



Analysis of the draft Law of Ukraine "On Amendments to Certain Laws of Ukraine Regarding the Restoration and Green Transformation of the Energy System of Ukraine"

by the Energy Community Secretariat

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PURPOSE STATEMENT

Compliance assessment of the draft Law of Ukraine "On Amendments to Certain Laws of Ukraine Regarding the Restoration and Green Transformation of the Energy System of Ukraine" provided to the Secretariat by the Committee on Energy, Housing and Utilities Services of Verkhovna Rada of Ukraine.

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Ukraine Energy Market Observatory

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Purpose statement

Assessment of the draft Law "On Amendments to Certain Laws of Ukraine Regarding the Restoration and Green Transformation of the Energy System of Ukraine" (No.9011-d) provided to the Secretariat by the Committee on Energy, Housing and Utilities Services of Verkhovna Rada of Ukraine.

Introduction

The present assessment follows a request of the members of the Committee on Energy, Housing and Utilities Services of Verkhovna Rada of Ukraine to the Secretariat to provide a compliance assessment of the draft Law of Ukraine "On Amendments to Certain Laws of Ukraine Regarding the Restoration and Green Transformation of the Energy System of Ukraine" (No.9011-d) (hereinafter "the draft Law") with the Energy Community acquis.¹

Background

a) The draft Law

The draft Law introduces amendments to several laws in Ukraine governing guarantees of origin, self-consumption and support schemes for electricity from renewable sources, most importantly the Law on Alternative Energy Sources and the Law on the Electricity Market (hereinafter "the Electricity Market Law").²

The draft amendments aim at fostering the deployment of renewable energy and green transition of Ukraine. They mainly concern the support scheme for electricity from renewable energy, renewables self-consumption, and guarantees of origin.

With regard to the support schemes for electricity from renewable energy, a National Action Plan for the Development of Renewable Energy is the envisaged basis for preparing support quotas. The draft amendments envisage auctions for a market-based mechanism and limit the application of the existing feed-in ("green") tariff to small-scale installations. The Law envisages the implementation of auctions already as of 1 July 2023.³ The Law also provides for the extension of the green tariff to eligible power plants, which need to be reconstructed or restructured following damages or destruction during the period of martial law, at the same level as originally granted. The deadline to finalize renewables projects (except solar PV) after conclusion of the pre-PPA contracts is extended to four years. This corresponds to a suggestion supported by the Secretariat.

¹ Since documents were submitted in Ukrainian only, Google Translate was used; hence any misunderstanding due to translation issues cannot be excluded.

² Further amendments are envisaged to the Law on the National Commission Carrying Out State Regulation in the Fields of Energy and Communal Services, the Law on Administrative Services, the Law on Commodity Exchanges, the Law on Unification of Co-Owners of an Apartment Building, the Law on Alternative Fuels, the Law on the Natural Gas Market, the Law on Energy Efficiency", and the Law on Regulation of Urban Development Activities.

³ Changes proposed by the draft Law to Article 9-3 of the Law on Alternative Energy Sources.

To foster renewables self-consumption, the draft amendments introduce a net-billing scheme, while still keeping the possibility to grant “green” tariff to existing self-consumers. The draft amendments also create a basis for the establishment of an electronic registry for guarantees of origin (hereinafter “GO”) for electricity and biomethane and appoints the National Energy and Utilities Regulatory Commission (hereinafter “NEURC”) as the issuing body for guarantees of origin for electricity.

b) Energy Community acquis governing renewable energy, governance and electricity markets

On 30 November 2021, the Energy Community Ministerial Council, by Decision 2021/14/MC-EnC, incorporated Directive (EU) 2018/2001 of 11 December 2018 on the promotion of the use of energy from renewable sources (hereinafter “REDII”) in the Energy Community *acquis*. The REDII updated the provisions related to the key subjects covered by the draft amendments, namely market-based support schemes, renewables self-consumption and guarantees of origin. The deadline for the transposition and implementation of REDII by Ukraine expired on 31 December 2022.

