activity is performed by such a large number of enterprises, that statistical assessment instruments may be applied.³⁰ The URE President in compliance with the law analyses and verifies costs, on the basis of financial reports and material-financial plans of energy enterprises, bearing in mind the creation of conditions for competitiveness and the promotion of efficiency in commercial activity and also in particular applying comparative methods in the assessment of the efficiency of energy enterprises undertaking the same type of activity in comparable circumstances but of course in the area of distribution. So we can conclude that these two types of tariffs in particular for end-users should be not approved by the URE President and the second for distribution should stay in the same scheme as it is regulated right now – approved by the URE President. One may then with confidence state that this market is more competitive, and free from end-user tariffs imposed by the URE President.

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³⁰ T. Kowalak, Quo vadis, sektorze? (2002) 1 *Biuletyn URE*, p. 39.

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Consolidation of the Polish Electricity Sector. The Merger Law Perspective

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CONTENTS

- I. Introduction
- II. Merger law in Poland (preventive control of concentrations)
- III. Consolidations in the electricity sector between 2000 and 2006
 1. Approvals of concentrations between electricity undertakings from 2000 onwards
 2. Competition concerns not enabling unconditional approval
 3. Fulfillment of criteria for deciding not to prohibit concentrations on the basis of the public interest test
- IV. The Polish competition authority against further concentrations in the electricity sector; the PGE/ENERGA case
- V. Factors that need to be taken into account when appraising concentrations in the electricity sector under merger law in Poland
 1. The market structure
 2. Other factors indicating whether or not there is a threat of 'significant impediment of competition'
- VI. Conclusions

Abstract

This article deals first of all with the most important characteristics, in terms of volume and quality, of all of those decisions issued by the Polish competition authority that were the basis for vertical consolidation of the Polish electricity sector, for which the authority gave unconditional or special approval between 2003 and 2007. This article also deals to a limited extent with the decision issued by the Polish competition authority prohibiting unconditionally the concentration of PGE and ENERGA, and which was referred for judicial review. This article attempts

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to verify the theory that the legal institution of special (exceptional) approval of a concentration, in the form in which it is created in Polish merger legislation (i.e. based mostly on the public interest test, but issued by the competition authority), is not the best formula for assessing whether there are legitimate grounds for consolidation, in particular consolidation of the Polish electricity sector.

Résumé

L'article présente les caractéristiques quantitatives et qualitatives de toutes les décisions publiées par l'autorité de concurrence polonaise, qui ont constitué la base de la consolidation verticale du secteur de l'électricité en Pologne dans les années 2003 – 2007. L'article discute aussi la décision prise par l'autorité de concurrence polonaise, concernant l'interdiction inconditionnelle de la concentration de PGE/ENERGA. Cette décision a été soumise à la révision judiciaire. L'objectif de cet article est de vérifier la théorie selon laquelle l'institution légale de l'autorisation spéciale (exceptionnelle), dans la forme donnée par la législation polonaise concernant les fusions, i.e. fondée surtout sur le test de l'intérêt public, mais publiée par l'autorité de concurrence, n'est pas la meilleure formule pour juger s'il y a une base légitime pour la consolidation, notamment la consolidation du secteur de l'électricité polonais.

Classifications and key words: Polish electricity sector; concentrations between electricity undertakings; vertical consolidation; preventive concentration control; special approval.

I. Introduction

When Poland entered the 1990s, its electricity sector was completely state-run, concentrated, and monopolized¹. The major elements of the bituminous and lignite coal extraction sector, commercial power stations, and electricity supplies went into the state-owned organization called the 'Energy and Lignite Coal Community' ('Wspólnota Energetyki i Węgla Brunatnego'). This enabled the state monopoly on electricity to be exercised.

During the 1990s the economic reforms brought with them a concerted deconcentration of the Polish electricity sector, based on the British model².

¹ For more see: P. Jasiński, T. Skoczny, G. Yarrow, *Konkurencja a regulacja w energetyce*, Urząd Antymonopolowy, Warszawa 1995, p. 105 ff; J. Popczyk, 'Od monopolu do rynku' [in:] *Elektroenergetyka*. Redakcja: P. Jasiński, T. Skoczny, Centrum Europejskie UW, Warszawa 1996, p. 235 ff.

² Ibidem. See also: K. Bobińska, 'The Defence of Monopoly as a Determinant of the Process of Transformation of State-owned Infrastructure Sectors', (2008) 1(1) *Yearbook of Antitrust*

The 'Energy and Lignite Coal Community' was disbanded. Bituminous and lignite coal mining companies and electricity producers (base load power stations) were given autonomy. They were separated from the transmission and wholesale undertaking 'Polskie Sieci Elektroenergetyczne' (PSE) and 33 local distribution and retail companies named 'Zakłady Energetyczne' (ZEs); the latter (the PSE and the 33 ZEs) retained their national or regional monopolies. Indeed, there was no significant change to their market position even after Poland's EU accession in 2004. However, EU membership did trigger the separation of the Transmission System Operator (TSO), which the PSE Operator became³, from which wholesale transactions were removed. This also included the separation of the Distribution System Operators (DSOs), which operated independently from the wholesale and retail companies trading in electricity, also separated within the ZEs. Some power stations and the ZEs were privatized and became part of foreign energy groups.

The decapitalization of both production assets and transmission and distribution networks meant that there was widespread support for measures to move away from the fragmentary structure of the Polish energy sector⁴. This was all the more important considering the investment needs in the energy sector, rapid economic growth and the resulting demand for electricity, the increasingly manifest political agenda of energy companies' special interests and of course Poland's EU accession. This was to be done by first performing horizontal concentrations (mergers) of the ZEs, and then vertical (re)consolidation based on the German model. Each consecutive government has introduced programmes to transform the electricity sector, and made them politically viable. Among these changes there are plans for further privatizations in the production of, as well as distribution and trade in electricity.

Despite being performed within the state-owned property, all of these consolidations required approval from the competition authority created in 1990 by the Anti-monopoly Act⁵ and operating, from 2000 onwards, on the basis – firstly – of the CCP Act 2000 (the Act of 15 December 2000 on

and Regulatory Studies, p. 131 ff; E. Mączyńska, *Restrukturyzacja przedsiębiorstw w procesie transformacji gospodarki polskiej*, Vol. 1, Warszawa 2001; T. Skoczny, 'The New Polish Energy Law (Including Its European Context)' (1998) 2 *Yearbook of Polish European Studies*, p. 173 ff.; A. Szablewski, *Mechanizmy rynkowe w energetyce i telekomunikacji*. Monografie, No. 8, INE PAN, Warszawa 1996.

³ Currently PSE Operator fulfills the requirements for ownership split-off under the 3rd EC energy package.

⁴ 'Transformacja systemu elektroenergetycznego'. Prezentacja kluczowych treści Raportu Ernst & Young. 31 styczeń 2011, pp. 3, 16. See also: A. Szablewski, *The Need for Revaluation of the Structural Canon of Electricity Liberalization* (published below in this volume of YARS).

⁵ Consolidated text in Journal of Laws 1999, No 52, item 547 with amendments.

Protection of Competition and Consumers)⁶ and – later – of the CCP Act 2007 (Act of 16 February 2007 on Competition and Consumer Protection)⁷. These statutes formed, among other things, a system of preventive control of concentrations between the undertakings, modelled on EU law⁸. It differed from EU law however in that the President of the Competition and Consumer Protection Office (Urząd Ochrony Konkurencji i Konsumentów; hereafter, UOKiK), unlike the European Commission, has the power not only to prohibit a concentration or to approve (without or with specific conditions) on the basis of a competition test, but also to decide not to prohibit a concentration when this is in the public interest (on the basis of the public interest test). The UOKiK President repeatedly exercised the option of issuing special approval, precisely in the cases of (re)consolidation of the Polish electricity sector that occurred between 2006 and 2007.

This present article aims firstly to present the most important characteristics, in terms of volume and quality, of all of those decisions issued by the UOKiK President that were the basis for vertical consolidation of the Polish electricity sector, for which the competition authority gave unconditional or special approval between 2003 and 2007. This article also deals to a limited extent with the decision issued by the UOKiK President prohibiting unconditionally the concentration of PGE and ENERGA⁹. This decision is not yet legally binding as it has been contested before the Court of Competition and Consumer Protection (Sąd Ochrony Konkurencji i Konsumentów, hereafter SOKiK). This article attempts to provide valuable insight into the theory that the legal institution of special (exceptional) approval of a concentration, based on the public interest test in the form in which it is created in the 2000 CCP Act and 2007 CCP Act, but issued by the competition authority, is not the best formula for assessing whether there are legitimate grounds for consolidation, such as in particular consolidation of the Polish electricity sector. Analyses have shown that the same circumstances and arguments can provide the basis for issuing decisions giving both special approval and absolute prohibition of concentrations. This depends on the appraisal of such circumstances and arguments by the Polish competition authority. As the UOKiK President is an authority specializing solely in issues relating to the application of the competition test, this gives rise to the open question of whether a competition authority should have the power to issue decisions based on the public interest test at all.

⁶ Consolidated text in Journal of Laws 2005, No. 244, item 2080 with amendments.

⁷ Journal of Laws 2007 No. 50, item 331 with amendments.

⁸ See A. Jurkiewicz, T. Skoczny, 'Poland' [in:] Rowley & Baker, *The International Mergers – Antitrust Process*, Vol. III, Chapter 48. Release 21. March 2011.

⁹ Decision No DDK – 1/2011 of January 13, 2011 – PGE/ENERGA; available at www.uokik.gov.pl.

II. Merger law in Poland (preventive control of concentrations)

The UOKiK President assessed the cases analyzed in this article on the basis of the CCP Act 2000 (creation of the PGE and TAURON energy groups) or the CCP Act 2007 (creation of the ENEA group and takeover by PGE of control over the ENERGA energy group). However this is not relevant in any way to the scope and findings of this analysis, as both of these statutes have the same axiology¹⁰, the same objective,¹¹ subjective¹², and geographical scope of application¹³, as well as create the same model for preventive control of concentrations¹⁴. The essence of this model is – firstly – the statutory obligation of undertakings, and this of course includes electricity undertakings, to file notification of the intention to concentrate¹⁵ and refrain from implementing

¹⁰ Article 1(1) of both the CCP Act 2000 and the CCP Act 2007 provide that ‘The Act determines conditions for the development and protection of competition as well as the principles of protection the interests of undertakings and consumers in the public interest.’

¹¹ Both the Acts are addressed to the economic entities called ‘entrepreneurs’ (‘przedsiębiorcy’); as the official translation of these Acts, these entities will be called in ‘undertakings’ in this article as well. See Article 4(1) of the CCP Act 2007. ‘For the purpose of this Act: (1) ‘undertaking’ shall have the same meaning as under the provisions on freedom of business activity, as well as: (a) natural and legal person as well as organisational unit without legal status, to which the legislation grants legal capacity, organising or rendering services of public utility nature, which are not business activity in the meaning of the provisions on freedom of business activity, (b) natural person exercising profession on its own behalf and account or performing activity in the frame of exercising such profession, (c) natural person having a control within the meaning of the subparagraph 4 over at least one undertaking, even if not conducting a business activity within the meaning of the provisions on freedom of business activity, provided that this person is undertaking further activities subject to a control of concentrations referred to in Article 13’.

¹² Article 1(1) of both the CCP Act 2000 and the CCP Act 2007 provide that ‘The Act regulates principles and measures of counteracting competition restricting practices and practices violating collective consumer interests, as well as anti-competitive concentrations of undertakings and associations of thereof, where such practices or concentrations cause or may cause effects on the territory of the Republic of Poland.’

¹³ *Ibidem*.

¹⁴ See Articles 12–23 of the CCP Act 2000 and Articles 13–24 of the CCP Act 2007.

¹⁵ See Article 13(1) of the CCP Act 2007 providing that ‘1. The intention of concentration is subject to a notification submitted to the President of the Office in the case where: 1) the combined worldwide turnover of undertakings participating in the concentration in the financial year preceding the year of the notification exceeds the equivalent of EUR 1 000 000 000, or 2) the combined turnover of undertakings participating in the concentration in the territory of the Republic of Poland in the financial year preceding the year of the notification exceeds the equivalent of EUR 50 000 000.’

a concentration¹⁶ of a national dimension, of which concentrations of the EU dimension, subject to European Commission review, are the upper limit¹⁷. Secondly – this model affords the UOKiK President the exclusive power to appraise the concentrations of which it receives notification in an anti-monopoly procedure and to issue the relevant decisions. The competition authority carries out this appraisal first and foremost on the basis of a competition test. The only change to this model (one which occurred in 2004 in connection with Poland's EU accession¹⁸) was actually a change regarding the competition test. As of May 1, 2004 notifications of the intention to concentrate are appraised from the point of view of implications for competition on the basis of the criterion used to assess whether the intended concentration would significantly impede competition in Poland as well. The previous criterion was the market dominant position test¹⁹.

As in the system of preventive control of concentration in place within EU countries and most other countries, Poland's competition authority can (absolutely) prohibit the concentration resulting in a significant impediment to competition, in particular by creation or strengthening of a dominant position in the market²⁰ or approve the concentration not resulting in significant impediments to competition, in particular by the creation or strengthening of a dominant position in the market²¹. Approval (so-called conditional approval) can also be issued when the concentration, upon fulfillment of the conditions laid down in the decision and specified as examples in the Act,

¹⁶ See Article 97(1) of the CCP Act 2007 providing that 'The undertakings whose intention of concentration is subject to a notification shall be under obligation to refrain from implementing the concentration until the issuance of the decision by the President of the Office or the lapse of the time limit in which such a decision should be issued.'

¹⁷ The EU dimension of concentration is defined in Article 1 of the Council Regulation (EC) No 139/2004 of 20 January 2004 on the control of concentrations between undertakings, OJ [2004] L 24/1; it replaced the Council Regulation (EC) 4064/89 of 21 December 1989 on the control of concentrations between undertakings, OJ [1990] L 395/1.

¹⁸ See CCP (Amendment) Act 2000 of 2004, April 24 (Journal of Laws 2004 No. 93, item 891); for more see: T. Skoczny [in:] *Ustawa o ochronie konkurencji i konsumentów. Komentarz*. Pod redakcją T. Skoczego, C.H. Beck, Warszawa 2009, p. 756-757. 753 ff, 839 ff.

¹⁹ According to Article 17 CCP Act 2000 (till 1.5.2004) the UOKiK President could approve an intended concentration when it does not create or strengthen a dominant position as a result of which competition on the market would be impeded.

²⁰ According to Article 20(1) of the CCP Act 2007 'The President of the Office shall, by way of a decision, prohibit the implementation of the concentration, if it results in a significant impediment to competition in the market, in particular by the creation or strengthening of a dominant position.'

²¹ According to Article 18 of the CCP 2007 'The President of the Office shall, by way of decision, issue a consent to implement a concentration, which shall not result in significant impediments to competition in the market, in particular, by creation or strengthening of a dominant position in the market.'

will not significantly impede competition in the market, in particular by the creation or strengthening of a dominant position²².

The Polish competition authority also has the power and the obligation (especially when the undertaking that files notification of the intent to concentrate makes such a request) to approve a concentration as a result of which competition in the market will be significantly impeded, in particular by the creation or strengthening of a dominant position, in any case when there are grounds for not prohibiting the concentration. These include, in particular, when (1) the concentration is expected to contribute to economic development or technical progress, or (2) it may exert a positive impact on the national economy²³. Approval of this kind (this means special or exceptional approval) is therefore issued in the public interest²⁴. In light of the fact that none of the special approval decisions issued to date (and thus this also applies to those decisions giving approval for vertical consolidations in the electricity sector) has ever undergone review by any judicial body, the nature of this legal institution and of the two criteria specified in the Act justifying non-prohibition of a concentration is currently a matter of debate²⁵. Indeed, this is a solution permitted under EU law as the Commission is restricted in its decision-making

²² Article 19(1) and (2) of the CCP Act 2007 ‘1. The President of the Office shall, by way of a decision, issue a consent to implement a concentration when, upon fulfillment of the conditions specified in Paragraph 2 by undertakings intending to implement the concentration, competition in the market will not be significantly impeded, in particular by the creation or strengthening of a dominant position. 2. The President of the Office may impose upon the undertaking or undertakings intending to implement a concentration an obligation, or accept their obligation, in particular: 1) to dispose of the entirety or part of the assets of one or several undertakings, 2) to divest control over an undertaking or undertakings, in particular by disposing of a block of stocks or shares, or to dismiss one or several undertakings from the position in the management or supervisory board, 3) to grant a competitor exclusive rights – determining in the decision referred to in Paragraph 1 the time limit for meeting the requirements.’

²³ Article 20(2) of the CCP Act 2007 provides that ‘The President of the Office shall issue, by way of a decision, a consent for the implementation of the concentration as a result of which competition in the market will be significantly impeded, in particular by the creation or strengthening of a dominant position, in any case that the desistance from banning concentration is justifiable, and in particular: 1) the concentration is expected to contribute to economic development or technical progress; 2) it may exert a positive impact on the national economy.’

²⁴ See Article 1(1) of the both CCP Acts 2000 and 2007.

²⁵ Best reflected in the commentaries on both CCP Acts 2000 and 2007. See: E. Modzelewska-Wąchal, *Ustawa o ochronie konkurencji i konsumentów. Komentarz*, Twigger, Warszawa 2-02, pp. 172; K. Kohutek [in:] K. Kohutek, M. Sieradzka, *Ustawa o ochronie konkurencji i konsumentów. Komentarz*, LEX a Wolters Kluwer business, Warszawa 2008, pp. 559 ff; *Ustawa o ochronie konkurencji i konsumentów. Komentarz*. Pod red. C. Banasińskiego i E. Piontka, LexisNexis, Warszawa 2009, pp. 372 ff; T. Skoczny [in:] *Ustawa o ochronie konkurencji i konsumentów. Komentarz...*, pp. 891 ff; A. Stawicki, E. Stawicki, *Ustawa o ochronie konkurencji i konsumentów. Komentarz*, LEX a Wolters Kluwer business, Warszawa 2011, pp. 495 ff.

power, when appraising concentrations of EU dimension, by the Member States' right to 'take appropriate measures to protect legitimate interests other than those taken into consideration' by the Merger Regulation²⁶. 'Public security' is considered to be one of these 'legitimate interests'²⁷. Such 'public security' certainly includes 'energy security'²⁸. This does not mean however that the solution used in the Polish legislation is correct, and there are many reasons for this. This is firstly because it suggests that 'economic development and technical progress' should not be included in the evaluation of the implications of the concentration under the competition test; in the EU (and in most EU Member States) 'development of economic and technical progress' is *expressis verbis* a criterion which must be taken into account when appraising concentrations²⁹. The second reason is that the power to decide not to issue a decision prohibiting concentration on the grounds of public interest has been conferred on a competition authority and not a political administration body, as is the case in other countries. In my view the special approval on the basis of the public interest test is a 'foreign body' for competition protection by an independent competition authority; thus, this instrument should be used sparingly and wisely.

III. Consolidations in the electricity sector between 2000 and 2006

1. Approval of concentrations between electricity undertakings from 2000 onwards

The processes of reconsolidation in the Polish electricity sector commenced just over a decade ago. Due to the scale and value of electricity undertakings and heat-energy undertakings (cogenerated electricity) most horizontal and vertical concentration in the energy sector had to be notified and evaluated on the basis of the Polish merger law. The UOKiK activity reports and online lists of decisions (available at the UOKiK website since 2003) reveal that between January 2003 and March 2006³⁰ the UOKiK President issued 38 unconditional

²⁶ See Article 21(3) of Regulation 4064/89 and Article 21(4) of Regulation 139/2004.

