

POLSKIE GÓRNICTWO NAFTOWE I GAZOWNICTWO S.A.

Gas Release Programme

Draft for public consultation

Warszawa, February 13th, 2012

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1. Introduction

This document contains a presentation of **Gas Release Programme („GRP”) concept** which is to be carried out on the natural gas market in Poland. The document also includes a description of a model of functioning of the natural gas market.

The document was prepared by **Polskie Górnictwo Naftowe i Gazownictwo S.A. („PGNiG”)**.

This document is intended for **public consultation** within which present and potential market participants, as well as other interested institutions and entities, may submit their comments and suggestions concerning the implementation of GRP model. Based on the outcome of the public consultation, a detailed concept of Gas Release Programme shall be elaborated.

The GRP concept was developed on the basis of the following documents and sources of information:

- Recommendations for gas release programme in Poland (*Rekomendacje dla programu uwalniania gazu ziemnego w Polsce*) of November 15th, 2011 (**„Recommendations for GRP”**) – the document was prepared by the President of the ERO in order to set out conditions for preparation and implementation of a gas release programme by PGNiG.
- Road map for deregulation of natural gas prices – Draft (*Mapa drogowa uwolnienia cen gazu ziemnego – Projekt*) (**„Road Map – Draft”**) – the document, containing draft of priority actions aimed at establishment of a competitive natural gas market in Poland, was provided by the President of the ERO on December 22nd, 2011.
- **Findings of a survey conducted by the President of the ERO** – the document of September 30th, 2011 was prepared by the President of the ERO (DPK-PUG-111/10/2011).
- **Experiences of the European Union member states concerning implementation of gas release programmes**, in particular:
 - Gas release programme in Great Britain (1992 – 1996),
 - Gas release programme in Germany (2003 – 2008),
 - Gas release programme in Spain (2001 – 2004),
 - Gas release programme in France (2004 – 2007),
 - Gas release programme in Hungary (since 2005),
 - Gas release programme in Czech Republic (since 2007).
- Guidelines of industry organizations on gas release programmes implementation rules (**„EFET Guidelines”**) – the document was prepared by the European Federation of Energy Traders - Implementation of Gas Release Programmes for European Gas Market Development – June 2003.
- **Reasoned Opinion of the European Commission addressed to the Republic of Poland** with regards to infringement of Directive 2009/73/EC of the European Parliament and of the Council of 13 July 2009.

GRP concept is presented in this document in the following manner:

- **Chapter 2.** contains a summary of GRP concept,
- **Chapter 3.** presents a concept of functioning of the gas market in Poland which should underlay the proper implementation of GRP,
- **Chapter 4.** contains a presentation of GRP implementation concept.

Comments on the presented draft Gas Release Programme shall be submitted in an electronic format, on the attached form, to the following e-mail address: pug.konsultacje@pgnig.pl until February 28th, 2012.

2. Summary

Gas Release Programme concept described in this document covers two interrelated areas:

- Gas market functioning model,
- GRP implementation model.

Main assumptions of gas market functioning model:

Implementation of GRP requires **modification of natural gas price regulation mechanisms currently used in Poland**. Model of gas price regulation shall be as follows:

- Conclusion of a **Regulatory Agreement** between PGNiG and the President of the ERO („Regulatory Agreement”, „Agreement”). The Agreement shall constitute a **voluntary commitment of the parties** to comply with rules set out therein, until 31st December, 2015. The Regulatory Agreement shall precisely define the following issues:
 - Methodology for calculation of price of gas offered by PGNiG within the scope of GRP (a price resulting from an auction, valid in the first quarter of delivery period under GRP),
 - Method of indexation of prices of gas offered by PGNiG under GRP in subsequent quarters of delivery periods under GRP, until December 31st, 2015,
- **Release of gas under GRP by PGNiG** at the price calculated in accordance with a method indicated in the Regulatory Agreement (price resulting from the GRP auctions, subject to indexation in subsequent quarters),
- **Decision by the President of the ERO to discharge PGNiG and other gas suppliers from the obligation to submit tariffs for approval with regards to the segment of customers other than household customers** (i.e. institutional customers),
- **Maintaining the obligation to submit tariffs for approval with regards to the segment of household customers**, on the assumption that the tariffs will allow for transferring the cost of gas incurred by PGNiG onto these customers.

Provisions of the Regulatory Agreement shall be fully consistent with stipulations of the detailed concept of GRP implementation.

