



The National Energy Regulatory Authority of Ukraine

Governance and Independence

An Update of the Energy Community Secretariat's Review of March 2018

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1. Introduction

1.1. Secretariat's audit report of March 2018

In March 2018 the Energy Community Secretariat (hereinafter 'the Secretariat') issued a report (hereinafter 'the 2018 Report') on the compliance of the National Commission for the State Regulation of Energy and Utilities of Ukraine (NEURC; hereinafter 'the Commission' or 'the regulator')¹ with the obligations stemming from the Energy Community *acquis communautaire* ('acquis'). The audit analysed the legislative framework defining the organisational structure, competences and duties of NEURC as well as practical independence, professionalism and expertise of the regulator. The assessment followed a request by NEURC at a time when the regulator was subject to a number of organisational turbulences and critical questioning of its decisions on the one hand and had to deliver numerous secondary acts on electricity and gas market reforms on the other.²

The 2018 Report concluded that practical implementation at that time did not live up to the legal framework for operation of NEURC that has been aligned with the acquis in 2016 by adoption of the Law "On the National Commission for the State Regulation of Energy and Utilities" (hereinafter 'the Law on NEURC').³ The report identified significant shortcomings as regards the commitment of public institutions of Ukraine to respect the independence of NEURC but also proved the need for the regulator to improve its independent performance and increase public trust in its decisions.

1.2. Scope of the present update review

Based on the findings of the 2018 Report, the Secretariat made a number of recommendations to strengthen NEURC's effective independence.⁴

The present update report analyses the progress made in implementing these recommendations. The update report does not provide an assessment of the performance of NEURC but exclusively evaluates whether progress has been made to strengthen the shortcomings identified in the 2018 Report related to *de facto* implementation of the legal independence framework of the regulator.

1.3. Secretariat's recommendations of March 2018

The Secretariat's conclusions of March 2018 specified the need for the public authorities of Ukraine to better respect and effectively implement the legal independence framework of NEURC, governed by the Law on NEURC.

¹www.nerc.gov.ua.

² Letter no. 7554/13/7-17 of 11.07.2017. The audit was confirmed by the Secretariat by letter of 19.07.2017 (ref. UA-MIN/jko/14/19-07-2017).

³ Law no. 1540 of 22.09.2016 entering into force on 16.11.2016.

⁴ 2018 Report, chapter 7.

1.3.1. Appointment of Commissioners

In the 2018 Report the Secretariat welcomed the introduction of a **competition commission** by the Law on NEURC as well as an open competition based on legally defined selection criteria for the selection of Board members as a significant improvement compared to the previous direct appointment by the President only. Indeed, the 2018 Report showed that the sole fact that the, at that time in office, members of the Commission,⁵ including the Chairman,⁶ were appointed by Decree of the President without a transparent and competitive selection process created mistrust to NEURC.⁷

On the other hand, the Secretariat expressed serious concerns about the fact that the responsible authorities of Ukraine failed in November 2017 to ensure effective operation of NEURC by not appointing a competition committee for selection of vacant Board member positions in time to avoid **lack of a decision making quorum** of the regulator.⁸ That blocked the adoption of 150 decisions of the regulator.

1.3.2. Legal adjustments

The 2018 Report suggested the following adjustments of the **Law on NEURC** tailor made to address shortcomings of factual independence of the regulators identified in the report:⁹

- The requirement for approval of the regulator's budget by the Budget Committee of the Verkhovna Rada should be abolished. As the Secretariat noted in its assessment, the approval of NEURC's budget by a Committee of the government does not sufficiently meet the requirement of budgetary autonomy and financial predictability as required by Article 35 (5) Directive 2009/72/EC and Article 39

⁵ Decrees no. 695/2014; no. 969/2014, no. 386/2015 appointed Mr *Andrii Gerus*, Mr *Volodymyr Yevdokimov*, Mrs *Yulia Kovaliv*, Mr *Ruslan Mashliakivskyi*, Mr *Valerii Tarasiuk* and Mr *Andrii Tkachenko* as Commissioners.

⁶ Decree no. 715/2014 of 10.09.2014 appointing Mr *Dymtro Vovk* as Chairman.

⁷ Cf. further elaborations in: 2018 Report, chapter 3.2.1.2.