²⁷ *Ibidem*.

²⁸ Energy security ('security of supplies') is considered to be an indication of 'public security' also in case law giving the Member State right to restrict free movement of goods within the EU; see especially the ECJ judgment of 10 July 1984 in case 72/83 – *Campus Oil Limited and others v Minister for Industry and Energy and others*, ECR 1984, 2727.

²⁹ Article 2(1)(b) of both Regulation 4064/89 and Regulation 139/2004.

³⁰ I.e. until the 'Programme for the Electricity Sector' was put into place; see below footnote 32.

approvals of concentrations in this sector³¹. This group also included approvals of concentrations in the form of privatizations of electric power stations or distribution companies (ZEs), by selling them to foreign firms (for example EdF, Electrabel, RWE, Vattenfall), as well as the first national consolidations of the distribution companies (ZEs).

As stated above, over the past decade there was a significant rise in the pressure for vertical consolidation of the Polish electricity sector within the sector itself. This met with a favourable response in government circles following the 2005 election. Vertical consolidation in fact became a major element of the government's 'Programme for the Electricity Sector' (*Program dla elektroenergetyki*) adopted by the Council of Ministers on March 28, 2006.³² This Programme involved plans for a vertical consolidation of specific undertakings (referred to by name) owned by the State Treasury – i.e., generators of electricity (electric power stations), sometimes associated with mines that supplied them with coal and with its distributors. The Programme was intended to bring about the creation of four powerful energy groups, now operating under the commercial names PGE, TAURON, ENERGA and ENEA. Approval decisions issued by the UOKiK President were a condition for their creation, however.

The creation of the ENERGA group – which took the form of a takeover by ENERGA of 'Koncern Energetyczny ENERGA' and 'Zespół Elektrowni Ostrołęka' – received unconditional approval from the UOKiK President³³. This was because the authority concluded that the small share in the electricity generation market (just over 2%, and sold mainly to the TSO) and the fact that ENERGA would continue to have to buy from generators from outside its capital group, were not grounds for the conclusion that there would be significant impediment to competition in the markets affected by the concentration.

Despite the widespread opinion that the vertical consolidations planned by the government in the electricity sector would lead to excessive concentration of the electricity generation market and impede competition in its wholesale distribution market, the UOKiK President gave special approval for:

- a) takeover by 'Polskie Sieci Energetyczne' (PSE) of control over 'BOT Górnictwo i Energetyka' (extraction of lignite coal and use of it to generate electricity), 'Zespół Elektrowni Dolna Odra' (a major producer

³¹ The legal basis for these decisions was Article 17 of the CCP Act 2000.

³² Available at <http://www.mg.gov.pl/node/5307>.

³³ Decision No DDK – 19/07 of February 16, 2007– ENERGA/KE ENERGA/Zespół Elektrowni Ostrołęka; available at www.uokik.gov.pl.

- of electricity from bituminous coal) and 8 ZEs in central and south-east Poland (distributing and selling electricity undertakings)³⁴;
- b) takeover by ‘Energetyka Południe’ of the – integrated beforehand – ZEs of the regions Małopolska and Dolny Śląsk, as well as the electricity power stations ‘Elektrownia Stalowa Wola’ and ‘Polski Koncern Energetyczny’³⁵;
- c) takeover by ENEA of the electricity power station ‘Elektrownia Kozienice’³⁶.

At this time the UOKiK President reached the conclusion that these consolidations could significantly impede competition but determined that there were justified reasons for not prohibiting them.

2. Competition concerns not enabling unconditional approval

In the view of the UOKiK President these concentrations gave rise to competition concerns on particular markets in the electricity sector in Poland affected by the concentration horizontally (mainly generation of electricity) and/or only vertically (national electricity generation; national electricity wholesale market, local electricity retail markets, and local electricity distribution markets).

The largest of the consolidations performed under the government ‘Programme for the Electricity Sector’ – the creation of the energy group PGE – was deemed by the UOKiK President to be a concentration that would lead to the creation of a dominant position on the electricity generation market. The authority based this view on the market share criterion, which – according to sources other than the published version of the decision – would have been approximately 40% following the concentration. Due to the fact that at the moment of appraisal no undertakings had an electricity generation market share that was even close to the market share of the created group, and the combined market share of the other three groups created under the Programme was approximately 25%, the UOKiK President decided the PGE

³⁴ Decision No DKK – 163/06 of December 22, 2006 – *PSE/10 other entities*; available at www.uokik.gov.pl. Following the split of PSE Operator (the transmission system operator) from PSE SA, on the basis of the assets that remained in PSE SA and assets of the holding company BOT, Elektrownia Dolna Odra and the distribution companies described above the PGE Energy group was formed. It operates under the commercial name PGE.

³⁵ Decision No DOK – 29/07 of March 8, 2007 – *Energetyka Południe/4 other undertakings*; available at www.uokik.gov.pl; it operates now under the commercial name TAURON.

³⁶ Decision No DKK 32/07 of September 28, 2007 – *ENEA/Elektrownia Kozienice*; available at www.uokik.gov.pl. This decision was then issued on the basis of Article 20(2) of the CCCP Act 2007. It still operates under the commercial name ENEA.

could operate independently of competitors and of its contracting parties³⁷. In the view of the competition authority the concentration in question would also lead to the creation of a dominant position on the national generation market for electricity from renewable sources and on the national market for provision of systemic services, as well as to strengthening a dominant position on the national wholesale market³⁸.

In each of these cases of special approval decisions (PGE, ENERGA, ENEA)³⁹ the UOKiK President stated clearly that the danger of significant impediment to competition through vertical consolidation of generators⁴⁰ (in the case of PGE and the TAURON group also having access to lignite coal or bituminous coal) and distributors of electricity⁴¹ was justified. The decision was above all based on the fact that as of the day each was appraised, the principle of Third Party Access (TPA)⁴² was not yet applicable in Poland because the majority of electricity users still remained so-called ‘tariff’ users, i.e. buyers of electricity from distribution companies to whose networks they were connected. In practice vertical relations between electricity generators, wholesalers, and retailers create a threat for (a) electricity generators not covered by the vertical consolidation; (b) distribution companies not covered by the vertical consolidation; (c) undertakings operating on the trading market;

³⁷ He deemed the quality-related prerequisites for a dominant position (Article 4(9) CCP 2000) to be fulfilled, stating that the entry to this market of new entities was capital- and time consuming and the existing generation capacity was decreasing. These assertions were not supported by any evidence, however.

³⁸ Also the reasons for these effects of the concentration were not given in the published version of the decision.

³⁹ It should be emphasized that in each of these decisions the wording of the statement of reasons is identical.

⁴⁰ At this point the UOKiK President cited also the EC standpoint presented in in the report on the electricity and gas markets published a little earlier (‘DG Competition report on energy sector inquiry’ (SEC(2006)1724, 10 January 2007) pointing clearly to vertical relations as a substantial barrier to further liberalization of those markets.

⁴¹ It is worth noting the generally negative standpoint of the UOKiK President towards vertical concentrations in sectors in which business activity depends on access to infrastructure. He prohibited for example the takeover by the dominant producer of crude oil (PKN Orlen) over the only Polish marine port through which crude oil is imported to Poland (NAFTOPORT). See decision No DDI – 38/2001 of June 29, 2001 – *PKN Orlen/ NAFTOPORT* (Dziennik Urzędowy UOKiK (2001) No 2, item 44).

⁴² In accordance with the Electricity Directive (Directive 2003/54/EC of the European Parliament and of the Council of 26 June 2003 concerning common rules for the internal market in electricity and repealing Directive 96/92/EC, [2003] L 176/37) and norms laid down in the Polish Act of 10 April 1997 – Energy Law (Journal of Laws 1997 No 54, item 348; unified text of 2011 available at www.sejm.gov.pl) in Poland as well first the industrial users (from July 1, 2004) and then households (July 1, 2007) were given the formal option of selection of a supplier.

and (d) users of electricity connected to a distribution network covered by the vertical consolidation.

In the view of the UOKiK President, all of these concentrations constituted a threat to the electricity generators not included in the vertical consolidation⁴³ because those generators could have problems with access to users connected to the distribution network of distribution companies covered by the vertical consolidation, and thus restricted market access.

It was assumed in the decision that the intended concentrations would present a threat to distribution companies not covered by the vertical consolidation⁴⁴ because those distributors could have problems buying electricity or buying electricity on non-discriminatory terms.

The intended concentrations also presented a threat for undertakings operating on the trading market because, in the view of the UOKiK President, the consolidated groups would try to eliminate those intermediaries in trading in electricity.

The threat for users of electricity connected to the networks of distribution companies covered by the vertical consolidation would, in light of those decisions, be that they would be forced to buy energy from generators being members of the distribution company's capital group.

In all of these three decisions the UOKiK President did indeed note that future amendments to Polish law and EU law might at least partially neutralize the significant impediment to competition anticipated at the moment those decisions were issued. This included amendments aiming, for example, at greater integration of the energy markets within the EU and strengthening of the regulatory powers of the energy regulatory authorities (in Poland: President of the Energy Regulatory Office), as well as at the envisaged ownership structure unbundling of energy network operators. The UOKiK President did not however consider it possible to issue unconditional clearance for those concentrations⁴⁵.

⁴³ In these decisions the example given of those generators privatized through sale to foreign firms are the electricity power stations 'Elektrownia Rybnik' (sold to EdF) and 'Elektrownia Połaniec' (sold to Electrabel).

⁴⁴ In these decisions the example given of those distributors privatized through sale to foreign firms are ZEs 'STOEN' (sold to RWE) i 'GZE' (sold to Vattenfall).

⁴⁵ These decisions do not show that the UOKiK President even considered using remedies as base for conditional clearance.

3. Fulfillment of criteria for deciding not to prohibit concentrations on the basis of the public interest test

Within the notifications of each of the concentrations discussed above the applicants stated that even if the UOKiK President came to the conclusion that they might cause significant impediment to competition, there were justified grounds for not prohibiting them. This was because the adverse implications in the case of these concentrations were outweighed by their positive effects, of which some were among the examples given in Article 19(2) of the CCP Act 2000 or Article 20(2) of the CCP Act 2007. The UOKiK President concurred with most of the arguments presented by the applicants regarding positive effects of the notified concentrations. His view with regard to the creation of the PGE group was that generally that ‘the concentration would contribute [...] to the ensuring of the country’s energy security and to creation of new jobs’⁴⁶. The special clearance decisions for concentrations establishing the TAURON and ENEA groups were based solely on the fact that they ‘would support [...] the ensuring of Poland’s energy security’⁴⁷. The detailed arguments in support of the potential positive outcomes of those concentrations were presented entirely (with respect to the creation of the PGE and TAURON groups) or were divided into three sets of criteria: ‘economic development and technical progress’, ‘impact on the national economy’ and ‘other positive outcomes’ (according to Article 20(2) of the CCP Act 2007). All those outcomes can be placed in a number of categories, contributing – as defined in the ‘Programme for the Energy Sector’ – towards **ensuring energy security** for the country through development and renovation of the generation assets and transmission and distribution networks. This will enable undertakings and households to be properly supplied with electricity in terms of both volume and quality (this includes being in accordance with rising environmental protection standards)⁴⁸.

It can therefore be no surprise that the principal argument for the decision by the UOKiK President not to prohibit the notified concentrations was the **rise in investment potential**, resulting above all from the combination of the

⁴⁶ Decision approving the creation of PGE Group (see footnote 34).

⁴⁷ Decisions approving the creation of TAURON and ENEA groups (see footnotes 35 and 36).

⁴⁸ Compare the ECJ judgement in case *Campus Oil* (see above footnote 28), in which the Court stated clearly: ‘(...) in light of their special role as a source of energy for the modern economy, crude oil products are a key asset for the functioning of a country, particularly as not only is the economy dependent on them, but above all the state institutions, its most vital public services, and even the physical survival of the civilian population (...)’. See also: *Transformacja systemu elektroenergetycznego*, p. 5–8.

economic potential of the undertakings being consolidated. 'The creation of a large undertaking should raise its financial standing and credibility as perceived by the financial sector'⁴⁹, due among other things to the strengthening of generators (for example 'BOT' or 'Dolna Odra') who were in debt as a result of pro-ecological⁵⁰ investments initiated during the 1990s. 'Only undertakings with considerably greater capital and cash flow than that demonstrated by the undertaking currently existing in the Polish electricity sector would be able to handle the necessary generation and network investments'⁵¹. However, no calculations of the credit rating of the created groups were presented in any of the analyzed special clearance decisions.

In the decisions giving special approval for the creation of the TAURON and ENEA groups other positive effects of the concentration were also described for the undertakings being consolidated, and indirectly for the overall national economy. They were seen as arising first and foremost thanks to the creation of a undertakings active along the entire energy sector value chain (generation, trading, distribution). The most important of these are the following:

- a) **mitigation of risks** (mainly in the area of trade in electricity), resulting from the expected rise in energy prices, originating from the deficiency in electricity production or growing investment and ecological burdens;
- b) **taking advantage of the scope and dimension** (for example with respect to negotiation of the conditions for purchasing electricity as well as other goods and services);
- c) **enhancing of a competitive position** with respect to the strong – predominantly vertically integrated – energy groups operating in EU Member States, whose electricity sector structure is typically much more concentrated than that of Poland.

The last of these⁵² could or should have been appraised within the – more difficult – economic competition test, and only after that with the – much easier – public interest test.

⁴⁹ Decision approving the creation of ENEA group (see footnote 36).

⁵⁰ Decision approving the creation of PGE group (see footnote 34).

⁵¹ Decision approving the creation of TAURON group (see footnote 35).

⁵² Along with certain other possible effects of the consolidation of electricity undertakings (for example the positive effects on economic development and technical progress) which were not however supported by specific economic analyses.

IV. The Polish competition authority against further concentrations in the electricity sector; the PGE/ENERGA case

In mid 2008, during preparatory work on the ‘Competition Policy for 2008–2010’⁵³, the UOKiK President drew up a preliminary report on the findings of a sector inquiry concerning the condition and prospects for growth of competition on the energy market. Following many months of discussions the report was finally published in 2010⁵⁴. Among the UOKiK Report’s findings are the characteristics of the most vital elements of the electricity sector (including its structure, resulting from the government’s 2006 ‘Programme for the Electricity Sector’⁵⁵). More over the UOKiK Report reveals the problems of further growth of competition in this sector. For instance, it addresses the question of further potential changes in the way the sector is structured, as well as the problems of liquidity of the wholesale electricity market. In that UOKiK Report the authority left no doubt that the UOKiK President would oppose further consolidation of the sector, especially enhancement of the PGE Group, for example by way of takeover of the ENEA or ENERGA groups. According to the UOKiK President consolidation of this kind ‘would mean that in practice all electricity could be sold to users connected to distribution networks of undertakings being members of the PGE group’⁵⁶. It should be noted at this point that during 2007–2011 the UOKiK President also gave unconditional approval for further concentrations that strengthened groups competitive to PGE – TAURON⁵⁷, ENEA⁵⁸ and ENERGA⁵⁹.

The UOKiK Report states clearly that for the UOKiK President, even in the event that TPA was introduced with respect to all energy users as of July 1, 2007, competition in the electricity sector would only be possible if

⁵³ ‘Polityka konkurencji na lata 2008–2010’. Available at: www.uokik.gov.pl.

⁵⁴ ‘Kierunki rozwoju konkurencji i ochrony konkurentów w polskim sektorze elektroenergetycznym (2010)’ [‘Directions of the development of competition and protection of consumers in the Polish energy sector (2010)’]. UOKiK, Warszawa 2010; available at: www.uokik.gov.pl/ (hereafter, UOKiK Report).

⁵⁵ As a result of this Programme the transmission company PSE Operator (OSP) and the 4 above-mentioned integrated energy groups PGE, TAURON ENERGA and ENEA groups were created.

⁵⁶ See UOKiK Report, p. 17.

⁵⁷ Decisions DKK-68/2007 and DKK-69/2007 of December 21, 2007 – *Energetyka Południe/heat power stations of Nowa Sól and Słbrowa Górnica*; available at www.uokik.gov.pl.

⁵⁸ Decision No DKK – 15/2008 of February 2, 2008 – *ENEA/litigate coal generators Adamów and Pątnów*; decision No DKK – 59/2011 of May 26, 2011 – *ENEA/heat power station Białystok*; available at www.uokik.gov.pl.

⁵⁹ Decision No DKK – 7/09 of February 23, 2009 – *ENERGA Elektrownie Ostrołęka/heat power station of Ostrołęka*; available at www.uokik.gov.pl.

there was the ‘appropriate market structure’ (no single or more than one vertically integrated producers were in a dominant position), ‘wholesale market liquidity’⁶⁰ and ‘effective separation of trade in energy from energy distribution’; the Report itself (as well as subsequent case law) says that the UOKiK President saw the ‘assurance of fluidity on the market, guaranteeing the appropriate level of energy was in trade’ as playing a special role⁶¹. It was also announced in the UOKiK Report that the UOKiK President would be supporting at least partial privatization both of electricity generators and of electricity distributors, of which a large majority were still owned by one owner – the State Treasury.

Despite the publication of the UOKiK Report containing the findings of energy sector inquiry, the Polish government continued work on changes to Poland’s energy policy, including improvement of the capacity to ensure Poland’s energy security over the next 10 and 20 years, and instruments for putting this into practice. At first the ENEA and ENERGA energy groups were intended to be privatized. Privatization of the ENEA group has been underway – with intervals – since 2010; one of the large vertically-integrated energy groups (for example EdF) will probably be its buyer. Due to the fact that the highest bid for the ENERGA group came from the PGE group – also state-controlled – the ‘Energy Policy of Poland until 2030’⁶² was amended⁶³ and the government decided to continue with concentrations by allowing PGE to take over ENERGA by way of the market sale by the Minister for the State Treasury of shares amounting to 84.19% of ENERGA’s capital. The fundamental reasons the government and the parties to that transaction gave for the concentration were as follows: the need to respond to the challenge presented by the progressive regionalization of the energy markets; the need for the PGE and ENERGA groups to go along with the government’s energy policy; the need to carry out development and rejuvenation investments and the resulting need to ensure a stable market profile of the PGE and ENERGA groups; the potential for making use of the unique synergy between the PGE

⁶⁰ The term ‘fluid’ is sometimes used in EU law for meaning ‘liquidity’. For instance in the opinion of the Economic and Social Committee in which it is declared: ‘The EU will certainly gain from being able to count on a wholesale electricity and gas market which is fluid, orderly and functional and above all protected from manipulation.’ See: ‘Opinion of the European Economic and Social Committee on the ‘Proposal for a regulation of the European Parliament and of the Council on energy market integrity and transparency’ COM (2010) 726 Final, OJ [2011] C 132/21, pont 3.1.

⁶¹ See UOKiK Report, p. 22 ff.

⁶² See Resolution No 202/2009 of the Council of Ministers; available at:<http://www.mg.gov.pl/Gospodarka/Energetyka/Polityka+energetyczna>.

⁶³ See Resolution No 157/2010 of the Council of Ministers amending the Resolution No 202/2009 (unpublished).

and ENERGA groups. The government's expectation was that the UOKiK President would give clearance for the transaction according to rules similar to those applied with respect to the past consolidations of the Polish electricity sector.

