



Understanding the EU's Association Agreements and Deep and Comprehensive Free Trade Areas with Ukraine, Moldova and Georgia

*Focus Group project evaluating the Association Agreements and DCFTAs
in Georgia, Moldova and Ukraine*

Focus Group No 5: Energy policy

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In March 2019 we began what will be a series of monthly focus group meetings on key aspects of the Association Agreements and DCFTAs between the EU and Georgia, Moldova and Ukraine. Focus group sessions will be held in each of the three capitals with a range of stakeholders (government, business, civil society, etc.) using a standardized questionnaire. The focus groups are organised and moderated by our partners in the three capitals: IER in Kyiv, Expert-Grup in Chisinau and Reformatics in Tbilisi.

The objective is to get fresh views on how the Association Agreements and DCFTAs are progressing in practice. This may lead to recommendations to policymakers in the three capitals and the EU institutions.

While the views of individual participants are treated as confidential, reports are published drawing together a synthesis of the findings.

Focus Group No 5 concerned energy policy, took place in October 2019, and was organised around six questions submitted to participants in advance. Written and oral replies to the questions were collected, and are reported on below.

¹ Of respectively CEPS, Brussels; Reformatics, Tbilisi; Expert-Grup, Chisinau; IER, Kyiv.



There were between 10 and 18 participants in the three country sessions, consisting of representatives of the government departments and regulatory authorities, business interests in the production and distribution of energy and think tanks/NGOs².

Question no 1: Electricity. *How do you assess progress in the electricity sector in legislation in approximating EU law, and in implementation?*

In **Ukraine** there has been substantial progress in legal approximation for 'unbundling' of electricity producers and distributors since a key law was adopted in 2017, with many subsequent legal acts. Many electricity companies have already been unbundled. A new electricity market was introduced successfully in July 2019. A sensitive issue politically is Ukraine's electricity network connectors with neighbouring countries. Ukraine is proceeding with the technical requirements for synchronous integration with the European ENTSOE-E system, alongside Moldova. However this cannot be completed without isolation from the Russian electricity system. However the Rada has amended legislation to authorize electricity imports from Russia and Belarus, raising questions about the political and technical coherence of current developments.

In **Moldova** the unbundling of electricity suppliers and distributors is nearly complete. More critical views are expressed regarding the regulatory agency ANRE, whose independence from political influence is not assured.

In **Georgia** there have been important developments since accession in 2017 to the Energy Community Treaty, albeit with exemptions for Georgia because of its lack of land connections with the EU. In 2018 Georgia adopted Concept Design for organizing the electricity market and adoption of key legislation is expected by the end of 2019, however, electricity generation and distribution companies have begun unbundling.

Question no 2: Gas. *How do you assess progress in the gas sector in legislation in approximating EU law, and in implementation?*

Legislative approximation advances in all three countries.

For **Ukraine** it is considered that unbundling legislation for the gas market is of exceptional importance. The political decision to unbundle Naftogaz was taken initially in May 2019, despite resistance by the company itself, before formation of the new government after the Rada elections in July. However the process was accelerated under the new government with decisions on the unbundling model in September, with

² For Ukraine there is a new and very detailed report by NGOs on the same themes as this Focus Group: "Energy Reforms - Annual Monitoring Report on Ukraine's Progress on the Implementation of the EU-Ukraine Association Agreement in the Fields of Energy and Environment in 9 months of 2019", http://dixigroup.org/storage/files/2019-12-08/dixi_association_2020_eng_web.pdf.

implementation due by 1 January 2020. These measures are considered crucial to conclusion of a new gas supply and transit agreement with Gazprom, currently being negotiated in the trilateral EU-Ukraine-Russia format. (These negotiations have subsequently been successfully concluded).

In **Moldova** the unbundling process for the gas sector is underway, but not yet completed. The national gas operator, MoldovaGaz, is looking for a solution with the regulatory agency ANRE. However the issue is complicated by Gazprom's controlling stake in MoldovaGaz and the huge unpaid debts for gas supplies to Transdnistria.

Georgia has important exemptions for gas from the full requirements of the Energy Community Treaty, because of its isolation from the EU market. However compliance with the 3rd Energy Package requires unbundling of distribution and supply, and Georgia has time for this by the end of 2020. Energy security will be enhanced by the current construction of gas storage facilities, and completion of the South-Caucasus gas pipeline from Azerbaijan to Turkey through Georgia and on to Europe.

Question no 3: Oil. *How do you assess progress in establishing the system for emergencies and minimum stocks?*

The key Directive (2009/119/EC) for minimum stocks is not yet reflected in legislation in any of the three countries, and implementation is accordingly unsatisfactory.