Main principles of Gas Release Programme:

The GRP concept provides for the release by PGNiG of total quantity of **9,4 bcm** of natural gas (GZ-50) **per year**, which corresponds to **70% of the market**, in auctions for **2013-2015**. GRP auctions will be carried out according to rules that guarantee public and equal access for all interested parties. PGNiG will not participate in the GRP auctions in the capacity of a buyer (however, PGNiG's subsidiaries - including DSOs, SSO, electricity producers and trading companies - will be entitled to participate therein).

Under GRP PGNiG will deliver gas to the **Virtual Trading Point**, situated in the transmission system of OGP Gaz-System. Gas will be released on GRP auctions in the form of **annual contracts** (deliveries in 2013,2014 and 2015). A general characteristics of offered products is presented below.

Product offered under GRP – annual contracts:

- **Tranches** –10 000 MWh (~ 1 mcm).
- **Supply period** –2013, 2014 or 2015 respectively.
- **Date of commencement of supply**– January 1st of each year.
- **Supply profile** – flat.
- **Supply price** – in the first quarter of 2013 price will be determined in the GRP auction; in subsequent quarters price will be indexed in accordance with method agreed upon in the Regulatory Agreement.

GRP contracts will provide for obligatory physical supply and physical receipt of gas at the level of 100% of contracted volume (i.e. *per analogiam* to trade of electricity on the commodity exchange market). Auction participants will be able to resell gas on the secondary market.

Under the GRP gas will be sold in auctioning system organized in cooperation with the commodity exchange. In accordance with recommendations of the President of the ERO, under the GRP gas will be offered on **5 auctions** held at regular **intervals of 2 weeks**. On each auction up to 1,9 bcm of gas will be offered for each year of duration of the GRP (approx. 14% of the market). Following the auction, the commodity exchange will launch a **secondary market** where free trade of natural gas will take place. Trade in the secondary market will be conducted **both in the commodity exchange market and also on the basis of bilateral contracts (OTC)**¹, like in all developed natural gas markets. Gas offered by PGNiG under the GRP, as well as gas sold on the wholesale market, **will be subject to the standard balancing rules** set out in transmission and distribution network codes (IRIESP and IRIESD).

The starting price of gas offered through the GRP auctions will be determined on the basis of the wholesale purchase price, taking into account **costs of gas from all sources** into account, including:

- cost of imported gas (for the entire import portfolio of PGNiG),
- cost of gas from domestic production, including due return on capital employed,
- cost of maintenance of the mandatory stocks of gas, as required by law,
- fees charged by OGP Gaz-System for bringing gas to the transmission system, i.e. to the Virtual Trading Point,
- PGNiG's wholesale margin.

¹ Trade on the OTC market will be possible once the President of the ERO lifts the obligation to submit gas sale tariffs for the approval.

In order to create space for competition PGNiG will **introduce a discount to the wholesale price**, which would constitute an incentive for potential participants of the GRP auctions. **The level of the discount** to the price of gas offered by PGNiG will be **equal to the wholesale margin of PGNiG**.

The starting price will undergo further modifications under the exchange market's auctioning mechanisms, depending on the level of demand.

In order to ensure coverage of actual costs of gas incurred by PGNiG and to avoid situation where PGNiG would generate unjustified profits from wholesale trade, precisely defined **system of periodical indexation of the price of gas offered under GRP** will be introduced (auction price in the first quarter of delivery period under GRP; indexation in subsequent quarters of delivery period under GRP, until December 31st, 2015).

The GRP implementation date depends on preparedness of the market from legal, regulatory and organizational standpoint. Currently, it is difficult to indicate a n exact date of GRP's commencement due to the fact that most of the modifications fall outside of the scope of PGNiG's competence.

In opinion of PGNiG, implementation of the GRP in accordance with this concept should commence within **2 – 3 months** from conclusion of the Regulatory Agreement, introduction of necessary legal, regulatory and organizational changes, and it should be continued for twelve consecutive quarters (**3 years**). Such a transitional period is necessary for potential participants of the Gas Release Programme to prepare themselves for participation, in particular to enter into indispensable contracts with TSO and the commodity exchange. For the purpose of this concept, it has been assumed that the necessary legislative, regulatory and organizational changes will be carried out in sufficient time to enable **the commencement of supply of the gas offered under GRP on January 1st, 2013**.

