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Polish Oil and Gas Company' responses to questions for stakeholders in consultations of the ERGEG's Draft Guidelines on Article 22

1. Do you consider the described general principles and guidelines appropriate to achieve a consistent and transparent framework for competent authorities when deciding on exemption procedures?

It is appropriate to issue the relevant guidelines for the deciding authorities with regard to TPA exemption principles. This will undoubtedly contribute to more uniform application of the procedure under Article 22 of the Directive.
However, it should be considered, that the conditions of the functioning of a particular market in each Member State are not homogeneous.
In order to avoid inconsistencies in the application of the Guidelines by the Regulators it would be worthwhile to include in them a clear catalogue of the features specific to individual markets with diverse characteristics, e.g. due to the dependency on a single direction/source of supply, funnel transportation system, need to develop security of supply, requirements to perform under long-term contracts or tariff-based and fully regulated gas trade.
In our opinion, disregarding these differences may in fact lead to a situation where new entrants enjoy disproportionately privileged position in the market at the expense of the incumbent's delivering on the obligations versus its customers.

Moreover, in our opinion, the Guidelines should clearly specify the interaction between two or more competent Regulators. These questions remain unaddressed by the Guidelines, e.g. there is no answer to the question about the scope of the consultation of one Regulator with another and the underlying principles. What is the method of resolving potentially conflicting decisions by regulators concerning the same project? Would the entity applying for an exemption under Article 22 have access to e.g. the correspondence between the Regulators concerning its case?

In order to provide a transparent framework for the Regulators in taking decisions concerning the exemption procedures it would be appropriate for the Guidelines to clarify the question of their applicability in a situation when infrastructure is developed pursuant to intergovernmental agreements. It would be a wrong practice if the sponsors resorted to such agreements in order to evade the requirements set forth in the ERGEG Guidelines.

2. Do you consider the present scope of eligible infrastructure to be too narrow?

Although the Directive defines the term "LNG facilities", there is little clarity however as to what "new technologies" mean. The lack of such definition leads considerable divergence of opinions and legal doubts as to the whether the scope of operation of a legislative act, i.e. the directive, may be broadened through such a procedure. The question arises about the consequences of a failure to conform with the Guidelines to the extent that the are not based on the specific wording of the Gas Directive.

We do not, however, accept the explanation provided by ERGEG on page 18 of the Guidelines regarding Article 22 para. 3(b) (ii) of the Gas Directive. This reasoning leads to over-interpretation of the wording of the Directive, i.e. a legally binding document. Any change in the scope of the infrastructure covered by

Article 22 para. 3(b) (ii) may only take place by adoption of a legislative act of an equal order, rather than through issuance of non-binding ERGEG Guidelines.

3. Do you consider open season (or comparable) procedures an important tool in assessing market demand for capacity with respect to determining the size of the project applying for exemption, as well as in the subsequent capacity allocation?

The results of the procedure may be helpful in assessing the demand for capacity in the market.

The procedure, however, presents a very high risk for the investor who is to take the investment decision. The negotiating position of the sponsor vis-à-vis banks weakens because the open season procedure creates uncertain conditions for implementation of a project. This is because of higher risk of project delay and change of business partners who could withdraw in the course of the procedure from their previous declarations to purchase the capacity.
The project risk further increases when the sponsor seeks an exemption from the TPA regime. This raises the cost of capital for an investment project covered with an open season procedure.

A significant interference in the planning of the open seasons can be noted in the Guidelines, as the provide that: "It must be ensured, that the result of the open season is not such that the incumbent receives a capacity share perpetuating or enhancing its dominant position". The outcome of the open season should not discriminate against the existing players but rather reflect the actual demand for capacity from the players in the relevant market and the contracted volumes they are to deliver to their consumers.

4. Should open seasons also be used to allocate equity?

Although the open season procedure may be a useful tool to asses the market demand for capacity, it should not be applicable to allocation of equity. The question of raising capital for the project should be an element of the investment process to be carried out by the sponsor/investor and be left to its sole discretion in the choice of the capital structure for financing of the investment. Such decision can be taken based on appropriate financial and economic analyses rather than mandatory procedures of gathering market interest in co-financing of the investment by other players. Accordingly, the use of the open season in equity allocation should be optional and non-binding for the sponsor and constitute a potential tool to be used in a situation when the sponsor does not have sufficient funds to finance the investment. Such treatment of the open season with respect to equity allocation does not affect free movement of capital – one of the four freedoms of the EU internal market. An obligation to hold open seasons for equity allocation would be in breach of the freedom of business activity.