Meanwhile, as of early 2011, the UOKiK President prohibited a takeover of ENERGA by PGE⁶⁴, because the proceedings led the competition authority to the conclusion that the concentration 'would however lead to a significant impediment to competition' on two national markets. Firstly, it would lead to a 'significant impediment to competition on the national electricity retail market'. Secondly 'the vertical relations that existed between the players on the national wholesale electricity market and the national retail electricity market would lead to significant impediment of competition'. By the same token the UOKiK President could not approve the transaction under Article 18(1) of the CCP Act 2007.

In the published statement of reasons for the decision in the PGE/ENERGA case the UOKiK President analyzed the option of not prohibiting that concentration on the basis of the prerequisites described in Article 20(2) of the CCP Act. 2007. The competition authority did not concur however with the standpoint adopted by the applicants – namely, that the concentration would also contribute to 'economic development and technical progress' and give rise to direct benefits for customers, as well as help to bring about greater energy security for Poland.

The UOKiK President also decided not to impose conditions on the applicants, since this would have made it possible to issue conditional clearance under Article 19 of the CCP Act 2007, as 'it was not possible to apply any conditions whatsoever that could be deemed appropriate'.

The applicants contested the decision prohibiting the PGE/ENERGA concentration; they appealed against the prohibition to the SOKiK. The SOKiK has the power to amend it and give approval or to annul it if it finds that the degree of error in observance of principles of procedural justice in the proceedings pertaining to the concentration means that the implications for competition might have been appraised wrongly⁶⁵.

⁶⁴ Decision No DKK – 1/2011 of January 13, 2011 – *PGE/ENERGA*; available at: www.uokik.gov.pl.

⁶⁵ This is not an issue addressed in this article, however.

V. Factors that need to be taken into account when appraising concentrations in the electricity sector under merger law in Poland

1. The market structure

To put it very simply, evaluation of any concentration of which a competition authority receives notification comprises two kinds of factors: the market structure and functional factors. The less the anti-competitive nature of the concentration is determined by the market structure, the more important it becomes to account for functional factors. However, even in this case threats to competition can be eliminated by applying remedies of a structural nature. In any case the potential competition (new entries), the strength of the demand (purchase power) side and the so-called efficiency gains can take prevalence over the anti-competitive structural consequences.

Looking at the matter from a historical point of view the structure of the market was the sole or fundamental criterion for appraisal of concentrations, especially on the basis of the Harvard School. Despite the fact that in the US and in the EU the fundamental grounds for economic theory of competition are today formed by the Chicago or NeoChicago School⁶⁶ (mostly concerning understanding of effective competition, market power and the relevant market⁶⁷), the market structure criterion still plays a major role in the process of appraisal of intended concentrations, especially – but not only – horizontal concentrations. In the EU this has been confirmed in guidelines for evaluation of horizontal and non-horizontal concentrations⁶⁸. In Poland this can be seen by the entire decision-making policy adopted up to now by the UOKiK President, based particularly strongly on the statutory presumption that a dominant position exists at 40%. This continued to be the prevalent practice even after May 1, 2004 (when Poland joined the EU), since when, as a result of the statutory change to the competition test for appraising concentrations, the structural criterion for market dominance has now been rendered merely

⁶⁶ See for instance G. Monti, *EC Competition Law*, Cambridge University Press, Cambridge 2007, p. 53–88.

⁶⁷ See: S. Bishop, M. Walker, *The Economics of EC Competition Law: Concepts, Application and Measurement*, University Edition, Sweet & Maxwell 2010. Part I. Concepts; A. Lindsay, *The EC Merger Regulation: Substantive Issues*. Second edition, Sweet & Maxwell, London 2006, passim; U. Schwalbe, D. Zimmer, *Law and Economics in European Merger Control*, Oxford University Press, Oxford 2009, part I.

⁶⁸ Guidelines on the assessment of horizontal mergers under the Council Regulation on the control of concentrations between undertakings, OJ [2004] C 31/5, p. 21; Guidelines on the assessment of non-horizontal mergers under the Council Regulation on the control of concentrations between undertakings, OJ [2008] C 265/7.

an example test of ‘significant impediment to competition’ which if proven can lead to a concentration being prohibited unless the criteria for conditional or special approval have been met.

Unilateral effects of a concentration with respect to market structure prior to and post concentration may be analyzed using three measures: the number of market players, market share and degree of concentration⁶⁹.

The UOKiK President has never raised the argument of the number of market players in any of the past unconditional or special approval decisions issued. The first time the competition authority decided to do this was in the decision prohibiting the PGE/ENERGA concentration. The UOKiK President deemed the reduction of the number of market players on the retail market – from 4 to 3 – when there are approximately 30 active players on that market selling electricity to end users – to be an important (but of course not the only) factor indicating a ‘significant impediment to competition’. Meanwhile the reduction of the number of market players cannot by itself be considered sufficient evidence of a ‘significant impediment to competition’, but a great deal of importance is attached to the shares of the parties to the concentration in relevant markets prior to and post the concentration. It is difficult to dispute this standpoint when the post-concentration market share exceeds 50%, and especially 70–80%⁷⁰; and this is also practice of the European Commission. A critical view must be taken of this standpoint when the ascertained market shares following the concentration, which were the main grounds for prohibiting it, fluctuate around 40% (the level of the rebuttable presumption defined in Article 4(8) of the CCP Act 2000 and Article 4(9) of the CCP Act 2007). In the analyzed decisions regarding electricity sector concentrations it was only in the case of decisions giving special approval for creation of the PGE group that it was confirmed to be anti-competitive in nature. One of the reasons for this was that this concentration would give PGE a total share in the generation market of approximately 40%, which – in the view of the UOKiK President – would lead to a creation of a dominant position on this market.

It needs to be stressed that, although the market share in the electricity generation markets would rise to approximately 42% following the PGE/ENERGA concentration, the UOKiK President did not find ‘strengthening of a dominant position’ and neither did the authority deem that market share to be sufficient to conclude that there was ‘significant impediment to competition’. Perhaps this is a symptom of the thinking that even the national leaders have the right (and even the obligation towards their stockholders)

⁶⁹ Ibidem. For more see: S. Bishop, M. Walker, *The Economics of EC Competition Law...*, s. 366 ff; A. Lindsay, *The EC Merger Regulation...*, s. 268 ff; U. Schwalbe, D. Zimmer, *Law and Economics in European Merger Control...*, p. 175 ff.

⁷⁰ As in case 85/76 *Hoffman La Roche v. EC Commission*, ECR 1997, 461.

to expand and increase their market share even up to the level of a dominant market position; the issue is only that they may not abuse a dominant position.

The criterion for the market share was however highly relevant to the determining of a ‘strong market position’ (and not market ‘dominant position’) of the undertaking to be created following the takeover of the ENERGA group by PGE. The total share in the retail electricity market of the PGE/ENERGA group would be slightly above 40%, while the market shares of the two remaining key players on this market (TAURON and ENEA) would be comparable (ca 42–43%)⁷¹.

The level of concentration on the markets on which further consolidations are to be carried out is measured in the traditional way using the Herfindahl-Hirschman Index (HHI) and its change (Delta indicator) directly brought about by the intended concentration. These indicators are well-known and applied in concentration proceedings in Poland. However, they were applied neither in any of the discussed special approvals nor in the decision prohibiting the PGE/ENERGA concentration. If the HHI had been calculated during these proceedings it would have demonstrated a high level of concentration of many of the electricity markets affected by this concentration.

Also the indicator C_3 and C_5 were not examined in the proceedings described in this article.

The low number of market players, the significant market shares (for example at the level of the rebuttable presumption of a dominant position) as well as the high level of concentration, do not however necessarily exclude efficient functioning of the market under conditions of effective competition. This seems to be the predominant view of the modern competition economy. All of these factors only constitute the ‘an initial indicator of the absence of competition concerns. However, they do not give rise to a presumption of either the existence or the absence of such concerns’⁷². This is because they only show the structural ‘macro’ relations of markets. Only consideration of the issue at ‘micro’ level – of the competitive position of specific undertakings offering specific groups of products – demonstrates the proper level of ‘market power’ (or ‘increased market power’). In order to show the true picture of the market structure the following questions also need to be asked, in the view of S. Bishop and M. Walker: ‘are some firms closer competitors to one another?; are rival firms able to expand in response to any putative price increase?; can rival firms alter their product offerings?; can new firms enter the market in

⁷¹ Approximated on dates available at www.ure.gov.pl/portal/pl/424/3553/Przedstawiamy_informacje_dotyczace_charakterystyki_krajowego_ryнку_energii_elekt.html and www.cire.pl/rynekenergii/podstawa.php?smid=207#dostarczenie.

⁷² ‘Guidelines on the assessment of horizontal mergers...’, point 21.

response to any post-merger price increase?; what actions can consumers take to undermine any attempt to increase prices post-merger?’⁷³

The reducing of the analysis of the effects of the concentration to a calculation of market shares following the concentration is a sign of belief in the traditional (and today highly criticized) Harvard School and its paradigm “structure-conduct-performance” (SCP). Nowadays there is a definite swing towards the view that a ‘high level of concentration does not necessarily mean that markets cannot function effectively’⁷⁴. The reduction in the number of basic electricity suppliers on the market, for example from 4 to 3 in the case of the PGE/ENERGA merger, cannot therefore be considered to be sufficient evidence of ‘a significant impediment to competition’.

Basing the evaluation of the concentrations (for instance, concentrations in the electricity sector) almost solely on the indicators that give a picture of the market structure means that they are appraised above all from the point of view of whether they give rise to unilateral effects⁷⁵. According to economic competition theory such effects arise when an undertaking ‘has the ability to increase price or reduce quality to the detriment of consumers despite the responses of the remaining competitors’⁷⁶; in other words if the concentration gives rise to increased market power, which is the ‘ability of one or more firms to profitably increase prices, reduce output, choice or quality of goods or services, diminish innovation, or otherwise influence parameters of competition’⁷⁷. At the core of every decision prohibiting a concentration of which anti-competitive coordinated effects do not constitute an essential aspect, there should therefore be the assertion that the ‘mostly liked’⁷⁸ result is the creation or strengthening of a dominant position on any of the defined relevant markets.

Meanwhile since May 1, 2004 the UOKiK President has rarely presented evidence of the ‘creation or strengthening of a dominant position’ as a result of the concentration being evaluated. The modification of the test, carried out after all to determine the anti-competitive coordinated effects of concentrations

⁷³ S. Bishop, M. Walker, *The Economics of EC Competition Law...*, p. 364.

⁷⁴ *Ibidem*, p. 366.

⁷⁵ The Polish antitrust authority did not look at the coordinated effects in any of the decisions issued cases regarding concentrations on the energy markets and for this reason these issues cannot be addressed at all in this article.

⁷⁶ S. Bishop, M. Walker, *The Economics of EC Competition Law...*, p. 350.

⁷⁷ ‘Guidelines on the assessment of horizontal mergers...’, point 8.

⁷⁸ More for the standard of proof in concentration cases see in my case comment on the EJC judgement in case C-413/06 P *Bertelsmann/Sony v. European Commission*: T. Skoczny, ‘*Bertelsmann AG i Sony Corporation of America przeciwko Komisji Wspólnot Europejskich*’ [w:] *Orzecznictwo sądów wspólnotowych w sprawach konkurencji w latach 2004–2009*, Oficyna a Wolters Kluwer company, Warszawa 2010, p. 126 ff, as well as the European literature cited therein.

on oligopolistic markets⁷⁹, is treated by the Polish competition authority as an opportunity to prohibit concentrations that do not create or strengthen a dominant position, and only enlarge a market share. I do not see any reason why derogation from the requirement to produce evidence that a dominant position is created or strengthened would help to lower the evidentiary threshold in the case of concentrations giving rise only to unilateral effects, i.e., its two substantive prerequisites – of either statutory⁸⁰ or case law⁸¹ origin: (a) the ability to ‘prevent effective competition within a relevant market’ and (b) the capacity ‘to act in a significant degree independently of competitors, contracting parties and consumers’. If the market share can indicate the ‘ability to prevent effective competition’, then this does not in any way determine the ‘capacity to act in a significant degree independently of competitors, contracting parties and consumers’. Nor in the case of the prohibited PGE/ENERGA concentration did the UOKiK President find a dominant position to have been created post concentration. The competition authority only found an increase in market share, albeit balanced by the market shares of main competitors. Also, the level of concentration in the Polish electricity sector is lower than in other EU Member States on the generation markets⁸² or moderate on the wholesale markets.

2. Other factors indicating whether or not there is a threat of ‘significant impediment of competition’

While limiting the discussion to unilateral effects of intended concentrations, one may say that the structural consequences of each concentration (creation or strengthening of a dominant position or at least a strong market position) can be always corroborated or countervailed mainly by the following three

⁷⁹ See: S. Bishop, M. Walker, *The Economics of EC Competition Law...*, s. 390 ff; A. Lindsay, *The EC Merger Regulation*, s. 294 ff; U. Schwalbe, D. Zimmer, *Law and Economics in European Merger Control...*, p. 221 ff.

⁸⁰ According to Article 4(10) of the CCP 2007 ‘a ‘dominant position’ shall mean a position of the undertaking which allows it to prevent the efficient competition within a relevant market thus enabling it to act in a significant degree independently of competitors, contracting parties and consumers; it is assumed that undertaking holds a dominant position if its market share exceeds 40%’.

⁸¹ See ECJ judgements in cases 27/76 *United Brands v. EC Commission*, ECR 1978, 207 or 85/76 *Hoffman La Roche v. EC Commission*, ECR 1997, 461.

⁸² According to Technical Annex to the Communication from the Commission to the Council and the European Parliament. Report on Progress in creating the internal gas and electricity markets of 11 March 2010; SEC (2010)251 Final; see also Communication from the Commission to the Council and the European Parliament. Report on Progress in creating the internal gas and electricity markets of 11 March 2009. SEC (2009)115 Final; *Transformacja systemu elektroenergetycznego*, p. 12.

factors: potential competition, purchasing power and efficiency gains⁸³. In the unconditional and special approval decisions analyzed above, issued for the notified concentration between electricity undertakings, those factors were not, unfortunately, considered – and if so only to a small degree (efficiency gains for example under the public interest test).

A fundamental element of the evaluation of the consequences of the intended concentrations by the competition authorities is or should be the possibility of new entries to given markets (**potential competition**)⁸⁴. Where there is that possibility, even large market shares do not bring market power. Where there is no such possibility or there are severe barriers to market access, an undertaking can have market power even with low market shares. In decisions giving special approval for creation of the PGE, TAURON and ENERGA groups this argument appeared only in reference to the European Commission's Report giving the findings of the inquiry into the internal electricity and gas markets, and which identified vertical relations as a substantial barrier to further liberalization of these markets⁸⁵. In Polish conditions the UOKiK President therefore already concluded at that point that to the extent, if at all, that the share in the electricity generation market and share in the retail electricity market were similar, the consolidated energy groups were not interested in entry of new market players to the market.

In the decision prohibiting the PGE/ENERGA concentration the UOKiK President stated only that 'entry into the electricity generation market by new parties was limited by substantial barriers (capital- and time-consuming – investments in production capacity require relatively high investment outlays, and the construction takes a long time)'. The authority deemed however only the historical argument to be evidence for this assertion, this historical argument being that recent entries by new undertakings to the electricity generation market amounted as a rule to takeover of Polish energy generators or distributors by foreign firms (EdF, Electrabel, Vattenfall, RWE). The UOKiK President did not however provide a detailed analysis of availability of capital loans or the potential for building generation capacity in short investment technologies, which could have undermined those arguments.

It is typical that the UOKiK President only conducted discussions surrounding potential competition (new entries to the market) when defining

⁸³ Inaczej niż Komisja Europejska in 'Guidelines on the assessment of horizontal mergers...', points 89–91, I see that 'failing company defence' serves more as 'absolute defence' than factors corroborating or countervailing results of SIEC analyses.

⁸⁴ See: 'Guidelines on the assessment of horizontal mergers...', points 68–75; S. Bishop, M. Walker, *The Economics of EC Competition Law...*, s. 384 ff; A. Lindsay, *The EC Merger Regulation*, s. 480 ff.

⁸⁵ 'DG Competition report on energy sector inquiry' (SEC(2006)1724, 10 January 2007).

the geographical dimension of the relevant markets (above all the generation and the wholesale market). It is difficult to contest the classification of those markets as national markets due to the currently negligible level of import of electricity to Poland (2–3%) and the low level of transmission capacity on cross-border connections in the direction of import. The evaluation of the intended concentrations differs from assessment, for example, of abuse of a dominant position in that it is prognostic and probabilistic in nature. While modification (extension) of the definition of a market does in fact require a major change to the above-described levels of import and cross-border transmission capacity, even a small increase in these could have a positive effect in terms of competition on the behaviour of the undertakings that hold the strongest position on the electricity retail market. If this were not the case the Commission would not be so determined in its efforts to bring about liberalization of the electricity and gas markets, including through imposing structural modification remedies on vertically integrated energy enterprises in the form of commitment decisions issued on the basis of Article 9 of Regulation 1/2003⁸⁶.

The UOKiK President did not examine the impact the **position of the contracting parties**⁸⁷ would have on the market position of those groups in any of the decisions giving special clearance for the creation of the PGE, TAURON and ENERGA groups. These contracting parties include in particular industrial (commercial) electricity **users** (buyers) who, since July 1, 2004, had the TPA to the network. In all of those decisions the UOKiK President stated only that the phenomenon of change of supplier was still negligible in Poland, due among other things to the barriers existing in this respect, or even the lack of awareness among electricity users that such a change can be made.

This argument was in essence repeated in the decision prohibiting the PGE/ ENERGA concentration. Although the so-called migrations are increasing year by year – to a significant extent in the case of industrial users and slightly in the case of households – the UOKiK President did not acknowledge this as being an argument favouring growing pressure of demand.

⁸⁶ See: U. Scholz, S. Purps, 'The Application of EC Competition Law in the Energy Sector', [2010] 1(1) *Journal of European Competition Law & Practice*, p. 37 ff.; J. Ruiz Calzado, R. Motta, M. E Leoz Martin-Casallo, 'The European Commission's Recent Activity in the Electricity and Gas Sectors: Integrated Approach, Pragmatism and Guidance in EU Competition Enforcement', *The European Antitrust Review*, GCR 2011, p. 90 ff.; K. Kloc-Evson, D. Koška, 'Kontrola koncentracji + regulacja = LIBERALIZACJA. Kontrola koncentracji na tle reform regulacyjnych w europejskim sektorze energetycznym' [in:] *Prawo i ekonomia konkurencji. Wybrane zagadnienia*. Redakcja B. Kurcz, LEXa Wolters Kluwer business, Warszawa 2010, p. 457 ff.

⁸⁷ See: 'Guidelines on the assessment of horizontal mergers...', points 68–75; S. Bishop, M. Walker, *The Economics of EC Competition Law...*, s. 388 ff.; A. Lindsay, *The EC Merger Regulation*, s. 467 ff.

It is typical that in all of the decisions granting special approval also the **efficiency gains**⁸⁸, if any, were not analyzed until the stage of examination of the grounds for not prohibiting under Article 19(2) CCP of the Act 2000 or Article 20(2) of the CCP Act 2007. It is difficult to say, but it also cannot be ruled out, that if that analysis had been carried out during the basic competition test analysis stage, significant impediment to competition would not have been found – at least in the case of creation of the TAURON and ENERGA groups.

