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27 June 2017

Dear Mr. Borchardt,

In recent letters to the European Commission and Polish authorities, EFET has brought attention to the introduction of extremely punitive storage obligations by the Polish Government. We have now learned of a further worsening of the obligations that would have the effect of removing international competition from the Polish gas market, in ways that we believe contravene European energy legislation.

We strongly urge DG Energy to assist in overturning the legislation through its engagement with the Polish authorities. By copy of this letter, we also bring notice to DG Competition as we believe that the changes are in breach of European competition principles.

**Our impression is that the Polish legislator is openly pursuing the foreclosing of the national natural gas market to the advantage of the incumbent's dominant position**.

**Description of the Issue**

Legislation introduced in 2016 extended to all parties importing natural gas in Poland the obligation to hold gas in storage fields. As the existing storage facilities in Poland are almost entirely in control of the national incumbent and is either not made available to the market or is priced significantly above competitive storage elsewhere in Europe, market parties became extremely concerned about how such an obligation could be met. Clarification was requested on how gas may be held in storage facilities elsewhere in the EU in ways that complied with Polish and EU law. Partial clarification came only in April 2017, after several meetings and exchange of further communication.

However, on 7 June 2017, without any public consultations and without informing interested or affected parties, the Government adopted a new amendment to the Polish Act on Mandatory Stocks of Gas, which will immediately impact all the market players as it is almost impossible to adapt to the proposed changes.

In short, the amendment provides for the following changes:

- A natural gas importer intending to maintain storage outside of Poland is now required to provide long-term firm transmission capacity at the border without being able to use it outside of emergency conditions as declared by the relevant authority.

This entails the following consequences:

  - The booking amounts to a situation of capacity hoarding and it is therefore incompatible with Annex I to Regulation (EC) No 715/2009 as amended by Commission Decision No 2012/490/EU. Therefore, the Polish Regulator or the Competent Authority of the relevant neighboring country may require the TSO to withdraw underutilized contracted capacity by a network user;
  - In the period before an emergency is declared not all the available capacity would be used. This would limit access to resources otherwise available and it would artificially constrain supplies;
  - The TSO receives additional revenues from a service that is not performed;

Moreover, as the wording of the amendment is very stringent and any Member State - including Poland - is given the right to interrupt deliveries in case of system failure, the level of transmission capacity firmness required to use storage abroad may in fact be impossible to achieve;

- The storage reserve requirements must now be maintained not only by entities that are still importing gas from abroad, **but also by entities that do not any longer do so**, even if they have given back their import license.

This entails:

  - A further form of subsidy to the advantage of the national incumbent as this is unlikely to import natural gas in Poland and possibly another form of undue state aid;
  - A mismatch between the actual storage requirement for a given level of import at a specific point in time and the real needs of the system;

- There is no specification of the compensation price for the natural gas released in the event of emergency. The price is defined by the Government, which results in the lack of any guarantee of a transparent and fair settlement. In fact, per current wording there could be a situation in which the settlement price could be set at a very low level, and even to 0.

On the whole, the proposed changes form a breach of Regulation 994/2010 concerning measures to safeguard security of gas supply which requires that the supply standard shall "not unduly distort competition or hamper the functioning of the internal market in gas" (Article 8.2(b)), that "obligations…shall not impose an undue burden on [natural gas undertakings]" (Article 8.4), and that "natural gas undertakings shall be allowed to meet these obligations at a regional or Union level, where appropriate" (Article 8.5).

EFET maintains that Polish storage obligations, as they exist today, are inefficient, distortive and unnecessary. They are possibly the costliest in Europe, as well as being operationally very complex or almost impossible to meet operationally and economically. As such, they represent a barrier to the development of a secure, liquid and competitive market, ultimately reducing its resilience during emergency situations. The revision to the Act would make them even more damaging both to the wholesale market and to Polish consumers and to aspirations of Poland becoming a regional gas hub.

## Inconsistency with European competition principles

In addition to the observations above and in the effort to provide you with a complete analysis we would also like to share a few considerations on more general compliance with EU law. In fact, we believe that the existing storage obligations, as worsened by the proposed amendments, constitute an infringement of European competition law from various angles.

