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**RECENT DEVELOPMENTS OF UKRAINIAN ENERGY POLICY AND
PRACTICE – TOWARDS EUROPEAN AND UKRAINIAN ENERGY
SECURITY**

A Summary of Relevant Documents, Experts' Analyses, Articles and Press Releases

Ukraine is undoubtedly a splendid example of maintaining successful internal and external energy policy. According to the recent European Bank for Reconstruction and Development' (EBRD) analysis "Ukraine is a major net importer of oil and gas, and an important transit country. At the same time, its economy remains one of the most energy-intensive and inefficient in the region. The energy sector has suffered from years of serving primarily quasi-fiscal or political, rather than commercial, objectives. Ukraine's accession to the Energy Community with the EU and the decision to raise domestic gas prices to import parity over time is expected to strengthen the gas and electricity sectors, create conditions for greater energy efficiency and conservation and support Ukraine's ambition to remain an energy transit country. Improving governance and transparency in the sector, as well as commercialisation and unbundling of NAK Naftogaz, will be needed to strengthen its ability to raise additional finance to modernise the gas transit system and develop its natural resource base"(1).

It explains why improving energy security (as well as energy efficiency) must be one of Ukraine's major goals (2). It has been major policy issue in Ukraine ever "as this land is not only a significant energy exporter, but also a key transit country for energy resources from Russia to the EU, particularly for gas where some 20% of the gas consumed in the EU is transited. A major challenge is the need to guarantee the overall performance, safety and security of the Ukrainian natural gas transit network, and this has been one of the main objectives of EU-Ukraine energy co-operation since 2001" (3).

However, Ukraine develops cooperation in energy matters not only with European Union. As reports the Ukrainian press service of the Ministry of Energy and Coal Industry of Ukraine "Governments of Ukraine and the United States discussed further cooperation in the nuclear energy sector and signed a memorandum of cooperation in the field of shale gas exploration in Ukraine [...] The issues of the Ukrainian energy sources diversification such as LNG-terminal construction and exhausted gas fields rehabilitation were also discussed during the second session of a Ukrainian-American working group on energy security.

The Minister of Energy and Coal Industry of Ukraine Yuriy Boyko emphasized the necessity to further develop Ukraine's cooperation with the U.S. in the nuclear energy sector in the area of nuclear plants' safety enhancement, extending life of

existing reactors, nuclear fuel supplies and building storage facilities for the depleted fuel.

He noted that Ukraine is interested to continue implementation of the International Nuclear Safety Program, the ten-year long (1993-2003) U.S. Department of Energy initiative in safety improvement of nuclear power plants built in the Soviet time.

In addition to nuclear safety, the minister also discussed the ways to diversify Ukrainian energy production. One such method could be the increase of shale gas production, which has recently changed the situation at the world gas market.

According to the preliminary scientific studies, Ukraine has significant potential for its shale gas bearing formations. Both Ukrainian and the U.S. governments plan to implement projects aimed at rehabilitation of the exhausted gas fields in Ukraine. Yuriy Boyko noted that the Ukrainian state-owned companies such as Naftogaz and Ukrnafta need technological cooperation to increase gas recovery in the insufficient or exhausted fields.

Yuriy Boyko also spoke of the steps undertaken by the Ukrainian government in order to diversify energy resources and natural gas suppliers. "Ukraine is interested in cooperation with American energy companies in order to complete the LNG-terminal project," said the minister.

Furthermore, Ukraine hopes to diversify the supply of liquefied natural gas from North Africa, Middle East and Azerbaijan. So far, Azerbaijan has confirmed its intention to sell Ukraine five billion cubic meters of LNG per year. The construction of the LNG terminal in the Black Sea region with the capacity of 10 billion cubic meters is planned for 2014" (4).

