

THE ENERGY
REGULATION
AND MARKETS
REVIEW

SIXTH EDITION

Editor
David L. Schwartz

THE LAWREVIEWS

THE ENERGY REGULATION AND MARKETS REVIEW

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PREFACE

In our sixth year of writing and publishing *The Energy Regulation and Markets Review*, we have seen dramatic changes in global energy policies. Notwithstanding President Trump's announcement that the United States will withdraw from the Paris Agreement, and the referendum in the United Kingdom to leave the European Union, there have been continued efforts to reduce greenhouse gases (GHGs) by the signatories to the Paris Agreement. There is still a significant need to invest in infrastructure, and we have seen significant investment throughout the supply chains in the oil, gas and power sectors globally. The Fukushima nuclear incident continues to impact energy policy, and we continue to see extensive liberalisation of the energy sector.

I CLIMATE CHANGE DEVELOPMENTS

With respect to climate change efforts, the Paris Agreement went into effect on 4 November 2016, and thus far, 148 countries have ratified the Agreement. President Trump has recently announced that the United States would be withdrawing from the Paris Agreement, but we continue to see significant carbon reduction efforts, such as increased development of renewable resources, as well as energy efficiency and demand reduction measures, globally, including in the United States.

In Europe, the European Union adopted 'A Framework Strategy for a Resilient Energy Union with a Forward-Looking Climate Change Policy', and it is expected that there will be a large amount of European secondary legislation to increase the amount of renewable resources. While the United Kingdom voted to exit the European Union, the United Kingdom continues to invest heavily in offshore and onshore renewable projects, and has been particularly active in the battery storage sector to round out intermittent renewable production, offset demand and arbitrage energy prices. President Macron has stated his intent to have France fulfil its goals of closing all coal fired power plants within five years and doubling the capacity of wind and solar renewable generation. Denmark continues to seek to have renewable energy meet all of its electricity demands by 2050. The Netherlands has a goal of reducing GHGs by at least 25 per cent by 2020, and is closing at least two coal-fired power plants. Germany undertook significant steps to increase reliance on renewable energy resources.

China released a plan to have 15 per cent of its energy supplied by non-fossil fuels, 20 per cent from natural gas and no more than 58 per cent from coal by 2020. Korea's goal is to cut GHGs by 37 per cent by 2030. India announced a goal to have at least 40 per cent of its installed electric capacity powered by non-fossil fuels. Japan and Australia are working to improve energy efficiency and conservation and to increase reliance on renewable

energy supply. The United Arab Emirates continues its efforts to reduce its carbon footprint, announcing a goal of having 25 per cent of its capacity from renewables by 2030, and 75 per cent by 2050. Australia is adding significant new renewable resources. Even the United States is seeing significant investment in renewable energy development. While the Trump Administration is seeking to reverse the Obama Administration's Clean Power Plan, individual states are moving forward to achieve reduced reliance on fossil fuels and greater reliance on renewable energy, including California and New York, which are seeking a 50 per cent renewable portfolio standard goal by 2030, and Hawaii, which is seeking 100 per cent reliance on renewables by 2045.

II INFRASTRUCTURE DEVELOPMENT

For many countries, reliable energy supply is the primary concern, regardless of fuel source. Rural electrification and system reliability remain priorities in Indonesia, Mozambique, Angola, parts of Nigeria and Central and West Africa and we are seeing significant efforts to pursue electric generation projects in those regions. Iran is seeking approximately US\$200 billion in investments for its oil and gas industries over a five-year period, and Iraq is seeking approximately US\$18 billion in foreign investments over a three-year period. Turkey is aggressively diversifying its energy industry and building infrastructure, including the TANAP pipeline from the Caspian Sea to Europe, and is pursuing shale gas opportunities. Malaysia is constructing a 2,000MW coal plant to meet its growing energy demands. South Africa has taken steps to add 863MW of coal generation, and is seeking to add over 3,000MW of natural gas-fired generation. Denmark has a new North Sea Agreement to secure future exploration and production of hydrocarbons from the North Sea, and Cyprus, Mozambique, Lebanon and Mexico are establishing mechanisms to license offshore oil and gas exploration and production.

