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Competition in Energy Markets – Note by Poland

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Poland

1. This contribution addresses the subject of the current situation on the energy market in Poland. It starts with a short introduction and an overview of key characteristics of the energy market in Poland, followed by some information relating to measures introduced to counter the effects of energy crisis. Then it introduces a brief description of the Polish Competition Authority (“UOKiK”, “NCA”)’s recent activities on the coal and fuel market as well as scrutiny actions taken on electricity and gas markets. The paper is closed by some concluding remarks.

1. Introduction

2. Energy sector in Poland is dominated by fossil fuels and is strongly affected by the European Union’s climate and energy policy. The sector faces many challenges, such as the need to guarantee energy security, maintain affordable energy prices for households and at the same time achieve EU climate goals.

3. The economic disruption initially caused by the Covid-19 pandemic and then Russia’s military aggression against Ukraine has a major impact on the entire Poland’s economy and undoubtedly created a shock on energy market, leading to price volatility, supply shortages and serious security issues. An unprecedented increase of energy prices has caused severe economic and social problems.

4. An exceptional situation on global energy markets and surging energy prices, as well as energy security challenge, created a necessity for special legal measures. Poland, along with other European countries, has taken steps to address the impacts of these events and introduced numerous solutions that aim at providing energy recipients with adequate support.

5. The measures include inter alia a suspension of the rules obliging gas companies to trade fuel on the Warsaw commodity exchange in the event of gas crisis, an extension of gas tariff price protection for consumers until 2027 and contingency planning for gas storage and transmission operators. Moreover, Polish government aims at adopting aid schemes to compensate for the additional costs due to severe increases in natural gas and electricity prices or aid for the decarbonization of industrial production. Another extraordinary measure sets up a cap of electricity prices for energy consumers, including small and medium-sized enterprises.

2. The Polish Competition Authority’s activities in the energy sector

6. Rising energy prices and the uncertain supply situation are reasons for additional expectations towards UOKiK to intervene. The NCA is called for increased scrutiny, which is understandable due to vulnerability of the sector. However, many of the problems that the energy sector currently faces are beyond the competition authority’s competence. We see a strong pressure on antitrust authorities to act, preferably by taking steps to quickly lower the prices in an artificial way. This is a dangerous trend in antitrust enforcement. This, however, does not mean that NCAs should be passive. It is rather about being vigilant, but at the same time: (i) realistic about the possible outcomes of investigations; and, (ii) objective when approached by stakeholders.

7. UOKiK constantly monitors the markets and take swift and effective actions in the event of suspicion that entrepreneurs use the circumstances to engage in anti-competitive practices. This is a major challenge in these troubled times because the current economic conditions trigger a chain reaction and affect all sectors of the economy, and also make it difficult to conduct reliable analysis and research that may help us determine whether certain entrepreneurs may violate competition law.

2.1. Market investigation on the coal market

8. War in Ukraine and an import ban on coal from Russia and Belarus - which in Poland was introduced on 14 April 2022 - resulted in significant price increases in solid fuels and its limited availability.

9. Soaring coal prices and limited supply made it necessary to examine the mechanisms of functioning of the coal market and determine whether the undertakings operating in the coal market may violate the competition law.