Nevertheless, one must not forget it is the European Union that plays the main role in Ukrainian energy policy and trade. The Mission of Ukraine to the European Communities explains this bilateral energy cooperation as follows: "The strategy of cooperation between Ukraine and the European Union in energy field is outlined in the Memorandum of Understanding on Co-operation in the field of Energy between Ukraine and the European Union (Memorandum), concluded on the 1st December, 2005. The Memorandum envisages implementation of 5 road maps (5): nuclear safety; integration of electricity and gas markets; enhancing security of energy supplies and transit of hydrocarbons; structural reform, enhancing safety and environmental standards in the coal sector.

During five years since the Memorandum came into force, the following results were achieved:

Nuclear Safety

On the 28th of May [2010], in Brussels the report on completion of the project in the framework of the Ukraine-EC-IAEA (International Atomic Energy Agency) group was signed, estimating the situation with nuclear safety on Ukrainian nuclear power plants with regard to project safety, operational safety, radioactive waste treatment and nuclear regulation. Besides, it was indicated that the planned tasks of this common project had been accomplished. Overall, international experts positively evaluated implementation of the project and confirmed that Ukrainian nuclear power plants meet the IAEA standards.

Integration of energy and gas markets

On 1 February 2011 Ukraine became a full fledged member of the Energy Community. This event proves Ukraine's commitment to reforming its energy sector in accordance with the European acquis. This is also a step towards integration of Ukrainian energy market into the EU one. Accession to the Energy community is important for Ukraine due to community's intrinsic principle of solidarity and mutual assistance. Internal benefits for Ukraine are also evident. First of all, it is competitive playing field, transparency, market based tariffs, wider access to energy resources for consumers, higher technical standards and regulation rules. It is also long-lasting financial stability for energy sector as well as improvement of investment climate. Membership of Ukraine in the Energy Community is also our country contribution to energy security and stability in Europe. As a Party to the Treaty, Ukraine will continue to put in place a transparent structure of energy market through implementation of the EU core legislation in this field.

The implementation of the project on synchronization of the United Energy System of Ukraine with the European Network of Transmission System Operators for Electricity (ENTSO-E) continues. This project is being implemented in accordance with the organizational and technical measures of NEC "Ukrenergo". In 2008, the "Program of organizational and technical measures to prepare for modernization of the UES generation equipment" to fulfill the conditions of UCTE (ENTSO-E became its legal successor from the 1st of July 2009) for primary and secondary regulation" was developed. The implementation was carried out in accordance with terms of reference of the UCTE project team called "Accession networks of Ukraine and Moldova to the UCTE electricity system".

Enhancing security of energy supplies and transit of hydrocarbons

To fulfill the commitments set out in the Joint Declaration of 23rd March 2009 on Modernization of gas transit system of Ukraine, the cooperation with International Financial Institutions (EBRD, EIB and WB) and the European Commission continues; its priority is mainly to prepare the consolidated feasibility study (FS) for the project of modernization of gas transit corridors and underground gas storage facilities in Ukraine. Particularly, in April 2010, the European Commission made a decision to allocate 2.5 million of Euros to finance preparation of feasibility studies and consolidated environment assessment and project management to modernize the GTS.

The implementation of the project called "Safety and reliability of the main gas transit infrastructure in Eastern Europe and Caucasus", financed by the European Commission in the framework of Tacis/INOGATE is almost over.

The general aim of the project is to strengthen the security of gas supplies to the beneficiary countries through the introduction of automated systems for security, reliability and maintenance of transit pipelines and internal networks, including use of universal technologies. This project also involves development and implementation of two pilot systems: monitoring and protecting integrity of the pipeline.

Another area of cooperation is implementation of the Eurasian oil transportation corridor project (EAOTC) through integration of the Ukrainian and Polish oil

transportation systems to supply Caspian oil to the European countries' markets through Odessa-Brody-Plock oil pipeline.

