



Assessment of Draft Law No 9024-d on Minimum Reserves of Oil and Petroleum Products

by the Energy Community Secretariat

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PURPOSE STATEMENT

Assessment of draft Law No 9024-d of 28 June 2023 “On Minimum Reserves of Oil and Petroleum Products” voted by the Verkhovna Rada of Ukraine on 10 August 2023 in the first reading.

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Energy Community Secretariat

Am Hof 4, 1010 Vienna, Austria

Tel: + 431 535 2222

Fax: + 431 535 2222 11

Web: www.energy-community.org

Twitter: https://twitter.com/ener_community

LinkedIn: <https://www.linkedin.com/company/energy-community/>



Ukraine Energy Market Observatory

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Introduction

The present assessment concerns draft Law No 9024-d of 28.06.2023 “On Minimum Reserves of Oil and Petroleum Products” (hereinafter “draft Law 9024-d”), finalised by the Committee of the Verkhovna Rada of Ukraine on Energy, Housing and Utilities (hereinafter “the Committee”), on the basis of draft Law No 9024 submitted by the Cabinet of Ministers of Ukraine. Draft Law No. 9024-d defines the legal, organisational and economic basis for creating and functioning the system of minimum reserves of oil and petroleum products in Ukraine and regulates relations in this area.

Background

The Committee considered two draft laws aiming to transpose Directive 2009/119/EC of 14 September 2009 imposing an obligation on Member States to maintain minimum stocks of crude oil and/or petroleum products (hereinafter “Oil Stocks Directive”)¹, No 9024 submitted by the Cabinet of Ministers of Ukraine (hereinafter “CMU”) and No 9024-1 submitted by deputies of the Verkhovna Rada.

The Secretariat previously assessed draft Law No 9024, and addressed comments/suggestions to the Ministry of Energy and the Committee. The Secretariat’s main concerns were related to:

- The emergency oil stocks should not be used to influence or control the price developments of crude oil and petroleum products.
- The minimum stocks should amount to 90 days of average daily net import or 61 days of average daily domestic consumption during the previous calendar year, whichever of the two quantities is greater.
- Lack of clarity of how to calculate the emergency stockholding obligation (the methodology is defined by the Oil Stocks Directive, however, not included in the draft Law nor envisaged by the secondary legislation; the obligation is to be calculated every year).
- The data to be used for calculating the emergency stockholding obligation.
- The reference year for meeting the stockholding obligation inclusive of its starting date and terminating date (not included in the draft Law; unclear when and how the stockholding obligation should be adjusted every year).
- Reporting on emergency oil stocks and commercial oil stocks to Eurostat and Energy Community Secretariat (mandatory according to the Oil Stocks Directive and Energy Community Treaty, but not included in the draft Law).
- International control over compliance (the draft Law should allow authorised persons of international bodies to inspect emergency stocks and pertaining documents).
- Crisis management and the contingency plan (organisational arrangements and the contingency plan should be known/available at all times).

After several discussions, the Committee prepared draft Law No 9024-d which more comprehensively and systematically regulates the range of issues and address most of the comments/suggestion of the Secretariat.

¹ Incorporated and adapted in the Energy Community by Decision of Ministerial Council Decision 2012/03/MC-EnC of 19 October 2012

Apart of draft Law No 9024-d (once adopted), the legal basis for the creation and functioning of the system of minimum reserves of oil and petroleum products in Ukraine are the Constitution of Ukraine, the Code of Ukraine on Subsoil, the Tax Code of Ukraine, the Civil Code of Ukraine, the Budget Code of Ukraine, the Laws “On Oil and Gas”, “On pipeline transport”, “On state regulation of the production and circulation of ethyl alcohol, cognac and fruit alcohol, alcoholic beverages, tobacco products, liquids used in electronic cigarettes, and fuel”, “On state registration of legal entities, natural persons - entrepreneurs and public formations”, “On Public Procurement”, the Association Agreement between Ukraine, on the one hand, and the European Union, the Treaty on the Establishment of the Energy Community, other international treaties of Ukraine, consent to the binding nature of which is provided by the Verkhovna Rada of Ukraine, and other acts of legislation.

