



Gas Regulation

in 29 jurisdictions worldwide

2014

Contributing editors: David Tennant and Jennifer Davis



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Dentons UKMEA LLP

Getting the Deal Through is delighted to publish the fully revised and updated 2014 edition of *Gas Regulation*, a volume in our series of annual reports, which provide international analysis in key areas of law and policy for corporate counsel, cross-border legal practitioners and business people.

Following the format adopted throughout the series, the same key questions are answered by leading practitioners in each of the 29 jurisdictions featured. New jurisdictions this year include Colombia, the European Union, Ghana, Myanmar, Norway and Turkey. The publication also benefits from a new Global Overview authored by David Tennant and Jennifer Davis at Dentons UKMEA LLP.

Every effort has been made to ensure that matters of concern to readers are covered. However, specific legal advice should always be sought from experienced local advisers. *Getting the Deal Through* publications are updated annually in print. Please ensure you are always referring to the latest print edition or to the online version at www.GettingTheDealThrough.com.

Getting the Deal Through gratefully acknowledges the efforts of all the contributors to this volume, who were chosen for their recognised expertise. *Getting the Deal Through* would also like to extend special thanks to contributing editors David Tennant and Jennifer Davis of Dentons UKMEA LLP for his assistance with this volume.

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Poland

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Description of domestic sector

- 1 Describe the domestic natural gas sector, including the natural gas production, liquefied natural gas (LNG) storage, pipeline transportation, distribution, commodity sales and trading segments and retail sales and usage.

For several years, the Polish gas market has been marked by a high level of concentration in all areas (production, storage, trading, transmission and distribution). The gas sector remains dominated by the capital group of Polskie Górnictwo Naftowe i Gazownictwo SA (PGNiG), whose operations include exploration, mining, storage and trading, and six distribution companies, dealing only with distribution since the spin-out of trading activities on 1 July 2007. Since that date, PGNiG, in which the State Treasury holds a majority stake (72.4 per cent), has handled both wholesale and retail sales.

Despite the presence of other players in the market, including leading global companies such as Chevron, Conoco Philips and Total, and others such as San Leon, Lane Energy, DPV Service, FX Energy, RWE DEA Polska, Aurelian Oil, CalEnergy Gas Polska and Lotos Petrobaltic SA (offshore gas exploration and production), which are not controlled by PGNiG, some 98 per cent of production activities in Poland are currently controlled by PGNiG. Likewise, PGNiG controls 100 per cent of underground storage capacity. PGNiG is supposed to provide storage services to other gas companies; however, in 2011 its storage capacity was used for PGNiG's own needs with only 50 million cubic metres shared with Gaz-System, the operator of the Polish national grid. Regardless of the above, in recent years there has been a growing interest in prospecting for and exploration for natural gas as well as coal bed methane, with new market players coming to Poland. This mainly relates to unconventional gas resources. Interest in unconventional deposits is currently running high due to their potential (estimated at some 346 to 768 billion cubic metres), which is sufficient to cover Poland's gas demand for 35 to 65 years. The first wells, which could confirm these findings were placed in northern and western Poland, as well as further wells already drilled and planned in southern Poland. If these findings are confirmed, gas production from unconventional sources may eliminate Poland's dependence on imported gas supplies and reinforce national energy security. The past few years have witnessed a dramatic increase in the amount of concessions issued for prospecting and exploring shale gas. Ninety-nine concessions have already been granted, and 51 wells have been drilled since 2010. However, drillings performed so far in the west and south of Poland were not as prospective as expected. The new Geological and Mining Law, which entered into force on 1 January 2012, was supposed to adjust Polish regulations to the European regulations on hydrocarbons, but, unfortunately, it has not significantly facilitated the undertaking of shale gas exploration and production. In the past year, Dart Energy, Marathon Oil Corp and Talisman Energy left the Polish market.

The increase of domestic gas production is one of the major aims of the government's long-term planning document, Polish

Energy Policy till the year 2030. To achieve this goal, the government is planning to carry out investments and provide support to investors from European Union funds. A consortium of state-owned companies was established to cooperate in the search for shale gas. Furthermore, the Blue Gas – Polish Shale Gas programme has been introduced, with the main aims of developing technologies related to shale gas extraction in Poland and their implementation by companies operating in Poland. For further details, see the 'Update and trends' section.

The transmission area of the Polish gas market is monopolised by one undertaking – Operator Systemów Przesyłowych Gaz-System. Gaz-System has managed the Polish national grid since 2006, and in 2010 was granted the concession for operating the transit Jamal-Europe pipeline (used to supply natural gas to Poland and Germany) until 2025.

In addition to PGNiG, there are several dozen other undertakings dealing with gas sales. These are dominant local players with their own networks, and they deal with both distribution and trading.

The LNG market in Poland remains in a very early growth phase – growth is estimated at 2 per cent per annum, but given newly started investment projects, LNG is expected to gain a growing share of gas supply.

PGNiG retains its dominant position on the domestic retail market. Other players operating on the market mostly deal with the resale of gas purchased from PGNiG. Their operations account for 2 per cent of the market. Households constitute the largest group of customers (96.9 per cent of the total in 2012), but industry customers purchase the largest amount of gas (60.2 per cent of total gas sales in 2012).

Based on a concession running until 31 December 2025, PGNiG (PGNiG Operator Systemu Magazynowania Sp z o.o.) was designated as the operator of the gaseous fuels management system on 31 December 2008. This is associated with the imposition of a number of obligations on PGNiG. Their implementation is supposed to bring about non-discriminatory treatment for the users of the storage system. Storage services are subject to tariffs approved by the president of the Energy Regulatory Office.

- 2 What percentage of the country's energy needs is met directly or indirectly with natural gas and LNG? What percentage of the country's natural gas needs is met through domestic production and imported production?