With respect to the decision prohibiting the takeover by PGE of the ENERGA group as well, the applicants pointed out the numerous efficiency gains. The UOKiK President concluded however that at best they were gains for the parties to the concentration, and did not translate into benefits for the public and the economy at large, and that therefore there were no grounds for justifying not prohibiting the concentration. Neither in this scope was the issue supported by specific and detailed economic evidence.

VI. Conclusions

The discussion of the issues presented above shows that the scale of threats to competition that might arise due to the vertical reconsolidation of the Polish electricity sector that occurred in 2006–2007 in the form of the creation of four vertically integrated energy groups was not great. Furthermore, the question shall be left unresolved as to whether allowing their creation under the Polish competition protection law (especially merger law) – in three instances, and particular in the case of the TAURON and ENEA groups – required special approvals, or whether that could have been achieved due to unconditional approval or – in the case of the PGE group – conditional approval from the UOKiK President. This is probably not the case but applying the legal institution of special approval for evaluating those transactions was relatively easy, and in any case easier than issuance of unconditional or conditional approval. There are many reasons for this. First, in none of these cases did the UOKiK President take a great regulatory risk even at the stage at which it was established that those consolidations were a potential source of ‘significant impediment to competition’. This is because the competition authority concluded that unilateral structural effects of those consolidations (a lower

⁸⁸ See: ‘Guidelines on the assessment of horizontal mergers...’, points 68–75; S. Bishop, M. Walker, *The Economics of EC Competition Law...*, s. 412 ff; A. Lindsay, *The EC Merger Regulation*, s. 510 ff; U. Schwalbe, D. Zimmer, *Law and Economics in European Merger Control...*, p. 318 ff.

number of market players, increase in the market shares to the level in the range of the presumed market dominance) were enough for the competition test to be proved. Second – as in the case of all of the decisions issuing clearance – in the end the intended consolidations could have been performed within the scope of implementing government policy (contribution to ensuring the country's energy security) and meeting the economic expectations of the players themselves (a rise in the value of their businesses and their investment capability). Third, under the Polish merger law it was also evident that, being positive decision, special approval is not contested by applicants and is not subject to judicial review. It can be of no surprise therefore that none of these decisions contains detailed economic analyses confirming both 'a rise in investment capability' and other efficiencies.

This is all the more reason why it is surprising that in the case of the PGE/ENERGA concentration the UOKiK President decided to prohibit the transaction. That consolidation does not give rise to a substantial shift in the balance of market power, apart from the fact that indeed the number of major players on the electricity production and marketing markets will go down from 4 to 3. Even if it was acknowledged that in this case as well the scale of potential competition, purchasing power and – in particular – efficiency gains, which should be analyzed during the stage of analysis of fulfillment of the competition test, does not completely eliminate the threats to competition, there is no doubt that proving the fulfillment of the public interest test (ensuring the country's energy security) should be even easier today than it was in 2006–2007. In any case the need for investment in generation capacity and electricity networks is of course now greater, which fact cannot be without relevance when evaluating the 'rise in investment capability' argument, which was the decisive factor in the issuance of special approvals for the creation of the PGE, TAURON and ENEA groups. The rejection of that argument, without carrying out detailed economic analyses to determine whether it is correct, could be considered a violation of Article 20(2) of the CCP Act 2007 due to failure to account for arguments relating to government energy policy. From the formal point of view the UOKiK President has the independent power to decide to prohibit a concentration or – but only in exceptional cases – to decide not to prohibit a concentration if he believes that there are justified grounds as defined in Article 20(2) of the CCP Act 2007. He cannot however simply reject government energy policy arguments because – precisely due to his decision-making autonomy with regard to competition issues – the UOKiK President is not a political administration authority⁸⁹. The burden of proof of fulfillment of the prerequisites of those provisions is on the applicants, who

⁸⁹ See Ustawa o ochronie konkurencji i konsumentów. Komentarz pod redakcją C. Banasińskiego, E. Pionka, p. 489.

have the right to expect that as they are implementing the energy policy of the state – acting as a political authority and owner – the arguments pointing out that further consolidation is needed in the electricity sector will be considered properly. By refusing not to prohibit the concentration, the UOKiK President questioned the instruments of implementation of energy policy, and only the government has the authority to select those.

Although it sounds demagogic, the statement made by the UOKiK President, that adoption of that stance could lead the applicants to rightly expect further potential consolidations of the existing energy groups, and that the UOKiK President should also give special clearance for those consolidations, is certainly not far from the truth. With the exception of the conditions existing due to EU law, as long as the public authorities with a democratic mandate, and therefore also accountable to the electorate (who are the final consumers of electricity) retain ownership control over the undertakings that are important for its national energy security policy, they should have the power to decide what position those undertakings have within the national energy market structure. The government can in principle only dispose of that power when it disposes of ownership control over those undertakings by way of privatization. It will then be possible to apply the rules for protection of competition without hindrance for the purpose of preventing further (excessive) concentration or abuse of market power.

The examples of experiences and problems presented above, relating to competition (merger) law assessment of vertical reconsolidation of the electricity sector in Poland, require that the issue again be raised of whether the solution that presently exists under Polish merger law (which affords the UOKiK President twofold authority to appraise concentrations which indeed might represent a threat to competition, but bring with them gains for the economy and public at large) is a legitimate one⁹⁰. Poland is among the few countries in which the competition authority is forced to apply the public interest test in concentration cases. It is true that there are countries in which concentrations that do not pass the competition test are allowed on the basis of the public interest test. In these countries however it is the political administration authorities (the government, ministers) that have power to issue special approval of this kind. In order to mitigate the risk that could arise due to overly frequent and easy exercising of those powers, in some of those countries the relevant institutional and procedural safeguards have been put in place.

⁹⁰ For more see: A. Stawicki, E. Stawicki, *Ustawa o ochronie konkurencji i konsumentów. Komentarz...*, pp. 500 ff; T. Skoczny [in:] *Ustawa o ochronie konkurencji i konsumentów. Komentarz*, p. 900 ff.

Among the countries that use not only the competition test but also the public interest test to evaluate a concentration are such EU countries as Belgium, Germany, and the United Kingdom – as well as non-EU countries such as Switzerland and Ukraine⁹¹. In all of those countries, the national competition authorities make concentration decisions on the basis of the competition test. In Belgium the Competition Council has to present a decision prohibiting a concentration to the government, which can issue clearance within 30 days of the date on which it is delivered to the parties if the public good (public security, competitiveness in that sector, consumer interests, the labour market) takes priority over the damage done by the detrimental effect on competition. The Federal Minister for Commerce can also grant special approval for a concentration prohibited by the Federal Cartel Authority, while prior to issuing that decision it is required to seek the opinion of the Monopolies Commission (Monopolkommission). In the United Kingdom there are three categories of public interest cases (general, special and ‘legitimate interest’) which involved the Secretary of State being in charge for business. They have in common, first, the issuing of a notice by the Secretary of State. The effect of such a notice is to require the Office of Fair Trading (OFT) to investigate the merger and provide a report. After receiving a report from the OFT a reference may be made by the Secretary of State to the Competition Commission (CC). If the CC decides that the merger is against the public interest, it must then answer questions relating to remedies. Upon receipt of the CC’s report, the Secretary of State has 30 working days in which to make a decision on the questions CC tabled. However, the Secretary of State is not bound by the CC’s views on the public interest test⁹². The Swiss government (Federal Council) also has the power to give ‘special authorization’ for a concentration if it will have a positive impact on the market. Finally, the Council of Ministers in Ukraine has the power to grant clearance for a concentration prohibited by the Ukrainian Antimonopoly Commission if the parties to the concentration manage to demonstrate the positive outcomes of the concentration for the public interest, and this outweighs the adverse effects of the concentration for competition (1st condition) and will not present a danger to existence of the market economy in Ukraine (2nd condition).

⁹¹ See national chapters in *Internationale Comparative Legal Guide to ‘Enforcement of Competition Law 2009’* available at www.iclg.co.uk and in Rowley & Baker, *International mergers...* For more in Polish see T. Skoczny, ‘Instytucjonalne modele wdrażania reuł konkurencji na świecie – wnioski dla Polski’, (2011) 73(2) *Ruch Prawniczy Ekonomiczny i Socjologiczny*, p. 77 ff.

⁹² See also Merger Assessment Guidelines. A joint publication of the Competition Commission and Office of Fair Trading, September 2010; available at www.oft.gov.uk/OFTwork/mergers/publications/substantive/, p. 65 ff.

Incidentally, the Polish competition authority seems to prefer to counter threats to competition caused by concentrations by way of prohibition, and not conditional approval. Since 2000 the UOKiK President in fact issued 5 decisions prohibiting concentrations and 9 decisions granting conditional approval (a ratio of 1 to 2)⁹³. As we see the European Commission and many competition authorities in EU Member States have different understandings of their mission to protect competition, preferring to issue decisions giving conditional approvals on the basis of which the applicants undertake or are obliged to undertake the remedies which, on the one hand, are intended to eliminate in an effective way the threat to competition, and on the other hand allow applicants to achieve acceptable commercial goals. The ratio of decisions prohibiting concentrations to decisions granting conditional clearance in the Commission's practice is 1 to 10⁹⁴.

In none of the decisions concerning consolidations in the energy sector in 2006–2007 did the UOKiK President even consider the option of conditional approval. The competition authority did do this however in a decision prohibiting the takeover by PGE over the ENERGA group. In that case the UOKiK President acknowledged that there were no remedies that could eliminate the competition concerns presented by that concentration (mainly those that were the result of vertical integration). The reasons for this decision were based however on speculative statements and not on specific economic evidence.

It is typical that the negative stances cited in the decision (for example lack of liquidity and transparency of wholesale market) taken with respect to the concentration by influential competitors – market players that were strong not only in Poland (for example RWE, E.ON or CEZ) – demonstrated that in order to amend them ‘mechanisms for releasing energy in groups through sale of energy in a competitive manner have to be imposed’ or ‘through making an undertaking that guarantees that liquidity and transparency of the Polish energy trading market will not deteriorate as a result of the concentration’. This commitments made by PGE/ENERGA ‘could infer that a specified percentage of electricity it generated would be sold to a platform that was publicly accessible and free from discrimination’. E.ON believes that ‘this undertaking should apply (including the already existing statutory obligation) to approximately 15–20 TWh of electricity per year’. According to the CEZ Trade's opinion ‘PGE should be ordered to sell all electricity... on the stock exchange... in a competitive and equal manner’. Organizations representing

⁹³ For more see T. Skoczny, ‘Polskie prawo kontroli koncentracji – ewolucja, model, wybrane problemy’, (2010) 5 *Europejski Przegląd Sądowy*, p. 15.

⁹⁴ See statistics of the EU merger cases available at <http://ec.europa.eu/competition/mergers/statistics.pdf>.

users of electricity also opposed the only ‘unconditional takeover of the market’, suggesting that any potential consent ‘could only be granted on a conditional basis’, for example ‘by imposing specific obligations on the new entity’. The UOKiK President did not address these ‘proposals’ in any way in his prohibition decision.

In my view a modifying behavioral condition (remedy) could and should be applied in this case. The commitment of the PGE group to ensure that for the next 10 years, i.e. 5 years longer than provided for in Article 49a(2) of the Act of 10 April 1997 – Energy Law (Energy Law)⁹⁵, energy generators in the PGE group will sell all of their energy in accordance with Article 49a(2) of the Energy Law, i.e. through the commodities market, the regulated market and online trading platforms on the regulated market⁹⁶, would be sufficient and effective and easy to monitor⁹⁷. This remedy could ensure public and equal access to that energy, a transparent role of PGE in electricity trading, and successful elimination of the threats to competition mentioned in the decision – threats caused by lack of market transparency. Of course that would mean specific economic evidence would have to be produced to prove that this assumption was correct. Moreover, the effective conditions would have to be put in place to guarantee that PGE complied with the imposed modification conditions (for example appointing – for the first time in Poland – a so-called monitoring trustee).

In the context of the PGE/ENERGA concentration it can also be seen clearly that there would also be a great need in Poland for a formal two-stage control procedure⁹⁸. The current procedural legislation in fact renders impossible a discussion between the applicants and the competition authority regarding the true merits of the case, as they do not place on the latter an obligation to present competition concerns during the proceedings that should be the basis for a proposal for conditions put forward by the parties to the

⁹⁵ Unified text available at www.ure.gov.pl/portals/pl/25/17/Ustawa_z_dnia_10_kwietnia_1997_r_Prawo_energetyczne.html.

⁹⁶ PGE’s argumentation, at the core of the appeal against the decision prohibiting the PGE/ENERGA concentration seems to be going in this direction. See ‘*Komentarz PGE do stanowisk i obaw UOKiK*’ [‘PGE Commentary to UOKiK stance and fears’] available at websites: <http://www.pgesa.pl/pl/PGE/CentrumPrasowe/InformacjePrasowe/Strony/KomentarzPGEdoobawistanowiskaUOKiK.aspx>; <http://www.pgesa.pl/pl/PGE/CentrumPrasowe/InformacjePrasowe/Documents/Prezentacja%20odwołanie%20UOKiK.pdf>.

⁹⁷ This means it would fulfill prerequisites defined in Commission Notice on remedies acceptable under Council Regulation (EC) No 139/2004 and under Commission Regulation (EC) No 802/2004, OJ [2008] C 267/1.

⁹⁸ There is a two-stage control proceedings in concentration cases in the EU (see Council Regulation 139/2004) and a substantial number of its Member States.

concentration⁹⁹. Fortunately, the introduction of such a two-stage procedure in concentration cases has been announced lately in the Polish ‘Competition Policy for 2011–2013’¹⁰⁰.

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⁹⁹ In the EU (see Council Regulation 139/2004) and in EU Member States the rule is for the parties to propose conditions of the concentration and not the competition authority, although that happens in exceptional cases.

¹⁰⁰ ‘Polityka konkurencji na lata 2011–2013’. UOKiK, April 2011; available at www.uokik.gov.pl.

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The Need for Revaluation of the Model Structure for Electricity Liberalization

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CONTENTS

- I. Introduction
- II. The origin of the fully unbundled concept
- III. Restructuring developments
- IV. EU unbundling initiatives
- V. The first signs of crisis in the restructuring canon
- VI. Concluding remarks

Abstract

The question about an appropriate structure for the electricity industry has been extensively discussed in scientific literature and experts studies. Since the beginning of electricity liberalization, it was apparent for its promoters that such a structure (in this paper referred to as the *model structure* or *ideal structural model*) for the electricity sector should involve a separation of its four sub-sectors, i.e., generation, transmission, distribution, and supply. With the exception of transmission, each sub-sector should consist of many stand-alone type companies. Given the high degree of vertical and horizontal integration of the electricity sectors, their pro-competitive restructuring (i.e., de-integration) became a standard component of electricity sector reform packages. This paper provides a concise review of the origins and justification of the initial model structure for electricity liberalization, as well as an overview of the restructuring developments in the early years of electricity liberalization. Some attention is also devoted to the EU's unbundling initiatives. The core part of this paper discusses the first signs indicating the crisis of the initial structural canon. The paper concludes with some comments referring to the modified form for a model structure that is emerging. It involves vertical integration of generation and supply and allows a higher degree of horizontal concentration of the electricity competitive markets.

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Résumé

La question de la structure de l'industrie de l'électricité appropriée a été beaucoup discutée dans la littérature scientifique et les études d'experts. Depuis le début de la libéralisation du marché de l'électricité, il était évident pour son promoteurs que cette structure (dans cet article elle est appelée "structure modèle") du secteur de l'électricité devra contenir la séparation de ses quatre sous-secteurs (génération, transmission, distribution et provision). A l'exception de la transmission, chaque sous-secteur devra contenir plusieurs entreprises indépendantes. Étant donné le haut niveau de l'intégration horizontale et verticale des secteurs de l'électricité, leur restructuration pro-concurrentielle (désintégration), est devenue un composant standard des paquets des reformes du secteur de l'électricité. L'article présente une révision des origines et la justification du modèle initial de la structure de la libéralisation du marché de l'électricité, aussi que la révision du processus de restructuration dans les premières années de la libéralisation du marché de l'énergie. L'article discute aussi les initiatives d'unbundling de l'UE. La partie la plus importante de l'article présente les premiers signaux indiquant la crise de la structure initiale. Finalement, l'article contient commentaires concernant la forme modifiée de la structure modèle qui émerge. Elle contient l'intégration verticale de la génération et la provision et permet le niveau plus élevé de la concentration horizontale du marché de l'électricité concurrentiel.

Classifications and key words: electricity liberalization, model structure, unbundling, internal electricity market, EU restructuring developments.

1. Introduction

In this paper the ideal structural model for electricity liberalization is treated as one of the key elements of the recommended standard reform package that was aimed at liberalization of the network industries, including the electricity supply industry. This package was based on the experience of the United Kingdom in transforming its network industries in order to make them responsive to the market type of incentives. It consisted of four elements: privatization; deregulation combined with setting out institutional arrangements required for development of competitive markets; re-regulation of the type of activities within each network industry that were characterized by strong natural-monopoly features and, finally; a restructuring component. The latter was to deal with the problem of the highly monopolized structure of network industries that had been dominant before their liberalization.

Given the high degree of the network industries' vertical and horizontal integration, their restructuring was perceived as a crucial factor in facilitating

the development and effective operation of competitive markets as well as in introducing regulatory mechanisms in those parts of each network industry where features of a natural monopoly still dominated, making effective competition impossible. For promoters of the network industries' liberalization, it was apparent that the restructuring component should involve various activities and efforts leading to vertical and horizontal de-integration of these industries. In the case of the electricity supply industry, its ideal structure model involved separation of the four sub-sectors, i.e. generation, transmission, distribution, and supply, with numerous stand-alone type companies within each of these sub-sectors (excepting transmission, where only one national-wide company was to operate). In the 1990s the above model became a recommended part of market-oriented reforms in other developed and developing countries.

Despite strong beliefs in its rationality and the increasing support of the European Commission for such a structural transformation of the electricity industry, the real structural changes that followed did not occur in the recommended direction. First of all, the restructuring component did not become a part of the liberalization reforms in a number of countries. Moreover, instead of the gradual de-monopolization that should accompany development of the electricity liberalization, the structural evolution of the electricity sector has in fact been going in the opposite direction. Since the end of the 90s, the pace of the industry's consolidation has been rapidly increasing. Through numerous mergers and acquisitions, the electricity industry has become more horizontally and vertically integrated than it had been prior to liberalization.

However, the most remarkable indication of this trend (opposite to what most experts had recommended and expected at the time when electricity liberalization was launched) were the cases of vertical and horizontal reintegration taking place in the industries that had earlier been restructured in line with the structural canon. This was particularly visible in the UK, whence the structural canon had originated. In the light of this reverse direction of the structural developments in the European electricity sectors a very important question arises. It concerns the reasons for the retreat from this structural canon.

The answer to this question has recently become the subject of lively discussion and controversy. The central issue is whether a growing degree of vertical and horizontal integration in the electricity industries results from (a) failure of the public and governmental organs responsible for the implementation of structural and competition policies to resist the pressures of the sector's vested interests to rebuild or strengthen the vertical and horizontal ties, and/or (b) the political will to establish national champions based on hopes that such entities will be better prepared to ensure the security of electricity

supply and to compete in the European electricity market, or (c) other factors which did not receive sufficient attention when the concept of market reforms was in the developmental stage.