The proposed practice impedes the free movement of goods and services as it leads to a barrier to entry in the Polish gas market through imposing financially and operationally more onerous conditions for companies which do not have storage in Poland. As they use storage abroad and the operation of the regime brings about substantial additional cost and the vast majority of the storage capacity in the country is controlled and owned by the national incumbent, the Act *de facto* triggers a negative commercial effect equivalent to a market barrier for new entrants.

In particular[1],

*i. On freedom to provide services*

Article 56 TFEU prohibits restrictions on the freedom to provide services within the Community in respect of nationals of Member States who are established in a State of the Community other than that of the person for whom the services are intended. Pursuant to Article 57 TFEU, services shall be considered to be 'services' where they are normally provided for remuneration, in so far as they are not governed by the provisions relating to freedom of movement for goods, capital and persons. Services shall in particular include: activities of an industrial character; activities of a commercial character; activities of craftsmen; activities of the professions.

Wholesale gas trading is a commercial activity which is provided for remuneration. Wholesale gas traders usually operate from one Member State in which they are established, from their place of establishment wholesale traders carry out their economic activities in other States on a temporary basis. Wholesale trading can thus also be qualified as a service in the sense of Article 56 TFEU.

*ii. On distinction between goods and services*

Although the European Court of Justice (ECJ) has held on several occasions that the import and export of natural gas falls within the scope of the EU Treaty rules on the free movement of goods[2], wholesale trading with gas also comprises further commercial elements as the main focus of trading is not the import or export of physical gas but the underlying commercial transaction that rather falls in the ambit of the provisions on the freedom to provide services. The legal nature of wholesale trading can thus be qualified as a mixed activity falling in the scope of provisions for goods and services as wholesale trading comprises different legal elements, i.e. the delivery of a physical commodity as well as underlying commercial activities.

The ECJ previously held in the area of telecommunications that the provisions on goods and services may be applied simultaneously where the national measure at

[1] As most of the case law refers to the original numbering in the Treaty on the Functioning of the EU (TFEU) we have kept the numbering as is.
[2] Cases C-393/92, Almelo [1994] ECR I-1477, C-158/94 Commission v. Italy [1997] ECR I-5789.

issue infringes both the provisions on the free movement of goods as well as the provisions on the freedom to provide services[3].

We conclude that, the EC Treaty provisions dealing with the free movement of goods as well as the provisions on the freedom to provide services are applicable to wholesale gas trading.

*iii. On restrictions to trade*

Art. 28 and Article 56 TFEU prohibit discriminatory barriers to trade. Discriminatory barriers to trade are restrictions that impose less favourable conditions on foreign that on domestic products or services. Import and export restrictions are such discriminatory measures that are caught under the aforementioned provisions. Imposed storage requirements are restrictions on import and are thus discriminatory barriers to trade that contravene Art. 28 and Article 56 TFEU.

Further, certain non-discriminatory barriers to trade are also prohibited in the internal market. In its case law the ECJ held that Article 30 TFEU can also apply to national rules which do not discriminate against imported products as such but which inhibit trade nonetheless. In its leading case Cassis de Dijon[4] the Court affirmed that Member States may regulate all matters which have not yet been subject of Community harmonization as long as such disparities in national law can be justified under the so-called “rule of reason”.

The ECJ has also held in its landmark ruling Keck[5] that selling arrangements, i.e. rules such as when, where by whom and at what price goods may be sold fall outside the scope of Article 30 TFEU if this selling arrangement indistinctly applies to domestic and imported goods. The Keck doctrine requires that the provision in question affects the marketing of domestic products and those from other EU Member States in the same manner in law and in fact.

Considered the concentration in the storage capacity market in Poland, the requirement to obtain storage without any need to use the storage other than for complying with the legislation, affect more entities other than the incumbent. These requirements are non-discriminatory measures which inhibit trade and thus fall under Article 30 TFEU.