Compliance assessment

The draft Law partially transposes the REDII and some other elements of the so-called Clean Energy Package. In its assessment, the Secretariat will focus on whether the draft amendments, within the scope covered by it and if adopted, will be compliant with the REDII. Already at this stage, the Secretariat notes that the draft Law will not be sufficient to ensure full transposition of the REDII.

Support schemes

In line with Article 4 of the REDII, Contracting Parties may apply support schemes to reach their (2030) renewable energy targets. In line with the applicable State aid regime, support schemes for electricity from renewable sources have to provide incentives for the integration of electricity from renewable sources in the electricity market in a market-based and market-responsive way, while avoiding unnecessary distortions of electricity markets as well as taking into account possible system integration costs and grid stability. To that end, with regard to direct price support schemes, support has to be granted in the form of a market premium, which could be sliding or fixed. Contracts for difference (two-sided sliding premium) are recommended as the best available mechanism to support renewables. Small-scale installations and demonstration projects may be exempted from this obligation. Furthermore, Contracting Parties have to ensure that support for electricity from renewable sources is granted in an open, transparent, competitive, non-discriminatory and cost-effective manner, i.e. through tendering.

Article 9(2) of the draft Law foresees that a National Action Plan for the Development of Renewable Energy is introduced as basis for preparing quotas. The National Renewable Energy Action Plan was an obligation under the 2020 legal framework. However, in line with requirements from the Clean Energy Package, policies and measures to achieve the 2030 renewable energy target should be incorporated into or at least fully aligned with the National Energy and Climate Plan.

Support under the scheme introduced in the draft Law is rightly based on a competitive process in line with Article 4 of REDII. The successful bidder is offered a contract with the state-owned offtaker, the Guaranteed Buyer, who then pays the service to the bidder in the amount of difference between auction price and the greater value between the average arithmetic value of the day ahead market (hereinafter “DAM”) price for the corresponding hour (of the settlement month and the two preceding months in the trading zone “UES of Ukraine”) and the hourly calculated market price (of the settlement month and the two preceding months), which is defined as the product of the weighted average price under bilateral contracts (excluding bilateral contracts for the PSO purposes) and the ratio of the values: weighted average value of the DAM price for the corresponding hour (of the

settlement month and the two preceding months in the “UES of Ukraine” trading zone) to the average weighted index of the DAM price (of the settlement month and the two preceding months for the base load period in the “UES of Ukraine” trading zone) (amendments to Article 65. of Electricity Market Law). To ensure full market integration of renewable electricity, the successful bidder might be obliged to pay to the Guaranteed Buyer the difference when market price is higher than auction price (i.e. a contract for difference).

As regards the timing of the auctions (as from 1 July 2023), the Secretariat considers that for successful auctions to take place, the legal framework should be in place beforehand (including all necessary secondary legislation, long-term schedule for allocation of support, necessary documentation for auctions etc.), and confidence of investors in the Guaranteed Buyer’s capacity to transfer the full amount of the support timely needs to be restored. Given the low level of payments to the Guaranteed Buyer by the electricity transmission system operator *Ukrenergo*, the Secretariat has requested that the surcharge for financial support of electricity produced from renewable sources is imposed separately from the transmission tariff and set at a level covering the commitments made towards renewable energy producers. This is also a requirement under the conditions for the certification of *Ukrenergo*.

The draft Law also introduces the right of the Guaranteed Buyer to sell electricity through export-import contracts, and to use the revenues to compensate renewable energy producers and hence decrease the financial burden on the TSO. The Secretariat supports that. At the same time, the provision in new paragraph 7 of the Article 65 of the Electricity Market Law stipulates “*The adjustment of the cost of the service to ensure an increase in the share of electricity production from alternative energy sources by the amount of income from the supply of electricity to the consumer and income from the sale of electricity under contracts of the export-import of electricity is carried out quarterly by the actual amount of income received, minus expenses that relate to obtaining access to the capacity of interstate crossings, taxes, fees and other mandatory payments related to the sale of electric energy under electric energy export-import contracts.*” This exemption creates an economic advantage for the Guaranteed Buyer in cross border capacity auctions which is not available to other market participants. Instead, the reasonable costs of the Guaranteed Buyer (including cross-border capacity rights (if any) should be recognized in the Guaranteed Buyer’s budget regulated by NEURC, and covered from its income. The difference between the total income and total cost incurred should be made available to support renewable energy production.