The development of modern technologies has turned natural gas into a universal raw material, and its share in primary fuels in Poland has varied between 11 per cent and 13 per cent in recent years. Gas resources in Poland amount to some 145 billion cubic metres, but domestic production capacities are insufficient to fully satisfy the demand, hence the need for imports. The growth of domestic gas production and finding new sources of gas other than

Eastern Europe, however, are the main targets of the government's energy policy.

Total natural gas consumption in 2012 was 15,463 million cubic metres. The structure of natural gas deliveries to the Polish market in that year was as follows: domestic production – 4,317.27 million cubic metres; imports from Russia – 9,017.32 million cubic metres; and imports from Germany and the Czech Republic – 1,928.63 million cubic metres.

LNG is used in Poland in marginal quantities (eg, PGNiG produces about 27.7 million cubic metres annually as converted into methane-rich natural gas); however, considering investment projects scheduled for the next few years, Poland should join the ranks of LNG importers.

Government policy

- 3** What is the government's policy for the domestic natural gas sector and which bodies set it?

The objective of the national energy policy is to ensure national energy security, enhance economic competitiveness and energy efficiency, and protect the natural environment in line with the standards imposed by EU law. Drawing on these assumptions and considering Poland's reliance on natural gas imports, the primary objective of the energy policy in this respect is to ensure national energy security through the diversification of the sources and geographic origin of natural gas supply, in particular through:

- investment projects allowing increased natural gas production in the Polish territory, including unconventional gas resources;
- ensuring alternative sources of natural gas supplies for Poland;
- extending the natural gas transmission and distribution system;
- increasing natural gas storage capacity;
- Polish companies obtaining access to gas fields outside Poland;
- gas production using coal gasification methods;
- economic utilisation of methane through the production of surface wells; and
- long-term supply agreements.

Activities in this area should include, inter alia, the implementation of a tariff policy promoting investment in domestic deposits, the construction of a terminal for LNG imports (an LNG terminal in Świnoujście is currently under construction, and is predicted to commence operations in December 2014), participation in the construction of pipelines allowing natural gas supply from different origins (projects Scanled and Baltic Pipe), the protection of national interests in the strategic companies of the gas sector (inter alia, in PGNiG and Gaz-System), as well as ensuring government control over strategic infrastructure used for natural gas transmission.

The ongoing investments to diversify the system of Polish gas supply are the Polish–Czech pipeline and investment at the entry point in Lasów (increase in capacity). Unfortunately, the planned construction of interconnectors with Denmark, Lithuania and Germany will not be carried out in the near future due to the negative outcome of market screening performed by the Energy Regulatory Office (the URE).

In 2009, PGNiG concluded a contract on LNG supplies from Qatar, and the first supplies shall be provided to the Świnoujście LNG terminal by the end of 2014. Under the contract, PGNiG is obliged to purchase 1 million tons of gas annually, irrespective of actual gas demands.

Underground gas storage facilities, with an active capacity of approximately 2.05 billion cubic metres, amounting to 13.26 per cent of annual consumption by domestic customers, are designed to guarantee gas supply security. According to its concession, the storage system operator (PGNiG) provides storage services; however, currently no spare bundled units are available for firm or interruptible services, and storage capacity is mostly used for PGNiG's own needs. This situation was a cause of concern for the president of

the Office of Competition and Customer Protection (UOKiK) as, according to the law on compulsory gas stocks, secured gas supply is a condition for taking part in foreign gas trading. This is why the regulation was changed. Pursuant to the amended Act, it is possible to hold compulsory gas stocks in storage facilities situated outside Poland.

The government's current policy aimed at increasing competition on the gas market is insufficient. There are therefore calls for a new approach to developing competition and allowing new entrants in the market, as well as for the rollout of new infrastructure and non-discriminatory access to gas storage facilities.

The competent authorities with this respect are the minister of the environment, the minister of the economy and the president of the URE.

In addition, new, separate regulation on natural gas issues is planned. At present, the Energy Law regulates the energy market, including the gas market. Due to the increasing role of the gas sector, and because of its difference from the electrical energy market, a comprehensive Gas Act was drafted; however, legislative action in that field is currently suspended. The new Act shall assure the development of a competitive gas market in Poland, namely, through liberalisation of the gas sector, creation of an LNG market (wholesale and retail market) and liberalisation of gas prices. The new Act shall implement the realisation of some Polish energy policies determined in the Polish energy policy until 2030; namely, an increase of security of gas and energy supplies.

Unconventional and conventional sectors are regulated by the same legal acts in Poland (ie, at present there is no distinction, and the applicable legal provisions are identical regardless of the energy sources).

Regulation of natural gas production

- 4** What is the ownership and organisational structure for production of natural gas (other than LNG)? How does the government derive value from natural gas production?

The natural gas is owned by the State Treasury and may be produced based on the concession and mining usufruct agreement issued by the minister of the environment in line with the regulations of the Geological and Mining Law. An entity interested in the production of natural gas is obliged to obtain these licences to start production. Both a concession fee and a mining usufruct fee are charged for the production of the natural gas.

The dominant entity in natural gas production is PGNiG. Given the potential risk to Poland's energy security, no further privatisation of PGNiG is anticipated prior to the achievement of national energy policy objectives (see question 3).

In addition to PGNiG, the following companies hold concessions for the production of natural gas in Poland: Lotos Petrobaltic, FX Energy, DPV Service and ZOK. The confirmation of the existence of unconventional natural gas deposits will lead to the diversification of the gas production market in Poland. At present, there are 55 entities holding gas exploration concessions.

- 5** Describe the statutory and regulatory framework and any relevant authorisations applicable to natural gas exploration and production.

The Council of Ministers develops the national policy guidelines in the gas sector. The leading bodies of the government administration competent for issues related to the enforcement of that policy are:

- the minister of environment, who is in charge of matters related to authorisation and natural resources management (exploration and production); and
- the minister of the economy, who is in charge of the operation of national energy systems, taking account of the principles of rational management and national energy security requirements.

