

The Minister of the Economy

The Policy for Natural Gas Industry

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Preliminary premises

One of the most important tasks delegated to the Minister of the Economy is to ensure energy security for the country¹, through the diversification of sources and directions of natural gas supplies. In order to successfully formulate the energy security policy for Poland and supervise its implementation there is a necessity to develop a framework for the administrative activities of the government and the companies operating in the gas sector.

On 3 January 2006, the Council of Ministers adopted a resolution² obligating the minister in charge of the economy, to undertake actions to prepare for investment and trade decisions aimed at diversifying natural gas supplies, with particular attention focused on the construction of the terminal to receive LNG (Liquefied Natural Gas). The resolution set another obligation on the Minister of Economy; namely to undertake activities aimed at implementing investments enhancing extraction of natural gas within the territory of the Republic of Poland and to increase the natural gas storage capacity.

On 31 May 2006, the Council of Ministers adopted a resolution³, where it prioritized the connecting of the Polish transmission system with gas deposits in Scandinavia, as well as the construction of the liquefied natural gas terminal on the Polish sea coast, as supplies from this direction are deemed consistent with the premises of diversification of natural gas supplies to Poland as well as with related Government policy.

The need to elaborate the *Policy for the natural gas industry* (hereinafter referred to as: *the Policy for Gas Industry or the Policy*) arose from three principal reasons:

- the necessity to summarize the implementation of the *Programme of restructuring and privatisation of Polskie Górnictwo Naftowe i Gazownictwo S.A.* adopted by the Council of Ministers on 5 October 2004, and of the *Programme for introducing a competitive market for natural gas and on the timetable for its implementation* adopted by the Council of Ministers on 27 April 2004,
- the necessity to take into account the diversification of the natural gas supply sources expressed in the resolutions of the Council of 3 January and 31 May 2006,
- the necessity to take account of the changes occurring in the natural gas sector and in its external environment, in order to assure energy security by energy companies and public administrative bodies, reflecting:
 - the policy of the European Union aimed at liberalising the natural gas sector, and
 - the policy applied by the principal natural gas suppliers to the European Union Member States.

The Policy for the natural gas industry constitutes the guidelines for the public administration and strategic companies in the gas sector towards the actions aimed at improved energy security for Poland.

Polskie Górnictwo Naftowe i Gazownictwo S.A. (PGNiG S.A.) and Gaz-System S.A. (Gaz-System) are the strategic companies in terms of the energy security policy of the Republic of Poland.⁴

¹ Pursuant to Article 9 (2) (1) of the Act on the divisions of government administration (Act of 4 September 1997 (J. of Laws No 159 item. 1548)], the minister in charge of the economy has particular responsibility for the issues concerning the operation of national energy systems, pertaining also to the principles of rational economy and the needs of the energy security of Poland.

² the resolution of the Council of Ministers of 3 January 2006 concerning the actions aimed at diversification of energy carriers.

³ Resolution No. 77/2006 of the Council of Ministers of 31 May 2006 on the actions designed to improve the energy security of the Republic of Poland.

⁴ In addition, under the resolution of the Council of Ministers of 13 December 2005 (J. of Laws, no. 260 item 2174) on the list of companies essential for public order or public security; both these companies were considered to be of such importance.

Objective

The energy security in the natural gas sector shall mean maintaining uninterrupted natural gas supplies to customers at reasonable prices (where possible).

The energy security so construed depends on a number of factors, and in particular on:

- the degree of diversification of the natural gas supply sources to Poland,
- available storage capacity for natural gas in Poland over time,
- the technical state of repair and functionality of natural gas distribution and transmission systems,
- the rate of increase in domestic extraction of natural gas,
- owner's control exercised by the state over the key natural gas transmission infrastructure,
- quality of legal regulations concerning investments in the area of infrastructure (including line infrastructure projects),
- quality of legal regulations concerning the functioning of the whole gas sector, particularly in the areas of trade, storage, transmission and distribution of natural gas,
- quality of legal regulations concerning energy security, including crisis prevention and management mechanisms and procedures, and
- the policy of European states and that of the European Commission concerning energy security.

The main objective of the *Policy for the natural gas industry* is to identify, the actions aiming at improving the energy security of the Republic of Poland and the development of its natural gas market. Having noted the above factors the *Policy* defines the following supporting objectives:

1. Providing long-term contracts aimed at meeting domestic demand for natural gas.
2. Constructing and extending the infrastructure so enabling the diversification of sources and supply routes of natural gas to the Republic of Poland along with securing uninterrupted supplies to consumers.
3. Creating a mechanism for responding to crisis situations.
4. Securing the interests of the state in strategic companies of the natural gas sector.

The tools to create the policy in terms of the energy security of the state are legislative actions regulating the functioning of the natural gas sector, including crisis type situations, as well as the oversight exercised by the state covering the strategic energy companies in its capacity as owner.

The *Policy for the natural gas industry* consists of three parts:

1. Summing up the *Programme of the restructuring and privatisation of Polskie Górnictwo Naftowe i Gazownictwo S.A.* of 5 October 2004.
2. Summing up the *Programme for introducing a competitive market for natural gas and on the timetable for its implementation* adopted by the Council of Ministers on 27 April 2004.
3. Programme of action aimed at improving energy security.

