PGNiG's position to the ERGEG (The European Regulators Group for Electricity and Gas) document entitled „Roadmap for a competitive single gas market in Europe".

Responding to ERGEG's invitation to present remarks to the „Roadmap for a competitive single gas market in Europe", especially to its invitation for sectoral players to present examples from industry participants of problems experienced in European markets that demonstrate the existence of obstacles to further progress towards a competitive single European gas market, PGNiG wishes to state its position on the current situation in Poland's gas market.

The 2003/55/EC Directive has been fully implemented into national law by amending the „Energy Act". Poland as one of few EU member countries has selected the most radical procedure of separating Transmission System Operators both in the gas and energy sectors, consisting in ownership unbundling. Apart from the government's decision expressed in the „Programme of restructuring and privatisation of PGNiG" (the company was then owned in 100% by the State Treasury, it was a vertically integrated company, operating as a TSO before the directive entered in force) which ordered the ownership unbundling of the TSO. The requirement was backed by the introduction of a respective entry in the amended „Energy Act", article 9k), by which the Transmission System Operator operates as a stock company, with the State Treasury as its sole owner.
The transmission system operator was separated from PGNiG's structure as a subsidiary in April 2004, subsequently transferred to the State Treasury in April 2005. Hence for about 9 months now a totally independent TSO has been operating in Poland, nevertheless according to information held by PGNiG, the TSO has not yet signed any agreement for transmission services with any shipper other than PGNiG, so far.
The above situation (lack of interest of potential competitors and customers in TPA service, or absence of competition), despite the provision of legal (amended legal act) and organisational foundations (ownership unbundling of TSO), compels to pose the question what other barriers hamper the development of a competitive gas market in Poland, and throughout the region.
PGNiG considers the calculation methodology applied to natural gas trade in Poland, to be the primary cause of the lack of competition. It is one of the topics not addressed by the document, which should be included among priority activities of ERGEG, especially regarding Central and Eastern European countries, where free market rules have been followed for only a dozen years or so.

1. Tariff in trade

Provided that the focus will be on revealing the practical issues that are most important to the further development of effective competition within each region, it should be stressed that the regulated price of traded natural gas, and especially the methodology of calculating the said price as defined by regulations, is the most serious hurdle in the development of a competitive natural gas market in Poland and the entire region as well, of which the Polish market could form part.
Current regulations force a company dealing with natural gas trade, to calculate the gas sales price for its customers in Poland, as a weighted average of purchase prices (of imports for PGNiG) and the **costs** (only the costs) of **producing natural gas from own sources.** Provided that the costs of natural gas production from own sources are several times lower than gas prices attainable in import contracts, the mentioned tariff calculation methodology causes that the price of natural gas approved by corporate tariff is determined at a level below

the attainable prices of imported natural gas, hence market new-comers are incapable of competing, if they don't perform production activity in Poland. The problem has also been discerned by DG Competition in the document „Energy sector inquiry – issues paper", where it states that "regulated tariffs may have a negative effect on competition, particularly if they are set too low so as to make cost-based competitive prices unattractive".

PGNiG's data indicate that apart from Lithuania, Poland is the only EU member country where regulated prices rule wholesale trade in natural gas. Most EU members adopted a solution preserving regulated prices for small customers (mainly households and small companies) and abolishing regulations for medium and large customers, while some have completely abolished regulation and approval of natural gas prices by Regulators.

Poland's tariff calculation methodology applied to natural gas sales widely diverges from market and pro-competitive solutions, because „cheaper" domestic gas is „put into one basket" with much costlier imported gas, and is **fully allocated for sale to domestic gas customers**, therefore the company cannot select its clients nor markets where it would like to sell the gas produced by itself. It hinders cross-border trade, creation of regional markets, and eventual progress to a competitive single European market for gas, because the gas which could be offered at competitive prices on the regional market, is itself being unavailable for applied tariff regime. That is the cause which determines that Poland remains a closed market, practically disconnected from the markets of other EU countries (apart from one connection with the German network, by which PGNiG imports German and Norwegian gas to Poland). The ruling tariff regime also constitutes an obstacle in the development of new connections with the markets of other EU member countries, because companies willing to import gas using those connections, will not be able to offer competitive prices, necessary to sell the gas to customers in Poland.

In the document „Roadmap for a competitive single gas market in Europe" ERGEG specified the objectives in its pursuit of a common European gas market:
"Important benefits of the single European market for gas will include all European consumers having a choice of gas supplier. Gas suppliers shall be able to market their services to all consumers across the EU."
"Gas shippers and suppliers should then be free to make a commercial judgment about which sources of gas to use to supply their customers. It is important that this decision is a commercial one."

It seems that Poland's methodology of calculating tariff gas prices is an obstacle in achieving those objectives. In order to enable the creation of a common competitive natural gas market in Europe, Poland should mainly:

- Free gas sales to medium and large customers, natural gas trading companies included, from the obligation to seek approval of tariffs;
- Change the tariff calculation methodology applied to gas sales for households and small non-household customers, by basing it on the price of purchase (import) of natural gas only;
- Launch a gas release programme from the portfolio of the dominating supplier.

2. Return on invested capital

Another issue we wish to address in this context is inextricably associated with market development, regional included, because the level of return on capital admitted by the

Regulator, determines the level of investments including trans-border investments, which will be implemented. Admittedly, the amended “Energy Act” allows to include return on invested capital in the tariff, nevertheless it leaves the determination of its level to the Regulator’s competence. We are convinced that the process of determining the rate of return on invested capital by the Regulator should be transparent, i.e. that the Regulator’s decision be announced publicly, addressed to all companies performing a specific activity without exceptions, determined the rate of returns for specific types of operations for a period of minimum several years (so no abrupt change of the project’s economics occurs in the investment process), and contained justification of the adopted rate of return on invested capital.

3. „Entry–exit” methodology and restricted access to information

In our opinion, another important barrier in the development of a competitive gas market, apart from the basic obstacle which is the binding methodology of calculating the tariff price for natural gas sales, is access to information on the transmission system (technical, reserved and available transmission capacities in specific entry and exit points to the system), and the lack of an „entry-exit” tariff (currently the TSO applies so-called group tariffs). The TSO has submitted for Regulator’s approval a draft Network Code, providing for a quite restrictive approach to the issue of unbalance (unbalance would be settled on a daily basis and as a so-called accumulating balance), without offering system users sufficient information on actual flows to them, what would enable them to deal with the problem and to avoid imbalance (despite the proposal to begin counting imbalance on a daily basis, the TSO does not plan to change the nomination during the gas day). Neither does the TSO offer any solutions that could enable system users to minimise their own imbalance, by implementing a transaction by which system users with negative imbalance purchase gas from system users with positive imbalance (the draft Network Code does not allow system users to perform commercial transactions in the so-called notional point, it only allows gas sales transactions in precisely determined entry and exit points to the system, or in system points where gas is physically measured, thus restricting the freedom of the parties to the sales agreement).