III NUCLEAR POWER GENERATION

Six years after the Fukushima disaster, Japan has shut down 45 out of its 48 nuclear power stations pending new detailed safety reviews. Germany continues its phase out all nuclear generation, and has agreed to assume the responsibility for nuclear waste management following shut-down, decommissioning and dismantlement by existing owners. France is seeking a reduction of nuclear power generation to 50 per cent of total electricity production within five years. Switzerland and Korea are planning to limit the life of their nuclear generation units. On the other hand, Turkey is continuing with development of the Akkuyu nuclear power plant, and the United Arab Emirates is still proceeding with construction of the Barakah nuclear power plant, both of which are expected to be operational in 2020. The United Kingdom continues to push forward with the Hinckley Point C new nuclear facility. South Africa is facing substantial resistance to its efforts to develop 9,600MW of new nuclear generation capacity. In the United States, the early retirement of certain nuclear plants has been driven by cost and power market considerations, rather than safety concerns. Some nuclear owners in the United States have sought state subsidies in New York, Illinois, Ohio and Pennsylvania, among others, in order to avert premature retirements. Illinois and New York have implemented legislative and regulatory payment programmes for nuclear facilities in those states, but they are currently being challenged in federal district court on constitutional grounds.

IV LIBERALISATION OF THE ENERGY SECTOR

We have seen significant energy sector regulatory reforms in many countries. Australia is continuing to move toward retail choice, and is seeking to implement a new energy market operator and market rule change committee. Italy is seeking to develop more competitive retail markets. Spain has been engaged in regulatory reforms to reduce its ‘tariff deficit’ and re-establish the correlation between costs and rates. Portugal continues to work on liberalising its electricity and gas markets. Japan is actively working on developing competitive retail electric and gas markets and is seeking to unbundle electric transmission and gas transportation sectors to improve competition. And we are seeing continued efforts to partially privatise state-owned energy companies in the United Arab Emirates, Turkey, Brazil and Colombia.

I would like to thank all the authors for their thoughtful consideration of the myriad of interesting, yet challenging, issues that they have identified in their chapters in this sixth edition of *The Energy Regulation and Markets Review*.

David L Schwartz

Latham & Watkins LLP

Washington, DC

June 2017

POLAND

Krzysztof Cichocki and Tomasz Młodawski¹

I OVERVIEW

Demand for primary energy sources in Poland is currently estimated at 103.7 million tonnes of oil equivalent (Mtoe) per annum. It is satisfied primarily by coal (39.5 per cent), oil (25.1 per cent), natural gas (14 per cent), lignite (11.6 per cent) and others, including renewable energy sources (9.8 per cent). According to the information published by the Polish Main Statistical Office with respect to 2015, the renewable energy sources (RES) included in the Polish primary energy mix comprised solid biomass (72.22 per cent), biofuels (10.78 per cent), wind (10.76 per cent), biogas (2.64 per cent), water (1.82 per cent), heat pump (0.56 per cent), photovoltaic (0.52 per cent) municipal waste (0.46 per cent) and geothermal energy (0.25 per cent).

Local production satisfies the entire hard coal demand and approximately 25 per cent of natural gas demand in Poland. Oil demands are primarily met by import, with only 4 per cent of petroleum products coming from local crude oil production. On the other hand, lignite consumption is almost fully covered with local production, which stems from the fact that lignite is not customarily transported for great distances for economic reasons.

Final energy consumption in Poland is estimated at 67.2 Mtoe per annum and is based on energy demand of: industry (27.4 per cent), transport (28.1 per cent), residential (31.8 per cent) and services (12.8 per cent).

According to the government publication 'Energy Policy of Poland until 2030', the total consumption of primary energy in Poland should increase to 118.5 Mtoe per annum in 2030 and it should be satisfied by coal (31.0 per cent), oil (26.2 per cent), natural gas (14.5 per cent), lignite (8.2 per cent), renewable energy sources (12.4 per cent) and nuclear energy (6.3 per cent). At the same time, final energy consumption should increase to 84.4 Mtoe.

In line with EU policies for the reduction of greenhouse gas emissions, the Polish government continues policy aimed at achieving the envisaged 15 per cent share of RES in final energy consumption by 2020. In general, these actions are focused on the following basic aims: (1) to support RES consumption, with special emphasis on stable electricity generation units based on biogas; and (2) to promote nuclear power generation – with the flagship project of the first nuclear power plant to be developed in Poland by PGE EJ1, a subsidiary of Polish Energy Group SA.

¹ Krzysztof Cichocki is a partner and Tomasz Młodawski is a senior associate at Soltysiński Kawecki & Szlęzak, and both practise as legal counsel.

