



POSITION PAPER

The return to regulated gas prices for households is a step backwards in the market reform

Why did “tariff protests” happen?

The Ukrainian society has traditionally been sensitive to the issue of energy pricing. On the one hand, there are evident reasons: the problem of energy poverty in Ukraine is quite high on the agenda. According to a survey regularly held by the State Statistics Service, as of 2019, 21.8% of households were unable to maintain proper temperature in their housing¹. In the first half of 2020, 17.2% of the total household expenses were spent on housing maintenance, water, electricity, gas and other utility bills – the second-largest item after food and non-alcoholic beverages (46.2%)².

On the other hand, the topic of tariffs/prices is frequently raised by mass media, and politicians actively speculate on it. The low capacity of government institutions and the absence of a targeted policy of empowering consumers in the energy market make it impossible to effectively address the manipulations and inform the society about real ways of saving on utility bills, in particular, by switching supplier and implementing energy efficiency measures.

In these conditions, in early 2021 the situation in the gas market caused a number of protests in various regions of Ukraine³. This situation resulted from the confluence of several circumstances. A seasonal growth of price offers from all gas suppliers took place in December 2020 – January 2021 in line with the dynamics at European hubs. The revised gas distribution tariffs went into effect on January 1⁴ as well, which can also be partially explained by the growing price of gas purchased by DSOs for technical needs. In addition, the increased tariff was intended to cover expenses of past periods for which insufficient revenues were received, as the distribution tariff had not been revised for quite a while and did not reflect all the actual expenses of DSOs. The decision of the Cabinet of Ministers to lift the reduced price for the first 100 kWh of monthly electricity consumption and to set the fixed price for households at 1.68 UAH/kWh⁵, as well as the rise of heat supply tariffs⁶, became additional factors.

Another factor is speculations by politicians. Public expectations of lowered prices for gas, heating and other utility services have risen under the influence of certain officials and politicians, particularly the President Volodymyr Zelenskyi⁷. It was supported by expectations of record high reserves in storage facilities⁸ and, in general, the consequences of market pricing and competition⁹. The record-breaking decline of gas price in spring and summer 2020¹⁰ caused by pandemic-related restrictions and, as a consequence, by declining demand created a favorable

¹ http://www.ukrstat.gov.ua/operativ/operativ2018/gdvdg/Arh_sdg_dtp_u.htm

² http://www.ukrstat.gov.ua/operativ/operativ2018/gdvdg/Arh_vrdu_u.htm

³ <https://www.pravda.com.ua/news/2021/01/10/7279448/>

⁴ <https://ua-energy.org/uk/posts/yakymy-budut-taryfy-na-rozpodil-hazu-v-2021-rotsi>

⁵ <https://zakon.rada.gov.ua/laws/show/1325-2020-%D0%BF#n10>

⁶ <https://www.epravda.com.ua/news/2021/01/1/669704/>

⁷ <https://www.pravda.com.ua/news/ukrayinski-rodini-mayut-vitrachati-menshe-koshtiv-na-splaty-57737>,

<https://www.epravda.com.ua/news/2019/12/2/654390/>

⁸ https://espresso.tv/news/2020/09/30/kobolyev_zayavyv_pro_rekordni_zapasy_gazu_v_ukrayini_ta_mozhlyvist_pochaty_eksport_vzymku

⁹ <https://ua-energy.org/uk/posts/ministr-finansiv-rozpoviv-koly-podeshevshaie-haz>

¹⁰ <https://www.uex.com.ua/exchange-quotations/natural-gas/medium-and-long-term-market/>

background for the continued process of gas market liberalization. It also helped adopt the long-needed decision to discontinue the public service obligations (PSO) for households: from August 1, 2020, prices became deregulated – with real incentives to switch supplier.

On the other hand, insufficient attention and time were devoted to the task of informing consumers about these changes and creating conditions for intensification of competition, even though the Antimonopoly Committee of Ukraine (AMCU) provided binding recommendations¹¹ and other stakeholders warned about the risks. That is why, when situation in the market gave way to the seasonal price growth¹² (which could be expected back when the market was liberalized) and disappointed citizens rallied for “tariff protests”, the government decided to take a U turn in the reform.

How did the government respond?