Energy Community Acquis on Emergency Oil Stocks

Oil Stocks Directive defines key provisions to be transposed into national legislation. In particular:

- *Definitions* (to ensure proper understanding of all corresponding substantive provisions and consider national specifics and stockholding model).
- *Stockholding obligation (amount)*, that is 90 days of net imports or 61 days of consumption – whichever is greater in any given reference year (thus, both methodologies must be calculated each calendar year).
- *Calculations needed* (obligation based on previous year's data (net imports/consumption) as set out in Annex I (import) and Annex II (consumption) of the Directive 2009/119/EC), monthly compliance with obligation (stock levels) as set out in Annex III of the Directive 2009/119/EC, biofuels and additives to be properly taken into account.
- *Availability and physical accessibility of stocks* guaranteed at all times (arrangements for the identification, accounting and control of the stocks should be established (reporting, physical inspections, audits, keeping the documents); prohibition of taking any measure hindering the transfer, use or release of emergency stocks held within national territory on behalf of another state).
- *Reporting requirements* (monthly statistics on oil supply/demand and emergency and commercial oil stocks as set out in Annex IV of the Directive 2009/119/EC, register of emergency stocks, annual report on the availability and physical accessibility of stocks).
- *Stockholding model* – Central Stockholding Entity (CSE) and/or Economic operators (CSE (if set up) should take the form of a body or service without a profit objective, and which acts in the general interest, the CSE is the only body or service allowed to acquire or sell specific stocks, the delegation of CSE's tasks is allowed only to another CSE/Member State or economic operators (“industry”) if a stockholding obligation is imposed on economic operators (“industry”) then Contracting Party must ensure that such economic operators are given the right to delegate these obligations to the CSE(s) or other economic operators in a country and abroad (within EnC).
- *Specific stocks (if applied)* (defined as stocks owned by the Contracting Party or the CSE set up by the Contracting Party and maintained on the territory of the Community and held in accordance with Article 9 of the Oil Stocks Directive, the petroleum products constituting specific stocks must be of those fuels where the combined consumption is equivalent to at least 75 % of the total inland consumption).
- *Stocks composition* (petroleum products must cover at least 1/3 of the national stockholding obligation (unless Contracting Party maintains at minimum 30 days of specific stocks).
- *Stockholding reviews* (inspections and access to all sites on which stocks are held and to all documents relevant for emergency stockholding, all data, records and documents

- relating to emergency and specific stocks are to be kept for a period of at least 5 years);
- *Ability to respond in crisis* (emergency response procedures are to be established which allow for the release of emergency stocks quickly, effectively and transparently, contingency plans and organisational measures are to be put in place to cope with major supply disruption);
- *Penalties* (substantial sanctions are to be established to ensure the industry's compliance; stockholding if applicable).

Oil Stocks Directive defines the main principles to be respected by Contracting Parties when adopting national legislation relevant to emergency oil stockholding and oil supply security. However, it is left up to each Contracting Party to decide how these principles are to be transposed given their particular national circumstances.

Security of Oil Supply

Oil plays a crucial role in the security of supply for many countries worldwide, particularly those heavily dependent on oil for their energy needs. Oil is a primary energy source for various sectors, including transportation, industry, and power generation. Ensuring a reliable and uninterrupted oil supply is essential to meet energy demands and sustain economic activities.

Countries struggle to diversify their sources of oil imports to reduce dependence on a single supplier or region. Countries can mitigate the risks associated with potential supply disruptions due to geopolitical tensions, conflicts, or natural disasters by having multiple sources.

Countries maintain emergency oil stocks to address sudden disruptions in oil supply. These reserves act as a buffer and provide a measure of security during times of crisis or unexpected supply interruptions.

Emergency oil stocks are to be released on the market only in the case of disruption to ordinary oil supply due to extraordinary circumstances.

