



First Quarterly Report

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by the Energy Community Secretariat

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PURPOSE STATEMENT

In January 2023, the Energy Community Secretariat established the Ukraine Energy Market Observatory to streamline and consolidate its monitoring functions under the Energy Community Treaty with regard to Ukraine and its commitments. The current report is summarizing the activities under the Observatory during the first quarter (Q1) of 2023.

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Ukraine Energy Market Observatory: Quarterly Report

Quarter 1, 2023

Introduction

In January 2023, the Energy Community Secretariat established the Ukraine Energy Market Observatory to streamline and consolidate its monitoring functions under the Energy Community Treaty with regard to Ukraine and its commitments.

The Observatory closely follows and reviews all developments related to the energy market(s) and corporate governance in Ukraine. This initiative is meant to support the further integration of the Ukrainian energy sector with Europe and help building trust in a predictable and transparent governance in line with European practices. The assessments are published and made available to domestic and international stakeholders involved. For this purposes a dedicated page on the Energy Community web-site was created and regularly updated (<https://www.energy-community.org/Ukraine/observatory.html>).

On 15 February 2023 the Secretariat organized a stakeholder workshop introducing the Observatory to Ukrainian and international stakeholders. The workshop was attended by representatives of the European Commission, USAID and Ukrainian stakeholders, namely state authorities, the energy regulatory authority NEURC, market participants, and associations. During the workshop, participants agreed that the Observatory is a valuable tool to increase transparency as regards measures intervening in the market governance for electricity and gas under martial law. According to the feedback received, it will be crucial also for the reconstruction of the Ukraine energy sector, where the success of the support provided by public donors and private investors alike will crucially depend on the fact how Ukrainian authorities and companies live up to their commitments.

The current report is summarizing the activities under the UA EM Observatory during the first quarter (Q1) of 2023.

Observatory Notes

Under the UA EM Observatory the Secretariat assesses the draft legal (regulatory) acts communicated to the Secretariat by Ukrainian authorities and market participants as well as measures related to the functioning of the energy markets and effecting their performance against compliance with the Energy Community acquis. For the period January-March 2023 the following assessment notes were prepared by the Secretariat and published on the Energy Community web-site:

- Assessment Note 01/2023¹: Analysis of Resolution No. 1689 of NEURC of 17 December 2022 on the settlement of urgent issues of ensuring security of supply and prevention of an emergency situation in the energy system of Ukraine.

Summary

The assessment follows the decision taken by the NEURC on December 17, 2022 regarding introduction of the emergency situation in the electricity market of Ukraine². The Resolution No. 1689

¹ https://www.energy-community.org/dam/jcr:e2e8e47c-c3e2-4cff-a861-affc94b75282/ECS_Ukraine-Energy-Market-Observatory_Note01.pdf

² NEURC Resolution No. 1689 of 25 February 2022 (Resolution #1689);

stipulates that in cases when an emergency situation was declared by the transmission system operator TSO to immediately suspend the markets for bilateral contracts (forward market) and offers accepted by the TSO in the balancing market, and the Market Operator (“MO”) to suspend day-ahead (DAM) and intraday (IDM) transactions for the duration of the emergency situation. Before the adoption of Resolution No. 1689, emergency suspension was envisaged only for the IDM. As a consequence, all electricity will be traded on the balancing market (operated by the TSO).

Articles 35-39 of Commission Regulation (EU) 2017/2196 of 24 November 2017 establishing a network code on electricity emergency and restoration (the “ERNC”) govern the suspension of electricity market activities³. The deadline for ERNC transposition by Ukraine is 31 December 2023. While, generally speaking, the suspension of market activities in emergency situations, as stipulated by Resolution No. 1689, is in line with Articles 35 et seq. of the ERNC Article 4(2) of the ERNC, requires that such rules are developed by the TSO and submitted to the regulatory authority for approval. The development and adoption of Resolution No. 1689 (as already the basic Resolution No332 of 25 February 2022) by NEURC would thus not be in line with Article 4(2) of the ERNC, and may affect also legal certainty.