⁸ With the new Law on NEURC a rotation scheme was established (approved by the President of Ukraine by Decree no. 78/2017 on 03.03.2017 in accordance with Section VI of the Law on NEURC) following which the term of two Commissioners expired on 29.05.2017, the term of two others on 26.11.2017. On this day, NEURC lost its decision making quorum as defined per Article 14(5) of the Law on NEURC. According to Article 8 of the Law on NEURC Commissioners are appointed based on the results of an open competition. The competition is conducted by a competition commission which consists of five persons appointed by the President (two), the *Verkhovna Rada* (two) and the Cabinet of Ministers. Despite the foreseeable risk of a lack of decision making quorum as of 26.11.2017 the competition commission was not formed in time to replace the Commissioners whose terms had expired. The competition commission was in place only as of 17.11.2017. To overcome the lack of a decision making quorum of NEURC, the *Verkhovna Rada* on 07.12.2017 adopted an amendment to Article 14 of the Law on NEURC that allowed the President to directly appoint Commissioners in the number equal to the amount of vacant positions (cf Law 7342-1). Two Commissioners have been appointed accordingly in December 2017, namely Mrs *Morozova* appointed by Order no. 429/2017 and Mr *Tarantun* appointed by Order no. 428/2017. Their terms expired on 23.03.2018. The Secretariat criticised the amendment to Article 14 of the Law on NEURC of December 2017 in the 2018 Report: in fact, it provided a temporary solution – however, for a home-made problem stemming from the lack of effective implementation of the Law on NEURC. The reversals to the previous procedure where Commissioners were appointed at the full discretion of the President was a setback, even if timely limited. Further elaborated in: 2018 Report, chapter 3.2.1.

⁹ Concrete proposals for related legislative changes were provided as an attachment.

(5) Directive 2009/73/EC and proved to be an instrument for depriving NEURC from certainty of its financial resources for 2018 for more than six months in late 2017.¹⁰

- Decisions of NEURC should become effective with their publication on the regulator's website instead of after publication in the *Uriadovy Kurier*, a medium controlled by the Cabinet of Ministers. The 2018 Report saw in the block of regulatory decisions by pending publication in the *Uriadovy Kurier* is a breach of Energy Community law that turned into a systematic obstacle for the entry into force of regulatory decisions.

The 2018 Report also recommended to amend the **Code on the State Budget** in order to ensure the financial independence of NEURC. Implementation of Article 11 and Article 13 of the Law on NEURC, according to which NEURC's budget is solely formed from related regulatory charges calculated by the regulator, requires an adaption of the Law on State Budget of Ukraine for each upcoming budgetary year of the regulator to introduce (or maintain) a special fund of the State budget to which regulatory charges can be paid by undertakings operating in the energy or public utilities sector of Ukraine. As the Secretariat underlined in its 2018 assessment, financial certainty for the regulator would be better guaranteed by a permanent adjustment of the Budget Code instead of reflection in the annual Law on State Budget only. To be financially independent, the regulator needs certainty on its annual financial resources.¹¹

2. Implementation of the 2018 recommendations

2.1. Current legal framework

NEURC's activities are governed by the Law on NEURC that defines the legal status of the regulator, its objectives, functions, powers and procedures. Competences of NEURC are also defined in the sectoral laws on electricity¹² and gas.¹³ Other than the shortcomings listed in the 2018 Report, the legal framework of NEURC complies with the *acquis*.¹⁴

2.2. Appointment of Commissioners

On 30 May 2018 five new Commissioners were appointed by the President of Ukraine.¹⁵ For the first time in the history of NEURC, the selection of board members followed a competitive procedure and involved an

¹⁰ Namely, Article 11 of the Law on NEURC foresees the possibility of the Committee to propose changes to NEURC's budget without clear limits or criteria for giving such comments. See as well: Secretariat, Policy Guideline 02/2015 on regulatory independence, page 3. See on further details: 2018 Report, chapter 4.2.2.

¹¹ 2018 Report, chapter 4.2.2.

¹² The Law on Electricity Market No 2019 of 13 April 2017.

¹³ The Law on the Natural Gas Market No 329 of 01 November 2016.

¹⁴ A detailed check of the *acquis*' requirements is available at: 2018 Report, Annex I.

¹⁵ Mrs. *Oksana Krivenko*, Chairwoman; Mrs. *Olena Antonova*, Commissioner; Mr. *Dmytro Kovalenko*; Commissioner; Mr. *Yevhen Mahlovannyi*, Commissioner; Mr. *Oleksandr Formagej*, Commissioner.

independent competition committee following the rules of Article 8 of the Law on NEURC. The competition committee consisted of five persons appointed by the President (two), the *Verkhovna Rada* (two) and the Cabinet of Ministers¹⁶ and was in duty as of 17 November 2017.¹⁷

In its 2018 Report the Secretariat, while in general welcoming the competitive selection procedure supported by a competition committee, identified that certain committee members were related to the regulated industry and noted that a more diligent selection of the members - e.g. including academia, think tanks, head hunters and (inter-) national energy experts - would have contributed to increasing trust in the commission's work.¹⁸

Nevertheless, the Secretariat is of the opinion that the mere fact that the new Commissioners of NEURC – different from any of the past – had to pass a selection process and were proposed by the competition committee to the President of Ukraine based on the highest ranking criterion as required by Article 8 of the Law on NEURC, has to be considered a historic improvement to safeguard the independence of the regulator's management. On the basis of verifiable information available to the Secretariat, the process for appointment of the five Commissioners has been transparent and followed strictly competitive criteria in line with the Law on NEURC. Allegations of shortcomings in the appointment procedure have not been brought to the attention of the Secretariat.