Besides auctions, the amendments included in Article 8 of the draft Law also provide for the possibility of direct budgetary support for companies entrusted with services of general economic interest to increase the share of renewables in electricity production. In this context, the Secretariat notes that any such support must be in line with the State aid acquis, which requires a clearly defined public service obligation and clearly defined parameters for the calculation of the compensation, which shall not exceed what is necessary to cover the costs incurred in the discharge of the obligation including reasonable profit. The existing public service arrangements do not satisfy these criteria.

The draft Law is silent with regard to the conversion of feed-in tariffs paid to existing producers (under the “green” tariff scheme). Given that Ukraine has a functioning day-ahead market for electricity, they could be converted to contracts for difference within a relatively short period, provided that the economic conditions and the overall viability of the projects remains unchanged in line with Article 6 of the REDII.

The draft Law further clarifies the currently complex situation when it comes to calculation of imbalances caused by renewables producers under support scheme. It releases renewables producers from the responsibility for imbalances caused by the trading activities of the Guaranteed Buyer, as well as for deviations not caused by the renewables producers. This creates a major and unjustified burden on renewable electricity producers. The draft Law limits responsibility to actual imbalances caused by deviations from the forecast, and distributes imbalance costs among producers in proportion to their deviations within the Guaranteed Buyer's balancing group.

In line with State Aid rules, Ukraine may grant green tariffs only to small-scale installations and demonstration projects, as envisaged by the draft Law. For these purposes, the level of the green tariff for different facilities should be calculated by way of secondary (not primary) legislation based on a well-defined methodology and regularly updated and without affecting the economic viability of the projects supported.

Renewables self-consumption

As part of the Clean Energy Package, a legally binding framework for self-consumption was introduced in the Energy Community acquis. Directive (EU) 2019/944 on common rules for the internal market for electricity (hereinafter "Electricity Directive") empowers final customers to participate in the power market as active customers. The REDII in Article 21 stipulates the legal framework for final customers to engage in renewables self-consumption, as renewables self-consumers or as jointly acting renewables self-consumers. According to these Directives, a renewables self-consumer is a final consumer who generates renewable electricity for its own consumption and can sell excess production of renewable electricity. Any self-consumption scheme should be designed in such a way that remuneration for self-generated renewable electricity reflects the market value of the electricity. The Secretariat supports the introduction of a net-billing scheme by the draft Law. Ukraine already had a green tariff, which boosted small-scale renewables self-consumption during the initial phase of its deployment. By enabling net-billing, Ukraine will allow self-consumers to actively participate in the market through contracts with suppliers.

Renewables self-consumers will be free to choose a supplier, or more suppliers, and agree to terms and conditions for purchase of electricity, as well as the sale of electricity under the defined scheme.⁴ The remuneration of self-consumers depends on the market price, imbalances, network tariffs and VAT. Feeding electricity into the grid at times of high wholesale electricity prices incentivizes self-consumers to support the system in periods of peak demand. The draft Law envisages the possibility of limiting the amount of surplus electricity for which self-consumer can be compensated, which can jeopardise the mechanism. Additionally, the installation of power limiters will create significant costs. Therefore, the Secretariat recommends to exclude the provision limiting self-consumers to supply electricity to the network and restricting the terms of the contract with suppliers (Article 9.5).

With regard to settlement, it is important to define when the offsetting will take place under the net-billing scheme, and how the surplus will be treated after the settlement period. One month has proved to be an optimal accounting period and one year could constitute an optimal credit compensation period. Any monetary credit surplus remaining after the annual compensation is usually forfeited (in order not to become producer) or subject to a special arrangement offered by the off-taker.

Self-consumers which already benefit from the "green" tariff may continue to operate under the current conditions until 31 December 2026. After that, the Electricity Directive requires Ukraine to

⁴ Amendments proposed to the Article 9-6 of the Law on Alternative Energy Sources.

phase out schemes not accounting separately for the electricity fed into the grid and the electricity consumed from the grid.

