



**Analysis of NEURC Resolution No. 182 of 31.01.2023
“On adoption of and amendments to some NEURC
Resolutions”, which aims to address the issue of
unauthorized natural gas offtakes**

by the Energy Community Secretariat

June, 2023

PURPOSE STATEMENT

Compliance assessment of NEURC Resolution No. 182 of 31.01.2023 “On adoption of and amendments to some NEURC Resolutions” (hereinafter “Resolution 182”), requested by the Ukrainian Energy Regulator National Commission for State Regulation in the Spheres of Energy and Communal Services (hereinafter “NEURC”).

TABLE OF CONTENT

Introduction	1
Background	1
Impact on the market	2
Compliance assessment	3
Recommendations	3

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Assessment 11/23

Introduction

The present assessment follows a previous request of NEURC and takes into account further developments related to unauthorised offtakes of gas.

Background

a) Unauthorised offtakes in Ukraine

Unauthorised offtakes of gas constitute a particular Ukrainian phenomenon whereby various network users withdraw gas from the transmission network system operated by *GTS Operator of Ukraine* LLC (hereinafter "GTSOU") without paying for it. This is a long-standing problem for the Ukrainian gas market, which became significantly worse due to the war and high energy prices. The root of the problem lies in the refusal of network users to pay for gas withdrawn and the impossibility, on different grounds, to stop transmission for such network users. The gas taken from the network was predominantly used to cover the users' disbalances (in the case of suppliers, most notably LLC GC Naftogaz of Ukraine (hereinafter "Naftogaz"), in its capacity of supplier of last resort and supplier under a public service obligation), and for technological use to carry out the functions of distribution system operation. GTSOU was prevented from switching off such network users of the grid as it would cause interruption of the supplies to the customers on the distribution grid, including household customers, leading to huge social and political upheavals.

One of largest unauthorised offtakes occurs due to (some) distribution system operators' systematic lack of purchase of natural gas for their technological needs. This systematic lack is caused above all by the lack of a sufficient distribution tariff that would cover gas for technological needs. This discrepancy skyrocketed when gas prices went up sharply and gas for technological needs had to be bought and paid monthly while costs for it were foreseen within the tariff in advance on a yearly basis.

Additionally, accumulation of unauthorised offtakes may occur in cases when customers connected to the distribution systems receive their supplies despite not having concluded supply contracts, notwithstanding the well-established institutions such as suppliers with public service obligations and/or suppliers of last resort. Non-payers are not disconnected in order to prevent social and political upheavals. Due to significant state involvement in the regulation of the natural gas market, market players are forced to carry out their activities in an economically unjustified manner.

b) Energy Community law

Balancing of natural gas systems in the Energy Community is governed by the Network Code on Gas Balancing of Transmission Networks, as adopted for the Energy Community Contracting Parties (hereinafter "Balancing Network Code"¹).

¹ https://www.energy-community.org/dam/jcr:0c739eda-a10f-4e0e-bfb6-aa2c0ba7a0b2/Regulation_312_2014_NC_B.pdf

c) Ukrainian law

Ukraine has transposed the Balancing Network Code into national legislation via the Gas Transmission Code², adopted by NEURC, and adopted a stepwise approach to neutrality arrangements and application of interim measures.

d) Resolution 182

Based on the results of monitoring and analysis of the practical aspects of the application of regulatory and legal acts, NEURC identified issues related to unauthorized withdrawals of natural gas which require improvement. The Resolution 182 changes the Gas Transmission Code, the Code of Gas Distribution Systems, the Standard Contract for the Transportation of Natural Gas, and the Licensing Conditions for Conducting Economic Activities with 1) improvement of the procedure for determining unauthorized offtake of natural gas and the obligation to pay the cost of volumes of natural gas that are unauthorized offtakes; 2) improvement of the procedure for price determination and calculation of the fee for unauthorized withdrawal; 3) establishment of a requirement for the implementation of economic activity for the production of thermal energy in terms of ensuring the availability of the resource used for the production of thermal energy, in particular, in the case of the use of natural gas.

Impact on the market

Since the beginning of its operations, GTSOU has been facing unpaid offtakes of natural gas from the gas transmission system. Resolution No. 222 of the Cabinet of Ministers of Ukraine dated 6 March 2022 approved a Regulation on the imposition of special duties on natural gas market entities to ensure general public interests in the process of functioning of the natural gas market (hereinafter "PSO Act"). It envisaged the provision of gas to DSOs to cover their needs of technological gas by the supplier of the last resort (hereinafter "SoLR"), namely Naftogaz. However, during 2022, the SoLR did not supply gas to cover the DSO's off-takes for technological gas, and did not pay to GTSOU a daily imbalance charge, the imbalances consequence of not nominating the needed quantities for DSOs which were nevertheless off taken and consumed.

According to GTSOU, as of 31 December 2022, the SoLR's debt to GTSOU for unpaid daily imbalance charge amounted to UAH 19.9 billion, and the overdue debt of the DSOs to GTSOU for gas taken from the gas transmission system for fuel needs in the period from January 1, 2020, to December 31, 2022, is UAH 17.9 billion.

