

# Assessing the Rules of Functioning and Organization of the Wholesale Natural Gas Market in the European Union and Ukraine: Legal and Socio-Political Perspective\*

## Part 2: Regulatory Issues and Requirements

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*This article considers current European Union and Ukraine's wholesale natural gas market in light of regulatory measures that had been enacted and/or implemented with respect to its organization and functioning. The analysis points to three major goals EU's energy sector regulation is geared to achieve: 1) economic (i.e. procompetitive support); 2) energy security; and 3) social goals. As such, the EU wholesale energy market can be regarded as a regulatory instrument. Ukraine assumed the obligation to implement EU legislation in the field of energy sector regulation (Energy Community acquis communautaire): Act of Ukraine No. 329-VIII of 9 April 2015 on natural gas market implements fundamental principles of the third energy package in the area of organization and functioning of the wholesale natural gas market. However, for Ukraine's wholesale energy market to assume characteristics of a regulatory instrument akin to the EU market, further implementation of EU regulation 1227/2011 (REMIT) and, to some extent, implementation of the fourth energy package is needed. Part 2 assesses current efforts and discusses regulatory requirements that Ukraine faces if it wants to successfully incorporate EU gas market principles within its natural gas market.*

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### 1. Introduction to Part 2

As stated in the Part 1. of this paper, at about one quarter of total supply, natural gas is a significant part of EU's primary energy consumption. Also, while consumption of other fossil fuels such as coal or oil is projected to decrease in the decades to come, both share and absolute

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volume of natural gas consumption are estimated to stay at current levels (Table 1). This is predicated upon: 1) gas-fired power generation ability to provide base capacity to balance the intermittent nature of renewables, which have increasingly been a fuel of choice in many European countries; and 2) large volumes of natural gas used directly in industry and for heating purposes which are not readily replaceable by renewable energy.

This paper applies a functional approach to defining „sectoral Regulation”, to include both regulatory acts as well as method of their implementation. Sectoral regulation is a special state interference in the economy directed at network infrastructure sector that includes enterprises, recipients and consumers of goods and services, and all other market participants<sup>1</sup>. The features that distinguish sector regulation from any other form of state intervention in the economy include: specific entities towards which the regulation is directed (market participants), specific type of enterprises involved (former state monopolies); specific nature of infrastructure held (managed by) those enterprises; regulatory mission relating to what is considered public interest; and existence of a regulatory body, i.e. market regulator that is specialized<sup>2</sup>, autonomous<sup>3</sup>, and has exclusive discretionary powers<sup>4</sup>. Regulations are usually

- 1 Also see: Eryk Kosiński, „Regulacja sektorowa – stałość czy zmienność pojęcia?”, [in:] *Prawne instrumenty oddziaływania na gospodarkę*, ed. Andrzej Powalowski (Warszawa: Wydawnictwo C. H. Beck, 2016), 119-120; and idem, *Regulacja sektora energetycznego w Unii Europejskiej oraz na Ukrainie. Cele i prawne środki regulacji sektora energetycznego* (Poznań: Wydawnictwo Naukowe UAM, 2019), 339-348.
- 2 That being said, some countries – i.e. Spain, Germany, Hungary, and to an extent Ukraine- employ multi-sectoral regulatory agencies.
- 3 For many scholars, the independence of the regulatory body is a basic criterion distinguishing sectoral regulation. Andrzej Szablewski also points out that formal autonomy is not enough for the criterion to be fulfilled. Andrzej, Szablewski, *Zarys teorii i praktyki reform regulacyjnych na przykładzie energetyki* (Łódź-Warszawa: Instytut Nauk Ekonomicznych PAN, 2000), 15. At the same time, Jan Walulik indicates that the position of the regulatory body is secondary to regulation understood as a function of the state in relation to the economy. Jan Walulik, *Reforma regulacyjna. Przykład transportu lotniczego* (Warszawa: Instytut Wydawniczy EuroPrawo, 2013), 151.
- 4 See apt remarks in this respect in Waldemar Hoff, *Prawny model regulacji sektorowej* (Warszawa: Wydawnictwo Difin, 2008), 88 et seq. and 102 et seq. Regulatory discretion is often criticized as undemocratic as regulatory bodies are usually not elected in democratic elections but appointed. At the same time, law gives them wide ranging power, which is subject to court review. See Stephen Breyer, „Analyzing Regulatory

introduced *ex ante* but *ex post* and *hybrid* actions are also possible<sup>5</sup>. Sectoral regulations are generally characterized by their focus on economic performance<sup>6</sup> and use of sector-specific regulatory measures (instruments).