II REGULATION

i The regulators

The primary regulation of the Polish energy industry is set forth in the following main statutes adopted by the Polish parliament (i.e., the Sejm and the Senate) and thereafter approved by the President of the Republic of Poland:

- a* the 2011 Geological and Mining Law, which provides the general legal framework governing exploration for and exploitation of fossil fuels within Poland (including coal, lignite, hydrocarbons, uranium, etc.); and the use of underground reservoirs for storage of hydrocarbons, liquid fuels and the carbon dioxide processed in carbon capture and storage projects;
- b* the 2014 Act on Special Hydrocarbon Tax and the 2012 Act on Tax on Extraction of Certain Minerals, which provide for additional tax burdens imposed on entities involved in the production of hydrocarbons;
- c* the 1997 Energy Law, which provides for regulation of the entire electricity and district heating sectors and for the midstream and downstream oil and gas sectors, including production, transmission, storage and trading in liquid fuels;
- d* the 2015 Act on Renewable Energy Sources, which provides for special regulatory framework covering operation of and support for renewable energy sources;
- e* the 2007 Act on Reserves of Crude Oil, Petroleum Products, Natural Gas and on Procedures in Cases of Emergency in Security of Fuel Supply and Disturbance on the Oil Market (the Act on Reserves), which provides for certain obligations imposed on entrepreneurs involved in the natural gas and oil sectors, with these obligations being aimed at ensuring security of natural gas, oil and petroleum products supplies;
- f* the 2006 Act on the System of Monitoring and Control over the Quality of Fuels;
- g* the 2006 Act on Liquid Bio-components and Biofuels;
- h* the 2016 Act on Energy Efficiency;
- i* the 2000 Nuclear Law;
- j* the 2011 Act on Preparation and Implementation of Investments in Nuclear Power Facilities and Associated Investments;
- k* the 2009 Act on Investments with Respect to the Regasification Terminal in Świnoujście;
- l* the 2007 Act on Emergency Management;
- m* the 2016 Act on Rules for Management of State Property; and
- n* the 2015 Act on Control of Certain Investments.

Under the statutes listed above, a number of governmental bodies, including the Council of Ministers, the Minister of Energy and the Minister of Environment, are authorised to lay down secondary legislation providing for more detailed regulations within the scope delegated to those bodies under the pertinent statute. Furthermore, the Council of Ministers is authorised under the 1997 Energy Law to adopt Poland's overall energy policy, setting general goals to be achieved by, *inter alia*, enforcement of existing statutes and adoption of new legislation.

The competence to enforce the above-mentioned legislation and policies, and to exercise supervisory and regulatory powers over energy market participants, is vested in the following bodies:

- a* the Minister of Environment, who is vested with power to grant authorisations for exploration and exploitation of fossil fuels within Poland and for the use of underground reservoirs for storage of hydrocarbons, liquid fuels and carbon dioxide;

- b* directors of mining offices, who are responsible for supervision of exploration and exploitation of fossil fuels and of the use of underground reservoirs for storage of hydrocarbons, liquid fuels and carbon dioxide;
- c* the President of the Energy Regulatory Office, who is vested with competence to, *inter alia*, (1) grant licences for production, storage, transmission, distribution, trading and supply of electricity, heat and fuels (including natural gas), and liquefaction and regasification of liquefied natural gas (LNG); (2) approve tariffs; (3) grant exemptions from tariff obligations; (4) approve grid codes; (5) certify operators of both gas and electricity transmission systems; (6) organise tenders for new electricity generation capacities; (7) grant tradable 'white' certificates to investors carrying out energy efficiency projects eligible to benefit from the support scheme based on tradable 'white certificates'; (8) grant tradable 'green' and 'red' certificates to energy producers benefiting from the support schemes addressed to RES and combined heat and power plants; (9) organise 'auctions' selecting the RES installations eligible to benefit from the new support system in force as of 1 July 2016; and (10) control compliance with a number of obligations imposed on energy market participants (including those related to compulsory stocks of natural gas, coal and lignite, and to the public sale of electricity and gas) and to enforce financial penalties for non-fulfilment of these obligations;
- d* the Minister of Energy and the President of the Material Reserves Agency, who is responsible for enforcement of compulsory stocks of crude oil and liquid fuels;
- e* the President of the Office for Competition and Consumer Protection, who is responsible for enforcement of antitrust regulations (control of mergers and acquisitions, investigation and punishment for conclusion of anticompetitive agreements or abuses of dominant position, etc.); and
- f* courts considering appeals against the decisions issued by the above-mentioned authorities.

ii Regulated activities

The following types of activities performed within the territory of Poland require prior authorisation in the form of a licence:

- a* exploration for and exploitation of fossil fuels, including crude oil, natural gas, coal, lignite, uranium, etc.;
- b* development and exploitation of underground storage facilities;
- c* production of electricity except for generation performed in facilities with total installed capacity not exceeding 50MW, it being specified, however, that generation of electricity in RES installation with installed capacity exceeding 0.2 MW and using other fuels than biogas and biofuel is always subject to a licence requirement;
- d* production of heat except for generation performed in facilities with total installed capacity not exceeding 5MW;
- e* production of liquid fuels;
- f* storage of gaseous fuels, liquefaction of natural gas and regasification of LNG, and storage/transshipment of liquid fuels in storage/transshipment facilities, except for local storage of liquid gas in installations with capacity below 1MJ/s;
- g* transmission and distribution of fuels and energy (including electricity and heat), except for distribution of gaseous fuels in networks with capacity below 1MJ/s and distribution of heat where the total booked capacity does not exceed 5MW;

- b* trading in fuels or energy (including electricity and heat) except for: (1) trading in solid fuels; (2) trading in electricity provided that trading is performed in installations with capacity below 1kV owned by the customer; (3) trading in LNG supplied from abroad to the delivery point in the Świnoujście LNG terminal; (4) trading in gaseous fuels provided that the annual turnover does not exceed €100,000; (5) trading in liquid gas provided that the annual turnover does not exceed €10,000; (6) trading in heat provided that the total ordered capacity does not exceed 5MW; (7) trading in gaseous fuels and electricity performed via the commodity exchange by certain qualified participants of exchange (including brokers, commodity exchange operators, clearing house or National Security Depository, etc.); and (8) trading in gaseous fuels and electricity performed by clearing house or National Security Depository in the course of fulfilment of their duties to settle over-the-counter (OTC) contracts; and
- i* transmission of carbon dioxide.

The exploration for and exploitation of fossil fuels is possible upon obtaining both an agreement setting up the mining usufruct rights within the areas specified therein, and the related licence granted by the Minister of Environment. In each case, the licences are limited to specific areas covered by the relevant mining usufruct agreement. Hydrocarbon exploration and production licences might be granted exclusively to the entrepreneurs that obtained positive opinions within the 'qualification procedure', which is aimed at preselection of entities that do not pose a threat to national security and – in the case of entrepreneurs intending to hold the status of licensed operator – ensuring the proper level of experience. Licences are granted upon completion of the tender procedure, which is intended to give priority to the most experienced and financially stable entrepreneurs, and prioritise the best method for the prospection or exploration and production of hydrocarbons, which means that each bid must be evaluated on the basis of the following criteria:

- a* the experience of the bidder in the prospecting or exploration and production of hydrocarbons;
- b* the technical and financial capacity of the bidder;
- c* the proposed technology to be utilised in the licensed operations;
- d* the scope and time frame of the proposed geological works and sampling; and
- e* the best remuneration for the mining usufruct right offered by the bidder within the tender process.

Entrepreneurs holding hydrocarbon exploration and production licences are also obliged to establish the security instrument assuring future performance of the obligations and duties related to the licensed activity.

The remaining energy licences for operation of installations and provision of services (i.e., other than for exploration and exploitation of fossil fuels) are granted by the President of the Energy Regulatory Office at the request of the interested party provided that they prove their compliance with statutory conditions, including: (1) having a registered seat within any country belonging to the European Economic Area or the Swiss Confederation (subject to certain exemptions); (2) having the technical and financial capacity to conduct licensed activities; and (3) provided that the granting of a licence to a given entrepreneur does not pose a threat to defence or security of the Republic of Poland and the applicant, its manager or its controlling entity has not been convicted for any (fiscal) crime related to the licensed

activity. In addition, the licence for production or international trade in liquid fuels requires prior establishment of the security instrument, assuring the future performance of public duties (including taxes) related to the licensed activity.

Regulatory consent of the President of the Energy Regulatory Office is also required for development of direct lines, including those connecting electricity or natural gas production installations with end-customers who are not interconnected to the transmission or distribution grid or network.

iii Ownership and market access restrictions

In general, Polish law does not impose restrictions on ownership of existing and new energy assets and these may be owned by any natural or legal person, either seated in Poland or abroad. However, as an exception to the foregoing general principle, any new elements of the electricity and gas transmission networks used for the provision of transmission services may be owned exclusively by joint-stock companies incorporated in Poland and wholly-owned by the Polish State Treasury. The foregoing restriction arises from the fact that Polish law provides for the ownership unbundling of gas and electricity transmission system operators and it further provides that gas and electricity transmission system operators should be joint-stock companies wholly-owned by the State Treasury.