5. Some stakeholders think that Art. 22 should be applied differently to LNG terminals as they may be generally better suitable for enhancing competition and security of supply than other types of eligible infrastructure. What is your point of view on this? If you agree, how should this be reflected in the guidelines?

LNG facilities should be treated differently than system interconnections, bearing in mind that the principles concerning interconnections mostly apply to entities from EU Member States. LNG exporters are usually based outside the EU. When combined, such applications could be ineffective and raise doubts as to their interpretation.
In the view of the creation of a single energy market in the EU, any investments in the construction of LNG import terminals are an extremely important element of ensuring the diversification of gas supply to the EU. Taking also into account the current structure of the global market, the gas delivered to the EU will definitely originate from outside of the EU, i.e. from non-regulated markets with different expectations of

the European party. Therefore, the Guidelines and regulations should not undermine the competitive position of European terminals in the global market.

6. Are the described criteria for assessing the effects of an investment in infrastructure on enhancement of competition in gas supply appropriate?

In principle, the criteria for assessing the impact of investments in infrastructure on enhancement of competition in gas supply, as described in the Guidelines, seem to be justified, however:

1) the impact of an investment in infrastructure on enhancement of competition in gas supply cannot be considered in terms of weakening the market position of the entity that seeks an exemption from the TPA regime, as proposed in point 3.2.1.3. of the draft Guidelines. The provisions concerning entities with dominant market position seeking an exemption go in a wrong direction as they lead a decrease in their position. In our opinion this is not appropriate, and even dangerous for the market, because these very players with their adequate resources (capital, people, knowledge, experience) are in the position to compete effectively with major non-EU players. Third party players are not obliged to observe EU unbundling requirements and do not have to incur the related additional costs. Moreover, unequal treatment of players operating in the market is contrary to the principle of non-discriminatory treatment of all business entities. One must not suggest that companies are "presumed guilty" when they want to: a) ensure the security of customer supply from a consciously selected new direction, b) achieve return on their investment - rather than block the competitors. In case of an energy "island", such as Poland, with a funnel-like nature of the transmission system characterised by a single direction of transmission flows from the east to the west, the first factors is key in any investment decision. The approach proposed in the Guidelines implies that the dominant player will have to take some steps that will undermine its position. The proposal of ERGEG seems to run counter to the right of freedom of business activity. It even suggest that the company will be required to provide evidence that it acts to its own disadvantage. Effectively, such provisions will hamper the development of the company whereas the stability/ confidence of the company in striving to maintain or even improve its value and market position is, in the case of gas companies, the guarantee of ensuring the security of gas supply to consumers defined as the possibility of supplying the customers from different directions of supply. PGNiG strongly opposes the provisions proposed in the Guidelines, which stipulate that the dominant market player applying for an exemption from the TPA regime must prove that his market position will decrease as a result of the exemption and must show how the investment is intended to enhance the position of smaller players;
2) in case of LNG market, which is a very demanding market, any attempts to constrain the development of companies involved in the LNG business adversely affect their negotiating position versus LNG exporters and, at the same time, have a negative impact on the costs of gas acquisition and the energy security of Europe;
3) with regard to the assessment of the market structure (section 3.2.1.2) PGNiG believes that the scope of information provided by the applicant for use by the regulator in the assessment of the market structure should not exceed the information framework defined in the open season. Furthermore, some terms listed in section 3.2.1.2c) provoke doubts as to their interpretation, such as: predominant cost structure in the relevant market, possible alternatives, expected behaviour and reaction of companies already active in the market.

In addition, in case of a dominant market player who wants to benefit from an exemption, a very important question to taken into account in the assessment of the effect of an investment in infrastructure on enhancement of competition in gas supply concerns the definition of the so-called compensating benefits for all the market players, resulting from the decision to grant an exemption to such dominant player. PGNiG believes that among the compensating benefits, it is necessary to address such questions as:

1. ensuring the security of gas supply to consumers – the need to perform on the agreements with the consumers in order to ensure the continuity and reliability of gas supply,
2. transformation of the structure and improvement of the liquidity of the transmission system, e.g. change of the system from one with funnel-like structure and one-way gas flow to an increasingly

diversified and flexible one, which will contribute to creation of opportunities for new and/or small entities with regard to connection to the system at the chosen point of the network and access to gas transportation services. The development of the above-described transmission system structure the will enable gradual alignment of the gas market with the EU requirements as regards a free choice of supplier, since it will be possible to transport gas to the selected point and direction in the system.