1. Summing up the *Programme for the restructuring and privatisation of Polskie Górnictwo Naftowe i Gazownictwo S.A.* of 5 October 2004. (Programme)

I. As regards the restructuring exercise, the *Programme, inter alia*, presumed the following.⁵ (the order below follows that of the *Programme*):

- **conducting of negotiations by the Management Board of the PGNiG S.A. with creditors, on the issue of an operational leasing agreement concerning transmission system assets, to be entered into by PGNiG S.A. the Transmission System Operator and TSO (Gaz-System S.A.),**
- **the sale by PGNiG S.A. of 100% shares of the TSO to the State Treasury by 31 December 2004.**
- **formal participation of PGNiG S.A. in the agreement with the TSO for operational leasing of the transmission system assets.**

In March 2005 PGNiG S.A. signed the relevant annexes to bank loan agreements and obtained a consent document from the holders of Euro obligations to redeem the obligations issued in 2001. The process of redeeming Euro obligations was finally completed on 6 April 2005.

On 28 April 2005, the PGNiG S.A. General Meeting of Shareholders approved a free of charge transfer of 100% shares in OGP Gaz-System Sp. z o.o. to the State Treasury. On 13 May 2005 the shares of OGP Gaz-System Sp. z o.o. were transferred to the State Treasury.

On 18 September 2006, an Extraordinary Meeting of Shareholders of the OGP Gaz-System Sp. z o.o. adopted a resolution transforming the company into a joint-stock company.

At present, Gaz-System S.A. still leases equipment from PGNiG S.A.; namely, the transmission system assets which serve primarily the transmission activities.

In the period 2005-2006, OGP Gaz-System S.A. acquired transmission assets worth a total of PLN 1.18 billion through a contribution from the State Treasury, in the form of a non-pecuniary dividend due to the State Treasury from the profits posted by PGNiG S.A.

II. The *Programme* further specified for the future⁶:

- **separation ('unbundling') within the PGNiG S.A. Capital Group, of the trade and distribution activities and equipment and the provision to distribution companies of all necessary material, financial and institutional assets, necessary for them to perform the functions of a TSO, on 1 July 2007, at the latest, in compliance with the directive 2003/55/EC of the European Parliament and the Council.**
- **separation of exploration (prospecting) and extraction activities from the structures of PGNiG S.A. by the end of 2006, after prior analysis of the economic and financial impacts of such an exercise.**

At present, in PGNiG S.A. a process of unbundling the trade activities from distribution activities is under way. According to the information provided by the Company's Executive Board, this process should have been completed by 30 June 2007.

The prospecting and extracting activities were not unbundled from the core activities of PGNiG S.A., in accordance with the position adopted by the Council of Ministers on this issue.

⁵ *Programme of the restructuring and privatisation of Polskie Górnictwo Naftowe i Gazownictwo S.A.*, a document adopted by the Council of Ministers on 5 October 2004 r., p. 12 subparagraphs 1,2,3.

⁶ *Programme*, p. 13-14, subparagraphs 8,9.

III. The *Programme* indicated the necessity⁷:

- **to formulate the corporate documents of PGNiG S.A., and the transmission system operator as well as of the transmission system assets, in a way that enables the minister in charge of the economy to implement the energy policy of the state and, in particular, to provide for the energy security of the state.**

The objectives of the *Programme* concerning the statutory documents of PGNiG S.A. have mostly been met. In October 2006, the Annual Meeting of Shareholders of the Company passed the amendments to the Company Statute (Articles of Incorporation), involving more precise determination of the decision-making procedures in the Company when deciding on investment projects relevant to energy security.

The Policy for the natural gas industry recommends further pursuance of the objective indicated in the *Programme*, concerning corporate documents in a way that enables the minister in charge of the economy to implement the energy policy and recommends that analogous amendments be made to the statute of the company Gaz System S.A.

IV. Additionally, the *Programme* deemed the following to be key issues⁸:

- **ensuring that the operator has the whole transmission system at his disposal as well as providing third party access to the transmission system.**
- **The necessity to extend the transmission system so enabling its increased throughput capacity as a necessary prerequisite for actual liberalisation of the natural gas market.**

The outcome of the implementation of planned items, as well as the level of financial commitments made towards investment projects in the transmission system extension, should be deemed negative. Repeated interruptions in the supply of imported gas from the east⁹ has highlighted the insufficient throughput capacity of the transmission system to maintain uninterrupted supplies to customers.

The transmission network is very poorly developed along its north-south axis which results in a lack of throughput capacity, especially in the northern and western parts of Poland.

For this area of Poland, natural gas is received in Lasów (900 million m³ a year) and from the Yamal pipeline – in Lwówek (ca. 1.2 billion m³ a year). These quantities are too small to meet the local demand for natural gas and to assure a gradual development of the market. As a result, in the case of an increased demand for gas in northern and southern Poland, the uninterrupted supplies cannot be maintained.

