



Analysis of the draft Law of Ukraine on the amendments to some legislative acts of Ukraine regarding the development of electronic trade of alternative fuels

by the Energy Community Secretariat

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PURPOSE STATEMENT

Assessment of the draft Law of Ukraine “On the amendments to some legislative acts of Ukraine regarding the development of electronic trade of alternative fuels” registered on 19 September 2022 (the “draft Law 8052”).

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Ukraine Energy Market Observatory

Assessment 13/24

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Introduction

Pursuant to the Memorandum of Understanding and Cooperation dated 24 June 2024, the Committee of the Verkhovna Rada of Ukraine on Energy and Housing and Communal Services and the Energy Community Secretariat have agreed to conduct joint consultations to discuss draft legislative acts in the field of energy, including compatibility with the Energy Community acquis, of current Ukrainian legislation in the field of energy in order to improve it based on the European best practice.

The present document provides an assessment of the compatibility of the draft Law 8052¹ with the Energy Community acquis and suggestions to improve the draft Law 8052 based on the European best practice.

Background

a) The draft Law 8052

The explanatory note for the draft Law 8052 (the “Explanatory Note”) justifies the need for its adoption by reference to the urgent need to reduce Ukraine’s imports of natural gas. The purpose of the draft Law 8052 is thus to introduce an electronic trading framework² for alternative fuels, mainly through changes and additions to the existing Law of Ukraine on Alternative Fuels³.

The Explanatory Note identified numerous challenges in the current alternative fuel market, including: the chaotic supply of biofuel due to lack of a single market and many intermediaries; unpredicted price corridor for biofuel due to lack of a single source of pricing; the difficulty of forecasting future purchases of energy resources due to lack of “long” contracts and significant price fluctuations; risks of failure to fulfil contracts for the supply of raw materials due to lack of responsibility on the part of suppliers; and biofuel quality due to lack of uniform requirements for standardization.

¹ <https://itd.rada.gov.ua/billInfo/Bills/Card/40449>

² Defined as a multilateral system satisfying the requirements established by the Law and through which the operator shall organize auctions

³ Vidomosti Verkhovnoi Rady Ukrainy (VVR), 2000, No. 12, Art. 94). The definition of relevant terms are provided in the existing law, including: alternative fuels – solid, liquid and gaseous fuel that is an alternative for traditional types of fuel and which is generated (produced) from non-traditional sources and types of energy raw materials; biomass – biologically renewable substance of organic origin that biologically decays (waste of agriculture (vegetation and animal breeding), forestry and technologically associated industries as well as organic part of industrial and household waste

The Explanatory Note recalls that some European countries already have a successful experience of organizing the alternative fuel market with the help of electronic commerce and specifically refers to Lithuania where the Baltpool biofuel exchange was introduced in 2012.

In Ukraine, it is thus expected that the draft Law 8052 will create a developed trading market of alternative fuels upon the example of the successful functioning of the gas, oil and wood markets; provide a real price indicator for biofuel and transparent pricing mechanism for the state; form a forecast and real balance of alternative types of fuel; warn and respond in a timely manner to market speculations; ensure rational use of production resources and supply; exclude intermediaries in the producer - processor - consumer chain; save budget funds and consumer funds; receive state supervision of the market situation in real time; increase the investment attractiveness of the industry for modernization in energy-saving technologies; ensure effective control of the execution of agreements, prevent disruption supplies and perform real quality control.

The most important change envisaged by the draft Law 8052 (in its article I) is to incorporate into the Law on Alternative Fuels a new Section II entitled "SPECIFICS OF ELECTRONIC TRADE IN ALTERNATIVE FUELS" with provisions addressing the following:

Article 8¹. Basic Principles of Functioning of the Electronic Trading System

Article 8². State Regulation of Electronic Trade in Alternative Fuels

Article 8³. Operator's Activities

Article 8⁴. Specifics of Purchase and Sale of Alternative Fuels

Additions to Article 13 of the Law on Alternative Fuels create new offences in the field of electronic trade in alternative fuels, including violation of the rules of conducting electronic trade in alternative fuels; and non-compliance with the requirements for the sale and purchase of alternative fuels in the electronic trading system, as specified by Article 8⁴ of the Law.

Additions to Article 14 of the Law on Alternative Fuels provide for the sanctions that the competent central executive body⁴ shall apply for non-compliance with the requirements for the sale and purchase of alternative fuels in the electronic trading system, as specified by Article 84 of this Law.

b) Relevant Energy Community acquis

The European Union adopted Directive (EU) 2018/2001 of the European Parliament and of the Council of 11 December 2018 on the promotion of the use of energy from renewable sources (the "REDII"), which was subsequently amended. REDII was adapted and adopted in the *acquis communautaire* of the Energy Community by Ministerial Council Decision 2021/14/MC-EnC of 30 November 2021⁵, amended by Ministerial Council Decision 2022/02/MC-EnC, which provided that each Contracting Party shall bring into force the laws, regulations, and administrative provisions to comply with REDII by 31 December 2022.

