

## The Obligation of Strategic Gas Storage Introduced in Poland as an Example of a Public Service Obligation Relating to Supply Security: A Question of Compliance with European Law

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### CONTENTS

- I. Introduction
- II. The EU legal framework of public service obligations in the gas sector
- III. Compliance with the gas strategic storage obligation, as set out in the Act on Fuel Reserves and the Proposal of November 3, 2010 with EU law
  1. Compliance with the provisions of Article 3(1) of Directive 2003/55/C
  2. Compliance with the requirement of justifiability of intervention in the general economic interest
  3. Compliance with the requirement that public service obligations must be clearly defined, transparent, non-discriminatory, and verifiable
  4. Compliance with the principle of proportionality and the “interest of the Union” principle
- IV. Conclusions

### *Abstract*

This paper presents the system for the strategic storage of gas imposed by the Act on Fuel Reserves and evaluates its compliance with the relevant provisions of EU law, in particular the so-called 2nd and 3rd Internal Energy Market Packages. Unlike the case of legislation on strategic oil stocks, EU legislation on gas does not impose on Member States any obligation to maintain strategic reserves of gas. Furthermore, Member States are obliged to implement common rules establishing an internal market in natural gas including Third Party Access (TPA) to storage facilities. However, Member States are allowed to impose on undertakings operating in the gas sector, in the general economic interest, public service obligations which may relate to supply security, and EU law recognizes the contribution of gas storage to the security of supply. Thus, the objective of this article is to evaluate

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whether the Act on Fuel Reserves as well as the amendments to it proposed by the Polish Ministry of the Economy are in line with the relevant provisions of EU law. The analysis includes the position of the Court of Justice presented in several judgements as regards the concept of public service obligations.

### *Résumé*

Ce document présente le système de stockage stratégique de gaz imposé par la loi sur les réserves en essence et évalue la conformité de ce système avec les provisions de la loi européenne et plus particulièrement les 2ème et 3ème paquets sur le marché intérieur de l'énergie. Contrairement à certaines législations sur les stocks pétroliers stratégiques, la législation européenne pour le gaz n'impose pas aux États membres une obligation de maintenir un stock stratégique en gaz. En outre, les États membres sont obligés d'appliquer des règles communes établissant un marché interne du gaz comprenant de l'accès des tiers aux installations de stockage. Cependant, ils sont autorisés à imposer aux entreprises opérant dans le secteur du gaz, dans l'intérêt économique général, des obligations de service public qui peuvent porter sur la sécurité d'approvisionnement et les lois européennes reconnaissent les installations de stockage comme un moyen essentiel, entre autres, de mettre en oeuvre les obligations de service public telle que la sécurité des approvisionnements. Donc l'objectif de cet article est d'évaluer si la loi sur les réserves en fuel et ses amendements proposés par le ministère de l'économie polonaise sont en accord avec les lois européennes correspondante. Cette analyse inclus notamment plusieurs jugements de Cour de justice concernant les obligations de service public.

**Classifications and key words:** public services obligations, security of supply of natural gas, obligation of strategic gas storage, TPA to storage facilities.

## **I. Introduction**

The access to gas storage facilities in Poland is regulated by the Act of 10 April 1997 – the Energy Law (hereafter, the Energy Law)<sup>1</sup>. Starting from 2004 it has been evolving in order to comply with EU energy law, including implementation of Directive 2003/55/EC<sup>2</sup>. It will be amended further in order to implement Directive 2009/73/EC<sup>3</sup>. It provides for designation of a Storage

<sup>1</sup> Consolidated text: Journal of Laws 2006 No. 89, item 625, as amended.

<sup>2</sup> Directive 2003/55/EC of the European Parliament and of the Council of 26 June 2003 concerning common rules for the internal market in natural gas and repealing Directive 98/30/EC, OJ [2003] L 176/57.

<sup>3</sup> Directive 2009/73/EC of the European Parliament and of the Council of 13 July 2009 concerning common rules for the internal market in natural gas and repealing Directive 2003/55/

System Operator (hereafter, SSO) for gas storage facilities located on Polish territory, and also requires the SSO to comply with numerous obligations<sup>4</sup>, including offering storage services to all system users on a non-discriminatory basis. The Energy Law provides for regulated access to all storage facilities located on Polish territory, as well as for the organization of access to ancillary services<sup>5</sup>. Therefore, the SSO is obliged to offer storage as well as ancillary services to system users on the basis of published tariffs, provided that none of the conditions for refusing access to the system is fulfilled<sup>6</sup>.

The demand for storage services in Poland is driven by two factors. The first regards the daily and seasonal variations of natural gas demand as is natural in every Member State. In particular, seasonal storages are used to manage the increase of demand in winter and the decrease of demand in summer. Small-scale storage facilities (salt caverns), which have a lesser volume of gas and

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EC, OJ [2009] L 211/94. Directive 2009/73/EC introduces significant amendments to Directive 2003/55/EC and to Regulation (EC) No. 1775/2003 of the European Parliament and of the Council of 28 September 2005 on conditions for access to the natural gas transmission networks (OJ [2005] L 189/1) with regard to third-party access to storage. However, Directive 2009/73/EC does not introduce substantial changes to the organization of public service obligation (which will be analyzed in the following sections of the Paper). In particular, Articles 3(1) and 3(2) of Directive 2003/55/EC remained unchanged (Articles 3(1) and 3(2) of Directive 2009/73/EC have the same wording as the relevant Articles of Directive 2003/55/EC). Directive 2009/73/EC is to be implemented by March 3, 2011.

<sup>4</sup> Provided for in Article 9c of the Energy Law Act and in line with Article 8 of Directive 2003/55/EC.

<sup>5</sup> Storage facilities are defined in Article 2(9) of Directive 2003/55/EC, nevertheless the legal position of natural gas storage in Directive 2003/55/EC is unclear. First, Directive 2003/55/EC provides definitions for five types of storage facilities: storage used for production operations, storage used for excluding facilities reserved exclusively for transmission system operators in carrying out their functions, a facility used for the stocking of natural gas (natural gas storage), the part of LNG facilities or LNG terminals used for storage, temporary storage necessary for the re-gasification process and subsequent delivery to the transmission system (temporary LNG storage). However, only natural gas and liquefied natural gas (LNG) storages are subject to the TPA regime for gas storage under Directive 2003/55/EC. Second, Directive 2003/55 provides for two different perceptions about the legal position of TPA Storage in different Articles of Directive 2003/55/EC, as the concept of 'available capacity' in Article 21 is not the same as the capacity of TPA storage under the 'TPA Necessity Condition' in Article 19 [...]. The problem was, at least to some extent, addressed in Directive 2009/73/EC. According to Article 33 of Directive 2009/73/EC, the portion of storage facilities falling under the access to storage rule is further delimited. In particular, Member States that limit application of the TPA rule only to the storage facilities and linepack when 'technically and/or economically necessary for providing efficient access to the system for the supply of customers, as well as for the organization of access to ancillary services' are obliged to define and publish criteria according to which the access regime applicable to storage facilities and linepack may be determined

<sup>6</sup> For more information refer to: A. Falecki, M. Mordwa, 'Komentarz do art. 4c' [in:] M. Swora, Z. Muras (eds.), *Prawo energetyczne. Komentarz*, Warszawa 2010, pp. 338–348.

higher output capacity, are to provide short-term flexibility during cold snaps. In Poland the seasonal and daily swing of gas consumption is a relatively important factor due to climate conditions and the vast share of natural gas supply being consumed for households and heating purposes<sup>7</sup>. According to the Commission's working document, Member States from the Baltic Region have the highest heating degree days, and therefore the highest demand for heating in the EU (Poland was the eighth country on the list)<sup>8</sup>. The second factor for demand for storage in Poland stems from the need to comply with requirements imposed on undertakings – namely, the legal obligation of maintaining strategic storage of natural gas on Polish territory. Mandatory gas stocks and mandatory use of gas from gas stocks for households was also introduced in Hungary (45 days of gas demand) and Portugal (15–20 days of gas demand), Spain (20 days of consumption – 10 days as strategic, and 10 days as commercial storage)<sup>9</sup>.