The licensed activities and services listed in Section II.ii, above may be generally conducted by any entrepreneur seated within any country belonging to the European Economic Area or the Swiss Confederation. However, as an exception to the foregoing general principle, gas and electricity transmission networks may be operated (and thus the related transmission services provided) exclusively by joint-stock companies incorporated in Poland and wholly-owned by the Polish State Treasury. Besides, in specific circumstances there might also arise certain restrictions on foreign control over licence holders, which stem either from the qualification procedure applicable to hydrocarbon licences (see Section II.ii, *supra*) or the fact that the authority may refuse to grant a specific energy licence or may withdraw a previously granted licence if it is justified by a need related to defence or the security of the Republic of Poland.

iv Transfers of control and assignments

Transfer of title to energy assets

Transactions concerning transfer of title to regulated energy assets are generally exempted from administrative approvals, except for common antimonopoly clearance. However, owners and operators of energy assets qualified as critical infrastructure under the 2007 Act on Emergency Management are subject to certain security obligations set forth in the 2007 Act on Emergency Management. In particular, owners and operators of the above-mentioned critical infrastructure are obliged to, *inter alia*, develop and enforce security and emergency plans for their assets.

Furthermore, under the 2015 Act on Control of Certain Investments, any direct or indirect acquisition of shares in 'protected entities' (entities engaged in, *inter alia*, the energy sector to be listed in a separate regulation of the Council of Ministers) shall be subject to prior notification to the Minister of Energy, who may raise objections to such transactions in certain circumstances, and in particular when it is justified on the grounds of public policy or public security. Under the aforementioned Act, both direct and indirect acquisition of shares resulting in achieving domination or a 'significant participation' in the protected entity is null and void if performed without the required notification, or despite the objection of the

Minister of Energy. In such cases, the shareholder shall also be deprived of its voting rights. Finally, achieving domination or gaining a significant participation without prior notification is subject to a fine of 100 million zloty or six months to five years' imprisonment.

Transfer of licences

As regards transfer of administrative authorisations to conduct regulated energy businesses, it is generally not possible under Polish law to transfer an energy licence to a third party, except in certain situations, indicated below. Therefore, if any entrepreneur would like to acquire the energy assets within the asset deal and ultimately continue business based on those assets and previously conducted by the vendor, it is generally required to purchase the regulated assets and apply to the corresponding authority for a new licence.

Nevertheless, it is possible to transfer energy licences in the course of a merger of companies effected under the 2000 Code of Commercial Companies, provided that the pertinent energy licence held by the merged company was issued after 1 January 2001. Such transfers are effected by operation of law.

Besides this, the 2011 Geological and Mining Law provides for the limited possibility of assignment of the licence covering prospecting, exploration or production of fossil fuels; such an assignment is subject to the prior consent of the Minister of the Environment and is granted in the form of an administrative decision.

Change of control

Change of control over companies holding energy licences is not generally subject to regulatory approval of the licensing authority. However, a change of control may in specific circumstances result in withdrawal (and effectively loss) of the licence if: (1) the licensing authority determines that regulated activity conducted by the licence holder controlled by a new shareholder poses a threat to defence or security of the Republic of Poland; or (2) the licensee does not meet licence conditions as a result of the change of control (e.g., the new entity controlling the licensee has been convicted for any (fiscal) crime related to the licensed activity). Change of control may also be subject to antimonopoly clearance by the President of the Office for the Competition and Consumers Protection.

III TRANSMISSION/TRANSPORTATION AND DISTRIBUTION SERVICES

i Vertical integration and unbundling

Subject to certain *de minimis* exceptions applicable to the electricity and gas distribution systems operators, Polish law provides for the unbundling of electricity and natural gas transmission and distribution systems operators, and of operators of gas storage facilities (transmission, distribution and gas storage facilities operators). In particular, Polish legislation sets forth detailed regulations implementing the European accounting, management and legal unbundling rules as laid down for transmission, distribution and gas storage facilities operators in the 2009/72 Directive and 2009/73 Directive and it further provides for ownership unbundling rules applicable to electricity and natural gas transmission system operators (except for services provided with gas transmission network existing and owned by the vertically integrated companies as of 3 September 2009 where appointment of an independent system operator is available). It is also provided that the gas and electricity

transmission system operators should be joint-stock companies wholly-owned by the State Treasury, which results in there being only one electricity and one gas transmission system operator appointed in Poland.

In practice, over the past 10 years the State Treasury separated the existing transmission assets previously owned by vertically integrated undertakings (this separation being effected in the course of either transfer of assets or division of companies controlled by the State Treasury) and established two sole-shareholder companies controlled by the State Treasury: PSE SA, which is appointed as a transmission system operator for electricity; and OGP Gaz-System SA, which is appointed as transmission system operator for natural gas. OGP Gaz-System SA is also appointed as an independent transmission system operator with respect to the Polish section of the Jamal pipeline owned by the vertically integrated company EuRoPol GAZ SA – a joint venture between Polish company PGNiG and Russian company GAZPROM. The foregoing transmission system operators are responsible for development of their respective transmission networks within the territory of Poland, and for expansion of transborder interconnectors. OGP Gaz-System also established its wholly-owned subsidiary Polskie LNG sp. z o.o., responsible for development and operation of the LNG regasification facility in Świnoujście.