In the Secretariat's view the applied selection procedure should also significantly contribute to build trust of the public in the work of the regulator and, by this, help to overcome one of the key shortcomings identified in the 2018 Report.

To this extent the Secretariat also sees its related recommendation of 2018 met.

¹⁶ Article 8 of the Law also defines criteria for selection of the members of the competition commission.

¹⁷ Composed of: Mrs *Svitlana Golikova*, Mr *Vasil Yastrubynskyi* (both appointed by the *Verkhovna Rada* on 05.10.2017), Mr *Mykola Nitsak* (appointed by the Cabinet of Ministers on 05.10.2017; cf. <https://www.kmu.gov.ua/ua/npas/250360362>), Mr *Semen Potashnik* and Mr *Vasil Kotko* (both appointed by the President on 17.10.2017; cf. <http://www.president.gov.ua/documents/3712017-23014>). Mr *Kotko* was selected chairman of the committee by the other members at the first meeting of the committee of 24.11.2017 in line with Article 8 of the Law on NEURC.

¹⁸ Cf. 2018 Report, chapter 3.2.1.2.

2.3. Legal reforms

The legal reform measures recommended in the 2018 Report have not been introduced. Namely,

- The regulator's budget is still subject to the approval of the Budget Committee of the *Verkhovna Rada* which infringes Article 35 (5) Directive 2009/72/EC and Article 39 (5) Directive 2009/73/EC;
- The Code on the State Budget has not been changed to ultimately ensure financial independence of NEURC; and
- Decisions of the regulators still only become effective after publication in the *Uriadovy Kurier*. According to the information available to the Secretariat the practise of delaying publication of NEURC's decisions has reduced but still continuous to be a systematic obstacle for the entry into force of regulatory decisions. Evidently, the *Uriadovy Kurier* constitutes an administrative tool to block decisions of NEURC which is not in line with the organizational dimension of regulatory independence: regulatory decisions can only be subject to judicial review, parliamentary supervision or appeal mechanisms. Therefore, the non-publication of the decision of the regulator by the *Uriadovy Kourier* violates Article 35 (5) litera (a) of Directive 2009/72/EC and Article 39 (5) litera (a) of Directive 2009/73/EC. The Secretariat has, again, pinpointed to this breach of the *acquis* by correspondence of 27 November 2018 to the President of Ukraine.¹⁹

The Secretariat therefore upholds its 2018 conclusion that legal reforms are needed to address the above shortcomings to ensure effective independence of NEURC.

2.4. Regulatory framework

As outlined at the beginning, the present review does not target an assessment of the quality of regulatory decisions taken since the 2018 Report or since the appointment of the new Commissioners of NEURC in May 2018.

Still, the Secretariat considers positively that the new board proves commitment and pro-activeness in addressing necessary reform measures of the gas and electricity market in Ukraine and has already issued numerous related decisions. To mention only a few examples, this includes in the gas sector the implementation of daily balancing of the gas transmission system and short-haul capacities, the approval of new gas storage tariffs; new gas transmission tariffs for 2019 for interconnection and internal points; as well as planned amendments to the network codes. In the electricity sector approval of tariff methodologies for distribution system operators, universal service suppliers and suppliers of last resort; licensing of retail market participants; approval of market monitoring reporting forms and procedures; approval of a methodology for calculation of connections fees; approval of an ancillary service pricing methodology; approval of a procedure for purchasing electricity at green tariff; approval of a procedure for dispute settlement; approval of a procedure

¹⁹ Ref. UA-MIN/O/jko/36/21-11-2018.

on submission and publication of data to the ENTSO-E transparency platform; and the approval of quality of service regulations can be mentioned exemplarily.

Different from the past the Secretariat has not been made aware of new cases where NEURC's decisions arouse suspicion of having been taken in favour of individual market participants, were not sufficiently justified from economic point of view or were a result of political influence.

The Secretariat also positively observes the declared interest of the new board to intensify cooperation with the Secretariat. Close cooperation will be crucial in imminent decisions of far reaching importance, such as the certification of the gas transmission system operator in Ukraine. NEURC also raised its profile in the Energy Community Regulatory Board.

To this extent and within the limits of the scope of this review, **the Secretariat does not have substantiated grounds to question independence of NEURC's management and its decision making.**

3. Summary and conclusions

In the view of the Secretariat reasonable improvements have been made on effective independence of NEURC since the issuance of the 2018 Report.