The minister of the environment issues concessions and concludes mining usufruct agreements for natural gas exploration, prospecting and production. The mining usufruct constitutes a right to the explored or produced mineral. The minister acts based on the Geological and Mining Law, which is the fundamental legal act that regulates the principles and conditions for the prospecting, exploration and production of natural gas from deposits. The president of the State Mining Authority, appointed by the prime minister, is competent, *inter alia*, for control and supervision over the management of mineral deposits in the process of extraction, environmental protection, including damage prevention, and mining plant construction and closure, including land reclamation and development of post-mining areas.

Obtaining a concession for prospecting for or exploration of gas deposits or production of natural gas from deposits usually requires a prior decision on the environmental aspects of the project, which implies the fulfilment of obligations resulting from the environmental impact assessment procedure. Concessions are awarded for fixed periods: exploration concessions are awarded depending on the scope of geological works, but usually for five years, while production concessions are never granted for longer than 50 years.

It is possible to apply for extensions of both exploration and production concessions provided that there are justified grounds, which may result from, for example, an extended scope of geological works or technical reasons.

The minister of environment may withdraw a concession or limit its scope without compensation where an enterprise breaches, *inter alia*, environmental protection regulations, regulations on the rational management of mineral deposits or fails to satisfy the conditions set out in the concession.

The Geological and Mining Law of 2011 introduced separate provisions for awarding concessions for hydrocarbons. As a principle, the award of a concession involving the prospecting for, exploration or production of hydrocarbons (namely natural gas) is preceded by a tender. This does not apply to situations where such rights may be established without a tender, where at least one of the following conditions has been satisfied:

- the concession authority has made public and published in the Official Journal of the European Union the list of areas in which a concession may be awarded without tendering (at present, there are no areas excluded from the tender procedure (ie, the list of non-tender areas was not published));
- the area to be prospectively covered by concession has already been tendered, but the tender did not result in the award of concession; or
- a different entity, which had already explored and documented a natural gas deposit and drawn up geological documentation in detail sufficient to obtain a concession for the production of the mineral, requests the establishment of mining usufruct rights with precedence before others; namely, the area is covered by a priority right to establish mining usufruct.

An enterprise that has obtained a concession for the production of natural gas has the obligation to set up a mine-closure fund.

A party contesting the decision of the minister of environment may apply to that body with an application to re-examine the case. Afterwards, a party may file a complaint to the Voivodship Administrative Court, and finally a cassation complaint to the Supreme Administrative Court.

Drilling and production activities are authorised by the minister of the environment, who approves geological operation programmes and geological documentation. The supervising authorities are the district mining offices and the State Mining Authority, which approves the mining operation plan. These authorities are often called the mining police.

Under the Geological and Mining Law, conventional and unconventional hydrocarbons are regulated in exactly the same way. There

are no plans to introduce a separate act or set of provisions dealing specifically with unconventional hydrocarbons such as shale gas. Moreover, the government plans to introduce a new hydrocarbons bill on taxation, which would create a special hydrocarbons tax calculated on the basis of the profitability of mineral extraction projects. The proposed law reforms are currently under discussion, and no final proposals have been published or laid before parliament.

Regulation of natural gas pipeline transportation and storage

- 6** Describe in general the ownership of natural gas pipeline transportation, and storage infrastructure.

Two undertakings handle transmission operations: Operator Systemów Tranzytowych Europol-Gaz SA and Gaz-System.

The shareholders of Operator Systemów Tranzytowych Europol Gaz SA, whose business concerns a 685km section of the transit pipeline Jamal-Europe in the Polish territory, are PGNiG (48 per cent), OAO Gazprom (48 per cent) and Gas-Trading SA (4 per cent). Given the ownership structure of PGNiG and Gazprom, it could be said that this entity is semi-state owned. Gas is transmitted in Poland by Gaz-System, which is the operator of the gas transmission system. This is a company wholly owned by the State Treasury, listed among companies with strategic significance for the Polish economy, in charge of the security of gas supplies delivered through transmission networks. According to 2007 figures, the company owned 55.3 per cent of transmission assets and managed the balance of transmission assets pursuant to an operating lease agreement, which will remain in force until 2022. As at 31 December 2012, the length of transmission networks owned by the company was 10,033km (out of a total of 18,500km of transmission networks in Poland), and it was used to transport 16.3 billion cubic metres of gas. In 2011, the building of transmission networks Szczecin-Gdańsk, Gustorzyn-Odolanów and Polkowice-Zary started, and by the end of 2014, Gaz-System plans to finish building about 1,000km of new gas transmission pipelines.

PGNiG (PGNiG Operator Systemu Magazynowania Sp z o.o.) owns 100 per cent of Poland's underground gas storage capacity, amounting to 2,050 million cubic metres. This capacity is made up of seven underground gas storage facilities.

- 7** Describe the statutory and regulatory framework and any relevant authorisations applicable to the construction, ownership, operation and interconnection of natural gas transportation pipelines, and storage.

The construction of the pipeline or storage facility shall be performed based on the building permit, followed by a number of other administrative decisions. The safety and reliable operation of the gas system, requirements for environmental protection, as well as for the construction and operation of equipment, installations and networks, are laid down in separate provisions of the Construction Law and several acts on environmental protection. The construction of transmission networks or storage facilities in general does not require obtaining any other specific permits.

