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Observations on Poland's market reform plan

ClientEarth assesses positively the electricity market reforms listed on pages 12-13 of the Polish implementation plan that is subject to the ongoing consultation process[1]. In our view, compared to the present regulatory situation, the abovementioned changes are for the better. However, the Polish electricity market is highly distorted in many other ways and the list of planned reforms addresses only a part of existing market failures. Therefore, the Polish implementation plan should be extended by other regulatory reforms that are not included in the submitted document. The additions that are the most important in ClientEarth's view have been listed below.

1 Reductions from the capacity levy for energy intensive users

While Poland's market reform plan refers to the capacity market itself, it is silent on the planned reductions from the capacity levy for energy intensive users. In ClientEarth's opinion, **the proposed design of the reductions scheme questions the efficiency of the capacity market as a whole**.

Reducing unit capacity charge rates for industrial customers that are responsible for a substantial share in Poland's peak power demand[2] and not connecting the capacity charge with actual electricity consumption – not only for households, but also for smallest business customers (as proposed by the Polish authorities) highly distorts the original concept of Poland's capacity market. The capacity mechanism scheme has aimed also at incentivising broader demand-side management among all Polish non-household customers, i.e. not only via direct participation of demand-side response units in capacity auctions, but also through adopting a progressive and variable method of charging companies with the new fee.

The proposed changes in the capacity charge collection mechanism (not yet adopted by the Polish Parliament and subject to State aid authorisation) would mean that ensuring the necessary flexibility in the Polish Power System would be exclusively dependent on small and medium-sized undertakings and public entities (offices, schools, hospitals etc.), which already pay the highest unit rates in case of all components of electricity bill and are responsible for the minority of electricity consumed in Poland.

[1] https://ec.europa.eu/energy/sites/ener/files/polish_implementation_plan_final.pdf.

[2] We understand that Poland submitted to the Commission that this share amounts to 12.2% of peak power demand – and not 43% as indicated in the Commission's opening decision on SA.51502.

The reductions scheme is now subject to a separate assessment process by the EC[3]. In ClientEarth's opinion, **in its present form, the proposed scheme is not compatible with the internal market** and should not be authorised. Full ClientEarth's observations on this scheme are available at: https://www.documents.clientearth.org/wp-content/uploads/library/2019-07-15-observations-on-reductions-from-a-capacity-mechanism-levy-for-energy-intensive-users-in-poland-ce-en.pdf. **As Poland's market reform plan refers to the capacity market, it should also take into account the described reductions scheme**.

2 Subsidising power consumption under the so-called Energy Prices Act

At the end of 2018, the Polish Parliament adopted the so-called Power Prices Act[4], aimed at "freezing" retail electricity prices for final customers in Poland at the level from mid-2018. In a recent report by ClientEarth and WiseEuropa the anti-market mechanisms contained in this act, which in addition, for the first half of 2019, is not compliant with the requirements of EU State aid law, have been assessed as extremely inefficient[5]. **Despite many negative assessments of the scheme that was in force in 2019, the Polish authorities have now published a proposal for similar regulation for 2020**[6].

The leading Polish think tank for energy, Forum Energii, has criticised the Power Prices Act, in particular because it may lead to the maintenance or even increase of energy demand and because instead of investing in emission reduction it supports the consumption of high-emission electricity[7]. These allegations are important from the point of view of the possibility of indirect aid to the power generation sector, by artificially maintaining demand for the goods it sells. Therefore, the act may also indirectly support high-emission generating assets operated by incumbent undertakings: in practice, under Polish conditions, additional demand for electricity is covered by the least cost-effective and least environmentally efficient existing hard coal-fired power units operated by state-owned companies.

Such state interventions may weaken price signals for investments in new, low carbon generation sources, especially those installed by final customers. Nor should it be forgotten that the funds to cover the compensations come from unused funds from the EU ETS, which were intended to finance the modernisation of the country's power sector and not to contribute to maintaining its current structure. Revenues of the four largest, state-owned power companies from compensation mechanisms provided for in the Power Prices Act in the first three quarters of 2019 have amounted in total to nearly PLN 3 billion (~EUR 700 mln).