The transparent selection of five new board members in May 2018 certainly is one of the biggest achievements towards *de facto* independence of NEURC. It has supported operational independence by safeguarding the regulator's decision making quorum, and contributed to building trust of the public in the work of the regulator. The Secretariat positively observes that with a pro-active and committed decision making policy the new management has already proven readiness to live-up to its legal competences and independence.

Barriers to full financial independence of NEURC and effective bindingness of its decisions still exist. Neither have the related recommendations of the 2018 Report been implemented, nor has further communication of the Secretariat with the authorities of Ukraine led to progress. The Secretariat therefore upholds its call for legal reforms to address the existing breach of the *acquis*.

Annex I – Legal compliance overview²⁰

Requirement	Energy Community acquis	Law on NEURC	Assessment
Institution is established by law		Law on NEURC	compliant
Vacancies for Board members are announced publically	[*] ²¹	Article 8(2)	compliant
Selection process and criteria for Board members is defined by law and includes a selection committee		Articles 7 and 8(3)	compliant
Single national regulator with nation-wide competences in gas and electricity	Article 35(1) Directive 2009/72/EC, Article 39(1) Directive 2009/73/EC	Article 1	compliant
Regional regulators	Article 35(2), (3)	-	Not applicable
Legal and functional independence from public and private interest is stipulated by law	Article 35(4) lit (a), Directive 2009/72/EC, Article 39(4) lit (a) Directive 2009/73/EC	Articles 1(1) and 5	compliant
Management and staff to act independently and not take/seek for instructions	Article 35(4) lit (b) Directive 2009/72/EC, Article 39(4) lit (b) Directive 2009/73/EC	Article 5(2)	compliant
Management is prohibited to hold shares in regulated companies or be member of a political parties		Article 7 (management) Staff: Article 10 Law on Civil Service	compliant
Sanctions in case of violation of the prohibition to hold shares in regulated companies or be member of a political parties	[*]	Article 8(6) indent 8	compliant

²⁰ Legal compliance does not necessarily have to equal to practical implementation. On the later see the text of the report.

²¹ These requirements are not stemming from the acquis directly but are elements of best practise (cf Secretariat's Policy Guidelines on independence of national regulatory authorities, PG 02/2015 of 28 January 2015).

Requirement	Energy Community acquis	Law on NEURC	Assessment
Autonomous and independent decision making	Article 35(5) lit (a) Directive 2009/72/EC, Article 39(5) lit (a) Directive 2009/73/EC	Articles 5(3) and 14(6)	<u>Revision needed</u> ²²
Decisions are immediately legal binding	Article 37(4) lit (a) Directive 2009/72/EC, Article 41(4) lit (a) Directive 2009/73/EC	Article 14(7)	Decisions of regulatory nature only after publication in the <i>Uriadovy Kurier</i> - <u>revision needed</u>
Decisions are subject to judicial review	Article 37(16) lit (a) Directive 2009/72/EC, Article 41(16) lit (a) Directive 2009/73/EC	Articles 5(3)	compliant
Decisions are to be duly substantiated and justified to allow for judicial review			Missing - <u>revision needed</u>
Term of Commissioners is limited to 5-7 years			
Commissioners' terms are renewable only once	Article 35(5) lit (b) Directive 2009/72/EC, Article 39(5) lit (b) Directive 2009/73/EC	Articles 8(5)	compliant
A rotation scheme is in place			
Dismissal reasons for Commissioners are limited to cases of criminal offence or non-compliance with independence	Article 35(5) lit (b) Directive 2009/72/EC, Article 39(5) lit (b) Directive 2009/73/EC	Article 8(6)	compliant
Separate budget and autonomy to use	Article 35(5) lit (a) Directive 2009/72/EC, Article 39(5) lit (a) Directive 2009/73/EC	Articles 5(3) and 11	compliant
Adequate human resources		Article 5(4)	compliant
Management has autonomy on internal organisation (work program, statutes)	Article 35(4) lit (a) Directive 2009/72/EC, Article 39(4) lit (a) Directive 2009/73/EC	Article 4	

²² Relevant revision proposals are available as attachment to this report.

Requirement	Energy Community acquis	Law on NEURC	Assessment
Budget is financed from levies		Article 13	compliant
Budget does not require approval by another public body [*]		Article 11	Approval by Budget Committee of Verkhovna Rada needed - <u>revision needed</u>
Certainty on financial resource			
NRA provides an annual activity report	Article 37(1) lit (e) Directive 2009/72/EC, Article 41(1) lit (e) Directive 2009/73/EC	Article 6(1)	compliant
Decisions are published	Article 35(4) lit (a) Directive 2009/72/EC, Article 39(4) lit (a) Directive 2009/73/EC	Article 14(8)	compliant
Board meetings are in general open [*]		Article 14(2)	compliant