This paper focuses on option (c). Although it would be inappropriate to fully ignore the first and second options, there is an increasing number of arguments for a more nuanced approach to the issue of the electricity industry's structure, especially to the model for the stand-alone electricity company. This approach is based on the assumption that the consolidation trend should not be interpreted as a process determined only by the vested interests of incumbents (and *ipso facto* not acceptable in terms of economic efficiency and interests of electricity consumers), but also as a form of rational adjustment of the electricity company model to the conditions imposed on and challenges created by competitive electricity markets. Moreover, in the longer term this adjustment can also benefit electricity customers, as well as be conducive to the strengthening of electricity supply security.

It is worth stressing that the issue of the electricity company model can be considered not only in a theoretical, but also in a practical context. The former puts the discussion on the correctness of the structural canon in a broader perspective involving barriers that may implicate the existence of limits for development of the competitive electricity markets. The latter refers to the targets of regulatory and competition policies. In the previous decade many countries targeted their policies at supporting market-oriented reforms in the electricity sectors. The visible form of these policies was active, though often not effective resistance to the consolidation pressure as it happened in both the UK and Poland. The most important conclusion of this paper is that the failure of the efforts to stop the consolidation process needs to be discussed and assessed from a wider perspective, one that should not confine the choice of industry structure to two extremes, i.e., full de-integration and full integration.

The paper starts with a short review of the origins and justification of the initial model structure for electricity liberalization as well as some discussion on the reality of the restructuring activities in the 90s. Attention is devoted to the EU unbundling initiatives. The core part of this paper discusses the signs indicating the crisis of the initial structural canon. Finally, the paper includes some comments referring to the modified form of the model structure that is emerging. This involves the vertical integration of generation and supply and allows a more horizontal concentration of electricity competitive markets.

2. The origin of the fully unbundled concept

In order to understand why promoters of electricity liberalization attached great importance to the restructuring component of such reforms, it is worth examining the peculiarity of the electricity sector liberalization as along with other network-based sectors like gas, water, railways, and, until not long ago, telecommunication. Said peculiarity results from the fact that each of those sectors is a combination of strictly interrelated types of activities out of which only some are potentially competitive¹. The potentially competitive activities include electricity generation and supply (wholesale trade and retail sale to final consumers). Both activities represent two ends of the electricity production-service chain. In the middle of this chain there are two network-based activities – transmission and distribution. As the network activities had, and still have, natural monopoly features, and could not be regulated by competition forces, it became obvious that they had to be subjected to some form of public regulation.

This, and the fact that the previous reforms in these sectors had not achieved the planned effect, made it clear for policy makers and reform designers that the reform package could not be confined to the deregulatory measures that had proved sufficient for a spontaneous and quick development of truly competitive markets in the earlier liberalizations of non-network-based industries. Thus, to achieve a key goal of liberalization, i.e. a decrease in the costs and prices of electricity generation and supply, more complex reform programs were designed and implemented in 1984 in respect to telecommunication, and then in 1986 in respect to the gas sector (1986). The reforms consisted of three main components: (i) privatization of the vertically and horizontally-integrated incumbents, i.e. British Telecom and British Gas respectively, with the aim to make them more responsive to market and regulatory incentives;; (ii) deregulation of access to the telecommunication and gas markets to enable development of competition; and (iii) implementation of an innovative type of economic regulation.

The last component embraced the two main categories of regulatory activities: price regulation and promotion of competition. The novelty of the British type of price regulation consisted in the replacement of a model well established in the private network industries for rate of return regulation with a form of incentive regulation, widely known as an RPI-X². The second

¹ For more on liberalization and introduction competitive and regulated markets in the network-based industries see: D. Helm, T. Jenkinson (eds.), *Competition in Regulated Industries*, Oxford University Press, Oxford 1994.

² Abundant literature has developed on the issue of incentive regulation in general as well as the RPI –X type. See in Polish: A.T. Szablewski, *Zarys teorii i praktyki reform regulacyjnych*

category of regulatory activity was innovative in itself, since the promotion of competition – also through encouraging new entries – was not a standard part of the previous regulatory regimes. Moreover, the most advanced traditional model of the United States' utility regulation was in fact designed to protect incumbents from competition and thus, not surprisingly, it had a long record of resisting new entries.

The decision to include the promotion of competition into the list of statutory duties of the British regulators was based on the assumption that competition in network industries could not occur and quickly develop without a sector regulator actively encouraging it. Two factors were determined as to why the telecommunication and gas regulators were made responsible for promotion of competition. The first was the evident failure of the British network industries' earlier reforms, dating to the beginning of the 1980s. Following the success of the liberalization of a number of the non-network-based sectors, these reforms had also been confined to only allowing newcomers access to the incumbent networks.

The second – much more important – factor referred to the fact that the privatization of both incumbents was not to be accompanied by their pro-competitive restructuring. As a result, they had been privatized as single entities having 100% of the telecommunication and gas markets respectively. This happened despite strong recommendations, especially in the British Gas case, for breaking them up. However, despite facing fierce resistance from British Gas, the British government decided to abandon its restructuring plans³. Therefore, in order to avoid repetition of previous failures in developing competition in highly concentrated markets, the Government expanded the list of the regulators' duties by adding an obligation to actively support development of competition through the use of a regulatory weapon.

Unfortunately, despite the vigorous efforts of regulators in both sectors, progress in promoting competition during the first years of their liberalization was rather slow. Moreover, the measures used by the regulators to facilitate new entries raised serious controversy over their economic rationality⁴. There was also one more factor that made the policy makers more determined to precede the privatization of another utility sector, i.e. electricity, with a restructuring of the biggest, vertically-integrated incumbent. This was the

na przykładzie energetyki, Monografie Nr. 12 Instytut Nauk Ekonomicznych PAN, DiG Łódź-Warszawa 2003, rozdz. 5.

³ For more details on the recommended options for restructuring British Gas see: J. Vickers and G. Yarrow, *Privatization: An Economic Analysis*, The MIT Press Cambridge, London, 1988, pp. 268–271.

⁴ For more on this see: A.E. Kahn, *The Economics of Regulation. Principles and Institution*, The MIT Press, Cambridge, Mass. 1990, p. XXXIV.

growing awareness of the nature of threats resulting from maintaining the vertical structure of privatized incumbents untouched. As the cases of both earlier privatized incumbents demonstrated, their vertical structure made it possible for them to use a well known cross-subsidy tool, one broadly applied in the network industries prior their liberalization, to prevent newcomers from entering the potentially competitive markets⁵.

Cross-subsidy is a kind of improper, in economic terms, assignment of costs among different activities that may also be easily utilized by a vertically-integrated incumbent to place potential entrants at a competitive disadvantage⁶. In practical terms, for a vertically-integrated company it is only an internal transfer of costs from one activity to another. It enables the integrated company to use profits from its monopoly operation to cover the costs of competitive operation. However, from the perspective of its potential competitors, this type of cost-accounting system provides a vertically-integrated company with an opportunity not only to overcharge their potential competitors for use of its network, but also to unfairly lower prices on the sale of electricity in the competitive (generating or supply) markets. As a result, a vertically-integrated company can effectively, and at the cost of potential competitors, maintain its market share and block development of competition in a formally open market.

In this context, the idea of restructuring vertically-integrated incumbents to remove monopoly from the potentially competitive activities seemed to be an obvious solution to the problems faced by the telecommunication and gas regulators attempting to control the anticompetitive practices of the privatized incumbents. The concept of pro-competition restructuring was supplemented by two other elements that were supposed to improve development of vigorous competition and effective regulation. The first element involved further unbundling of activities leading to the separation of transmission from distribution activities and separation of the network activities from trade activity (wholesale and retail).

The second element of the restructuring referred to horizontal de-integration within generation, trade, and distribution activities, leaving the transmission activity as a national monopoly. De-integration of generation and trade was aimed at enhancing competition through the creation of a competitive structure for both types of electricity markets. In turn, de-integration of distribution

⁵ The concept of cross-subsidy attracted the attention of many economists a long time before the liberalization processes started. See more on this with extensive list of publications: E Ralph, *Cross-subsidy: A Novice's Guide to the Arcane*, Duke University, Durham NC 27706 USA, 1992, paper available on the web.

⁶ In Polish that issue is discussed by: A.T. Szablewski, 'Konsolidacja a konkurencja na polskim rynku energii elektrycznej', (2002) 2-3 *Gospodarka Narodowa*.

was justified on regulatory grounds. Two arguments were provided here. The first one indicated the advantages of transparency in cost calculations that could facilitate non-discriminatory access to the network. This argument also referred to the unbundling of transmission. The second argument stressed that the existence of several distribution companies, each having monopoly power in its own region, was conducive to implementation of incentive regulation in the form of so-called ‘yardstick competition’⁷.

This approach to the optimal structure for the electricity industry, based on the fully vertically and horizontally de-integrated sector, led to the model for a stand-alone electricity company. Unlike the traditional model, the new model assumed that an electricity company could perform only one of four key types of activities. Justification of the new model included an assumption that technological change, including the development of computer and internet technology, had significantly diminished economies of vertical integration and made electricity generation and trade potentially competitive activities. Due to the low transactions costs, the stand-alone generating and trading companies had become a better – in terms of economic efficiency – alternative to the traditional model for an integrated company⁸.

3. Restructuring developments

Though the rationality of the structural canon for electricity liberalization was not seriously questioned in the first stage of the reform programs’ implementation, few countries decided to embark on a radical restructuring of their vertically- and horizontally-integrated incumbents⁹. Wherever the governments began discussing the restructuring option as part of the liberalization reform package, the incumbents put up strong resistance that significantly slowed, or even inhibited its implementation. The course of the de-integration process depended on the following factors: (i) the extent of the initial degree of vertical sector integration in a given country; (ii) the ownership status of electricity companies; and (iii) the type of de-integration strategy chosen.

⁷ Yardstick competition involves use by a regulator of information from several firms to determine the incentives for each firm. J. Sobel, ‘A Reexamination of yardstick competition’ (1998) 8(1) *Journal of Economics and Management Strategy*.

⁸ For more on this see: R.J. Mitchels, ‘Vertical Integration: The economics that Electricity Forgot’ (2004) 17(10) *The Electricity Journal*, pp. 12–13.

⁹ See for example the restructuring plan for Enel in Italy: M. Giuletti, R. Sicca ‘The liberalization of the internal market for electricity: what choices for Italy’ (1999) 8 *Utilities Policy*.

As far as the first factor is concerned two traditional models of vertical integration – the fully- and partially-integrated model – need mention. The fully-integrated model involved a national monopoly company performing all vertically-related types of activities (from electricity generation to its supply). Breaking up such a company could theoretically lead to an ideal – in vertical and horizontal terms – structure for the electricity sector. According to the views promoted at the initial stage of the sector's liberalization, the splitting of a national incumbent was to result in the division of the electricity sector's structure into three separate sub-sectors – namely, generation, transmission, and distribution. The first sub-sector was to consist of a number of competing companies. The second was to operate as a single, nation-wide company, while the third sub-sector was also to consist of a number of companies, but these companies would perform two activities – distribution and the supply of electricity to final consumers. The unbundling of the distribution companies was scheduled to take place later and it was to complete the process of shaping the electricity sector's structure as a one based solely on stand-alone companies.

Poland was one of the very few countries whose electricity sector was structured closely in line with this model. At the beginning of the 90s, the domestic electricity sector that had operated as a nation-wide monopoly structure called *Zjednoczenie*, was disintegrated into three sub-sectors. These sub-sectors included more than 20 big generating companies, one national transmission company, and 33 distribution companies. The disintegration, however, was not a result of a planned restructuring operation aimed at creating conditions for developing competitive electricity markets. It was rather an effect of the market transformation of the whole Polish economy. The transformation led to the collapse of many of the old corporate structures, including *Zjednoczenie*. This, in turn, inspired some experts to consider and undertake work on the concept of market-oriented reforms that would take advantage of such a favourable sector structure. The program of reforms that followed was based on the assumption that supply sub-sector (which at the time was non-existent) would naturally evolve as a result of a regulatory framework that has to be developed in order to enable real competition in the sale of electricity for final consumers¹⁰.

The partially-integrated model embraced two types of companies. The first type consisted of companies that combined generation and transmission

¹⁰ For more extensive discussion of the Polish program of reforms in the electricity sector in: A.T. Szablewski, 'Koncepcja i programy wdrażania reform w energetyce polskiej' [in:] P. Jasiński, A.T. Szablewski, G. Yarrow, *Konkurencja i regulacja w przemyśle energetycznym. Brytyjskie doświadczenia a polskie problemy*, Polska Akademia Nauk, Instytut Nauk Ekonomicznych, ELIPSA, Warszawa, 1995.

activities. The second referred to distribution companies that, as mentioned above, performed both network and trade activities. Depending on the country, the number of such vertically-integrated companies varied. However, distribution-supply companies were significantly more numerous than the generation-transmission companies.

The restructuring of the first type of vertically-integrated electricity company involved separation of generation from transmission accompanied by a further horizontal de-monopolization of the generation sub-sector. The restructuring of the British generation and transmission company CEBG that preceded its privatization may serve as an example of that type of unbundling. It resulted in the creation of three generating companies and one national transmission monopoly company. On the distribution side of the British electricity sector, there was no need for companies' horizontal restructuring as this sub-sector had already been divided into twelve companies. During their privatization, they maintained their vertical structure, i.e., distribution and retail activities. However, instead of their ownership separation, these companies were obliged to implement what was known as an accounting unbundling. It consisted of performing a separate calculation of distribution and supply costs.

It is worth noting that in all cases of the successful electricity liberalization, the reform package included measures that ensured effective unbundling of the managing transmission activities. This conclusion is based on numerous empirical studies that analyzed various implications of transmission unbundling¹¹. Although the research results are mixed in respect to some unbundling implications, it is beyond a doubt that the effective unbundling of transmission was a crucial factor that facilitated liberalization. In all the countries that have succeeded in creating a competitive electricity market, the reform package included implementation of arrangements that ensured independent management of transmission activity. In turn, countries that failed to proceed fast with development of competitive electricity markets (like Germany and France), have not had the effective unbundling regime in place.

In the 1990s, wherever the process of forced vertical de-integration took place, it stopped with unbundling generation, transmission and distribution, leaving unbundling of the electricity trade from distribution for the future. New Zealand is the only case known to date of forced ownership unbundling at the distribution level¹². The unbundling was carried out in 1998 as the

¹¹ A review of results of many research projects can be found in the paper by M. Pollitt, 'The arguments for and against ownership unbundling of energy transmission networks' (2008) 36 *Energy Policy*.

¹² See: P. Nillesen, M. Pollitt, 'Ownership unbundling in electricity distribution: empirical evidence from New Zealand' *EPRG Working Paper in Economics* 0836, 2008, paper available on the web. The Authors point out that forced ownership unbundling at the distribution level has

third phase of the reform process that started in 1987. The earlier phases had provided a set of conditions there were to establish a legal framework for the operation of competitive and regulated electricity markets. However, the disappointing results of the implemented legal measures – especially in terms of development of competition – led the government to decide to prohibit companies from being involved in a network (transmission or distribution) and to prohibit potentially competitive businesses (generation and supply) from performing both types of activities. In the case of distribution, the majority of companies retained their distribution business and sold their supply business¹³.

Not by chance, forced ownership unbundling occurred in the electricity industries with the state-owned companies. This is because such an operation seems, at least theoretically, much easier to carry out. The splitting up of a state-owned company prevents accusations of interference with private property rights which may result in inhibiting the planned restructuring, or significant increase of the costs of legislation or procedures needed to implement planned pro-competitive reorganizations of the private entity. Therefore, in the case of the network industries with state-owned incumbent companies, a key recommendation for governments preparing reforms aimed at their liberalization was to implement the pro-competitive structural changes prior to privatization (only if the latter was part of the reform program).

However, in practice, the restructuring of a state-owned company was not so easy to perform. As the British and Italian cases demonstrated, governments usually faced very strong resistance from the incumbent companies and their employees based on what seem to be rather obvious reasons. Generally, it was a defence of their vested interests since the unreformed structure let them use market power to block new entries to formally open markets¹⁴. Usually, these vested interests were masked by the more rational argument stressing that the unbundling operation had to involve significant transaction costs. These costs arise when the internal links within an integrated company are replaced by market transactions between unbundled companies. Though the argument set a solid base for attacking the unbundling concept, its supporters claimed that the decrease of costs due to a rapid development of competition in electricity generation and supply spurred by an unbundling operation far outweighed

also been imposed by law in the Netherlands in 2007. The unbundling is to be obligatory since January 2011. More on the Netherlands case in: R. Kunneke, T. Fens, 'Ownership unbundling in electricity distribution: The case of the Netherlands' (2007) 35(3) *Energy Policy*.

¹³ According to Nillesen and Pollitt, of the then 36 integrated distribution companies only three decided to continue operating as electricity supply companies, divesting their network (distribution) activity. *Ibidem* p. 18.

¹⁴ For more discussion of this argument see: K. Bobińska, 'The Defense of Monopoly as a Determinant of the Process of Transformation of State-owned Infrastructure Sectors in Poland' (2008) 1(1) *Yearbook of Antitrust and Regulatory Studies*.

its disadvantages in the form of transaction costs. Therefore, they strongly advised the governments to precede privatization with the implementation of pro-competitive restructuring¹⁵. However, this advice was rarely taken by the governments and shaped their structural policy.

To complete the list of the methods through which unbundling has been implemented, voluntary ownership separation needs to be mentioned. It refers to the unbundling of distribution and commercial activities, since unbundling at this level is a much less common practice than in the case of transmission¹⁶. At a significant scale, voluntary separation took place in the UK as well as in certain other countries like the US, where one of the most developed and successful competitive electricity markets in the world operates in Texas. When – after a few years of the Texas wholesale competitive market operation – retail competition was introduced in 2002, two of the three largest incumbent utilities decided to voluntarily divest their competitive operations, i.e., generation and retail service, and concentrate exclusively on regulated transmission as well as distribution as a single company¹⁷.

4. EU unbundling initiatives

The unbundling concept was strongly promoted by the European Commission during a 7 year-long process of negotiation the first Electricity Liberalization Directive¹⁸ (the Directive). It was to provide a suitable legal framework that would force effective and coordinated implementation of the liberalization programs in the Member States. However, because of the strong opposition of some Member States that were generally reluctant toward electricity liberalization, most provisions of the Directive were a result of an unsatisfactory compromise that made its adoption in 1996 a symbolic rather than significant event¹⁹. A good example of such a compromise was

¹⁵ The importance of strong governmental determination for the success of electricity sector liberalization was underlined many times. M.B. Rosenzweig, C. Pabon-Agueldo, 'Power Sector Reform: Is there a Road Forward?' (2006) 19(6) *The Electricity Journal*.

¹⁶ A review of transmission unbundling status in the European countries is provided by: R. Haas, J-M, Glachant, N. Keseric, Y. Perez, 'Competition in the Continental European Electricity Market; Despair or Work in Progress' [in:] F.P. Sioshansi, W. Pfaffenberger (eds), *Electricity Market Reform. An International Perspective*, Elsevier, 2006, p. 276.

¹⁷ See P. Adib, J. Zarnikau, 'Texas: The Most Robust Competitive market in North America' [in:] F.P. Sioshansi W. Pfaffenberger (eds), *Electricity Market Reform...*, p. 392.

¹⁸ Directive 96/92/EC of the European Parliament and of Council of 19 December 1996 concerning common rules for the internal market in electricity, OJ [2007] L 27/20.

¹⁹ L. Hancher, 'Slow and not so sure: Europe's long march to electricity liberalization', (1997) 10(9) *The Electricity Journal*.

an unbundling requirement that took the weakest form of management and accounting. In practical terms, the Directive required vertically-integrated electricity companies to carry out their activities (generation, transmission, and distribution) by separately managed units that were also obliged to produce separate sets of accounting.