In November 2022 NEURC had published a set of draft amendments to the Electricity Market Rules, DAM/IDM Rules and the Transmission Network Code related to the suspension of operations on the electricity market and the functioning of the market in the event of an emergency situation in the UES of Ukraine. The Secretariat recommended that even under conditions of martial law, NEURC finalizes the draft amendments to the Market Rules, the DAM/IDM Rules and the Transmission Network Code in the proper procedure, and subsequently repeals Resolution No.332 as amended by Resolution No.1689. It is further recommended that these amendments are aligned with the ERNC as much as possible and consulted with the Secretariat.

Follow up

The rules adopted by the Resolution No 1689 so far have not been used in practice. There was no announcement from the TSO on the emergency state in UPS of Ukraine since their adoption. The amendments to Electricity Market Rules, DAM/IDM Rules and the Transmission Network Code related to the suspension of operations on the electricity market and the functioning of the market in the event of an emergency situation in the UES of Ukraine have not been adopted yet. The drafts have not been consulted with the Secretariat either.

- Assessment Note 02/2023⁴: Analysis of the amendments to NEURC Resolution No 332 related to Financial Guarantees in the Electricity Balancing Market, and the Recommendations of the Antimonopoly Committee of Ukraine.

Summary

Note 02/2023 assessed the changes to the regime applicable to financial guarantees in the Ukrainian electricity balancing market as approved by the NEURC, as well as related recommendations of the Antimonopoly Committee of Ukraine (“AMCU”). NEURC and market participants approached the Secretariat with a letters on the same subject.

³ Ministerial Council Decision 2022/03/MC-EnC of 15 December 2022 on the incorporation of Regulation (EU) 2019/942, Regulation (EU) 2019/943, Regulation (EU) 2015/1222, Regulation (EU) 2016/1719, Regulation (EU) 2017/2195, Regulation (EU) 2017/2196, Regulation (EU) 2017/1485 in the Energy Community acquis, amending Annex I of the Energy Community Treaty, and on the amendments of the Ministerial Council Decisions No 2021/13/MC-EnC and No 2011/02/MC-EnC

⁴ https://www.energy-community.org/dam/jcr:8fa2d1f7-6a75-45a7-b208-c629a91b5f40/ECS_Ukraine-Energy-Market-Observatory_Note02.pdf

In September 2022, the Market Rules' provisions on financial guarantees of balance responsible parties had been amended by NEURC's Resolution No 923, which amended NEURC's Resolution No 332 of 25.02.2022, which stipulates that collaterals in form of bank guarantees for settlement of imbalance costs may be issued by system important banks, designated by the National Bank of Ukraine, only. The amendments were adopted in response to a number of cases in the electricity balancing market of Ukraine when certain market participants provided the TSO bank guarantees from banks that later defaulted on their obligations, which in turn led to debts of the TSO. AMCU had recommended to NEURC that not less than 50% of financial security should be provided in cash, while the remaining 50% should be provided by a bank guarantee issued by any financial institution.

The Secretariat assessed that Directive 2019/944 requires that market rules, including with respect to balancing responsibility, treat all market participants in a non-discriminatory manner, transparently and proportionately and do not put a burden on them to enter the market. In its assessment the Secretariat questioned the transparency and the proportionality of Resolution No 923, which was adopted without involvement of stakeholders. The Secretariat recognised that the objective of imposing collaterals is to ensure that market participants actually pay imbalance costs to the TSO and that the principle of balancing responsibility requires from market participants to be financially liable towards the TSO for the imbalances they are causing. In assessing the proportionality of solutions involving cash payments and/or bank guarantees, a variety of factors need to be taken into account by NEURC, to ensure that any collateral imposed are not excessive. The Secretariat provided also a summary of current practice in different EU Member States and Contracting Parties as regards collaterals.