Thus, on the 14th of January 2010, an international energy conference called "The development of the Southern Corridor – the development of energy supplies from Caspian region" took place in Batumi (Georgia), with participation of the European Commission and such countries as Azerbaijan, Belarus, Bulgaria, Georgia, Lithuania, Kazakhstan, Poland, Romania, Turkey, Turkmenistan and Ukraine. During the conference, the key results of EAOTC project were presented. The Conference participants positively evaluated the activity of the International Pipeline Enterprise "Sarmatia" on implementation of the project as one of the priority projects in the framework of Caspian-Black Sea-Baltic energy space, aimed at diversifying sources and routes of energy supplies to the European markets. The total cost of extending the pipeline is estimated to be about 252 million of Euros. On 27 October, 2010 in the framework of the Energy security platform of the Eastern Partnership the International Pipeline Enterprise "Sarmatia" made a comprehensive presentation of the Odessa-Brody-Plock project. Implementation of this project is supported by Azerbaijan, Belarus, Georgia, Poland and other countries of EaP. In addition, the project received a positive assessment of the study "Technical aspects of variable use of oil pipelines coming into the EU from third countries", conducted by independent experts of the European Commission.

Enhancing safety and environmental standards in the coal sector

Since September 2008, the Ministry of Coal Industry of Ukraine is actively involved in the project "Coal Sector Support Program for Ukraine", financed by the EU. The implementation of this project is foreseen within 28 months. In the framework of the project implementation work is being done in five areas:

- A. Institutional strengthening of the Ukrainian coal industry
- B. Development of the general plan on development of Ukrainian coal industry
- C. Social Policy: the establishment of social development fund
- D. Work safety improvement
- E. Catalogue of territory pollution

The final document "Coal Sector Support Program for Ukraine" is the General Plan for the Ukrainian coal industry. The work takes into account the tasks envisaged by the Program of economic reforms for 2010-2014 called "Prosperous society, competitive economy, efficient government", introduced by the Committee of Reform of the President of Ukraine and the State Program of economic and social development of Ukraine for 2010, approved by the 2278-VI Law of Ukraine of 24th of June 2010.

Energy efficiency and renewable sources of energy

The program of investment support for renewable energy technologies in Ukraine is developed and being gradually implemented. An agreement was also reached on involvement of European experts into development of Ukrainian standards of energy marking of household and industrial implementing the new energy efficient equipment which would correspond to the relevant EU Directives as well as Western European practice.

In July 2009, Sweden as the EU Presidency started the "Initiative of energy efficiency and environmental protection in Eastern Europe/Ukraine" in the framework of the EU Program "Eastern Partnership". The main aim of this initiative is launching projects that would help to reduce energy use in household utilities sector. The initiative is based on Sweden's experience (reduction of Sweden's excessive fossil fuel consumption in the 70s to the current 14-15% which transformed Sweden from an electricity importer into its exporter)" (6).

As explains one of experts on energy policy "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 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" (7).

One of the major problems in achieving the abovementioned goal could be lack of money. This obstacle can be handled only with participation of foreign institutions, such as EBRD. According to its latest strategy for Ukraine "energy security is a major policy issue in Ukraine, and its dependency on external supplies is exacerbated by the low efficiency of energy use. Improving energy efficiency is therefore a key priority for the country. The Bank will support diversification of the sources of energy, improving energy security and energy efficiency. This will include safety upgrades in the nuclear sector, electricity transmission networks, and operations that would integrate Ukraine into the European energy market. The Bank would also support the modernisation of Ukraine's gas transportation and distribution system, provided the authorities pursue a comprehensive and credible reform agenda, including restructuring of NAK Naftogaz. Safety for the NPPs [Nuclear Power Plants], which produce almost 50 per cent of electricity in Ukraine, is also of high priority.

Policy dialogue will focus on promoting privatisations of non-strategic state enterprises as well as corporatisation and further commercialisation of the key remaining state enterprises (NAK Naftogaz, Ukrenergo, etc). In the electricity sector, the Bank would promote reform of the wholesale electricity market leading to the replacement of the single buyer market with a bilateral contracting market, tariff reform moving towards full cost recovery, strengthening the independence of the sector regulator NERC, and the corporatisation of Ukrenergo. In the gas sector, working with the other IFI's and the EU to enact critical structural reforms and

improved transparency, governance and restructuring of the state-owned energy company Naftogaz.

The Bank's operations will focus on:

In the power sector

- Pursuing the implementation of an integrated approach to reform in the Ukrainian power sector, combining development of a mid-term project pipeline with a targeted, longer term strategy for policy dialogue and technical support for the market reform agenda in the transmission and generation sectors.