According to the Act on Fuel Reserves<sup>10</sup> every undertaking which is shipping natural gas to Poland or supplying customers on Polish territory with natural gas not originating from domestic production is obliged to keep strategic storage of gas on Polish territory. The amount of natural gas to be stored shall equal the volume of natural gas shipped to Poland by the undertaking during an average 30 days of its operation. Nonetheless, the level of 30-days reserve of natural gas will be required from October 1, 2012 and the Act on Fuel Reserves provides for the progressive timetable of achieving this target starting from the level of an 11-day reserve of natural gas from the day of implementation of the Act on Fuel Reserves<sup>11</sup>. Undertakings that are shipping to Poland less than 50 million cubic meters of natural gas and supplying fewer than 100,000 customers may receive an exemption from this obligation from the Minister of the Economy. Such exemption is valid for one year.

In Poland all underground gas storage facilities belong to the Polish Oil and Gas Company S.A. (hereafter, PGNiG). In 2009 and 2010 the company

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<sup>7</sup> 'National Report from the President of the Energy Regulatory Office in Poland', July 2008, p. 72 (available at: [http://www.ure.gov.pl/portal/en/17/67/Activity\\_Report.html](http://www.ure.gov.pl/portal/en/17/67/Activity_Report.html)). The demand for gas is highly seasonal in the countries where a large part of the demand for gas stems from household temperature-dependant gas consumption and at the same time the share of imported gas to a country is substantial ('Study on natural gas storage in the EU (draft final report)' (2008) 10 *Ramboll*; see: IEA – Gas Trade Flows in Europe; available at: <http://www.iea.org/gtf/index.asp>).

<sup>8</sup> Commission staff working document, accompanying document to the proposal for a regulation of the European Parliament and of the Council concerning measures to safeguard security of gas supply and repealing Directive 2004/67/EC. Assessment report of directive 2004/67/EC on security of gas supply, SEC (2009) 978, Table: Winter Comparison, p. 18.

<sup>9</sup> *Ibidem*, p. 23.

<sup>10</sup> Articles 24 and 25 of the Act of 16 February 2007 on Reserves of Oil, Oil Products, Natural Gas and on Procedures in Case of Emergency in Security of Fuel Supply and Disturbance on Oil Market (Journal of Laws 2007, No. 52, item 343, as amended).

<sup>11</sup> Article 74 of the Act on Fuel Reserves.

operated underground gas storage facilities of a total working capacity equal to 1.630 billion m<sup>3</sup> and covered from 30 to 50 days (12%) of domestic gas consumption depending on climate conditions<sup>12</sup>. PGNiG made 50 million m<sup>3</sup> of storage capacity available to OGP Gaz-System SA in connection with its transmission system operator function. The remaining storage capacity, including capacities offered on the basis of Third Party Access (TPA) requirements, was used for PGNiG's needs<sup>13</sup>.

PGNiG uses storage facilities not only in order to ensure the continuity of gas supply to its customers, but also to fulfill the strategic storage of gas obligation imposed by the Act on Fuel Reserves. On May 30, 2009 the strategic reserves kept by PGNiG totaled 296 million m<sup>3</sup> of gas. In 2009 seventeen undertakings holding a license to ship gas to Poland did not keep a strategic gas reserve. Thirteen of them were not subject to the strategic storage of gas obligation as they had not begun the activity of shipping gas to Poland (Elcom, PKN Orlen, Pol Aqua, Megagaz, Gas Trading, Energia Trading, ZA Puławy, Ekoenergia, Bartimpex, Emfesz, ZA Anwil, Polenergia, Petro Wigor) and the four remaining received exemption from the Minister of the Economy (Handen, KRI, CP Energia, EWE energia)<sup>14</sup>.

The impact of the Act on Fuel Reserves on competition on the gas market in Poland is undeniably negative. The President of the Energy Regulatory Office (*Prezes Urzędu Regulacji Energetyki*; hereafter, the URE President) identified the strategic storage obligation as one of the impediments to the development of a competitive gas market in Poland<sup>15</sup>. In 2006 and 2007, the URE President initiated two dispute settlement proceedings regarding PGNiG's refusal to

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<sup>12</sup> 'Monitoring report of security of gas supply issues from Minister of the Economy from 1 January 2009 to 31 December 2009', p. 31 (available at: <http://www.mg.gov.pl/Gospodarka/Ropa+i+gaz/Sprawozdania>).

<sup>13</sup> PGNiG-Storage System Operator Division operates: 1) five underground storage facilities located in the depleted fields (UGS Wierzchowice, UGS Husów, UGS Strachocina, UGS Swarzów, UGS Brzeźnia) – used as seasonal storages serving to cope with seasonal demand as well as to fulfil strategic storage obligation; 2) one smaller scale storage facility located salt caverns (UGS Mogilno); 3) three remaining storage facilities used for production operations (UGS Daszewo, UGS Bonikowo, UGS Kosakowo) and thus excluded from the scope of the definition of 'storage facility' (refer to <http://www.pgnig.pl/osm/magazyny>). According to the PGNiG – Storage System Operator Division, the Storage service rules, from May 17, 2010, storage service are provided through the storage installations: a) CUGS Mogilno, b) Virtual Storage Installation consisting of UGS Husów and UGS Wierzchowice a) CUGS Mogilno, b) Virtual Storage Installation consisting of UGS Husów and UGS Wierzchowice (document available at: <http://www.pgnig.pl/osm/uslugi/zasady/18482>).

<sup>14</sup> 'Annual Activity Report from the President of the Energy Regulatory Office in 2009', March 2010, p. 92 (available at <http://www.ure.gov.pl/portals/pl/423/2916/Sprawozdania.html>).

<sup>15</sup> The URE President pointed out that in 2007 PGNiG didn't offer any storage services to system users and only used storage capacities for its own use in order to ensure continuous gas

provide storage services to two enterprises: Emfesz NG Polska sp. z o.o. and Media Odra Warta sp. z o.o.<sup>16</sup> PGNiG justified refusal to grant access to storage facilities on the grounds of a lack of available capacity. Moreover, in January 2009, the URE President denied PGNiG an exemption from Third Party Access (TPA) to storage requirements on the grounds of Take-or-Pay obligations.

Simultaneously to the proceedings carried out by the URE President, on November 28, 2007, the European Commission initiated infringement proceedings against Poland in order to verify whether the provisions regarding storage facilities included in the Act on Fuel Reserves and the Energy Law were infringing Directive 2003/55/EC (Directive 2009/73/EC), as along with Directive 2004/67/EC (Regulation 994/2010)<sup>17</sup>. The European Commission pointed out that there was no SSO for storage facilities located in Poland and that storage services were not provided to third parties, as well as that the provisions on strategic storage obligation were infringing competition on Polish, as well as on EU markets<sup>18</sup>. Subsequently, on December 31, 2008 the PGNiG Storage System Operator Division was designated by the URE President as an SSO for the period from January 1, 2009 to December 31, 2025 and implemented TPA to storage<sup>19</sup>. In July 2009 the SSO conducted an open season procedure in order to allocate available storage capacity to the market participants<sup>20</sup>. Eventually, in the Act of January 8, 2010 introducing amendments to the Energy Law Act, the Polish Parliament adopted provisions strengthening the competences of the URE President in the procedure for

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supply to the customers ('National Report from President of the Energy Regulatory Office in Poland', July 2008, p. 50).

<sup>16</sup> The proceeding was initiated on the basis of Article 8(1) of the Energy Law (replay from March 2008 of W. Pawlak, Minister of Energy to MP interpellation No. 753, available at: <http://orka2.sejm.gov.pl/IZ6.nsf/INTop/00753?OpenDocument>).

<sup>17</sup> Council Directive 2004/67/EC of 26 April 2004 concerning measures to safeguard security of natural gas supply, OJ [2004] L 127/92.

<sup>18</sup> The infringement proceeding initiated by the Commission against Poland (Infringement No 2006/4918) originally was to verify that the provisions regarding storage facilities included in the Act on Fuel Reserves and the Energy Law Act are not in compliance with Art. 3(1), 7, 8(1)(b) and (d) and Art. 19 of Directive 2003/55/C as well as Article 3(2) of Directive 2004/67/EC (M. Nowacki, *Prawne aspekty bezpieczeństwa energetycznego w UE*, Warszawa 2010, p. 136).