In this context the goal of energy sector regulation is to: 1) support **economic principles** related to demand and supply, effectiveness, efficiency, and market competition; 2) ensure **consumer protection**, including individual consumers, particularly those most economically vulnerable; and relatedly and **social welfare**; 3) provide **energy security** understood as security of supply in natural gas and electricity, including security of transmission and distribution systems; and 4) safeguard **environmental and climate protection**.

## 2. Regulating Wholesale Natural Gas Market in The European Union

Rules and principles related to organization of wholesale natural gas system constitute an important regulatory instrument of the energy sector geared toward economic and social goals (consumer welfare)<sup>7</sup>. In addition, literature highlights the importance of free and competitive market as a guarantee

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Failure: Mismatches, Less Restrictive Alternatives, and Reform” *Harvard Law Review*, No. 3 (1979): 3. A competing view represented posits that broad discretion guarantees independence from political influence. That said it is emphasized that the rules for exercising discretion should be subject to strict legal regulation. See Anthony I. Ogus, *Regulation: Legal Form and Economic Theory* (Oxford – Portland Oregon: Hart Publishing, 2004): 341.

- 5 See extensive considerations on this topic Marek Szydło, *Prawo konkurencji a regulacja sektorowa* (Warszawa: Wolters Kluwer, 2010): 34 et seq.; Katarzyna Włazłak, „Inflacja prawa administracyjnego w zakresie planowania”, [in:] *Kryzys prawa administracyjnego?*, ed. Dariusz Ryszard Kijowski, Patrycja Joanna Suwaj, vol. II; Patrycja Joanna Suwaj, *Inflacja prawa administracyjnego* (Warszawa: Lex a Wolters Kluwer business, 2012): 125-126; and Michał Będkowski-Kozioł, „Plan jako instrument regulacji sektorów infrastrukturalnych?”, [in:] *Instrumenty i formy prawne działania administracji gospodarczej*, ed. Bożena Popowska, Katarzyna Kokocińska (Poznań: Wydawnictwo Naukowe Uniwersytetu Poznańskiego, 2009), 181 et seq.
- 6 Teresa Rabska, „Działania administracji publicznej w świetle współczesnej koncepcji publicznego prawa gospodarczego”, [in:] *Instrumenty i formy prawne działania administracji gospodarczej*, ed. Bożena Popowska, Katarzyna Kokocińska (Poznań: Wydawnictwo Naukowe Uniwersytetu Poznańskiego, 2009), 19.
- 7 Kim Talus, *Introduction to EU Energy Law* (Oxford: Oxford University Press, 2016), 42-48.

of energy security. At the same time, the key is solidarity among the Member States, full exchange of relevant information and access to energy networks (trans-European and cross-border inter-connections)<sup>8</sup>.

The First Energy Package in the field of natural gas, the Directive 98/30/EC of the European Parliament and of the Council of 22 June 1998 concerning common rules for the internal market in natural gas, recognized the wholesale market by including wholesale customers as part of its definition of natural gas customers (Article 2 (20) of Directive 98/30 /EC)<sup>9</sup>. The Directive defined the concept of wholesale customer, as a natural or legal person buying or selling (...) natural gas, not carrying out activities related to transmission, generation or distribution (Article 2 (22)). In Article 4 (1-4), the Directive introduced general principles for granting licenses to suppliers and wholesale customers of natural gas, essentially referring to the requirement to apply objective and non-discriminatory criteria<sup>10</sup>. At the same time, implementation and specific regulations were left to the discretion of each Member State.

