

ENERGY SECURITY: Cooperation between Ukraine and the EU



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Background

Energy security and efficiency incentives come predominantly today from the EU countries. Despite the political background of talks on energy, one should clearly understand that energy security and efficiency concepts have been strongly developed in consumer countries. Indeed Ukraine, as a state in charge of energy transit, is stuck between opposite approaches of the EU aimed at “efficiency and security promotion” and “non-energy efficient Russian Federation” which as a supplier has not been paying attention to the reduction of energy consumption and dependence on hydrocarbons compared, for instance, to the Gulf States.

Since Russia ignored the mechanism of the Energy Charter Treaty which, in fact was an instrument for market access to its fossil energy sources by foreign capital, the understanding of energy security and efficiency has been elaborated by consumers such as the EU, which are actively seeking solutions for stability of energy supplies. The EU invented various instruments of cooperation with supply and transit states.

The European Commission has in the past decade developed an overall goal for European Energy Policy to ensure safe, secure, sustainable and affordable energy for all, business and consumers alike. Europe has taken several steps such as bilateral relations and endorsement of the

Energy Community in order to enhance a dialog with markets on its borders. In the case of Russia, it is highly unlikely that multilateral institutional mechanisms will succeed, as for Ukraine, which is also dependant on the supply chain and benefits from transit, it could be a solution.

One of the basic recent documents establishing a framework for cooperation between Ukraine and the EU in the energy sector is the *Memorandum of Understanding on Energy* signed on 1 September 2005 (hereinafter — MOU). It presents the following list of main issues which Ukraine should focus on in order to facilitate transition to an energy efficient economy and join the energy market of the EU:

- a) Reforming electricity tariffs and gas pricing;
- b) Easing the impact of reforms on vulnerable customers;
- c) Reducing unregulated losses;
- d) Reducing network losses, in particular, transmission losses;
- e) Increasing energy efficiency necessary to abate demand;
- f) Ensuring full payments for providing gas and electricity;
- g) Diversifying supply, including energy substitution by, e.g., renewable energy sources, whilst maintaining a free market framework;
- h) Optimising the energy mix in electricity generation with a view to increasing efficiency, environmental safety, operational reliability, and security of supply¹.

In fact, the MOU only creates a platform for further institution-

al and legal reforms. EU as a big consumer of energy is trying to optimize its consumption via two main directions: promoting energy efficiency and creating a secure supply network.

Energy efficiency in the EU has been increasing with considerable pace in the recent decade and is currently under way. Some priorities were dropped due to the world financial crisis. However, the EU still devotes much effort to the goals of energy efficiency and sustainable development.

With regard to security of network supply and energy security — the EU is dependent on suppliers and transit countries such as Russia and Ukraine, respectively. Nevertheless, in the long-term perspective the EU is looking forward to diversification of supply chains and reduction of its dependence on supplies from third states. Moreover, implementation of high energy efficiency standards and an approach towards a shared view on energy security has triggered an intensive technological progress not only in the EU but also in emerging economies which, at the end of the day, will result in reduced dependence on fossil energy and, consequently, a cut in the influence of supply and transit states. This should be emphasized in the context of Ukraine’s extremely inconsistent policy in

¹ Memorandum of Understanding on Cooperation in the Field of Energy between the European Union and Ukraine of 1 September 2005 available at http://ec.europa.eu/energy/international/bilateral_cooperation/doc/ukraine/2005_12_01_ukraine_mou.pdf

energy efficiency and low dedication towards developing the alternative energy sector.

In the meantime, the EU is focused on adoption of a shared view in the area of sustainable energy policy with its partners all over the world. One possibly effective instrument for Ukraine to manage its energy policy and retain the pace of modern challenges is to follow institutional cooperation with the EU.