As to the network dimension, the installed capacity eligible for self-consumption under support schemes should not exceed the requested connected and/or contracted capacity of the customer. The threshold for the currently defined connection capacity for households is too high and probably will exceed the need of a household, turning it into a producer. This should be avoided. In line with the REDII, Ukraine may allow renewables self-consumers to operate outside its own premises. European practice is to allow operating within the same branch of distribution system operator (hereinafter “DSO”). Specific tariffs for self-consumers, as a separate subclass(es) of network users, should be designed to incentivise self-consumers to alleviate the burden on the grid, and to mitigate risks related to cost reflectivity and cost recovery of the project.

To provide clarity and ensure efficiency, it is also important to define in the Law which authorized body is in charge to issue a certificate confirming the readiness for operation of self-consumers, and to determine the deadline for issuance of the certificate. The deadline should not be longer than 30 days. The DSOs should be obliged to keep the register of self-consumers and their capacities. They need to ensure non-discriminatory access to data under clear and equal terms to all eligible parties, in accordance with the relevant data protection rules.

Guarantees of origin

Article 19 of the REDII governs GOs. Among others, the REDII extends GOs coverage to other carriers besides electricity, namely renewables gases and heating and cooling. This is not fully transposed in the draft Law. In the Law, guarantees of origin are introduced only for electricity and biomethane. GOs for biogas, green hydrogen and heating and cooling have not been included.

In general, the draft Law provides a solid basis for the implementation of a system for GOs in line with the European rules and practice. It sets out the procedures for issuance, transfer and cancellation of GOs, includes the information a GO has to contain, appoints the issuing body and lays the foundation to establish an electronic registry for GOs, which would ensure the integration with the Energy Community’s regional system. The issuing body has to make sure that the registry is accurate, reliable and fraud-resistant and complies with the European Energy Certificate System (EECS) and standard CEN - EN 16325. This is covered in new Article 9⁷ proposed by the draft Law, and needs to be further spelled out in secondary legislation. To accurately issue GOs, the issuing body also has to receive metering data from the metering point of the production plant from the transmission system operator (hereinafter “TSO”) and the DSO. This should be clearly specified in the Law.

The REDII also requests Contracting Parties to make sure that when a producer receives financial support from a support scheme, the market value of the GO for the corresponding volumes of energy consumed is taken into account appropriately by the support scheme. The draft Law proposes that GOs issued for electricity production under support schemes are transferred to the Guaranteed Buyer or a universal service provider. In further defining the operation of that mechanism, NEURC should envisage that GOs are sold by the Guaranteed Buyer or the universal service provider either through an auction, or by obliging all suppliers to purchase certain quantities. It should be assured that the revenue gained from selling those GOs is used to compensate the cost of the support scheme.

Partial transposition of the Electricity Directive

The draft Law also partially transposes provisions from the Electricity Directive, in particular with regard to active customers, energy communities and aggregation, etc.

As regard the active customers (amendments proposed to Article 1 and a new Article 58-1 of the Electricity Market Law), the draft Law defines active customers as those (including private households, energy cooperatives and a consumer who is a customer of an energy service) who consumes electricity and produces (and/or stores, and/or sells surpluses of produced/stored) electricity from alternative energy sources, or participates in energy efficiency and demand management measures in accordance with the requirements of the Electricity Market Law, provided that these activities are not of a professional or economic nature. According to the Article 58-1(1), customers obtain the status of active customer if they conclude agreements (on the sale-purchase of electricity (as an annex to the supply contract) under the self-consumption mechanism :with the universal service supplier (for private households) or the Guaranteed Buyer (for other customers) – for selling electricity under the ‘green’ tariff; if they install an energy storage device for the purpose to participate in the ancillary services market and sell balancing energy). The proposed definition of active customers and the requirements in Article 58-1(1) of the draft Law seem to be not fully harmonized and will require further clarifications. The main purpose of the active consumer scheme according to the Electricity Directive is still the consumption of the self-generated electricity, with surpluses to be sold or made available for flexibility or energy efficiency reasons. The Electricity Directive does also not support limitations to the types of installations of self-generated electricity (such as from alternative energy sources only).