Although the case law on Article 30 TFEU cannot directly be applied to Article 56 TFEU the ECJ has in fact applied a similar set of rules to Article 56 TFEU and consistently held that genuinely non-discriminatory restrictions are also caught under Article 56

[3] Case C-390/99, Canal Satélite Digital SL [2002] ECR I-607.
[4] *Case* 120/78, Rewe v. Bundesmonopolverwaltung für Branntwein [1979] ECR 649.
[5] Cases C-267-8/91, Keck et Mithouard [1993] ECR 6097.

TFEU[6]. The Court set out that Article 56 TFEU requires not only the elimination of all discrimination on grounds of nationality against providers of services who are established in another Member State but also requires the abolition of non-discriminatory restrictions which are liable to prohibit, impede or render less advantageous the activities of a service provider established in another Member State where he lawfully provides similar services[7].

As set out above non-discriminatory restrictions are such that apply across the board to national and foreign companies but which affect companies other than the incumbent more.

*iv. On no justifying restrictions*

Barriers to trade that fall in the ambit of Arts. 30 and 56 TFEU may be justified on the grounds of a set of written derogations under the TFEU. These overriding reasons are, inter alia, public morality, public policy, public security, the protection of health and life of humans and are only applicable to discriminatory measures by Member States. Import licences which are discriminatory in nature can thus only be justified on grounds of public morality, public policy, public security etc. None of these overriding reasons are applicable to imposed storage requirements in particular not "security of supply", as the supply is sufficiently protected through existing legislation that have been reinforced by the SoS solidarity mechanisms.

Member States must show that those restrictions are objectively justified in pursuance of a legitimate public interest:

- and provide that the measure in question is proportionate for the attainment of these objectives
- this double-test applies to any discriminatory measure.
- the discriminatory measure must be proportionate.

The security of supply provide that Member States shall ensure the security of supply issues covering the supply/demand balance on national markets, the level of expected future demand and envisaged additional capacity being planned or under construction, the quality and level of maintenance of networks as well as measures to cover peak demand and to deal with shortfalls of one or more supplier.

The storage obligations will not lead to any higher degree of security of supply. On the contrary, the storage legislation is likely to result in companies other than the incumbent to abandon the activities in the Polish market due to the load of operation cost created by the storage obligation.

[6] Case 275/92, Schindler [1994] ECR I-1039, Case C-384/93, Alpine Investment [1995] ECR I-1141
[7] Case C-272/94, Guiot, [1996] ECR I-1905, Case C-3/95, Reisebüro Broede [1996] ECR I-6257, para. 25.

The disappearance from alternative suppliers will result in clustering the supply risk with the incumbent company. Experience from previous supply-shortage in 2008/2009 has shown that the supply is better managed through a multitude of suppliers, compared to a single supplier. The storage obligation is in consequence not leading to a higher degree of security of supply but to a lesser degree of gas supply. The storage law cannot lead to any increased security of supply and is not proportionate.

We conclude that the proposed storage arrangements are disproportionate and do not hold the test established by the European case law.

**Conclusion**

The nature of these obligations renders market entry impossible, and severely penalizes existing and recent entrants who are unable to meet the conditions. The most recent (June 26th) communication received from Gaz System by some market participants stating that (i) Gaz-System does not have the powers to verify the availability of storage located abroad, that (ii) they disagree with URE's interpretation in this regard and therefore (iii) they will not proceed with any such verification until a new law is passed, represents only the final act of a systematic direct and/or indirect act of preclusion to perform ordinary marketing activities in Poland for companies other than the national incumbent.

Once again, we look forward to receiving feedback on the above points from the Polish Authorities and we remain available for any clarification on this or on other matters, in particular with a view to discuss ways to amend the legal framework and introduce security of supply requirements that are market based, more effective and less burdensome for market participants and for end users.

Moreover, we re-iterate that due to the seriousness of the matter, we may also need to instigate legal proceedings. Finally, we remain available to discuss these issues at your earliest convenience.

Yours Sincerely,
On behalf of the European Federation of Energy Traders,

Jan van Aken
Secretary General