Article 3 of REDII establishes an overall Energy Community target of 31% for renewable energy's share in gross final consumption by 2030 and specifies the contributions required from each Contracting Party. As outlined in ANNEX I, Ukraine's target for the share of renewable energy in its

⁴ The central executive body implementing state policy in the field of efficient use of fuel and energy resources, energy saving, renewable energy sources and alternative fuels

⁵ Decision 2021/14/MC-EnC of the Ministerial Council of the Energy Community of 30 November 2021 amending Article 20 and Annex I to the Treaty establishing the Energy Community and incorporating Directive (EU) 2018/2011, Directive (EU) 2018/2002, Regulation (EU) 2018/1999, Delegated Regulation (EU) 2020/1044, and Implementing Regulation (EU) 2020/1208 in the Energy Community acquis.

gross final energy consumption by 2030 is set at 27%. Pursuant to article 4 of REDII, Ukraine may apply support schemes in order to reach or exceed such target.

Article 23 of REDII imposes specific obligations on Contracting Parties in order to promote the use of renewable energy in the heating and cooling sector: “each Contracting Party shall endeavour to increase the share of renewable energy in that sector by an indicative 1,3 percentage points as an annual average calculated for the periods 2021 to 2025 and 2026 to 2030, starting from the share of renewable energy in the heating and cooling sector in 2020.

Contracting Parties may implement such increase by means, inter alia, of one or more of the following options:

- (a) physical incorporation of renewable energy or waste heat and cold in the energy and energy fuel supplied for heating and cooling;
- (b) direct mitigation measures such as the installation of highly efficient renewable heating and cooling systems in buildings, or the use of renewable energy or waste heat and cold in industrial heating and cooling processes;
- (d) other policy measures, with an equivalent effect, including fiscal measures or other financial incentives.”

Article 25 of REDII mandates that Contracting Parties, including Ukraine, integrate renewable energy into the transport sector by requiring fuel suppliers to ensure that renewable energy comprises at least 14% of the final energy consumption in this sector by 2030. This target must follow an indicative trajectory set by the Contracting Party and be calculated according to the methodologies specified in Articles 25, 26, and 27. Article 26 outlines specific rules for biofuels, bioliquids, and biomass fuels produced from food and feed crops, while Article 27 details the calculation rules for the minimum shares of renewable energy in the transport sector. Additionally, Article 29 establishes sustainability and greenhouse gas emission-saving criteria for these fuels, Article 30 addresses the verification of compliance with these criteria, and Article 31 provides the calculation of the greenhouse gas impact of biofuels, bioliquids, and biomass fuels.

c) Baltpool as an example of European best practice⁶

Baltpool primarily operates as an international biomass exchange, facilitating trade auctions for standardised biomass products. In Lithuania, Baltpool also organizes timber and heat auctions and manages funds for public interest services in the electricity sector.

As part of Lithuania's state-owned EPSO-G energy transmission and exchange group, all biomass exchange operations conducted by Baltpool are licensed and supervised by the National Energy Regulatory Council (NERC).

The centralised electronic trade in biomass administered by Baltpool is an internet trading platform that operates according to the set rules and enables the buyers (mainly heat generating enterprises) and sellers (biomass suppliers) to anonymously enter into electronic transactions biomass products traded on the exchange. With the help of the exchange trading system, the participants can sell their production easily and in a short time and acquire the required quantity of biomass. The main objective of the biomass exchange is to encourage competition on the biomass market and to ensure transparent, objective and economically justified prices of products traded on the exchange.

⁶ Information extracted from the Notes to the Financial Statements of Baltpool for the Year 2023, accessible at <https://www.baltpool.eu/wp-content/uploads/2024/03/baltpool-fa-ir-mp-2023-final-en-su-ivada.pdf> and Baltpool website

The amendment to the Law on Energy Resources Market of the Republic of Lithuania adopted on 16 December 2014, among other things, established that from 2016 heat providers, regulated independent heat producers and combined heat and electric power producers using biofuel in electric power and/or heat generation must compare the price of biofuel acquired under over-the-counter transactions with the price of transactions conducted on the energy resources exchange and give priority to the energy resources exchange when prices differ not more than 5%.