- Modernisation of the transmission network, including its integration with the neighboring markets and providing electricity to energy-deficient regions of Ukraine.

- Development of renewable energy generation capacities, including under the Ukraine Sustainable Energy Lending Facility (USELF) and for rehabilitation of existing hydro power plants.

- Support to gradual de-carbonisation of energy generation through the rehabilitation of existing power generating assets, including improvement in efficiency and environmental performance of thermal generation.

- Where appropriate, participating in privatisations leading to introduction of reputable strategic investors and increased competition.

In the natural resources sector

- Support of modernisation of the gas transit system along with other IFIs in connection with the sector reform and corporatisation and un-bundling of the state owned NAK Naftogaz, and the possible provision of energy efficiency finance.

- Support to greater local sourcing of oil and gas, reducing dependency on imports – where possible with the implementation of enhanced oil/gas recovery combined with CO₂ sequestration.

- Further support of the private sector – both upstream and downstream activities – including by improving refining quality and reducing the environmental impact.

- Support of mining projects leading to greater transparency, improvement of health and safety standards or energy efficiency. The Bank will consider developing an integrated approach in the area of mine safety, including policy dialogue in this area, once the authorities focus on this subject following effective creation of the new Ministry of Energy and Coal.

In nuclear safety

- Following the successful completion of the EBRD/Euratom K2R4 programme, financing nuclear safety upgrades to bring the other 13 units to the same internationally accepted safety levels, in line with the EBRD's Energy Policy.

- Continued support for decommissioning of Chernobyl NPP and transformation of the object shelter over Unit 4 into an ecologically safe system. The Chernobyl projects funded by EBRD managed donor funds and supported by an EBRD EUR 135 million grant will reach a crucial phase in 2011. The contract for the supply of equipment and construction of the spent fuel storage facility ISF-2, which provides a solution to one of the most significant safety issues at the site and is a prerequisite for the safe decommissioning of units 1, 2 and 3 of Chernobyl NPP, is scheduled to receive a license for operation in 2014.

- Proceeding with implementation of the SIP as it reaches a decisive point. Construction of the key project within the SIP, the NSC, and fabrication of the structural steel are scheduled to start in spring of 2011 after regulatory approval of the corresponding licensing package. The overall NSC design, including all its auxiliary systems, should be finalised and receive regulatory approvals in 2011. When completed in 2014 and slid into place it will enclose the radioactive inventory of the site and allow for safe deconstruction and waste management activities over a period of 100 years.

- Helping address the challenge of filling a large funding gap which needs to be bridged in order to complete the projects. G8/EU and Ukraine, with the support of the EBRD, are working together to raise the required EUR 740 million with a view of holding a pledging event in April 2011 to coincide with a high level international conference to commemorate the 25th anniversary of the Chernobyl accident. Successful implementation of these uniquely complex projects will require professional excellence by the contractors and the Chernobyl NPP with its Project Management Units. It will also require dedication and close co-operation of the Ukrainian administrative and regulatory authorities. The Bank, together with its Ukrainian counterparts, will continue to play a major role in ensuring an environment conducive to making good progress and completing the projects as scheduled in 2014.

- Assuring ongoing high-level policy dialogue with the Ukrainian authorities for their commitment to implementation of projects operating under the EBRD's CSF and Nuclear Safety Account, smooth regulatory review processes, effective action to support nuclear liability frameworks, and provision of dependable state budget support. Recognise that both funds need further significant contributions from donors" (8).

One of the latest important EU-involvements is the technical assistance project "Preparatory studies for modernization of Ukraine's gas transit and storage", that has been operating since the 18th of February 2011. It "has been launched in the context of the joint EU-EIB-EBRD-World-Bank-Ukraine initiative to modernise Ukraine's gas transit system.

The project, funded by the EU in the framework of the Neighbourhood Investment Facility (NIF), will assist the three International Financial Institutions in their due diligence, thereby preparing the ground for investments into Ukrainian gas transit system. The project is managed by the EBRD on behalf of the EU and the three International Financial Institutions.