3. Concept of functioning of the natural gas market in Poland for the purpose of GRP implementation

3.1. Assumptions adopted for the purpose of the development of the concept

Main assumptions adopted by PGNiG for the purpose of the development of the GRP concept and, as a result, restructuring of the natural gas market model, include:

- **Creation of conditions for emergence of viable and sustainable competition on the natural gas market in Poland** and effective possibility to choose a supplier.
- **Fulfillment of the European Commission's requirements** regarding the change of regulatory mechanisms for the natural gas market in Poland.

On June 26th, 2009 the European Commission issued a reasoned opinion, addressed to the Republic of Poland, concerning infringement of the Gas Directive. The Commission's objections refer to gas price regulation mechanisms used in Poland. In the Commission's opinion prices for both wholesale customers and retail customers **should be determined as a result of market forces** (supply and demand). Price regulation as such does not constitute an infringement of the Directive as long as it is used in general economic interest and in accordance with principles of: proportionality, transparency and equality of access for the European and domestic natural gas undertakings. **The Commission, however, found the system of price regulation in Polish natural gas market (under Energy Law Act) not to fulfill the conditions set out in the Directive and thus infringing the European Union law.** In view of the above, solution of the problem indicated by the Commission requires the change of market regulation mechanisms (i.e. elimination of tariffs regulation with regards to institutional customers) and a partial adjustment of the concept of the functioning of the natural gas market in Poland.

- **Necessity to protect end customers** from unjustified increase in prices of gas through:
 - Maintaining regulated gas prices for household customers,
 - Creation of a liquid secondary market and deregulation of prices for institutional customers.
- **Necessity of gradual alignment of prices** on the domestic natural gas market with prices on developed gas markets of the European Union member states in order to secure sustainability of changes initiated by the GRP. After completion of the GRP maintaining (by administrative means) the price difference between the domestic natural gas market and developed gas markets would most likely lead to withdrawal of the new suppliers from the market and, in result, situation prior to the implementation of the GRP would reappear.

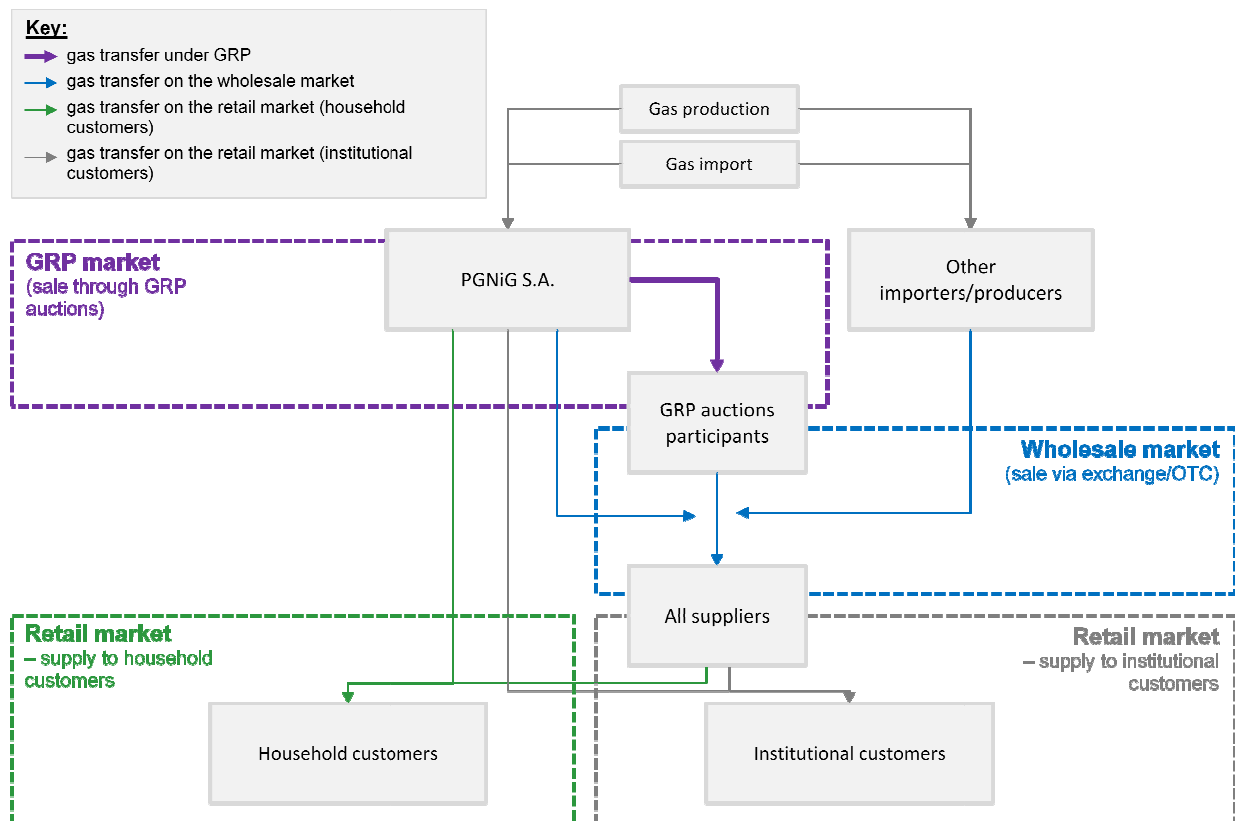
3.2. Structure of the natural gas market in Poland