The fundamental legal act that regulates issues concerning the transmission and storage of natural gas is currently the Energy Law Act, but a separate Gas Act is being drafted and will, in future, regulate this activity. In general, storage and transmission of natural gas require a concession. No concessions are required for the local storage of liquid gas in facilities with a throughput not exceeding 1MJ/s (megajoules per second) or for the storage of liquid fuels in retail trade. The URE president awards concessions for a specified duration, from 10 to 50 years, but it is possible to apply for concessions for periods of less than 10 years. Where warranted by public interest, the URE president may mandate an undertaking to continue its activities covered by a concession for up to two years after its expiry. However, if such operations mandated by the URE president generate losses, then such an energy company may demand that the

losses be covered by the State Treasury up to the amount of the costs incurred in connection with these activities. The URE president, appointed by the prime minister and supervised by the minister of economy, is moreover competent to approve and oversee tariffs for natural gas transmission and distribution, which includes analysing and reviewing the costs that energy undertakings adopt as reasonable costs in calculating their prices and rates in their tariffs.

Appeals against the URE president's decisions may be lodged to the Competition and Consumer Protection Court through the URE president. The judgments of this Court can be further appealed to the Court of Appeal, and finally brought to the Supreme Court.

The operator of the transmission system in Poland is designated by the URE president. At present, this is Gaz-System (current concessions expire in 2025 and 2030). Gaz-System has specific obligations related to the balancing of the system and the management of system limitations. To this end, the operator develops an operation and maintenance manual for the transmission network, and its requirements are taken into account in the manual of the distribution system operator, which lays down the rules and regulations for the provision and use of gaseous fuels transmission. This is associated with the fact that the transmission of natural gas takes place in transmission networks in order to deliver them to distribution networks or end-users connected to transmission networks.

8 How does a company obtain the land rights to construct a natural gas transportation or storage facility?

In 2008 a limited material right, called the transmission easement, was introduced into the Civil Code. On this basis, a property may be encumbered with the right of an enterprise to use such real estate if it intends to build or owns facilities used to supply or drain gas, or other similar equipment not being a part of the property, if they are a part of the undertaking's assets. The scope of such use must conform to the purpose of such facilities. Where the owner of the property refuses to enter into an agreement on the establishment of a transmission easement, if such easement is necessary for the proper use of the designated equipment, then the enterprise may request the establishment of such easement against appropriate remuneration by taking the matter to litigation. The transmission easement is transmitted to the buyer of such undertaking or such facilities.

Moreover, if the construction and maintenance of pipelines and equipment intended for gas transmission or other structures or facilities required for the operation of such pipelines and equipment cannot be achieved without divesting or limiting rights to a specified property and such rights cannot be acquired under an agreement, then such property may be expropriated. However, the property may be expropriated only in favour of the state treasury or a local administration body.

Plans are being made to introduce public transmission corridors to optimise investment associated with energy supplies. Such transmission corridors would be set up at the request of undertakings with compensation provided for property owners (and users or persons who also have limited property rights to such land). No buildings or structures would be allowed in such corridors, and persons representing the company whose installations are covered by a corridor would have access to such land. The draft law on transmission corridors was published on 19 July 2013 but, as yet has not been laid before parliament.

9 How is access to the natural gas transportation system and storage facilities arranged? How are tolls and tariffs established?

Access to the natural gas transmission and storage system is regulated by the Energy Law Act and the ordinance on the detailed conditions for connecting entities to gas networks and the operation of such networks.

Connection to a gas network and the provision of transmission services is performed under the third-party access rule (TPA), stipulating the principle of the equal treatment of entities requesting such connection or using such services, on the basis of an appropriate agreement and subject to the existence of technical and economic conditions allowing connection to the network, and where the entity requesting connection satisfies the conditions for connection to the network. The situation with regard to the provision of services by an energy company dealing with the storage of natural gas is identical.

Energy companies dealing with the transmission of natural gas have the obligation to enter into agreements on the provision of transmission services with the 'official seller', namely an energy undertaking holding a concession for trading in natural gas, providing comprehensive services to residential customers. Controversial issues regarding a refusal to enter into an agreement, in particular on connection to the network, provision of fuel transmission services, natural gas transmission services or storage, are settled by the URE president at the request of any of the parties concerned.

Tariffs for natural gas fixed by concessioned energy undertakings are subject to approval by the URE president and remain in force for a fixed time. The URE president refuses the approval of tariffs if they breach the principles or provisions of the Energy Law. To this end, the president analyses and reviews the justified costs of energy undertakings presented in their financial statements and material and financial schedules, taking account of the conditions required to foster competition and promote efficient business.

As a general principle, energy undertakings may differentiate their prices and fee rates set out in their tariffs for natural gas for different customer groups only on the basis of costs justified by the performance of the service.

Companies dealing with the transmission of gaseous fuels have the obligation to enable customers buying gaseous fuels to change their supplier. Moreover, energy end-users have the right to terminate agreements on the basis of which gaseous fuels are supplied to them without incurring any additional costs or compensation, other than those set out in the existing agreements.

The storage system operator (PGNiG) publishes information about the availability of storage space on its website. As of 22 January 2014, there were no spare bundled units available, and it must be said that this is not an exception but the typical situation.

10 Can customers, other natural gas suppliers or an authority require a pipeline or storage facilities owner or operator to expand its facilities to accommodate new customers? If so, who bears the costs of interconnection or expansion?

In general, there is a lack of mechanisms that would ensure effective pipeline and storage expansion. An energy company has the obligation to connect new entities to the network only where the necessary technical and economic requirements are satisfied. However, where economic reasons are the issue, then a company may charge the entity requesting connection with a special fee for such connection. All refusals to requests for connection to the network must also be notified to the URE president. Where an entity requesting connection to the network disagrees with the refusal, it may apply to the URE president to settle the dispute. One should also bear in mind that the operators of the transmission and natural gas storage systems, depending on the scope of their activities, have the obligation to ensure the long-term ability of the gas system to meet reasonable demands for the extension of the gas system and, if applicable, for the extension of connections to other gas systems, using objective and transparent criteria ensuring the equal treatment of these systems' users and taking account of environmental requirements.