The modernization of the Ukrainian Gas Transit System remains a key priority for the Ukrainian Government and the EU, as outlined in the March 2009 Joint EU-Ukraine International Investment Conference on the modernization of Ukraine's Gas Transit System.

In the Joint Declaration signed at this Conference, the EU and the International Financial Institutions (the World Bank, the European Investment Bank and the European Bank for Reconstruction and Development) highlighted their readiness to support the reform, restructuring and modernisation of Ukraine's gas sector.

In this context, it was agreed that the EU will finance, in the framework of the Neighbourhood Investment Facility (NIF), a feasibility study and environmental and social impact assessments of the modernization of the Ukrainian Gas Transit System and underground storages with up to 2,650,000 EUR” (9).

However, “in the realm of [...] 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 amending 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 biofuels or other renewable fuels for transport (Plan for the implementation of Directive 2003/30/EC by 1 July 2011).

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 1775/2005 repealed by Regulation 715/2009 (hereinafter respectively — Gas Directive and Gas Regulation) [...]

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, all of the abovementioned 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 undertaking. The principle of unbundling will obviously not, according to the Gas Market Act, 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 [...], 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 antimonopoly 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*" (10).

A relevant document on the progress in achieving closer energy cooperation between the EU and Ukraine is the Fifth joint EU-Ukraine report on the implementation of the EU-Ukraine Memorandum of Understanding on Energy Cooperation (11). It has been published by the European Commission in November 2010 and covers developments since November 2009. "Key progress since 2009 includes:

1) Road map on nuclear safety: in this context, a Ukrainian nuclear power plant safety evaluation was successfully completed at the end of 2009, with the English language version of the final report agreed to by the steering committee in February 2010. The report verified the compliance of Ukrainian nuclear power plants with current International Atomic Energy Agency (IAEA) standards.

2) Road map on the integration of electricity and gas markets: the Energy Community Ministerial Council adopted a Decision in December 2009 on the accession of Ukraine to the Energy Community Treaty (EnCT), conditional upon Ukraine bringing its gas sector into line with EU Directive 200/55. Legislation adopted by Ukraine in July 2010 was assessed by the European Commission as being a sound basis from which to achieve this.

3) Road map on the security of energy supplies and the transit of hydrocarbons: the modernisation of the Ukrainian gas transit system has been another key priority for both Ukraine and the EU. At a Technical Coordination Meeting in September 2010, donors agreed to consider a project submitted by Ukraine on the reconstruction of sections of the Urengoy-Pomary-Uzhgorod gas pipeline. The project is expected to cost €220 million.

4) Road map on the coal sector: progress has also been made in Ukraine's coal mining sector, and a draft master plan for the restructuring of the industry has been drawn up.

5) Road map on energy efficiency and renewable energies: while energy consumption has declined due to the economic crisis, a programme on energy efficiency for the period 2010-15 has been developed, defining priorities for the period. The EU is also supporting Ukraine's hydropower rehabilitation programme, with some €3.6 million allocated through the Neighbourhood Investment Facility (NIF).

6) Commission support: budget support remains a key element for supporting the implementation of the Memorandum of Understanding on energy elaborated between the European Commission and the Ukrainian Ministry of Energy and signed in 2005" (12).

One cannot forget, however, about another important player: Russia, especially in contrary to European Union. Energy relations between EU and Russia regularly end up with a crisis involving Ukraine. A thorough analysis of current Ukrainian energy situation has been developed by E.P. Sauvageot (UCM University, UNISCI Junior Researcher):

"It must be stated that Russian and European interests do not necessarily go hand with hand in what respects the energy sector [...]. The EU and Russia hold opposing positions in the energy business. The EU 27 represents a net importing block, while Russia is a net exporter [...].

The main victory for Russia has been so far the renewal of the lease treaty for the Russian Fleet in Sebastopol. Russia has linked it to her hold of gas resources for Ukraine: Ukraine has permitted the Russian Fleet to stay until 2042 with the possibility of extension until 2047. In exchange, Ukraine will receive a 30 % discount on its gas from Russia. But Russia seriously considers realizing a much tastier deal: the fusion of Gazprom and Naftohaz.

