

# **ENERGY COMMUNITY WEBINAR SERIES**

## **Ukrainian Gas Exchange: A pipedream or imminent reality?**

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- I. Introduction – EBRD and Energy Community Gas Exchange Project
- II. What is a Gas Exchange and how does it work?
- III. Example of the European Market Development
- IV. Important developments in Ukraine for the gas exchange establishment
- V. Conclusions

- The **EBRD**, the **Energy Community** and **Baringa** were engaged in a project to structure the **development** of a **gas exchange** in Ukraine
- Several meetings were held and major **European established exchanges** have provided their **expression** of **interest** to support the development of a gas market in Ukraine
- Due to the **elections, unbundling** and the **transit negotiations** this **initiative stopped**
- During that time the **situation** of the **development** of the **gas market** in **Ukraine changed**
- The **development** of the **Ukrainian Energy Exchange (UEEX)** is showing strong progress towards the establishment of a well functioning gas exchange
- In order to support and accelerate the process, the EBRD and the Energy Community are standing ready to help

## ***I. The importance of a gas exchange for Ukraine`s economic development***

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- Ukraine is **one of the largest gas markets** both in terms of size and infrastructure (storage) in Europe
- The **gas price** in **Ukraine** was historically **traded at premium compared to EU markets**, while following the **logic** of the **transportation routes** and **own gas production** it should be at **discount**
- The gas infrastructure in Ukraine was built in Soviet times to serve European consumers, a **successful market liberalization** could **revalue** some of the **assets** that can fit the current forecast of gas demand in the EU
- Through the availability of **300 traders**, **own gas production** and **large storage facilities** **gas exchange trading** would enable Ukraine to provide a **strong Eastern European gas market index**

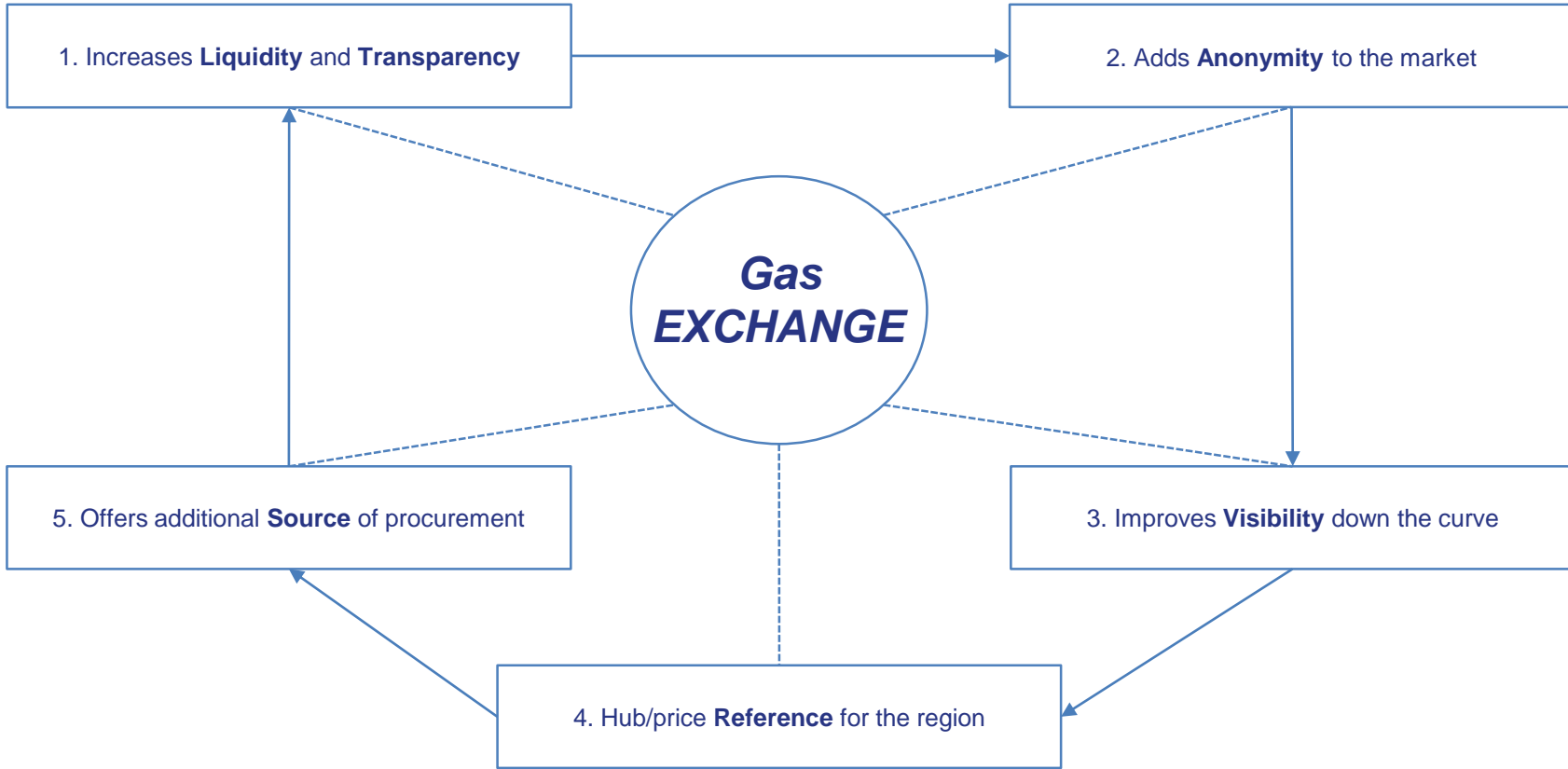
## II. What is a gas exchange and how does it work? (1/3)