The concept of GRP implementation involves a division of natural gas market into the following submarkets:

- I. **GRP market** – comprising sale by PGNiG of imported and domestic natural gas to other market participants on auctions, with a purpose of further resale,
- II. **Wholesale market** – comprising sale of gas by GRP auctions participants, natural gas importers (including PGNiG) and gas production companies, with a purpose of further resale,
- III. **Retail market** – comprising sale of gas to end-customers, divided into:
 - a. **Retail market for institutional customers** and
 - b. **Retail market for household customers.**

Illustration 1. contains a graphic layout of individual components of the natural gas market in Poland, in the form recommended by PGNiG.

Illustration 1: Recommended structure of the natural gas market in Poland



Source: PGNiG

3.3. Method of natural gas market regulation in Poland

Pursuant to the recommendations of the President of the ERO , the concept of GRP presupposes the following regulatory solutions:

- Conclusion of a **Regulatory Agreement** between PGNiG and the President of the ERO („Regulatory Agreement”, „Agreement”). The Agreement shall constitute a **voluntary commitment of the parties** to comply with rules set out therein, until 31st December, 2015. The Regulatory Agreement shall precisely define the following issues:
 - Methodology for calculation of price of gas offered by PGNiG within the scope of GRP (a price resulting from an auction, valid in the first quarter of delivery period under GRP),
 - Method of indexation of prices of gas offered by PGNiG under GRP in subsequent quarters of delivery periods under GRP, until December 31st, 2015,
- Release of gas by PGNiG through the GRP auctions at the price calculated in accordance with the method indicated in the Regulatory Agreement (the auction starting price, indexed in subsequent quarters).
- Decision by the President of the ERO to discharge PGNiG and other gas suppliers from the obligation to submit tariffs for approval with regards to the segment of customers other than household customers (i.e. institutional customers),
- Maintaining the obligation to submit tariffs for approval with regards to the segment of household customers, while transferring onto them the wholesale price determined in accordance with the Regulatory Agreement.

Discharge of suppliers from the obligation to submit for approval the tariffs for institutional customers will constitute a direct fulfillment of the European Commission’s demands, as expressed in the reasoned opinion of June 26th, 2009.

Trade of gas on the wholesale market (secondary market) will be discharged from the obligation to submit the tariffs for approval and it will be conducted on both – the Exchange market and the OTC market, as it happens in all developed natural gas markets.

Lack of conclusion of the Regulatory Agreement implementing the provisions of the draft GRP shall be deemed sufficient to justify PGNiG’s withdrawal from implementation of obligations undertaken by the company under GRP.

3.4. Regulatory Agreement between the President of the ERO and PGNiG

The Regulatory Agreement shall constitute a bilateral commitment of the parties (the President of the ERO and PGNiG) to comply with rules set out therein, within the period of GRP's implementation.

Provisions of the Regulatory Agreement shall be fully consistent with stipulations of the detailed concept of GRP implementation, as prepared by PGNiG (having taken into account findings of the public consultation).

Main elements of the Regulatory Agreement shall cover:

- a) Duration of the Agreement,
- b) Methodology for calculation of price of gas offered by PGNiG under GRP,
- c) Method of indexation of prices of gas offered by PGNiG under GRP.

Ad a) Duration of the Agreement

The Regulatory Agreement will be binding for the parties (the President of the ERO and PGNiG) **until December 31st, 2015**.

Ad b) Methodology for calculation of price of gas offered by PGNiG under GRP

The starting price of gas offered on GRP auctions shall be set on the basis of the wholesale price, taking into account **average costs of gas from all sources** (gas from import and gas from domestic production).

The methodology for calculation of price of gas offered within the scope of GRP is described **in Chapter 4.5** of this document.

