

# UKRAINE'S IMPLEMENTATION OF EU ENERGY ACQUIS\*

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*The EU's Third Energy Package is composed of two Directives and three regulations. These include Directive 2009/72/EC<sup>2</sup> concerning common rules for the internal market in electricity and repealing Directive 2003/54/EC<sup>3</sup> and Directive 2009/73/EC<sup>4</sup> concerning common rules for the internal market in natural gas and repealing Directive 2003/55/EC<sup>5</sup>. The latter are Regulation (EC) No 714/2009<sup>6</sup> on conditions for access to the network of cross-border exchanges in electricity and repealing Regulation (EC) No 1228/2003<sup>7</sup>, Regulation (EC) No 715/2009<sup>8</sup> on conditions for access to the natural gas transmission networks and repealing Regulation (EC) No 1775/2005<sup>9</sup>, and Regulation (EC) No 713/2009<sup>10</sup> establishing an Agency for the Cooperation of Energy Regulators.*

The self-professed aim and essence of the Third Energy Package is the improvement of the internal energy market's functioning and the resolution of unresolved structural problems.<sup>11</sup> This involves the unbundling of the energy sector, which refers to the separation of energy generation and supply from network

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<sup>2</sup> Directive 2009/72/EC of the European Parliament and of the Council of 13 July 2009 concerning common rules for the internal market in electricity and repealing Directive 2003/54/EC, ELI: <http://data.europa.eu/eli/dir/2009/72/oj>

<sup>3</sup> Directive 2003/54/EC of the European Parliament and of the Council of 26 June 2003 concerning common rules for the internal market in electricity and repealing Directive 96/92/EC - Statements made with regard to decommissioning and waste management activities, ELI: <http://data.europa.eu/eli/dir/2003/54/oj>

<sup>4</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/EC, ELI: <http://data.europa.eu/eli/dir/2009/73/oj>

<sup>5</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, ELI: <http://data.europa.eu/eli/dir/2003/55/oj>

<sup>6</sup> Regulation (EC) No 714/2009 of the European Parliament and of the Council of 13 July 2009 on conditions for access to the network for cross-border exchanges in electricity and repealing Regulation (EC) No 1228/2003, ELI: <http://data.europa.eu/eli/reg/2009/714/oj>

<sup>7</sup> Regulation (EC) No 1228/2003 of the European Parliament and of the Council of 26 June 2003 on conditions for access to the network for cross-border exchanges in electricity, ELI: <http://data.europa.eu/eli/reg/2003/1228/oj>

<sup>8</sup> Regulation (EC) No 715/2009 of the European Parliament and of the Council of 13 July 2009 on conditions for access to the natural gas transmission networks and repealing Regulation (EC) No 1775/2005, ELI: <http://data.europa.eu/eli/reg/2009/715/oj>

<sup>9</sup> Regulation (EC) No 1775/2005 of the European Parliament and of the Council of 28 September 2005 on conditions for access to the natural gas transmission networks, ELI: <http://data.europa.eu/eli/reg/2005/1775/oj>

<sup>10</sup> Regulation (EC) No 713/2009 of the European Parliament and of the Council of 13 July 2009 establishing an Agency for the Cooperation of Energy Regulators, ELI: <http://data.europa.eu/eli/reg/2009/713/oj>

<sup>11</sup> European Commission, *Market Legislation*, <https://ec.europa.eu/energy/en/topics/markets-and-consumers/market-legislation>.

operators.<sup>12</sup> The logic behind this is that without unbundling, single companies which both generate and sell energy, while also operating transmission networks, may have reason to obstruct competition, thus preventing fair competition, and thus being disadvantageous for consumers due to possibility of increased prices.<sup>13</sup> In addition, the Package seeks to strengthen and safeguard the independent status and nature of energy regulators.<sup>14</sup>

Behind the Commission's campaign is the belief that a fully interconnected and competitive energy market would help to ensure energy security through making emergency supplies more easily transferable throughout the EU, and would help to deal with the issue of climate change through the maximalization of efficient energy use and the minimalization of emissions.<sup>15</sup>