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- A **gas exchange** can be seen as a **service provider** for the TSO as the TSO can **interact** as a **market participant** on the exchange to **balance** its system using the provided liquidity by all market participants
- A **gas exchange** is different from a broker/trading platform, through:
  - **centralized clearing**
  - **standardization of traded products**
  - **Direct nominations and integration to the system of the TSO**
- The products traded on the exchange are divided into **two main categories**:
  - **Spot markets**: immediate or near time transactions with physical delivery (within day, day ahead products)
  - **Futures markets**: Month ahead and contracts with further duration (mostly used for hedging purposes and are in the most cases not going into physical delivery)

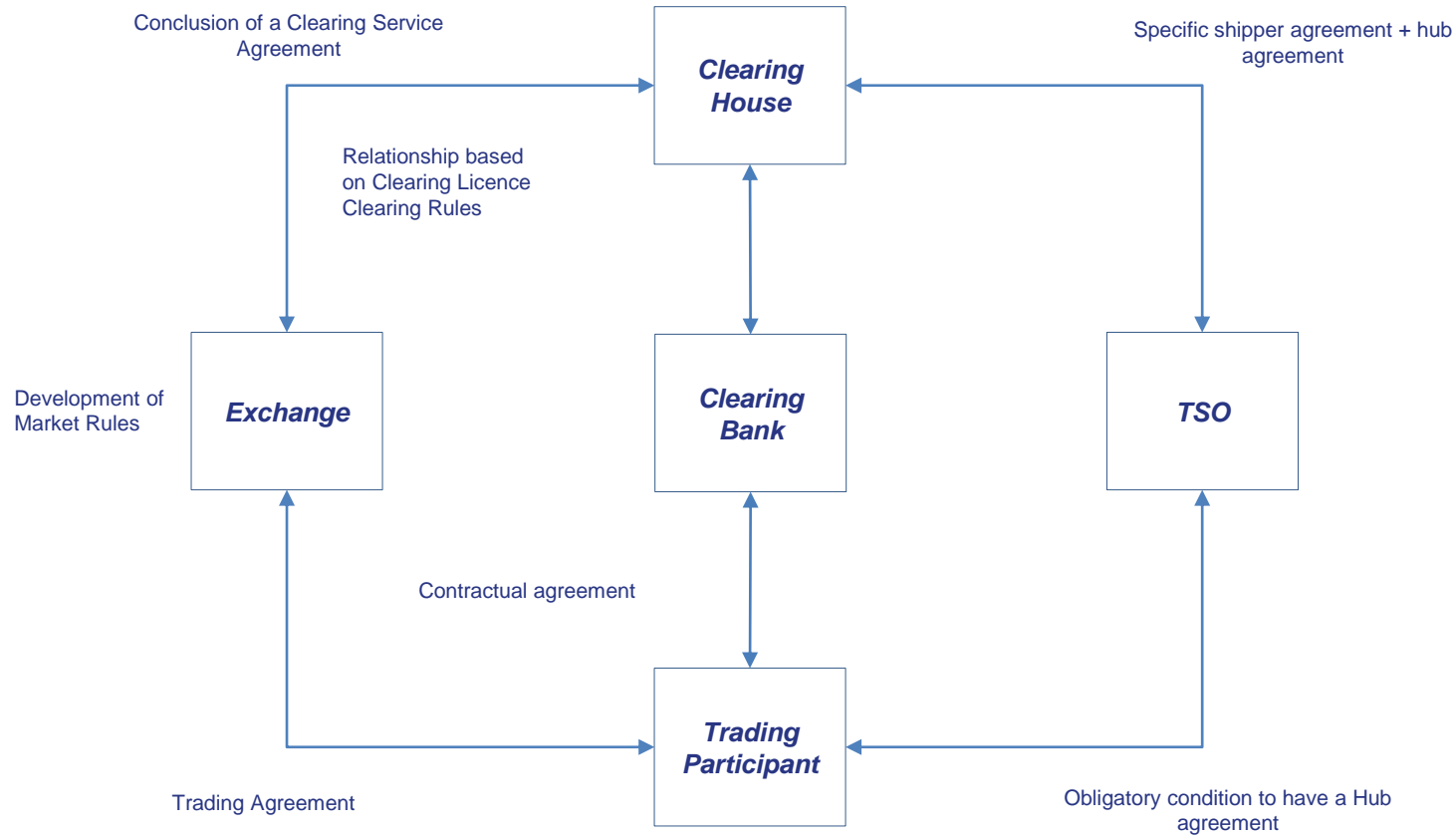
## II. What is a gas exchange and how does it work? (2/3)