The distribution network also operates inefficiently because of the failure to complete investments in ring pipelines, particularly in north-eastern Poland.

The *Programme* did not consider any other system supplies from sources other than those from the east, ignoring the obvious threat of interruptions and disturbances in supplies. For this reason, the *Programme* did not envisage the extension of the transmission network along the north-south axis.

V. In the area of the privatisation process, the *Programme* presumed¹⁰:

- **carrying out the privatisation of PGNiG S.A. through an additional issue of shares in order to increase the share capital of the Company,**
- **after a maximum of six months after the first quotation of the shares, the possibility for the State Treasury to offer and transfer a minority block of shares to eligible employees.**

⁷ *Programme*, p. 13, subparagraph 7.

⁸ *Programme*, p. 11.

⁹ In recent years there have been repeated disruptions in natural gas supplies. In February 2004, the natural gas supplies were discontinued for two days at Kondratki. At the beginning of 2005 and 2006, the pressure at the Drozdowicze receiving station dropped suddenly, resulting in the limiting of supplies of natural gas to end-users. Similar disruptions occurred also in October 2006 when the drop in gas pressure was recorded at the Drozdowicze receiving stations.

¹⁰ *Programme*, p. 14-15, subparagraph 1.

The Programme allowed¹¹ for the provision of a minority block of shares to an investor from within the sector.

On 23 September 2005, the share capital of PGNiG S.A. was increased through issuing new shares on the stock exchange.¹² As a result, 15.25% of the shares of the Company were held by the minority shareholders. The State Treasury still holds a majority stake (84.75%). Since 20 October 2005, the shares of the Company have been quoted on the Warsaw Stock Exchange.

The offer to sell the minority stake in PGNiG S.A. has not been made by the State Treasury.

Before going public with the shares of PGNiG S.A.; the State Treasury has not protected itself against losing indirect control over the shares of SGT EuRoPol Gaz S.A. company¹³, in which PGNiG S.A. still holds a 48% stake. The remaining shares are held by OAO Gazprom (48%) and Gas-Trading S.A. (4%). According to the statute of the EuRoPol Gaz S.A. the right of refusal concerning the shares of the Company rests with its founders (OAO Gazprom and Gas-Trading S.A.).

Additionally, prior to PGNiG S.A. going public, the right to the strategic assets of the transmission system has not been transferred to the Gaz-System S.A. company. Making them available to the Gaz-System S.A. was effected through a leasing agreement valid for 17 years, so generating a new high cost gas import-transmission-trade value chain. Although the value of PGNiG S.A. shares have greatly increased as a result of this, it meant that at the same time, the Gaz-System S.A., a company 100%-owned by the State Treasury, suffered a significant financial charge.

As a consequence, all new investments in the extension of the transmission system being carried out by Gaz-System S.A., require the agreement with PGNiG S.A. and become the subject of a leasing agreement based on the same principles as the remaining transmission assets. Any extension of the transmission system requires agreement on the investment plans developed between PGNiG S.A. and Gaz-System S.A. This solution is very complex from the legal and formal viewpoints (e.g. construction permits, undetermined legal status of real estates) and breaches the recommendations of the directive 2003/55/EC, concerning the full independence of the operator in elaborating plans for system development.

It should also be noted, that the decision on privatisation of PGNiG S.A. has not been made in order to improve the financial position of the Company, and investment plans have not been developed to the degree that would allow speedy utilisation of funds obtained from the sale of the public stock.

The initiation of the privatisation process of PGNiG S.A., before the State has secured its exclusive influence over the essential decisions that remains under the control of PGNiG S.A., could impact on the energy security of Poland and should therefore be assessed negatively.

From the viewpoint of the energy security of Poland, there have been worthwhile changes in the market policy adopted by the most important companies in the natural gas sector operating in the region, and particularly by the largest supplier – OAO Gazprom. The government-issued *Energy strategy of the Russian Federation to the year 2020*, of 28 August 2003, contains the following statement:

„Strategic objectives of the gas industry development are: (...) securing the political interests of Russia in Europe in neighbouring states as well as in the Asian and Pacific regions”¹⁴.

OAO Gazprom – a monopolist in the export and transmission of natural gas in the Russian Federation – is a natural executor of this strategy¹⁵. In this publicised strategy, the following elements should mainly be

¹¹ *Programme*, p. 15, subparagraph 3.

¹² Opening quotation of the PGNiG S.A. shares on 23 September 2006 was PLN 3,81 per share. In the last quotation of 2006 (29 December) the share price was PLN 3.6.

¹³ The EuRoPol Gaz S.A. Company. pursues business in the trade of natural gas (import and export) as well as in the construction and operation of gas pipelines (paragraph 2 (7) of the Company's Statute). The company holds a licence from the Energy Regulatory Office for domestic and foreign trade, as well as for transmission and distribution of natural gas. The company owns the Polish section of the Yamal-Europe gas pipeline.

¹⁴ Electronic version of the document can be found on the website of the Ministry of Industry and Energy of the Russian Federation, <http://www.minprom.gov.ru/docs/strateg/1>; quotation comes from the official document, p.. 71, Chapter. VI, subparagraph 3.