Recent developments

Ukraine has recently finalized the process of transition from the status of observer to full membership of the Energy Community when on 24 September 2010 Yuriy Boyko, Minister of Fuel and Energy of Ukraine and Fatmir Besimi, Minister of Economy of the Former Yugoslav Republic of Macedonia presiding over the Energy Community, signed a *Protocol Concerning the Accession of Ukraine to the Treaty Establishing the Energy Community* (Protocol of Accession). This organization is an institutional mechanism created by the EU for the purpose of extending its internal energy market to South East Europe and beyond on the ground of legally binding framework².

Members of the Energy Community are the European Union, Albania, Bosnia and Herzegovina, Croatia, the former Yugoslav Republic of Macedonia, Moldova, Montenegro, Serbia and the United Nations Interim Administration Mission in Kosovo pursuant to *United Nations Security Council Resolution 1244*³.

By virtue of commitment to the *Energy Community Treaty*, Ukraine's membership in the Energy Community shall mean implementation of substantial rules of EU law in the area of energy and environment. Moreover, it is expected that the

² http://energycommunity.org/portal/page/portal/ENC_HOME/ENERGY_COMMUNITY/Facts_and_Figures

³ Information available at http://www.energy-community.org/portal/page/portal/ENC_HOME/ENERGY_COMMUNITY/Stakeholders/Parties



main principles of the EU competition law will also be applicable. According to the commitments under the *Energy Community Treaty*, Ukraine will be obliged to increase the usage of renewable energy and its energy efficiency and also contribute to tackling climate change⁴. The EU is expecting an improvement in Ukraine's investment climate and financial stability in the context of its previous and new international commitments which are supposed to benefit both investors and the Ukrainian state.

Article 3 of the *Energy Community Treaty* establishes a three-tier structure of mutual integration of the parties with subsequent commitments and, in fact, has three stages: Extension of the *acquis communautaire* (*acquis* — Law of the EU); Development of the Mechanism for Operation of Network Energy Markets; and

⁴ Information available at http://www.energy-community.org/portal/page/portal/ENC_HOME/NEWS/News_Details?p_new_id=3721

Creation of Single Energy Market. In the realm of these requirements of the *Energy Community Treaty* and pursuant to the *Protocol of Accession*, Ukraine is still obliged to implement an impressive amount of the EU rules on energy and related areas in the course of several years up to 2018, starting from the day of its accession.

Such gradual implementation will include legislation on application of common rules for the internal market in natural gas (*Directive 2003/55/EC* by 1 January 2012); conditions for access to natural gas transmission networks (*Regulation No. 1775/2005* by 1 January 2012); measures to safeguard security of natural gas supply (*Directive 2004/67/EC* by 1 January 2012); common rules for the internal market in electricity (*Directive 2003/54/EC* by 1 January 2012); conditions for access to the network for cross-border exchange in electricity (*Regulation No. 1228/2003* and *Commission Decision 2006/770/EC* amen-

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ding the *Annex to Regulation No.1228/2003* by 1 January 2012); measures to safeguard security of electricity supply and infrastructure investment (*Directive 2005/89/EC* by 1 January 2012); assessment of the effects of certain public and private projects on the environment (*Directive 85/337/EEC* amended by *Directive 97/11/EC* and *Directive 2003/35/EC* by 1 January 2013); reduction in the sulphur content of certain liquid fuels (*Directive 1999/32/EC* by 1 January 2012); restriction of emissions of certain pollutants into the air from large combustion plants (*Directive 2001/80/EC* by 1 January 2018); conservation of wild birds (*Directive 79/409/EC, Article 4(2)* by 1 January 2015); promotion of electricity produced from renewable energy sources on the domestic electricity market (*Plan for implementation of Directive 2001/77/EEC* by 1 July 2011); and promotion of the use of bio-fuels or other renewable fuels for transport (*Plan for the implementation of Directive 2003/30/EC* by 1 July 2011)⁵.