<sup>19</sup> SSO adopted on May 17, 2010 Storage Service Rules (Storage Services Code), received on 16 June 2009 a approval from the URE President of Gas Storage Services Tariff No. 1/2010 (effective from July 1, 2009); documents available at <http://www.osm.pgnig.pl/osm>.

<sup>20</sup> However, the only undertaking that applied for available storage capacity was PGNiG ('National Report to the European Commission from the President of the Energy Regulatory Office in Poland', July 2010, p. 62; available at [http://www.ure.gov.pl/portal/en/17/67/Activity\\_Report.html](http://www.ure.gov.pl/portal/en/17/67/Activity_Report.html)). This raises concerns as to whether the Storage Services Code together with conducted allocation procedure were in line with Directive 2003/55/EC especially as regards requirements of competitiveness and non-discrimination.

designating a system operator and thus ensured compliance of the Energy Law with the provisions of Directive 2003/55/EC. Therefore, the European Commission limited its further investigation to the issue of compliance of the provisions on strategic storage of gas with EU law<sup>21</sup>.

In order to adjust the provisions on strategic storage of gas with EU law, as well as to address concerns raised by the European Commission, the Ministry of the Economy on June 2, 2010 launched public consultations on a proposal of the Act amending the Act on Fuel Reserves (hereafter, the Proposal of November 3, 2010)<sup>22</sup>. According to the Proposal of November 3, 2010 the obligation to maintain strategic storage of gas imposed by the Act on Fuel Reserves will be sustained. Nevertheless, it contains several provisions mitigating the negative impact of the strategic storage obligation to competition on the gas market. As a result the Proposal of November 3, 2010:

- 1) limits the categories of undertakings being subject to the strategic storage obligation – at present the obligation is imposed on every undertaking shipping natural gas to Poland or supplying customers on Polish territory with natural gas not originating from domestic production. According to the Proposal of November 3, 2010 only undertakings performing the activity of supplying customers on Polish territory with natural gas not originating from domestic production will be subject to the strategic storage obligation, thus undertakings that perform only the activity of shipping natural gas to Poland in particular in order to use it for their own consumption will be exempted from this obligation;
- 2) increases the limits for an undertaking to be eligible to receive an exemption from the obligation of strategic storage – at present exemption from this obligation may be issued by the Minister of the Economy only to undertakings shipping to Poland less than 50 million cubic meters of natural gas and supplying less than 100,000 customers. According to the Proposal of November 3, 2010 these limits will be 100 million cubic meters of natural gas and 100,000 customers;
- 3) entitles newcomers to apply to the Minister of the Economy for exemption from strategic storage obligation – at present the Minister of the Economy denies an exemption from strategic storage obligation to undertakings interested in shipping gas to the Polish market on the grounds that Article 24 of the Act on Fuel Reserves provides only for

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<sup>21</sup> Commission Press release No. IP/10/945, Brussels, July 14, 2010.

<sup>22</sup> The Proposal of November 3, 2010 of the Act on amendment of the Act on Reserves of Oil, Oil Products, Natural Gas and on Procedures In Case of Emergency In Security of Fuel Supply and Disturbance on Oil Market and of the Energy Law Act, version 1.0015. The Proposal of November 3, 2010 incorporates comments given by stakeholders during consultation process (documents available at: <http://bip.mg.gov.pl/node/11962>).

- exemption of undertakings that are already active on the Polish Market<sup>23</sup>, according to the Proposal of November 3, 2010 also undertakings that received from the President of the ERO pre-license for trading natural gas with other countries are entitled to apply to the Minister of the Economy for exemption;
- 4) enables undertakings to use gas storages in another Member State, provided that: i) storage facilities located in another Member State are directly connected to the gas system<sup>24</sup>; ii) technical parameters of storage facilities and of the grids to which these storage facilities are connected are such that they guarantee possible injection of all the gas kept in order to comply with the strategic storage obligation to the Polish transmission system within no more than 40 days; and iii) the undertaking receives consent from the Minister of the Economy to keep strategic gas reserves outside Polish territory based on the opinion of the transmission system operator that the shipper has presented substantiated proof that gas will be physically injected into the Polish transmission system within 40 days.

## **II. The EU legal framework of public service obligations in the gas sector**

Both Directive 2003/55/EC as well as Directive 2009/73/EC seek to complete the internal market in natural gas and to speed up liberalization in this sector with a view to achieving a fully operational internal market. Pursuant to Recital 1 of Directive 2009/73 ‘the internal market in natural gas, which has been progressively implemented throughout the Community since 1999, aims to deliver real choice for all consumers of the European Union, be they citizens or businesses, new business opportunities and more cross-border trade, so as to achieve efficiency gains, competitive prices, and higher standards of service, and to contribute to security of supply and sustainability.’ Consequently, Article 3(1) of Directive 2003/55/EC (Directive 2009/73/EC) imposes on Member States the obligation to ensure that ‘natural gas undertakings are operated in accordance with the principles of this Directive with a view to achieving a competitive, secure and environmentally sustainable

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<sup>23</sup> ‘Activity Report of the President of the Energy Regulatory Office’, July 2008, p. 74.

<sup>24</sup> According to Article 24a(1) of the Proposal of November 3, 2010 the strategic storages of gas may be kept in storage facilities on the territory of another Member State directly connected to the ‘gas system’. In Article 2(24) of the Act on Fuel Reserves ‘gas system’ is defined as ‘gas grids together with connected to them facilities and installations cooperating with the grids, as well as installations located on Polish territory used for introduction of gas to Polish territory and distribution of it on Polish territory’.



market in natural gas, and shall not discriminate between these undertakings as regards either rights or obligations.’ The implementation of the internal market in natural gas is strengthened further by Article 3(5) of Directive 2009/73/EC imposing on Member States the obligation to ensure that ‘all customers connected to the gas network are entitled to have their gas provided by a supplier, subject to the supplier’s agreement, regardless of the Member State in which the supplier is registered, as long as the supplier follows the applicable trading and balancing rules and is subject to security of supply requirements. In this regard, Member States shall take all measures necessary to ensure that administrative procedures do not constitute a barrier for supply undertakings already registered in another Member State.’

However, the foregoing provision of Article 3(1) of Directive 2003/55/EC (Directive 2009/73/EC) is ‘without prejudice to paragraph 2’ of this Article which provides that ‘having full regard to the relevant provisions of the Treaty, in particular (Article 106 of Treaty on the Functioning of the European Union (hereafter, TFEU), Member States may impose on undertakings operating in the gas sector, in the general economic interest, public service obligations (PSO)<sup>25</sup> which may relate to security, including security of supply (...). Such obligations shall be clearly defined, transparent, non-discriminatory, verifiable and shall guarantee equality of access for EU gas companies to national consumers.’ As stated in Recital 27 of Directive 2003/55/EC compliance with public service requirements ‘is a fundamental requirement of this Directive, and it is important that common minimum standards, respected by all Member States, are specified in this Directive, which take into account the objectives of (...) security of supply and equivalent levels of competition in all Member States. It is important that the public service requirements could be interpreted on a national basis, taking into account national circumstances and subject to the observance of Community law.’ The power of Member States to impose PSO is subject to verification by the European Commission, since according to Article 3(6) of Directive 2003/55/EC (Article 3(11) of Directive 2009/73/EC) Member States are obliged to inform the European Commission of all measures adopted to fulfill public service obligations and their possible effect on national and international competition.