¹⁵ On 5 July 2006, the lower chamber of the Federal Assembly, the State Duma adopted, upon a submission of deputies of „The One Russia”, the *Act on the export of natural gas*, giving Gazprom the exclusive right to transmit gas in the territory of the Russian

distinguished: attempts by OAO Gazprom to gain access to retail markets through controlling transmission and distribution networks in the gas consumer-countries, as well as seeking new transmission routes bypassing transit countries, including Poland.

The *Policy for the natural gas industry* constitutes an attempt to adapt the strategic interests of the Republic of Poland, to the policy adopted towards the sector by both the country being the single largest supplier of natural gas to Poland, as well as by the European Commission.

Federation and to export it. On 18 July 2006, the *Act* was signed by the President of the Russian Federation. (*Act on gas export*, <http://duma.consultant.ru/doc.asp?ID=34809>).

2. Summing up the *Programme for introducing a competitive market for natural gas and on the timetable for its implementation* adopted by the Council of Ministers on 27 April 2004 (Competitive market programme)

Introducing market mechanisms, while retaining the reliability and development of transmission systems, as well as compliance with the requirements of the European Union concerning operation of the internal market in natural gas, has been indicated as one of the goals of the *Competitive market programme*.¹⁶

It was assumed that as a result of implementing the *Competitive market programme*, a competitive market of natural gas would be created, where network services will continue as regulated activities while the prices for customers become contract prices exempted from regulation. The rules for the functioning of the natural gas market were set along with an agreed organisational structure, and methods of eliminating the barriers restricting development of competition identified. The necessity to monitor the market was also indicated along with the impact of this process on the security of energy supplies, and the necessary legislative actions and steps to support its development.

In order to achieve the objectives of the *Competitive market programme*, the actions of the organisational, regulatory, infrastructural and development-supporting nature were identified and the timetable for them set out.

It must be emphasised that the actions listed in the document by no means exhausted the catalogue of necessary measures and areas connected with implementation of the programme objectives. In addition, the tasks identified in the programme are undeniably behind schedule.

As regards the organisational measures envisaged in the *Competitive market programme*, and in particular the procedure for separating the transmission system operator together with relevant assets and peak gas storage capacities, it should be pointed out that, contrary to the assumptions of the document, major errors were committed in the unbounding of transmission activities in terms of infrastructure of ownership and investment activities. The transmission system leasing agreement executed between PGNiG S.A. and OGP Gaz-System S.A. essentially infringes the interests of the state, generates significant costs, and above all hampers developmental investment.

The completion of activities for appointing distribution system operators and commencing their operations had been planned for the second quarter of 2004, while the legal unbounding was scheduled for the fourth quarter of 2005. These deadlines were not met, and the work on setting up distribution systems operators within the date provided for in the Directive 2003/55/EC, i.e. by 1 July 2007, commenced in January 2006.

The *Competitive market programme* envisaged also, the regulatory steps aimed at amending the *Energy Law* act and its implementing regulations (the deadlines were set for the second and third quarters of 2004). These deadlines were not realistic. The amendments to the *Energy Law* came into effect only on 3 May 2005. At the same time, the drafting of the implementation regulations began, with completion planned for the first quarter of 2007.

The code for the grid was elaborated and then approved on 21 June 2006 by the President of the Energy Regulatory Office, with respect to the sections dealing with the balancing and managing of grid constraints, while the codes for the distribution networks are in the process of consultation with the ERO (the completion of these activities was originally planned for the second quarter of the year 2004).

The remaining activities listed in the *Competitive market programme* are of a continuous nature. Among them, the following should be specified:

- the issues related to elimination of cross-subsidies between the groups of consumers,
- construction and implementation of IT systems and network metering,
- activities supporting development (at present, they concentrate on securing financing from the EU structural funds and the cohesion fund in the financial perspective 2007-2013. The implementation of the *Operational Programme: Infrastructure and Environment*, concerning

¹⁶ *Programme for introducing a competitive market for natural gas and on the timetable for its implementation*, the document adopted by the Council of Ministers on 27 April 2004 p. 8. *Objectives and premises of the Programme*.

the tasks required in the area of energy security and development of gas networks should markedly facilitate the management of investment projects.

It is worth noting that the task of developing infrastructure for the gas system defined in the document and identified there as an essential factor for market development, is still seen as a key factor in the full opening up of the market and assuring third party access to infrastructural services.

Summing up the state of implementation of the tasks set out in the *Programme*, it should be pointed out that a significant majority of these have either been completed or are nearing completion. The *Policy for the natural gas industry* sets out further milestones in the area of developing a competitive market of gas.

3. Programme of actions aimed at improving energy security.

The diversification of sources of supplies of natural gas to the administrative territory of Poland is a necessary condition for achieving energy security.

Although the diversification indicators resulting from the regulation of the Council of Ministers, concerning the minimum level of diversification of gas supplies from abroad¹⁷, these are not sufficient to ensure uninterrupted supplies from imports, because of the adverse structure of the supply agreements still prevailing.

