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Joining the Energy Community: A way for Ukraine to secure gas supplies?

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Ukraine is about to join the Energy Community. The decision on its accession was approved during the Energy Community Treaty Ministerial Council on 18 December in Zagreb. Now the Verkhovna Rada of Ukraine should ratify the Energy Community Treaty. For Ukraine, the main benefits of joining include: more transparent and understandable rules of play on the energy market, greater competition and efficiency among domestic producers, a more attractive investment climate, and access to the European market for Ukrainian exports, especially electricity. In addition, Energy Community members have to implement a set of measures to ensure secure supplies of natural gas. Such measures are stipulated in Council Directive 2004/67/EC of 26 April 2004. The issue of security of gas supplies is very urgent, both for Ukraine and the EU. This paper attempts to identify the costs and benefits for Ukraine in terms of security of gas supplies and determine whether gas supplies to Ukraine will become more secure after the country accedes to the Energy Community.

Council Directive 2004/67/EC: Purpose and requirements

As soon as Ukraine signs the Energy Community Treaty (EnCT), it has to harmonize its own energy law with related EU Directives. One of the 14 energy *acquis* to be adopted and implemented is the Council Directive 2004/67/EC of 26 April 2004 concerning measures to safeguard security of natural gas supply.¹ The Directive's main purpose is to establish "measures to safeguard an adequate level for gas supply security" by pursuing common supply security policies and implementing specific procedures.

The Directive establishes the measures to effectively monitor security of gas supplies and deal with major gas supply disruptions. An effective monitoring system makes it possible to prevent or anticipate disruptions, while an effective management mechanism helps to deal with any disruptions that do occur.

In Ukraine, the problem of gas supply disruptions became especially urgent after a series of gas crises in recent years. Hence, it is especially important for Ukraine to develop and implement an effective gas supply security monitoring system, as well as to study opportunities for closer cooperation with other members of the Energy Community to effectively manage gas supply disruptions.

¹ On 16 June 2009, the European Commission issued a proposal for the European Parliament and Council to repeal Directive 2004/67/EC and implement a Regulation concerning measures to safeguard security of gas supplies. This Regulation has not yet been implemented. This paper therefore is based on the still-valid Directive 2004/67/EC.

Measures to improve gas supply security as set out in Directive 2004/67/EC

- working gas in storage facilities
- withdrawal capacity of gas storage facilities
- pipeline capacity allowing diversion of gas supplies to affected areas
- use of alternative fuels
- production flexibility
- import flexibility
- diversification of sources of gas supplies
- long term contracts, and so on

The Directive establishes specific requirements to be fulfilled by members of the Energy Community. Members have to guarantee gas to residential customers and certain small and medium enterprises in case of partial disruptions in the national supply, during times of extreme cold, during peak periods designated at the national level, and during periods of extremely high demand during the coldest weather. For this purpose, member states must:

- take the necessary measures to ensure sufficient gas storage facilities within their territory;
- set minimum targets for a potential contribution of gas storage to security of supply;
- monitor and report on gas supply security using designated indicators;
- cooperate with other members on the use of gas storage facilities located within their territory, provided that there is an adequate level of inter-connection among the states.

Preventing gas supply disruptions: Monitoring and reporting

A two-level mechanism for monitoring gas supply security is applied by members of the Energy Community.

First, each member monitors gas supply security at the national level using specific indicators. The monitoring results are regularly submitted in reports to the European Commission.

After that, the European Commission carries out its own monitoring based on the reports received.

Gas supply security indicators to be used for monitoring and reporting
(as set out in the Directive 2004/67/EC)

- supply/demand balance on the domestic market
- level of expected future demand and available supply
- anticipated additional capacity being planned or under construction
- quality and level of network maintenance
- measures to cover peak demand and handle shortfalls with one or more suppliers
- storage capacity
- duration of long-term gas supply contracts, excluding commercial information
- regulatory framework providing adequate incentives to invest in exploration and development, storage, LNG, and gas transport

Gas supply security indicators used by the European Commission for monitoring purposes

- level of import from third countries set in long-term contracts
- level of working gas and of withdrawal capacity of gas storage facilities
- interconnection of members' national gas distribution systems
- anticipated gas supply, demand, supply autonomy and available sources at community level, and so on

