

<p>EU-UKRAINE CIVIL SOCIETY PLATFORM</p>		<p>ПЛАТФОРМА ГРОМАДЯНСЬКОГО СУСПІЛЬСТВА УКРАЇНА-ЄС</p>
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## **The European Union and Ukraine: Cooperation for the Strengthening of Energy Security**

*Drafted by: Alfredas Jonuška, member of the EESC  
Experts: Simonas Klimanskis, Linas Kojala, Mindaugas Liutvinskis*

### **Introduction**

Energy policy appeared on the European agenda for the first time after the countries of Central-Eastern Europe joined the European Union (EU) in 2004. When compared to the old ones, the new Member States were significantly more vulnerable and isolated from the rest of the EU in the energy domain. The importance of energy security<sup>1</sup> and, in particular, supply diversification was clearly demonstrated by the 2006 and 2009 gas crises when transit through the territory of Ukraine was suddenly halted, leaving large parts of Central-Eastern Europe without adequate resource supply in winter, causing humanitarian and economic damage.

This experience, together with the current troubled geopolitical situation in the region, allows claiming that energy resources may be employed as geopolitical tools, aiming to reach strategic and political ends. Understanding the risks involved, it is crucial for Europe to find a way to mitigate the current situation of vulnerability, primarily by diversifying supply routes, enhancing domestic generation capacity, optimizing energy consumption patterns, while at the same time ensuring competitive price levels. Without doubt, all these factors have a substantial impact on the European economy as a whole and the ability of the EU to act as an independent political actor in the global arena.

This report assesses the current energy situation in the EU, with particular attention to Central-Eastern Europe. It also looks at the major recent developments with regard to the EU common energy policy, highlights the interconnection between European and Ukrainian energy security under the Energy Community framework and offers several relevant recommendations both Ukraine and the EU.

### **1. Status quo of the EU energy situation**

The main EU energy policy objectives are *security of supply*, *competitiveness* and *sustainability*. Security of supply is defined as a reliable supply of energy resources, competitiveness is understood as the availability of these resources at a competitive price, while sustainability is seen as the energy sector (both production and consumption) being as environmentally-friendly as possible. Achieving the right balance between these three objectives is crucial for economic competitiveness of the EU, its political autonomy and efforts in fighting climate change.

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<sup>1</sup> Energy security is understood as reliable supply of energy resources at competitive price.

Today EU is largely dependent on imports, importing 53 percent of the energy it consumes. EU imports almost 90 percent of its crude oil, 66 percent of its natural gas, 42 percent of its coal and other solid fuels and 40 percent of its uranium and other nuclear fuels.<sup>2</sup> The highest dependency on imports is witnessed in two strategically important sectors – oil and gas. While the levels of oil imports are projected to remain at roughly the same levels in the upcoming years, gas import volumes are expected to increase even further.

The Russian Federation remains the main supplier of crude oil and natural gas to the European markets, with around 35 percent of the EU imports of oil coming from Russia.<sup>3</sup> Of course, oil is a rather easily transportable energy resource, meaning that it is tradable on international markets. This renders the risk for EU energy security relatively low in terms of oil, especially when bearing in mind the current over-supply of the global oil markets. Russia provides more than 39 percent of European natural gas imports<sup>4</sup>, followed by Norway and Algeria, respectively 29.5 and 12.8 percent.<sup>5</sup> Nearly half of the EU Member States are importing over 50 percent of natural gas from Russia, with some still being fully dependent on Russian gas.<sup>6</sup> Without doubt, such overly dependence on a single supplier makes Europe as a whole vulnerable to external shocks in supply. The possibility for politically motivated shocks to occur has increased dramatically since the beginning of the Ukrainian crisis, threatening renewed gas shortages in Central-Eastern Europe – approximately 15 percent of EU gas imports<sup>7</sup> and about half of total Russian gas supplies still reach EU markets via Ukraine<sup>8</sup>.