### - What does a gas exchange bring?



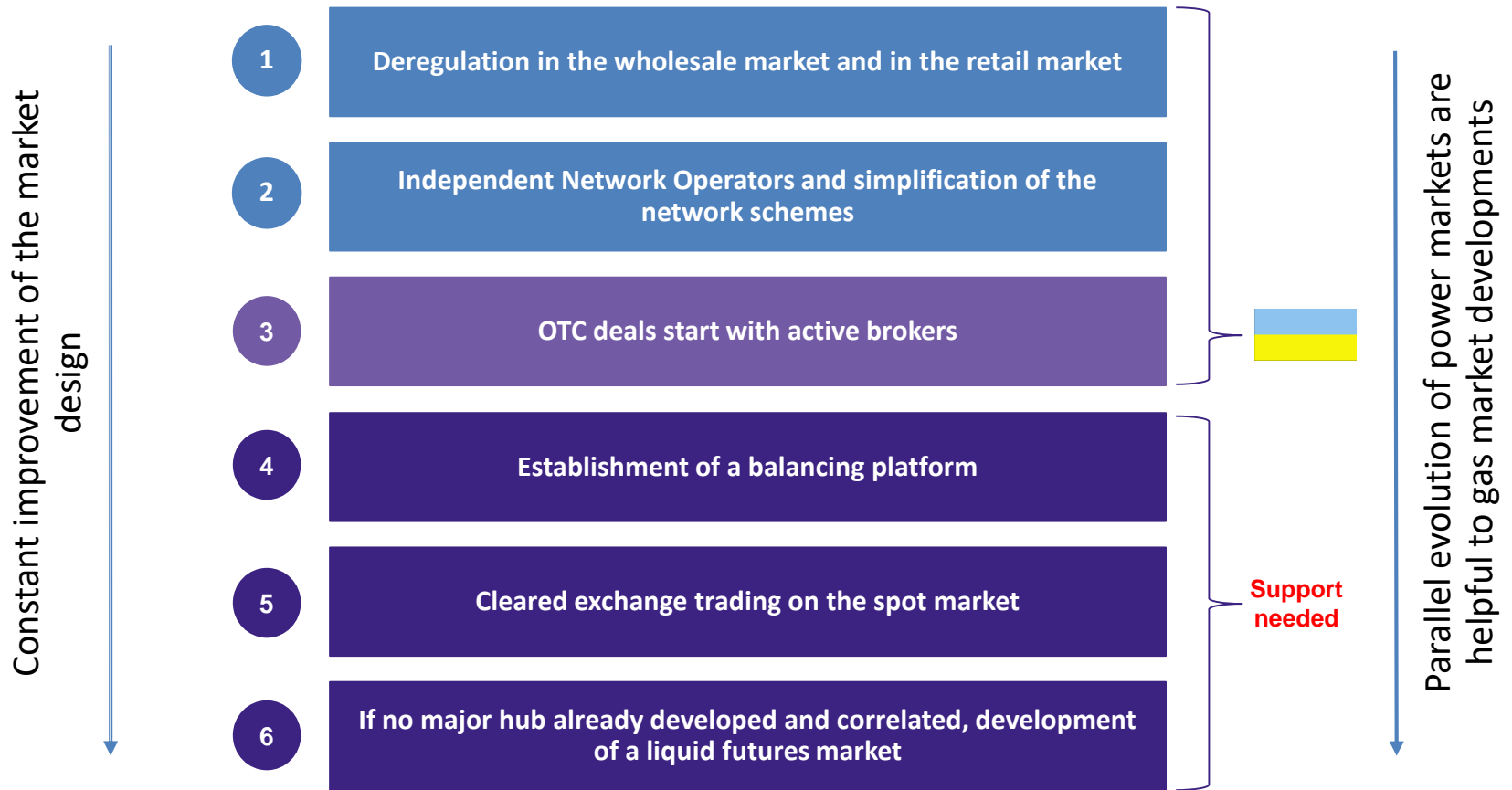
## II. What is a gas exchange and how does it work? (3/3)

### - Technical and contractual structure of a gas exchange



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### III. Example of the European market development - It always follows the same approach





### **III. Looking back in history**

#### **– the example of the French gas exchange creation**

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#### **STEP 1:**

#### **Creation of a balancing platform with the French TSO**

- December 2006: Consultation by GRTgaz (TSO) and CRE (regulator) on the implementation of a market-based balancing to cover the TSO's balancing needs
- April 2007: Powernext launched a balancing platform with GRTgaz
  - Powernext designed a platform solely dedicated to the TSO needs
  - GRTgaz is systematically the counterpart of every trade
  - 2 auctions per day (within-day at 11:15 and Day-Ahead at 16:15)