3. possibility to develop competition in gas supply in the longer term as opposed to the lack of such possibility in case when the investment is abandoned because of the refusal to grant an exemption.

With respect to the test for infrastructure that is difficult to duplicate by third parties, the result of which is taken as the basis for assessment of the level of competition and security of supply, PGNiG is of the opinion that the test of this kind as suggested in the Guidelines may be only treated hypothetically and should not serve as an instrument taking the decision by the regulatory authority to grant an exemption, because:

1. The assumptions taken in the test are not comparable and are of hypothetical nature – another interested player willing to execute the sponsor's investment actually cannot be treated identically as the sponsor. Both players (sponsor and another interested player) will always differ in terms of the resources required for the project, available to each of them: knowledge, experience, human and financial capital, fixed assets, etc. Furthermore, in case of investments in infrastructure the existence of a customer base for whom the investment is designed by the sponsor, is a crucial question. One cannot assume that another interested player will assume the same customer base in their analysis when assessing the profitability of the investment in question. It cannot be reasonably expected that the sponsor will voluntarily hand over its customer base for the benefit of another player interested in the investment. Therefore it is obvious that an alternative player could address the investment to a different customer base, which definitely implies that the investment being planned by such entity is incomparable to the investment contemplated by the sponsor.
2. The result of the non-duplicable infrastructure test creates uncertainty in realisation of investment projects, as it allows for a situation where the result of a test based on incomparable assumptions permit the deciding authority to refuse an exemption from TPA. What is more, the Guidelines do not specify whether this means that such exemption is automatically granted to another interested player. Under the circumstances, what should be the reaction of the sponsor applying for an exemption for an investment dedicated to a specific customer base? Moreover, the Guidelines do not specify how the regulatory authority becomes aware of other players interested in the project - is the regulator supposed to "look for" them in the interest of enhancement of the competition? Will the party that originally applied for an exemption be informed of such steps of the regulator? Due to all these doubts the non-duplicable infrastructure test will discourage energy companies to undertake investment projects and, as a result, constrain their development, which means that a number of compensating benefits will be forgone both for those consumers for whom the investment in infrastructure was intended and for other market participants.

In view of the above remarks PGNiG suggests such modification of the Guidelines by ERGEG where the criteria for assessing the effects of an investment in infrastructure on enhancement of competition in gas supply ensure that:

- the assessment of the criterion of enhancement of competition in gas supply will be based on the principle of non-discrimination against all parties taken into account in the process of issuing an exemption decision,

- the deciding authority takes into consideration the current situation in the market, as well as the characteristics of the transmission system existing in such market and the specifics of its functioning,

including the need for modernisation of the transmission system in order to create the conditions for the development of a common single gas market in Europe.

7. Are the described criteria for assessing the effects of an investment in infrastructure on enhancement of security of supply appropriate?

The criteria for assessing the effects of an investment in infrastructure on enhancement of security of supply are by themselves appropriate. However, the Guidelines do not specify whether the criteria are to be applied taking into account the existing market structure, position of the key exporters and imports structure, existing capacity and the related technical constraints, etc., similarly as in the case of the criteria for assessing the effects of an investment in infrastructure on enhancement of competition in gas supply. PGNiG believes that the market structure is of crucial importance for assessing security of gas supply to consumers and is instrumental in determining the investment decisions of energy companies undertaken with a view to ensuring such security.

The relevant market may have different structure and different characteristics, and thus may influence in different ways the development of the competition in gas supply and enhancement of security of supply to consumers. PGNiG believes that the assessment of investments in infrastructure applying for an exemption under Article 22 needs to take into account the type of market concerned by the assessment of the enhancement of competition or security of supply. In case of markets with funnel-like structure of the transmission system and one-way gas flow through the system, which is the case in Poland, security of gas supply to consumers much be given priority importance. The differentiation of the directions of gas supply through investments in infrastructure for a specific customer base is one of the ways to ensuring the continuity and reliability of gas supply to consumers. In case of markets such as the Polish one, the development of competition in gas supply must not be an in itself. The market entry of new, small players and the expected increased competition in gas supply do not provide a guarantee of improved security of gas supply to consumers.