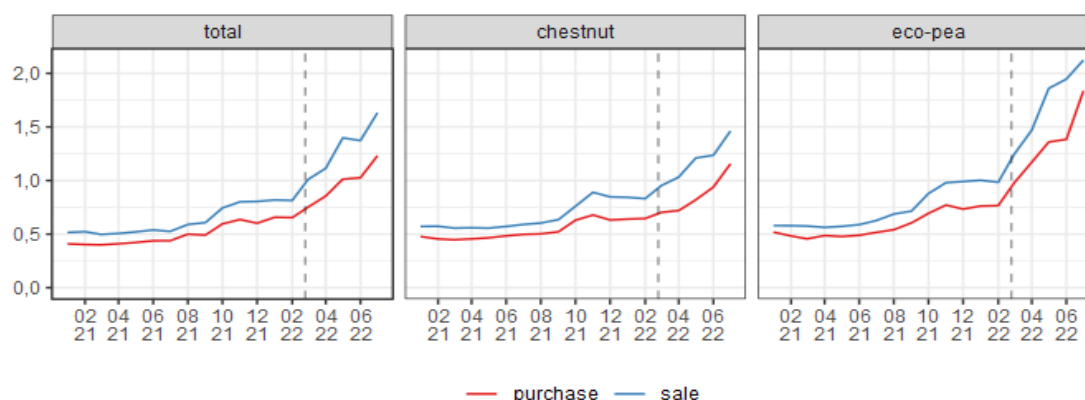
10. Considering the above, in July 2022 UOKiK initiated preliminary proceedings regarding the study of the hard coal distribution market, especially for households.

11. In the course of the proceedings, in August 2022, an inspection was carried out and it covered 201 entrepreneurs operating a total of 255 coal depots throughout Poland. Coal depots operate primarily on a local scale. Therefore, in order to obtain possibly the most representative sample, the inspection covered entities operating in different localities situated on the territory of each province (voivodeship), whose core business activity involves the sales of solid fuels. The entrepreneurs under investigation supplied approximately 1.5 million tonnes of solid fuels to end-users in 2021, which accounted for approximately 17% of household demand.

12. Most entrepreneurs indicated that the purchase price has the greatest impact on the price of the products they offer. Entrepreneurs operating coal warehouses pointed out that the increase in sales prices was also caused by an increase in transport prices from the producer or importer (even by 50%), as well as a subsequent increase in operating costs (taxes, salaries, fuel and energy).

13. Indeed, rocketing prices in coal depots were mostly due to the increasing purchase costs incurred by these entrepreneurs following February 24, 2022, i.e. after Russia's attack on Ukraine. As can be seen from the diagram below, this applies to the total volume of coal sold and purchased by the entities under investigation. An upward trend is also evident in the selling price of the most popular products "chestnut" and "eco-pea". It should be emphasised, however, that since the outbreak of the war in Ukraine, the selling prices of all grades were going up proportionally to the increase in their purchase prices by depots from suppliers or importers.

Average monthly selling prices and purchase prices of selected grades of coal at the entities under investigation (thousand PLN / t) in the period January 2021 - July 2022.



Source: responses from entities under investigation

14. Quite importantly, there was no significant increase in profit margin, i.e. the difference between the average purchase price of coal by depots and the average selling price from February to July 2022. For coal in total, however, it increased from approximately 20% (February) to approximately 25% July).

15. Entrepreneurs running fuel depots indicated also that there are no new sources of supply after the introduction of a ban on coal imports from Russia and Belarus. As alternative sources of supply the entrepreneurs indicated Kazakhstan, Colombia, Indonesia, Australia or African countries. The entrepreneurs pointed out that due to the need to import coal from the above-mentioned countries, the cost of its transport will increase by an estimated 50% to 400% compared to the costs before the introduction of the embargo.

16. In most cases entrepreneurs assessed the prospects for the market, and thus for their business, in a negative manner. Thus, it should be acknowledged that in a situation where negative forecasts as to the development of the situation prevail among entrepreneurs, as well as among a significant part of them, there is uncertainty as to the possibility of obtaining products from suppliers in the future, it is conducive to further price increases. It results from the need to generate greater profits per ton of fuel with a decreasing volume of sales (due to shortages in supply) and the risk of not being able to replace the sold goods (rising prices at suppliers, shortages of solid fuels).

17. UOKIK inspectors also checked whether the warehouses store coal for later sale with a greater profit. However, no cases were found in which a significant amount of coal in the composition would not be available for sale without cause. Most of it was intended for further sorting, so it could not be offered to potential buyers at a given moment. In other cases, it was, inter alia, goods already sold or reserved.