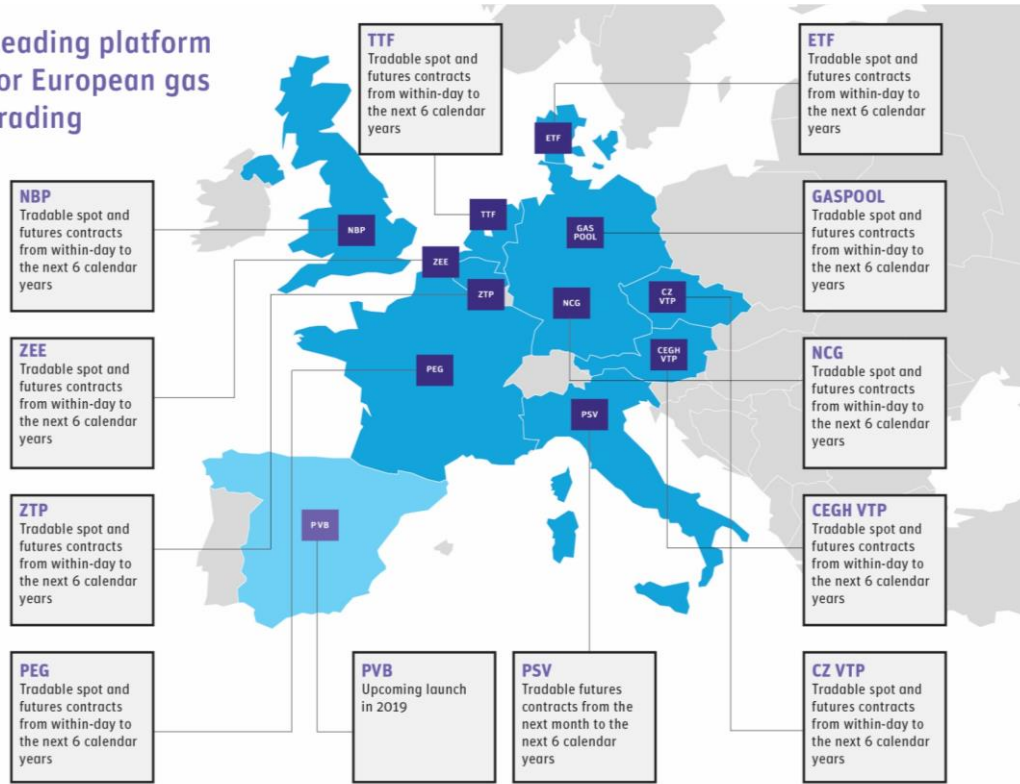
#### **STEP 2:**

#### **Launch of a gas exchange**

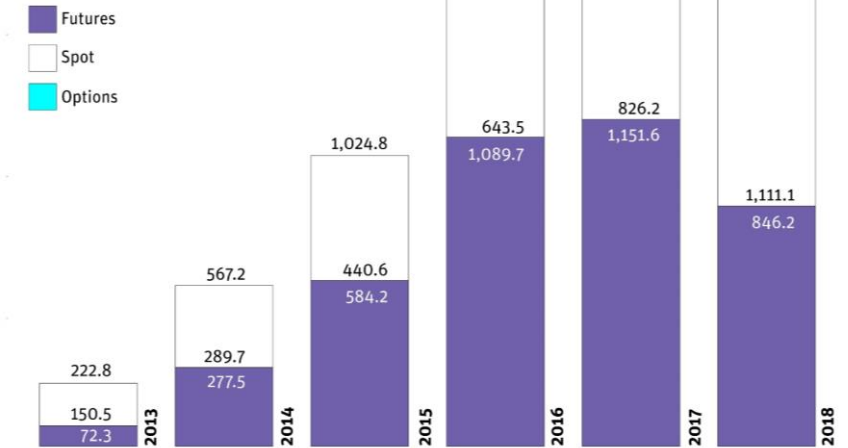
- 2007-2008: In-depth study from Powernext with 40 market participants on how to set up a gas exchange in France
- November 2008: Powernext launched a physical gas exchange on spot and futures:
  - Continuous market
  - Spot: within-day, day-ahead futures, months, quarters, seasons, calendar