Follow up

At the beginning of February 2023, NEURC informed AMCU about the adopted Resolution No 150 amending Resolution No 332. The resolution entered into force on 1 March 2023 and fully takes into account the recommendations provided by AMCU. On 25 April 2023 NEURC approved draft amendments to the Electricity Market Rules, drafted together with the TSO on the request of market participants, as regards implementation of a new settlement model on the balancing market between TSO and market participants using escrow accounts. The draft amendments were published on the NEURC website⁵ and currently under the public consultations. They will be assessed by the Market Observatory. The fact that the balancing market settlement rules are amended following the general regulatory procedure with public consultations and AMCU approval is a positive step to ensure transparency of the regulatory framework.

- Energy Community Secretariat's Letter on Draft Law No 6013⁶

Summary

Draft Law No 6013 on the peculiarities of the regulation of business activities of certain types of legal entities and their associations in the transition period passed the first reading in the Verkhovna Rada of Ukraine on 12 January 2023. The draft Law introduces a series of amendments to various other legal acts and repeals the Commercial Code of Ukraine. The amendments created risks for the certification of the electricity and gas TSOs under the Energy Community acquis, and possibly also for the proper implementation and application of Regulation (EU) No 1227/2011 on wholesale energy market integrity and transparency ("REMIT").

⁵ <https://www.nerc.gov.ua/news/oprilyudnyuetsya-proyekt-postanovi-shcho-maye-oznaki-regulyatornogo-akta-zmini-dopravil-rinku-shchodo-vikoristannyam-rahunkiv-umovnogo-zberigannya-eskrou>

⁶ https://www.energy-community.org/dam/jcr:3e834508-5855-4d5b-9556-a4960edf5276/UA-MC_O_alo_09_24-01-2023.pdf

In the certifications of both the gas and the electricity TSOs, the Secretariat and NEURC had relied on the corporate governance based on the so-called Unbundling Law No. 264-IX of 31 October 2019. The draft Law included several provisions calling that basis for certification in question.

Follow up

At the end of January 2023, the Committee on Energy, Housing and Utilities Services addressed the Secretariat with the request to review amendments prepared by the Committee for the second reading of the draft Law. The Secretariat reviewed those amendments, and found that the concerns expressed by the Secretariat in the letter dated 24 January 2023 were largely taken into account. However, the provision ensuring protection of the TSO's property rights also from the owner was missing. The Secretariat recommended to include this provision (or another one, but with the same effect) both in Article 18 of draft law 6013 and new Article 1029(2) of the Civil Code. The draft Law is still pending in Verkhovna Rada.

- Assessment Note 03/2023⁷: Analysis of Resolution No. 1 of Cabinet of Ministers of Ukraine of 3 January 2023 on the peculiarities of the import of electricity during the autumn-winter period of 2022/2023 under the conditions of the legal regime of martial law in Ukraine.

Summary

Resolution No 1 adopted by the Cabinet of Ministers of Ukraine on 3 January 2023 determines a procedure on the peculiarities of the import of electricity during the autumn-winter period of 2022/2023 under the conditions of the legal regime of martial law in Ukraine⁸. It limits the disconnection of consumers using imported electricity only to emergency situations, thus promoting electricity imports by protecting customers, consuming imported electricity, from load-shedding.

Directive 2009/72/EC does not contain rules on load shedding in addition to the tasks of TSO for ensuring the safe and secure operation of the system and for managing electricity flows (Article 12). Regulation (EU) 2019/941 of 5 June 2019 on risk-preparedness in the electricity sector,⁹ however, stipulates the content of risk-preparedness plans [to provide a framework for manual load shedding, including [...] specifying which categories of electricity users are, in accordance with national law, entitled to receive special protection against disconnection], the first of which is due in 2025. Thus, those acts are not providing for a full harmonization of the rules on load shedding and on disconnection of system users but leave discretion to the national authorities and TSO in charge.