In 2006, ca. 91.5% of natural gas imports came to the Republic of Poland from the east (including: 68.2% from the Russian Federation¹⁸).

In the light of the above, the discontinuation of the process of providing Poland with diversified sources of natural gas supplies, by abandoning the implementation of agreements for supplies of natural gas executed by PGNiG S.A. with suppliers from Denmark and Norway, should be negatively evaluated. These two agreements were signed and came into effect in 2001 and they required the suppliers to construct gas pipelines linking Poland with the North Sea gas deposits.

I. Main tasks in the field of energy security and the activities designed to develop a competitive gas market.

The key tasks in improving Poland's energy security concerning natural gas are:

- including the tasks associated with the diversification of natural gas supplies in the activities of the companies essential to energy security:
 - direct connection by a gas pipeline with Scandinavian gas deposits,
 - constructing a terminal to receive liquefied natural gas (LNG) on the Polish coast,
 - ensuring long-term contracts for natural gas supplies from sources other than from the east,
- securing state control over strategic infrastructure serving the purpose of natural gas transmission,
- extending the natural gas transmission system,
- increasing the working capacities of underground gas storage facilities,
- increasing the potential for domestic gas extraction,
- containing the risks to the energy security of the Polish Republic resulting from PGNiG S.A. stock being publicly traded,
- obtaining access by the PGNiG Group to deposits of crude oil and natural gas, and also their acquisition abroad.

¹⁷ The regulation of the Council of Ministers of 9 November 2000 (*J. of Laws* No. 95, item1042) concerning the minimum level of diversification of gas supplies from abroad.

¹⁸ Source: PGNiG S.A.

Implementing Directive 2003/55/EC

Poland has implemented provisions concerning the liberalisation of the gas market. However, the rate of liberalisation will depend greatly on four factors:

- extending the transmission system in the directions so enabling increased throughput transmission capacity,
- extending the volume and capacity and throughput of underground natural gas storage facilities,
- implementing projects, to be carried out by PGNiG S.A. and Gaz-System S.A. aimed at diversifying supplies of natural gas,
- gradual elimination of cross subsidies in tariffs.

Transmission networks

The Polish transmission network differs principally from those of its Western neighbours . The quantity of gas transmitted annually calculated per 1 km of network, is ca. 0.9 million m³. To compare, a similar indicator for operators in Spain or Belgium stands at 3.62 and 4.37 million m³ per 1 km of network, respectively.

The relevant indicators are presented in the Table below:

Country	Operator	Length of network in km ¹⁹	Consumption of gas in billion m ³ in 2004 ²⁰	Consumption of gas (in billion m ³) per 1 km of transmission network ²¹	Quantity of gas in billion m ³ transmitted in 2005 ²²	Quantity of gas transmitted (n billion m ³) per 1 km of transmission network ²³
Belgium	Fluxys	3 730	16.3	4.37	21.4	5.74
France	GdF	31 589	44.7	1.42	67.9	2.15
Spain	Enagas Group	7 538	27.3	3.62	37.4	4.96
the Netherlands	Gasunie	11 600	43.5	3.75	97.3	8.39
United Kingdom	National Grid	6 880	98	14.24	n/a	n/a
Italy	Snam Rete Gas	30 712	73.3	2.39	80.4	2.62
Poland	Gaz-System	14 830	13.2	0.89	15.4²⁴	1.04

In the case of the Polish transmission system, the low indicator of the gas transmitted per 1 km of the transmission network results, *inter alia*, from a lack of reserve capacities, particularly in north-western Poland and a poorly developed network in the north-eastern part of the country.

An additional factor hampering the development of competitiveness of the gas market and that also undermines the security of gas supplies, is the fact that the transmission systems are not sufficiently diversified in terms of trade sources and physical supplies of gas. The physical diversification is understood here as the infrastructural connections of the Polish systems with terminals receiving liquefied natural gas or with direct gas pipelines, through which the possibilities of supplying natural gas to Poland from suppliers other than the current supplier, may materialize.

¹⁹ Data presented in websites of particular system operators:

Belgium, <http://www.fluxys.net>

France, <http://www.gazdefrance.com>

Spain, <http://www.enagas.es>

The Netherlands, <http://www.nvederlandsegasunie.nl>

United Kingdom, <http://www.nationalgrid.com>

Poland, <http://www.gaz-system.pl>

²⁰ Source: BP Statistical Review of World Energy June 2005 r.

²¹ Source: Ministry of Economy, own calculations.

²² Data presented in websites of particular system operators. Ministry of Economy, own calculations

²³ Source: Ministry of Economy, own calculations.

²⁴ The data does not include the transit through the Yamal – Europe pipeline, the owner of which is EuRoPol Gaz S.A.

Compared with similar systems in the other EU Member States, the Polish transmission system has very limited options to supply gas other than from eastern suppliers.