Therefore, it is not surprising that the Directive was not a driving force behind electricity liberalization in some European countries. According to the Commission and the energy traders²⁰, one of the most important reasons for the very unsatisfactory progress in opening most of the domestic electricity markets was the existence of persistent anticompetitive practices among vertically-integrated companies. By setting discriminatory terms of use for transmission and distribution lines, such companies blocked the access of their potential competitors to electricity markets. Further strengthening of the unbundling regime for vertically-integrated companies had therefore become a priority goal of the Commission determined in speeding up real progress in electricity liberalization in the EU.

During the drafting stage of the next Liberalization Directive²¹, the Commission succeeded in getting approval for a more advanced form of the unbundling requirement imposed on the vertically-integrated companies. This involved the obligation to establish system operators – the Transmission System Operator (TSO) and Distribution System Operator (DSO) respectively – as subsidiaries of such vertically-integrated companies (i.e., their parent companies) that were to operate on the basis of the ‘legal unbundling regime’. This regime included a list of detailed requirements that were to ensure that those persons responsible for network management would have a necessary degree of independence from the owners of the network²². For example, one of these requirements referred to salary rules of the TSO/DSO staff that had to depend exclusively on the performance of the network business and be established on the basis of pre-fixed elements. The other one provided that the staff were not allowed to undertake tasks referring to other non-network-related activities within the parent company.

It is worth emphasizing that in the comments made in the document discussing the details of the unbundling regime, a vertically-integrated company

²⁰ See: *Unbundling as a crucial factor in the completion of European Electricity and Gas Market liberalization*, Position Paper, EFET, September 2000.

²¹ Directive 2003/54/EC of the European Parliament and of Council of 26 June 2003 concerning common rules for the internal market in electricity and repealing Directive 96/92/EC, OJ [2003] L 176/37.

²² A detailed description of this regime was provided in: An detailed description of this regime was provided in: *The Unbundling Regime, Note Of DG Energy &Transport On Directives 2003/54 and 2003/55/EC On The Internal Market In Electricity and Natural Gas*.

was defined as a company that performs “at least one of the functions of transmission or distribution and at least one of the functions of generation or supply of electricity”²³. Therefore, the unbundling regime did not apply to generation and supply activities. In other words, from the EU legislation perspective, both activities were allowed to be performed within one company.

Despite more demanding unbundling requirements contained in the second Liberalization Directive, the reports of the Commission inquiry into the functioning of the EU electricity markets that were regularly published indicated that vertically-integrated companies were still able to continue blocking access to their transmission and distribution grids and prevent or hinder new entry to the electricity markets. Therefore, in the opinion of the EU Commission, introduction of further measures addressing the problem of effective unbundling was necessary in order to deliver non-discriminatory access to electricity networks and thereby speed up the process of internal electricity market completion. Preparing its Third Energy Package²⁴, the Commission’s preferred option was ownership unbundling.

However, because the Commission anticipated problems with getting approval for this proposal from certain countries rather reluctant to implement more aggressive pro-liberalization measures, its proposal was restricted to imposing stricter unbundling requirement only with respect to transmission activity, leaving unbundling at the distribution level for further discussion and decisions²⁵. In addition, in the Third Package put forward on September 19, 2007, the Commission added a second, compromised option. It assumed retaining by generating companies of their network assets, but it deprived them of the ongoing, operating management of these assets. The crucial point of this option was transfer of responsibility for network management that involved daily management and also the right to make commercial and investment decisions to a special company, the Independent System Operator

²³ *Ibidem*, p. 5.

²⁴ The Package includes 2 Directives and 3 Regulations: Directive 2009/72 EC of 13 July 2009 concerning common rules for the internal market in electricity and repealing Directive 2003/54/EC; Directive 2009/73/EC 13 July 2009 concerning common rules for the internal market in natural gas and repealing Directive 2003/55/EC; Regulation (EC) No 713/2009 of 13 July 2009 establishing an Agency for the Cooperation of Energy Regulators; Regulation (EC) No 714/2009 of 13 July 2009 on conditions for access to the network for cross-border exchanges in electricity and repealing Regulation (EC) No 1228/2003; Regulation (EC) No 715/2009 of 13 July 2009 on conditions for access to the natural gas transmission networks and repealing Regulation (EC) No 1775/2005.

²⁵ As it was explained by the Commission, because ‘...of the recent entry into force of the last liberalization date in a number of states, it would seem to be disproportionate to go a step further in forcing unbundling in this activity’ (distribution). Impact Assessment, Accompanying Report, European Commission, Brussels, 2007, p. 4.

(ISO). This company was to be designated by national governments with the Commission's prior approval and be provided with appropriate arrangements ensuring a sufficient level for its independence.

This compromise option turned out to be unacceptable, especially for France and Germany. Both countries had very powerful vertically-integrated companies that strongly opposed the concept of transferring all decisions concerning management of transmission activity to an ISO. Under pressure of these countries, a third option for Independent Transmission Operator (ITO) was introduced to the final version of the Third Package. This option was similar to the ISO option in allowing integrated companies to retain ownership of network assets, but in contrast to the ISO, a newly established company (ITO) would be responsible only for daily network management. Although the integrated companies were left to make commercial and investment decisions, the ITO option included a list of 5 institutional arrangements that were to ensure independent management of the grids, and especially to prevent the ITO from discriminating against suppliers applying for access to the grid.

The Third Package, including these three unbundling options, was adopted finally by the Council on June 25, 2009. To strengthen its impact on the pace of the European electricity market liberalization, some other important provisions, especially concerning the regulatory framework, have been included. They provide more power for national sector regulators and create a new European agency with the task of overseeing and improving cross-border regulation for electricity and gas transmission between the Member States. In addition, the earlier voluntary cooperation of national TSOs is to be formalized through the establishment of a new body – the European Network for Transmission System Operators. Its purpose is to harmonize standards for grid access as well as coordinate and ensure proper network planning and investment to prevent blackouts.

5. The first signs of crisis in the restructuring model

The beginning of the current decade brought a visible change to the overall liberalization climate. Visible in some countries, the decrease in support for the radical actions that were intended to introduce competitive electricity markets was followed by, *inter alia*, a change in attitude towards the sector's structure. The change was a result of a number of factors, in particular the Enron bankruptcy, the Californian crisis, the British Energy problems, and the return to the vertical structure – although in a modified form – that took place in the British electricity sector. The importance of these events lies in

the fact that they inspired intensive development of research on the specific features of the electricity markets which previously had been overlooked or undervalued by promoters of electricity liberalization.

The results of the research demonstrated a growing need for reevaluation of the issue of vertical integration in the electricity sector, and thus also the earlier discussed structure model for electricity liberalization. It is therefore worth taking a closer look at these cases. The Enron insolvency, the Californian crisis, and the British Energy problems are interesting in that they show real threats faced by stand-alone electricity companies operating in competitive wholesale and retail electricity markets. In turn, the British case of backward vertical integration shows how companies that are free to decide about their structure react to the upcoming full opening of the electricity market, i.e., the time when all customers, including households, can choose their supplier.

The collapse of Enron is usually considered in a broader context that goes beyond the normal (for the market economy) case of corporate bankruptcy. Because of the size of Enron²⁶ and the fact that its insolvency to a great extent was of a criminal nature, some observers saw it not only as a problem of losing trust in capital markets, but even as a reason to question free markets at all²⁷. On the other hand, sceptics of radical electricity liberalization treated it as proof of the defeat of the whole idea of energy liberalization²⁸. Even if this opinion was exaggerated, certain factors indicate that Enron's fall and the Californian crisis have significantly contributed to weakening support for electricity liberalization among US regulators, policy makers, experts, and public opinion.

Enron's case should be considered from the perspective of the structural aspect of the liberalization concept. In this respect, at least two factors seem important. Firstly, in the US, Enron was the most recognizable product of liberalization and an example of an energy company which, without having meaningful generation or network assets, could make a huge financial success in a very short time²⁹ by focusing its activity on competitive gas and electricity wholesale markets. Secondly, *Fortune* magazine ranked Enron as the most innovative company for six years in a row for launching a novel business in energy (electricity and gas) trading. It was therefore no surprise that its

²⁶ Enron was the second largest corporation to have ever gone bankrupt.

²⁷ See Editorial Board, 'Enron's Sins', (2002) *Wall Street Journal*, January 12.

²⁸ This opinion was expressed for example by J. Stiglitz *The Roaring Nineties: A New History of the World's Most Prosperous Decade*, 2003, ch. 10. In-depth discussion of Enron's Case is presented by: J.L. Weaver, 'Can Energy Markets Be Trusted? The Effect of the Rise and Fall of Enron on Energy Markets' 2004 *Houston Business and Tax Law Journal*.

²⁹ In December 2001 – the year when Enron was listed as the seventh largest company in the Fortune 500 – it declared insolvency.

bankruptcy significantly weakened belief in the workability of the model of a stand-alone electricity company focused on wholesale and retail activities.

On the other hand, the British Energy case signalled the poor workability of this model with respect to electricity generation. Providing 20% of Britain's total electricity supply, British Energy was the largest electricity producer and the only one that had not been involved in the process of vertical reintegration of generation and distribution/supply activities. Unlike the other reintegrated British electricity generators, it was unable to compete in the fully liberalized domestic electricity market. In 2002, its financial condition was so grave that it was close to becoming insolvent. The company was rescued by the government which provided substantial financial aid and therefore kept British Energy operational³⁰.

However the collapse of Enron was not as important – at least in the US – as the Californian crisis, especially in terms of its impact on the increasingly critical attitude towards radical liberalization, in particular that in line with the British patterns³¹. The Californian program of considerable restructuring and the launch in 1998 of competitive generation, wholesale and retail markets were to significantly improve companies' efficiency, but mostly to decrease electricity prices for final consumers. However, only two years after the new market mechanisms were set in motion, it became clear they had not achieved the above goals. The most undesired results of the Californian reforms were: an explosion of wholesale electricity prices (within 14 months average prices increased tenfold), their very high volatility, long lasting supply shortages, and unprecedented insolvencies of the two largest electricity state companies.

Without focusing closely on the factors that triggered the collapse of California's electricity reform program³², it is worth taking a closer look at the role of the structural factor. This was emphasized in most of the serious analyses of the Californian electricity reform failure as a factor that significantly contributed to such failure, but not always was it treated as an argument indicating an important weakness of the vertical unbundling concept. To advance this argument, two pivotal components of the Californian electricity liberalization reform package should be mentioned.

³⁰ M. Zakary, *British government saves British Energy from bankruptcy*, available at: http://www.bellona.org/english_import_area/energy/nuclear/26199.

³¹ A lot of publications indicate the negative impact of that crisis on the course of liberalization of the US electricity sector: S.A. Blumsack, J. Apt, L.B. Lave, 'Lessons from the Failure of U.S. Electricity Restructuring' (2006) 19(2) *The Electricity Journal* or T.M. Lenard, 'Electricity "Restructuring": What Went Wrong' (2005) 18(6) *The Electricity Journal*.

³² There are many references to the reasons and consequences of California's electricity crisis on the course of liberalization of the US electricity sector: S.A. Blumsack, J. Apt, L. B. Lave, 'Lessons from the Failure...'; T.M. Lenard, 'Electricity "Restructuring"...'.

The first component referred to the forced ownership unbundling requirement. Two of the three largest Californian electricity companies were ordered to divest – as specified by law – part of their generating capacity. They were also strongly encouraged by regulatory measures to divest all other capacity, as well. As a result, they were left with generating capacity much below the level needed to fulfill their duty as a default supplier of electricity³³. The second factor was the adoption of a new model for trading arrangements, based on the assumption that utilities supplying electricity to final consumers would be buying electricity only from the just established, competitive spot wholesale market. This model also forbade utilities from buying electricity for its resale to consumers directly from generators on the basis of long purchase contracts. Since such contracts normally serve as an efficient measure protecting utilities from the very high – by nature – volatility of short-term wholesale electricity prices, their lack made utilities susceptible to the monopolistic manipulation of the generators. This susceptibility was significantly strengthened by another component of the trading arrangements' model, i.e., a price cap imposed on retail prices that made it impossible for the utilities to pass on the fast rising costs of their wholesale electricity purchases to final consumers.

Examining the causes of the Californian crisis, P. Joskow, one of the most distinguished researchers and experts on energy markets, noted the unusual attributes of electricity that make design of a well-functioning competitive electricity market a very difficult task³⁴. His crucial point was that spot competitive electricity markets work well where supplies are abundant due to adequate capacity and reliable generation and network infrastructure³⁵. However, when supplies become tight and demand is not elastic, prices can explode, which is exactly what happened in California. Concluding his analysis, Joskow focused on the structure of the trading arrangements introduced in

³³ This is a supplier obliged to sell electricity at regulated prices to customers who do not want to change supplier.

³⁴ P.L. Joskow, 'California's Electricity Crisis' 17(3) *Oxford Review of Economic Policy*. There is a growing literature on the peculiarities of electricity competitive markets and their implications for the structural model of an electricity company D. Newbery, *Regulatory Challenges to European Electricity Liberalization*, DAE Working Paper WP 0230, 2002, p. 13 or D.W Bunn, 'Institutional Intent and Strategic Evolution Electricity Markets' [in:] *Complex Electricity Markets* (Editor: W. Mielczarski), Series: The European Power Supply Industry, Wyd. Instytut Elektroenergetyki Politechniki Łódzkiej I Stowarzyszenie Elektryków Polskich, Oddział Łódzki, Łódź 2006.

³⁵ This point has also been made in many other publications. See for example: D. Newbery, 'Problems of liberalizing the electricity industry', (2002) *European Economic Review* 46. In Polish, a broad review of views on implications of electricity competitive markets provides: A.T. Szablewski, *Liberalizacja sektora elektroenergetycznego a bezpieczeństwo dostaw. Wnioski dla polityki energetycznej i regulacyjnej*, forthcoming.

the Californian market as one of the main reasons for the troubles in their functioning.

According to Joskow, solving problems generated by volatile and very excessive spot prices for electricity needs to use long-term, fixed-price contracts negotiated well in advance of spot market crises. Therefore, a key weakness of this structure was prohibition imposed on vertically-restructured distribution companies to enter into long-term fixed-price electricity purchase contracts that could stabilize electricity prices. However, a further question arises – namely, if such long contracts are a viable option in markets where retail competition is allowed.

This question became an important subject of discussion in the UK just when plans for the Californian package of reforms involving the strict unbundling of distribution and supply business were being prepared. Due to the approaching date on the full opening of the British retail electricity market (1998), it was becoming obvious that distribution companies would be much less willing to enter into long-term contracts with generators. The reason for this was the lack of certainty as to whether customers would be willing to purchase such contracted electricity if they had a choice to select their own supplier. This, in turn, could create serious problems for generators, as without such contracts they would face difficulties in attracting new capital needed to finance new generation facility³⁶.

One obvious answer to the above question was vertical integration initiated by the generators and, later, also distribution/supply companies. Initially, the generators' pressure to begin vertical consolidation was strongly resisted by the government, the regulator, and Monopoly and Mergers Commission (MMS) because of its potentially anticompetitive effects. However, with time resistance weakened and a new approach to vertical integration prevailed in the governmental and MMC circles. This approach was based on the argument that competition in generation had developed and the stable competitive structure of generation and supply markets gave little scope to use vertical linkages to exploit customers.

In a very short time, vertical integration again became a standard model for the largest British electricity companies, although with some important differences in comparison with the earlier recommended model structure based on full ownership unbundling. The process of integration took two forms, the first being more traditional with integration of generation, distribution, and supply (retail) businesses and the second being more innovative with integration of merely generation and supply businesses. Many factors justify the view that the latter model of vertical integration may become the leading

³⁶ For more on this see: D. Helm, *Energy, the State, and the Market. British Energy Policy since 1979*, Revised Edition, Oxford University Press 2003, chapter 12.

model in the future. This includes the increasing pressure of the European Commission on further deepening of separation of supply from distribution activities and the fact that other countries with mature liberalization in the electricity sector also follow that trend.³⁷

6. Concluding remarks

The increasing intensity of the consolidation processes in the first years of the new century seems to indicate that the above outlined cases were the first symptoms of the non-workability of the ideal structural model that was recommended as a part of the electricity liberalization reform package. This model was formed in the early days of network industries' liberalization and it predicted that electricity sectors would be evolving into a structure with a large number of separate generating and wholesale/retail supply companies responsive only to market forces. However, the currently emerging vertical model for electricity companies is quite different from this initial model. Moreover, many in-depth economic studies on the structural dimension of electricity liberalization re-examine arguments for and against vertical integration, and their conclusions tend to underline the advantages of a balanced mixture of vertical integration and liberalized markets³⁸.

In other words, the structural canon (or, as some authors call it, the industrial reference model or industrial paradigm)³⁹ for electricity have changed. It has shifted from a preference for vertical disintegration between generation and trading activities towards a preference for vertical reintegration of these activities within one company. This shift represents a more serious change to energy policy priorities. Liberalization was a response to the growing need to make electricity companies more efficient in terms of costs. Through lower prices liberalization was to pass the advantages of increased cost efficiency to the final electricity consumers. To achieve this task, conditions for the effective operation of competitive markets had to be created. This required an appropriate legal and regulatory framework, pro-competitive restructuring

³⁷ A good example is again New Zealand. Shortly after the full vertical unbundling of electricity companies and imposition on network owners a legal prohibition to enter competitive activities, there was a rapid realignment of the sector with energy retail businesses being quickly acquired by generators.

³⁸ Intensive research in this subject is presented in: H-P. Chao, S. Oren, R. Wilson, 'Revaluation of Vertical Integration and Unbundling in Restructured Electricity Markets' [in:] F.P. Sioshansi, (ed), *Competitive Electricity Markets: Design, Implementation, Performance*, Elsevier, 2008.

³⁹ R. Haas, J.-M. Glachant, N. Keseric, Y. Perez, *Competition in the Continental...*, p. 286.

of the incumbents, as well as active regulation to promote competition in order to increase the number of generating and supplying companies.

The development of competitive and regulated electricity markets has resulted in a crucial reallocation of bearing economic risk. In the traditional model of regulated, vertically-integrated electricity companies, the whole risk was passed to the final consumers. Due to such risk allocation, the regulated utilities were assured of full recovery of prudently incurred investments and expenses, including the cost of capital. These regulatory arrangements, in turn, would facilitate them access to cheap capital necessary to finance costly generation and network investments. The introduction of competitive electricity markets (regulated through quasi-market incentives) reversed the direction of bearing risk. Shifting risk to the electricity companies led to a significant increase of the cost of capital and made it much more difficult for them to arrange financing of their investments.

This was not a problem in the first years of liberalization since the electricity sectors inherited a significant excess of generation and network capacity. However, when, as a result of investment shortage, this began to diminish, a traditional priority of energy policy (i.e. ensuring security of electricity supply) was back in the game. The cost of capital and easy access to capital again became key energy policy and regulatory issues. The solution to those issues involves a compromise between generating market-based incentives to reduce companies' operating costs and incentives to increase investments in electricity generation, transmission, and distribution. The central part of this compromise seems to be a structural change of the model for electricity liberalization. The emerging model involves the vertical integration of generation and supply and allows more horizontal concentration of competitive electricity markets.