Because of the failure to take measures to fulfil the obligations imposed by PSO, such as supplying the DSOs with the gas for technological needs, the debt of the market participants to GTSOU has significantly increased and currently amounts to UAH 38.2 billion.

The functioning and financial stability of the gas transmission system operator, which has to operate, maintain and develop under economic conditions secure, reliable and efficient transmission³, but

² <https://zakon.rada.gov.ua/laws/show/z1378-15#Text>

³ Article 13 of the Gas Directive (https://www.energy-community.org/dam/jcr:004b3ca7-fa52-4633-875e-8ac1b2cea021/Directive_2009_73_GAS.pdf)

also provide gas for the purpose of balancing and technological consumption and extraordinary maintenance in the current situation has been put at risk.

Compliance assessment

The Secretariat assessed Resolution 182 against the Balancing Network Code. However, it has to be highlighted that the solution to the problem of unauthorized offtakes does not solely depend on the implementation of the Balancing Network Code. In this respect, broader recommendations are provided by the Secretariat below.

As parts of unauthorized offtakes might be attributed to the implementation of the Balancing Network Code, the lack of distinction between the imbalances in the transmission network and the non-payment of gas withdrawn from the network. In other words, it is unclear how the process of nomination, re-nomination and information on imbalance status are implemented in practice, therefore contributing to amassing of the total amount of unauthorized offtakes.

However, in line with the Balancing Network Code, interim measures should be developed and implemented by the transmission system operator in accordance with the annual report describing the state of development and the liquidity of the short-term wholesale gas market and the measures to be applied. This report is also to be consulted with market stakeholders and submitted to the regulatory authority for approval. The Secretariat has been informed about the preliminary consent of the transmission system operator to the balancing amendments of the Gas Transmission Code, proposed by the regulatory authority, provided in the form of a letter. However, an assessment of both the transmission system operator *and* the regulatory authority, as required by Article 46 of the Balancing Network Code, would ensure that all gas sector stakeholders understand the responsibilities and current circumstances and consequently work towards a fully functioning gas market in Ukraine.

It is clear that the achievement of sufficient liquidity in the short-term wholesale gas market, as the crucial precondition for the full implementation of the Balancing Network Code, has been slowed down and jeopardized due to the military actions in the country. Although it is understandable that market participants currently may not be in a position to fulfil the requirements of the GTSOU's network code and the Balancing Network Code, further effort in implementing existing rules in practice by all market stakeholders and the GTSOU (for nominations, re-nominations and information on imbalance status) would contribute to decreasing the financial losses.

Recommendations

Resolution 182 represents a step for the unauthorised offtakes to be decreased and contribute to a better financial standing of GTSOU in the future. The recognition of unauthorized offtakes and the definition of such a category in the regulatory framework within the circle of balancing and payment responsibilities is indeed overdue. The Secretariat appreciates such efforts to address this issue and stresses that the other stakeholders, most notably the Government, should consider actions to eliminate unauthorised offtakes to the maximum extent possible, by proposing necessary legislative changes in cooperation with NEURC, GTSOU and the Secretariat within its remit. The consultation with the Secretariat is particularly needed when redesigning the PSO Act that the Government has

adopted in the course of 2022 and 2023, which has affected unauthorised offtakes. This is also required by the Gas Market Law⁴.

The Secretariat proposes the following additional measures which would allow the unauthorised offtakes to be reduced effectively:

1. Requiring the DSOs to purchase sufficient volumes of gas would to a high extent eliminate the magnitude of the unauthorised offtakes if inserted in licensing conditions. The Secretariat suggests that DSOs provide contracts for purchasing technical gas as a precondition for being or remaining licensed.
2. Revising the amount of distribution tariff to allow the coverage of costs for the purchase of gas for technological consumption and network losses. Ensuring that the DSOs' tariff is cost-reflective and that the DSOs' tariff revenues are used for the purchase of technological gas would mean re-establishing NEURC's authority to decide on the distribution tariffs which at the moment is superseded by martial law.
3. The Gas Transmission Code needs to be amended to make a clear difference between the responsibilities related to imbalances and unauthorised offtakes. More precisely, the DSOs should have the role of system users only for the amounts of gas for technological consumption and losses, pay the required transmission charges for the said amounts of gas and consequently participate in the balancing regime with respect to these volumes. The responsibilities of the suppliers regarding balancing and unauthorized off-takes should also be specified and clearly distinguished from those of the DSOs.
4. Making suppliers responsible for booking capacity at the exit from the transmission system and for their balances and imbalances.
5. Ensuring that procedures related to the balancing of the transmission network are fully implemented by system users and the transmission system operator.
6. Abandoning the practice of prohibiting cut-offs of consumers in default.
7. Amending the Regulation on Imposing Special Obligations (PSO) on Natural Gas Market Participants to target supplies to the PSO customers in a manner that would made such customers accountable or the subject under the PSO compensated for the incurred costs.
8. Obliging market participants to sell a certain amount of extracted natural gas through the commodity exchange to promote the development of the liquid market.
9. Unauthorized off-takes could be also classified as criminal acts under criminal law, as an additional measure.

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⁴ <https://zakon.rada.gov.ua/laws/show/329-19#Text>