Ad c) Method of indexation of prices of gas offered by PGNiG under GRP

In order to ensure coverage of actual costs of gas incurred by PGNiG and to avoid a situation where PGNiG would generate unjustified profits from wholesale trade, there will be a precisely defined system of periodical indexation of the price of gas offered under GRP (quarterly indexation, starting from the second quarter of delivery period under GRP).

The method of indexation of prices of gas offered by PGNiG within the scope of GRP is described **in Chapter 4.5** of this document.

4. Gas Release Programme (GRP)

4.1. GRP schedule

The GRP implementation date depends on preparedness of the market from legal, regulatory and organizational standpoint. Currently, it is difficult to indicate an exact date of GRP's commencement due to the fact that most of the modifications fall outside of the scope of PGNiG's competence. Nevertheless, PGNiG considers it possible to begin GRP in sufficient time to enable the commencement of supply of the gas from on January 1st, 2013.

PGNiG is ready to commit to commence GRP no later than 3 months from the moment of conclusion of the Regulatory Agreement and introduction of necessary legal, regulatory and organizational changes (including changes described in this document), and to continue the programme for 3 years.

The framework schedule for implementation of GRP is shown below.

Illustration 2: GRP implementation - framework schedule

Task	Responsible	Framework schedule
1. Publication of the GRP draft	PGNiG	14 February 2012
2. Public consultation of the GRP draft	PGNiG	2 weeks
3. Preparation of a detailed GRP concept	PGNiG	2 - 4 weeks
4. Publication of the detailed GRP concept	PGNiG	
5. Introduction of legislative changes necessary for implementation of GRP	Ministry of Economic Affairs, President of the ERO	1 - 3 months
6. Introduction of regulatory changes necessary for implementation of GRP	President of the ERO, PGNiG, market operators	1 - 3 months
7. Introduction of organizational changes necessary for implementation of GRP	Market operators, commodity exchange	1 - 3 months
8. Complete implementation of legal and regulatory framework indispensable for GRP commencement	ditto	
9. Ensure readiness to implement GRP and market participants preparations for auctions planned under GRP	PGNiG/ market participants	2-3 months
10. Commencement of GRP implementation (first action)	PGNiG	

For the purpose of this concept, it has been assumed that the necessary legislative, regulatory and organizational changes will be carried out in sufficient time to enable **the commencement of supply of the gas offered under GRP on January 1st, 2013.**

4.2. Source of gas released under GRP

Pursuant to the EFET Guidelines concerning organization of gas release programmes, the released gas ought to be released:

- a) in more than one entry point,
- b) in point where the monopolist receives the greatest volume of imported gas,
- c) in point selected in view of possibilities of further gas transportation.

Additionally, in accordance with the abovementioned guidelines, gas should not originate from a single source; it should involve the whole portfolio of the dominant player.

Participants of the survey conducted by the President of the ERO expressed the need for release of gas in the Virtual Trading Point, or – in case of lack of such a possibility – release of gas in other specified entry points, yet ensuring the possibility of transportation of gas to any entry/exit point.

Therefore, PGNiG suggests that natural gas released under GRP should - as proposed in the EFET guidelines and recommendations of the President of the ERO - include sources of gas from the entire portfolio of the company, i.e. including gas from import contracts, as well as from PGNiG domestic gas production.

Gas released by PGNiG under GRP will be delivered to the **Virtual Trading Point**, set up within the transmission system of OGP Gaz-System. Such a solution requires OGP Gaz-System to implement organizational changes and introduce amendments to the network code (IRiESP).