It was further noted by the Secretariat, that in principle the Energy Community law does not prohibit measures that are more detrimental to national products (in this case electricity produced in Ukraine) as compared to imported products (electricity imported from the EU). The load-shedding rules do also not confer an economic advantage involving State resources which could amount to State aid to consumers using imported electricity. The Secretariat recommended that the existing procedures adopted by the Ministry of Energy and Resolution No. 1 are aligned and that the results of monitoring of the impact of Resolution No 1 on the markets by NEURC and the Ministry of Energy are published (taking into account confidentiality). To attract more imports, the caps on prices at the Ukrainian DAM as well as the obligation for electricity importers to sell a fixed share of their volumes at DAM are to be reviewed.

Follow up

⁷ https://www.energy-community.org/dam/jcr:0c4f28db-29e2-4ede-8c60-eb55e1a95aa0/ECS_Ukraine-Energy-Market-Observatory_Note03.pdf

⁸ CMU Resolution on a Procedure on the peculiarities of the import of electricity during the autumn-winter period of 2022/2023 under the conditions of the legal regime of martial law in Ukraine, No.1 of 03.01.2023

⁹ Ministerial Council Decision 2021/13/MC-EnC of 30 November 2021

Resolution No.1 expired on 1 May, 2023. The monitoring results of the impact of Resolution No 1 on the markets are not publicly available.

- Assessment Note 04/2023¹⁰: Assessment of the draft amendments to the Law “On the Electricity Market” related to the harmonization of the rules for the cross-border capacity allocation provided by the NEURC

Summary

Draft amendments to the Electricity Market Law proposed by NEURC concern joint capacity allocations on interconnectors between Ukraine and neighbouring Parties to the Energy Community, such as the European Union and Moldova. The implementation of the joint capacity allocation on interconnectors by the electricity TSO of Ukraine has been delayed due to an alleged ambiguity in Article 38(5) of the Electricity Market Law. The proposed amendments foresee the simplification of the adoption procedure (NEURC will not approve, but provide its consent on the rules and does not have the obligation to organize public consultations on the rules proposed by TSOs). The draft amendments also propose changes to Article 38(5), specifying that the rules can be developed per border.

The Secretariat assessed the proposed amendments to the Law are largely compliant with the Energy Community *acquis* in force. However, the Secretariat highlighted, in particular, that proposed consent procedure should be complemented by the right of NEURC to amend or ask for amendments to the rules, and be subject to public consultations on the draft rules to be held by NEURC or by the TSO. The Law should not also restrict the possibilities to adopt different rules for different timeframes and for different sets of borders. To ensure swift implementation it was recommended to stipulate deadlines by the Law for the proposal on the rules to be set by the TSO, and for the procedure regulating NEURC’s consent. Acknowledging that the Electricity Market Law lacks clarity on the sharing of congestion revenues with neighbouring TSOs, the Secretariat recommended to introduce an additional provision defining that the congestion revenues are shared among the TSOs involved in accordance with the point 6.3 of Annex I to Regulation (EC) 714/2009.

Follow-up

Following the publication of Assessment Note 04/2023, NEURC submitted updated draft amendments to the Secretariat on 6 April 2023, in which it took into consideration several of the Secretariat’s comments. The Secretariat submitted its additional review on 17 April 2023, expressing its support for the draft amendments to the Electricity Market Law with few remaining caveats, namely, the need for public consultation with all interested parties (including foreigners), the need to define a procedure for congestion revenue sharing under unilateral auctions to be applied in the transitional period until joint auctions are introduced, and the need to include a clear deadline for submission of the rules on joint cross-border capacity allocation by the TSO to NEURC. On the same day, NEURC published draft amendments to the Electricity Market Law on its website for public consultation¹¹.