The Second Energy Package, i.e. Directive 2003/55/EC of the European Parliament and of the Council of 26 June 2003 on common rules for the internal market in natural gas and repealing Directive 98/30/EC<sup>11</sup>, defined the concept of wholesale customers as „any natural or legal persons other than transmission system operators and distribution system operators who purchase natural gas for the purpose of resale inside or outside the system where they are established” (Article 2 (29)). The Second Energy Package no longer allowed Member State discretion in regulating functioning of wholesale energy markets. However, it included no specific regulatory measures as to the organization of the wholesale natural gas market.

The regulatory ambiguity pertained until 2009 when the Third Energy Package, i.e. Directive 2009/73/EC of the European Parliament and of the Council of 13 July 2009 concerning common rules for the internal

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8 See especially in Jean-Michel Glachant, François Levéque, and Pippo Ranci, „EU energy security of supply: conclusions”, [in:] *Security of Energy Supply in Europe. Natural Gas, Nuclear and Hydrogen*, ed. François Levéque, Jean-Michel Glachant, Julián Barquín, Christian von Hirschhausen, Franziska Holz, William J. Nuttall (Cheltenham, UK, Northampton, USA: Edward Elgar, 2010), 295-301.

9 O. J. L 204, 21.07.1998, p. 1. Polish special edition: Chapter 12, v. 2, p. 28.

10 These stipulations were repeated in the next natural gas directives: 2003/55/WE, Article 4(1-4) and 2009/73/WE, Article 4 (1-4).

11 O.J. L. 176, 15.07.2003, p. 57.

market in natural gas and repealing Directive 2003/55/EC<sup>12</sup> entrusted national regulatory authorities with the task of monitoring the level of transparency of the functioning of entities on the natural gas market. This encompassed determination of wholesale price and the level and effectiveness of market opening and competition (wholesale and retail market), including on the natural gas exchange (section 59 of the Preamble; Article 41 (1) (ij)). The Directive also imposed obligations on natural gas suppliers regarding record keeping of transactions and contracts concluded with wholesale customers (Article 44 (1-7)). Additionally, Regulation (EC) No 715/2009 of the European Parliament and of the Council of 13 July 2009 on conditions for access to the natural gas transmission networks and repealing Regulation (EC) No 1775/2005 specified the conditions for the proper functioning of the wholesale natural gas market at a cross-border level<sup>13</sup>.

The Fourth Energy Package (climate and energy; energy union)<sup>14</sup> leaves the above regulations in force. Including to promote and strengthen competition on the EU natural gas market by facilitating access to cross-border networks (interconnectors), and ensuring security of natural gas supply (Preamble (14) (19); Article 1 (c)).

Protection of competition on the wholesale energy market and detailed regulation of the organization of wholesale markets, including registration of participants in the wholesale market for natural gas (and electricity), is the subject of the Regulation of the European Parliament and of the Council (EU) No 1227/2011 of October 25, 2011 on wholesale energy market integrity and transparency (so-called REMIT)<sup>15</sup>. The goal of the regulation is to ensure the proper functioning of wholesale markets, primarily their integrity, preventing market abuse, guaranteeing the functioning of market forces of free competition, demand and supply (as per sections 1-4 and 11-17 of the Preamble). The wholesale market is broadly understood as regulated markets, multilateral trading platforms and transactions concluded on the OTC

12 O.J. L 211, 14.8.2009, 94.

13 O.J. L 211, 14.8.2009, 36.

14 The provisions for energy union are included in Regulation (EU) 2018/1999 of the European Parliament and of the Council of 11 December 2018 on the Governance of the Energy Union and Climate Action, (O. J. L 328, 21.12.2018, 1); Directive (EU) 2018/2001 of the European Parliament and of the Council of 11 December 2018 on the promotion of the use of energy from renewable sources (O. J. L 328, 21.12.2018, 82); Directive (EU) 2019/944 of the European Parliament and of the Council of 5 June 2019 on common rules for the internal market for electricity and amending Directive 2012/27/EU (O. J. L 158, 14.06.2019, 125).

15 O. J. L 326, 8.12.2011, 1.

market, as well as bilateral agreements concluded either directly or through brokers (Preamble (5)).