# III. Example of European market development - PEGAS – Now EEX Gas

## Leading platform for European gas trading



## PEGAS Volumes (TWh)



Source: Powernext Annual Report 2018

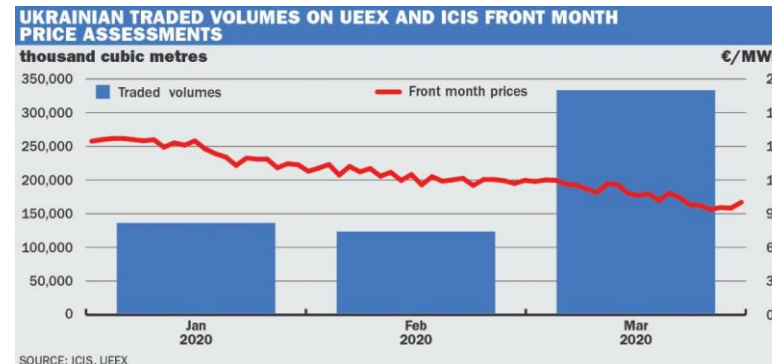
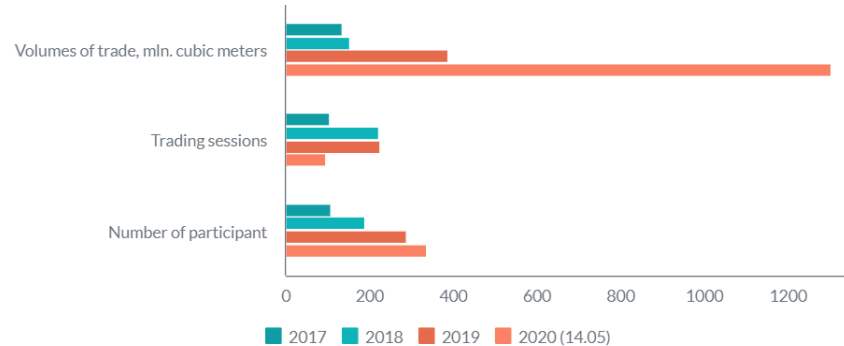
## ***IV. Ukraine's market development – 2020, the window of opportunity to accelerate the market development***

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- **Independent gas TSO** established following the unbundling of Ukrtransgaz from Naftogaz
- **New gas transit contract** with Russia
- Further liberalisation steps such as **releasing households from the PSO regulation from July 2020**
- Introduction of **daily balancing** - but without an accurate balancing platform
- The development of **UEEX**, successfully providing services for gas trading (OTC market)
- UEEX statement to be **technically ready** for trading of **short-term standardized products**
- **Accreditation** on **UEEX** of the **gas TSO** of **Ukraine** for **balancing operations**



- **UEEX** was established in 2010 and is operating in different commodity segments
- Today, **UEEX** is the only platform in the country where **most** of the **liquidity** is **concentrated (OTC auctions)**
- **UEEX** has **335 participants** accredited in the section of **natural gas trading**
- **UEEX quotations** are becoming **market price indicators**, which are used by state authorities, market participants, international and Ukrainian analytical agencies
- **UEEX** became a member of Europex – Association of European Energy Exchanges