18. The increase in prices was accompanied by a shortage of coal in the warehouses. After 24 of February the quantity and value of their purchases decreased significantly. The main reason was the loss of steady sources of supply. 77% of entrepreneurs surveyed confirmed that domestic suppliers or importers refused to deliver the goods to them. The main reasons for the refusal were the lack of coal or its limited quantity and the embargo on products from Russia and Belarus. In addition, over 15% of entrepreneurs indicated that there were changes or termination of solid fuel supply contracts at that time.

19. To sum up, the probe confirmed that the main problems of entrepreneurs running fuel depots are: difficulties in finding sources of solid fuel supplies and difficulties in selling it (a decrease in demand caused by the price level and consumers' expectation of regulatory solutions). Taking into account the above and the fact that there are many independent entities on the market, the possibility of concluding an anti-competitive agreement, even on local markets, seems unlikely.

20. Regardless of the above, the preliminary proceeding is still pending. As part of the ongoing market research, which covers coal producers (mines) and several dozen of the largest importers and distributors, it will be determined, inter alia, the size and value of the market for placing coal on the market for the small customers sector, including households.

21. UOKiK is currently analysing extensive data obtained during the inspection and provided by entrepreneurs, as well as thoroughly analysing all market signals received by the agency and observing market behavior that may indicate the use of anti-competitive practices.

2.2. Recent activity on the fuel market

22. Due to soaring fuel prices and incoming complaints, UOKiK has taken steps to clarify the reasons for such a large increase in prices - whether, in addition to market conditions, potential anti-competitive behaviour may have affected this.

23. The study showed that the increase in fuel prices in Poland, as in other European countries, has market foundations – there were no grounds to conclude that it may result from prohibited practices of entrepreneurs. According to the carefully conducted analysis, the increase in fuel prices in recent months in Poland results from objective market factors. The most important of them include the following:

- decrease in the capacity of refineries operating in Europe. This is due, inter alia, to the closure of some of them in recent years due to the limited prospects of the industry (expected drop in petrol consumption due to the shift to electric cars) and short-term problems (significant decrease in fuel demand in the first pandemic period);
- an increase in oil prices and the US dollar exchange rate (in relation to PLN) in which it is valued;
- China's significant reduction in fuel exports in 2022;
- sanctions against Russia, which is a significant exporter of both crude oil and finished fuels, including petrol.

24. According to our analysis, the problem of high fuel prices caused by the global situation and market factors is not only faced by Poland, but also by other European countries. This applies not only to oil prices, but also to petroleum products, i.e. petrol and diesel. Both the increase in fuel prices and the growing difference between oil and petroleum products in H1 2022 were a global phenomenon. It should be noticed that the fuel quotations in Europe have direct impact on retail prices at petrol stations which indicates the decisive influence of external factors in the process of price formation on the domestic market.

25. UOKiK asked PKN Orlen and Lotos Group (two Polish refineries)¹ for information concerning their sales policy in the period from January 2021. Then the method

¹ In August 2022, PKN Orlen finalised its merger with Lotos Group.

of calculating wholesale and retail prices of fuels by entrepreneurs was verified, including the factors taken into account in determining the sales price, its components, along with the determination of shares in the final price and price formulas used by companies. In addition, information on how to calculate the so-called model refinery margins was examined. The results of this analysis show that the change in prices is due to the previously indicated situation on the world fuel markets.

26. Similarly, it is in line with the increase in model refinery margins. It should first be stressed that they do not fully reflect the actual profit achieved by refineries. These are highly simplified indicators for estimating the profitability of crude oil processing.

27. The analysis showed that rising fuel prices in Poland were caused by market conditions, not by anticompetitive conduct. The problem of rising fuel prices affects the entire European market and Russia's invasion of Ukraine and the sanctions imposed affect the price of raw materials and cause perturbations on the market. Notwithstanding the foregoing, the UOKiK continues to monitor the market and is examining thoroughly any sign indicating the possibility of anti-competitive practices in this market.