The Ukrainian government is obviously very cautious in this regard, but Russia will not easily discard the project of South Stream, as the new leadership suggested: The Press-Secretary of the Russian Prime Minister, Dmitry Peskov, said in March that the proposed fusion would guarantee the viability of Ukraine's energetic sector after the unavoidable losses incurred after building South Stream.

This example of linkage between concessions to Russia in exchange of advantages is a clear proof of the inconveniences that await the EU if Russia's influence grows in Ukraine. South Stream, which is a clear competitor to Nabucco, could be fought back if the EU was to support not just Nabucco, but also Ukraine's improved energetic efficiency (which is disastrous by any standard) and expanded transit capacity. With a pro-Russian president in Kiev, the EU has lost huge capacity for influence in Ukraine, but it would be nevertheless naive to expect Yanukovich to be a mere stooge of Moscow. He has been favoring so far, good relations with Russia and has dramatically expanded deals with her. Besides, the threat that a clique of rent seeking officials looking for the energy milking cow to prosper for prospective Kuchma like shady private deals, prone to advance obscure agreements with Gazprom, is a worrying factor. Therefore as Andrew Wilson proposes from the European Council on Foreign Relations: "The EU thus needs a new twin-track approach of encouraging Kiev to engage with it and with Russia in trilateral formats in areas where the EU and Russia have common interests, while using the good will this generates to push Kiev more strongly in areas where interests diverge".

A trilateral approach might be a good alternative for a Gazprom-Naftohaz merger if it could bring forward an international consortium where both the EU and Russian would have a say. Yanukovich has advocated stripping the project South Stream in exchange of an upgrade of the transit infrastructure. Russia does not seem to agree with such perspective, but if it did, it would be in exchange on many concessions that would leave even less breathing space to the EU within Ukraine.

The lesson from the last year [...] is that the EU must have a coherent external policy regarding energy security in order to secure a sufficient influence in Ukraine to avoid that bilateral deals between Ukraine and Russia harm the EU's interests. The path to win the race against South Stream and to strengthen the rationale for Nabucco might have to go across Ukraine and extensive reforms in its energy sector. The blueprint for that, if the EU was to solve the divisions within its ranks among "pro-Russian" countries (Germany, Italy, France) and "anti-Russian" ones (mainly East European countries), is to draw a division between short-term and longterm interests.

Long-term interests are crucial, as the reform of the Ukrainian energy sector and the role that European institutions could play will require time. But if the EU is not ready to gather means to come up with short-term challenges as helping Ukraine to balance its budget and is not able to avoid crippling conditionality standards to get across this strategy, then Russia, who has an objective advantage, will step in and offer easier conditions for dialogue. This will then put in jeopardy long-term interests.

This is not to say that the EU has to evince Russia from Ukraine. This, apart from being unrealistic, is unnecessary and counterproductive. Russia does hold a leverage over Europe, but the contrary is even truer. Russia does not seek to "control"

Ukraine as to decide when to hold Europe hostage to its blackmail. What Russia seeks is to ensure that conditions prosper for her to push ahead with diversification projects (North Stream and South Stream), which will increase the leverage over Ukraine and then improve the bilateralization of relations with key EU countries (see Germany and Italy) and prevent her from being hostage of a hostile European common energy policy. Interests in this regard, are opposite. But competition between the EU and Russia should be seen not as political, but as economic competition. An expanded cooperation with Russia should provide for making up for the strain of relations that would ensue.

Therefore, pursuing trilateralization between the EU, Russia and Ukraine in the latter's energy sector could be optimal, as it might ensure a modicum of influence for Brussels and ensure Russia a significant position too. [...] The EU must be prepared to acknowledge Russia's influence but at the same time be ready to aggressively pursue her interests. A wise combination could lead to the scheme proposed and be beneficial for our energy interests" (14).