The above-mentioned provisions apply equally to undertakings performing the activity of storage of natural gas in storage facilities. According, to Recital 6 of Directive 2003/55 ‘the main obstacles in arriving at a fully operational

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<sup>25</sup> Directive 2003/55 does not define the term ‘public service obligations’. However, under EU law, Article 2 of Council Regulation No. 1191/69 of June 26, 1969 concerning PSOs in inland transport (OJ [1969] L 156) defines PSOs as ‘obligations which the undertaking ..., if it were considering its own commercial interests, would not assume or would not assume to the same extent or under the same conditions’.

and competitive internal market relate to, amongst other things, issues of (...) access to storage (...)’<sup>26</sup>. The core provision, as far as the regulatory framework for operating storage facilities is concerned, constitutes Article 19 of Directive 2003/55/EC (Article 33 of Directive 2009/73/EC) which imposes on Member States the obligation to choose either or both of the procedures for the organization of access to storage facilities and linepack (negotiated or regulated access regime) and ensure that the TPA system is operated in accordance with objective, transparent, and non-discriminatory criteria. Furthermore, according to Article 21 of Directive 2003/55/EC access to storage facilities can be refused on the grounds of lack of capacity, PSO, and take-or-pay (ToP) problems<sup>27</sup>.

As stated above, PSO, including these imposed on an SSO, may relate to security, including security of supply. Directive 2003/55/EC recognizes the fundamental role that storage facilities can perform in the Member States’ security of energy supply policy. In Recital 21 of Directive 2003/55/EC it is stated that ‘storage facilities are essential means, amongst other things of implementing public service obligations such as security of supply’. However, ‘this should not lead to distortion of competition or discrimination in the access to storage.’ The European Commission is of the position that ‘a clear and transparent definition of Public Service Obligations, as required by Article 3(2) of Directive 2003/55/EC (Article 3(2) of Directive 2009/73/EC), in terms of storage capacities is considered an indispensable prerequisite for refusal of access to storage facilities on the grounds of PSOs. If PSOs are not in line with the requirements of Article 3(2) of Directive 2003/55/EC, as well as (Regulation 2010/994<sup>28</sup>), they cannot constitute grounds for refusing access to storage’<sup>29</sup>.

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<sup>26</sup> The same logic was followed in Directive 2009/73/EC introducing obligation of legal and functional unbundling of OSM as well as strengthening the transparency requirements in respect of the storage capacity that is offered to third parties.

<sup>27</sup> For more see: B. Nowak, *Wewnętrzny rynek energii w Unii Europejskiej*, Warszawa 2009, pp. 102–123.

<sup>28</sup> Regulation (EU) No. 994/2010 of the European Parliament and of the Council of 20 October 2010 concerning measures to safeguard security of gas supply and repealing Council Directive 2004/67/EC (OJ [2010] L 295/1); Regulation 994/2010 repeals from December 2, 2010 Directive 2004/67/EC with the exception of Article 4(1) and (2) of that Directive which shall apply until the Member State concerned has defined protected customers in accordance with Article 2(1) of this Regulation and has identified the natural gas undertakings in accordance with Article 8(1) of this Regulation. Nonetheless, Article 4(1) and (2) of Directive 2004/67/EC shall no longer apply after June 3, 2012.

<sup>29</sup> Note of DG Energy & Transport on Directives 2003/54/EC and 2003/55/EC on the internal market in electricity and natural gas, third party access to storage facilities, 16.1.2004, p. 9; ‘Commission staff working paper: interpretative note on Directive 2009/73/EC concerning common rules for the internal market in natural gas third-party access to storage facilities’, 22 January 2010, p. 15 (both documents are available at: [http://ec.europa.eu/energy/gas\\_electricity/interpretative\\_notes/interpretative\\_note\\_en.htm](http://ec.europa.eu/energy/gas_electricity/interpretative_notes/interpretative_note_en.htm)).

Further requirements for PSO related to security of supply are laid down in Directive 2004/67/EC and in Regulation 2010/994 repealing Directive 2004/67/EC. According to Article 3(2) of Directive 2004/67/EC Member States are obliged to ensure that the measures to safeguard security of natural gas supply adopted on the basis thereof do not place an unreasonable and disproportionate burden on gas market players and thus distort competition, and are compatible with the requirements of a competitive internal gas market, i.e., are not discriminatory<sup>30</sup>. The Annex of Directive 2004/67/EC presents a non-exhaustive list of instruments which should enhance the security of gas supply. One of the instruments mentioned therein consists of working gas in storage capacity, and withdrawal capacity in gas storage. The Annex to Directive 2004/67/EC does not provide any further specifications or details of the suggested instruments, their importance, nor any relation between them, their impact on the security of gas supply, nor any preferences towards a particular measure. Although the Directive does not mandate any gas storage targets, it puts a strong emphasis on this instrument, as it is the only instrument facilitating security of supply which is specifically addressed in Directive 2004/67/EC. According to Recital 7 of Directive 2004/67 'indicative minimum targets for gas storage could be set either at the national level or by industry'. Those indicative targets, if set, 'should not create any additional investment obligations'. Furthermore, according to Article 4(6) of Directive 2004/67 such minimum storage targets should be published for transparency reasons.

Also, the Annexes of Regulation 2010/994 provide a non-exhaustive list of security of gas supply measures to be used by Member States. Usage of strategic gas storage may be introduced only as a non-market based measure applied in the event of an emergency. Therefore, neither Directive 2004/67/EC nor Regulation 994/2010 introduced an EU-level obligation as regards strategic storage of gas. The European Commission strongly encourages all Member States to support the development of commercial storages, but does not propose an EU-level obligation as regards strategic stocks. This is due to the fact that Member States have different levels of exposure to risks and hence different gas supply security requirements. A country with diversified gas import or a high share of own production, good level of interconnections with neighbours, developed market and high fuel switching possibilities (high share of industry or power generation consumption) may be less exposed to risks and may develop less expensive measures than strategic stocks to deal efficiently with supply shortages. Furthermore, geological conditions in certain areas may

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<sup>30</sup> The requirements for PSO introduced in Article 3(2) of Directive 2004/67/EC are sustained in Article 3(6) of Regulation 994/2010. Furthermore, Article 3(6) of Regulation 994/2010 requires that the measures to ensure the security of supply do not endanger the security of gas supply of other Member States or of the Union as a whole.

also limit the development of gas storage facilities. Moreover, according to European Commission estimations stockpiling of natural gas is several times more expensive when compared to oil stocks<sup>31</sup>. Therefore, the European Commission is of the opinion that strategic stocks might be the preferable or midterm solution only for countries with single-source dependence and a high share of uninterrupted demand. The European Commission also pointed out that if a Member State chooses strategic gas stocks as a national measure, ‘the use of strategic stocks has to be carefully regulated to avoid market distortions: strategic stocks should not be released in non-crisis situations to influence the value of storage and other flexibility instruments that are developed under competitive market conditions’<sup>32</sup>. According to the European Commission strategic storages of gas are ‘still considered a storage facility under the definition of the Gas Directive’, as Directive 2003/55/EC (and Directive 2009/73/EC) ‘does not provide for special treatment of such storages, but it allows Member States to take such measures under Article 3(2) Gas Directive under strict conditions, requiring a notification to the European Commission under Article 3(11) Gas Directive’<sup>33</sup>.

### **III. Compliance with the gas strategic storage obligation as set out in the Act on Fuel Reserves and the Proposal of November 3, 2010 with EU law**

#### **1. Compliance with the provisions of Article 3(1) of Directive 2003/55/EC**

The provision on strategic storage provided by the Act on Fuel Reserves is designated as a measure to safeguard an adequate level for the security of gas supply. According to the Polish government’s Statement of Reasons

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<sup>31</sup> The cost per unit of energy for gas is approximately 16.7 MEUR per PJ, compared to 3.33 for oil. Commission staff working document, accompanying document to the proposal for a regulation of the European Parliament and of the Council concerning measures to safeguard security of gas supply and repealing Directive 2004/67/EC. ‘Assessment report of directive 2004/67/EC on security of gas supply’, SEC (2009) 978, Table: Winter Comparison, p. 24.

<sup>32</sup> Communication from November 13, 2008 from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of Regions on the Directive 2004/67/EC of 26 April 2004 concerning measures to safeguard security of natural gas supply, COM(2008) 769 final.