With regard to competitiveness, high dependency on a single supplier has a negative impact on the economy of the EU, making its industry and other related business sectors less competitive globally. This is especially clear when compared to countries such as the US that enjoys low prices for both natural gas and oil due to the ongoing shale boom domestically. For example, in 2013 EU gas import prices were USD 360-400 per 1000 m<sup>3</sup>,<sup>9</sup> compared to only USD 160 per 1000 m<sup>3</sup> in the United States. To add to this, despite overall decrease in EU wholesale electricity prices since 2008 (35–45 percent), electricity prices for industry remain around 40 percent above the average levels in the US. These differences in price levels are likely to persist, despite the recent convergence of international gas prices, with the EU spot gas prices falling to a seasonal record low of USD 280 per 1000 m<sup>3</sup> due to radical decrease of the oil price globally<sup>10</sup>. Being forced to pay a higher price than its competitors for both natural gas and electricity restricts the growth potential of the EU economy, which is still rather energy-intensive.

Understanding these dynamics, the EU as a whole and particular Member States have taken the necessary steps to reduce energy dependency. Almost all the Member States have already implemented the EU Third Energy Package, which aims to separate production and supply activities in gas and electricity sectors, creating possibilities to integrate these energy networks into the common internal market. Also, some of the previously missing cross-border infrastructure links have been built or are currently under construction. Certain countries, including Ukraine, already benefit from new gas transmission infrastructure and reverse flows, higher liquefied natural gas (LNG) import capabilities and gas storage capacities. In the electricity

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<sup>2</sup> Communication From the Commission to the European Parliament and the Council “European Energy Security Strategy” (COM(2014) 0330), Brussels 28.5.2014, p. 2.

<sup>3</sup> Eurostat, Main origin of primary energy imports, EU-28, 2003–13 (% of extra EU-28 imports), <[http://ec.europa.eu/eurostat/statistics-explained/index.php/File:Main\\_origin\\_of\\_primary\\_energy\\_imports\\_EU-28\\_2003%E2%80%9313\\_\(%25\\_of\\_extra\\_EU-28\\_imports\)\\_YB15.png](http://ec.europa.eu/eurostat/statistics-explained/index.php/File:Main_origin_of_primary_energy_imports_EU-28_2003%E2%80%9313_(%25_of_extra_EU-28_imports)_YB15.png)>.

<sup>4</sup> Gas in Focus, “Ukrainian crisis: can Europe do without Russian gas?”, <[http://www.gasinfocus.com/en/focus/can-europe-do-without-russian-gas/#\\_ftn1](http://www.gasinfocus.com/en/focus/can-europe-do-without-russian-gas/#_ftn1)>.

<sup>5</sup> Eurostat.

<sup>6</sup> Commission Staff Working Document “In-depth study of European Energy Security”, Brussels, 2.7.2014.

<sup>7</sup> International Energy Agency, *Executive Summary*, “Energy Policies of IEA Countries: European Union”, 2014 Review, p. 7.

<sup>8</sup> Gas in Focus.

<sup>9</sup> 1000 m<sup>3</sup> of natural gas is equivalent to 40 MMBtu.

<sup>10</sup> International Energy Agency, p. 6.

sector, an integrated day-ahead market has been set up across the EU through price coupling regions: the Nordic and Baltic markets, Central Europe, North Western and South Western Europe.<sup>11</sup> However, a further increase in cross-border interconnections and more diversification of energy supply by routes and by sources is still necessary.

Another crucial aspect of the question at hand is the fragmented external dimension of EU energy policy. There is a necessity to strengthen it while introducing more solidarity in coordinating positions and ensuring a more coherent speaking with major external energy partners – introducing regional or EU-level gas purchasing groups. This would restrict the ability of monopoly companies from third countries to dictate politically motivated resource prices for particular states. Efforts to improve the external dimension of EU energy policy should also include a coordinated initiative to develop a gas pipeline with South Eastern neighbors to bring gas from Caspian Sea region to Europe, allowing for further diversification in supply routes.