On January 11, 2021, the President initiated a conference having “tasked the government with urgently resolving the issue of gas tariffs for households”¹³. The same day, the head of government held a conference with the Acting Energy Minister and the representatives of the NEURC, Naftogaz and Gas TSO of Ukraine, with two approaches discussed. The first approach, proposed by the Ministry of Energy, envisaged a tariffing formula “hub minus” (prices at European hubs less the costs of transmission to the Ukrainian border) and simultaneous capping of a supplier margin. The second approach, proposed by Naftogaz, suggested intensification of market competition through mandatory publication of a fixed annual price by all gas supply companies.

Eventually, at the government’s meeting of January 13, the Prime Minister Denys Shmyhal announced the introduction, for the duration of quarantine or until the end of the heating season, of a fixed gas price for households at 6.99 UAH per cubic meter¹⁴, and also, the audit of gas distribution tariffs by the NEURC. According to mass media, this decision could have been implemented by fixing the wholesale price at “hub minus” (the average value of November forwards for 2021 at NCG) and capping the suppliers margin by 10%¹⁵. Another version of this document, which was temporarily published on the Ministry of Energy website, envisaged a simple capping at 6.99 UAH/cm¹⁶. The IMF expressed concern about these actions¹⁷.

Finally, the Resolution No. 25 of the Cabinet of Ministers of January 18, 2021 has capped, starting from February 1 and for the duration of quarantine but until March 31, 2021, the gas price at 6.99 UAH per cubic meter¹⁸. At the same time, supply terms remained in effect, which means that consumers can choose offers below the maximum price and switch a supplier. The contracts with a fixed price below the maximum one remained in force¹⁹. The Prime Minister Denys Shmyhal assumed the restrictions can be lifted given positive market dynamics (decline of prices)²⁰.

Separate focus was given to the issue of distribution tariffs feasibility, and as a result, the AMCU launched an investigation into this issue²¹ and initiated the capping of these tariffs at 1.79 UAH per cubic meter per month²².

¹¹ <https://amcu.gov.ua/npas/pro-zdijsnennya-zahodiv-spryamovanih-na-zapobigannya-porushennyam-zakonodavstva-pro-zahist-ekonomichnoyi-konkurenciyi-6>, <https://amcu.gov.ua/npas/pro-zdijsnennya-zahodiv-spryamovanih-na-rozvitok-konkurenciyi-zapobigannya-porushennyam-zakonodavstva-pro-zahist-ekonomichnoyi-konkurenciyi-6>

¹² <https://www.unian.ua/economics/energetics/ukrajinu-chekaye-cherhova-hvilya-pidvishchennya-cin-na-gaz-novini-sogodni-11282015.html>

¹³ <https://www.president.gov.ua/news/pitannya-znizhennya-tarifiv-na-gaz-dlya-naseleння-obgovoril-65977>

¹⁴ <https://www.kmu.gov.ua/news/premyer-ministr-bude-zaproponovano-timchasovo-vstanoviti-cinu-na-gaz-699-grn-za-metr-kubichnij-dlya-vsih-pobutovih-spozhyvachiv>

¹⁵ https://lb.ua/economics/2021/01/12/474995_kabmin_pidgotuvav_postanovu_pro_novu.html

¹⁶ https://docs.google.com/document/d/19BKZtFv8miuS4dCt0FuV-5u9Kma_mJx84gKFBjYBy_4/

¹⁷ <https://ua-energy.org/uk/posts/marchenko-mvf-zanepokoieni-namirom-ukrainy-znyzty-tsiny-na-haz>

¹⁸ <https://zakon.rada.gov.ua/laws/show/25-2021-%D0%BF#Text>

¹⁹ <https://www.kmu.gov.ua/news/vstanovlennya-granichnoyi-cini-na-gaz-znizit-jogo-vartist-dlya-naseleння-v-serednomu-na-30-premyer-ministr>

²⁰ <https://www.kmu.gov.ua/news/denis-shmigal-uryad-rozrobit-richnij-gazovij-produkt-yakij-zahistit-naseleння-vid-rizkih-kolivan-cin-na-rinku>

²¹ <https://ua-energy.org/uk/posts/amku-pereviryt-obgruntovanist-taryfiv-na-rozpodil-hazu>

Why price regulation may hamper the market

The price regulation regime has already existed in Ukraine in 2015-2020 in the form of public service obligations (PSO) on Naftogaz and regional supply companies. It was regarded as a temporary measure to protect households against a sharp rise of gas prices. However, a number of factors adversely affecting the gas market in Ukraine became evident during the five years of PSO regime, and these factors may appear again if the price regulation is restored.