In turn, electricity and gas distribution systems are generally operated by separate companies belonging to vertically integrated undertakings, the most significant of them being local incumbents (ENEA in northwest Poland, ENERGA in northern Poland, TAURON in southern Poland, PGE in central and eastern Poland). Depending on the specific situation, distribution system operators (DSOs) are appointed with respect to either certain geographic areas (especially operators belonging to incumbent vertically integrated undertakings) or specific installations (e.g., operators of local distribution grid developed within industrial zones, office complexes, etc.). Nevertheless, Polish law does not provide for exclusive rights of DSOs to provide distribution services in a particular geographic area; the rights to provide distribution services are limited to installations operated by given DSOs.

ii Transmission/transportation and distribution access

In general, Polish law implements the third-party access principle within the electricity and natural gas transmission and distribution sectors. According to the foregoing principle, the transmission and distribution system operators are required, subject to certain exemptions, to render services to all market participants on an equal, transparent and non-discriminatory basis. The foregoing principle is envisaged to foster competition in wholesale and retail electricity and natural gas market within the single European zone.

iii Rates

Except for transborder transmission services provided based on prices set within the capacity allocation auctions, the remuneration for access to the transmission and distribution system is generally calculated based on rates set forth in regulated tariffs, which are developed by a given system operator and subject to review and approval by the President of the Energy Regulatory Office. According to Polish law, the rates set forth in tariffs should reflect actual ('justified') costs incurred by service providers in the course of the provision of their respective services, as well as reasonable return on capital employed. Except for the minimum rate of return for storage of natural gas, which is set in the 1997 Energy Law at 6 per cent, the rates of return are not provided in legal acts. The rates of return are established by the President of the Energy Regulatory Office in accordance with its own current regulatory policy adopted

with respect to a given type of business or sector. The algorithms used for calculation of the tariff also include certain factors envisaged to encourage efficiency and cost reductions, which are often established by the President of the Energy Regulatory Office in accordance with its own current regulatory policy to restrain increase in prices. The foregoing regulatory power vested in the regulator results in much uncertainty as to what rates are acceptable to the authority in a given year.

iv Security and technology restrictions

The energy interests and security of Poland are protected by number of instruments spread across several acts, including: (1) the power of a regulator to refuse or withdraw energy licences if it is justified by needs related to defence or security of the Republic of Poland; (2) the power of the Minister of the State Treasury to prevent or invalidate legal acts or resolutions resulting in actual threats to the functioning, continuity of operation or integrity of critical infrastructure; and (3) numerous obligations imposed on market participants, *inter alia*, the obligation to diversify natural gas supplies, maintain compulsory stocks of crude oil, petroleum products, natural gas and coal or lignite used for generation of electricity, and to develop security and emergency plans for critical infrastructure.

IV ENERGY MARKETS

i Development of energy markets

The organised trade in electricity was originally established in Poland by Towarowa Giełda Energii SA (TGE). At present, TGE is controlled by Giełda Papierów Wartościowych w Warszawie SA (the Warsaw Stock Exchange) and it operates the Polish Power Exchange commodity exchange, allowing for (1) trading in electricity within the Polish national electricity system, and in transborder exchanges with the neighbouring EU electricity systems (market coupling) carried out in accordance with Commission Regulation (EU) 2015/1222 establishing a guideline on capacity allocation and congestion management; (2) trading in emission allowances, certificates issued under the incentive schemes addressed to RES and CHP installations, and energy-efficiency investments; (3) trading in natural gas; and – from 2015 onwards – (4) entering into derivatives contracts based on commodities traded at Polish Power Exchange. TGE also renders a system designed for public auctions of power. Transactions executed at the Polish Power Exchange are cleared and settled by Izba Rozliczeniowa Giełd Towarowych SA (the Warsaw Commodity Clearing House). The order of priority of the physical performance via the transmission system of transactions concluded within the Polish Power Exchange depends upon their respective grid codes.

ii Energy market rules and regulation

Trading in electricity and natural gas at the Polish Power Exchange is regulated by the 2000 Act on Commodity Exchange and by internal by-laws developed by the operator of the commodity exchange and subject to the prior approval of the Polish Financial Supervisory Commission. The remaining OTC electricity and gas sale agreements are regulated by the 1997 Energy Law and secondary legislation issued thereupon and by the grid codes that are binding on market participants upon their approval by the President of the Energy Regulatory Office.