<sup>33</sup> ‘Commission staff working paper: interpretative note on Directive 2009/73/EC concerning common rules for the internal market in natural gas third-party access to storage facilities’, January 22, 2010, p. 14.

for the Act on Fuel Reserves<sup>34</sup>, the Act on Fuel Reserves implements into Polish law Directive 2004/67/EC. According to Article 24(1) of the Act on Fuel Reserves, the stockpiling of natural gas is destined to be used exclusively in emergency situations; therefore natural gas is inaccessible under normal market conditions.

The measure obviously restricts competition, as it imposes a burden on enterprises shipping natural gas to Poland or supplying customers on Polish territory with natural gas originating not from domestic production, in the form of obligatory strategic storage of gas on Polish territory. Thus the gas strategic storage obligation is not in line with Article 3(1) of Directive 2003/55/EC (Directive 2009/73/EC).

As mentioned above, however, Article 3(2) of Directive 2003/55 (Directive 2009/73/EC) allows Member States to derogate from general provisions on compliance with common gas market principle of Article 3(1) of Directive 2003/55/EC (Directive 2009/73/EC) when introducing public service obligations. The term 'services of general economic interest' is specific to EU law<sup>35</sup>. Moreover, neither EU Treaties, nor the EU energy acts analyzed above give definition of that expression. As provided for in the TFEU, in particular Articles 14 and 106 thereof and as confirmed in Protocol No. 26 on services of general interest, annexed to the Treaty on European Union and to the Treaty on the Functioning of the European Union, Member States are primarily responsible for defining what they regard as services of general economic interest on the basis of the specific features of the activities<sup>36</sup>. However, this definition can be subject to control by the European Commission for 'manifest error'<sup>37</sup>. A 'manifest error' would occur when the measure employed

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<sup>34</sup> Sejm RP of V term, document No: 1238, available at: <http://www.sejm.gov.pl>.

<sup>35</sup> M. Stoczkiewicz, *Pomoc państwa dla przedsiębiorstw energetycznych w prawie UE*, Warszawa 2011, p. 205.

<sup>36</sup> Protocol No. 26 on services of general interest, annexed to the Treaty on European Union and to the Treaty on the Functioning of the European Union specifies that '[t]he shared values of the Union in respect of services of general economic interest within the meaning of Article 14 of the Treaty on the Functioning of the European Union include in particular: the essential role and the wide discretion of national, regional and local authorities in providing, commissioning and organising services of general economic interest as closely as possible to the needs of the users; the diversity between various services of general economic interest and the differences in the needs and preferences of users that may result from different geographical, social or cultural situations; a high level of quality, safety and affordability, equal treatment and the promotion of universal access and of user rights', OJ [2008] C 115/308.

<sup>37</sup> Refer to European Commission in Communication from 20 September 2000 on Services of General Interest in Europe Brussels, COM(2000) 580 final, paragraph 22.

is incompatible with EU law or with criteria established by the European Court of Justice<sup>38</sup>.

In order to be in line with EU law it is indispensable for public service obligations in the gas sector to ensure their compliance with the requirements defined in Article 3(2) of Directive 2003/55/EC (Directive 2009/73/EC) and in Article 3(2) of Directive 2004/67/EC (Article 3(6) of Regulation 994/2010). It follows from the wording of these EU legislative acts that for a PSO to be introduced it must: be in the general economic interest, be clearly defined, transparent, non-discriminatory, verifiable, guarantee equality of access for UE gas companies to national consumers and thus do not distort competition, as well as have full regard to the relevant provisions of the TFEU, in particular Article 106 thereof.

Hence, it is necessary to analyze the compatibility of the stockpiling of natural gas measure introduced in the Act on Fuel Reserves with the conditions set out in above-mentioned provisions.

## **2. Compliance with the requirement of justifiability of intervention in the general economic interest**

Article 3(2) of Directive 2003/55/EC incorporates the concept of the PSO into the list of measures for the organization of the gas sector and permits Member States to impose certain burdens on undertakings operating in the gas sector. Thus, the provision allows Member States wide discretion in assessing whether, in the general economic interest, it is necessary to impose public service obligations on undertakings operating in the gas sector in order, in particular, to ensure the security of gas supply to final consumers. Nevertheless, it follows from Article 3(2) of Directive 2003/55/EC that in each case when creating a PSO the Member State is obliged to examine whether a task of general economic interest exists.

As regards the issue of justifiability of intervention in the general economic interest there is no definition of that expression in Directive 2003/55/EC, but the reference in Article 3(2) of Directive 2003/55/EC both to that condition and to Article 106 TFEU, which concerns undertakings entrusted with the management of a service of general economic interest, implies that the

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<sup>38</sup> Refer to E. Gromnicka, 'Komentarz do art. 16 Traktatu ustanawiającego Wspólnotę Europejską' [in:] A. Wróbel, D. Miąsik, N. Półtorak (eds.), *Traktat ustanawiający Wspólnotę Europejską. Komentarz, Tom 1*, Warszawa 2008, p. 430, as well as M. Szydło, 'Komentarz do art. 86 Traktatu ustanawiającego Wspólnotę Europejską' [in:] A. Wróbel, K. Kowalik-Bañczyk, M. Szwarc-Kuczer (eds.), *Traktat ustanawiający Wspólnotę Europejską. Komentarz, Tom 2*, Warszawa 2009, p. 518.

condition should be interpreted in light of the latter provision of the TFEU<sup>39</sup>. The Court of Justice has specifically addressed the formula of public service obligation provided for in Article 106(2) TFEU. It has stated that Article 106(2) of TFEU, in allowing, in certain circumstances, derogations from the general rules of the Treaty seeks to reconcile the Member States' interest in using certain undertakings, in particular in the public sector, as an instrument of economic or fiscal policy with the Community's interest in ensuring compliance with the rules on competition and preservation of the unity of the common market. Therefore, Member States cannot be precluded, when determining the services of general economic interest which they entrust to certain undertakings, from taking account of objectives pertaining to their national policy or from endeavouring to attain them by means of obligations and constraints which they impose on such undertakings<sup>40</sup>.

The Court of Justice has held a large and varied group of services to be of general economic interest. In case C-393/92 *Municipality of Almelo and Others*, the Court of Justice accepted, with respect to a regional undertaking entrusted with electricity distribution, that the uninterrupted supply of electricity throughout the territory in respect of which the concession is granted to all consumers, whether local distributors or end-users, in sufficient quantities to meet demand at any given time, at uniform tariff rates and on terms which may not vary save in accordance with objective criteria applicable to all customers, is a task of general economic interest within the meaning of Article 106(2) of TFEU<sup>41</sup>. In case C-159/94 *European Commission v French Republic*, the Court of Justice recognized as public service obligations, the obligations of gas supply, continuity of gas supply, and equal treatment between customers or consumers<sup>42</sup>. Advocate General Ruiz-Jarabo Colomer in his opinion delivered in Case C- 265/08 *Federutility* enumerates the conditions for the provision of services of general economic interest – namely, that the service should be: uninterrupted (continuity); for the benefit of all consumers throughout the

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<sup>39</sup> Opinion of Advocate General Ruiz-Jarabo Colomer delivered on October 20, 2009 C-265/08 *Federutility, Assogas, Libarna Gas SpA, Collino Commercio SpA, Sadori gas SpA, Egea Commerciale, E.On Vendita srl, Sorgenia SpA v Autorità per l'energia elettrica e il gas* (not yet reported), para. 40–46.

<sup>40</sup> Judgements of the European Court of Justice: 202/88 *France v Commission* ECR [1991] I-1223, para. 12; C-157/94 *Commission v Netherlands* ECR [1997] I-5699, para. 39, 40; Case C-67/96 *Albany International BV v Stichting Bedrijfspensioenfonds Textielindustrie* ECR [1999] I-05751, para. 103, 104; C-265/08 *Federutility, Assogas, Libarna Gas SpA, Collino Commercio SpA, Sadori Gas Srl, Egea Commerciale Srl, E.On Vendita Srl, Sorgenia SpA v Autorità per l'energia elettrica e il gas*, para. 28, 29.

<sup>41</sup> C-393/92 *Municipality of Almelo and others v NV Energiebedrijf Ijsselmij* ECR [1994] I-01477, para. 48.