First, it may “freeze” the market and preserve market domination of existing players (first of all, supply companies of RGC group). According to the AMCU, in five months of the liberalized market operation, only 3% of household consumers selected a new gas supplier²³. With regulated prices, consumers have no incentives to switch supplier, despite the simplified procedure. The price capping initiative looks even stranger, given that - according to data of Gasoteka (a comparison tool created by DiXi Group) - the lowest market price in January was exactly 6.99 UAH/cm, and many suppliers were offering gas at 7.05-7.5 UAH/cm²⁴.

Second, players in the gas market – primarily, state-owned companies (Ukrghazvydobuvannia, Naftogaz of Ukraine) – may sustain losses or at least not receive the expected profit, which UGV could invest, for example, in increasing production on the promising onshore and offshore fields. The difference between the market price and the regulated price may be substantial (especially over time), thus causing losses to suppliers that will have to be compensated²⁵. In late 2020, Naftogaz was paid 32.2 bn UAH in compensation from the state budget for performing PSO in 2015-2019²⁶.

Third, the difference between the prices for households and industrial consumers creates the risks of corruption on part of suppliers. Various schemes were applied, whereby the gas intended for sale to households at a regulated price was instead resold to industrial consumers at a market price. That, it turn, caused losses to state-owned companies²⁷.

Fourth, regulation of prices at possibly below-market levels is less incentivizing for residential consumers to implement energy efficiency measures. Harmonization of gas prices with market level, even if gradual, helped to reduce consumption by households and district heating companies from 19.2 bcm in 2016 to 15.4 bcm in 2019²⁸.

Fifth, along with the existence of targeted and monetized system of housing subsidies, the introduction of regulated prices looks like duplication. Such interference cannot be considered a replacement or supplement of the existing social assistance system. Moreover, in entire Europe only three EU member states and Norway use general regulation of gas prices to protect vulnerable consumers (as of 2019). Major support schemes include disconnection bans, assistance in implementing energy efficiency measures, financial assistance with installing energy efficient equipment, deferral of payments for energy²⁹. To help vulnerable consumers, EU member states almost never use instruments of manual market regulation.

The Ukrainian government explains the introduction of manual regulation of gas prices by economic consequences of the coronavirus pandemic; however, only part of the Ukrainian

²² <https://www.facebook.com/andriy.gerus/posts/10222666864553958>, <https://www.nerc.gov.ua/?news=11121>

²³ <https://amcu.gov.ua/news/shchodo-situaciyi-na-rinkah-prirodnogo-gazu>

²⁴ <https://gasoteka.ua-energy.org/>

²⁵ According to Article 15 of the Law on Prices and Pricing, if regulated prices are set below economically justified levels, the government must “compensate to business entities the difference between these amounts from the relevant budgets”.

²⁶ <https://www.naftogaz.com/www/3/nakweb.nsf/0/7FCE13CB0D15EB05C2258646004A4DFB?OpenDocument&year=2020&month=12&nt=%D0%9D%D0%BE%D0%B2%D0%B8%D0%BD%D0%B8&>

²⁷ https://www.naftogaz.com/files/Information/170926_Report_re_RSCs_v2-pdf_ENG.pdf

²⁸ Calculations based on data by Naftogaz of Ukraine (<https://www.naftogaz-europe.com/subcategory/ua/GasConsumption>).

²⁹ https://www.acer.europa.eu/Official_documents/Acts_of_the_Agency/Publication/ACER%20Market%20Monitoring%20Report%202019%20-%20Energy%20Retail%20and%20Consumer%20Protection%20Volume.pdf, p. 73

population feels the loss of income. Therefore, defining the vulnerable categories of household consumers and providing targeted assistance to these particular consumers would have been more appropriate than the general lowering of prices for all consumers without exception.

What's next?

While fixing the gas price for households until March 31, 2021, the government should not ignore a number of problems in the market to be solved in the coming months anyway. Otherwise, similar crisis situations may occur again.