The possibilities to acquire natural gas by some selected countries are compiled in the Table below:

country	Sources of natural gas (existing infrastructure and projects under construction)
Belgium	1 import terminal, re-gasification units under construction (gas from Algeria, United Arab Emirates, Australia, Nigeria, Oman, Qatar), connections with the United Kingdom, Norway, the Netherlands, Germany, and France
France	2 import terminals (Algeria, Nigeria, Oman, Qatar, Egypt, United Arab Emirates), 1 terminal under construction (gas from Egypt), connection with Belgium, Spain, Germany, Switzerland, and Italy.
Spain	4 import terminals, 2 terminals under construction (gas from Algeria, United Arab Emirates, Australia, Libya, Malaysia, Nigeria, Oman, Qatar, Trinidad and Tobago), a gas pipeline from Morocco /Algeria, Portugal and France, next connection with Algeria („Medgaz”) under construction
the Netherlands	direct connection with the Norwegian shelf, connection with Germany, Belgium, the connection with the United Kingdom under construction
United Kingdom	1 terminal (gas from Algeria, Trinidad and Tobago), 2 terminals under construction (gas from Qatar among other sources), direct connection with the Norwegian shelf and the North Sea gas rigs, connections with Ireland, and Belgium and the Netherlands
Italy	1 import terminal, 2 terminals under construction, connection with Tunisia/Algeria, with France, Switzerland, Austria and Croatia, the connection with Algeria under construction
Poland	connection with Germany (gas from German supplier, principally of Russian origin), connections with Belarus and the Ukraine, Russian gas And Asian gas brought by transit via Russia) – no other options to import gas

Source: Ministry of the Economy, based on World LNG Map, 2006 edition, Petroleum Economist Ltd., and own materials.

This structure of inputs and the directions of its development determine the trade diversification of gas supplies to a given country:

Diversification of natural gas supplied by trade sources (in 2005)

Country	Gas acquired*		Proportions of imported supplies, by country														
	Domestic production (%)	Import (%)	Algeria	Belgium	Denmark	Egypt	the Netherlands	Qatar	Libya	Malaysia	Germany	Nigeria	Norway	Oman	the Russian Federation and transits via the FR	United Kingdom	Inni (UAEZE, Trinidad and Tobago)
Belgium**	0%	100%	15%				39%				6%		37%		1%	1%	
France	0%	100%	15%	4%		2%	17%				ca.0.2%	9%	29%	ca.0.16%	24%		
Spain	0%	100%	44%			11%		14%	3%	1%		15%	6%	5%			ca.2%
The Netherlands**	84%	16%			2%						33%		32%		20%	13%	
United Kingdom	89%	11%	3%	12%			2%				7%		76%				ca.0.5%
Italy	16%	84%	38%				11%		6%		3%		9%		32%	1%	
Poland	33%	67%									3%		5%		92%		

Source: Ministry of the Economy, based on the BP Statistical Review of World Energy and own materials.

* The gas acquired means the sum of gas produced by the given country and the imports to the country (without taking exports into account). In 2004 and 2005, Belgium, the Netherlands and the United Kingdom were net exporters of natural gas.

** Data for 2004.

92% of the natural gas imported to Poland enters the transmission system through receiving stations on the eastern border and from the Yamal pipeline, and the whole transmission system is orientated towards the transmission of gas from east to west.

Such a network structure increases the risk of interruptions in supplies for trade and technical reasons (malfunctions, protracted periodic repairs, payment disputes etc.), as well as political reasons (disputes between the government of the Russian Federation, and the government of Belarus and the Ukraine). The *Policy for the natural gas industry* defines the actions aimed at the true diversification of natural gas supplies to Poland, via the construction of the terminal to receive liquefied natural gas on the Polish coast and by direct connection with gas sources in Scandinavia. These two diversification options are complementary.

In addition, owing to infrastructural connections diversifying the gas supplies and the extension of the transmission system and increase in its throughput capacity, it will become technically feasible to increase the degree of the third party access to the system.

Inter-system connections

Until the decision included in the resolutions of the Councils of Ministers of 3 January and 31 May 2006, concerning diversification of natural gas supplies to the Republic of Poland are executed, creating connections which would result in more dependence of the supplies to Poland from one producer or entities under his control will be contrary with the assumptions of this *Policy*.

Natural gas storage facilities

The small capacity of the underground natural gas storage facilities combined with the low throughput capacity of the system are hampering the development of the competitive natural gas market, including the practical application of the principle of third party access to the transmission network.

The working capacity of the underground gas storage facilities in Poland amounts to ca. 1 600 million m³. Even filling them to capacity would not support uninterrupted supplies to the end consumers, in the event of sudden, short interruptions in supplies from the east.

Extending the capacity and throughput of underground natural gas storage facilities is a necessary condition for the functioning of a competitive gas market as well as increasing security of and the continual flow of supplies to consumers.

Cross-subsidising

The mechanism of cross-subsidising persists in tariffs (particularly the subsidising of minor gas consumers by major consumers). Such situations exert an adverse impact on the formation of a competitive market for gas.

The minister in charge of the economy shall undertake suitable steps by amending the tariff regulations designed to speed up the rate of elimination of cross subsidies.

II. Actions pursued by the representatives of the Government of the Republic of Poland at the European Union forum

The Members of the Council of Ministers and representatives of the Government of the Republic of Poland shall support the actions by the EU bodies, aiming towards ratification of the Energy Charter Treaty by the Russian Federation and the signing of the Transit Protocol to the Energy Charter Treaty, as well as towards broadening the group of countries that are signatories of the said treaty.

