

DIXI GROUP ALERT:

AMENDMENTS TO THE LAW ON ENERGY REGULATOR ARE A TEMPORARY SOLUTION

DIXI GROUP RECOMMENDATIONS REGARDING THE ADOPTED LAW ON THE NEURC CONSTITUTIONAL STATUS

DiXi Group think tank consistently supports reforms in Ukraine and takes a lot of effort to create independent regulatory authority in energy and utilities.

In particular, following the initiative of DiXi Group and with support of the International Renaissance Foundation, a Strategic Advisory Group was created in 2015 with the participation of leading Ukrainian and international experts (Energy Community Secretariat, Support Group for Ukraine at the European Commission, Council of European Energy Regulators and the U.S. Agency for International Development). With participation of the Strategic Advisory Group, international partners, experts and journalists, many public discussions were held on the basic principles of the Regulator's activity and the EU legislation requirements to be taken into account. As a result of complex but public discussion process involving all stakeholders, in 2016 the Verkhovna Rada adopted the Law on NEURC. The document was considered to be compliant with the requirements of the EU Third Energy Package.

Following the implementation of the Law, DiXi Group has also run integrity checks of the candidates for positions at the NEURC board and assessed the overall compliance of the Regulator performance with the EU rules. We monitor the implementation of the EU-Ukraine Association Agreement on a permanent basis, including the provisions on independent regulatory authority. It should be emphasized that our findings and recommendations to strengthen the Regulator's independence and capacity are in line with the position of the Energy Community Secretariat.

DiXi Group welcomes the attempts to regulate the NEURC legal status aimed at implementing the Constitutional Court decision No. 5-r of June 13, 2019, and addressing other issues, including those conducted through the adoption of the Law "On Amending Certain Laws of Ukraine on Ensuring the Constitutional Principles in Energy and Utilities" (reg. No. 2490-1 of November 25, 2019).

At the same time, attempts to resolve some issues should not cause other problems regarding transparency and independence of the Regulator. DiXi Group experts have analyzed the Law adopted and draw attention to the following.

POSITIVE CHANGES

1. Provisions that the NEURC regulatory acts enter into force after publication in Uriadovyi Kurier gazette have been lifted. Instead, the decisions take effect the next day upon their publication on the NEURC website.

First, this approach will allow saving some funds from the Regulator budget – app. 7 million UAH, or 2% of the estimated budget for 2019. Second, the problem of significant delays in the publication of regulatory acts, which took place in previous years, is solved. In fact, delays in Uriadovyi Kurier publication created conditions for the absence of rules in the markets, when the old rules were no longer valid and the new ones did not enter into force. In addition, it is now clearly stated that the Regulator decisions "are not subject to approval by governmental authorities" except in cases prescribed by this law.

2. A 'safeguard' is introduced to the Code of Administrative Procedure, making impossible to block the Regulator decisions on prices (tariffs) as well as to block a competition for selection of the NEURC member(s) by a court decision.

The competition announced in 1H2018 for two vacancies at the NEURC was blocked by a court decision on the claim of ineligible candidates. In fact, the process is clearly delayed, and the plaintiffs did not appear at the court for the entire period of proceedings.

CHANGES THAT CAN BE USED FOR BOTH POSITIVE CHANGES AND MANIPULATIONS/BREACH OF EUROPEAN LAW

1. The Regulator has been given the powers to set price caps (temporary minimal and/or maximal price limits) in the electricity markets, namely the day-ahead market, the intra-day market and the balancing market for each trade zone.

The implementation of such a rule may have both positive and negative impact in view of its application. On the one hand, it will allow "insuring" consumers (both household and non-household) from a sharp increase in wholesale electricity prices, and make this transition smoother. On the other hand, it is a "manual" market management that does not meet the principles of free pricing. The Main Legal Department of the Verkhovna Rada (MLD), referring to paragraph 4 of Article 269 of the EU-Ukraine Association Agreement, notes that the entry into force of these provisions should be preceded by the approval of a relevant methodology for setting price caps by the Regulator.

It should also be mentioned that pricing in electricity market is additionally distorted by conditions of public service obligations, i.e. restrictions for certain electricity producers (Energoatom and Ukrhydroenergo).

2. The Regulator influence on business entities in terms of their compliance with the licensing conditions has been increased.

The implementation of such a rule may have both positive and negative impact depending on its use. On the one hand, the NEURC has received

functions of investigating violations in the energy markets, amending the investment programs as a result of inspection and/or monitoring, conducting unscheduled inspections to confirm the reliability of reporting data, determining the terms, procedure and amount of compensation to consumers in case of non-compliance with the supply / service quality standards.

On the other hand, the investigative function requires a clear procedure to minimize abuse. Today, it is unknown what the investigation procedure will look like and how the rights of market participants will be protected in such activity.