The state intervention under the Power Prices Act therefore raises wider doubts as to the compatibility with EU competition law and, all the more, should be formally notified to the EC in order to obtain legal certainty as to the admissibility of the regulatory arrangements provided for therein. **The Polish authorities should commit in the consulted market reform plan that the country will not continue to subsidise electricity consumption by final customers. The available funds should be redirected to comprehensive schemes supporting long-term**

[3] Case SA.51502.
[4] Act amending the Excise Duty Act and certain other acts (Journal of Laws of 2018, item 2538, as amended).
[5] See: https://www.documents.clientearth.org/library/download-info/subsydia-motor-czy-hamulec-polskiej-transformacji-energetycznej/ (the report will soon be available in English).
[6] https://legislacja.rcl.gov.pl/projekt/12330500.
[7] See: https://forum-energii.eu/pl/analizy/ustawa-pradowa.

investments in energy efficiency or distributed energy sources, targeting the most vulnerable groups of consumers.

3 Lack of plan for implementing market-based supply prices

As regards retail electricity market, Poland does not also have a plan for deregulating power prices for household customers. According to the amended directive on the internal market for electricity, **state interventions in the retail market should be limited to vulnerable consumers**. In ClientEarth's view, **a proposal for market-based supply prices for all groups of Polish customers should be included also in the country's market reform plan**.

4 Lack of legal framework for power storage

Poland still does not have any specific legal framework regulating the power storage sector, which prevents it from a broader development. Such legal framework is under consideration in Poland since 2018[8], but the relevant draft proposal has never gone beyond the stage of governmental work. **As storage is to play a crucial role in the power system of tomorrow, Poland's proposals regarding this market sector should also be included in the consulted market reform plan.**

5 Expiration of RES auction scheme

Since 2018, Poland has been implementing a new auction scheme for the sale of electricity from renewable energy sources. This scheme has proven to be very successful, with average prices being well below the level of forward power contracts on the Polish Power Exchange (where the clearing price is set by existing coal-fired power plants). **From an economic point of view, the RES auctions increasingly cease to function as a support scheme and become a means of cost-competitive contracting of large volumes of electricity for the Polish consumers**. According to the recent study by ClientEarth and WiseEuropa, the auction scheme is already bringing savings for the final customers[9].

Despite such auctions' results, according to the current legal status (i.e. the Polish Act on Renewable Energy Sources and the corresponding EC's decision approving the auction scheme[10]) the last auction under this scheme shall be held by June 30, 2021 at the latest. In other words, unless the authorities decide otherwise, this very well functioning mechanism will expire as soon as next year (new auctions cannot be held from 1 July 2021 onwards). Poland's RES market is not as developed as the ones in the Western Europe and the **prolongation of the scheme is especially important in the context of fulfilling the country's 2030 RES-related obligations under the Clean Energy Package**, as well as in a broader climate-neutrality perspective.

[8] See: https://legislacja.rcl.gov.pl/projekt/12317354/katalog/12543041#12543041.
[9] https://www.documents.clientearth.org/library/download-info/subsydia-motor-czy-hamulec-polskiej-transformacji-energetycznej/.
[10] SA.43697.

6 Wind Energy Investments Act

Poland's Wind Energy Investments Act has been in force since July 2016[11]. Despite some changes in the legislation, in practice, in its present form the act blocks the development of all new onshore wind project that have already not been commissioned in the auctions held in 2018-2019. This means that Poland does not allow the construction of new zero carbon power plants in the technology that has already proven to be the cheapest in the Polish power market conditions. The act does not even allow for repowering the existing turbines with new, much more efficient ones, in existing locations.

Onshore wind energy is the only power generation technology in Poland that could already be developed on a market basis (i.e. without involving State aid) and such development is banned due to an unfounded spatial planning legislation. In ClientEarth's view, **repealing the Wind Energy Investments Act would be good not only from a general low carbon energy transition, but also from a pure power market perspective. Therefore, the Polish authorities should commit to make changes in the act also in the consulted market reform plan**.

7 Overall level of subsidies on Poland's power market

Poland's power market has been highly distorted with various State aid mechanisms that subsidise mostly conventional power generation technologies (in practice, coal-fired power units). According to the recent study by ClientEarth and WiseEuropa, only in the years 2013-2018, the Polish authorities have granted approx. PLN 45 billion (~EUR 10 bln) in various subsidies to the country's power generation sector and nearly PLN 30 billion (~EUR 7 bln) of this total sum has been granted to carbon intensive technologies[12]. This means that in 2013-2018 Poland allocated twice as much public funds to help conventional power sector (mostly coal) than for the renewable power sector.