Regulation 1227/2011 introduces definitions of the following terms: inside information (Article 2 (1)), market manipulation (Article 2 (2)), attempts at market manipulation (Article 2 (3)). It also defines the concept of wholesale energy market (French *marché de gros de l'énergie*) as „any market within the Union on which wholesale energy products are traded”. Wholesale energy products (French *produits énergétiques de gros*), in turn, are understood as “contracts and derivatives, irrespective of where and how they are traded, the subject of which is “electricity and natural gas produced, traded or delivered” in the EU) and “transportation of electricity or natural gas” (Article 2 (4)).

To guarantee the fairness of trade in natural gas (and electricity) and to prevent manipulation on the wholesale market, Article 3 (1) of Regulation 1227/2011 prohibits the use of insider information, i.e. acquiring or disposing of, or trying by to acquire or dispose of, for own account or someone else's account; disclosing that information to any other person; and recommending or inducing another person to acquire or dispose of wholesale energy products on the basis of this information<sup>16</sup>. The participants of the wholesale market are also subject to obligation to disclose/publish inside information relevant to the functioning of the market (Article 4, (1-7)). An absolute ban on manipulating (or attempting of it) is included in Article 5. The monitoring of the wholesale market was entrusted to the European Union Agency for the Cooperation of Energy Regulators (ACER) (Articles 7-8)<sup>17</sup>. Market participants are required to submit to the Agency „records of wholesale energy market transactions, including orders to trade” (Article 8, section 1)<sup>18</sup>. Market participants required to inform the Agency about these transactions and orders are have to register in the national register of wholesale market participants kept by the national regulatory authority for the energy sector in the Member State (Article 9 (1-5)). The supervision of compliance with the prohibitions and

16 The scope of the ban is regulated in Article 3 (2) and (5). Exclusions are listed in Article. 3 (3), (4) and (6).

17 See: Regulation (EU) 2019/942 of the European Parliament and of the Council of 5 June 2019 establishing a European Union Agency for the Cooperation of Energy Regulators (O. J. L 168, 14.06.2019, 22). Regulation 2019/942 entered into force July, 4 2019.

18 For scope of the obligation, formal principles and deadlines go to: Regulation (EU) No 1348/2014 of 17 December 2014 on data reporting implementing Article 8(2) and Article 8(6) of Regulation (EU) No 1227/2011 of the European Parliament and of the Council on wholesale energy market integrity and transparency (O. J. L 363, 18.12.2014, 121).

obligations introduced by the regulation rests with national regulatory authorities (Articles 13-14).

The analysis of the above legal regulations leads to the conclusion that the regulatory instruments implemented by the European Union – in the form of a legal framework and the principles of organization and functioning of the wholesale energy market – accomplishes most of its regulatory objectives with respect to its economic, energy security and social/welfare goals.

### 3. Natural Gas Sector of Ukraine

The functioning of the energy sector is one of the most important issues Ukraine's authorities have faced since the country gained independence in 1991<sup>19</sup>. Natural gas plays an important role in the energy mix of Ukraine as it constitutes 27.8% of gross domestic energy consumption and 25% of the country's primary energy mix<sup>20</sup>. Initially self-reliant, the country has become largely dependent for natural gas on external supplies<sup>21</sup>. Since the 1970 the