In **Ukraine** the situation with regard to establishing minimum oil stocks was described as "terrible", with conflicts between the Ministry of Economy and the State Reserve during the previous administration. A draft law was prepared but not yet adopted by the government. New people are now in charge, but the situation remains stalled. Apart from the basic minimum aggregate stock requirement, there are also serious logistic problems in ensuring adequate distribution channels (defective railway system with insufficient locomotives, etc.), alongside serious black market practices, partly linked to the war in eastern Donbas.

Moldova currently has oil stocks for only 15 to 30 days of supplies, compared to the 2 months required. A draft law for conformity with the EU Directive (2009/119/EC) was drawn up in 2017 but has not passed the parliament, partly for financial reasons. However Moldova has until 2022 to achieve the minimum stock levels.

For **Georgia** the terms of accession to the Energy Community Treaty only require conformity with the EU's minimum stock requirements by the end of 2023, and so matters are still at a preliminary stage.

Question no 4: Renewables.

Legislation approximating Directive 2009/28/EC for renewables is at different stages of elaboration in all three countries. However **Ukraine** is much more advanced than the other two, notably in actual investments in renewables.

Ukraine has progressed with legal approximation regarding solar and wind power, and this sector has been growing rapidly, with a doubling of installed capacity in 2019. This actually leads to a new problem of insufficient accumulator storage capacity to balance supply and demand and underdeveloped auxiliary services. New capacity should best be located in regions with electricity deficits.

In **Moldova** legislation is promoting production from renewable sources, but cumbersome regulations for authorization are deterring investors.

In **Georgia** legislation in conformity with Directive 2009/28/EC is before the parliament. After the law is passed the government is expected to produce an action plan for renewables.

Question no 5: Energy efficiency. *How do you assess progress in implementing energy efficiency measures, especially in the household sector?*

Progress is registered in **Ukraine**, but much less so in **Moldova** and **Georgia**.

In **Ukraine** valuable progress is being made in both legislation and implementation, even if the size of the outstanding challenges is huge. While the legislative basis for energy efficiency needs improvement, there have been two important initiatives at the level of concrete action. The first is the State Agency for Energy Efficiency and Energy saving, which since 2014 has operated its "Warm Loans" scheme, providing credit to multi-apartment building owners for energy saving investments, reaching 650,000 households. The second is a newly established Energy Efficiency Fund, which will become operational in 2020 and supply also grant funding for energy efficiency investments. Financial assistance is being obtained from the EU, EBRD and other donors, but in relation to the overall objectives these initiatives remain chronically underfunded.

In **Moldova** there is less progress, with no common platform of mechanisms whereby the government and apartment owners can work together to increase energy efficiency.

In **Georgia** the situation is also most challenging. There has been some progress at the legislative level, with a law approximation Directive 2010/31/EU on the energy efficiency of buildings submitted but not yet adopted by the parliament. However the low level of incomes in most apartment buildings makes implementation extremely difficult, and the new standards will increase the price of new buildings. As in Moldova, and unlike Ukraine, there is no financial mechanism to aid energy saving investments in multi-apartment buildings.

Question no 6: Energy security. *How do you assess progress in achieving adequate security of energy supply?*

In the focus group in **Ukraine** the large majority of participants from Ukraine consider the energy security situation still to be inadequate, with specific concern over the

implications of the North Stream II pipeline. This is notwithstanding that Ukraine has in recent years achieved a high degree of independence from supplies of gas from Russia, partly enabled by reverse flow facilities at the borders with neighbouring EU countries. However there are concerns about renewal of imports of electricity from Russia.

In **Moldova** also the high dependence on Russian sources of gas and gas-based electricity supplies from Transdnistria electricity amounts to a condition of strategic vulnerability of energy supplies. Power linkages with Romania are being built, but this is not yet a reliable source.

Georgia on the other hand is much better placed in terms of energy security, with gas supplies from Azerbaijan and abundant domestic hydro power.

Concluding remarks.

The energy sector is an exceptionally important part of the Association Agreements, by virtue of the complex, substantive, legal and economic policy content, and also its geo-political and security ramifications.

The EU's 3rd energy package, and its unbundling provisions in particular, is the core feature of the legal approximation provisions. The process of legislation is well underway in all three countries.

The issue of further integration with the EU energy market, and limitation of dependence on Russian supplies for both gas and electricity, remains an ongoing challenge for both Ukraine and Moldova.

All three countries are behind schedule in terms of satisfying minimum oil reserve requirements, but this seem not to be a matter of huge concern, given the open and competitive nature of the global oil market.

Ukraine makes notable progress in building up solar and wind power capacity, whereas **Moldova** and **Georgia** lag behind. Similarly for energy efficiency, **Ukraine** makes most progress in engaging with the huge challenges of energy waste in the household residential sector.

Georgia now enjoys a much higher degree of energy security than either **Ukraine** or **Moldova**, and aspires to a regional energy hub role.