- 11** Describe any statutory and regulatory requirements applicable to the processing of natural gas to extract liquids and to prepare it for pipeline transportation.

Any user of a transportation system in Poland has to ensure that natural gas delivered to the system operator for transportation complies with certain quality specifications included in the respective general terms and conditions for pipeline access stipulated in the Energy Law Act and its by-laws. The processing of gas lies outside the transportation service of the network operator. In particular, an upstream pipeline network, such as a gas pipeline or a grid of gas pipelines used for the transport of natural gas from the location of its production to the cleaning and processing plant or to the terminal, or used to transport natural gas to the final coastline loading terminal, is not a part of the transportation grid.

- 12** Describe the contractual regime for transportation and storage.

As set out in the Energy Law, an agreement on the transmission of natural gas should specify at least:

- the contractual effectiveness and the terms of amending it;
- the amount of the natural gas transmitted broken down by contractual terms;
- the locations to which the natural gas should be delivered to the grid and the locations where it should be collected from the grid;
- quality standards;
- the terms of securing reliability and continuity of the natural gas supply;
- the fee rates or the tariff group applied in the settlements and the terms of introducing changes to those rates and tariff group;
- the billing method;
- the technical parameters of the natural gas and the amount of discount for the failure to maintain such parameters or meet customer service quality standards;
- the responsibility of the parties for breach of the terms of the agreement; and
- the term of the agreement and the terms of its termination.

An agreement on the provision of natural gas storage services should include the following provisions:

- the contractual effectiveness and the terms of amending it;
- the amount of the natural gas;
- the location, the period and the method of its storage;
- the fee rate or the tariff group used in the settlements and the terms of introducing changes to that fee rate or tariff group;
- the billing method;
- the responsibility of the parties for a breach of the terms of the agreement; and
- the term of the agreement and the terms of its termination.

Natural gas may be also supplied on the basis of comprehensive agreements, which include the provisions of a sales agreement and of an agreement on the transmission or distribution of natural gas and also, of an agreement on the provision of storage services.

Regulation of natural gas distribution

- 13** Describe in general the ownership of natural gas distribution networks.

Following the spinout of distribution and trading activities by PGNiG, it currently has six distribution companies, in which PGNiG is the only shareholder. These companies are now involved only in distribution activities as the operators of the distribution system. PGNiG handles both wholesale and retail sales.

In addition to PGNiG, which is mostly state-owned (the state holds an 72.4 per cent stake), there are several dozen other privately owned entities selling gas in the market. For the most part, their activities consist of the resale of natural gas purchased from PGNiG to end-users through their own local distribution networks. Given

the scale of their activities, they are not subject to transformations associated with the obligation to separate distribution and trading activities. Some of the biggest are ENESTA, G.EN. Gaz Energia, KRI, CP Energia and EWE Energia.

- 14** Describe the statutory and regulatory structure and authorisations required to operate a distribution network. To what extent are gas distribution utilities subject to public service obligations?

The Energy Law regulates matters associated with the distribution of natural gas. Under this Law, the conduct of business activities consisting of the distribution of natural gas, with the exclusion of the distribution of natural gas in networks with capacities below 1MJ/s, requires a concession. The principles applicable to the award of such a concession by the URE president are similar to those described in question 7. Likewise, following an application by the owner of a distribution network, the URE president designates, for a period not exceeding the duration of the concession, the operator of the distribution system, and the area in which business operations shall be conducted. The operator of the distribution system has obligations associated with the balancing of the system and the management of system limitations. To this end, the distributor will develop an operating and maintenance manual for the distribution network.

The requirements concerning the safety of the construction and operation of distribution networks have been set out in separate provisions of the Construction Law. However, the construction of such networks does not require any special permits other than those stipulated in these regulations.

The Energy Law also authorises the URE president to impose the obligation on an energy undertaking to continue the business specified in the concession, even after its expiry, for a period not exceeding two years, if necessary in view of the public interest. However, if such a business makes losses, then the State Treasury must cover these losses, although such payment is limited to the justified costs of the activities specified in the concession. These costs are approved by the URE president. See question 7 for the appeal procedure.

- 15** How is access to the natural gas distribution grid organised?

Describe any regulation of the prices for distribution services. In which circumstances can a rate or term of service be changed?

Access to the natural gas distribution system is regulated by the Energy Law and the ordinance on the detailed conditions for the connection of entities to gas networks and the operation of these networks, while observing the TPA principle mentioned in question 9 (these conditions are identical to those presented under question 9).

In addition, the principles for setting tariffs for natural gas by undertakings dealing with their distribution are identical to those set out for undertakings dealing with their transmission (see question 9). Tariffs fixed by distribution undertakings are calculated in a manner ensuring, inter alia, the coverage of the justified costs of their business activities in the distribution of natural gas, plus a fair return on capital used in these activities, the coverage of justified costs incurred by the operator of the distribution system in connection with the discharge of its duties, and the protection of customer interests against unwarranted increases in prices and fee rates.

Unless an energy undertaking has been exempted from that obligation, the URE president approves its tariff for a fixed time or refuses approval. Tariffs change in the event of:

- changes in the conditions for the application of prices and fees set out in the tariff;
- changes in the conditions in which an energy undertaking conducts its business that justify the modification of prices and fees set out in the tariff;
- the introduction of a corrective coefficient by the URE president designed to reflect a planned improvement in the operating efficiency of the energy undertaking; or

- a change in the conditions in which that undertaking conducts a particular type of its business.

16 May the regulator require a distributor to expand its system to accommodate new customers? May the regulator require the distributor to limit service to existing customers so that new customers can be served?

An undertaking dealing in the distribution of natural gas cannot be required to extend its existing facilities to connect new customers to the network or to impose restrictions with regard to service provided to existing customers to increase the customer base (see question 10).