19 Eryk Kosiński, *Prawo Energetyczne Ukrainy. Wybór źródeł* (Poznań: Wydawnictwo Naukowe UAM, 2018), 7-8.

20 Data for 2016 available at: <https://www.energy-community.org/implementation/Ukraine.html>. [accessed: 17.07.2019].

21 Compare: Kataryna Wolczuk, „Managing the flows of gas and rules: Ukraine between the EU and Russia” *Eurasian Geography and Economics*, No. 1 (2016): 116. In 1949 r. a pipeline was built to deliver natural gas from northern Ukraine (northern Carpathian Mountains – the *Дашава* play, currently Lvov region) to Moscow and further to Minsk (Belarus) and the Baltic republics. In 1960s and 1970s natural gas production from: Szebelinskie gazokondensatne rodowiszczce (*Шебелинське газоконденсатне родовище*, discovered in 1956), Efremywskie gazokondensatne rodowiszczce (*Єфремівське газоконденсатне родовище*, discovered in 1964 r.) and Jablunyskie gazokondensatne rodowiszczce (*Яблунівське газоконденсатне родовище* discovered in 1972 r.) constituted substantial source of supply for natural gas consumption in the Soviet Union. Toward the end of the 1970s, however, centres of gas supplies were moved to Western Siberia and Central Asia. See also (noting many inaccuracies in the names of cities and geographical regions): Matt Mushalik, „The Ukraine conflict, peak cheap gas and the MH17 tragedy” *Crude Oil Peak*, July 29, 2014. <http://crudeoilpeak.info/the-ukraine-conflict-peak-cheap-gas-and-the-mh17-tragedy>. [accessed: 3.06.2020]. See additionally: special report by Ministry of Energy and Coal Industry of Ukraine (2012) available at: [http://www.naftogaz-europe.com/newsfiles/Ukraine%20Policy%20Dialogue%20report\\_IHS%20Cera-Ministry%20of%20Energy%20and%20Coal%20Industry%20of%20Ukraine.pdf](http://www.naftogaz-europe.com/newsfiles/Ukraine%20Policy%20Dialogue%20report_IHS%20Cera-Ministry%20of%20Energy%20and%20Coal%20Industry%20of%20Ukraine.pdf). [accessed:

exploitation of Ukrainian natural gas deposits has been systematically limited as part of a larger pan-Soviet plan to develop large industry and mining sectors. As a result, the country became reliant on imports of gas from other parts of the Soviet territory and, after Soviet Union's collapse, on imports from Russia.

That being said, in recent years Ukraine's dependence on natural gas imports has been decreasing. For example, in 2017 imported gas constituted 84% of Ukraine's consumption vs. 33% in 2018. The trend, however, does not have much to do with conscious policy of security of supply, efficiency measures, or increase in domestic resource extraction, which remained more or less at the same level since 1991 (22.8 billion m<sup>3</sup> in 1991 and 19.44 billion m<sup>3</sup> in 2017). Instead, lower imports are results of cuts in domestic consumption (in 1991 Ukraine consumed 18.2 billion m<sup>3</sup> of gas vs. 32.3 m<sup>3</sup> in 2018)<sup>22</sup> related to: 1) economic downturns; 2) Ukraine-Russia disagreements on pricing and complete stop of Russian gas sales to Ukraine; 3) Ukraine having to buy gas at market prices via reverse flows from the EU; 4) loss of Crimea; and 5) Russian occupation of significant part of Ukraine's territory.

Russian occupation of eastern Ukraine has not only implications for natural gas consumption. In fact, one can argue that it has greater consequences for Ukraine's ability to access existing and potentially develop new natural gas resources. Of the total natural gas resources – estimated at 2,880 billion m<sup>3</sup> to 7,584 billion m<sup>3</sup> – between 2,347 to 4,654 billion m<sup>3</sup> are located in eastern Ukraine<sup>23</sup>. According to official data of the Ukrainian authorities, 62% of all conventional natural gas resources in Ukraine are located in the

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17.07.2019]; and Shinichiro Tabata and Liu Xu, „Russia's energy policy in the Far East and East Siberia”, [in:] *Russia's Energy Policies. National, Interregional and Global Levels*, ed. Pami Aalto (Cheltenham, UK, Northampton, MA, USA: Edward Elgar, 2012), 156 et seq.

- 22 See: *Natural Gas Consumption and Import in Ukraine, 1991-2018*, Naftogaz Europe. <https://www.naftogaz-europe.com/article/en/naturalgas-consumptionandimportinukraine19912018eng>. [accessed: 23.08.2019]. Also: *Ministry of Energy and Coal Industry of Ukraine. Natural Gas and Ukraine's Energy Future. Ukraine Policy Dialogue. Special Report (2012)*. [http://www.naftogaz-europe.com/newsfiles/Ukraine%20Policy%20Dialogue%20report\\_IHS%20Cera-Ministry%20of%20Energy%20and%20Coal%20Industry%20of%20Ukraine.pdf](http://www.naftogaz-europe.com/newsfiles/Ukraine%20Policy%20Dialogue%20report_IHS%20Cera-Ministry%20of%20Energy%20and%20Coal%20Industry%20of%20Ukraine.pdf). [accessed: 17.07.2019], 4.2.
- 23 Specific numbers vary depending on source. The highest values are reported by the government of Ukraine in: *Ministry of Energy and Coal Industry of Ukraine. Natural Gas and Ukraine's Energy Future. Ukraine Policy Dialogue. Special Report (2012)*, *ibidem*.