The Minister of the Economy shall constantly monitor the actions within the EU forum related to energy policy and shall participate actively in the efforts of working groups and committees devoted to the issues of energy security and the natural gas market.²⁵

²⁵ including, *inter alia*: WPENER (Working Party on Energy), TENs (Trans European Energy Networks – an advisory committee to the European Commission), Gas Co-ordination Group appointed by the European Commission, European Gas Regulatory Forum of Madrid, Madrid Forum for the regulation of gas market (including the initiatives: Gas Regional Initiatives South South East and GRI North North West) and others.

III. Legislative actions concerning the gas sector

In order to improve the energy security of the Republic of Poland, it is assumed the following actions in terms of amending the law will take place:

1. The revision and introduction of suitable changes to the present system of tariffs for natural gas, to ensure that the capital projects pertaining to the construction and extension of underground natural gas storage facilities and the transmission system are justified on economic grounds.
2. The gradual removal of the cross-subsidies in tariffs.
3. Within one month of the adoption of the *Policy for the natural gas industry*, the Minister of the Economy shall, in co-operation with the companies in the gas sector listed in the *Policy for the natural gas industry* elaborate the list of legal barriers to the implementation of infrastructure investment projects in the sector within the territory of Poland, as well as those concerning acquisitions abroad and then I submit them to the Council of Ministers under the procedure of providing information.
4. The ministers in charge of the economy, construction spatial development and housing, maritime economy, transport, public finances, and of the environment, as well as the State Treasury, shall set the scope of legislative efforts necessary for the removal of the barriers identified by the Minister of the Economy, in order to facilitate speedy implementation of the necessary infrastructure investment projects in the gas sector, with particular attention devoted to transmission pipelines and the LNG unloading terminal, within one month of the submission indicated in subparagraph 3.

The work on drafting legislation so defined should be completed in time and no later than 7 months from the submission indicated in subparagraph 3, in co-operation with the Energy Regulatory Office, Office for Competition and Consumer Protection and the Public Procurement Office.

5. The possibility of simplifying procedures for investment projects for PGNiG S.A. and Gaz-System S.A. companies, in order to enable to them to keep up with the completion dates of investment projects which could have impact on the energy security of the state.
6. The Minister of the Economy, in co-operation with the companies in the gas sector shall elaborate a mechanism, allowing information to be shared with the transmission system operator, on the directions of development of the natural gas market over a 10 year period, with the objective to facilitate preparation of suitable extension of transmission network. The information will be elaborated on by the end of 2007 and updated every 2 years.

IV. The objectives of the economic policy of the state towards particular companies of the sector.

Polskie Górnictwo Naftowe i Gazownictwo S.A. (Polish Oil and Gas Company – joint stock company)

The following concept has been adopted covering the actions to be undertaken with respect of PGNiG S.A.:

1. With respect to the restructuring it is assumed that PGNiG S.A. will complete the process of separating (unbundling) its trade activities from the distribution activities. After the separation,

the gas companies in the PGNiG S.A. Capital Group shall become distribution systems operators endowed with assets specific to distribution activity.

2. Without any delay, and not later than 1 July 2007, the exemption of the assets specific to the distribution system, from the scope of the leasing agreement between PGNiG S.A. and Gaz System S.A., and their transfer to the gas companies – or future distribution system operators will be completed. The criteria for separating assets shall be set out by the interested companies.
3. The possibility has been raised for the minister in charge of the economy to appoint a special team, to oversee the process of exempting from the leasing agreement, the assets referred to in subparagraph 2, and to provide opinions on the adopted solutions from the viewpoint of the security of the transmission system operation
4. The dividend of the State Treasury due from the profits of PGNiG S.A. for the years 2006 and 2007 shall be a non-cash dividend. The State Treasury shall increase the share capital of the company Gaz System S.A. by contributing the transmission assets obtained as the dividend.
5. Within the shortest time possible, PGNiG S.A. shall sell to Gaz System S.A. the transmission assets owned by the Company, covered by the leasing agreement and included in the non cash-dividend for the years 2006 and 2007.
6. Until the issue of the prohibition of re-exports in the contracts of PGNiG S.A., the separation of a company pursuing exploration and extraction activities from the structure of PGNiG S.A. is not envisaged.

The analyses carried out as early as in 2004,²⁶ indicated the legitimate justification for keeping the exploration and extraction activities within the structures of PGNiG S.A. The extraction activities are a factor helping to stabilise supplies in a period of increased demand for gas.