The main impetus for establishing Ukraine's emergency stockholding system is to meet the objectives of Oil Stocks Directive in terms of its own security of oil supply and meeting international commitments towards Energy Community. Creating an emergency stockholding system also provides numerous and substantial opportunities for achieving other benefits. This justifies why emergency oil stockholding should not be viewed as a cost but rather as a long-term investment for Ukraine.

Oil is a commodity and should be viewed as an asset in which the government is investing. The primary purpose of such an investment is the security this brings in the face of an oil disruption; however, the oil held in storage remains a store of value for the nation's citizens. As with any other commodity, the oil purchased remains a liquid asset of value over the long term, which could be reconverted to currency.

The need for storage capacity to hold emergency stocks provides a strong incentive for the investment in the refurbishment of relevant existing storage facilities or the development of newly built capacities; these capacity refurbishments and expansions represent a significant modernisation of the country's oil infrastructure and provide the opportunity to improve oil supply chain efficiencies.

More timely and detailed information on oil supply and demand will become available by establishing the necessary framework for data reporting under Oil Stocks Directive. It should be used at an aggregate level to increase market transparency and openness. This information can also be used internally to verify individual company activities regarding oil product imports to support and improve the gathering of VAT and excise duties.

Thus, establishing an emergency oil stockholding system in compliance with Oil Stocks Directive can significantly improve domestic oil market operations and transparency, as well as develop available storage capacity. Such a development would represent not only an enhancement in oil supply security for Ukraine but also an improvement in the country's business environment.

Compliance assessment

As a Contracting Party of the Energy Community, Ukraine committed to implement Directive 2009/119/EC by 1 January 2023.

The model chosen by draft Law No 9024-d for emergency oil stocks in Ukraine is industry related. This model refers to the overall framework and processes within the oil industry for establishing and managing emergency oil reserves. This model involves various stakeholders, including oil companies, refineries, storage operators, and relevant government agencies.

The industry model of emergency oil stocks aims to ensure the availability of strategic oil reserves to manage supply disruptions, safeguard energy security, and mitigate the impact of crises on the oil industry and the broader economy.

Draft Law No 9024-d considers most of the Secretariat's comments related to draft Law No 9024. In particular, sharp price fluctuations are no longer part of the crisis situation definition in Article 1 of the draft Law. The composition of emergency oil stocks (the selected products should be at least 1/3 of their stockholding obligation, reflecting consumption patterns and have to cover at least 75% of inland consumption of the previous year) is added in Article 5.2.1. The reference year for meeting the stockholding obligation inclusive of its starting date and terminating date and how to calculate the emergency stockholding obligation are added in Article 5.2.2. Provision on what data to use for calculating the emergency stockholding obligation and all reporting obligations (Register, Annual, Monthly Emergency and Commercial etc.) are introduced in different articles of this draft Law. The party obligated to establish emergency oil stocks is specified in Article 6 and a contingency plan is specified in Article 18 et seq.

However, some provisions of draft Law No 9024-d still need improvement to fully comply with Oil Stocks Directive. In Article 8, it is specified that the total volume of minimum stocks of oil and oil products, which must be kept to meet the needs of the domestic market of Ukraine during the crisis situation in the oil and oil products market, is determined by one of the following two indicators: 90 days of average daily net import or 61 days of average daily domestic consumption. The phrase "*whichever of the two quantities is greater*" from Oil Stocks Directive is missing and should be added to reflect the criterion for which of the two options should be chosen based on their respective quantities. It aims to prevent or mitigate potential shortages or disruptions in the supply chain by comparing the duration of imports and the duration of inland consumption.

The Oil Stocks Directive explicitly explains how the average daily net imports and the average daily inland consumption are to be calculated. Both shall be calculated based on *crude oil equivalent* during the previous calendar year, determined in accordance with the methods and procedures set out in Annex I and Annex II of the Directive.

Systematically, separate calculations for net imports and consumption will be performed each year based on data from the previous calendar year. As Ukraine has indigenous oil production and oil refineries, it is necessary to compare the yearly results of the calculations related to net imports and inland consumption to determine the national obligation.