8. Are the described criteria for the risk assessment appropriate?

In the opinion of PGNiG, one of the key criteria for assessing the risk involved in an investment concerns the security of supply and the implications of the undertaken commitments. Consequently, a question arises as to how deeply the Regulator will analyse the above criteria and whether it can interfere with the project assumptions and arbitrarily evaluate such assumptions.
Moreover, PGNiG would like to point out that the provision proposed in the Guidelines, which instructs the regulatory authorities to provide a stable, foreseeable and legally binding regulatory framework and consideration of special tariff treatment of new infrastructure projects could not be applicable in the Polish situation because the Polish energy regulator does not have the powers to issue regulatory frameworks.

9. Are the described criteria for assessing whether the exemption is not detrimental to competition or the effective functioning of the internal gas market or the efficient functioning of the regulated system to which the infrastructure is connected, appropriate?

The criteria for assessing whether the exemption is not detrimental to competition or the effective functioning of the internal gas market or the efficient functioning of the regulated system to which the infrastructure is connected, as proposed in the Guidelines are, in principle, appropriate. The must, however, by supplemented with the provisions proposed by PGNiG in these responses, which would take into account the specific nature of markets such as an energy “island" with gas supply coming only from a single, specific direction. The efforts of companies aimed at increased diversification of the supply directions and, consequently, at enhancement of security of gas supply to consumers, must not be discriminated against.

10. To what extent should consultations with neighbouring authorities be done?

The fundamental question concerning consultations with neighbouring authorities is to define what specifically does the term "neighbouring countries" mean. Are these the countries where the beginning and the end of an interconnection is located, or other countries affected by such interconnection? Moreover, the Guidelines should clearly specify the interaction between two or more competent regulators. If the sponsor/investor is to be able to operate in a stable legal framework, the decision by the regulators should be certain, uniform (fully consistent), and issued before specific project activities are undertaken. Particularly when such activities are carried out under private law contractual arrangements. The Guidelines do not address a situation when projects are implemented within the framework of international agreements, although most interconnections are developed in such circumstances. What is the extent of Regulator's interference in such case? Why investors being able to choose the law they are subject to (between private and public) are treated differently in the same territory, depending on the type of agreement that is applied?
A number of further issues call for clarification, such as:

- does the applicant have access to e.g. correspondence between the Regulators concerning its case?
- what are the principles of resolving contentious issues between regulators in issuance of the final decision for the applicant?
- is any ranking/hierarchy of individual regulators envisaged as regards their contribution to/impact on the final decision issued to the applicant?

11. Parts 3.3.1.1 and 3.3.1.2 of the proposed guidelines deal respectively with partial and full exemptions. Do you consider the described decisions (partial/full exemption) appropriate in safeguarding the goal of Directive 2003/55/EC in making all existing infrastructure available on a non-discriminatory basis to all market participants and safeguarding the principle of proportionality?

If the decisions on full and partial exemption are based on the supplemented wording of the Guidelines, as suggested in these responses, such exemptions will be appropriate in safeguarding the goal of Directive 2003/55/EC.

12. Do you believe that Art 22 exemptions should also benefit incumbents or their affiliates? If yes in what way and to what extent?
Yes, exemptions under Article 22 should also benefit incumbents or their affiliates. PGNiG believes that a company must not be "punished" by the very fact that it has operated in the market for a longer time. Its strong and stable position in the market is a guarantee of providing reliable gas supply to consumers. With its long-standing experience in gas supply business such company can successfully compete with gas producers/suppliers from outside of the European Union. In addition, although the idea to develop competition of supply in the European energy market is undoubtedly a legitimate goal, one should avoid pursing it through disproportionate interference in functioning of the market. Completion must not be developed by giving, by definition, preference to new entrants at the expense of companies that already operated in the market and are in the position to offset the exemptions granted to them with compensating benefits.

13. Do you agree that under certain circumstances, deciding authorities should be entitled to review the exemption?

Such revision should not apply in those cases where external factors independent of the applicant's activities and will occurred during the pay-back period of an investment covered by an exemption under Article 22, e.g.:

- change in foreign exchange rates,
- change in the cost of feedstocks, materials and labour affecting the project opex,
- change in legal environment.

A potential revision of an exemption should only take place on a clearly defined principles. Therefore PGNiG supports the provision in the Guidelines, which requires that clear and stable rules be established including the circumstances under which the exemption may be revised.