The amendment to the Law on Energy from Renewable Sources of the Republic of Lithuania adopted on 28 April 2022, appointed Baltpool as the operator of the energy resources exchange to implement a national scheme assessing biomass compliance with sustainability and greenhouse gas emission reduction criteria. As of 2 May 2023, Lithuania launched its national biomass sustainability scheme "RED BP." Subsequently, on 19 May 2023, Latvia amended its regulations to recognize biomass purchased on Baltpool's exchange with the RED BP label as compliant with the REDII.

Compliance assessment

As presented in details above, the Energy Community acquis imposes upon Ukraine specific targets in relation to the share of renewable energy in gross final consumption of energy for 2030 (27%) and for increasing the share of renewable energy in the heating and cooling sector by an indicative 1,3 percentage points as an annual average calculated for the periods 2021 to 2025 and 2026 to 2030. However, the Energy Community acquis does not specifically prescribe the measures that Contracting Parties should adopt in order to achieve or exceed these targets, and it does not expressly regulate the trade of alternative fuels. In this context, the measures that would be adopted by Ukraine to strengthen the market of alternative fuels should, in due course, further develop the use of alternative fuels for energy consumption, thus increasing the share of renewable energy in gross final consumption of energy. Therefore, the Secretariat views that the measures envisaged in the draft Law 8052 are compatible with the Energy Community acquis.

It should be noted, however that the draft Law 8052 only provides the high-level principles of the electronic trading system, including that:

- The operator shall be a commodity exchange in compliance with the Law on Commodity Exchanges and holding a license issued by the National Commission for Securities and the Stock Marke.
- The competent central executive body⁷ shall approve the rules of electronic trade in alternative fuels establishing the procedure for conducting auctions, the specifics of concluding a contract for the purchase and sale of alternative fuels, and the conditions for access to the electronic trading.
- Under Article II of the draft Law 8052, the Law on Capital Markets and Organized Commodity Markets⁸ shall not apply to relations related to the functioning of the market of electronic trade in alternative fuels.
- Under Article III of the draft Law 8052, the Law on Commodity Exchanges⁹ shall not apply to the activities of the operator or to relations related to the functioning of the market of electronic trade in alternative fuels.

⁷ The central executive body ensuring the formation of state policy in the field of efficient use of fuel and energy resources, energy saving, renewable energy sources and alternative fuels

⁸ Vidomosti Verkhovnoi Rady Ukrainy (VVR), 2006, No. 31, Art. 268

⁹ Vidomosti Verkhovnoi Rady Ukrainy (VVR), 1992, No. 10, Art. 139

In these circumstances, and particularly considering that the electronic trade in alternative fuels will not benefit from the relevant legislative framework applicable to organized commodity markets and commodity exchanges, the applicable rules, as well as the contractual documentation and technical specifications for trading on the exchange, should provide a detailed and robust framework for the functioning of the electronic trading framework. These should be developed taking into consideration the best practices of the industry, including Baltpool.

To ensure sufficient liquidity on the electronic trading framework, the new Article 8⁴ to be incorporated by the draft Law 8052 will oblige certain sellers of alternative fuels¹⁰ to sell a certain percentage of their production (ramping up to 100% over a period of 4 years) on the electronic trading system and certain buyers of alternative fuels¹¹ to purchase a certain percentage of sourcing needs (ramping up to 100% over a period of 4 years) on the electronic trading system. As presented above, the best industry practice at Baltpool provides for a derogation, allowing participants on the exchange to proceed with over-the-counter transactions if the prices for transactions outside the exchange are significantly lower.

Finally, it is crucial for Ukraine to transpose and implement the sustainability and greenhouse gas emission reduction criteria for biofuels, bioliquids, and biomass fuels as outlined in Articles 25-31 of REDII, reflecting best practices such as the national scheme for assessing biomass compliance implemented by Baltpool.

Conclusions and recommendations

In this context, the Energy Community Secretariat:

- welcomes the measures envisaged by Ukraine to strengthen the market of alternative fuels by enhancing competition and transparency;
- highlights the importance that the applicable rules, as well as the contractual documentation and technical specifications for trading on the exchange, provide a detailed and robust framework for the functioning of the electronic trading framework; and
- recalls the importance for Ukraine to transpose and implement provisions on sustainability criteria and greenhouse gas emission reductions for biofuels, bioliquids, and biomass fuels.

¹⁰ Alternative fuel manufacturing enterprises in which the state or communal share (stock units) exceeds 50 percent of their authorized capital

¹¹ Entities engaged in the production of electricity from alternative fuels under a "green" tariff; those holding the right to state support based on the results of an auction, and those for which tariffs have been set in accordance with Part four and/or Part five of Article 20 of the Law of On Heat Supply, except for customers within the meaning of the Law of Ukraine on Public Procurement.