Ukrainian legislation on gas supply security

- There is no separate legislation regulating gas supply security in Ukraine.
- The main document that regulates Ukraine's oil and gas industry is the Law of Ukraine №2665-III "On oil and gas" dated 12 June 2001. This law contains a list of norms governing the oil and gas sector, including the use of gas storage facilities and Ukraine's gas distribution (Sections VII and VIII).
- The metering of gas supplied to Ukraine's domestic market is established in Cabinet Resolution №1729 "On the supply of consumers with natural gas" dated 27 December 2001. According to this Resolution, the Ministry of Fuel and Energy and the Ministry of Economy, together with Naftogaz Ukrainy, are to develop annual estimates of the anticipated balance of gas supply and distribution. Gas suppliers are to meter consumed gas on a monthly basis and prepare a report for the Ministry of Fuel and Energy, the Ministry of Economy and the National Electricity Regulatory Commission on gas supply, consumption and production, on the use of gas storage facilities, and so on.

Managing gas supply disruptions at the national and community levels

Gas supply disruptions are managed at both the national and Community levels.

At the national level, as set out in the Directive, a member state has to develop an emergency plan and measures.

At the Community level, a community or mutual assistance mechanism is applied. According to the community mechanism, when there is a sudden disruption in gas supply, the European Commission is to set up a group that will assess the situation and assist the affected member state to coordinate its efforts to deal with the crisis at the national level. If the emergency cannot be handled at the national level, the Commission, together with the Gas Coordination Group established under the Directive, provides guidelines to all member states on how to assist the affected member(s). In other words, if any member of the Energy Community faces large-scale gas supply disruptions that cannot be handled at the national level, all member states are expected to use all possible measures, including providing extra gas from their gas storage facilities, to help the affected state.

Implementing Directive 2004/67/EC in Ukraine

The correspondence of Ukrainian legislation with Directive 2004/67/EC and the measures to be implemented in Ukraine to ensure secure gas supply after accession into the Energy Community will be analyzed according to the requirements of the Directive:

- gas storage facilities at the national level;
- availability of minimum targets for a possible contribution of storage to gas supply security;
- monitoring of gas supply security;
- interconnection between Ukraine's gas distribution system and those of other Energy Community members.

In short, there are no essential barriers to the implementation of Directive 2004/67/EC in Ukraine. The priority tasks at the moment are to:

- set minimum targets for contribution of storage to gas supply security;
- develop a single system for monitoring gas supply security and reporting on the established indicators.

Correspondence between Ukraine's legislation and Directive 2004/67/EC and gas supply security measures to be implemented in Ukraine

Criterion	Requirements of Directive 2004/67/EC	Status of Ukraine	Evaluation
Gas storage facilities	Art. 4, Cl. 4 No specific targets for gas storage facilities. The Directive requires having adequate gas storage facilities at the national level.	Regulated by the Law of Ukraine №2665-III "On oil and gas" dated 12 June 2001 There are 13 underground gas storage facilities in Ukraine, with a total working capacity of 34.5 billion cu m. Domestic demand for gas storage is around 27 billion cu m.	Overall, capacity at Ukraine's gas storage facilities is enough both to meet domestic demand and to provide a certain amount of gas to third countries.
Minimum targets for gas storage	Art. 4, Cl. 6 No specific minimum targets.	Minimum targets are not set in Ukrainian legislation.	Appropriate indicative minimum targets should be developed. However, there are no essential barriers to fulfilling this requirement of the Directive.
Gas supply security monitoring	Art. 5 Monitoring must be carried out according to the list of indicators mentioned above (8-10) and be delivered in the form of report.	Stipulated in CMU Resolution №1729 "On the provision of consumers with natural gas" dated 27 December 2001. There is a strong gas metering system in Ukraine. There are 10 gas metering stations (GMS) and 3 Gas Consumption Measurement Points (GCMP). A number of programs are underway to develop and install European state-of-the-art technologies in gas metering.	At the moment, there is no single system in Ukraine for monitoring gas supply security using the indicators provided in the Directive. However, there should be no problem with implementing this requirement of the Directive in Ukraine.
Interconnection of Ukraine's gas distribution system with those of other members of the Energy Community	Art. 4, Cl. 5 The requirement of having an adequate level of interconnection gives the right to use the community or "mutual assistance" mechanism	Regulated by Laws of Ukraine №2665-III "On oil and gas" dated 12 June 2001 and №192/96-VR "On pipeline transport" dated 15 May 1996. Ukraine's gas system is closely interconnected with the systems of Russia, Belarus, Poland, Slovakia, Hungary, Romania, and Moldova and thus is integrated into the European gas network.	The community mechanism gives Ukraine the right to get/give gas from the national gas storage facilities from/to such members of the Energy Community as Poland, Slovakia, Hungary, and Romania.