Finally, on 25 April 2023, NEURC sent a request to the Secretariat asking its assessment of draft amendments to the Electricity Market Law pending discussion in the Committee on Energy, Housing and Utilities Services of Verkhovna Rada of Ukraine as part of the draft Law aiming to transpose the

¹⁰ <https://www.energy-community.org/dam/jcr:f004fe99-eea7-429e-9b41-ffa4a070689c/Note04.pdf>

¹¹ See: <https://www.nerc.gov.ua/news/oprilyudnyuyetsya-proyekt-zakonu-ukrayini-pro-vnesennya-zmin-do-zakonu-ukrayini-pro-rinok-elektrichnoyi-energiyi-v-chastini-vregulyuvannya-okremih-pitan-provedennya-spilnih-aukcioniv?fbclid=IwAR1cJOiKG7wpWma5xUAebCqDXPsKSGPQWhK1HzYx1AVErH6W1PgO4BE0E00>

REMIT Regulation, registered as Law No 5322. This draft considered the Secretariat's comments on congestion revenue sharing under unilateral auctions. The detailed analysis of these amendments are subject to Assessment Notes 06/2023¹² and 07/2023¹³. On 10 June 2023, Law No 5322 was voted by the Verkhovna Rada of Ukraine in the second reading.

On 31 March, 2023 under coordination of the Secretariat the meeting on joint cross-zonal capacity allocation on Ukrainian interconnections took place between neighbouring EU and Contacting Parties TSOs and NRAs, with NEURC and Ukrenergo as well as representatives of ENTSO-E and JAO. Participants reconfirmed that the finalization of the allocation rules and their submission for approval to NRAs depends on the adoption of the amendments to the Tax Code of Ukraine and the Electricity Market Law of Ukraine. Participants informed that three to six months following the removal of these legal obstacles will be needed for daily allocation through JAO to be operationalized. In the meantime, unilateral daily auctions should continue to apply for the borders with Moldova and the Slovak Republic. On the border with Poland, unilateral auctions will be applied for the allocation of capacity on new interconnection (started from May 2023). Joint daily auctions will be applied on the border with Romania (agreed by TSOs, approved by ANRE and sent to NEURC for approval under the existing Law). On 4 April, 2023 NEURC published for public consultations a draft resolution on approval of the procedure for cross border capacity allocation and amendments to NEURC Resolution of 3 April 2020 No 763, which provides for procedure for the cross-border capacity allocation and special regional conditions for cross-border capacity allocation for long-term and daily auctions at the border between Ukraine and Romania, annexed to the general Procedure. Moreover, on 21 April 2023 the export of electricity in the direction from Ukraine to Slovakia was halted. In response to NEURC's request to find a solution to resume electricity exports from Ukraine the Secretariat's Director Artur Lorkowski and Deputy Director Dirk Buschle met with NEURC's Chairman Ushchapovskyi. On April 26, 2023, a joint meeting was held under coordination of the Secretariat with the participation of representatives of the European Commission, the Energy Community, the regulators and TSOs of Ukraine and Slovakia to discuss the issue of resuming the export of electricity from Ukraine to Slovakia. The participants reached an agreement that the TSOs of Ukraine and Slovakia will agree on conditions of revenue sharing from unilateral auctions and Ukrenergo submit it to their regulators for approval. These meetings are being continued on a regular basis, but so far Ukrenergo has not yet agreed to the conditions of revenue sharing proposed by the TSO of Slovakia.

Other key developments in the Ukrainian energy market

The Secretariat also performs systematic monitoring of all energy-market measures, legal initiatives and developments. They may become subject to in-depth review for the Market Observatory. In the following, a summary of these developments is provided:

- a) In the reporting period a number of draft laws were registered falling within the Energy Community acquis were submitted to Verkhovna Rada:
 - Draft Law No 9011 dated 13 February 2023 on amendments to certain Laws of Ukraine on improving the conditions for supporting the production of electric energy from alternative energy sources by consumer generating installations. The draft Law was followed by three alternative draft Laws No 9011-1, No 9011-2 and No 9011-d.