Faced with the problem of climate change, the EU has committed itself to reducing greenhouse gas emissions by 20 percent by 2020 (compared to 1990 levels), while also increasing the share of renewables in the primary energy consumption.<sup>12</sup> In 2014, the EU produced 15.3 percent of its energy from renewables.<sup>13</sup> Looking to the future, more ambitious goals are raised, with plans to cut greenhouse gas emissions by 40 percent, produce 27 percent of energy from renewables and enhance energy efficiency by 30 percent by 2030.<sup>14</sup> The recent Paris climate deal (December, 2015), creating binding commitments to limit global warming well below 2 degrees C and establishing mechanisms for a review of targets every 5 years, will undoubtedly provide an additional impetus for reaching these goals. It is important that the EU and its particular Member States stand out as the major providers of financing for developing countries to facilitate their efforts in reducing CO<sub>2</sub> emissions<sup>15</sup>.

Substantial progress has already been made towards reducing atmospheric pollution, and the majority of Member States have advanced in this regard. However, in order to achieve the targets outlined, more coordination and uniform efforts will be needed. While reaching the goals set, the EU must also fully take into account resource price competitiveness considerations and the possible negative impact that the increase in the share of renewables in energy production might have on the domestic industries.

## ***2. Upcoming plans of the European energy policy***

The initial phase of European integration in 1950s was based on energy – the formation of the European Coal and Steel Community. Nevertheless, up to this day, in the words of Jerzy Buzek, “Energy is the missing piece not only of the EU’s internal market but also of the whole European integration”<sup>16</sup>.

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<sup>11</sup> Ibid, p. 4.

<sup>12</sup> Communication From the Commission to the European Parliament and the Council, the European Economic and Social Committee and the Committee of the Regions „20-20 by 2020: Europe's climate change opportunity“ (COM(2008) 30, Brussels 23.7.2014.

<sup>13</sup> Communication From the Commission to the European Parliament and the Council, the European Economic and Social Committee and the Committee of the Regions “Renewable energy progress report” (COM(2015) 293), Brussels, 15.6.2015, p. 3.

<sup>14</sup> Communication From the Commission to the European Parliament and the Council „Energy Efficiency and its contribution to energy security and the 2030 Framework for climate and energy policy “ (COM(2014) 520), Brussels 23.7.2014.

<sup>15</sup> European Commission, Paris Agreement,

<[http://ec.europa.eu/clima/policies/international/negotiations/future/index\\_en.htm](http://ec.europa.eu/clima/policies/international/negotiations/future/index_en.htm)>.

<sup>16</sup> Anca Gurzu, Europe’s energy (dis)union. Politico <<http://www.politico.eu/article/europe-energy-union-community-infrastructure-pipelines-interconnectors-plan-juncker>>.

Up until very recently EU has lacked a “joined-up approach”: various policy elements reflected different objectives, stemmed from different powers and were developed more or less in isolation from each other. For example, the single market proposals were not integrated into another significant goal of transition to a low carbon energy system, which is an example of so called European Commission’s “silo” mentality, where each directorate pursues its own agenda, rather than focusing on integrity.<sup>17</sup> In order to tackle this problem, the Commission presented A Framework Strategy for a Resilient Energy Union with a Forward-Looking Climate Change Policy (February, 2015), as well as additional State of the Energy Union (November, 2015), which followed the Energy Security Strategy (May 2014). While these documents were not entirely new, as they used many proposals from previous communications, they were aimed to build a more coherent and unified strategy towards energy integration at EU level.<sup>18</sup>

The Energy Union is based on five mutually reinforcing and closely interrelated dimensions designed to strengthen energy security, sustainability and competitiveness<sup>19</sup>:

- **Energy security, solidarity and trust.** Diversification of supply is seen as a key, as a variety of energy sources ensures security and resilience. In order to implement this goal, the Commission focuses on development of physical infrastructure. For instance, the Southern Gas Corridor is envisaged as a way to improve Europe's connectivity to the resources of Central Asian Countries, while Northern Europe is seen as a region where liquid gas hubs should be established. Furthermore, LNG trade is seen as a way to bring global natural gas prices closer together. Moreover, Commission puts emphasis on cooperation of neighbouring countries and adds that it will “assess options for voluntary demand aggregation mechanisms for collective purchasing of gas during a crisis”. Lastly, EU seeks to ensure full compliance of agreements related to the buying energy resources from third countries with EU law.
- **A fully integrated European energy market.** Infrastructure is again the main component, as the European electricity and gas transmission systems, notably cross-border interconnections, are still not sufficient to make the internal energy market work properly. “A specific minimum interconnection target has been set for electricity at 10 percent of installed electricity production capacity of the Member States, which should be achieved by 2020”. At the same time, full implementation of 3rd Energy Package remains the central goal.
- **Energy efficiency contributing to moderation of demand.** Commission notes that huge efficiency gains are possible in the buildings sector; it aims to simplify access to existing financing and offers various templates to improve the situation. It also notes the need to tighten CO<sub>2</sub> emission standards for passenger cars and vans post-2020, with the aim to promote the use of “road charging schemes based on the polluter-pays and user-pays principles and increase efforts to create a single European transport area”.
- **Decarbonising the economy.** As already mentioned, the EU has committed itself to at least 40 percent domestic reduction in greenhouse gas emissions compared to 1990 levels, as well as of at least 27 percent for the share of renewable energy consumed in the EU in 2030.

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<sup>17</sup> David Buchan, Malcolm Keay, Europe’s ‘Energy Union’ plan: a reasonable start to a long journey. *Oxford Energy Comment*, March 2015, p. 2 <<http://www.oxfordenergy.org/wpcms/wp-content/uploads/2015/03/Europes-Energy-Union-plan-a-reasonable-start-to-a-long-journey.pdf>>.

<sup>18</sup> Francesca Batzella, EU Energy Union: Is There Anything New Under the Sun? *European Futures*, University of Edinburgh <<http://www.europeanfutures.ed.ac.uk/article-2471>>.

<sup>19</sup> European Commission, A Framework Strategy for a Resilient Energy Union with a Forward-Looking Climate Change Policy <[http://ec.europa.eu/priorities/energy-union/docs/energyunion\\_en.pdf](http://ec.europa.eu/priorities/energy-union/docs/energyunion_en.pdf)>.

- **Research, Innovation and Competitiveness.** The new European energy Research and Innovation approach is seen as a way to ensure development of renewable energy technologies, facilitation of the participation of consumers through smart grids, smart home appliances, etc.

The State of the Energy Union evaluated achievements of the first nine months. Progress has been noted in all five dimensions, with substantial developments in the Baltic States that were finally integrated into the Nordic electricity market through the completion of interconnections to Sweden and Poland in December 2015. However, it was also clearly stated that “more interconnections are still needed in specific regions”<sup>20</sup>, as the creation of the Energy Union is a relatively long and complex process.

### 3. *Central-Eastern Europe in Focus*

Central-Eastern Europe stands out as a region of high complexity – it is characterized by a lack of sufficient infrastructure interconnections across national borders, especially in the natural gas sector, and to a lesser extent with regard to the electricity sector. This is especially evident when looking at the three Baltic countries. Despite recent improvements into physical interconnections, Estonia, Latvia and Lithuania remain integrated in the old Soviet-era BRELL energy ring, meaning that in the electricity sector they are still more closely connected to third countries than other EU Member States. Overly dependence on Russian electricity imports is what makes the Baltic three stand out from other Central-Eastern European states, with other countries in the region enjoying much lower levels of electricity imports and having better cross-border interconnections.

Until recently, most of the countries in the region have been extensively dependent on Russian gas imports, providing it with the upper-hand in price negotiations and creating incentives to utilize this asymmetrical relationship while pursuing foreign policy goals. Certain recent developments in physical infrastructure have mitigated this situation, albeit only to a certain and still largely insufficient extent.