From this perspective, monitoring the structural changes of the competitive electricity markets becomes of critical importance. This leads to another controversial issue – namely, the division of responsibility for competition policy in the electricity sector between specialized sector regulatory agencies and competition authorities. In other words, this is a question as to whether finding an appropriate level of vertical and horizontal integration in the electricity markets requires a much deeper knowledge of electricity markets and therefore should not be subjected to the general competition law enforced by the competition authorities⁴⁰.

⁴⁰ Contrary views on this subject are presented in: D. Newbery, *The Relationship Between Regulation and Competition Policy for Network Industries*, CWPE 0631 and EPRG 0611, March 2006 and M. Pollitt, *The Future of Electricity (and gas) Regulation*, CWPE 0811 and EPRG 0819, May, 2008.

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C A S E C O M M E N T S

**Which authority is competent to decide when a power company
is abusing monopolistic power:
the President of the UOKiK or the President of the URE?
Case comment to the judgement of the Supreme Court of April 2, 2009
– ENION S.A.
(Ref. No III SK 36/08).**

Facts

By the decision of July 10, 2006 (No. RKT-42/2006), the President of the Polish Office for Competition and Consumer Protection (hereafter, UOKiK) found that the practice of the Częstochowa Power Company, a branch of ENION SA based in Kraków (hereinafter ENION SA), was restricting competition by abusing its dominant market position in the transmission and distribution of electricity by making the conclusion of contracts subject to acceptance by the other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of such contracts. The UOKiK President imposed a fine on ENION SA of 100 000 zł.

ENION SA appealed the contested decision alleging, in particular, that the UOKiK President had violated provisions of the Act of 10 April 1997 – the Energy Law¹ – by contempt and had also violated provisions of the Act of 16 July 2007 on Competition and Consumer Protection² through his erroneous interpretations. ENION SA indicated that the UOKiK President has no power to decide on the unjustified suspension of supplying electricity by the energy company. ENION SA also claimed that the fee for illegal consumption of electricity has a substantial or customary relation with the contract for supplying electricity.

The Competition and Consumer Protection Court in Warsaw³ on June 4, 2007 issued a judgement in which it dismissed the appeal of ENION SA indicating that the contested decision concerns the evaluation of large-scale, applied general practice in the defined relevant market, not just an individual practice of the current recipient of an energy company. The Court emphasized that the proceeding initiated by the

¹ Journal of Laws 2006 No. 89, item 625 with amendments.

² Journal of Laws 2007 No. 50, item 331; amendments: Journal of Laws 2007 No 99, item 660; Journal of Laws 2007 No. 171, item 1206.

³ In Poland this court delivers the judgements as a court of the first instance.

UOKiK President sought to determine whether it was violated the public interest. The Court pointed out that in this case there is an abuse of ENION SA's dominance, since the fee charged for illegal consumption of electricity is not a provision that customarily related to the subject of the contract, which is to sell electricity. The court emphasized that the charge is a penalty fee and it is not in fact payment for purchased energy or service.

ENION SA appealed this judgement to the Court of Appeal in Warsaw. In its judgement of April 8, 2008, the Court of Appeal upheld the judgement of the Competition and Consumer Protection Court in Warsaw. The Court of Appeal pointed out that the trial court had correctly interpreted the law – the Energy Law Act – and the Act on Competition and Consumer Protection by recognizing that the UOKiK President is competent to assess whether certain conduct is an abuse of the power company's dominant position. The Court shared the opinion of the trial court by stating that the penalty fee for illegal consumption of electricity was neither substantially nor customarily related with the subject of the contract for the supply of energy and that the obligation to pay for the electricity obtained is not the same as the penalty fee for illegal consumption of energy. The Court stated that the penalty fee contains an element of compensation, but it is not a charge for the energy actually delivered.

Against the above judgement of the Court of Appeal in Warsaw ENION SA filed a cessation appeal to the Polish Supreme Court alleging violation of the rules of substantive law in the interpretation of the Act on Competition and Consumer Protection and Energy Law. The complainant stated that the Appeal Court had incorrectly recognized that the UOKiK President is competent to decide on the above practice of the power company and that the penalty fee for illegal consumption of electricity has no substantial connection with the subject of the contract for the supply of electricity.

Key legal problems of the case

Which authority is to deal with the case?

In the cessation appeal ENION SA pointed out that the Court of Appeal had misinterpreted the rules of the Act on Competition and Consumer Protection and the Energy Law. According to ENION SA Article 8 Paragraph 1 of the Energy Law regulates the same matter as Article 8 Paragraph 2 point 4 of the Act on competition and consumer protection. Therefore, the legal norm contained in a provision of the Energy Law is the specific regulation and should have primacy over the general regulation contained in the provision of the Act on Competition and Consumer Protection. In conclusion ENION SA pointed out that if the facts of a case apply to both of the above acts, the application has only a specific norm and hence the competence to deal with this case rests only the President of the Energy Regulatory Office (hereafter, URE).

The Supreme Court indicated that ENION SA had interpreted the rules incorrectly. According to the Court, we are dealing in this case with the practice of an electricity company which holds a monopoly position on the relevant market. Such practice is general, addressed to an undetermined group of recipients, and consists in using its monopoly position by making the resumption of electricity supply dependent on payment of fees set by the power company for illegal consumption of electricity. The Supreme Court stressed that this practice was a repeated practice as it was determined in an internal instruction as a rule of conduct in restoring energy supply.

This means that the whole case is not only an individual dispute between the power company and the customer for the preservation of energy, but a case which deals with a practice of the energy company that uses monopolist position to refuse to supply electricity to customers, not because of the suspicion of illegal consumption of electricity in the future, but due to non-payment of a penalty fee for illegal consumption of energy in the past. The Supreme Court pointed out that the facts of the case and its effect – depriving the household electricity supply, which is a necessary element of the standard equipment of civilization – indicates that provisions that prohibit abuse of a dominant position should be used. As a result of the presented findings about ‘practice’ and the existence of the public interest in its counteracting, the authority responsible for dealing with such cases is the UOKiK President.

The Supreme Court did not agree that in this case Article 8 Paragraph 1 of the Energy Law should be used. That provision states that in litigation matters including e.g., the case of wrongful withholding of energy fuels, the URE President is to decide at the request of the party. Under that provision, the URE President has gained only limited powers to adjudicate on civil matters⁴. Jurisdiction of the URE President in such cases is the result of the request of a party and applies to the specific, individual interest of the applicant, which is subject to dispute about unjustified withholding energy supply. However, in this case we are dealing with abuse of a dominant position in the relevant market as defined in the Act on Competition and Consumer Protection. Protection against such practices is carried out by the above act, which created a special body to counteract this – namely, the UOKiK President. It should be added that the purpose of this Act is to protect the public interest, not private interest⁵. However, in this case, since the practice of the electricity company was directed against an unspecified group of recipients, there is public interest.

Practice having connection with the subject of an agreement

ENION SA in the cessation appeal alleged that the court misconstrued the question that the practice has no customary or substantial connection with the subject of an agreement within the meaning of Art. 8 Paragraph 2 point 4 of the Act on

⁴ M. Czarnecka, T. Ogiódek, *Prawo energetyczne. Komentarz [Energy Law. Commentary]*, Warszawa 2009, p. 173.

⁵ Judgement of Antimonopoly Court [now Competition and Consumer Protection Court] of 24 January 1991 r., XV Amr 8/90, Wokanda 1992, No 2, item 39.

Competition and Consumer Protection. In the opinion of the Supreme Court two situations should be distinguished: the first in which a refusal to supply electricity is based on an agreement concluded between the parties, and the other where the refusal to supply energy is due to a demand of payment of a penalty fee for illegally downloaded energy. These two situations according to the Court shows difference between these two practices: the first is the “ordinary” practice resulting from a contract, and the second is a practice particularly involving the illegal consumption of energy and as the consequent of paying the penalty fee⁶.

The second above-mentioned situation is governed by Article 57 of the Energy Law, which provides for the fact that the power company charges for illegally downloaded energy in the amount specified in the tariffs, or seeking damages in general. The tariff includes a flat fee for the illegal download of energy⁷. The court pointed out that regulation has a compensatory character: moreover energy companies are entitled to collect that penalty fee using administrative enforcement proceedings. This means that the legislature established the legal means for collecting penalty fees for illegal energy consumption. The court emphasized that the energy company which enforces payment of penalty fee by withholding energy, until the fee was paid, conducts illegal practice⁸. It is the advantage of the power company, which is a monopoly on the relevant market, that allows for the imposition of this duty to customers, although the law provides for a totally different form for the collection of such a penalty fee.

It is worth mentioning that Article 6 Paragraph 3 point 2 of the Energy Law allows the power company to suspend the supply of electricity if the result of an audit found that there was illegal download of electricity. However at the same time, the power company according to Art. 6 Paragraph 3b of this Act is obligated to immediately resume electricity supply if the reasons for the suspension of the supply cease. This means that the duty by public law to resume electricity supply had been imposed on the energy company when the reasons for suspension no longer exist⁹. Thus the Energy Law in a casuistic indicates the cases in which the company may suspend the supply of energy, implying the obligation to restore the supply when the condition of suspension of deliveries will disappear.

⁶ In judgement of May 25, 2005 (Ame XVII11/04) Court for Competition and Consumer Protection indicated that the fee charged by the power company for the illegal consumption of energy is not a “payment for downloaded energy, but the penalty fee for violation of the terms of electricity download”.

⁷ The Energy Law in Article 3 point 18 defines that the illegal consumption of energy is the energy consumption without a contract, with total or partial exclusion of the measurement system or through interference in the measurement and billing system.

⁸ The Court for Competition and Consumer Protection in judgements of 9 May 2005 (Ame XVII 46/04) and of 25 May 2005 (Ame XVII 11/04) pointed out that for obvious reasons, the cause of suspension of electricity supply may not be a recipient’s failure to pay charges for illegal consumption of energy, therefore, that the determination of its height and the obligation to pay arises only after disclosure of illegal consumption of energy.

⁹ M. Czarnecka, T. Oglódek, *Prawo energetyczne...*, p. 137.

It is certainly right that the Supreme Court stated that there is neither a substantial nor customary relation between the practice of ENION SA and the subject of the contract for the supply of energy. These restrictions do not result from the contract for supplying energy, but they affect it.

It is therefore necessary to point out that under Article 8 Paragraph 2 point 4 of the Law on Competition and Consumer Protection it is defined that the prohibited practice is the practice involving the abuse of a dominant market position by making the contract subject to acceptance or fulfillment by the other party of another performance, having neither a substantial nor customary relation with the subject of the contract. Thus, the practice described above is simply a manifestation of abuse of dominant position under the Act on Competition and Consumer Protection.

Final remarks

The Supreme Court judgement presented here clearly affirmed that the UOKiK President, not the URE President, is the competent authority in matters of the practice of a power company abusing its dominant position by making the supply of electricity dependent on paying a penalty fee for illegal consumption of energy. Clearly there is public interest in fighting such practices, which are addressed to unspecified recipients of energy and such interest is determined by the Act on Competition and Consumer Protection. Thus, the Court pointed out that precisely this type of abuse of a dominant position is counteracted by the special antitrust body – the UOKiK President.

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**Are the rights and obligations arising from a license transferable
under Article 40 of the Privatization and Commercialization Act?
Case comment to the judgement of the Supreme Court
of November 20, 2008 (Ref. No. III SK 13/08).**

Facts

The judgement of the Supreme Court here described refers to the acquisition of rights arising from a license by an entity which has acquitted a state enterprise as a result of direct privatization, pursuant to Article 40 of the Act of 20 August 1996 on Privatization and Commercialization¹ (hereafter PCA). In the event the aforementioned acquisition occurs, the purchaser shall become the subject of the rights and obligations under the license; *inter alia* the purchaser is eligible to request performing the amendment of the decision which granted the license under Article 155 of the Code of Administrative Procedure (hereafter: CAP).

Therefore the crucial issue of this judgement is general succession in the event of the direct privatization of a state enterprise, in light of Article 40 of the PCA. In our opinion, the Supreme Court finding referring to the facts of the case was correct and appropriate.

The President of the Energy Regulatory Office (hereafter, URE), acting as a defendant, granted the trade license for liquid flues to the state enterprise in the decision dated February 20, 2001. Subsequently, the state enterprise was acquired by a legal entity which was a limited liability company. The purchaser of the state enterprise, acting as a claimant (hereafter, Purchaser or Claimant) acting on the grounds of Art. 40 of the PCA in connection with Article 155 of the CAP, applied for an amendment to the aforementioned decision consisting in a replacement of the licensee.

The URE President did not agree with the request submitted by the Purchaser. Consequently, in the decision dated May 17, 2006, the URE President refused the amendment arguing that the request cannot be accepted due to the fact that the Claimant was not a party to the licensing proceedings and did not acquire the rights to the license. In the opinion of the URE President merely the administrative side of the licensing proceedings has a right to the claim, on the aforementioned grounds, to

¹ Consolidated text in the Journal of Laws 2002 No. 171, item 1397 with subsequent amendments.

the amendment of a final administrative decision, hence the Claimant cannot demand changes to the concessions under Article 155 of the CAP.

The Claimant appealed the decision to the first instance Court of Competition and Consumer Protection (hereafter, SOKiK). The Court reversed the applied decision². The first instance Court found that the Claimant is the legal successor of the licensee. The Claimant went in all the rights and obligations of the state enterprise, regardless of the nature of the legal relationship in which those rights or obligations had arisen, due to the fact that the Claimant acquired the state enterprise, according to Article 40(1) of the PCA.

The URE President appealed the judgement issued by SOKiK to the Court of Appeal. The Court of Appeal changed the verdict of the first instance Court dismissing the appeal³.

The Claimant appealed the judgement to the Supreme Court submitting a cassation appeal, claiming that the Court of Appeal infringed the substantive law (Article 40 in connection with Article 39(1)(3) of the PCA and in connection with Article 2(3) and Article 55¹ of the Civil Code⁴) and the procedural law which had a significant impact on the trial result.

Key legal problems of the case

First, it should be indicated that Article 40(1) of PCA stated that, unless the Act provides otherwise, the buyer or transferee of an enterprise enters into all the rights and obligations of the state enterprise, regardless of the nature of the legal relationship from which the rights and obligations arise. At the same time, Article 155 of CAP stated that a final decision by which a party acquired the rights may be amended at any time upon the consent of the party.

The main problems assessed by SOKiK and the Court of Appeal were as follows:

- 1) whether the rights and obligations issued from the license are transferable under Article 40 of PCA;
- 2) subsequently, whether the acquirer is entitled to submit an application for the amendment of the license.

As indicated above, SOKiK ruled in favour of the Claimant, although the second instance Court rejected the SOKiK's argumentation.

The Court of Appeal stated that the concession may not be the subject of succession. According to the court, the divestiture of the state enterprise produced effects in the sphere of civil law, however, it has no influence on the sphere of administrative law.

² Judgement of SOKiK of 17 April 2007, Ref. No. XVII AmE116/06.

³ Judgement of the Court of Appeal of 5 December 2007, Ref. No. VI Aca 1074/08.

⁴ The Journal of Laws 1964 No. 16, item 93 with subsequent amendments.

The Court of Appeal quoted the judgement of the Supreme Court of May 8, 1998⁵ where the Supreme Court pointed out that the license constitutes a kind of individual authorization which is granted by the public authority to the determined entity who meets statutory criteria. In regard to the above it is not possible to transfer the rights arising from the license to a third party, either in whole or in part. Moreover, the Court of Appeal pointed out that Article 40 of the PCA does not literally indicate a concession. The Court of Appeal found that the presented construction is confirmed by the regulations concerning the assignment of the concessions in case of a merger of companies. The court cited the provisions of Article 494 § 2 of the Commercial Companies Code⁶ where the concession is literally indicated by the legislator.

Accordingly, the court found that the license expired upon the date of the removal of the state enterprise from the enterprises register and therefore it was not possible to modify the decision without a prior administrative procedure referring to awarding the concession. Thus, the proceedings before the URE President were irrelevant and therefore had to be terminated.

Key findings of the Supreme Court

As indicated above, the Purchaser submitted the cassation appeal to the Supreme Court which dismissed the appeal on November 28, 2008. The Supreme Court agreed with the views of the first instance court. In the opinion of the Supreme Court the Claimant's argument that the URE President's decision infringed Article 40 of the PCA is correct and merits acceptance.

The wording of Article 40 of the PCA establishes precisely that direct privatization consists in acquiring all of the rights and obligations. The Supreme Court found that in this case it needs to be settled whether the rights and obligations issued from a license are transferable on the grounds of direct privatization, whereas the occurrence of direct privatization is an undisputable fact. The Supreme Court emphasized that Article 40 of the PCA includes the phrase 'unless the Act provides otherwise', which should be understood as follows: exclusion of the concession or the rights and obligations under the concession from the scope of the enterprise and universal succession requires an explicit statutory provision. In light of that, the Claimant entered into all of the rights and obligations which had arisen from the URE President's decision dated February 28, 2001. The Supreme Court noted that the contrary opinion of the Court of Appeal arises from an incorrect construction of the Supreme Court's judgement of May 8, 1998⁷.

⁵ Ref. No. RN 34/98.

⁶ The journal of Laws 2000 No. 94, item 1037 with subsequent amendments.

⁷ Ibidem.

Legal analysis and the assessment of the judgement

Firstly, it should be pointed out that the law does not contain a legal definition of a concession. However, the literature suggests that ‘a concession is one of the manifestations of the legal regulation of economic activity consisting in the competent public authority expressing its consent to undertake and perform, in a specific area, economic activity upon the conditions under the concession and under separate legislation’⁸.

The concession is a form of regulation of an economic activity by the state. Thus, it expresses the act of the consent of a public authority to undertake and perform a business activity by the particular entrepreneur. The requirement to obtain a license to perform a particular economic activity on the one hand limits the freedom of this activity, but on the other it is a kind of guarantee for the contractors and the customers that the entrepreneur who is licensed will be operating in accordance with the law and secures the proper performance of the activity.

On the grounds of the Energy Law⁹, all of the activities related to the state energy economy are subject to the duty of obtaining the concession¹⁰.

The granting of concessions, as well as the refusal to grant, change, or withdrawal takes the form of an administrative decision. It is worth emphasizing that rights and obligations which have an administrative character are related to the person for whom they are established. In light of the judgement of the Supreme Administrative Court of February 6, 1995¹¹, a licensee may transfer its rights to perform the activity under the license to a third party neither as a whole nor in part. Moreover, the Court stated that licensing is the exception to the general principle of economic freedom.

This means that only the entrepreneur appointed by the competent authority which granted the concession may undertake and perform economic activity in the areas covered by licensing.

Furthermore, the Supreme Administrative Court pointed out that the rights within the scope of administrative law which are granted by the decision of the competent authority to the individual (specified) entity may not be the subject of a legal transaction between the addressee of the decision and the third party.

Also, in the judgement of May 8, 1998 the Supreme Court accepted the concession’s character as the subjective authorization of public law and therefore, in principle, it is excluded from trading within civil law.

The Supreme Court rightly observed that the Court of Appeals had misinterpreted the judgement cited above; consisting in acknowledgement that neither the concession nor the rights arising from it may be the subject of trading or succession.

⁸ K. Strzyckowski, *Prawo Gospodarcze Publiczne (Economic Public Law)*, Warszawa 2005, p. 261.

⁹ Consolidated text in the Journal of Laws 2006 No. 89, item 625 with subsequent amendments.

¹⁰ Article 32 of the Energy Law fully indicates the scope of the energy activities which are subject to the duty of obtaining the concession.

¹¹ Ref. No. II SA 1835/93.