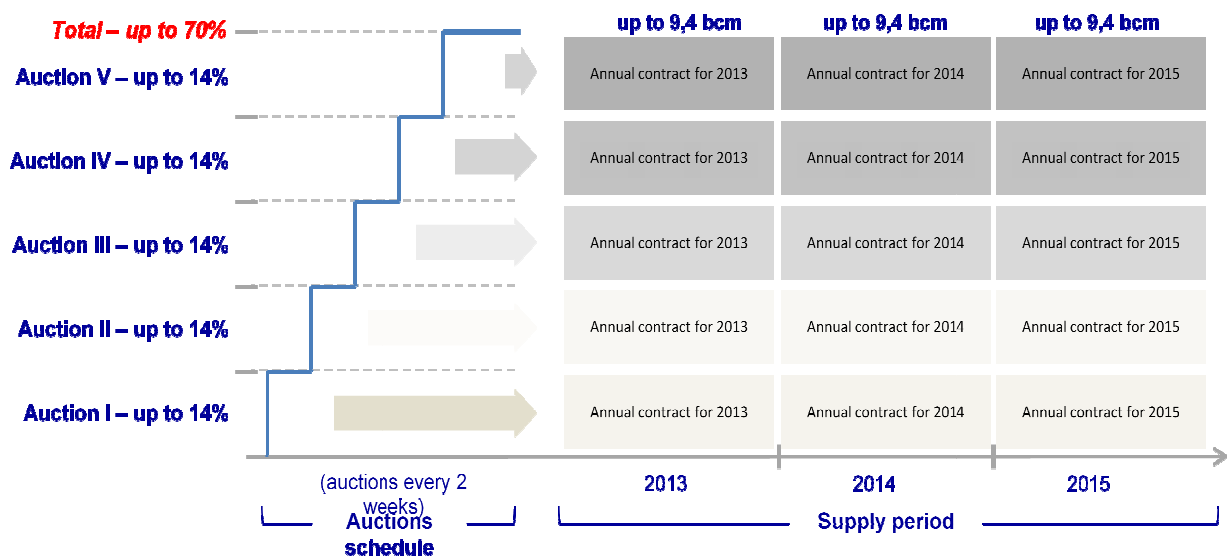
4.3. Quantity of gas offered under GRP

Consistently with recommendations of the President of the ERO, the GRP concept provides for a release by PGNiG of total quantity of **9,4 bcm** of natural gas (GZ-50) **per year**, which corresponds to ca. **70% of the market**, in auctions for **2013-2015**.

GRP auctions will be carried out according to the rules that guarantee public and equal access for all interested parties. PGNiG will not participate in the GRP auctions in the capacity of a buyer (however, PGNiG's subsidiaries - including DSOs, SSO, electricity producers and trading companies - will be entitled to participate therein).

In each auction the maximum quantity of gas available for purchase by a single entity shall be limited to 25% of the total quantity offered in a single auction.

Illustration 3: Quantity of gas offered under GRP



Source: PGNiG

In order to ensure security of gas supply to all present customers of PGNiG, as well as to ensure secure functioning of the national gas system, it is necessary to introduce the following security mechanisms:

- Implementation of mechanisms **limiting export** of gas purchased under GRP,
- Implementation of control mechanisms under which:
 - commodity exchange informs TSO and President of the ERO about planned delivery points of gas purchased under GRP,
 - President of the ERO verifies information received from commodity exchange, in particular with regards to delivery points of gas purchased under GRP (in particular those concerning exit points from the domestic transmission system (export)),
 - President of the ERO provides verified information to the Minister of economy, which is responsible for energy security of the state, about delivery points of gas purchased under GRP along with an opinion on the merits of pursuing subsequent auctions,
 - On a basis of the abovementioned information the Minister of economy may grant permission for a subsequent auction, having taken into account risk of imbalance of the gas system and possibility to eliminate gas supply interruptions to customers situated in the territory of the Republic of Poland.

- An option to withdraw from the GRP by PGNiG, should the process threaten the balancing of its customers that have decided to continue cooperation with their present supplier or threaten the functioning of the entire domestic gas system.

4.4. Products offered under GRP

Under GRP PGNiG will deliver natural gas to the **Virtual Trading Point**, located in the transmission system of OGP Gaz-System. Gas will be released on GRP auctions in the form of **annual contracts** (deliveries in 2013,2014 and 2015). A general characteristics of offered products is presented below.

Product offered under GRP – annual contracts:

- **Tranches** –10 000 MWh (~ 1 mcm).
- **Supply period** –2013, 2014 or 2015 respectively.
- **Date of commencement of supply**– January 1st of each year.
- **Supply profile** – flat.
- **Supply price** – in the first quarter of 2013 price will be determined in the GRP auction; in subsequent quarters price will be indexed in accordance with methodology agreed upon in the Regulatory Agreement.

GRP contracts will provide for **obligatory physical supply and physical receipt of gas** at the level of 100% of contracted volume (i.e. *per analogiam* to power contracts traded on the commodity exchange). Auction participants will be able to resell gas on the exchange.

Contracts offered by PGNiG will be subject to **modifications on the exchange in accordance with standard exchange procedures**, e.g. cascading quarterly, monthly and weekly products – differentiation of contracts will depend on diversity of contracts provided for by the commodity exchange and traded therein.

4.5. Price of gas offered under GRP

In accordance with the EFET guidelines concerning organization of gas release programmes, the GRP should be successful provided that the price at which gas will be offered would be “sufficiently” attractive for the customers. The guidelines specify that the price shall be calculated on the basis of weighted average cost of gas (WACOG). Furthermore, the price should not exceed wholesale price derived from the retail price paid by customers of the dominant subject.