All transactions covering wholesale energy products (made either on organised markets or on an OTC basis) are subject to the transparency rules set forth in Regulation (EU)

No. 1227/2011 of the European Parliament and of the Council on wholesale energy market integrity and transparency (REMIT) and secondary legislation issued thereupon, which (1) prohibit market manipulation and insider trading; and (2) oblige market participants to disclose inside information and report to the EU Agency for the Cooperation of Energy Regulators on fundamental data and all transactions in wholesale energy products, including orders to trade.

iii Contracts for sale of energy

In principle, electricity and natural gas may be traded either via commodity exchange or in OTC contracts. However, recent amendments to the 1997 Energy Law provide that:

- a* every electricity producer is obliged to sell at least 15 per cent of its annual production via the commodity exchange or other organised trading platforms operated by the company operating the regulated stock exchange;
- b* furthermore, the electricity producers entitled to compensation for the stranded costs are obliged to sell their outstanding production (i.e., not subject to the above-mentioned 15 per cent commodity exchange obligation) via the commodity exchange or other organised trading platforms operated by the company operating the regulated stock exchange or in public auction;
- c* the above-mentioned obligations related to public sale of electricity do not apply to certain types of electricity (*inter alia*, electricity delivered via direct lines, electricity generated in installations with total installed capacity not exceeding 50MW or renewable energy sources or certain CHP installations, and electricity used for the producer's own purposes or for statutory tasks allocated to system operators); and
- d* the entrepreneur trading in natural gas is obliged to sell via the commodity exchange or other organised trading platforms operated by the company operating the regulated stock exchange at least 55 per cent of natural gas introduced into Polish gas transmission system, it being specified that the foregoing obligation does not apply to certain quantities of natural gas (*inter alia*, compulsory stocks, natural gas exported from Poland or used for own purposes of the gas trader or used for statutory tasks allocated to system operators).

iv Market developments

At present, the main goals of the Polish legislature and regulators include (1) restructuring and strengthening the coal mining industry; (2) securing long-term profitability of large conventional system power plants by, *inter alia*, organisation of the power supply capacity market; and (3) supporting the most efficient CHP and RES generation, while at the same time limiting the budget allocated for incentive schemes.

V RENEWABLE ENERGY AND CONSERVATION

i Development of renewable energy

RES operators currently benefit from a number of incentives, including (1) an incentive scheme based on an obligation imposed on certain market participants (mainly electricity suppliers and major end users) to acquire and redeem green certificates corresponding to a pre-defined percentage of electricity sold to end customers or pay a substituting fee (the fee working in practice as maximum level of support available to beneficiaries); (2) exemption from excise tax; (3) reduction of interconnection fees payable by certain RES energy

producers; and (4) preferential financing, etc. In general, the current incentive system does not differentiate in the level of support depending on the RES technology applied (biomass, wind, photovoltaic, etc.) or generation capacity of a given RES installation. It does not provide RES operators with stable support as the level of support depends on the global amount of RES energy supplied to the market in a given period (thus if the overall production of RES energy is higher than the general aim set forth in the law, the level of support is lower).

The foregoing drawbacks of the current system resulted in the adoption of the new 2015 RES Act, which significantly changed the RES support system as of 1 July 2016. The 2015 RES Act introduced the new auction-based support system under which auctions shall be carried out at least once a year to select the most competitive RES operators authorised to benefit from support in the form of either:

- a* a 15-year long-term power purchase agreement concluded with the obliged purchaser and providing for sale of electricity for the price agreed within the auction – in the case of RES installations below 0.5MW; or
- b* the right to compensation of the difference between (1) the envisaged revenues from the sale of actually generated electricity for the price agreed within the auction and (2) the market value of the same electricity calculated based on average daily prices of electricity quoted at the commodity exchange – in the case of RES installations with installed capacity of 0.5MW or higher.

The above is valid provided that the period of support in any form must end no later than 31 December 2035, save for offshore wind installations where the expiration date may be extended to 31 December 2040.

Financial resources available to RES producers under the new auction system will be collected from the final energy consumers by DSO and TSO (RES Payers) and then transferred through the state-controlled company Settlement Operator SA to the RES operators selected within the auction either directly or – in the case of RES installations below 0.5MW – through obliged purchasers.