Beyond the Member States of the European Union, these norms and regulations have also become binding upon third party states, who have become signatories to the Energy Community Treaty. Thus, these countries are bound to implement the EU's energy *acquis*, among which is Ukraine. Ukraine's general approach to implementing the Third Energy Package has been described as „incredibly fragmented”.<sup>16</sup> It has been characterised by real reform and success in part, most notably in the gas sector, whereas as other areas have come up for criticism. Below there shall be a survey and evaluation of Ukraine's attempt to conform its energy regime in line with its obligations as a signatory of the Energy Community. This shall focus on three major areas: gas, electricity and the creation of an independent regulatory authority.

## Gas

Directive 2009/73/EC states that „The internal market in natural gas, ..., 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.”<sup>17</sup>

Ukraine is considered to be effectively reforming its gas sector, through the implementation of its Gas Sector Reform Implementation Plan, having been hailed as the first Contracting Party of the Energy Community to have developed a significant natural gas market regulatory framework.<sup>18</sup> It is also argued that this reform of the gas sector has the potential to increase Central and Eastern Europe's energy security, and

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<sup>12</sup>Ibid.

<sup>13</sup>Ibid.

<sup>14</sup>Ibid.

<sup>15</sup>David Buchan (2015), *Energy Policy: Sharp Challenges and Rising Ambitions*, In, Helen Wallace, Mark A. Pollack and Alasdair R. Young (Eds.), *Policy-Making in the European Union*, Seventh Edition, Oxford: Oxford University Press, 2015, pp. 349.

<sup>16</sup>Maksym Popovych, *Energy regulator in Ukraine is another fight for independence*, *Kyiv Post*, May 22 2016, <http://www.kyivpost.com/article/opinion/op-ed/max-popovych-energy-regulator-in-ukraine-is-another-fight-for-independence-414294.html>. [accessed Oktober 10, 2017]

<sup>17</sup>Preamble (1)

<sup>18</sup>Energy Community, „Energy Community Country Brief: Spotlight on Ukraine”, Issue 3, 9 March 2016, 1.

thus Ukraine's domestic reforms in this area have an influence and importance beyond its own borders.<sup>19</sup>

In April 2015 the Ukrainian Rada passed the Law of Ukraine on the Natural Gas Market. The law was drafted by the Ukrainian government in close consultation with the Energy Community Secretariat, and Naftogaz, the Ukrainian state gas and oil company.<sup>20</sup> The legislation states that „In pursuance of Ukraine's obligations under the Treaty establishing the Energy Community and the [*Ukraine-EU Association Agreement*] the present law is directed at implementation of the Energy Community *acquis* on energy, in particular: Directive 2009/73/EC concerning common rules for the internal market in natural gas and repealing Directive 2003/55/EC; Regulation (EC) 715/2009 on conditions for access to the natural gas transmission networks and repealing Regulation (EC) 1775/2005; as well as Directive 2004/67/EC on measures to safeguard security of natural gas supply.”<sup>21</sup>

It begins with, „This Law defines legal fundamentals of the functioning of the natural gas market in Ukraine founded on principles of free competition, due protection of consumers and security of supply as well as capable of integration with natural gas markets of the states parties of the Energy Community, including by means of creation of regional natural gas markets.”

According to Article 23 Ukraine's Gas Law, entitled „General requirements of unbundling and independence of a gas transmission system operator (unbundling mode OU), paragraph 1:

„The gas transmission system operator shall be a separate legal person which is not part of a vertically integrated undertaking and carries out its commercial activities independent from activities independent from activities of production, distribution, supply of natural gas, activities of wholesale sellers. The gas transmission system operator may not carry out activities of production, distribution or supply of natural gas.”