Donetsk Basin<sup>24</sup>. Also, Russia's annexation of Crimea resulted in loss of resources of at least 1,200 billion m<sup>3</sup><sup>25</sup>.

At stake, is also the issue of Ukraine's status as a transit territory for Russian gas flowing to Central and Western Europe<sup>26</sup>. Ukraine used this decades-long relationship as a leverage to request below market parity prices and accumulate debt for gas delivered by Russia to Ukraine. This has handed Russia tool of geopolitical influence as it could demand increase in prices or payments of debt in least importunate moments. Russia has also used as an excuse breaks in gas deliveries to Europe that resulted from spats over debt and pricing. Now, alternative routes for Russian gas such as NS1, NS2 or Turkish Stream can well render the Ukrainian transit obsolete and deprive the country of transit fees of approximately \$2 billion, a sum that could, for example, pay for the country's entire defence budget<sup>27</sup>.

Ukraine's problems related to natural gas sector have been additionally augmented by outdated, inefficient infrastructure, and the system of organization and management of the energy sector inherited from the Soviet Union (state-owned enterprises vertically integrated, monopolists on the markets).

#### 4. Energy Reforms of 2015-2017 and Legal Underpinnings of Natural Gas Sector in Ukraine

Already under the presidency of Viktor Yanukovich, on February 1, 2011 Ukraine formally joined the Energy Community<sup>28</sup>, assuming a number of obligations that implementation of EU energy laws and principles (acquis communautaire of the Energy Community)<sup>29</sup>.

24 Mushalik, „The Ukraine conflict”.

25 Ibidem.

26 Margarita Mercedes Balmaceda, „Ukraine, Central Europe, and Russia in a New International Environment”, [in:] *On The Edge. Ukrainian – Central European – Russian Triangle*, ed. Margarita Mercedes Balmaceda (Budapest: Central European University Press, 2000), 12-13.

27 Mansur Mirovalev, „Russian gas pipeline divides the West and ‘punishes’ Ukraine. Germany wants cheap Russian gas via Nord Stream 2, while Ukraine fears economic ruin” *Aljazeera*, 4 June 2019. [accessed: 3.06.2020].

28 Treaty establishing the Energy Community: Ratified by Ukraine on December 15, 2019. <https://www.energy-community.org/implementation/Ukraine.html>. [accessed: 15.04.2019].

29 The beginnings of the process of integration of Ukraine with the European Union date back to 2005, when the memorandum of Understanding on cooperation in the field of energy was signed. There, Ukraine

The main goal of the Community is „to create an integrated pan-European energy market”, mainly by facilitating trade in electricity and natural gas through the creation of a single regulatory space with a specific geographical scope. To this end „Member States of the Energy Community are obliged to implement into their legal order the EU *acquis communautaire* in the field of energy, seeking to open, liberalize and guarantee competition in their energy markets and ensure energy security”<sup>30</sup>.

On March 21, 2014, the Association Agreement between the European Union and its Member States and Ukraine was signed in Brussels. The Association Agreement already in its preamble refers to the need to develop cooperation between the parties in the energy sector and to the obligations arising from membership in the Energy Community, pointing to „the pursuit of increased energy security, infrastructure development, integration of energy markets, adjustment of regulatory provisions to implement key elements of the Union *acquis*, promoting energy efficiency and the use of renewable energy as well as guaranteeing a high level of nuclear safety”<sup>31</sup>.

The mutual relations between the Association Agreement and the Energy Community Treaty are governed by art. 278 of the Agreement. In accordance with the indicated legal regulation in the event of a conflict between the Treaty or provisions of EU law forming part of the EU *acquis* in the field of energy and the Agreement (specifically the regulation contained in Chapter 11, Articles 268-280, concerning trade in energy<sup>32</sup>), priority should be given to the Treaty and legal regulations forming part of the *acquis* (Article 278 (1)).