Article 8(6) of draft Law No 9024-d stipulates that oil and/or oil products from the minimum reserves of oil and oil products may be pledged to obtain a bank guarantee. In certain cases, emergency oil stocks can be pledged or used as collateral to obtain a bank guarantee. This practice is known as “inventory monetisation” or “inventory financing”. It involves utilising the value of stored oil or petroleum products as security to secure a loan or bank guarantee from a financial institution.

However, it is important to note that the decision to pledge emergency oil stocks and the specific terms and conditions of the financing arrangement would depend on the agreements reached between the borrower and the lender. Ukraine should take all necessary measures to prevent all obstacles and encumbrances that could hamper the availability of emergency stocks.

Article 15(4) establishes the control over compliance by operators, market subjects and responsible custodians with the requirements for entering (updating) information regarding the creation, storage, use, replacement, renewal and sale (sale) of minimum stocks of oil and oil products of market subjects is carried out by the administrator of the electronic reporting system in accordance with this Law and other normative legal acts. It should be added that the operator, in cooperation with market entities, shall enable authorised persons of international bodies to inspect emergency stock in accordance with the ratified international agreements, as well as inspect documents on emergency stock and on-site access to the facility where minimum reserves of oil and petroleum products are held - as required by the Article 18(3) of Oil Stocks Directive.

Article 19(4) specifies that the CMU takes a decision regarding the crisis situation on the market of oil and oil products in the event of the occurrence of the conditions, at the request of the Ministry of Energy, and immediately informs the Secretariat on the adopted decision regarding the disclosure of minimum stocks of oil and oil products subject to sale (realisation).

The final and transitional provisions (Chapter V) of draft Law No 9024-d provide that obligations of market entities regarding the creation and storage of minimum stocks of petroleum products arise 12 months after the date of entry into force of this Law, and the obligations to create minimum oil reserves in accordance with the requirements of this Law arise six months after the month in which martial Law is terminated or abolished in Ukraine. The Secretariat considers that appropriate under the given circumstances. However, draft Law No 9024-d also proposes that the creation of minimum reserves of oil and oil products is carried out in stages, with the achievement of the targeted volume within 8 years. This is a substantial delay compared to the Energy Community commitments, as the deadline for establishing the emergency oil stocks as a transitional period of 11 years expired on 1 January 2023.

Conclusions and recommendations

Emergency oil stocks are strategic reserves of crude oil and petroleum products that countries maintain to address potential disruptions in oil supplies. While emergency oil stocks can play a crucial role in mitigating the impact of supply disruptions, they also come with certain challenges.

It's important for governments and policymakers to regularly review and update their strategies for emergency oil stocks to address these challenges effectively. Flexibility, cooperation, and a holistic approach considering energy diversification and sustainability are key to managing

emergency oil stocks in a rapidly changing energy landscape.

Draft Law No 9024-d takes into consideration most of the Secretariat's comments on draft Law No 9024. To be fully compliant with Oil Stocks Directive, the Secretariat recommends the following:

- Article 8 (1) specifies the total volume of minimum stocks of oil and oil products, which must be kept to meet the needs of the domestic market of Ukraine during the crisis situation on the oil and oil products determined by one of the following two indicators: 90 days of average daily net import or 61 days of average daily domestic consumption. The phrase "*whichever of the two quantities is greater*" should be added at the end of this paragraph.
- At the end of Article 15(4), it should be added that the operator, in cooperation with market entities, shall enable authorised persons of international bodies to inspect emergency stock in accordance with the ratified international agreements, as well as to inspect documents on emergency stock and on-site access to the facility where minimum reserves of oil and petroleum products are held.
- The deadline for full implementation of the emergency oil stocks obligations in Ukraine should be shortened, considering that these stocks play a crucial role in ensuring energy security for Ukraine. Having emergency oil stocks in place will allow Ukraine to respond quickly to oil supply disruption and avoid significant economic consequences.
- In the final and transitional provisions (paragraph 7), in order to create the possibility of storing minimum stocks of oil and petroleum products not only in Energy Community Contracting Parties but also in the EU Member States, it is recommended to refer to Parties to the Energy Community Treaty (not only Contracting Parties).

Artur Lorkowski

Dirk Buschle