17 Describe the contractual regime in relation to natural gas distribution.

See question 12; the contractual regime is the same as that for transmission.

Regulation of natural gas sales and trading

18 What is the ownership and organisational structure for the supply and trading of natural gas?

PGNiG, which sells imported natural gas and gas produced from domestic deposits, is the dominant entity in the Polish gas market. In 2012, residential customers were the largest group of PGNiG clients (96.9 per cent). Industrial customers accounted for the bulk of natural gas sales (60.2 per cent), with nitrogen-processing works, refineries and petrochemical plants being the biggest clients. PGNiG also supplies gas to the operators of the national grid and distribution system, the gas being used to keep the system running.

In addition, there are some 30 independent entities dealing with gas distribution and sales in the Polish market, including ENESTA, G.EN. Gaz Energia, KRI, CP Energia, E.ON edis energia, PL Energia and EWE Energia.

19 To what extent are natural gas supply and trading activities subject to government oversight?

Government oversight of the gas supply and trading in natural gas can be seen in the obligation to obtain concessions for the conduct of business activities involving trading in natural gas, with the exception of trading in natural gas where the volume of such trade does not exceed €100,000 annually, trading in liquefied natural gas where the value of such trade remains under €10,000 and trading in natural gas on commodity exchanges by brokerage houses conducting brokerage activities in commodities pursuant to the law on commodity exchanges.

Moreover, the influence of the state on this form of business activity is reflected in the approval and review of tariffs for natural gas for compliance with the principles set out in the Energy Law, which includes the analysis and review of the costs adopted by energy undertakings as justified costs in their price and fee rate calculations. This has a direct impact on the prices of natural gas sold.

No further restrictions or controls are contemplated with regard to gas supply and trading activities.

20 How are physical and financial trades of natural gas typically completed?

Gas trading in Poland is based on bilateral contracts and transactions concluded on the Polish Power Exchange. According to the Energy Law, bilateral contracts should specify as a minimum:

- the location to which the natural gas should be delivered to the customer and the quantity of the natural gas (broken down into contractual terms);

- contractual effectiveness and the terms of introducing amendments to the agreement;
- the price or the tariff group applied in the settlements;
- the terms of introducing changes to that price or tariff group;
- the billing method;
- the applicable discount for the failure to meet the qualitative standards of the customer service;
- the responsibility of the parties for breach of the terms of the agreement; and
- the terms of the agreement and the terms of its termination.

These terms and conditions should be included in both the direct agreement on the sale of the natural gas by the entity dealing with the production and in agreements on the resale of it by trading entities.

As a result of having completed work on amending the Regulation on detailed conditions relating to the operation of the gas system, and following the approval of the new Transmission Network Code, which introduced the possibility for natural gas trading at a virtual point, on 20 December 2012, natural gas trading was launched on the Polish Power Exchange. Market participants can trade in monthly, quarterly and annual contracts on every session on the Commodity Forward Instruments Market. Trading takes place in deliveries of gas in the same amount during all hours of the delivery period. At the end of December 2012, the natural gas spot market – the Day-Ahead Market – was also launched.

In the current legal system, exchange transactions on the gas market can only be concluded and cleared with the mediation of brokerage houses and commodity brokerage houses that are members of the Polish Power Exchange and of the Exchange Clearing House. The first brokerage houses to sign agreements necessary to operate on the gas market were Dom Maklerski BOŚ SA, Noble Securities SA and TRIGON Dom Maklerski SA.

According to the data contained in the Report on the results of monitoring the security of gaseous fuel supply prepared by the Ministry of the Economy, natural gas trading on the Polish Power Exchange, with gas delivery on the day following the trading day, reached the level of 179,071MWh in the first half of 2013. A total of 370 transactions (based on delivery date) were concluded on the Day-Ahead Market. Furthermore, natural gas trading on the Commodity Forward Instruments Market amounted to 285,577MWh over the same period, and 46 transactions on monthly contracts covered the total turnover in the first half of 2013. The average volume-weighted transaction price for this contract for the first half of 2013 amounted to 116.75PLN/MWh.

21 Must wholesale and retail buyers of natural gas purchase a bundled product from a single provider? If not, describe the range of services and products that customers can procure from competing providers.

In line with the drive to liberalise the gas market in Poland, all customers, including households, have the status of authorised customers; that is, they have the right to purchase gas from a supplier of their choice. This relates to the enforcement of the TPA principle, which requires third-party access to transmission and distribution networks and, consequently, the possibility of entering into separate agreements on the provision of transmission or distribution services or gas sales agreements.

Regulation of LNG

22 What is the ownership and organisational structure for LNG, including liquefaction and export facilities and receiving and regasification facilities?

The LNG market in Poland is in a very early growth phase. The LNG sales amount to approximately 22,000 tons per year. The

construction and operation of an LNG terminal in Świnoujście by Polskie LNG SA is currently the most important LNG project in Poland, and is treated as a strategic project for national energy security. This company, originally formed by PGNiG, is currently fully owned by Gaz-System (in other words, it is fully state-owned).

It is estimated that the construction of the terminal should be completed by December 2014. Polskie LNG SA estimates that the LNG terminal will enable the re-gasification of 5 billion m³ of natural gas annually. In the next stages, depending on the increase of demand for gas, it will be possible to increase the dispatch capacity up to 7.5 billion m³ without the need to increase the area on which the terminal will be constructed. In the LNG terminal in Świnoujście, the construction of two standard-sized containers (such as those used in other terminals around the world) with a capacity of 160,000 m³ is planned.