In ClientEarth's view, such **distribution of subsidies results in mutual elimination of the effects of the aid, preserving the Polish power sector and hindering its transformation towards low carbon technologies**. This transition has also been slowed down by the progressive link between the power sector and mining. Moreover, the vast majority of the existing support schemes for the Polish power sector should be considered as inefficient in terms of costs and environment, especially in comparison to the countries of Western Europe.

By way of example, State aid granted for the Bełchatów Power Station has proven to be particularly inefficient in the context of a long-term energy transition. The average annual value of support for this power plant has been estimated at approx. 9-10% of its total revenues. In the years 2013-2019 the Bełchatów Power Plant received approx. PLN 2.5 billion (~EUR 600 mln) in the form of free EU ETS allowances, and for the years 2021-2025 the State guaranteed the same amount of support within the capacity market. This means that only one power station in Poland (which, despite such level of public support, continues to be the biggest single CO_2 polluter in Europe) has obtained about 1/4 of the country's total free allowance allocation under Article 10c of the ETS Directive.

In ClientEarth's opinion, **Poland's energy transition can be increasingly carried out through market price signals. State intervention in the energy sector should aim at achieving**

[11] OJ of 2019, item 654, as amended.
[12] https://www.documents.clientearth.org/library/download-info/subsydia-motor-czy-hamulec-polskiej-transformacji-energetycznej/.

additional environmental benefits, in particular by promoting solutions significantly reducing carbon dioxide emissions.

8 Not respecting EU State aid law requirements

Poland has not been fully fulfilling its power market-related obligations under EU State aid law, including specific commitments contained in the EC's decisions approving particular State aid mechanisms. In particular, the EC decision approving State aid referred to in Article 10c of the ETS Directive has not been adopted unconditionally. The Commission has not objected to this aid, in view of the commitments made by the Polish authorities concerning:

- decrease in the installed capacity level in coal-fired power plants by 2020 (from 31,375 MW at that time to 28,854 MW); and
- deconsolidation of the domestic electricity generation market, in particular by "seeking to ensure that the market shares of the main electricity generator, the PGE group, will not increase or even slightly decline from 37.7% (2011) to 33.4% (2020)"[13].

The Polish authorities have not implemented the abovementioned elements of the EC Decision and the recent data show that at the end of 2019 the volume of installed capacity in domestic coal-fired power plants was even higher than at the time of the Commission's approval of State aid under Article 10c of the ETS Directive.

In addition, in the Polish power market, we are confronted with progressive consolidation and strengthening of the market position of the main beneficiaries of the free allowance allocation mechanism, and this market is currently operating under actual oligopoly conditions, with the dominant position of the PGE Group. In particular, as a result of the acquisition of the assets of the French EDF Group (in 2011 it was the third largest electricity generator in Poland) in 2018 PGE's share in the domestic electricity generation market increased year-on-year by 6 percentage points and amounted to 43%, and the group 2020 target resulting from the PGE strategy is "over 40%"[14].

This shows that distorting competition with such **State aid mechanisms aimed at subsidising conventional power generation has been leading to strengthening the market position of domestic incumbent utilities and lowering the level of competition on the Polish power market**. In ClientEarth's opinion, **Poland should include in its market reform plan additional measures aimed at reducing the level of oligopoly in the domestic power market**.

Furthermore, based on the Polish intervention mechanisms in the power market which have never been officially notified to the EC, the conditions for State aid within the meaning of the TFEU appear to be met by the compensation mechanisms provided for in:

- the abovementioned Power Prices Act (in particular the refunding of the price difference and the freezing of retail electricity prices for all categories of customers in the first half of 2019);
- the existing capacity mechanisms (Cold Contingency Reserve and Operational Capacity Reserve); and

[13] SA.34674.
[14] See: Report of the Management Board on the activities of PGE S.A. and PGE Capital Group in 2018.

- the possibility of exchanging investment certificates into shares of energy companies as referred to in the amended act on long-term power purchase agreements[15].

Importantly, strategic reserves notified to the EC by the authorities of other Member States (Germany, Belgium) have been very similar to the abovementioned Polish mechanisms and the Commission finally concluded that they constitute State aid.

The Polish authorities should therefore each time notify the EC of such doubtful mechanisms in order to obtain legal certainty as to the legality of their implementation in the proposed form. This is of particular importance for the beneficiaries themselves.

[15] OJ of 2019, item 1874.

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ClientEarth is a non-profit environmental law organisation based in London, Brussels and Warsaw. We are activist lawyers working at the interface of law, science and policy. Using the power of the law, we develop legal strategies and tools to address major environmental issues.

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