<sup>42</sup> C-159/94 *Commission v French Republic* ECR [1997] I-5815, para. 89, 96.

relevant territory (universality); at uniform tariff rates and of similar quality, irrespective of specific situations or of the degree of economic profitability of each separate transaction (equality); and transparent and affordable<sup>43</sup>.

The security of gas supplies raises serious concerns. The primary supply instruments are measures like diversifying the risk of disruption and financing pipeline construction, and long-term contracts with producers. Other instruments to provide security of supply include measures to increase system flexibility (e.g., fuel switching, interruptible contracts, cross-border pipeline capacity and liquid spot markets). However, these mechanisms have a limited capacity to absorb shocks that would endanger all the Member States at the same time, similar in scale to the gas supply disruptions in the EU that have occurred on several occasions (the most significant in January 2006 and 2009 with respect to gas supplies from Russia through Ukraine). To ensure uninterrupted services in the short-medium term, precautionary gas storage is indispensable<sup>44</sup>. Against this background and taking into account that both Directive 2004/67/EC as well as Regulation 994/2010 allow for using gas strategic storage as a non-market based security of gas supply measure to be applied only in the event of an emergency, the objective of ensuring continuity of gas supply to final consumers in case of disruption of gas supply constitutes grounds for ‘general economic interest’ and justifies public intervention designed as the gas strategic storage obligation<sup>45</sup>.

Nevertheless, it is indispensable that the other conditions of Directives 2003/55/EC and 2004/67/EC be met.

### **3. Compliance with the requirement that public service obligations must be clearly defined, transparent, non-discriminatory, and verifiable**

As mentioned above, from Article 3(2) of Directive 2003/55/EC (Directive 2009/73/EC) and from Article 3(2) of Directive 2004/67/EC (Article 3(6) of Regulation 994/2010) it follows that measures designed as a PSO must be: clearly defined, transparent, non-discriminatory, verifiable, and must guarantee equality of access for UE gas companies to national consumers.

In particular, a measure would be discriminatory if in reality intervention were to lead to imposing the burden arising from the intervention only on

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<sup>43</sup> See the Opinion of Advocate General Ruiz-Jarabo Colomer in case C-265/08 *Federutility*, para. 54, 55.

<sup>44</sup> The dependency on storage and its flexibility was clearly demonstrated in January 2009 when most MS doubled the gas supply from their storages in comparison to January 2008 [...]

<sup>45</sup> In Poland disruptions of gas supplies occurred in 2004, 2006 and 2010, refer to the Polish governments Statement of Reasons of the Act on Fuel Reserves, point 1 (The aim of the Act).



some of the undertakings active in the gas market. The requirement thus seeks to ensure that PSO binds all of the undertakings equally, so as to prevent the lack of competition from becoming worse<sup>46</sup>. The European Commission states that ‘in determining the storage needs for fulfilling PSOs, there must be no discrimination against newcomers, i.e., new market entrants taking PSOs must be given the same right and their storage needs for PSOs must be taken into account in the same manner as for the incumbent companies’<sup>47</sup>. The European Commission is of the opinion that the only way to effectively guarantee non-discrimination is to use a competitive tendering process to carry out public service obligation.

According to the European Commission and in line with established Court of Justice case-law the criterion of transparency is met when the public service task is assigned in the way of an official public instrument ‘that may take the form of a legislative or regulatory instrument or a contract or instruction’. Furthermore, the European Commission states that “this official instrument must specify: the nature of the public service obligations, the undertakings and territory concerned, the responsibility for determining the undertaking’s selling prices and the conditions for reviewing such prices, the nature of any exclusive or special rights assigned to the undertakings, the amount of any compensation granted to the undertakings and any revision clauses, as well as the period covered by these obligations.”<sup>48</sup>

As regards the criterion of verifiability, the European Commission, in the note on public services obligations from 2004, states that it will be assured when the measure chosen is the least restrictive possible for competition and trade between Member States. Moreover, according to the European Commission the burden of proof lies with the public authorities which impose the measure or with the undertaking if, in the context of the internal subsidiary of the Member State, it can choose the measure to fulfill the objective imposed on it<sup>49</sup>.

As far as the issue of non-discrimination is concerned it must be noted that the strategic storage obligation as framed in the Act on Fuel Reserves is imposed on every undertaking that ships natural gas to Poland or supplies

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<sup>46</sup> See the Opinion of Advocate General Ruiz-Jarabo Colomer in case C-265/08 *Federutility*, para. 81.

<sup>47</sup> ‘Commission staff working paper: interpretative note on Directive 2009/73/EC concerning common rules for the internal market in natural gas third-party access to storage facilities’, 22 January 2010, p. 15; available at: [http://ec.europa.eu/energy/gas\\_electricity/interpretative\\_notes/interpretative\\_note\\_en.htm](http://ec.europa.eu/energy/gas_electricity/interpretative_notes/interpretative_note_en.htm).

<sup>48</sup> Note of DG Energy & Transport on Directives 2003/54/EC and 2003/55/EC on the internal market in electricity and natural gas, public services obligations, 16.01.2004, p. 5 (available at: [http://ec.europa.eu/energy/gas\\_electricity/interpretative\\_notes/interpretative\\_note\\_en.htm](http://ec.europa.eu/energy/gas_electricity/interpretative_notes/interpretative_note_en.htm)).

<sup>49</sup> *Ibidem*, pp. 6–8.

customers on Polish territory with natural gas not originating from domestic production. Therefore, it does not apply to the undertakings performing the activity of gas production from domestic sources<sup>50</sup>. Neither does the Act on Fuel Reserves provide the possibility of exempting from the strategic storage obligation those undertakings interested in commencing the shipment of gas to the Polish market, as it only allows for exemption of undertakings that are already active on the Polish market and fulfill the conditions introduced in Article 24 of the Act on Fuel Reserves<sup>51</sup>. Moreover, the Act on Fuel Reserves includes the territorial clause, as the strategic storages of gas must be kept in storage facilities located on Polish territory. It can be seen from the above that the measure on strategic gas storage from the Act on Fuel Reserves infringes EU law as it is not compatible with the requirement of non-discrimination. The Proposal of November 3, 2010 introduces several changes (presented in the first section of the Paper) in order to adjust the Act on Fuel Reserves to the requirement of non-discrimination. Nevertheless, it must be pointed out that even after the Proposal of November 3, 2010 enters into force, still this criterion will not be met, as the Proposal does not impose the PSO on domestic production.

Regarding the second criterion, the obligation to maintain strategic storages of gas is imposed on undertakings by the official instrument – namely, the Act on Fuel Reserves, which is of a general nature. Also, the Act on Fuel Reserves specifies most of the details for implementing the PSOs enumerated by the European Commission. A separate issue is whether the provisions on the stockpiling of natural gas are accurately and exhaustively designed. As far as the issue of compensation granted to the enterprises, the Act on Fuel Reserves provides that the costs of keeping the strategic storage of gas are to be treated as justified costs and thus can be reimbursed through the tariffs for gas sold on Polish territory (Article 28(1) and 2 of Act on Fuel Reserves). Moreover, according to Article 45(1) of the Energy Act, undertakings investing in or maintaining storage facilities are ensured that the tariffs cover the justified costs of such investment but also the rate of return of not less

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<sup>50</sup> In Poland, domestic production provides an important part of gas mix as it satisfies almost 31% of domestic demand; however, the provision can be justified on the grounds that domestic production doesn't involve the same risks as imports, therefore there is no need to impose security measures on undertakings performing this activity. Nevertheless it should be noted that PGNiG has an almost 100% share in domestic production subsector ('National Report to the European Commission from the President of the Energy Regulatory Office in Poland', July 2010, p. 8, 14, 65) is subject to the obligation of maintaining strategic gas storages due to its gas import activity.

<sup>51</sup> 'National Report from the President of the Energy Regulatory Office in Poland', July 2008, p. 74.

than 6%<sup>52</sup>. Therefore, it can be evaluated that this criterion is in principle met. Nevertheless, the revision clause should be introduced to the Act on Fuel Reserves.