23 Describe the regulatory framework and any relevant authorisations required to build and operate LNG facilities.

The conduct of business activities involving the storage of LNG in storage facilities, liquefaction of natural gas and regasification of LNG in LNG installations is regulated pursuant to the Energy Law. The transmission or distribution of LNG requires a concession with the exception of LNG distribution in networks with capacities under 1MJ/s, LNG trading where the annual value of such trade is below €100,000 and trading in LNG on commodity exchanges by brokerage houses conducting their activities pursuant to the law on commodity exchanges. The principles for the award of these concessions by the URE president are similar to those described in questions 7 and 14. Likewise, following an application by the owner of a natural gas liquefaction installation, the URE president designates the operator of the natural gas liquefaction system.

24 Describe any regulation of the prices and terms of service in the LNG sector.

The charges for LNG supplied to customers are calculated on the basis of prices and rates provided in the tariff or prices and fees prevailing on the competitive market (see questions 9 and 15). LNG tariffs set by energy undertakings should be calculated to ensure, in particular, the coverage of the justified costs of the business activities of such undertakings associated with the liquefaction or regasification of natural gas, plus a fair return on the capital involved in these activities.

Mergers and competition

25 Which government body may prevent or punish anti-competitive or manipulative practices in the natural gas sector?

The president of UOKiK, operating pursuant to the law on the protection of competition and consumers, is the authority in charge of protecting competition in Poland. Where anti-competitive practices could affect other European Union member states, the European Commission has the right to act in parallel with the president of UOKiK. Some competition promotion activities are entrusted to the URE president. In practice, there is some controversy regarding the competencies of these authorities, since the president of UOKiK is also deemed to be the relevant authority in matters that are, in the Energy Law, attributed to the URE president. There are Supreme Court judgments that provide answers to these issues.

26 What substantive standards does that government body apply to determine whether conduct is anti-competitive or manipulative?

There are various specific regulations that define standards for energy companies. The provisions of the law on the protection of competition and consumers are similar to the provisions of the Treaty on the

Functioning of the European Union, mainly articles 101 and 102 (formerly articles 81 and 82 of the EU Treaty). There are some additional regulations protecting consumers from the abusive activities of energy companies. The law prohibits, inter alia, agreements that aim at or result in the elimination, restriction or any other violation of competition in relevant markets, in particular, consisting of:

- price fixing or fixing of other conditions for the purchase or sale of products;
- division of sales or purchase markets;
- restriction or control of production or sales, technical progress or investment;
- application of onerous or different terms and conditions in similar agreements with third parties, thus differentiating the competitive conditions for such entities; or
- restriction of access to markets or elimination of enterprises that do not participate in such arrangements, etc.

The abuse of individual or collective dominant positions, for example, by imposing unfair prices or onerous terms and conditions, is also prohibited.

27 What authority does the government body have to preclude or remedy anti-competitive or manipulative practices?

Where the principles of competition have been violated, the president of UOKiK is authorised to issue a decision declaring that a practice restricts competition, ordering that it be discontinued and consequently impose a fine on the entity committing such a violation and on its management. Such sanctions are applied in the course of proceedings conducted by the president of UOKiK. The decisions of the president of UOKiK may be appealed to the Competition and Consumer Protection Court. As described in question 25, some competencies are held by the URE president, but these are mainly related to the issues stipulated by the Energy Law, such as refusal of a grid connection.

28 Does any government body have authority to approve or disapprove mergers or other changes in control over businesses in the sector or acquisition of production, transportation or distribution assets?

Mergers and other changes in control shall in general be notified to the president of UOKiK, where a combined global turnover of the entrepreneurs involved in the concentration exceeded, in the financial year preceding the year of notification, the equivalent of €1 billion or the combined turnover in Poland of the entrepreneurs involved in the concentration exceeded, in the financial year preceding the year of notification, the equivalent of €50 million. If the above thresholds are not met, such mergers or other changes in control do not require notification. Mergers and other changes in control are subject to a notification to the European Commission if thresholds stipulated in the EC Merger Regulation are met. In such case, notification to the president of UOKiK is not necessary.

29 In the purchase of a regulated gas utility, are there any restrictions on the inclusion of the purchase cost in the price of services?

Energy undertakings calculate their tariffs so as to cover the justified costs of their business activities. These costs should be understood as costs that are necessary to perform obligations arising in connection with the business conducted by such energy undertakings related to production, processing, storage, transmission or distribution, trading in fuels or energy and used in the calculation of prices and fee rates fixed in the tariffs in an economically justified manner, while using their best efforts to protect consumer interests. However, these are not business expenses within the definition of the tax regulations.

Update and trends

In March 2014, the Council of Ministers accepted the new draft of the amendment to the Geological and Mining Law. According to the government, the new provisions shall accelerate shale gas prospecting and exploration activities and prepare the country for production.

The government's proposals provide several facilitations for potential investors. First, there shall be only one joint concession required for prospecting, exploration and production of hydrocarbons. This shall constitute a huge change compared with the current Law, which requires three separate concessions. The concessions already granted shall remain in force; moreover, the possibility of conversion of concessions already granted to the joint version shall be also provided. New provisions will also allow the commencement of the exploitation of the resources after documentation of only part of the deposit. Thanks to such provision, production can begin sooner, while remaining prospecting and exploration activities are still being conducted. Generally, the new concession shall be granted following a public tender, but under certain circumstances, granting of the concession following a request will also be possible. No concession shall be required for exploration works conducted without any geological operations. In addition, the documentation proceedings shall be simplified.

Another act is also being debated: a new Tax Law on exploitation of hydrocarbons. Under such Law, the tax will be imposed in parallel to other regular taxes and charges, including exploitation charges and mining usufruct fees. However, new provisions provide a tax exemption for production of shale gases until 2020.

The above-mentioned amendments shall be accepted by the parliament in 2014.