Given that, DiXi Group experts recommend:

- **Lawmakers: to launch transparent sales of SOEs' gas resources at commodity exchanges (gas release program).** Most of the gas consumed in Ukraine comes from Ukrgezvydobuvannia resources. Presently, the exclusive "controller" of this resource is parent company of UGV, Naftogaz of Ukraine NJSC, which potentially can take advantage of this leverage to strengthen its market positions. The introduction of a regulatory obligation for Ukrgezvydobuvannia to sell its production volumes at the commodity exchange would improve the situation. Obligations of this kind are applied in the European practice: in November 2020, the Energy Community Secretariat recommended Ukraine to launch a gas release program for domestically produced gas³⁰.
- **Cabinet of Ministers of Ukraine (CMU), NEURC, National Securities and Stock Market Commission: to speed up development of gas trading in the spot market** with transparent pricing of short-term products. The release of substantial gas volumes for trading would allow Ukraine to create **its own market index**, making it a major benchmark. The use of Ukrainian indications would substantially increase liquidity, promote market coupling with the European ones, and have positive effect on pricing. The implementation of Regulation (EU) No 1227/2011 on wholesale energy market integrity and transparency (REMIT) should also promote formation of a healthy environment.
- **NEURC, AMCU: to ensure regular publication of market monitoring data** - structural indicators of competitiveness for the wholesale and retail segments, weighted average prices, and markups. Actions in response to abuses, particularly to manipulations of suppliers and excessive profit margins, must be taken constantly, based on the monitoring data.
- **NEURC, CMU: to increase requirements on unbundling in the retail market and to ensure efficient control.** One of the necessary steps is to ensure effective unbundling of suppliers (*gazzbud* companies) from DSOs (*oblgaz* companies). The control over compliance programs and actions of DSOs' authorized representatives must cease to be a formality, and any instances of abuse (in particular, obstructing the switch of supplier) must be addressed with an adequate response. A more radical version (which, at the same time, should explain how to engage new owners) may envisage the adoption of regulatory acts prohibiting DSOs from being shareholders in supply companies (ownership unbundling).
- **NEURC: to disclose information about the condition of gas distribution networks and to increase control over the use of tariff revenues.** The energy regulator must oblige DSOs to make information about the condition of networks public and disclose, in a convenient form, information about the use of tariff revenues (primarily, on investment programs and installation of gas metering). This information would make the process of calculating and setting the distribution tariff more comprehensible and transparent, and help clarify a number of aspects of the tariff's feasibility. The publication of information about the condition of networks would help understand how high the distribution tariffs should be, and whether maintaining a distribution network with declining consumption and excessive capacities is justifiable.

³⁰ <https://energy-community.org/news/Energy-Community-News/2020/11/26.html>

- **Lawmakers: to secure the rights of consumers and gas suppliers in the context of access to information.** There have been lengthy talks about **opening of customer databases**, which would provide an incentive for suppliers to reach consumers with commercial offers. Since this approach envisages access to personal data, consumers themselves could provide consent to the access to their profile in such a data hub. On the other hand, every consumer must have the guaranteed right to receive own personal data, in particular EIC (Energy Identification Code) required to switch supplier.
- **CMU, NEURC: to set requirements concerning publication of commercial offers from retail gas suppliers.** These requirements (which are presently being discussed)³¹ include mandatory availability of offers with fixed prices (contracts for a quarter, year, season, other longer period). It is important that the regulatory authority makes sure all suppliers publish their prices for the next billing period in advance. It is also important to create conditions in which suppliers are obliged to publish their offers on the respective platforms (comparison tools).
- **CMU (Ministry of Energy, Ministry of Social Policy): to develop and adopt the Procedure of Protecting Vulnerable Consumers** as required by Article 16 of the Gas Market Law. This document must set clear criteria for vulnerable consumers, a procedure of registering and monitoring them, controlling their eligibility for this category, and most importantly, support and protection measures.
- **CMU: to increase the funding of energy efficiency programs and ensure their availability for the broader range of housing associations and building managers.** It would be a much better solution for dealing with energy poverty than price regulation. The EU member states have the practice of price intervention in the gas sector, but the procedure of and reasons for these decisions are clearly described, there is a clear action plan on lifting this policy in the future, and it is clear when this part of regulation will be discontinued.
- **CMU, NEURC, and other public authorities: to communicate changes in the energy sector in general.** It is important that changes in distribution tariffs are sufficiently justified and communicated to all local authorities and communities. The overwhelming portion of information about the gas market, which is presently being classified as “commercial information”, must be opened. It is important to focus on informing the public about the advantages and opportunities of the gas market, not to stop reforms because of certain public discontent. Separate attention must be devoted to countering manipulative statements and busting the myths being widely circulated in information space.

³¹ <https://www.kmu.gov.ua/news/vstanovlennya-granichnoyi-cini-na-gaz-znizit-jogo-vartist-dlya-naselennya-v-serednomu-na-30-premyer-ministr>