As far as the criterion of verifiability is concerned, it is worth remembering that the Court of Justice in Case C-159/94 *European Commission v French Republic* stated that ‘it is not necessary, in order for the conditions for the application of Article 106(2) of the TFUE to be fulfilled, that the economic viability of the undertaking entrusted with the operation of a service of general economic interest should be threatened. It is sufficient that, in the absence of the rights at issue, it would not be possible for the undertaking to perform the particular tasks entrusted to it, defined by reference to its public-service obligations. (...) Whilst it is true that it is incumbent upon a Member State which invokes Article 106(2) of the TFUE to demonstrate that the conditions laid down in that provision are met, that burden of proof cannot be so extensive as to require the Member State, when setting out in detail the reasons for which, in the event of elimination of the contested measures, the performance of the tasks of general economic interest under economically acceptable conditions would, in its view, be jeopardized, to go even further and prove, positively, that no other conceivable measure, which by definition would be hypothetical, could enable those tasks to be performed under the same conditions’<sup>53</sup>. Therefore, the position of the European Commission appears to be very restrictive and does not take into account the position of the Court of Justice, which agreed that the measure should be the least restrictive possible but placed the burden of proof on the European Commission. Moreover, it should be noted that the scope of verifiability criterion, as defined by the European Commission in the note on public services obligations from 2004, is similar to the criterion of proportionality and the ‘interest of the Union’ introduced by the Court of Justice and thus will be discussed in the next section.

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<sup>52</sup> The latter provision seems to be designated in principle as a measure to promote investment in the new storage facilities, as it limits the risk for the investor as regard costs recovery. Investment in the storage facilities, in particular seasonal storages are considered to be of high risk. These risks are the uncertainty over overall costs of the investment (storage facilities are not only capital-intensive but also the costs of cushion gas are not precisely known upfront), as well as uncertainty over future flow of income (for more information see: M.-K. Codognet, J.-M. Glachant, ‘Weak investment incentives in new gas storage in the United Kingdom?’, p. 10, available at: <http://www.grjm.net/documents/M-K-Codognet/CodognetGlachantUKstorage.pdf>).

<sup>53</sup> C-159/94 *Commission v French Republic* ECR [1997] I-5815, para. 89, 96, 101.

#### 4. Compliance with the principle of proportionality and the “interest of the Union” principle

As mentioned above, it follows from Article 3(2) of Directive 2003/55/EC (Directive 2009/73/EC) that the measures designed as a PSO must be adopted in a manner having full regard for the relevant provisions of the TFEU, in particular Article 106 thereof. The Article provides, first, that undertakings entrusted with the operation of services of general economic interest are subject to the rules on competition insofar as the application of such rules does not obstruct the performance, in law or in fact, of the particular tasks assigned to them, and, secondly, that the development of trade must not be affected to such an extent as would be contrary to the interests of the Union.

The first part of Article 106(2) TFEU establishes the so-called proportionality test. Thus, the foregoing provisions do not preclude the freedom of Member States to impose a gas strategic storage obligation, provided the measure is designed so as to fulfill the requirement of proportionality. The Court of Justice provides in case-law all the necessary indications for that purpose in regard to the law of the Union. In case C-265/08 *Federutility*, the Court of Justice applied the proportionality test in order to evaluate the compliance with EU law of the measure whereby *Autorità per l'energia elettrica e il gas* of Italy defined “reference prices” for the supply of natural gas<sup>54</sup>.

First, the measure must be of a temporary nature. As a PSO is an exception to the rules of the internal market<sup>55</sup> ‘it must be limited in duration to what is strictly necessary’. The Court of Justice states that ‘the mere fact that the national law in question labels the intervention as temporary is not in itself sufficient for a finding that it is proportionate from the point of view of its duration’. Moreover, relevant national law should require the administration to ‘make a periodic re-examination, at close intervals, of the need for it to intervene in the gas sector and the manner of its doing so, having regard to the development of that sector’.

Secondly, ‘the method of intervention used must not go beyond what is necessary to achieve the objective which is being pursued in the general economic interest’.

Thirdly, the measure, in order to be proportional, must limit the beneficiaries of the state measure: in particular, the level of protection for final consumers should be higher than that of the commercial users, since the situation of

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<sup>54</sup> C-265/08 *Federutility, Assogas, Libarna Gas SpA, Collino Commercio SpA, Sadori gas SpA, Egea Commerciale, E.On Vendita srl, Sorgenia SpA v Autorità per l'energia elettrica e il gas*, para. 33–43.

<sup>55</sup> This can be derived from the fact that Article 3(2) of Directive 2003/55/EC, providing a legal basis of the PSO, is an exception to the provisions of Article 3(1) of Directive 2003/55/EC.

undertakings is different from that of domestic consumers – moreover, there are objective differences between the undertakings themselves, according to their size<sup>56</sup>.

In considering the above, it should be noted that the requirement does not prevent Member States to impose a gas strategic storage obligation, provided it is well designed. In this regard it should be noted that neither the Act on Fuel Reserves nor the Proposal of November 3, 2010 provides for a temporary nature of the strategic storage obligation. On the contrary, according to Article 74 of Act on Fuel Reserves, undertakings subject to this obligation will in time be obliged to increase the strategic storages of gas in order to achieve the required level of 30-days reserve of natural gas. Also, the foregoing provisions do not require the administration to make a periodic re-examination at close intervals in order to adapt the PSO to changing situation. Thus, neither the Act on Fuel Reserves nor the Proposal of November 3, 2010 allow taking into account the result of investments currently developed in Poland that would involve substantial changes in the way the gas industry is run in Poland. As several times underlined in this paper, storage services are not the unique flexibility source for gas supplies. Flexible production fields, flexible importing contracts together with a sufficient portfolio of interruptible contracts with industrial customers, as well as access to spot market for gas may constitute a substitute for gas storage. These tools will become more available to the smaller undertakings when the above-mentioned investments will be accomplished.

As far as the second requirement is concerned, it is obvious that the strategic storage of gas obligation is a strong intervention into the market. In that respect, it should be evaluated whether this is the most effective measure and if the objective of ensuring the security of gas supply could be achieved by using other instruments. It is to be noted that the Act on Fuel Reserves introduces two instruments to enhance security of gas supply: gas strategic storage obligation and limitation of gas supply to non-protected consumers, i.e., consumers to whom more than 417 m<sup>3</sup>/hour of gas is supplied from the exit point of the gas network to which they are connected<sup>57</sup>. Meanwhile, in Annex A to Directive 2004/67/EC there is a much wider non-exhaustive list of instruments which may be used in order to achieve the security of supply standards<sup>58</sup>. Moreover, the European Commission, in the Communication

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<sup>56</sup> C-265/08 *Federutility, Assogas, Libarna Gas SpA, Collino Commercio SpA, Sadori Gas Srl, Egea Commerciale Srl, E.On Vendita Srl, Sorgenia SpA v Autorità per l'energia elettrica e il gas*, para. 35–42.

<sup>57</sup> For more information refer to footnote 66.

<sup>58</sup> These instruments are: working gas in storage capacity, withdrawal capacity in gas storage, provision of pipeline capacity enabling diversion of gas supplies to affected areas, liquid tradable gas markets, system flexibility, development of interruptible demand, use of alternative back-up

‘Second Strategic Energy Review’<sup>59</sup>, supported by the European Council in March 2009<sup>60</sup>, pointed that, ‘there is insufficient evidence at this stage for the EU to decide upon obligatory strategic gas stocks. Strategic gas stocks cost at least five times more than oil stocks. A more effective approach is to promote the development and effective transparent operation of commercial storages, diverse supply connections enabling flexible sourcing from LNG or neighbouring providers within the EU internal market, and rapid demand reduction through interruptible contracts and fuel switching especially in electricity generation’. This philosophy of supporting the tools increasing the flexibility of the gas market, like demand-side measures, combined with a focus on stronger integration of the internal market is also reflected in Regulation 2010/994. Also, the Study on natural gas storage in the EU shows that gas storages are not the only tool of flexibility on the supply side that can cover swing demand as this purpose can be also achieved by indigenous production and natural gas imports<sup>61</sup>. These instruments are however positively correlated with market shares and are more available to the incumbent than to new entrants. Therefore, in practice a new entrant has no flexibility tools available but storage. Moreover, even if the duplication of storage is considered economically viable by new entrants, it would require suitable sites and a long time span to carry out investment. The discussed measure on strategic storage not only doesn’t support competition on the gas market but enables to the incumbent company prevent the follower from extending its market shares by hoarding storage capacity.<sup>62</sup> In this regard and having taken into account that the availability and distribution of market storage resources are considered among the causes of market foreclosure in Europe and the access to existing storage remains a regulatory issue, the lack of profound economic

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fuels in industrial and power generation plants, cross-border capacities, cooperation between transmission system operators of neighbouring Member States for coordinated dispatching, coordinated dispatching activities between distribution and transmission system operators, domestic production of gas, production flexibility, import flexibility, diversification of sources of gas supply, long term contracts, investments in infrastructure for gas import via re-gasification terminals and pipelines.