According to the Council of the European Union, "[...] EU will continue to support Ukraine in enhancing energy efficiency and the use of renewable energy sources, implementing the necessary reforms to modernize its energy sector in line with its commitments under the Energy Community Treaty as well as the conditions envisaged in the Joint Declaration of the EU-Ukraine international conference on modernisation of Ukraine's gas transit system of March, 2009" (15).

Hopefully the Polish EU-Presidency – in the second half of 2011 – would establish a solid ground to fulfill those obligations.

Notes:

(1)European Bank for Reconstruction and Development, *Strategy for Ukraine 2011-2014 (draft)*, p. 5.

(2)EBRD's relevant strategic direction states: "The Bank will support safety upgrades in the nuclear sector, electricity transmission networks, operations that would integrate Ukraine into the European energy market and operations that will increase the overall energy efficiency and decrease the carbon intensity of the sector. The Bank will also support the modernisation of Ukraine's gas transportation and distribution system, provided the authorities pursue a comprehensive and credible reform agenda, including restructuring of NAK Naftogaz". Ibidem, p. 6.

(3)European Commission, *Energy. External dimension – Ukraine*, at http://ec.europa.eu/energy/international/bilateral_cooperation/ukraine_en.htm (accessed the 12th March 2011)

(4)Nuclear Power Daily, *Ukraine Cooperates With USA In The Energy Sector*, at http://www.nuclearpowerdaily.com/reports/Ukraine_Cooperates_With_USA_In_The_Energy_Sector_999.html (accessed the 12th March 2011)

(5)Originally, the Memorandum of Understanding defined four roadmaps for bilateral cooperation, to which a fifth was added later.

(6)Mission of Ukraine to European Communities, *Ukraine-EU Energy Cooperation*, at <http://www.ukraine-eu.mfa.gov.ua/eu/en/publication/content/47147.htm>, (accessed the 12th March 2011)

(7) Yevhen V. Fedorchenko, *Energy Security: Cooperation between Ukraine and EU [Expert Opinion, 11 November 2010]*, at <http://www.ujbl.info/article.php?id=100>, (accessed the 12th March 2011)

(8) European Bank for Reconstruction and Development, *Strategy for Ukraine 2011-2014 (draft)*, pp. 21-23.

(9) Delegation of the European Union to Ukraine, *Technical assistance project "Preparatory studies for modernization of Ukraine's gas transit and storage" has been launched today (18/02/2011)*, at http://ec.europa.eu/delegations/ukraine/press_corner/all_news/news/2011/2011_02_18_02_en.htm, (accessed the 12th March 2011)

(10) Yevhen V. Fedorchenko, *Energy Security: Cooperation between Ukraine and EU [Expert Opinion, 11 November 2010]*, at <http://www.ujbl.info/article.php?id=100>, (accessed the 12th March 2011)

(11) Available at http://ec.europa.eu/energy/international/bilateral_cooperation/doc/ukraine/2010_11_22_report.pdf, (accessed the 12th March 2011)

(12) Analysis of ENPI (European Neighbourhood and Partnership Instrument), *Report charts progress made in EU-Ukraine energy cooperation*, at http://www.enpi-info.eu/maineast.php?id=23290&id_type=1, (accessed the 12th March 2011)

(13) See also more detailed: Delegation of the European Union to Ukraine, *Fifth joint EU-Ukraine report on cooperation in energy sphere (25/11/2010)*, at http://ec.europa.eu/delegations/ukraine/press_corner/all_news/news/2010/2010_11_25_02_en.htm, (accessed the 12th March 2011):

“The Joint EU-Ukraine Report on cooperation in energy sphere was signed on 22 November in Brussels. The Report was signed in the framework of the implementation of the Memorandum of Understanding on Cooperation in the Field of Energy between the EU and Ukraine during 2010. This fifth Joint Report highlights progress which has been achieved since November 2009.

The Memorandum establishes a joint strategy towards the progressive integration of the Ukrainian energy market with that of the EU and consists of road maps covering (1) nuclear safety; (2) the integration of electricity and gas markets; (3) security of energy supplies and the transit of hydrocarbons; and (4) the coal sector. Since 2008, the Memorandum also includes a fifth roadmap on cooperation in the promotion of cooperation in energy efficiency and renewable energies.