#### 3.1. *Recent and planned developments in the region – the “hardware” part*

In order to eliminate the “energy island” constituted by the Baltic countries, the Baltic Energy Market interconnection Plan (BEMIP) was developed, with the goal of full integration of the Baltic republics into the European energy market.<sup>21</sup> Some of the crucial missing parts of the physical infrastructure for this purpose have already been completed. The “EstLink 2”, enhancing the interconnection between Estonia and Finland and the interconnections linking Lithuania to Sweden and to Poland are primary examples of this. In terms of gas, the recently launched Lithuanian and Polish LNG terminals and the improved Poland-Germany interconnection at Mallnow (ensuring the possibility of reverse gas flows) should be noted as some of the most essential advances, increasing the diversification of supply routes and the overall energy security of the region.

The establishment of the PCI at the EU level has without doubt provided an impetus for more rapid development of the necessary infrastructure. With 248 projects on the list (3/4 of which should be finished by 2020) and 5.35 billion euros dedicated to the cause via the Connecting Europe Facility, the creation of

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<sup>20</sup> European Commission, State of the Energy Union 2015 <[http://ec.europa.eu/priorities/energy-union-and-climate/state-energy-union\\_en](http://ec.europa.eu/priorities/energy-union-and-climate/state-energy-union_en)>.

<sup>21</sup> European Commission, Baltic Energy Market Interconnection Plan, <<http://ec.europa.eu/energy/en/topics/infrastructure/baltic-energy-market-interconnection-plan>>.

PCI has been an important step boosting energy interconnections in Central-Eastern Europe.<sup>22</sup> If the ongoing and planned infrastructure development projects were successfully implemented, this would alter the situation in the region radically with regards to both electricity and gas sectors.

When looking at particular planned or undergoing projects in the electricity sector, the third interconnector between Latvia and Estonia should increase the transmission capacities to levels necessary for a sufficiently functioning electricity market in the Nordic-Baltic region, without congestions that have so far undermined its operation. Also, despite the freshly built interconnections linking the Baltic countries to other European states, de-synchronization from the BRELL system, followed by a synchronization with the continental European system will be required in order to ensure a full-fledged Baltic integration into the common EU electricity market<sup>23</sup>.

Hungary, being a crucial regional player in electricity transit, should be able to use the PCI framework to further boost its interconnections with the neighboring Slovakia (two projects foreseen, starting operation in 2018 and 2021 respectively) and Slovenia (to be finished in 2016). This would constitute a positive step towards closer integration in the electricity sector in the region, allowing for a more efficient functioning of the already coupled Hungarian-Czech-Slovak electricity markets<sup>24</sup>. Adding the planned Slovak-Polish interconnection to this would further expand the regional electricity market that would in turn constitute an important building block in the EU internal energy market.

Ongoing and planned developments in the gas sector also look promising, while the implemented projects have already altered sectoral dynamics substantially. The LNG terminal that started operating in Lithuania in late 2014 has turned the country from 100 percent dependent on Russian imports to practically independent from gas provided by “Gazprom”, with further possibilities to exploit the Lithuanian terminal as a regional one, supplying gas to the two other Baltic republics or even the broader region.

While Estonia has already started diversifying its gas imports by purchasing gas from the Lithuanian LNG, insufficient gas transmission grids between Latvia and Lithuania have reduced the capacities to take full advantage of the opportunities created by the terminal. Latvia has been reluctant to cooperate primarily because of the fact that “Gazprom” still maintains the monopoly in the national gas sector, controlling gas transmission networks inside the country and making Latvia unable to diversify away from Russian gas imports<sup>25</sup>. Poland has also just recently started the operation of its LNG terminal in Swinoujscie, pledging to radically reduce the importance of Russian gas imports, with plans to expand the pipeline grid in order to transport gas from the terminal to neighboring countries, such as the Czech Republic, Slovakia, Ukraine and Lithuania. This would further increase the diversification of gas supply in Central-Eastern Europe and reduce the region’s reliance on Russia.