This legislation was praised by the Director of the Energy Community Secretariat, who said that „Ukraine is well advanced in gas sector reform, having adopted the EU Third Energy Package compliant Law on Natural Gas Market which entered into force in October 2015”.<sup>22</sup> In general, its adoption was seen as a success which can act a model and be emulated in other attempts at approximation to EU law.<sup>23</sup>

The adoption of this law was followed by the creation of secondary legislation, with the assistance of the Energy Community Secretariat.<sup>24</sup> However, all of the secondary legal regulations were not entirely adopted, and in the case of some of those that were, some of their provisions did not wholly comply with the Gas Market Law.<sup>25</sup>

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<sup>19</sup>Dixigroup, *Ukraine's Gas Sector Reform*, 1.

<sup>20</sup>McKenna, „Ukraine”.

<sup>21</sup>Article 2.1

<sup>22</sup>Energy Community Secretariat hopes Ukraine's energy regulator will correct gas market regulations, 24 May 2016, Interfax-Ukraine Ukraine News Agency, <http://en.interfax.com.ua/news/economic/345478.html>. [accessed Oktober 10, 2017]

<sup>23</sup>Maksym Popovych, Ukraine's Gas Market: A thorny way to liberalisation, 9 April 2015, *New Eastern Europe*, <http://www.neweasterneurope.eu/articles-and-commentary/1562-ukraine-s-gas-market-a-thorny-way-to-liberalisation>. [accessed Oktober 10, 2017]

<sup>24</sup>Energy Community Country Brief Spotlight on Ukraine, Issue 3, 9 March 2016, 1.

<sup>25</sup>„Energy Community Secretariat hopes Ukraine's energy regulator will correct gas market regulations”

A bill was approved on July 1 2016 by the Cabinet of Ministers of Ukraine which will split Naftogaz of Ukraine according to the requirements of the EU's Third Energy Package,<sup>26</sup> as specified in the Ukrainian „On the Natural Gas Market” law.<sup>27</sup> The resolution, named „On unbundling of operations for transportation and storage (injection, withdrawal) of natural gas”<sup>28</sup> was drafted by the Ukrainian government in conjunction with the Energy Community Secretariat.<sup>29</sup> The plan includes provision for the creation of two new entities: JSC „Main Gas Pipelines of Ukraine” (MGU) and JSC „Underground Has Storage Facilities of Ukraine” (UGSF).<sup>30</sup> These will both take over the assets of the Ukrainian transmission system operator (TSO), Ukrtransgaz.<sup>31</sup>

At the time of writing, in Ukraine it is Naftogaz, along with its subsidiaries, which carries out such tasks as gas production, storage, supply and transmission.<sup>32</sup>

In September 2016 the Ukrainian government announced that the economy ministry would take over control over Ukrtransgaz, the subsidiary gas transportation operator of Naftogaz.<sup>33</sup> This decision would have placed both the generator/supplier and transmitter of gas under the control of the same ministry. The Secretariat of the Energy Community, in response stated that “this unilateral move is not in line with the Resolution on Unbundling adopted by the government on July 1, nor was it consulted with the Secretariat.”<sup>34</sup> Furthermore, it said that „control by the same public body – the ministry of economic development and trade – over both transmission system operator and Naftogaz' gas production and supply activities violates the unbundling provisions applicable under Energy Community law”.<sup>35</sup> There was also a threat of a possible action to enforce Energy Community rules.<sup>36</sup> In addition, the country's creditors warned that the move could put in jeopardy the disbursement of money connected to the country's IMF bailout package.<sup>37</sup>

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<sup>26</sup> Brent Haight, Ukraine Government Authorizes Naftogaz Split, *Gas Compression*, July 5 2016, <http://gascompressionmagazine.com/2016/07/05/ukraine-government-authorizes-naftogaz-split/>. [accessed Oktober 10, 2017]

<sup>27</sup> Vitaliy Radchenko, Ukraine: Naftogaz Unbundling Plan Adopted, *Lexology*, July 7 2016, <http://www.lexology.com/library/detail.aspx?g=230892a7-d324-4d08-89df-0055bef81b84>. [accessed Oktober 10, 2017]

<sup>28</sup> Naftogaz of Ukraine, Ukraine's government approves Naftogaz unbundling plan, July 4 2016, <http://www.naftogaz.com/www/3/nakweben.nsf/0/471E4A2222A20B92C2257FE6003174D0?OpenDocument&year=2016&month=07&nt=News&> [accessed Oktober 10, 2017]

<sup>29</sup> Radchenko, *Ukraine*.