One can anticipate problematic legal issues with regard to adoption of such an amount of legal rules on the environment of EU law within a short timeframe. Indeed, this is the price paid for the opportunities of promoting investment in the Ukrainian energy market. According to the official position presented on 18 December 2009 in Zagreb (Croatia) during approval of future accession of Ukraine and Moldova to the Energy Community, Ukraine will benefit from effective accession when and if its laws at this stage of integration comply with the EU *acquis* requirements, including *Directive 2003/55/EC*, which is now repealed in EU by *Directive 2009/73/EC* regulating the gas market and *Regulation 715/2009* (hereinafter respectively — Gas Directive and Gas Regulation).

⁵ According to Article 2 of the Protocol Concerning the Accession of Ukraine to the Treaty Establishing the Energy Community of 24 September 2010.

Ukrainian legislative initiatives

In line with the requirements set out in the Gas Directive and Gas Regulation, the President of Ukraine signed the *On Principles of Natural Gas Market Functioning Act of Ukraine of 8 July 2010* (hereinafter — *Gas Market Act*). The *Gas Market Act* calls for the liberalization and opening up of the gas market; separation of supply and production activities from network operations; market access, including Gas Transportation System (hereinafter — GTS) and storage facilities; establishment of an independent regulatory body on the gas market.

In its provisions the *Gas Market Act* follows the rules of the Gas Directive with regard to free choice of the natural gas supplier subject to the relevant contractual relationship⁶. Legislators are making an effort to create a free market of natural gas supply based on the principles of fair competition and transparency. Theoretically, each enterprise can enter the market in order to provide services of natural gas supply, but such entity has to comply with respective licensing requirements. The consumer is also entitled to receive information on the availability of natural gas at the disposal of the supplier and its qualitative characteristics.

The *Gas Market Act* has endorsed the principle of unbundling of transmission, distribution, supply and storage of natural gas, which was introduced by the Gas Directive. According to the *Gas Market Act*⁷, all of the above-mentioned types of activity shall be separated due to the declared

aim of creating competition on the energy market and avoiding a state monopoly. This approach has been applied in EU in the past decade not only in the energy sector in order to eliminate state involvement in the mechanism of the internal market.

Thus, under the *Gas Market Act*, transmission operators are prohibited from acting in the area of extraction and supply of natural gas, whereas a distribution operator is not allowed to undertake extraction, supply, storage and transmission of natural gas. The unbundling principle of transmission, supply and distribution is also related to vertically-integrated undertakings, where the *Gas Market Act* requires its legal and organizational separation from other activities of such an undertaking⁸. The principle of unbundling will obviously not, according to the *Gas Market Act*⁹, effect small enterprises.

The *Gas Market Act* introduces the principle of the independence of the National Electricity Regulatory Commission of Ukraine, which is the main regulatory body on the Ukrainian energy market. By virtue of the *Gas Market Act* this body has received a wide remit, but its *de facto* independence from the government should be assessed in due diligence after the lapse of some time.

Despite positive signals described in this article, the issue of financial control over the chain of enterprises either included in the vertically-integrated enterprises or functioning at every stage of the market starting from extraction and ending with supply still does not remain crystal clear and probably subject to regulation in anti-monopoly legislation. The latter will presumably absorb the experience of the EU, Ukraine's membership of the Energy Community will mostly affect respective legislative initiatives. The quick way for Ukraine to develop its energy legislation is to implement relevant rules of the *acquis*.

⁶ According to Article 2 of the Protocol Concerning the Accession of Ukraine to the Treaty Establishing the Energy Community of 24 September 2010.

⁷ Article 16 of the *On Principles of Natural Gas Market Functioning Act of Ukraine of 8 July 2010* No. 2467-VI.

⁸ Para. 4, Article 16 of the *On Principles of Natural Gas Market Functioning Act of Ukraine of 8 July 2010* No. 2467-VI.

⁹ Para. 6 Article 16 of the *On Principles of Natural Gas Market Functioning Act of Ukraine of 8 July 2010* No. 2467-VI.