The successful experience of Lithuania and Poland with regard to the construction of LNG terminals and increased geopolitical tensions in the region have also pushed Estonia forward with its plans to construct the “Baltic LNG” terminal (works should begin in 2016, with anticipated start of operation in 2019). Plans to build a gas interconnection between Estonia and Finland – the “Baltic Connector” – would also help to

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<sup>22</sup> European Commission, Projects of common interest, <<https://ec.europa.eu/energy/en/topics/infrastructure/projects-common-interest>>.

<sup>23</sup> Communication from the Commission to the European Parliament and the Council “European Energy Security Strategy” (COM(2014) 0330), Brussels 28.5.2014, p. 24.

<sup>24</sup> Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of Regions “Progress Towards Completing the Internal Energy Market”. Accompanying document – Country Reports. SWD (2014) 311 final, Brussels 13.10.2014, p. 112-113.

<sup>25</sup> Ibid, p. 134-135.

further boost the energy security parameters of the region. What is more, using the PCI framework in an efficient manner, Hungary should be able to reduce its reliance on Russian gas imports via Ukraine: plans and projects under construction include reverse flows from Romania, additional gas pipelines to the Austrian gas hub and the Slovak-Hungarian gas interconnection<sup>26</sup>.

Looking at Poland, the abovementioned LNG terminal and the enhanced gas interconnection with Germany have both significantly reduced the country's dependency on Russian gas. However, in order to reach more comfortable energy security levels, Poland should continue developing gas interconnections with its neighboring states, particularly with Lithuania (GILP, expected to link the Baltic states' gas markets to the broader Central-Eastern region from 2019), also with Slovakia and the Czech Republic.

Increased links with the former two countries would not only improve Poland's interconnectedness, but also serve as a means to reduce the nearly total dependency on Russian gas for both the Czech Republic and Slovakia (reverse gas flow possibility). The Romanian-Bulgarian gas interconnection is also of particular regional importance – it is supposed to ensure minimum gas flows in case of an emergency shortage of supply (expected to start operation in 2016), substantially increasing the energy security of both countries involved<sup>27</sup>.

### *3.2. Supplementing physical infrastructure – the “software” side*

Alongside the construction of the missing infrastructure and the expansion of the existing capabilities, a harmonized application of common legislation, particularly the 3<sup>rd</sup> Energy Package in electricity and gas sectors, is essential for an efficiently functioning internal energy market and the creation of the Energy Union. In other words, there is a need for a stable, transparent and equal legal framework across the EU to empower the “hardware” for efficient functioning.

The European Commission has recently called for a rigorous application of the 3<sup>rd</sup> Energy Package by all EU Member States,<sup>28</sup> with particular emphasis on the unbundling (functional and ownership) and third party access clauses. Even though significant progress has been made in this direction, with the vast majority of system operators certified as compliant with one of the 3<sup>rd</sup> Energy Package's unbundling models, differences in progress of implementation of regulations remain. In the region analyzed, Lithuania, Estonia, Hungary, the Czech Republic and Slovakia can be said to have already successfully transported the necessary legal provisions into national legislation. The situation in Poland is still being reviewed in order to determine its current level of compliance, while in both in Romania and Bulgaria the process is still lagging behind, undermining EU-level efforts.

A case that deserves special attention is Latvia. The Baltic country has only implemented EU legislation in the national electricity sector. Even so, it still lacks adequate participation in the regional Nord Pool Spot electricity market. With regard to the gas sector, Latvian authorities have postponed the enforcement of the provisions of the 3<sup>rd</sup> Energy Package until 2017. This has helped to maintain the monopoly of “Gazprom” in the gas market, particularly the transmission and distribution systems, and has severely limited third party access (especially to the strategically important Inčukalns underground gas storage facility)<sup>29</sup>.

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<sup>26</sup> Ibid, p. 112-113.

<sup>27</sup> Ibid, p. 27.