RISKS TO INDEPENDENT AND PROFESSIONAL PERFORMANCE OF THE REGULATOR

1. The Regulator's independent status is not described clear enough.

Article 1 on the Regulator's status is amended to provide that the NEURC is no longer an independent public collegiate authority but a central executive authority (CEA) with a special status. Given this, the NEURC falls under the Law "On Central Executive Authorities". At the same time, the amendments to the CEAs Law only include the NEURC by adding it to the list of authorities with such a status and listing the Cabinet of Ministers powers to appoint its members according to the results of competitive selection. There is no clear definition of the term "CEA with a special status", nor a clear definition of the procedure for the CMU interaction with such CEAs (or a separately written article in the context of interaction with the NEURC).

Attention should also be paid to the comments of the Main Scientific and Expert Department of the Verkhovna Rada (MSED) that the CEAs with a special status mean those directly (or indirectly) envisaged in the Constitution. In addition, according to MSED, the legislative obligation of the CMU to establish the Regulator "is the interference with the constitutional powers of the Government per se". Similar are the comments of MLD, which states that the proposed legal status of the NEURC does not result from the constitutional model of power in Ukraine, and "the exhaustive list of authorities... formally not attributed to any of the branches of the government is directly established by the Constitution of Ukraine". Thus, there is a reason to dispute the constitutionality of the proposed status of the Regulator.

In addition, the law does not lift or grant exceptions to the government right to completely or partially repeal the acts of such CEA, as provided by part six of Article 21 of the Law “On the Cabinet of Ministers”. Moreover, according to paragraph 9 of Article 116 of the Constitution, the direction and coordination of the executive authorities’ activity also falls within the competence of CMU.

It also proposed to change the wording of Article 5 from the “Guarantees of the Regulator’s independence” to the “Guarantees of the Regulator’s exercising powers”. It is determined that “the Regulator in its activities shall be guided by the Constitution of Ukraine, this Law and other legislative acts of Ukraine”. Therefore, it is possible to influence the NEURC through amendments to other laws.

2. The procedure for dismissal of the NEURC members is discretionary and threatens the independence of the Regulator.

The law provides for the Cabinet of Ministers right to early terminate the powers of a member of the Regulator, and the terms of such a decision include “detecting the actual violation of... the requirements of the laws governing the activities in energy and utilities”. At the same time, it is not specified which violations may result in such a decision, and the procedure, under which the fact of such violation is confirmed, is not defined as well.

Thus, the law gives the Cabinet of Ministers discretionary powers to determine the actual violation of the law that contradicts the norms of the Constitution on the separation of executive from judiciary.

3. The balance of forming the membership of the Competition Commission on the selection of candidates for the positions of NEURC members is violated.

According to the law, the Competition Commission is established by the CMU under the following principle:

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- ▶ *3 persons upon the recommendation of the Verkhovna Rada Committee for Energy and Utilities;*
 - ▶ *1 person upon the recommendation of the Ministry of Energy and Environmental Protection;*
 - ▶ *1 person upon the recommendation of the Ministry of Territories and Communities Development.*
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A key aspect is that 3 persons will be approved by decision of the Committee and not by voting of the entire Verkhovna Rada. In this way, the Committee is given the opportunity to form a majority of this Commission. I.e., a small group of individuals will have a decisive influence on forming the NEURC. Such a framework ignores the democratic foundations of parliament as a body representing the interests of different political forces.

Attention should also be paid to the comments made by MSED and MLD of the Verkhovna Rada that such provisions do not take into account the legal status of the parliamentary committees, which cannot have independent external powers under the Constitution.

In addition, the law eliminated restrictions on participation in the Competition Commission of persons duly authorized to perform the functions of government or local self-government authorities (according to paragraph 1 of Article 3 of the Law “On Prevention of Corruption”). Thus, there is a threat to politicize the work of the Competition Commission – e.g. by delegating MPs, representatives of central executive authorities, law enforcement agencies, etc. as its members.

4. The procedure of rotation for current members of the Regulator appointed under different procedures is not regulated

The law proposes to exclude the provisions concerning periodic rotation (enacting the initial rotation only in Final and Transitional Provisions) and limitation on terms of office (in the current Law – no more than two terms). This may create risks for new people emerging at the Regulator’s top positions.

The status of four NEURC members appointed by the President on October 29, 2019, on a temporary basis (based on paragraph 3-1 of Final and Transitional Provisions of the current Law) remains unclear.

The law proposes at the same time:

- ▶ *to keep such “temporary members” in their positions defining the term of office as the difference between a) 6 years and b) the term of office until the day the new Law enters into force;*
 - ▶ *to start rotation of the current NEURC composition already in 2020-2021, while imposing the responsibility for the approval of the rotation scheme on the President.*
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Thus, it is unclear how to meet these mutually exclusive rules for “temporary members” of the Regulator. If the NEURC members, who were appointed following open competitive selection on May 28, 2018, are subject to initial rotation, it will be a violation of the Law requirements on their term of office (it should be completed no earlier than May 2024).

In addition, these provisions equalize the status of NEURC members appointed both by open competition and by a temporary procedure – which can be considered as discrimination. In other words, the law “legalizes” the President’s appointment of temporary NEURC members and their almost full term of office, which is contrary to the requirements of the law regarding the competitive selection of the Regulator’s members.