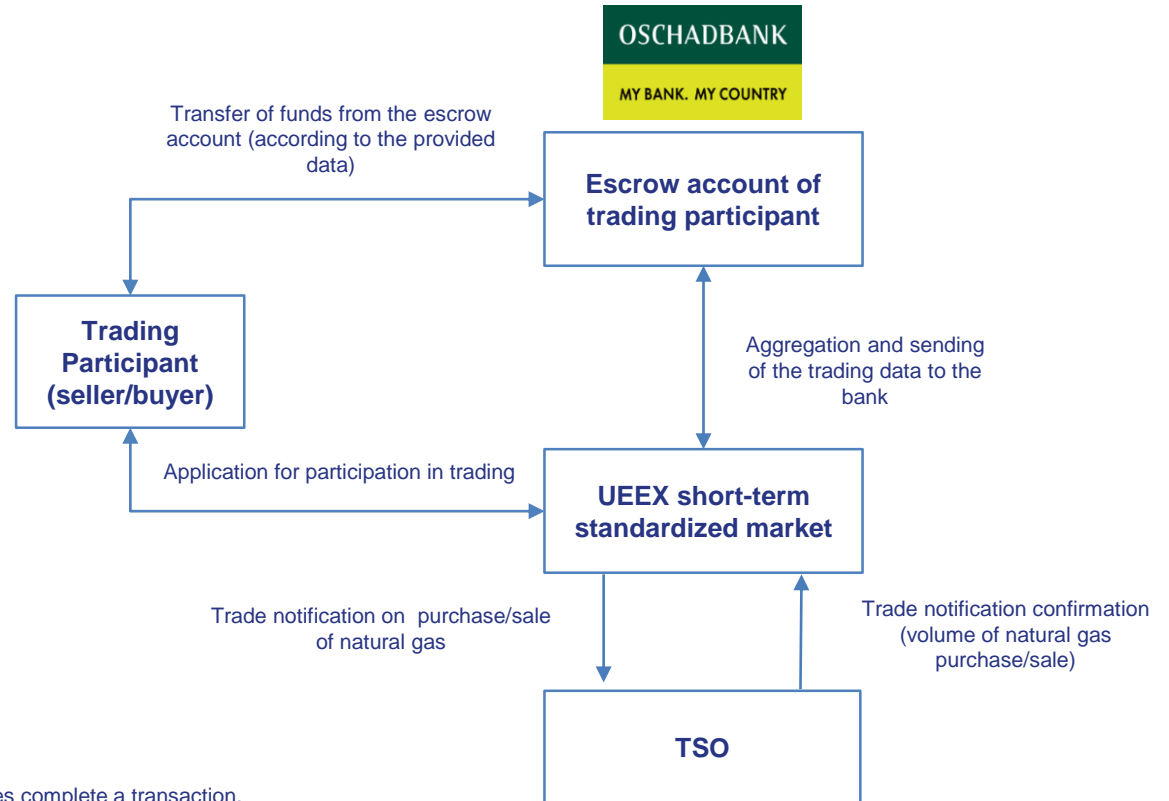


Source: Information provided by UEEX



## UEEX states to be technically ready for trading of short-term standardized products:

- Integration with the TSO platform
- Working with escrow accounts (CCP-light)\*
- Accreditation of the TSO on UEEEX



\* An escrow account is an account where funds are held in trust whilst two or more parties complete a transaction.

Source: Information provided by UEEEX

### 1. Marginal gas prices should be brought to a stimulating level

- The weighted average price of gas (including marginal prices) has been very different from market prices, as it was calculated at the level of the purchase price of the TSO balancing services. This led to abuses by market participants, which could artificially create negative imbalances and additionally earn at the expense of the TSO.

### 2. The TSO shall support the liquidity on the platform of UEX and take part in daily trading (sell and buy)

- The TSO is the main beneficiary, as participants will be able to balance their portfolio themselves.

### 3. The tolerance limit should be decreased

- The tolerance of 10% should be significantly reduced, this does not encourage participants to balance themselves and allows them to speculate at the expense of the TSO.

### 4. The daily balancing on the market is the necessary precondition for the creation of the spot market

—————→ **The main and most effective method for determining the level of marginal prices is the trading platform!**

- **Amendments** to the Law of Ukraine "On Public Procurement" are of crucial importance (reg. No. 3176), which will allow the TSO to use trading platforms and energy exchanges for balancing purposes and not be obliged to use Prozorro
  - **No obligatory initial liquidity provision possible by the TSO**
  
- **Pending adoption** of "Law of Ukraine on Capital Markets and Organized Commodity Markets", which is enabling a **clearing setup** in Ukraine (Draft Law 2284)
  - **Missing legal framework to develop a clearing house**

## V. Conclusions - Gas Exchange Project 2.0 - The role of the EBRD and the Energy Community

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- The **gas exchange** in Ukraine is definitely **not a pipedream** but close cooperation and a strong commitment of all market participants is needed
- In order to **support the development**, the EBRD and the Energy Community will join forces
- The main aspect will be the support of the launch of the **spot/balancing market**:
  - **Supportive schemes for trading**:
    - Know-how and best-practices on how to operate the market
    - Support of the development of market surveillance tools
  - **Supportive schemes for clearing**:
    - Support for the setup of a clearing system and execution of a central counterparty operated by the exchange or a separate exchange structure
    - Providing of know-how and best practices on how to establish a clearing system including cooperation with experienced international and local companies





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