<sup>28</sup> Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of Regions “Progress towards completing the Internal Energy Market” COM (2014) 634, Brussels, 2014.10.13.

<sup>29</sup> Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of Regions “Progress Towards Completing the Internal Energy Market”. Accompanying document – Country Reports. SWD (2014) 311 final, Brussels 13.10.2014, p. 134-135.

#### 4. The interconnection between the energy security of the EU and Ukraine

As mentioned before, Ukraine still constitutes the principal route for Russian gas transit into European markets. Despite ongoing talks about the diminishing importance of Ukraine in the European energy map and Russian efforts to develop supply routes by-passing the state, it retains the position of a major transit partner, especially with regard to Central-Eastern European countries, such as the Czech Republic, Slovakia and Hungary. This means that the immediate interest of the EU is to render transit via the territory of the country as reliable as possible.

The primary way to ensure this is using the framework of the Energy Community, of which Ukraine is a member since 2010. This framework should be regarded as key for pushing reforms in the country's national energy sector and as a central part of energy security of the Central-Eastern Europe and the EU as a whole. Energy Community creates formal obligations for Ukraine to implement EU *acquis* in the energy sector into national law. Since the change of government (post-Maidan events) substantial progress has been made in this direction (with the previous government having been reluctant to fulfill their obligations), signaling Ukraine's renewed commitment to become a fully-fledged part of the Energy Union.

With the adoption of the new Gas Market Law and Laws on Electricity and Regulatory Authority under development, Ukraine has moved closer to compliance with the EU requirements, particularly the 3<sup>rd</sup> package Directive 2009/72/EC and Regulation (EC) 714/2009 in the electricity sector and Directive 2009/73/EC and Regulation (EC) 715/2009 in the gas sector. The new Gas Law was adopted by the national Parliament and signed by the President in April 2015, providing a legal basis for unbundling of system operators, deregulation of prices, third party access and other requirements in line with EU regulations.<sup>30</sup> Even though secondary acts and by-laws are still required to ensure full enforcement of this new law, it has laid ground for future reform Ukraine's gas sector, which has already manifested itself in the abolition of highly expensive gas subsidies and official plans to carry out an LNG terminal project in Odesa in order to increase the level of gas import diversification, as well as plans to construct an additional gas pipeline to Poland that would better link the country to European markets.

These recent developments should be regarded as a substantial step in enhancing European energy security by increasing the transparency and predictability of gas transit through the country. At the same time, adopting EU rules allows the country to reduce Russian leverage and its ability to use energy resources as a foreign policy tool. Russian influence has also recently been downgraded by cutting the overall amount of Ukrainian gas imports using reverse gas flows from EU Member States as Slovakia and Hungary, with a possibility to further increase the amount of gas imports by advancing additional reverse flows from Romania and increasing the existing capacities from Poland<sup>31</sup>. The experience of the winter of 2014 indicates that increased reliance on reverse flows, combined with a more efficient usage of the existing gas storage capacities and sustained levels of national gas production may reduce the need for Russian imports to a minimum (only around 6.2 bcm was imported from Russia last year, compared to 44.8 bcm back in 2011<sup>32</sup>).

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<sup>30</sup> Energy Community Secretariat, *Annual Implementation Report*, 2015, p. 210–212.

<sup>31</sup> *Ibid*, p. 209.

<sup>32</sup> Financial Times, "Gazprom Lost Friends and Ceded Influence Over European Gas", <http://www.ft.com/cms/s/0/ed84bbda-bf82-11e5-846f-79b0e3d20eaf.html#axzz3xoa3rCuT>.

Despite many problems that still plague the Ukrainian energy sector – lack of accountability, corruption, insufficient levels of transparency – to name a few, Ukraine is on the track of EU style reforms. With the rationale behind Nord Stream II being questioned and the South Stream project paused indefinitely, Ukraine is bound to remain the main transit route for Russian gas to reach European markets for the foreseeable future. This means that the EU must be even more pro-active in pushing through further reforms in the country by employing the “carrots and sticks” method, with the primary aim of enhancing its own energy security.