<sup>30</sup> Naftogaz, *Ukraine's government approves Naftogaz unbundling plan*.

<sup>31</sup> *Ibid*.

<sup>32</sup> Radchenko, *Ukraine*.

<sup>33</sup> Roman Olearchuk, Ukraine under fire over gas group revamp, *Financial Times*, September 18 2016, <https://www.ft.com/content/89a349a4-7da2-11e6-8e50-8ec15fb462f4>. [accessed Oktober 10, 2017]

<sup>34</sup> Alyona Zhuk, Economy Ministry puts seizing control over Ukrtransgaz on hold, *Kyiv Post*, September 19 2016, <https://www.kyivpost.com/article/content/business/economy-ministry-puts-seizing-control-over-ukrtransgaz-on-hold-423225.html>. [accessed Oktober 10, 2017]

<sup>35</sup> William Powell, Bank, EC Condemn Ukraine Economy Ministry, *Natural Gas World*, September 17 2016, <http://www.naturalgaseurope.com/bank-ec-condemn-ukraine-economy-ministry-31655>. [accessed Oktober 10, 2017]

<sup>36</sup> EurActiv.com, After striking murky gas deal, Ukraine bows to West, *EurActiv*, September 26 2016, <https://www.euractiv.com/section/europe-s-east/news/after-striking-murky-gas-deal-ukraine-bows-to-west/>. [accessed Oktober 10, 2017]

<sup>37</sup> Olearchuk, *Ukraine under fire*.

## *Electricity*

Upon obtaining independence in 1991, Ukraine inherited a highly developed electricity sector as well as high energy consumption levels from the USSR.<sup>38</sup> In the mid-1990s Ukraine was the first country that had been part of the Soviet Union that underwent extensive reforms in the electricity sector.<sup>39</sup>

A key priority of the European Commission in relation to energy reform in Ukraine has been the introduction of a new model for the electricity market.<sup>40</sup> On 31 March 2016 the Ukrainian Parliament's energy committee recommended the approval of the Electricity Market Law draft.<sup>41</sup> The adoption of this law had been delayed for around one and a half years, even though by this time the secondary legislation necessary for the practical implementation of the law was already prepared.<sup>42</sup> The vacillating in the passing on the necessary legislation in order to reform the electricity market even provoked the intervention of the United States Ambassador to Ukraine, Geoffrey Pyatt, who stated that his government insisted that the electricity law should be adopted in the Autumn of 2016.<sup>43</sup>

Ukrainian Prime Minister Volodymyr Groysman sought to reassure interested parties that passing of legislation in conformity with EU standards was a major aim of the government and that the process was moving forward, stating on June 30 2016 at the Ukrainian Energy Conference in Kyiv that the passing of the electricity law was a priority, and that work was underway with the various parties and factions of the Ukrainian parliament in order to bring about the passing of the legislation, and was confident of its approval, with the aim being to have the legislation passed in the autumn of this year.<sup>44</sup>

## *Independent Regulator*

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<sup>38</sup>Laslo Lovei, Electricity Reform in Ukraine: The impact of weak governance and budget crises, *Public Policy for the Private Sector*, December 1998, Note No. 168, 2.

<sup>39</sup>Russell Pittman, Restructuring Ukraine's Electricity Sector: What Are We Trying to Accomplish, February 7 2015, *voxukraine*, <http://voxukraine.org/2015/02/07/restructuring-ukraines-electricity-sector-what-are-we-trying-to-accomplish/>, [accessed Oktober 10, 2017]

<sup>40</sup>European Commission hopes Ukraine reforms energy market soon, 3 June 2016, *Interfax-Ukraine Ukraine News Agency*, <http://en.interfax.com.ua/news/economic/347862.html>, [accessed Oktober 10, 2017]

