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Vienna, 24 January 2023
UA-MC/O/alo/09/24-01-2023

Subject: Draft Law No 6013

Dear Mr. Natalukha,

We are writing with regard to Draft Law No 6013 (hereinafter "the Draft Law"), which is currently being debated in the Verkhovna Rada of Ukraine. On 12 January 2023, the Draft Law passed the first reading. The Secretariat of the Energy Community has not been consulted on the initial draft.

The Draft Law introduces a series of amendments, by itself or by amending various other legal acts, which may create risks for the certification of the electricity and gas transmission system operators (hereinafter "TSOs") under the framework established by the Energy Community, and possibly also for the proper implementation and application of Regulation (EU) No 1227/2011 on wholesale energy market integrity and transparency (hereinafter "REMIT").

1. *Certification of gas and electricity TSOs*

Both the electricity and the gas TSOs, the Joint Stock Company National Power Company *Ukrenergo* (hereinafter "*Ukrenergo*") and the *Gas Transmission System Operator of Ukraine LLC* (hereinafter "*GTSOU*") have been certified in accordance with the Independent System Operator (hereinafter "ISO") model. For the electricity sector, the ISO model is enshrined in Article 13 of the Directive 2009/72/EC and transposed in Articles 36^1-36^4 of the Law of Ukraine "On the Electricity Market" No 2019-VIII (adopted on the 13 April 2017). For the gas sector, the ISO model is enshrined in Articles 14 and 15 of the Directive 2009/73/EC and transposed in Articles 27 to 29, 31 of the Law of Ukraine "On the Natural Gas Market" No 329-VIII (adopted on 9 April 2015).

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The above-mentioned provisions establish a set of requirements that need be fulfilled in order to obtain certification as an ISO. The Secretariat has analysed them in detail in its Opinions 4/2019 on the certification of the *GTSOU* and 4/2021 on the certification of *Ukrenergo*. For both certifications, the Secretariat as well as the National Commission for State Regulation of Energy and Public Utilities of Ukraine (hereinafter "NEURC") relied on the corporate governance of *GTSOU* and *Ukrenergo,* which in turn are based on a the Law No. 264-IX dated 31 October 2019 on Amendments to Certain Laws of Ukraine in Relation to Separation of Natural Gas Transportation Activities ("the Law on Unbundling"). Besides the Law on Pipeline Transport and the Law on Management of State Property Objects, the Law on Unbundling amended and reinforced the Commercial Code of Ukraine. Repealing the Commercial Code, as Article 4 of the Draft Law's Final and Transitory provisions envisages, *prima facie* eliminate a crucial pillar for the certification of both TSO. Depending on its application in practice, it may prompt the re-opening of the certification procedure in both cases.

Besides this general concern, the Draft Law raises a number of more specific concerns

2. *Independence of the gas and electricity system operator*

In order to obtain certification as a TSO, the independence of the system operators must be ensured. To this end, the public body controlling the TSO may not intervene in the day-to-day operations of the TSO. The TSO must be able to act independently with respect to transmission activities without being influenced by the controlling public body (a ministry) or by any overarching public authority (the government).

Prima facie, the following provisions of the Draft Law may raise concern, and a clarification in the Draft Law that they do not apply to the gas and electricity TSOs, and/or a review and improvements together with the services of the Secretariat should be considered:

- **Article 3 of the Draft Law (and in particular its paragraph 3)** create a "one-size-fits-all" approach to corporate governance of state-owned enterprises based on a model charter, which does not allow for taking into account the specifics of TSOs in need to be certified and to maintain certification.

- In the same vein, **Article 4(3) of the Draft Law** introduces a standard procedure governing the supervisory boards, including those of TSOs. The certification of *GTSOU* and *Ukrenergo*, however, hinges on a *sui generis* governance of the supervisory board, including a majority of members independent of the shareholder, an approach which is likely to be frustrated by the Draft Law.

- **Art 8(1) of the Draft Law** states that "*State enterprises are obliged to accept and execute state orders delivered to them in accordance with the procedure established by law, take them into account when forming a production program, determining the prospects of their economic and social development and choosing contractors, as well*

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as draw up and execute an annual and quarterly financial plan for each subsequent year." This seems to run counter to the essence of unbundling. **Article 8(3)-(5) of the Draft Law** also involves a number of public bodies (including the Ministry of Economy) in the approval of financial plans, which is not in line with the unbundling rules. The Commercial Code excluded the right of the Cabinet of Ministers of Ukraine to approve the financial plan of the TSOs. This provision will cease applying as of the date of the entry into force of the Draft Law.