A comparative analysis of gas release programmes conducted in other EU countries shows preference for the valuation methodology based on weighted average cost of gas (WACOG).

The starting price of gas offered through the GRP auctions will be determined on the basis of a wholesale price, taking into account **costs of gas from all sources**, including:

- cost of imported gas (for the entire import portfolio of PGNiG),
- cost of gas from domestic production, including due return on capital employed,
- cost of mandatory gas reserves maintenance, as required by law,
- transmission system entry fees charged by OGP Gaz–System, i.e. to the Virtual Trading Point,
- PGNiG’s wholesale margin.

In order to create space for competition PGNiG will **introduce a discount to the wholesale price**, which would constitute an incentive for potential participants of the GRP auctions. **The level of the discount** to the price of gas offered by PGNiG will be **equal to the wholesale margin of PGNiG**.

Simultaneously, in order to ensure attractiveness of the GRP and protection of customers from excessive price increase, gas released under GRP – through auctioning system organized in cooperation with the commodity exchange – should be discharged from all transaction costs related to sale of gas through auction.

The price of gas, taking into account the discount incentivising the participation in the GRP auctions, will constitute **the starting price** for the GRP auctions. The starting price will undergo further modifications under the exchange auctioning mechanisms, depending on orders placed by auction participants.

The price at which transaction will be settled (**transaction price**) shall be subject to **quarterly indexation**, according to the following rules:

- in the first quarter of 2013, the price of gas supplied under GRP will be set at a level of the transaction price,
- in subsequent quarters (including supply in first quarters under contracts for 2014 and 2015) the price of gas will be indexed (up or down) in accordance with the indexation model described in detail in the Regulatory Agreement,
- price indexation model for gas supplied to the customers under the GRP will define:
 - rules of quarterly gas price indexation (gas price in the previous quarter * indexation rate)
 - rules of calculation of the indexation rate (based on, e.g. fluctuations of currency rates, prices of petroleum products, prices of gas on the traded markets), and
 - sources of data for individual parameters used in the indexation process.

Rules of quarterly price indexation of gas offered under GRP will be specified in the Regulatory Agreement and will be made available to all market participants. In order to ensure full transparency of the adopted solution, the President of the Office of Competition and Consumer Protection will receive the indexation calculations for the purpose of verification of their accordance with the methodology set out in the Regulatory Agreement.

4.6. Model of gas release under GRP

The participants of the survey carried out by the President of the ERO suggested that either PGNiG would conduct auctions by itself or should cooperate in this scope with the commodity exchange. The comparative analysis of gas release programmes in other EU member states also showed the preference for auctions (Hungary, France, Spain, Germany, Great Britain) held periodically, with a gradual growth of released quantity of gas.

For this reason PGNiG proposes to conduct **sale of gas through auctions organized in cooperation with the commodity exchange**. The GRP auctions will be held in a way that guarantees public and equal access to all interested entities. PGNiG will not participate in the GRP auctions in the capacity of a buyer (however, PGNiG's subsidiaries - including DSOs, SSO, electricity producers and trading companies - will be entitled to participate therein).

Gas released by PGNiG under GRP will be delivered to the Virtual Trading Point, situated in the transmission system of OGP Gaz-System.

In accordance with recommendations of the President of the ERO, under GRP gas will be offered on 5 auctions held at regular intervals of 2 weeks. On each auction approximately 1,9 bcm of gas will be offered for each year of duration of the GRP (ca. 14% of the high-methane gas market). Following the auction, the commodity exchange will launch a secondary market where free trade of natural gas will take place.

In each auction the maximum quantity of gas available for purchase by a single entity shall be limited to 25% of the total quantity offered in a single auction.

PGNiG shall be granted an approval for the conduct of each auction in accordance with rules set out in Chapter 4.3.

Gas released by PGNiG on the GRP auctions will be subject to potential reselling to other participants of the wholesale market (secondary market) and delivered to the Virtual Trading Point located in the transmission system of OGP Gaz-System. Access to the wholesale gas market shall not be restricted. All players shall have the right to participate in the market in the capacity of sellers, including:

- entities that purchased gas from PGNiG on auction,
- entities importing gas independently from PGNiG,
- entities producing gas in Poland independently from PGNiG,
- companies from PGNiG capital group (excluding PGNiG S.A.),
- other entities (banks, brokers etc.).