The draft Law does not propose amendments to the concept of “energy cooperatives” that already exists in the Law on alternative energy sources” of 2019. The concept defines an *energy cooperative* as “a legal entity established in accordance with the Law on Cooperation or the Law on Consumer Cooperation to carry out economic activities in the production, procurement or transportation of fuel and energy resources, as well as to provide other services to meet the needs of its members or territorial community, as well as for the purpose of obtaining profit, in accordance with the requirements of the law”. Contrary to this, the Electricity Directive stipulates that a citizen energy communities is a legal entity with the primary purpose of providing environmental, economic or social community benefits to its members or shareholders or to the local areas where it operates, rather than generating financial profits.

The draft Law (in amendments to Article 30-2(1) to the Electricity Market Law) is based on the assumption that aggregation is a licensed activity, except in cases when the same entity already has a license to perform other activities in the market, such as production/storage/supply or the Guaranteed Buyer). In addition, the draft Law should stipulate non-discriminatory and proportionate rules clearly assigning roles and responsibilities to electricity undertakings and customers (existing licensees as well as independent aggregators), including their balancing status, data exchange requirements, a conflict resolution mechanism as well as other rights and obligations for this new type of market participation, as defined by the Electricity Directive.

The draft Law also foresees (in its amendments to Article 65(2)) of the Electricity Market Law) that the Guaranteed Buyer is obliged to purchase electric energy produced by generating facilities of active customers (including energy cooperatives), the installed capacity of which does not exceed 150 kW, at a “green” tariff in an amount that exceeds the monthly consumption of electric energy by such active customers. For this reason, the active consumers are obliged to conclude the contract with the Guaranteed Buyer to obtain the status of the active consumer (Article 58(2) of the amendments to the Electricity Market Law). In its amendments to Article 63(5)(4-1) of the Electricity Market Law, the draft Law includes provisions that the universal service suppliers are obliged to buy electricity produced by the generating facilities of private households (the installed capacity of which is not more than 30 kW) and small non-households (the installed capacity of which is not more than

50 kW under the mechanism of self-generation; in the Article 63(6) of the Electricity Market Law defines that for the installed capacity of private household up to 50 kW, the universal service suppliers shall buy electricity produced under “green” tariff .In the proposed amendments to Article 58-1(2) of the Electricity Market Law, the draft Law is unclear about the limits of installed capacity for self-consumers.⁵

Conclusions and recommendations

The proposed amendments to the Law constitutes an important steps towards ensuring compliance with REDII. In developing it further, the Secretariat:

- recalls the importance of establishing an appropriate system to ensure that support granted is timely paid to renewable energy producers and that it is not revised in a way that undermines the economic viability of projects that already benefit from support. This should include a revision of the surcharge system outside the transmission tariff which in turn requires amendments to the Electricity Market Law to be included in the draft Law under assessment;
- recommends ensuring that the necessary framework for auctions is timely prepared including secondary legislation, a long-term schedule for allocating support, and the necessary documentation;
- proposes to replace direct budget support by a guarantee facility hedging against the offtaker default risk;
- recommends ensuring that the net billing scheme provides for recognition and allocation of the network and balancing costs incurred by active customers, including renewable self-consumers and clarifies liability for these costs;
- welcomes the proposal to nominate the issuing body and enable the implementation of a system for GOs in Ukraine, and suggests to extend it to other carries besides electricity and biomethane;
- suggests to clearly distinguish between requirements (as regards the level of installed capacity, connection requirements, licensing requirements and support schemes) applicable to producers from renewable energy and for active consumers;
- recommends a review of the definitions and provisions related to customer empowerment, including active consumers, aggregation and citizens energy cooperatives to ensure full compliance with the Clean Energy Package.

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⁵ Initially of 30 /50/150 kW, and afterwards, concerning specific connection requirements for generating facilities of active customers of 5 MW and more.