- **Art 5(1) of the Draft Law's Final and Transitory provisions** includes amendments to the Civil Code, including a new wording for the first part of 97: "*Management of the company is carried out by its bodies or directly by the sole shareholder of the company in the event that he decides to do so*." This seems to encroach upon the functional independence of the TSO in operating transmission activities.

- **Art 5(25) of the Draft Law's Final and Transitory provisions** includes amendments to the Law of Ukraine "On management of state-owned objects". Among the proposed amendments, the new item 2 in Art 1 reads "*The Cabinet of Ministers of Ukraine and other subjects of management of state-owned objects in accordance with this Law, the Civil Code of Ukraine and other laws of Ukraine manage subjects of the state sector of the economy - legal entities whose state share in the authorized capital exceeds fifty percent or is the amount that provides the state with the right to decisive influence on the economic activity of these subjects*." For the sake of certification, it should be ruled out that this provision places the two TSOs under the influence of an overarching public authority, the Cabinet of Ministers. The control and influence dynamics between the Ministry of Energy and the Cabinet of Ministers has been discussed at large in the Secretariat's Opinions 4/2019 on the certification of the *GTSOU* and 4/2021 on the certification of *Ukrenergo*. The safeguards existent in the legal framework at that time were found reconcilable with the unbundling provisions. A similar balance would yet have to be established under the regime of the Draft Law,

3. The notion of economic management for the electricity and gas sectors

Under the Independent System Operator ("ISO") model under which *GTSOU* and *Ukrenergo* were certified, the transmission system ownership remains with the state and is held by the Ministry exercising the function of transmission system owner (currently the Ministry of Energy), whereas the management of the assets is to be carried out by the ISO. For this purpose, Article 136 of the Commercial Code was amended by the Law on Unbundling to the effect that the TSO "shall be fully independent in deciding on the use, operation, maintenance, planning and development of such state-owned property and its financing" from the state as system owner and grantor of the economic management right. The amendments to Article 136 of the Commercial Code stipulate that the ministry exercising the function of the owner "may not refuse financing … by the gas transmission system operator … or by other interested parties".

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Article 4 of the Draft Law's Final and Transitory provisions, however, envisages the abolition of the Commercial Code, which includes provisions on economic management rights tailored for the purpose of certification. Whether Article 18 of the Draft Law can maintain these standards is yet to be established.

Furthermore, **Art 5(20) and 5(21) of the Draft Law's Final and Transitory provisions** includes amendments to the Law of Ukraine "On the natural gas market" and to the Law of Ukraine "On the electricity market" which, if adopted, would exclude the economic management from the types of transfer of state rights over the gas and electricity transmission systems. Should this provision lead to a situation in which state-owned transmission assets are to be let to the operators under a different legal title, a new assessment of compliance with the ISO model, especially with regard to the independence of the ISO in deciding on the use, operation, maintenance, planning and development of such state-owned property and its financing from the state as system owner, may be required.

4. Implementation of REMIT

Wholesale market integrity and transparency is vital for ensuring fair and open competition on the wholesale energy markets. REMIT introduces the concept of penalties that are proportionate, effective and dissuasive, and reflect the gravity of the infringements, the damage caused to consumers and the potential gains from trading on the basis of inside information and market manipulation. Draft law 5322 on amendments to some laws of Ukraine regarding the prevention of abuses in wholesale energy markets has already passed its first reading in Verkhovna Rada. With regard to penalties, the Secretariat requested that the level of penalties that can be issued by NEURC needs to be adjusted to comply with the requirements of REMIT in case of a breach.

Article 23 of the Draft law (application of economic and administrative sanctions) lists, in its para (2), a series of sanctions to be applied to non-conforming enterprises. It should be ensured that these generally worded and generally applicable sanctions are not contradictory to and/or not take precedence over the legislation specifically governing REMIT, namely draft law 5322 on amendments to some laws of Ukraine regarding the prevention of abuses in wholesale energy markets, taking into account the Secretariat's comments.

5. Further discussions

The considerations above are to be understood as reflections to be taken into account in further amendments of the Draft Law, and aimed at preventing a situation which may negatively affect the governance and certification status of the electricity and gas TSO, as well as good market governance. They are not exhaustive and may be clarified in further discussions with the Secretariat. In this respect, we also note that the Draft Law, once in force, is meant to apply for a transitional period of seven years, i.e, going beyond the applicability of martial law.

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Should you have any questions, please do not hesitate to contact us anytime.

Yours sincerely

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