28. It is worth mentioning, that many complaints that UOKiK receives concern the fact that the movements of prices (mostly petrol prices) do not correspond to the actual costs incurred by undertakings in specific time periods. As part of our actions, UOKiK reviewed our past investigations in the energy sector and their results. Over 20 years ago, long before the spread of the “more economic approach”, UOKiK attempted to challenge price increases of petrol, based on a theory of harm which used a simple cost benchmark. The decision in this case was set aside by the courts which criticised the cost-based approach in the circumstances of that case. While the case was a loss 20 years ago, it now proves to be useful in explaining to our stakeholders the dangers of oversimplifying market developments.

2.3. Threats to the competitive functioning of gas and electricity sectors

29. Taking into account the situation in the energy sector, as well as characteristics of Poland's gas and electricity markets, UOKiK remains vigilant in ensuring that those markets are not affected in any way by anticompetitive practices.

30. The electricity market is dominated by four key players, four vertically integrated groups² (generation, distribution and supply activities). Additionally, the obligation to sell electricity through the stock market has been lifted recently. Commercial transactions will continue to be concluded on commodity exchange, while each energy provider will decide independently, according to their own market strategy, to use this form of trading or not. UOKiK as well as national sector regulator (NRA) have been against this legislative change as it can lead to lower market transparency, greater possibility for strong market participants to influence the price and generally negatively affect competition mechanisms.

31. Taking into account the structure of the market, soaring prices as well as the recent change in market operations, the electricity market is a subject of UOKiK's supervision. It cannot be excluded that during these difficult times companies will be tempted take advantage of their strong position or in other way hinder the competition and distort energy prices. The risks of an unjustified increase in electricity prices as a result of the use of

² PGE Polska Grupa Energetyczna Group, ENEA Group, TAURON Polska Energia Group, PKN Orlen Group.

market power or other forms of market manipulation cannot go unseen, so UOKiK carefully assesses all the complaints received and closely cooperates with NRA in order to preserve healthy competition on this vulnerable market.

32. UOKiK constantly monitors the situation on gas market. The Polish gas market is still dominated by one supplier and one seller – PGNiG S.A. The group holds a dominant position in production, import, wholesale and retail trade, storing and distribution. Between 2018 and 2020, UOKiK investigated the issue of possible abuse of the dominant position in the gas market by PGNiG. The investigation, based on a thorough analysis of the market for the supply of nitrogen-rich gas, did not however reveal any unlawful activity.

33. During the investigation, it was established that companies selling nitrogen-rich gas to households are free to choose the price formula for a given gas year based on the stock exchange prices or fixed prices. If they opt for a price formula based on the stock exchange prices, the price is determined on the basis of methane-rich gas prices on the Polish Power Exchange. An alternative to this formula is the fixed price formula which, if chosen by the company, constitutes the basis on which the supply of nitrogen-rich gas is settled in the subsequent contract year. It is worth noting that in the course of the investigation, it was also established that in subsequent years, a distributor of nitrogen-rich gas supplied to households may change the basis for determining the price of the gas - freely and independently of any prior settlement methods. Despite the above findings, UOKiK still closely monitors gas market, especially conditions on which it is delivered to end users.

3. Conclusions

34. Competition policy is not a tool to combat soaring energy prices. Our hitherto experience shows that rapidly rising fuel and coal prices in Poland are caused by market conditions, not by anticompetitive conduct. Having said that, it has to be underlined that the role and activity of the competition authorities in times of crisis is particularly important. Crisis environment can give cover to companies with market power to exploit that power or to collusive behavior. Therefore, competition authorities cannot hesitate to investigate cases in which price rises might be caused by anticompetitive practices.

35. Competition policy is a permanent element of the social economy and its importance cannot be ignored in times of economic downturn. The competition policy cannot back away, however it also cannot be enforced regardless of other public goals pursued by the state and the EU. The period of economic turmoil undoubtedly influence the change of priorities which is reflected in the areas of particular involvement and activities undertaken by antitrust authorities.