The Association Agreement itself, regardless of the Treaty establishing the Energy Community, imposes on the parties an obligation to continue and deepen cooperation in the field of energy, including in the field of energy security and to bring Ukraine’s sectoral regulation closer to the EU regulation (Article 337 (1)). The Agreement refers to the Treaty for solving

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expressed its readiness to implement elements of EU’s legal regulations in the area of energy, environmental protection, competition, and renewable energy sources, and undertook to join the newly created Energy Community. In the next step to bring Ukraine closer to the EU, in March 2009, EU and Ukraine signed a declaration on the modernization of the Ukrainian natural gas transit system. See: Wolczuk, „Managing the flows of gas and rules”, 125-128.

30 Treaty establishing the Energy Community: The Preamble.

31 The Ukraine – European Union Association Agreement was ratified by Verkhovna Rada of Ukraine on September 16, 2014 and signed the same day by President Poroshenko.

32 These resources are defined as „energy goods” per Article 268 (1) of the Agreement.

energy crises with reference to solidarity, modernization of energy infrastructure, construction of new infrastructure, construction of the energy market in accordance with EU regulations, guaranteeing secure energy trading, etc. (Article 338).

To execute its commitment to adjust the domestic legal order to EU regulations, Ukraine first repealed Act No. 2467-VI of July 8, 2010 on the basic principles of the natural gas market (Закон України від 8 липня 2010 року № 2467-VI «Про засади функціонування ринку прию да»<sup>33</sup>. On April 9, 2015 Ukraine instituted new law on the natural gas market (Закон України від 9 квітня 2015 року № 329-VIII «Про ринок природного газу»)<sup>34</sup>.

The scope of activity and competence of the regulatory authority for the (entire) energy sector were then spelled out by the Act of Ukraine No. 1540-VIII adopted on September 22, 2016 by the National Commission for State Regulation in the Field of Energy and Municipal Services (Закон України від 22 вересня 2016 року № 1540-VIII «Про Національну Комісію що здійснює державне регулювання у сферах енергетики та комунальних послуг»). This has been a significant change as previously the scope of activity, competences and structure of the regulatory body were dispersed among various legal acts<sup>35</sup>.

The Act of Ukraine of 9 April 2015 on the natural gas market ensures the functioning of the wholesale gas market. The Act defines the basic concepts: a wholesale buyer and a wholesale seller. The wholesale buyer is an entrepreneur „who purchases natural gas on the basis of a sales contract not for his own consumption” (Article 1 (1) (21)). In turn, a wholesale seller is an entrepreneur who „sells natural gas to a wholesale buyer or supplier based on a sales contract” (Article 1 (1) (22)). The wholesale market for natural gas trading, regulated by the Act, is implemented on the basis of bilateral agreements (OTC -over the counter- market). The vast majority of transactions occurs on the OTC market despite the presence of Ukrainian Energy Exchange (Товарна біржа ‘Українська енергетична біржа’, ТБ ‘УЕБ’) established

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33 Bulleting of the Supreme Council of Ukraine (Widimosti Wierchownoj Rady Ukraini, *Відомості Верховної Ради України*): 2010, No. 48, p. 566 with amendments.

34 VVR 2015, No. 27, p. 234 as amended.

35 Compare to: Wojciech Konończuk, „Reform #1. Why Ukraine has to reform its gas sector” *Centre for Eastern Studies OSW Commentary* Number 181 (01.09.2015): 1-9. [https://www.osw.waw.pl/sites/default/files/commentary\\_181\\_0.pdf](https://www.osw.waw.pl/sites/default/files/commentary_181_0.pdf). [accessed: 3.06.2020].

in 2017<sup>36</sup>. The Act on the Natural Gas Market posits that prices for natural gas are to be freely shaped and, as a rule, are not regulated (Article 12 (2))<sup>37</sup>.