## **Conclusions and recommendations**

To sum up, the EU faces a significant dependency on a single external supplier, which is particularly evident in the gas sector. This issue is especially relevant for the Central-Eastern Member States that, despite recent developments, retain high levels of vulnerability. Dependency on one dominant source of supply leads to Europe as a whole paying globally uncompetitive prices for its energy resources, which in turn puts limits on its economic performance, while at the same time increasing the risks of harmful politically motivated supply disruptions.

Recent infrastructure developments are examples of positive steps towards the creation of a fully-functioning EU internal energy market, while projects currently under implementation or in the planning phase are likely to significantly add to this trend, if implemented successfully. However, developments of physical infrastructure do not automatically lead to enhanced energy security and a well-functioning internal energy market – ensuring adequate compliance with common EU level legislation in both gas and electricity sectors is thus crucial.

As a major transit route, Ukraine is bound to remain an important partner for European energy security. Therefore, the EU has a clear interest in the country being able to guarantee secure and stable gas transit through its territory. Despite numerous remaining problems in the national energy sector, current Ukrainian authorities have demonstrated the willingness to fulfil their obligations under the Energy Community to fully transport EU *acquis* into national law. Successful cooperation with Ukraine would not only boost EU energy security levels by increasing the predictability and transparency of gas transit, but also serve to further reduce the Russian leverage over Central-Eastern Europe, including Ukraine.

### *Recommendations for the EU:*

- To ensure sufficient funding and timely implementation of the PCIs in order to further improve cross-border interconnections and enhance their capacities to levels adequate for a fully functioning internal energy market;
- To effectively utilize the frameworks of Projects of Energy Community Interest and the support available for energy infrastructure projects under the European Neighbourhood Policy as a supplement to infrastructure developments under PCI;
- To enforce full compliance with EU-level legislation, particularly provisions of the Third Energy Package, while eliminating any remaining national non-compliance;
- To form gas purchasing groups at regional or EU level in order to increase the bargaining power of buyers and augment the level of transparency in gas trade, while at the same time ensuring greater European solidarity with regard to third parties;

- To critically assess the compliance of the Nord Stream II project with EU law and not to support the project due to it being contrary to the objectives of the Energy Union, and instead prioritize cooperation with Ukraine and on the implementation of Southern Gas Corridor project;
- To continue active engagement with Ukraine in the Energy Community framework by employing financial incentives – used primarily for the modernization of the national energy sector, with the specific focus on security of supply and emergency situation management at a regional level;
- To enhance the existing capacity of the Energy Community secretariat to provide Ukrainian authorities with the necessary technical, legal and other related expertise while ensuring full implementation of EU regulations;
- To further enhance the capacity of reverse gas flows to Ukraine by launching additional flows from Romania, in order to help Ukraine maximally diversify its supply routes and ensure sufficient gas provision in emergency situations.

*Recommendations for Ukraine:*

- To actively engage in the Energy Community framework, while implementing de-oligarchization and de-monopolization of the energy sector and ensuring full application of transparency rules and of good governance practices (OECD standards) in companies operating in the sector;
- To implement energy efficiency measures, following the successful experience of other Central-Eastern European states, and engage the domestic civil society in order to facilitate efforts such as the implementation of housing renovation programs;
- To increase the efficiency and levels of domestic gas production, adequately utilize the vast biofuel potential and ensure transparent progress in expanding energy production from renewables;
- To urgently push through the necessary legislation ensuring adequate levels of autonomy of the regulator in the energy sector in order to comply with one of the crucial elements EU *acquis* in the energy domain;
- To improve competition capacity in the market and ensure enforcement of rules regulating monopolies, empowering the consumers and protecting their rights as participants in the market;
- To develop a long-term strategy and a new business model (such as developing a regional gas hub in Western Ukraine) for the national gas sector, regarding it as integral part of the Energy Union.