<sup>59</sup> In the Communication from November 19, 2008, from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions, Second Strategic Energy Review, An EU energy security and solidarity action plan, COM (2008) 781, p. 12.

<sup>60</sup> European Council Conclusions from March 19/20, 2009, point 24 (available at: <http://www.consilium.europa.eu>).

<sup>61</sup> ‘Study on natural gas storage in the EU, Draft Final Report by Ramboll Oil & Gas from October 2008’, p. 49.

<sup>62</sup> P. Bertolotti, A. Cavaliere, A. Tordi, ‘The Regulation of Access to Gas Storage with Capacity Constraints’, First Draft, 7 February 2008, available at: [www.economia.unipv.it/pagp/pagine\\_personali/pberto/papers/StorageBCT3.pdf](http://www.economia.unipv.it/pagp/pagine_personali/pberto/papers/StorageBCT3.pdf).

analysis of other measures to ensure PSO for security of supply in the Polish government's Statement of Reasons for the Act on Fuel Reserves (as well as the Polish government's Statement of Reasons for the Proposal of 3 November 2010) raises doubts as regards the conformity of the measure with Article 106 of TFUE.

As for the third requirement, i.e., the limited scope of beneficiaries of the state measure, it must be pointed out that neither the Act on Fuel Reserves nor the Proposal of November 3, 2010 differentiate the scope of beneficiaries of the strategic storage obligation. In particular, every undertaking which is shipping natural gas to Poland or supplying customers on Polish territory with natural gas originating from other than domestic production is obliged to keep strategic storage of gas in Poland, regardless of to whom the gas is being delivered. However, the Council of Ministers Regulation on the introduction of limitation to the gas supply leaves small consumers outside the group of consumers who may suffer limitation of gas supply in the case of gas supply disruption.<sup>63</sup> In this way it differentiates the beneficiaries of the PSO, although there is no difference between the level of protection of households and other small consumers. Thus, the provision will have to be modified, in order to be in line with Regulation 2010/994 and the definition of protected customers.

Without prejudice to the proportionality test, the second part of Article 106(2) TFEU seeks to ensure that the measure adopted does not affect the development of trade to such an extent 'as would be contrary to the interests of the Union'. Advocate General Ruiz-Jarabo Colomer in his opinion delivered in case C-265/08 *Federutility* states that, even though the Court of Justice stated in its case-law<sup>64</sup> that it was incumbent on the European Commission to define the interest of the Union, these statements can be explained by the rules governing the burden of proof in infringement proceedings. Thus, 'in order to find that there is a detrimental effect on intra-community trade within the meaning of Article 106(2) of TFEU, unlike the classic concept of measures having an effect equivalent to a quantitative restriction, proof would be required that the measure in issue has substantially disrupted the operation of the internal market'<sup>65</sup>. According to Article 3(6) of Directive 2003/55/EC (Article 3(11) of Directive 2009/73/EC) Member States are obliged to

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<sup>63</sup> According to paragraph 4 of the Council of Ministers Regulation of September 19, 2007 on the introduction of limitation to the gas supply (Journal of Laws 2007, No. 178, item 1252), limitation of gas supply cannot be imposed on consumers if less than 417 m<sup>3</sup>/hour of gas is supplied from the exit point of the gas network to which they are connected.

<sup>64</sup> See the following judgements of the Court of Justice: C-157/94 *Commission v Netherlands* ECR [1997] I-5699; C-158/94 *Commission v Italy* ECR [1997] I-5789; C-159/94 *Commission v French Republic* ECR [1997] I-5815; C-160/94 *Commission v Spain* ECR [1997] I-5851.

<sup>65</sup> Opinion of Advocate General Ruiz-Jarabo Colomer in case C-265/08 *Federutility*, para. 78.

inform the European Commission of all measures adopted to fulfill public service obligations and their possible effect on national and international competition. Thus, the provision allows the European Commission to verify whether a measure established by a Member State, in accordance with the principle of subsidiary, on the basis of Article 3(2) of Directive 2003/55/EC (Directive 2009/73/EC) is in the interest of the Union and does not affect the developments of trade to such an extent contrary to the interests of the Union. The European Commission stated that ‘from 1 July 2007, the Community interest will include compliance with full competition’<sup>66</sup>.

#### IV. Conclusions

The provision on strategic storage is introduced as a measure to safeguard an adequate level of security of gas supply, according to the Polish government’s Statement of Reasons for the Act on Fuel Reserves. The measure obviously restricts competition and thus is not in line with Article 3(1) of Directive 2003/55/EC (Directive 2009/73/EC). It might however be justified on the basis of Public Service Obligation in line with Article 3(2) of Directive 2003/55/EC (Directive 2009/73/EC) and Article 3(2) of Directive 2004/67/EC (Article 3(6) of Regulation 994/2010). Both Directive 2004/67/EC and Regulation 994/2010 allow for using strategic gas storage as a non-market based security of gas supply measure to be applied only in the event of an emergency, and gas storage is recognized as the most flexible tool to ensure uninterrupted services in the short-medium term. Therefore, the objective of ensuring continuity of gas supply to final consumers, even in the case of disruption of gas supply, does justify public intervention designed as the strategic storage of gas obligation. Nevertheless, it is indispensable that the other conditions of Directives 2003/55/EC and 2004/67/EC be met.

In this regard it must be evaluated that the measure on strategic gas storage provided in the Act on Fuel Reserves, even after being amended by the Proposal of November 3, 2010 will not fully comply with EU legislation. In particular, the Polish provisions on strategic storage do not fully heed the proportionality principle. First of all, the measures are not of a temporary nature, nor do they require the administration to make a periodic re-examination, at close intervals, of the need for it to intervene in the gas sector and of the manner of its doing so, in regard to the development of that sector. On the contrary, according to Article 74 of the Act on Fuel Reserves enterprises subject to this obligation

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<sup>66</sup> Note of DG Energy & Transport on Directives 2003/54/EC and 2003/55/EC on the internal market in electricity and natural gas, public services obligations, 16.01.2004.



will in time be obliged to increase the strategic storage of gas. Secondly, the discussed provision does not introduce an alternative to the strategic storage flexibility tools. As a result the measure on strategic storage not only does not support the availability of gas storages for smaller enterprises, but enables the incumbent company to prevent the follower from extending its market shares by hoarding storage capacity. Thirdly, the measure on strategic gas storage provided in the Act on Fuel Reserves is not compatible with the non-discrimination clause. The Proposal of November 3, 2010 introduces several changes (presented in the first section of the Article) in order to adjust the Act on Fuel Reserves to the requirement of non-discrimination. However, even after the Proposal of November 3, 2010 enters into force, this criterion will still not be met as the Proposal does not impose the PSO on domestic production. Also, the scope of the beneficiaries of the state measure should be redefined in order to ensure compliance with EU law, in particular Regulation 994/2010. In conclusion, the amendments included in the Proposal of November 3, 2010 appear to go in the right direction to ensure the compliance of Polish law with EU law. Nevertheless, the measure of strategic gas storage to be provided in Polish law still seems to infringe EU law. Thus the aim of the amendment, as declared in the Polish government's Statement of Reasons for the Proposal of November 3, 2010, i.e., to avert the action being brought by the European Commission against Poland to the Court of Justice, might not be achieved.

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