In the opinion of the Supreme Court, usage of the phrase *in principle* means that civil law permits the possibility of trading rights and obligations under the concession.

Therefore it should be found that the rights under the licenses are generally non-transferable. However this general rule suffers some exceptions, namely statutory provision is needed to change this general rule¹².

In particular, the exception to the indicated rule is the administrative succession under Article 40(1) of the PCA.

The undisputable fact in this case is that the Claimant had acquired for use against payment the state enterprise by direct privatization, pursuant to Article 39(1)(3) of the PCA. Under Article 39(1) of the PCA, direct privatization consists in the disposition of all tangible and intangible business assets of a state enterprise, by:

- 1) sale of the company,
- 2) lodgement of the company to the company,
- 3) conveyance of the company for use against payment.

However, in accordance with Article 40(1) of the PCA, unless the Act provides otherwise, the buyer or transferee of the enterprise enters into all the rights and obligations of a state enterprise, regardless of the nature of the legal relationship from which the rights and obligations arise¹³.

The wording of the first part of the article, namely ‘unless this Act provides otherwise’, supports the view that the succession may be limited merely by clear legal regulation.

The Supreme Court emphasized that the phrase ‘unless the Act provides otherwise’ should be understood to mean that the exclusion of concessions or the rights and obligations under the concession, from the term of enterprise and of universal succession, requires an express statutory provision. As noted by the Supreme Court, the Court of Appeal did not indicate such a provision.

It should be noted that the PCA does not contain a provision that would place any restrictions on the succession. Additionally, this exclusion or limitation does not include the Energy Law or the others statues (e.g., the Act on Freedom of Conducting Business Activity¹⁴).

Thus, if there is no provision that explicitly restricts the transfer of all the rights and obligations on the state enterprise’s purchaser as a result of direct privatization, it is not possible to analogously apply the provisions of the Civil Code (Article 55¹). The construction of the provision of the Civil Code leads to the conclusion that the sale of the enterprise under this provision does not result in the acquisition of administrative law rights, including concessions.

¹² See Article 494 § 2 of the Code of Commercial Companies; A. Kidyba, The Code of Commercial Companies – Commentary (art. 494 The Code of Commercial Companies).

¹³ The manner of the privatization indicated in Article 40(1) PCA consists in the disposition of all tangible and intangible business assets of the state enterprise, or the company (partnership) which was established as a result of the commercialization. The core of the direct privatization is the aforementioned disposition in order to change the owner.

¹⁴ The Journal of Laws 2010 No. 220, item 1447 with subsequent amendments.

Furthermore, it is crucial that the provisions of the PCA are specific regulations (*lex specialis*) in relation to the Civil Code, which means that in the case of direct privatization sale of the enterprise is assessed pursuant to the provisions of the PCA and not the Civil Code.

An identical assertion was made by the Supreme Court in its decision of December 8, 2006¹⁵, namely: ‘to the effects of the state enterprise’s privatization, which was completed under the Commercialization and Privatization Act dated 30 August 1996 (Journal of Laws No. 118, item 561, with subsequent amendments), the provisions of this Act shall be applied. As a result of the direct privatization the buyer or transferee of the state enterprise is a general legal successor of the state enterprise’.

The Supreme Court rightly deemed that ‘the general succession in the case of direct privatization of a state enterprise has a specific character, shaped by the Act on Commercialization and Privatization’. Moreover, the Supreme Court held that ‘it is evident that Article 55¹ of the Civil Code is not a legal basis to enter into the rights and obligations of the privatized state enterprise which had arisen from the concession. The exclusive basis for this makes the provision of Article 40(1) of the PCA’.

Moreover, it should be borne in mind that the legal provision’s interpretation should comply with all the constitutional principles. One of the main principles of economic law, expressed in Articles 20 and 22 of the Constitution of the Republic of Poland, is economic freedom. Hence the general succession, defined in Article 40 of the PCA, benefits from constitutional protection expressed in Article 22 of the Constitution.

Any exclusions from this rule should be treated as exceptions justified by extremely important public interest. The aforementioned was clearly stated in the judgement of the Supreme Court of 12 September 2008¹⁶, namely ‘any limitation on the principle of freedom of business activity (...), acceptable in light of the statutory grounds with a view to the (significant) public interest, are the exception and must be considered strictly, not broadly. Therefore, their existence cannot be implied, presumed or taken for example by way of analogy’.

No doubt the Supreme Court rightly observed that from the clear contents of Article 55¹ of the Civil Code it appears that the concession is a part of a state enterprise. Article 40(1) 1 of the PCA delivers a similarly unequivocal answer that the acquirer of the state enterprise enters into all the rights and obligations of the state enterprise, regardless of the nature of the legal relationship from which the rights and obligations arise. Adopting a position that universal succession does not include the rights and obligations under the license would pose an unacceptable restriction on freedom of performing economic activity.

The enterprise definition included in Article 40 of the PCA is identical with the definition included in Article 55¹ of the Civil Code¹⁷. Thus, the relation between the aforementioned provisions is unquestionable.

¹⁵ Ref. No. V CSK 368/06.

¹⁶ Ref. No. I PK 27/08.

¹⁷ Pursuant to art. 55¹ of the Civil Code, the enterprise is an organized group of tangible and intangible assets designed to undertake and perform the business activity.

In this regard, the Supreme Court was correct in its statement that the company is being acquired under direct privatization, as the enterprise within the meaning of Article 55¹ of the Civil Code encompasses, *inter alia*, the trade license for liquid flues.

The functional interpretation of Article 40 of the PCA allows us to assume that the legislature – when speaking about entering into all of the rights and obligations of the converted company without any limitations or exclusions – regards all the rights in the broad sense. Entering into all the rights and obligations constitutes the general succession (such a view was expressed by the Supreme Court, e.g., in the ruling of the decision of December 8, 2006¹⁸).

The wording of Article 40 of the PCA leaves no doubts in the scope of interpreting the language. In the interpretation of legal texts the priority is given to the literal interpretation, also referred to as grammatical or linguistic. In a law-respecting country, citizens have the right to rely on what the legislature said in a legal text, not on what it is going to say or what it would potentially say if new circumstances were known.

The interpretation should not have a creative character, e.g., it should not create new standards on any pretext of interpretation, hence, it should be within the permissible lexical meaning. In addition, assuming the rationality of the legislature, the following rule finds justification: “where a distinction is not made by the legislature, the commentator is not allowed to do it and is not allowed to interpret the legislation in such a manner that some fragments are treated as unnecessary”¹⁹.

For the foregoing reasons, the Supreme Court rightly referred to the linguistic and grammatical interpretation and emphasized the usage of the phrase ‘all the rights and the obligations’ and the phrase ‘regardless of the legal relationship from which these rights arise’. These phrases no doubt contain the rights and obligations which have arisen from the concession granted by the URE President. Consequently, the purchaser of the state-owned company is the general successor of the state-owned enterprise (as a result of the direct privatization).

With respect to the functional and teleological interpretation of Article 40 of the PCA used by the Supreme Court, it should be added that a rational legislature aims for socially approved purposes and does not constitute unnecessary norms. The undoubted intention of Article 40 of the PCA is the continuation of existing economic activities. The rights resulting from administrative decisions, such as licenses, permits, or patents (Article 55¹(5–8) of the Civil Code) may determine the possibility of performing that activity, such that their exclusion would cause the acquisition of companies to be ineffective.

Crucial in this context – as was stressed by the Supreme Court – is also the substance of the agreement dated December 29, 2004. It states that the will of the parties to this contract was that of the Claimant joining in all of the rights and obligations of the merging enterprise.

¹⁸ Ref. No. V CSK 368/06.

¹⁹ L. Morawski, *Wstęp do prawoznawstwa (Introduction to the Law)*, Toruń 2002, pp. 171–174.

Final remarks

The judgement of the Supreme Court herein considered settled an important issue related to the transfer of the rights which arise from concession. It concerns both the regulations of the PCA and Article 55¹ of the Civil Code. In our opinion the question whether the rights and obligations issued from a license are transferable on the grounds of Article 40 of the PCA is solved. Considering all of the above, this judgement should be supported as correct and consistent with the idea of the lawful state.

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**Bożena Borkowska, *Regulacja monopolu naturalnego w teorii i praktyce*
[Regulation of a natural monopoly in theory and practice],
Wydawnictwo Wrocławskiego Uniwersytetu Ekonomicznego,
[Publishing House of the Wrocław University of Economics],
Wrocław 2009, pp. 229.**

Monopolization of the economy may result from a company's market strategy consisting in winning over its competitors and reinforcing its position on the market. Achieving such a position may be the consequence of effective rent seeking leading to State protection of businesses against competition and collecting monopoly rent. Monopolization of the market may also be the end-result of economic calculation which may show that increasing benefits of scale justify the operation of just one business in a given sector. The latter case, called a natural monopoly, is the subject of Bożena Borkowska's considerations when discussing various types of regulation. The author also presents case studies of three natural monopoly markets in the US: the transportation, cable telephony, and electricity supply sectors.

The first chapter interestingly and chronologically analyzes the understanding of a natural monopoly, starting from its classical concept up to the contemporary understanding of the essence of such a market structure. The theory of monopoly itself was the subject of considerations and theoretical generalization by A. Cournot in the first half of the 19th century. The classical concept seeks to justify the existence of a monopoly by increasing economies of scale and by optimized allocation of resources resulting from the operations of one company on the market.

Borkowska presents the views of economists who theoretically contributed to the development of monopoly theory, including natural monopoly (J. Dupuit, F.Y. Edgeworth, J. S. Mill, T.H. Farrer, H.C. Adams, R.T. Ely, A.M. Henderson, R.A. Posner, A.E. Kahn). Their common feature is that of highlighting the assumption of the economies of scale and resulting optimization of allocation of resources as justifications for operations of one entrepreneur, i.e., a natural monopoly. Economic and technological premises indicated market monopolization, but the monopolist's behaviour could go against customers and consumers' interests as he could take advantage of his market position to maximize monopolistic profit. The views differ, as their authors point out other premises of a natural monopoly. For instance, T.H. Ferrer stresses political reasons while R.T. Ely speaks of competition possibilities in natural monopoly markets, although he calls them destructive.

Contemporary concepts of a natural monopoly represented mainly by: W.J. Baumol, E.E. Bailey, R.D. Willig, J.C. Panzar assume that this market structure does not necessarily require the administrative interference of the State. Representatives of this line of thinking also propose we understand a natural monopoly as an outcome of increasing economies of scale but, at the same time, they accept it is linked with subadditivity of the cost function. They also draw attention to the issue of sustainability of a natural monopoly assuming that when certain conditions are met a monopolist may not abuse his position without provoking potential competitors to enter the market controlled by the incumbent. The above laid the foundations for the theory of contestable markets, which was a reaction to regulatory ideas concerning natural monopolies. Classical natural monopoly concepts led to the conclusion that an economically justified monopoly in some markets and possible conflict of interest between a monopolist and his customers and consumers call for State-originated regulations imposed in the public interest and with a view to maximize social welfare.

The second chapter of the book is devoted to views on regulating a natural monopoly in the public interest. The starting point is an assumption of market weakness under optimum allocation of resources in monopolized markets. The theory of welfare economics recognizes Pareto optimum conditions and reasons why the reality diverges from the optimum. In accordance with the concept of regulations adopted in the public interest, the State is expected to eliminate market weaknesses and to regulate the market to arrive at optimal allocation of resources and, by the same stroke, to prevent negative external effects resulting from market monopolization.

Consistently with the theory of institutional economics, the starting point for these views is the assumption that the State acts in the public interest, its interference is cost-free, and weaknesses are characteristic of the market – not of the State. Regulation of a natural monopoly by specifying an optimal price of goods or services of a given monopolist is of key importance to these ideas. When these theories emerged, a natural monopoly was true of markets of goods having primary importance to both the consumers and the economy (power generation, railway transport, telecommunication) and limiting the increase in monopolists' prices was the main objective in order for it not to translate into higher costs of manufacturing, higher prices, and the reduced welfare of society. In a slightly more moderate form, the problem remains up to date, hence the search for effective and efficient ways of regulating natural monopolies of local and regional scope.

Searches for optimal price led to the following concepts: marginal cost pricing (A. Marshall, A.C. Pigou, R.F. Khan, A.P. Lerner, H. Hotelling, J. Dupuit, R.H. Coase), average cost prices (R.D. Willig, J.M. Clark), two-part tariff (J. Hopkinson, M.S. Feldstein, S.C. Littlechild, R.D. Willig), multipart tariff (S.J. Brown, D.S. Sibley, J.A. Ordovery, J.C. Panzar, R.A. Meyer, D. Dimopoulos), peak load pricing (J.M. Clark, O.E. Williamson, M. Boitex, J. Hirshleifer, A. E. Khan) and finally price differentiation in accordance with Ramsey's principle (F. Ramsey, W.J. Baumol, D.F. Bradford, M. Boiteux, S.V. Berg). All these concepts form a part of the traditional theory of natural monopoly regulation, have their roots in the theory of social welfare, and assume the need to regulate natural monopoly because of market weaknesses and

negative external effects of market monopolization resulting from them. Various concepts of price regulation came into being in attempts to find a solution bringing outcomes as close to optimum Pareto as possible.

Three types of potential State interference feature in the views of the advocates of classical theory: by means of taxes and subsidies, by regulating private monopolies, or by nationalizing a natural monopoly and subjecting it to direct supervision of the State. The author outlines these views highlighting the diversity between them that exists despite their common starting point. She asks many questions to which theory not always can find an unambiguous answer, but which inspire us to further theoretical and empirical studies. The problem cumulates especially in subsequent chapters where Borkowska refers to practice. The critics of market failure theory, State reliability, and cost-free State regulation of natural monopolies (K.J. Arrow, R.B. Horowitz, R.H. Coase) was the starting point for models of economic regulation based on interest groups.

The third chapter of the book reviews concepts of interest group behaviour in the context of State regulation of natural monopolies (G.S. Becker, A.F. Bentley, M. Olson, S. Peltzman, G.J. Stigler, D.B. Truman). Ideas for regulation disregard the thesis of a regulator acting in favour of optimal allocation of resources and care for social welfare but with reference to practice, facts are quoted confirming that operations by regulators are subject to political pressure and take account of not only consumers' interest as the weaker side of market transactions, but also producers', especially natural monopolists as influential players in the market of political services.

This chapter provides interesting descriptions of the behaviour of regulators and businesses subjected to regulations using examples from the US and resulting in the operations of pressure groups, lobbyists, and rent seeking. Differently from classical theory, regulation (as operating models for pressure groups) considers economic benefits equal to political ones, e.g., winning political popularity and votes by pressure groups. Politics and economics intertwined together is a more reliable reflection of reality. The theory of pressure groups also draws attention to the asymmetry of information between a regulator and a regulated company (classical theory assumes both sides of the regulatory process are perfectly well informed) and to the possibility of regulation being taken over by a regulated entity. G.S. Becker, J.J. Laffont, and Tirol construed an agency theory which says that conflict of interests between groups may deepen regulation inefficiency.

The final part of chapter three includes case studies of regulation history in the US in sectors like railway transport, cable telecommunication services, and electricity markets. In the late 19th and early 20th centuries in the US it was decided that all of the above sectors manufacture products and render services in the general economic interest and for that reason they should be regulated by the State in the public interest. Observations of regulatory activities in the market of railway transport show these activities were outcomes of the pressure of many different groups of interest and consumers, as the weakest and the least organized group were not represented in the game. We cannot say that regulation was taken over by railway companies as its content took account of business users of railways. The description of regulation

in the market of cable telephony tells a story of a natural monopolist, which Bell Telephone Company (BTC) was at the end of the 19th century. That history starts with BTC building monopolistic power with the support of the State, while in 1949–1982 they forced out the division of the company enjoying such a strong market position that competition could not develop, whether real or potential. Telecommunication and antitrust regulators had problems with information asymmetry and with the involvement of a group of eminent economists and lawyers on the side of the operator who fought for the company's interests.

The author draws our attention to a very important element which weakens the need for regulation and competition. That is technical progress which created competition to cable telecommunication from the side of mobile telephony and VOIP. The example of electricity market regulation is not as unambiguous as the previous ones. The reason is the high share of sunk costs in capital investment outlays to start and to continue operations in the market of electricity and power. The description of American experiences include many aspects familiar to Poles from their own experience: the dilemma of operations concentrated in huge multinationals, unbundling of transmission and distribution from generation and sales, and stimulating energy generation from renewable resources. In presenting historical American experiences, the author asks numerous interesting questions but finding answers to them would require deepened studies. These questions are also to the point for the Polish regulatory experience of the last two decades.

The fourth chapter presents new regulations for natural monopolies based on the theory of new institutional economics. Following R.H. Coase's concept it is assumed that information in the market (economic, political) is incomplete and asymmetric, the rationality of market players is limited, they are inclined to display opportunistic approaches and in the entire regulatory process we should compare the weaknesses of market and public administration. The new approach to regulation consists in proposing the following theoretical solutions applied in practice: auctioning as a form of competing to enter the market (E. Chadwick, H. Demsetz, O.E. Williamson, M. Armstrong, S. Cowan, J. Vickers), yardstick competition (A. Shleifer, J.J. Laffont, J. Tirole, M. Armstrong, S. Cowan, J. Vickers), price-cup regulation (S.C. Littlechild), essential facility access price (R. Willig, W.J. Baumol, J.G. Sidak, M. Armstrong, S. Cowan, J. Vickers), and structural regulation of natural monopoly (S. Peltzman, R.J. Gilbert, E.P. Kahn, O. Shy, O.E. Williamson, M. Armstrong, S. Cowan, J. Vickers, P.G. Klein). All these concepts assume activated competition if not on the market, then by relating regulation instruments to averaged economic reality. Proposed solutions may be applied in regulating municipal monopolies where in practice it is usually difficult to find solutions directly based on market competition.

By the end of the fourth chapter the author focuses upon the relation between exercising political power and effective regulations, with efficiency here meaning the smooth exploitation and development of natural monopolies. The studies quoted in the book reveal a large scope of discretion in political decisions which does not favour investments in infrastructure as the absence of regulatory stability contributes to higher investment risk. The studies on regulatory contracts cited in the book show

they offered poor protection to entrepreneurs against the opportunism of political authority.

The theory of new regulation is a response to imperfect interference of the political system with the economy, also in natural monopolies. Theoretical attempts to make objective the criteria used in regulatory decisions proved to be little effective; hence the new approach to economic regulation based on the principle of regulation for competition. The author's reference to experiences of countries with long-established regulatory practice and a democratic state is very instructive for Polish readers and the book can be recommended not only to theoreticians but also to practitioners engaged in natural monopoly sectors as well as politicians with whom many regulatory operations and decisions originate. The book is based on well selected, representative publications, mostly American and British. The book allows us to follow the development of economic and political views on regulating natural monopolies. The developmental trends indicate a rather clear direction of changes: from normative to positive concepts resulting from experiences accumulated in regulatory processes.

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YEARBOOK OF ANTITRUST AND REGULATORY STUDIES
VOL. 2010, 3(3)

ARTICLES

DAWID MIĄSIK, *Solvents to the Rescue – a Historical Outline of the Impact of EU Law on the Application of Polish Competition Law by Polish Courts*

MARCIN KOLASIŃSKI, *Influence of General Principles of Community Law on the Polish Antitrust Procedure*

MACIEJ BERNATT, *Right to Be Heard or Protection of Confidential Information? Competing Guarantees of Procedural Fairness in Proceedings Before the Polish Competition Authority*

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