7. PGNiG S.A. will continue the activities aimed at obtaining gas supplies from sources other than those used to date, in accordance with the guidelines presented in the resolutions of the Council of Ministers of 3 January and 31 May 2006, concerning the diversification of energy carriers. The years 2010/2011 are the planned completion date for the diversification projects concerning implementation of the energy carrier supplies. .
8. PGNiG S.A. shall complete the relevant economic analyses and develop a plan for extending the underground natural gas storage (UGS) facilities, taking into account co-financing from the funds of *Operational Programme Infrastructure and Environment (European Regional Development Fund)*, which after adoption by the corporate bodies of the Company, shall constitute the basis for the necessary investment project, aimed at extending the existing UGS and the construction of new facilities to reach the capacity necessary for providing security and uninterrupted supplies of natural gas to domestic customers.
9. The PGNiG S.A. Capital Group shall continue as owner and operator of the UGS, currently owned and constructed by the Group.
10. It is recommended that PGNiG S.A. completes feasibility analyses pertaining to the increase of domestic extraction of natural gas, over a 10 year time period and elaborate investment plans to increase domestic extraction of hydrocarbons. In order to coordinate the investment development in the gas sector, these analyses should be completed by the time of submission of proposals for co-financing by the *Operational Programme Infrastructure and Environment* of other projects concerning energy security.
11. The actions undertaken by PGNiG S.A. aimed at gaining access to the deposits of natural gas and crude oil outside Poland's borders shall be supported as well as those aimed at obtaining new sources and routes of natural gas supplies.
12. Further privatisation of PGNiG S.A., including the availability of so-called employee shares is not envisaged before the objectives of this *Policy* are achieved. The risk of blocking the changes by

²⁶ *Programme of the restructuring and privatisation of PGNiG S.A* of 5 October 2004, p. 6-7

minority shareholders results from the Company going public. For this reason, selling the shares of the Company by the State treasury increases the risk, of permanently blocking the implementation of the objectives presented in the *Policy for the natural gas industry* and through it may prevent the supreme goal from being attained; namely to assure the energy security of Poland.

The State Treasury shall take adequate measures to minimise the above risk.

OGP Gaz-System S.A.

The following concept has been adopted towards the actions to be undertaken in respect of Gaz-System S.A.:

1. The State Treasury shall continue as the 100% shareholder of the Gaz System S.A., the transmission network operator in Poland.
2. The dividend due to the State Treasury from the profit of PGNiG S.A. for the years 2006 and 2007 shall be a non-cash dividend and shall be in the form of a portion of transmission assets covered by the leasing agreement with the Gaz-System S.A. company. The State Treasury shall increase the share capital of Gaz System S.A. company, contributing the assets obtained as a dividend.
3. In order to improve the functionality of the transmission and distribution systems, the assets specific to the distribution system operation will be exempted from the leasing agreement between PGNiG S.A. and Gaz System S.A as soon as possible but not later than on 1 July 2007, and the assets will be contributed to gas companies – the future distribution system operators. The criteria for dividing assets shall be set out by the interested companies
4. In the shortest time possible, Gaz-System S.A. shall buy out the transmission assets owned by PGNiG S.A. and not included in the non-cash dividend for the years 2006 and 2007.
5. Gaz-System S.A. shall undertake adequate actions aimed at reducing the level of the transmission tariff through the increased effectiveness of the Company's operations.
6. Gaz-System S.A. shall elaborate and implement investments associated with the extension of the transmission system for suitable potential capacity. The system should enable the handling of additional quantities of natural gas from the north within the dates set out by PGNiG S.A. for diversification projects and related contracts for supplies.
7. The funds for the extension of the transmission system will be supplemented from the *European Regional Development Fund* under the *Operational Programme Infrastructure and Environment* in the years 2007-2013 and from the company's own cash flow and funds raised in the open money and loan markets.
8. The remaining investment aimed at the extension of the natural gas transmission system, including enhancing the capacity of the existing transmission system and those concerning the improvement of the energy security of the country, will be conducted according to the investment plans of the Company, in line with the development of the domestic gas market.

EuRoPol Gaz S.A.

The State Treasury will strive to secure itself against the loss of control over the assets of EuRoPol Gaz S.A. and prevent its influence over the management of the company being reduced.

Conclusion

The investment projects resulting from the implementation of the *Policy for the natural gas industry* will be subject to the environmental impact analysis under the binding regulations.

The investment projects will be implemented by the companies of the gas sector listed in this document, under financing from their own funds. In the case of co-financing from the EU funds, the relevant provisions concerning the use of such funds shall apply.

The Minister in charge of the economy acting in co-operation with the minister in charge of foreign affairs, shall support the actions of the companies in this sector in terms of gaining access to deposits of natural gas as well as to new sources and routes for the supplies to Poland.

On the date of the *Policy for the natural gas industry* into effect, the provisions of the *Programme of the restructuring and privatisation of PGNiG S.A.* adopted by the Council of Ministers on 5 October 2004 shall become invalid.

The implementation of this *Policy* shall contribute to enhancing the energy security of the Republic of Poland, improve order in the ownership structure in the natural gas sector as well as to increased competitiveness in the domestic market for natural gas.

The Minister in charge of the economy whose responsibilities include, *inter alia*, matters pertaining to the proper functioning of the domestic energy systems, and taking into account the principles of rational economy and the needs of the energy security of the country, shall oversee the implementation of the *Policy for the natural gas industry*.

Every two years, up to 2015, the minister in charge of energy security will present to the Council of Ministers a report on the implementation of the *Policy for the natural gas industry*.