The possible introduction of a Gas Law is also being discussed, but departmental work on this has already been underway for two years and was recently suspended. The intention of the Ministry of the Economy, as author of the act, is that regulation of the gas sector is to be excluded from the scope of the Energy Law (which currently regulates the area) and regulated in a separate and dedicated act – namely, a Gas Law. Supporters of gas sector regulation have pointed out that the allocation of this regulation, together with the rules governing other industries, adversely affects development of the gas sector and complicates the business activities of gas companies. The need for separate regulation was highlighted because of the specificity of gas as an energy carrier, and the fact that technical requirements associated with organising the transportation of natural gas are different from those in the case of electricity transmission.

The argument that prevailed concerns a different degree of market development – the gas sector requires market-oriented development regulations and implementation of competitive mechanisms to a much greater degree than does the electric energy sector.

The Gas Law is to be an act that comprehensively regulates activity within the sector. However, this regulation will apply only to natural gas to be sold through the gas system (ie, natural gas which is, or may be, injected into the system). The provisions of the act shall not apply to the sale of natural gas, which is supplied outside the gas system. Moreover, this regulation aims to ensure the full compliance of Polish law with EU regulations on the functioning of the gas market, including the security of gas supplies, the Third Energy Packet and Regulation (EU) No. 994/2010 concerning measures to safeguard security of gas supply and repealing Council Directive 2004/67/EC.

The Gas Act shall cover:

- the principles of undertaking and conducting activity within the gas sector;
- the designation and functioning of operators;
- the rules for fees and tariffs determination;
- grid connection rules;
- the resolution of disputes between operators and grid users;
- consumer protection, in particular protection for vulnerable consumers;
- the security of gas supplies to Poland;
- energy policy in the gas sector; and
- the definition of the competencies of the URE president within the natural gas sector.

Finally, Poland has launched the Blue Gas – Polish Shale Gas R&D programme, which is a joint undertaking of the National Centre for Research and Development and the Industrial Development Agency. The goals of the programme are to support integrated large R&D projects, to test results of pilot projects and to implement and commercialise innovative technologies in the area of shale gas extraction by companies operating in Poland. The programme will also encourage entrepreneurs to invest in R&D activities, and is addressed to research-industrial consortia. Supported projects must seek to elaborate innovative technology related to shale gas extraction, which will be validated in real conditions as pilot schemes. The programme shall be in place until 2020.

It is therefore possible to apply for a tariff rise in connection with equipment purchases or higher business expenses. However, this principle is subject to certain limitations due to the ban on cross-subsidising, namely covering the costs of one type of business activity or the costs associated with one customer group with revenues generated from another business activity or from a different customer group.

30 Are there any restrictions on the acquisition of shares in gas utilities? Do any corporate governance regulations or rules regarding the transfer of assets apply to gas utilities?

In principle, Polish law does not restrict the purchase of stocks or shares in energy undertakings. These issues are regulated by the provisions of the Code of Commercial Companies. One exception is that it is impossible to acquire shares in the transmission system operator, as by law it is wholly owned by the State Treasury. One should also note the existence of certain indirect limitations derived from the rights of the State Treasury associated with the exercise of ownership rights. In particular, pursuant to the law on the special rights of the State Treasury and the exercise of such rights in companies with special significance for public law and order or public security, the minister competent for the State Treasury may veto resolutions adopted by the management board or other legal transactions carried out by the board that involve the disposal of core company business assets. Such a veto may only apply to legal transactions by a company with special significance for public law and order or public

security, where there are grounds to suspect that such a transaction could violate public law and order or public security. PGNiG and Gaz-System are listed as such companies. The veto may also apply to the resolutions of general shareholders' meetings or shareholders' meetings dealing with the sale or lease of the enterprise or a part thereof, or the establishment of encumbrances on such assets.

International

31 Are there any special requirements or limitations on foreign companies acquiring interests in any part of the natural gas sector?

Polish legislation does not provide for any special requirements or restrictions with regard to the acquisition of rights in the Polish gas sector by foreign entities apart from some limitations regarding the acquisition of land by foreigners. However, there are some general restrictions as described in question 30.

32 To what extent is regulatory policy affected by treaties or other multinational agreements?

As a member state of the European Union, Poland's regulatory policy is influenced by the solutions adopted at the Community level. Moreover, in 2008, Poland joined the International Energy Agency, and therefore ratified the Agreement on an International Energy Program drawn up in Paris on 18 November 1974, as amended on 30 November 2007.

Poland ratified the Energy Charter Treaty and the Energy Charter Protocol on energy efficiency and related environmental aspects signed in Lisbon on 17 December 1994. It is on the basis of these documents that the countries that have adopted the Charter have the obligation to, inter alia, facilitate the transit of energy raw materials through their territories, establish stable, equal, beneficial and transparent conditions for investment in the energy sector, and strive to eliminate any obstacles to the achievement of these objectives.

33 What rules apply to cross-border sales or deliveries of natural gas?

As a country relying on foreign gas supplies, Poland tries to ensure the security of such supplies, which depends on the fastest possible mobilisation of its reserves in crisis situations. The award of concessions for the conduct of business in foreign gas trading is, therefore, conditional upon the need to take account of the diversification of gas supply sources and energy security. More specifically, this means that the URE president will prefer to award a concession for foreign gas trading to an applicant that has its own storage facilities or has concluded a preliminary agreement on the provision of storage services for compulsory natural gas reserves in quantities set forth in applicable regulations.

Transactions between affiliates

34 What restrictions exist on transactions between a natural gas utility and its affiliates?

There are no special restrictions on trading between public gas utilities and their affiliates, other than the general principles applicable to commercial companies.

It should be noted, however, that there are separate formal, legal and organisational requirements designed to ensure the autonomy of system operators of transmission or distribution services that remain within the structure of a vertically integrated undertaking.

35 Who enforces the affiliate restrictions and what are the sanctions for non-compliance?

There are no specific restrictions or sanctions regarding transactions between affiliates. However, such transactions should be performed at arm's length for the purposes of tariff calculations and for tax reasons.



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