It doesn’t look clear why the approval of the rotation scheme for the body established by CMU is attributed to the President. According to the comments of MSED and MLD of the Verkhovna Rada, these norms are not consistent with the constitutional requirements concerning the powers of the President (in particular, Article 106 of the Constitution).

5. A number of provisions regarding transparent competitive selection of candidates for the positions of the Regulator’s members have been excluded

There is no requirement to video-stream meetings of the Competition Commission in real time. Thus, the confidence in its decisions decreases and the risk of their appealing increases.

In the context of transparency, the rule of non-application of the open discussion procedure for draft decisions of the Regulator on setting gas transmission tariffs in 2019-2020 is also a concern. Understanding the reason of such a decision (the need to quickly approve tariffs and ensure the continuous operation of gas transmission system following progress in the negotiations on transit), we believe that such a regime should not be used under normal conditions.

6. The issue of salaries at the NEURC is settled by means of their reduction.

As known, a previous provision of the current Law regarding the pegging of salary of the Regulator’s staff to the minimum wage was not fulfilled. Change in the approach (pegging to the living wage while maintaining the final level of salaries) will allow

more correct remuneration funding. Moreover, it should be mentioned that the maximum level of regulation fee is increased from 0.1% to 0.15% of the net income of licensed entities.

At the same time, as a result of changing the accrual basis, the actual salary may be reduced by 24.4% for the chairperson and members of the Regulator and by almost 40% – for other employees. The changes actually deteriorate the financial conditions of the Regulator, and therefore do not comply with the principle of ensuring its financial independence.

Given the above, DiXi Group think tank considers the adopted law to be a temporary solution designed to ensure the legitimate activity of the NEURC after January 1, 2020. Despite solving a number of issues, the law does not per se address the issue of the Regulator’s legal status, the procedure for appointing its members (especially in terms of rotation for acting members), and of its financial independence.

The shortcomings of the adopted law create grounds for violating the principles of political, functional and financial independence of the Regulator as required by the provisions of the EU-Ukraine Association Agreement as well as the Treaty Establishing the Energy Community.

It is possible that the constitutionality of certain provisions of the adopted law can be challenged with unpredictable implications, especially in view of the unsettled status of the Regulator at the level of the Constitution. The only draft law No. 1014 (on the assignment of the President powers to establish independent regulatory authorities) submitted on this matter was found to be inconsistent with part one of Article 157 of the Constitution by the Constitutional Court opinion No. 7-v/2019 of December 16, 2019, and therefore will not be considered.

DIXI GROUP RECOMMENDATIONS

Recognizing the NEURC role in implementing reforms in the energy sector and the risks existing even after the enactment of the law adopted, DiXi Group think tank proposes the following steps to remedy the situation:

ON THE STRATEGIC LEVEL, WE RECOMMEND

Subjects of legislative initiative:

- ▶ to submit to the Verkhovna Rada a new draft law on amending the Constitution of Ukraine, which would clearly establish the status of independent regulatory authorities, powers of other authorities to form them, and the procedure of interaction between regulators and other bodies;
- ▶ after the entry into force of these amendments to the Constitution, to submit to the Verkhovna Rada a new draft law on amending the Law “On the National Energy and Utilities Regulatory Commission” and other laws.

ON THE TACTICAL LEVEL, WE RECOMMEND

- ▶ **Subjects of legislative initiative:** to consider submitting to the Verkhovna Rada a draft law on “fast changes”, namely adjusting the terms of rotation (priority application to the NEURC members appointed on a temporary basis, specifying frequency of rotation), setting a limit on the terms of office for NEURC members, changing the approach to salaries funding, transparency of the Competition Commission activity and the procedure for delegation of the Verkhovna Rada representatives, etc.;
- ▶ **the President:** to approve a rotation scheme which would provide for the priority rotation of the NEURC members appointed by the President on a temporary basis (not following the results of open competitive selection);

- ▶ **the Verkhovna Rada Committee on Energy and Utilities, the Ministry of Energy and Environmental Protection, the Ministry of Territories and Communities Development:** to refrain from delegating to the Competition Commission persons duly authorized to perform the functions of government or local self-government authorities (according to paragraph 1 of Article 3 of the Law “On Prevention of Corruption”), in order to depoliticize competitive procedures;
- ▶ **the Verkhovna Rada Committee on Energy and Utilities:** to decide on the candidates for the Competition Commission to be proposed to the Verkhovna Rada, based on the proposals of parliamentary factions (groups);
- ▶ **the Cabinet of Ministers:** to ensure, on a voluntary basis, the possibility of real-time broadcasting (live streaming) the meetings of the Competition Commission on the selection of candidates for the positions of NEURC members;
- ▶ **the Cabinet of Ministers (Ministry of Finance):** to ensure unconditional inclusion of the draft NEURC budget estimate to the draft 2021 State Budget, without any changes and reductions.

In turn, DiXi Group think tank is ready to take an active part in improving the legal basis for the Regulator’s activities by means of stakeholder dialogue and according to the EU law requirements.