<sup>41</sup>Energy Community „Ukraine Electricity”, [https://www.energycommunity.org/portal/page/portal/ENC\\_HOME/AREAS\\_OF\\_WORK/Implementation/Ukraine/Electricity](https://www.energycommunity.org/portal/page/portal/ENC_HOME/AREAS_OF_WORK/Implementation/Ukraine/Electricity) [accessed Oktober 10, 2017]

<sup>42</sup>Director of Energy Community: In the area of energy efficiency Ukraine did almost nothing, *Interfax-Ukraine Ukraine News Agency*, <http://en.interfax.com.ua/news/interview/345602.html>, [accessed Oktober 10, 2017]

<sup>43</sup>U.S expects Ukraine to adopt legislation on electricity market next fall – Ambassador Pyatt, *Ukrinform*, 30 June 2016, <http://www.ukrinform.net/rubric-economics/2042404-us-expects-ukraine-to-adopt-legislation-on-electricity-market-next-fall-ambassador-pyatt.html>, [accessed Oktober 10, 2017]

<sup>44</sup>Ukraine Energy Conference assures private investors ahead of planned privatization of energy companies, *Kyiv Post*, June 2 2016, <http://www.kyivpost.com/article/content/ukraine-politics/ukraine-energy-conference-assures-private-investors-ahead-of-planned-privatization-of-energy-companies-417659.html>, [accessed Oktober 10, 2017]

A major issue in the Ukraine's complying with the Energy Community standards is that legislation establishing an independent energy regulator.<sup>45</sup> After much delay and criticism, on September 22 this year the Ukrainian parliament passed the law to create an independent energy market regulator.<sup>46</sup> The legislation is titled Draft Law No 2966-d "On the National Commission for State Regulation of Energy and Public Utilities Sector"<sup>47</sup> and was written with in consultation with the Energy Community Secretariat.<sup>48</sup> This was signed into law by President Petro Poroshenko on November 23 of this year.<sup>49</sup> This independent commission will have the responsibility of setting power tariffs,<sup>50</sup> and shall be composed of two members nominated by the president, two members nominated by the parliament, and one nominated by the Cabinet of Ministers.<sup>51</sup> It is hoped that the adoption of this legislation and it being successfully implemented will create a truly independent regulatory authority. The passing of this legislation was critical for Ukraine, as the European Union directly tied to receiving a 600-million-euro loan to the reforming of this area.<sup>52</sup>

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<sup>45</sup>Director of Energy Community.

<sup>46</sup>Alyona Zhuk, Parliament passes long-awaited law on energy market regulator, *Kyiv Post*, September 22 2016, <http://www.kyivpost.com/article/content/ukraine-politics/parliament-passes-long-awaited-law-on-energy-market-regulator-423486.html>. [accessed Oktober 10, 2017]

<sup>47</sup>Vitaliy Radchenko, Law on Energy Regulator Finally Adopted, *Lexology*, October 7 2016, <http://www.lexology.com/library/detail.aspx?g=d22ccbe5-3634-4d4c-94da-871a123ecdc4>.

<sup>48</sup>Olena Kuchynska, New law in Ukraine establishes independent national energy regulator, *Kinstellar*, November 2016, <http://www.kinstellar.com/insights/detail/425/new-law-in-ukraine-establishes-independent-national-energy-regulator>. [accessed Oktober 10, 2017]

<sup>49</sup>Ibid.

<sup>50</sup>Natalia Zinets and Alexei Kalymkov, Passing energy bills, Ukrainian MPs clear path for new EU loan, *Reuters*, September 22, <http://www.reuters.com/article/ukraine-energy-idUSL8N1BY2K3>. [accessed Oktober 10, 2017]

<sup>51</sup>Alyona Zhuk, A Week in the Rada: What was done on Sept. 20-23, *Kyiv Post*, September 23 2016, <https://www.kyivpost.com/article/content/ukraine-politics/a-week-in-the-rada-what-was-done-on-sept-20-23-423602.html>. [accessed Oktober 10, 2017]

<sup>52</sup>Zinets and Kalymkov, *Passing energy bills*.

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