

Polish Shale Gas Law Update – Tax-Free Opportunities!

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After years of anticipation and delay, the Polish government has finally taken significant steps forward in opening up the shale gas industry in Poland. Either fortuitously or intentionally, this comes just in time. The E.U. countries, especially in Eastern Europe, expeditiously need to find alternative sources of natural gas to counter Russia's dominant position. One obvious source is to tap into the shale gas reserves in Poland. So, given that North American companies have the most experience and technical expertise in shale gas production and hydraulic fracturing techniques, it is logical that companies will find opportunities in Poland.

Background

Shale gas reserves were discovered in Poland several years ago, and are estimated to be the third largest in Europe (after Norway and the Netherlands). But no meaningful production or drilling has yet occurred in Poland due to a non-existent regulatory and legal structure as well as an uncertain tax regime for shale gas. On March 11, 2014, the Polish government announced it had adopted draft bills to establish a favorable tax scheme for shale gas production and to amend Poland's Geological and Mining Law. Although the final wording of these drafts still need to be worked out and enacted by the Polish Sejm (Parliament), they finally provide much of the legal and tax framework that was needed to encourage commercial drilling and production operations.

Clarification to Concession Process

Significantly, the draft legislation breaks from the past paradigm as well as a common E.U. scheme of requiring a state-controlled, "national operator" to be involved in each concession. This model was strongly criticized by potential investors and energy companies, and the Polish Government paid attention to them. Accordingly, pursuant to the draft legislation, shale gas projects and operations will not be required to include a state-owned enterprise in their investments, and no such state-owned entity will be created.

Second, the old law required separate concessions for the researching, prospecting/exploration stages and for the production stage. Under the draft bills, a single, joint concession can be applied for and obtained (pursuant to a transparent tender process) to conduct all these activities, thereby making the process more certain and less bureaucratic. Existing owners of concessions would be entitled to apply for additional concessions based on current conditions, and would also be entitled to apply to convert their existing concessions into one joint concession. The joint concession would be granted for 10-30 years, rather than for 3-50 years as is presently the case. Concessions would also be possible for joint venture applicants.

Environmental Regulations

The new bills contemplate that conducting and submitting an environmental impact study on shale gas projects would be required at the time before drilling begins. Currently such environmental assessments are required at the beginning of the process, i.e., even before an exploration concession is granted. This should significantly alleviate the need to undertake costly and often unnecessary environmental studies, as the concessionaire would only be required to focus on the area actually drilled in, rather than the entire area of the concession.

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At the same time, on March 12, 2014, the European Parliament adopted changes to the directive on environment impact assessment procedures. These changes eliminated the requirement to conduct comprehensive environmental impact studies in the prospective stage. However, certain new procedures were added to the environmental studies (assessment of health risks caused by the contaminated water, water and soil usage, quality and regeneration capabilities of underground water). Once these changes come into force, Poland would need to add them to its regulatory scheme as well.

Taxation

The most anticipated changes introduced by the draft legislation deal with the favorable tax scheme for natural gas production activities. The Polish Prime Minister announced that shale gas production would be exempt from any special taxation until 2020, in order to promote and intensify shale gas exploration and production as soon as possible.

After that year, shale gas production will be taxed at two levels. First, a royalty equal to 1.5% of the value on each cubic meter of gas extracted will be assessed (3.0% in the case of shale oil), regardless of extraction costs. Second, a "hydrocarbons tax" ranging from 0-25% of the net profit generated in a specific deposit would be assessed. Additionally, regular corporate income taxes will be assessed on companies engaged in the activity. However, most significantly, the Polish Government also announced that it will seek to limit the cumulative burden of these taxes so they would not exceed 40% of the income of the production companies.

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