The Act also establishes a regulatory body for the natural gas sector, the National Commission for State Regulation in the field of Energy and Municipal Services, (Національна комісія, що здійснює державне не регулювання а к на на 2-6 of the Act). In accordance with art. 4 paragraph 2 the role of National Commission is, i.a.: 1) supporting cooperation with the Energy Community Regulatory Board and national regulatory authorities in the field of energy of other member states of the Energy Community; 2) creating a competitive single market for natural gas within the Energy Community taking into account the opening of the natural gas market for all customers and wholesale suppliers from Member States of the Energy Community; 3) developing competition and ensuring the proper functioning of regional (international) markets within the Energy Community; 4) eliminating obstacles and restrictions to trade in natural gas between Member States of the Energy Community (in particular by ensuring an adequate level of cross-border connection capacity); 5) supporting safe, reliable and economical operation of the gas infrastructure and ensuring simple and easy-to-use connection (transmission, distribution, storage and LNG) for new facilities to remove barriers limiting access for new wholesalers and suppliers; 6) providing incentives for natural gas market entities to increase the efficiency of gas infrastructure and integration of the natural gas market; and 7) creating economically favourable conditions for the consumers based on effective and competitive functioning of the natural gas market (Article 4 paragraph 2 (2-7)).

That being said, there is no full implementation of specific EU solutions, such as those of Regulation 1227/2011 (so-called REMIT). Moreover, it should be emphasized that the majority of natural gas in wholesale

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36 98.5% of wholesale gas is sold on the OTC market. To date, Naftohaz of Ukraine sells gas only through bilateral agreements. See: *Potenzial birzovoi torgieli gozom v Ukraini pierieetzue 10 mlrd dolarie CSA*, 8.12.2017. Available at: <https://104.ua/ua/news/id/potencial-birzhovoji-torgivli-gazom-v-ukrajini-per-26484>. [accessed: 3.06.2020]. It is first this in 2019 when Naftoha begins selling gas on the Ukrainian Power Exchange. To this end, a subsidiary, Naftogas Trading was created, a limited liability company (ООО Газопаставляющая компания “Нафтогаз Трейдинг”, „Газопоставляющая компания “Нафтогаз Трейдинг”). See: „*Naftogaz*” *natzniot torgi gazom na Ukrainskoi energetizieskoi birze*, available at: [https://biz.censor.net.ua/news/3129447/naftogaz\\_nachnet\\_torgi\\_gazom\\_na\\_ukrainskoyi\\_energeticheskoyi\\_birje](https://biz.censor.net.ua/news/3129447/naftogaz_nachnet_torgi_gazom_na_ukrainskoyi_energeticheskoyi_birje). [accessed: 3.06.2020]. .

37 Except natural gas deliveries by a default provider.

trade is still sold by the Ukrainian monopolist National Joint Stock Company „Naftogaz Ukraine” (Національна акціонерна компанія “Нафтогаз України”) in bilateral agreements.

## 5. Concluding Remarks

The analysis of the legal regulation of wholesale trade in natural gas in the European Union and Ukraine indicates that the regulatory instrument in the form of a legal framework and the principles of organization and functioning of the wholesale energy market implements most of the regulatory objectives, i.e. economic goals (efficiency, efficiency, functioning efficiency, balancing supply and demand, supporting market competition), energy security objectives, and social goals (protection of consumer welfare).

EU regulation is undergoing a metamorphosis that is reinforced by changes in the nature of natural gas market, which has become more globalized and more liquid as more suppliers and consumers entered the market and as LNG became part of everyday natural gas arbitrage.

In 2015, Ukraine adopted a new law regulating the natural gas sector. These provisions provide the legal framework for the functioning of the wholesale electricity market and implement EU regulations of the Third Energy Package into the Ukrainian legal order. However, implementation of the laws in Ukraine is lagging. Also, monopoly status of the natural gas wholesaler, Naftogaz Ukraine can become detrimental to the functioning of the country's natural gas sector at the time when it needs to modernize to break dependence on artificially cheap and geopolitically conditioned gas supplies from Russia. Much will depend on the new Ukrainian President, Volodymyr Zelenski and his party, Servant of the People that won October 2019 parliamentary elections. With much of the old political establishment out of the picture, it remains to be seen how new leaders approach the issue of energy security, including supply of natural gas and to what extent this will be an EU-centric vs. Russia-focused approach.

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