Sources: Honchar, M. (ed.), *Ukraine's oil and gas sector: Transparency of functions and incomes*,² SYLA, Kyiv, 2008; official website of Naftogaz Ukrainy; assessments: ICPS³

² However, NERC has recently developed proper targets for Ukraine's thermo-electric stations (TESs): there should be a minimum of 140,000 coal storage facilities.

³ For instance, GMS Tekovo, Hrebenyky and Khotiv and the Eastern European Metrology Center in Boyarka under the TACIS INO-GATE Program.

The costs and benefits of gas supply security

The pros and cons of joining the Energy Community for Ukraine's gas supply security are presented in the table below.

Regarding "mutual assistance" and "loss of surplus national gas storage capacities," a number of additional arguments should also be considered:

- For the moment, Ukraine has an adequate level of gas storage facilities, with surpluses of around 5-7 billion cu m.
- Most of gas in the countries with which Ukraine's gas distribution system is interconnected (Poland, Hungary, Romania, Slovakia) is imported

and transits through Ukraine. Thus, in case of disruptions of gas supplies to Ukraine:

- disruptions of gas supplies to those countries are also highly probable;
- both technically and practically, it would be very difficult to diversify the necessary amount of gas to Ukraine, one of the biggest gas consumers in Europe.

This makes it quite improbable that Ukraine will get mutual assistance as it is intended in the EC Directive. Rather the reverse is likely, that is, Ukraine will have to divert an extra 5-7 billion cu m to affected countries.

Breakdown of costs and benefits of EnCT accession

COSTS	BENEFITS
<p>Partial limitations on autonomy</p> <p>With accession, Ukraine must follow up the development of its domestic gas market, the security of its gas distribution system, and external relations with third countries, keeping in mind the appropriateness of measures applied to gas supply security among all members of the Energy Community and not only in Ukraine.</p>	<p>Independent auditing</p> <p>According to Art. 6 of Directive 2004/67/EC, the European Commission does its own monitoring of gas supply security based on reports received from Energy Community members. Thus, Ukraine will get independent, unbiased auditing of a highest quality on its gas supply security.</p>
<p>Loss of surplus national gas storages capacities</p> <p>After accession, if there are sudden disruptions of gas supplies to other members, Ukraine will have to provide all possible assistance to ensure gas supply security in those countries, even if it is not always in its national interests.</p>	<p>Competent consulting</p> <p>Ukraine gains access to competent consultations on gas supply security matters, both inside the country and at the European level. Consultations may be based on the current practice of Energy Community members in developing energy security policies, long-term energy strategies, and so on.</p>
	<p>Mutual assistance</p> <p>In case of a sudden disruption in national gas supplies, Ukraine has a right to apply for assistance from Energy Community members, with whose systems Ukraine's gas distribution system is interconnected (Poland, Hungary, Romania, Slovakia).</p>

Source: Directive 2004/67/EC; assessments: ICPS

How much more secure will Ukraine's gas supplies become?

Ukraine's accession to the Energy Community will not strategically resolve the problem of ensuring secure gas supplies on the country's territory. However, Ukraine's membership in the Energy Community may provide additional arguments in resolving conflicts related to disruptions of gas supply transiting through Ukraine. After joining the Energy Community, Ukraine should implement a more efficient, more transparent system for monitoring gas supply security. This monitoring will, in turn, be endorsed by the European Commission's own monitoring of gas supply security based on reports received from Ukraine. This should make it possible to impartially determine the primary causes of gas supply disruptions and make the situation around them more transparent.

In addition, Ukraine's accession to the Energy Community will encourage sharing experience and implementing best European practice in the country's energy policy, especially that related to gas supply security. Finally, even though the community mechanism will require Ukraine to provide extra gas storage facilities to third countries, for Ukraine this will

be good experience in cooperation at the European community level.

However, lack of political will to reform among Ukrainian politicians still threatens the effective implementation of all the commitments and requirements stipulated in Directive 2004/67/EC and other EU energy *acquis*. If nothing is done over the next two years in this area, it will mean Ukraine did not pass the first test on integration into the EU at the energy sector level.

Yet, the most important point for Ukraine is to join the Energy Community in the understanding that implementing all the *acquis* and additional reforms will benefit Ukraine, first of all, and are in the country's interest, since it would make Ukraine's energy sector more efficient, transparent and secure. There is no more time to postpone reforms. The Energy Community gives Ukraine a chance to use workable, effective EU practice in getting energy sectors to operate efficiently and effectively. Now, it's up to Ukraine to take this chance or to waste it.

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