The wholesale market will not be limited solely to the commodity exchange. Following the example of developed European gas markets, also gas trade via bilateral contract concluded on a OTC market will be possible. **Gas trade on the wholesale market (secondary market) will be discharged from the obligation to submit tariffs for the approval**, regardless of whether it will take place on the commodity exchange or through bilateral contracts (OTC).

Gas offered by PGNiG under the GRP, as well as gas sold on the wholesale market, **will be subject to the standard balancing rules** set out in transmission and distribution network codes (IRIESP and IRIESD).

4.7. GRP price-setting mechanism

Starting price for gas sale under GRP auction will be set in accordance with provisions of the Regulatory Agreement concluded between PGNiG and the President of the ERO, and it will include an incentive to participate in the auction in the form of a discount. The price will undergo further modifications under the exchange market's auctioning mechanisms.

The starting price will constitute a floor price limit, below which conclusion of the gas sale/purchase contract shall not be possible.

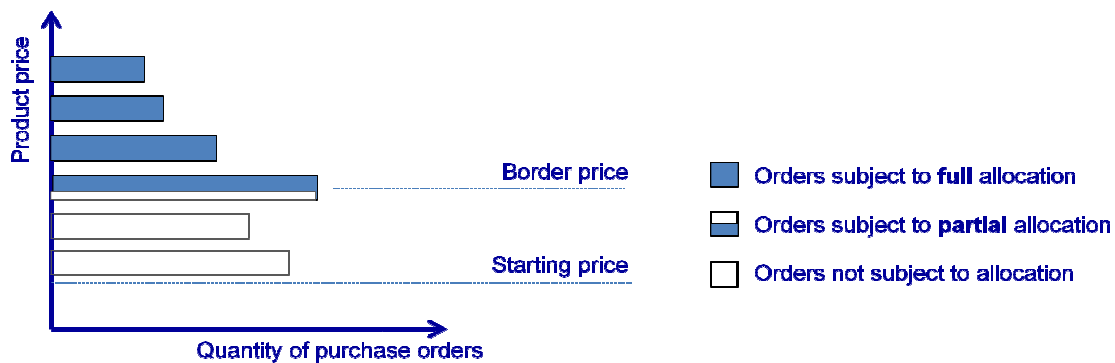
Auction participants will be able to place orders to purchase a specified **quantity of units of the offered product** while stating the **prices** at which they would be willing to make a purchase.

The price at which transaction will be settled (**transaction price**) shall be set individually, in accordance with the following rules:

- The transaction price for allocated quantities is equal to the price offered in the order,
- Gas is allocated in order from the highest to the lowest purchase order,
- Allocation of gas at the border price (exhausting the volume put on the auction) is conducted proportionally to the orders placed (pro-rata),
- Purchase orders at prices lower than floor price will not be executed.

The illustration below shows the mechanism of price setting in the process of auctioning.

Illustration 4: Price setting in the gas auctioning system



Source: PGNiG

4.8. Wholesale market

Implementation of the GRP (in the form of auctions) will result in establishment of a wholesale market (secondary market) for natural gas in Poland, where trade would be carried out **both on the commodity exchange and on the OTC market.**

Main advantages of OTC market are:

- **Lack of products standardization** – allows to adjust transactions to specific requirements of supplier or customer, e.g. with regards to terms of supply, delivery periods, take-or-pay clauses etc.
- **Low transaction costs** – in case of OTC transactions there is no need to lodge security deposits and costs of provisions for the transactions executed are lower. Taking into account very low margins in the wholesale trade, savings on costs of trade financing and transaction costs may influence the profitability of wholesale gas market participants to a very high extent

According to the knowledge of PGNiG, bilateral contracts concluded on the OTC market account for the vast majority of all transactions entered into on developed European markets. For example, on the German market over 98% of transactions involving physical gas supply is concluded on the basis of OTC contracts and only less than 2% through the exchange.

4.9. Release of exit capacity

In case the customer terminates the supply contract with PGNiG or reduces the quantity of ordered gas as a consequence of the purchase of gas from another supplier who acquired it under the GRP auctions, PGNiG shall release all or part (proportionally to the reduction of the order) of exit capacity booked in the gas delivery point to which the customer is connected.

PGNiG assumes that the partial or full reduction of booked capacity, resulting from a change of supplier, will be directly transferred to the level of capacities purchased from a given transmission or distribution system operator transporting gas to the customer that switched. Such a mechanism would allow to avoid the risk of double charging of transportation fees – from the old and the new supplier.