¹² <https://www.energy-community.org/dam/jcr:46ea12c9-6260-41e3-ad12-d229ef6af55e/Note06.pdf>

¹³ <https://www.energy-community.org/dam/jcr:c77b3cf8-d955-4b68-9895-edc9c14f805d/Note07.pdf>

On 2 May 2023 the draft Law No 9011-d was voted by the Verkhovna Rada in the first reading; it subject to Assessment Note 08/2023¹⁴.

- Draft Law No 9012 dated 13 February 2023 on amendments to certain Laws of Ukraine on the introduction of the register of issuance, use and termination of the guarantee of origin of electric energy produced from renewable energy sources. The draft Law was followed by the two alternative draft Laws, No 9012 -1 and No 9012-2. At the end, provisions as regards Guarantees of Origin were transferred to the draft Law No 9011-d.
 - Draft Law No 9024 dated 16 February 2023 on minimum reserves of oil and oil products, which defines the basic legal, organizational, financial and economic principles for the creation and operation of the system of minimum reserves of oil and petroleum products in Ukraine. The draft Law was followed by the alternative draft Law No 9024 -1.
 - Draft Law No 9138 dated 22 March 2023 on projects of national interest in the field of energy, which governs the procedure for designing the list of projects of national interest in the field of energy (including projects of common interest of the Energy Community and projects of mutual interest), conditions for their implementation and reporting, regulatory regime etc.
- b) In the reporting period, also two decrees falling under the Energy Community acquis were adopted by the Cabinet of Ministries of Ukraine:
- By Decree dated 24 March 2023 No 262 amending the CMU resolution of 5 June 2019 No 483 on the approval of the Regulation on the imposition of special duties on the participants of the electric energy market to ensure the interests of the general public in the process of functioning of the electric energy market, the CMU prolonged the current public service obligation mechanism and electricity prices for household customers for one month until 30 April 2023.
 - By Decree dated 30 March 2023 No 277 on making changes to the resolution of the Cabinet of Ministers of Ukraine dated 19 July 2022 No 812, the CMU prolonged the current public service obligation mechanism regulating the functioning of the natural gas market and the specifics of natural gas supply to heat producers energy and budgetary institutions for one month until 30 April 2023.

Both Public Service Obligations (PSO) were adopted by the CMU without consultations with the Secretariat as envisaged by the Energy Community acquis, namely Article 3 of the Directive 2009/72/EC and Article 3 of Directive 2009/73/EC, the Electricity Market Law (Article 62) and Gas Market Law (Article 11) of Ukraine. To reinforce that obligation, in December 2022 a Memorandum of Understanding between the NEURC and the Secretariat on mutual cooperation in the area of public service obligations was signed. According to that MoU NEURC, when preparing draft PSO for the CMU, should notify the draft to the Secretariat at the earliest stage possible, and take utmost account of the Secretariat's opinion. Upon receipt of the Secretariat's opinion, and prior to submission of the revised draft to the CMU, NEURC is expected to notify the Secretariat again of the revised draft. Similarly, under the Roadmap for further market integration following the synchronisation of the Ukraine (and Moldova's) electricity networks with the Continental European

¹⁴ <https://www.energy-community.org/dam/jcr:f58f9b75-dc4a-4ee6-b34e-b1d4cc367173/Note08.pdf>

Network, any PSO introduced under martial law is to be consulted with the Secretariat, and should be of temporary nature. The Secretariat addressed its concerns in implementing these commitments in its letters of 31 of March 2023 to the NEURC and of 13 April 2023 to the Ministry of Energy. In April 2023 the CMU took several other decisions¹⁵ amending the PSOs for the electricity and gas markets (without consulting the Secretariat).

¹⁵ CMU Decree No. 363 of 21.04.2023, CMU Decree No. 384 of 25.04.2023, CMU Decree No. 395 of 28.04.2023, CMU Decree No. 394 of 25.04.2023