The operators of RES installations commissioned before 1 July 2016 may be authorised to choose whether to benefit from the current support scheme based on the tradable certificates of origin (acquired rights) or the new auction system, but in any case the total period of support available to the existing RES cannot exceed 15 years from the first generation confirmed by green certificate. Besides this, the current support scheme based on tradable green certificates will be adjusted to:

- a* limit the total period of support to 15 years from commissioning of given installation; and
- b* limit the amount of support addressed to multi-fuel power plants using biomass and hydro-power installations.

The Polish parliament also adopted the 2016 Act on Investments in Wind Power Plants, which negatively affected onshore wind-farm businesses in Poland, including:

- a* setting of a minimum distance between wind turbines and buildings, which negatively affected viability of projects including wind farms under construction and modernisation of existing wind farms; and
- b* changes to the rating of wind turbines for the purposes of property tax, which resulted in a significant increase in property tax paid on wind turbines.

ii Energy efficiency and conservation

The main incentive scheme relating to energy efficiency and conservation is based on tradable white certificates, which are granted to investors that undertake to make investments related to energy efficiency. According to the 2016 Act on Energy Efficiency, certain market participants (including electricity suppliers and major end-users) are obliged to acquire and redeem white certificates corresponding to a certain percentage of energy and gas sold to end-users or pay a substituting fee (the fee working in practice as the maximum level of support available to beneficiaries). Apart from the foregoing incentive scheme, there are preferential financing schemes offered by governmental funds and banks (e.g., the National Fund for Environmental Protection and Water Management) addressed to energy-efficiency investments.

iii Technological developments

The Polish government supports the development of RES and CHP generation and investments aimed at energy efficiency, with such investments currently benefiting from, *inter alia*, (1) incentive schemes based on tradable certificates; (2) tax exemptions; (3) reduction of interconnection fees; (4) preferential financing; (5) exemption of ‘prosumers’ from licensing obligations; and (6) support for investments in smart grid and smart metering, etc. Besides this, under the new 2015 RES Act the RES operators are able to benefit from the new auction system (see Section V.i, *supra*), while RES prosumers are able to benefit from the feed-in tariff, which will allow for the automatic sale of electricity generated in micro-installations at a price equal to 100 per cent of the electricity market price.

VI THE YEAR IN REVIEW

Polish energy policy is subject to significant changes arising from adoption regulations that would, in particular, strengthen the coal-mining sector, support stable (including coal, lignite, gas and biogas-fired) power generation units, strengthen security of electricity and gas supplies as well as creating level playing field for businesses related to liquid fuels, impose increased administrative and tax burdens on onshore wind-farm developers and operators and increase the overall reliability of the distribution grid, as well as ensuring proper levels of security within the Polish energy market, including state instruments to block potential hostile takeovers of energy companies currently controlled by the Polish state. Major developments in the Polish energy market in this year include:

- a* the entry into force and further amendments to the new RES Act adopted by the Polish parliament on 20 February 2015, which restrains the costs of the RES support system and guarantees stable revenues from RES generation to the entities that won the auction (see Section V.i, *supra*);
- b* entry into force of the 2016 Act on Investments in Wind Power Plants which negatively affected onshore wind-farm businesses in Poland (see Section V.i, *supra*);
- c* legislative works on introduction of the capacity market in order to support investments in power plants with stable generation profile;
- d* adoption of the Act of 22 July 2016 on Amendments to the 1997 Energy Law, which introduced additional licence requirements applicable to production, storage, transshipment and trade in liquid fuels as well as extended the natural gas storage obligations;

- e* implementation of the ‘quality regulation’ providing for a potential decrease of tariff revenues as a penalty for the incumbent distribution system operator not meeting the ambitious reliability targets established by the President of the Energy Regulatory Office in respect of power distribution services; and
- f* enforcement of the Act of 24 July 2015 on Control of Certain Investments, which vests in the Minister of Energy powers of control over energy company takeovers (see Section II.iv, *supra*).

VII CONCLUSIONS AND OUTLOOK

The Polish energy market is still under reconstruction stemming from the implementation of European energy and climate change policies, technological revolution, and a need to foster market competition and replace worn energy assets developed more than 40 years ago. On the other hand, the government is aware of the costs related to reconstruction and it would like to prepare balanced reforms that will not become excessive burdens for the Polish industry and customers. In practice, the delayed reforms and uncertainty with respect to future regulation restrained investments in energy projects (especially development of RES installation and conventional power generation), which may have a negative impact on the future energy security, especially for generation capacities after 2018 when a number of old and worn power plants will be decommissioned. Therefore, the Polish government currently seems to be determined to complete regulatory reforms to ensure the progress of energy investments and avoid disturbances in the energy market.

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