

BRIEF ON KEY BUSINESS ISSUES

№4/2016 12.02.2016 Kyiv

Coal stocks at DTEK and other power plants, k/mts

Coal stocks at Ukrainian power plants increased to 2.4 mln tonnes, which is twice higher than at the same period of 2015.

	01.01.2015	11.02.2016	2016/2015, % increase	min. essential level of stocks*	2016/min stocks, %
DTEK TPPs	957	1553	62%	1 767	88%
G+DG grade including:	867	1160	34%	1 365	85%
Zaporiz'ka	121	239	98%	175	137%
Ladyzhins'ka	125	155	24%	178	87%
Burshtyns'ka	246	276	12%	455	61%
Dobrotvirs'ka	59	75	28%	114	66%
Zuyivs'ka	71	115	62%	180	64%
Kurahivs'ka	245	301	23%	263	114%
A+T grade including:	90	393	336%	402	98%
Krivoriz'ka	23	144	539%	151	96%
Prydniprovs'ka	28	97	243%	116	84%
Luhans'ka	39	152	286%	136	112%
Other Ukrainian TPPs**	197	843,2	328%	699	121%
G+DG grade	45	307	582%	197	155%
A+T grade	152	537	253%	502	107%
All Ukrainian TPPs	1 154	2 396	108%	2 467	97%
G+DG grade	912	1 467	61%	1 562	94%
A+T grade	242	929	284%	904	103%

* on the basis of coal reserves for 1 month of work in the mode of the ministerial forecast balance for 2015

**including TPPs situated in the non-controlled areas

A-grade coal supplies out of temporarily occupied territories of Donbas

From 1st January to 10th February 552 k/mts of coal were supplied to our TPPs through the temporarily occupied territories of Donbas (Luhanska, Prydniprovska and Kryvorizka TPPs).

Legislative developments

Over the past weeks significant discussions took place on the long-awaited market reforms, namely concerning independence of the Regulator, electricity market, coal market, and EITI standard implementation.

- **Draft Law on the Regulator**

On February, 3rd the Rada Fuel and Energy committee has approved the draft law for further vote in the Rada in its first reading. The original draft law has been significantly amended. In the course of this work, the following issues turned out to be the most debated:

- a. Issues related to Candidates' Selection Committee such as Selection Committee composition,
- b. Professional criteria applied to potential Commissioners, incl. age threshold, education, experience in the spheres to be regulated,
- c. The rotation procedure as applied to Commissioners currently holding Office.

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- **Draft Law on the Electricity Market**

The Ministry of Energy and Coal Industry in close cooperation with the Energy Community Secretariat developed the draft law meeting the requirements of the Third Energy package¹. According to most of market members, the major problem of this draft law is that it provides only general framework, allowing for interpretations. More specific wordings on key issues are required, such as:

- a. Public Service Obligations (PSO) concept (the clear exhaustive list of PSO types, PSO financing sources, specific entities or types of entities to which PSO obligation may be applied)
- b. Emergency situation in the market. The draft law envisages two types of emergencies – in the energy system of Ukraine (of technical nature) and in the electricity market (for almost whatever reason). Knowing the practices of declaring emergencies in the energy market during 2015, we strongly believe that this provision aims to provide a tool for manipulative hand management of the market.
- c. Retail electricity market issues. It would be worthwhile to include a separate article dealing with the retail market issues to allow the consumer to understand its role, contractual arrangements, rights and obligations in the new market.

- **EITI standard implementation**

On February 9th, 2016 the draft law on information disclosure in the extractive industries was discussed at the meeting of the Verkhovna Rada Energy Committee. It is aimed to implement the EITI² Standard and EU Transparency and Accounting Directives. DTEK took part in the meeting and provided its comments on the text of the draft law. Besides DTEK states that this draft law needs to be substantially amended as it does not meet the EITI International Standard stipulating that governments should also disclose payments received from extractive companies.

The current version does contain excessive obligations of extracting companies while obligations of the government are limited. In particular, the draft law does not impose obligations on the government to explain how the funds received from the extractive companies are used. On the contrary, it strengthens the Ministry's control over the private companies, which is not required by the Standard and contradicts the announced deregulation policy.