In the framework of the road map on nuclear safety the joint working group report on the safety evaluation of Ukrainian Nuclear Power Plants was presented. In general, the safety evaluations found full compliance with most of the IAEA's Safety Standard requirements. Non-full compliance was found in areas such as: equipment qualification, consideration of severe accidents and seismic design margin.

The sides also confirmed their readiness to participate in the international conference on the occasion of the 25th anniversary of the Chernobyl catastrophe in Kyiv in spring 2011 in order to mobilize support for the completion of the Chernobyl Nuclear Power Plant projects.

In regard with the road map on the integration of electricity and gas markets the sides paid attention to the Law “On the Principle of Functioning of the Natural Gas Market” adopted by Ukraine before the country's signature of the Protocol on the

Accession to the Energy Community. The Law adoption is a starting point to align the Ukrainian Gas Market to European standards, the report says.

The report highlights Ukraine joining the Extractive Industries Transparency Initiative (EITI) and assesses this step as an important result that should move Ukraine forward to achieve "Candidate Status" by meeting the four "sign up".

The road map on the security of energy supplies and the transit of hydrocarbons says that the modernization of the Ukrainian Gas Transit System (GTS) remains a key priority for the Ukrainian Government and the EU as outlined during the March 2009 Joint EU-Ukraine International Investment Conference on the modernization of the Ukrainian Gas Transit System.

In particular, at the most recent meeting of the Technical Coordination Unit (TCU) on 9 September 2010, donor agreed to consider a first project that has been submitted by Ukraine on the reconstruction of sections of the Urengoy-Pomary-Uzhgorod gas pipeline. The project is estimated to cost around EUR 220 million and last for three year.

Road map of the coal sector stresses the progress has been achieved since May 2010 by Ukraine's and the EU's side. Bearing in mind the Ukraine's legislation on state secrets, the project and the Ministry of Coal have nonetheless been able to exchange sufficient information to allow the Master Plan to be developed.

Further strengthening of the coal mining sector has been achieved through regular seminars and workshops in Kyiv and in the regions (Lviv, Luhansk and Donetsk). A study tour to Germany was organized in June 2010 to gain experience from the Ruhr Hard Coal and Mitteldeutsche Brown Coal basins. A TAIEX seminar on the "European experience with restructuring, privatization and investment in the coal sector" is due to be held in November, the report states.

Moreover, the sides agreed on the further support of Ukraine in the framework of the coal sector development.

Road map on energy efficiency and renewable energies says that Ukraine's legislation on the energy efficiency is under the development. It needs further improvement, in particular, to foster the development of renewable energies in Ukraine.

The EU is also supporting, together with the EBRD and EIB, Ukraine's "hydropower rehabilitation program" that aim to improve the country's energy security as well as the environmental safety of it energy supply. A EUR 3.6 million grant has been allocated for this program, the report says.

The report was signed by the EU Commissioner for Energy Günther Oettinger and Ukraine's Minister for Fuel and Energy Yuriy Boyko.

Four reports on the progress achieved in 2006 and up to September 2009 were presented respectively to the EU-Ukraine Summit held in Helsinki on 27 October 2006, in Kyiv on 14 September 2007, in Brussels on 9 September 2008 and in Kyiv on 4 December 2009".

(14)Eric P. Sauvageot, *The Second Energy Crisis in Ukraine in 2009: Russo-Ukrainian Negotiations up to 2010 and the Role of the European Union, Analysis of a Challenge to the EU Diplomacy*, at <http://www.jhubc.it/ecpr-porto/virtualpaperroom/033.pdf>, (accessed the 12th March 2011)

(15) Council of the European Union, *14th EU-Ukraine Summit (Brussels, 22 November 2010), Joint Press Statement*, at http://ec.europa.eu/energy/international/bilateral_cooperation/doc/ukraine/2010_11_22_summit.pdf, (accessed the 12th March 2011).

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