- **Draft Law on the coal market**

Ministry of Energy and Coal Industry developed a draft law aimed to ensure establishment of transparent coal pricing mechanism and encourage market players to use coal exchange. However, the draft law version, published on the Ministry's website, calls into question creation of free market trading mechanisms of coal, namely:

- a. obligatory state registration of all agreements for sale and purchase via coal exchange;
- b. mandatory sale of 25% of coal via coal exchange, which limits producer's market freedom of choice;
- c. coal pricing mechanism requires further development;
- d. the Ministry insists on linking coal price indicator to the subsidized price of state-owned coal mines. This would lead to market price distortions and eliminate incentives for improving efficiency of coal enterprises.

¹ The current Electricity Market Law is Second Energy Package – compliant and it came into force on January 1st, 2014.

² Extractive Industries Transparency Initiative (EITI) is an independent standard of transparency, supported at the international level and implemented in 49 countries. Ukraine was accepted as an EITI Candidate country on October 17th, 2013. The first Ukrainian EITI report was published in 2015 and contains information about key Ukrainian oil and gas fields, license holders, production volumes, as well as the payments companies made to budgets of all levels in 2013 (including the data on DTEK-owned PrJSC Naftogazvydobuvannya).

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DTEK purchases G-grade coal from state-owned mines

The Ministry of Energy and Coal Industry of Ukraine reached an agreement with DTEK concerning supply of 60-70 k/mts of coal from the state-owned mines of the Lviv-Volyn coal basin to DTEK TPPs of Zakhidenergo. This was announced by Minister Volodymyr Demchyshyn during the hearings on state of affairs in Ukraine's coal sector held in the Verkhovna Rada's Fuel and Energy Committee on February 9th, 2016.

Minister Demchyshyn added that *Lvivvugillya* could increase output up to 100-110 k/mts of coal per month, but it needs financial support from the state.

Importance of electricity export increase (cont., see Brief #1/2016)

Both the Ministry of Energy and Coal Industry and DTEK agree that urgent measures to stimulate electricity export should be undertaken. On February 9th at the hearings on the state of affairs in Ukraine's coal sector at the parliamentary Fuel and Energy Committee, DTEK has called for ensuring parity and balanced load for both nuclear and thermal power generating capacities. This would help solving the problem of excessive coal stocks. In 2015 increased load of state owned nuclear power plants to the disadvantage of TPPs resulted in 35%-decrease of electricity output by TPPs, thus leading to reduced coal consumption and increasing coal stocks.

"TPPs power units are mothballed due to demand reduction, which results in reduced coal intake. Electricity export is the most evident solution for increasing load of generation capacities. Capacities which are currently not used on the internal market could work for external markets, thus ensuring load for TPPs and employment at coal mines, as well as hard currency income", - said Vitaly Butenko, DTEK Energo Commercial Director. The Minister Demchyshyn followed up saying that the Ministry has already started working on electricity export stimulation: negotiations were held with Belarus, Moldova, Lithuania and other European countries. "The Ministry has got understanding that active electricity export should take off since April", - stated the Minister.

Participants of the hearings underlined that a balanced approach is needed towards pricing of the Ukrainian electricity. DTEK advocates that in order to stimulate electricity export and to make Ukrainian kWh competitive on the European market, the government should take appropriate measures, i.e. exclude cross-subsidies from the wholesale market price which increase the price by one third and thus make export unfeasible.

New Memorandum of Understanding between the EU and Ukraine in the field of energy

The European Commission and the Ministry of Energy and Coal Industry of Ukraine have started drafting process of the new Memorandum of Understanding (MoU) on cooperation in the field of energy between EU and Ukraine. The previous MoU dates back to 2005. The new MoU will set areas of strategic cooperation between Ukraine and EU based on the principles laid down in the EU-Ukraine Association Agreement, Energy Community Treaty and the future EU Energy Union. Parties intend to discuss and approve the new MoU by the end of 2016.

On February 4th, 2016 the future MoU was discussed at the EBA Fuel and Energy Committee meeting with Mr. Hans Rhein, Directorate General for Energy, Desk for Ukraine, Belarus and Moldova, European Commission. DTEK has taken and will further take part in these consultations, through EBA and other possible discussion platforms. We believe that implementation of the Memorandum and respective monitoring and reporting procedures should allow for incorporating, through appropriate transparent procedures, views of all groups of

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relevant stakeholders: consumers, relevant businesses and industry associations, donors, international financial institutions and development banks, civil society organizations, expert centers, etc.