International Energy Agency

Ukraine 2012

Energy Policies Beyond IEA Countries

UA-33

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- Promote sustainable energy policies that spur economic growth and environmental protection in a global context – particularly in terms of reducing greenhouse-gas emissions that contribute to climate change.
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TABLE OF CONTENTS

1. EXECUTIVE SUMMARY AND KEY RECOMMENDATIONS....9

Executive summary....9
Key recommendations....16

2. GENERAL ENERGY POLICY....17

Country overview....17
Critique....27

3. ENERGY EFFICIENCY....33

Overview....33
Energy efficiency potential....34
Energy efficiency institutions and organisations....34
Policy framework....34
Policies and measures....38
Critique....46
Recommendations....49

4. DISTRICT HEATING....51

Overview....51
District heating: main characteristics....52
Heat market....53
Energy savings potential and investment needs....55
Institutional, legal and regulatory framework....56
Investment and modernisation policies....60
Critique....62
Recommendations....64

5. CLIMATE CHANGE AND ENVIRONMENT....67

Overview....67
GHG emissions....68
Carbon intensity....69
Institutions....70
Policies and measures....71
Air quality....74
Critique....78
Recommendations....79

6. UPSTREAM OIL AND GAS ... 81

Overview ... 81
Oil and gas exploration and production ... 82
Institutional framework and industry structure ... 88
Development of unconventional hydrocarbon resources ... 93
Critique ... 95
Recommendations ... 99

7. NATURAL GAS MARKET ... 101

Overview ... 101
Demand ... 101
Supply ... 105
Gas system infrastructure ... 109
Institutional framework ... 115
Prices and subsidies ... 124
Critique ... 127
Recommendations ... 130

8. OIL MARKET ... 131

Overview ... 131
Supply ... 131
Petroleum product demand ... 133
Retail market ... 135
Oil transportation system and transit ... 137
Refineries ... 142
Ports and storage facilities ... 145
Oil market regulation ... 145
Security of supply and emergency preparedness ... 147
Critique ... 148
Recommendations ... 149

9. COAL ... 151

Overview ... 151
Resources ... 151
Supply ... 154
Subsidies ... 157
Trade ... 157
Demand ... 157
Policy and institutional framework ... 160
Environment ... 162
Critique ... 164
Recommendations ... 165

10. ELECTRICITY 167

Overview 167
Demand and supply 167
Prices and tariffs 170
Industry structure 173
Market design, competition and regulation 178
Trade 179
Critique....180
Recommendations 182

11. NUCLEAR ENERGY....183

Overview 183
Legal and institutional framework 183
Uranium production and fuel cycle 185
Nuclear capacity....187
Nuclear electricity tariffs....192
Research and development, education and training....193
Critique....194
Recommendations 195

12. RENEWABLE ENERGY....197

Overview 197
Primary energy supply 197
Legal and institutional framework 202
Critique....209
Recommendations 211

ANNEX A: Organisation of the review 213
ANNEX B: International Energy Agency "Shared Goals" 217
ANNEX C: Glossary and list of abbreviations....219
ANNEX D: Currency conversion table....221

List of figures, tables and boxes

FIGURES

2.1 Map of Ukraine 18
2.2 Domestic primary energy production, 1990-2010 21
2.3 Primary energy mix, 2010....22
2.4 Total primary energy supply 22
2.5 Energy intensity indicators in select countries (TPES/GDP) 23
5.1 GHG-gas emissions by sector, 1990-2010 69
5.2 GHG-gas emissions projections 73
5.3 Trend in SO_2 and NO_x emissions, 1990-2010 75

5.4 Emissions of local pollutants by major thermal installations 76
6.1 Hydrocarbon resource map of Ukraine 83
6.2 Natural gas production, 1991-2011 86
6.3 Oil and gas condensate production, 1991-2011 86
6.4 Naftogaz structure and subsidiaries 87
6.5 Oil and natural gas sector structure 89
7.1 Impact of gas import prices on industrial gas demand, 2005-11 103
7.2 Impact of production levels and GDP growth on industrial gas demand, 2005-11 103
7.3 Natural gas production, imports and import dependency, 2001-11 105
7.4 Naftogaz gas import prices compared with average German border prices, 2006 to first quarter 2012 107
7.5 Gas transmission system and volumes, 2008-10 110
7.6 Gas transit volumes via Ukraine, 1991-2011 113
7.7 Gas export pipeline capacity to Europe, exports volumes to Europe, transit volumes via Ukraine, 2005-20 114
7.8 Natural gas market organisation 117
7.9 Import and end-user natural gas prices, 2004-12 125
7.10 Impact of annual gas import costs on budget deficit and current account balance 126
8.1 Oil and condensate production, 2000-11 132
8.2 Gasoline product consumption by fuel standard, 2011 133
8.3 Diesel product consumption by fuel standard, 2011 134
8.4 Oil transportation system 138
8.5 Total refinery output, 2010 and 2011 143
9.1 Ukraine's major coal basins 153
9.2 Total coal production by type, 2001-11 154
9.3 Production costs in the main coal mining companies, 2010 155
9.4 State subsidies for coal production, 2001-10 156
9.5 Crude steel production in Ukraine, 2001-10 159
10.1 Final electricity demand 168
10.2 Annual maximum system load 169
10.3 Installed generation capacity (53.3 GW), 2011 170
10.4 End-user prices compared with neighbour countries, 2012 171
10.5 Wholesale electricity prices and tariffs 172
10.6 Prices paid to generators and end-user prices 173
10.7 Prices paid to generators and capacity factors 175
10.8 Power lines, thermal generation company location and ownership 177
11.1 Nuclear energy governance structure 184
11.2 Nuclear installations in Ukraine 186
11.3 Cost structure of nuclear electricity generation 193
12.1 Renewable energy in total primary energy supply, 1990-2010 198
12.2 Renewable energy in TPES in Ukraine and IEA countries, 2010 198
12.3 Renewable energy in electricity generation in Ukraine and IEA countries, 2010 199

TABLES

2.1 Economic and energy indicators, 2000-10 21
4.1 Heat production and supply by heat-only plants in urban and rural areas, 2011 (million Gcal)....52
5.1 Indicators relevant for GHG emissions and removals 70
5.2 Estimated emission reduction potential of policies and measures by sector, 2010 and 2020 73
8.1 Main oil pipeline characteristics 139
8.2 Institutional framework for downstream oil market....146
9.1 Coal production, 2011 (million tonnes) 154
9.2 Coal-fired power plants 158
9.3 EU Large Combustion Plant Directive's emission reduction requirements....163
11.1 Nuclear reactors: operational and under construction 188
12.1 Renewable energy installed capacity and generation, 2011 199
12.2 Projected electricity generation from renewable and unconventional energy sources ...202
12.3 Projected biofuels production (million tonnes) 202
12.4 Minimum tariffs green rates 205
12.5 Local content requirements to qualify for green tariffs 206

BOXES

2.1 Ukraine's membership in the Energy Community....25
3.1 Examples of international financing organisation activities....37
3.2 IEA 25 energy efficiency policy recommendations....39
4.1 Potential for renewable sources of fuel in district heating systems 62
6.1 Unconventional hydrocarbon resources 84
6.2 The Vanco PSA dispute 92
6.3 Golden rules for a golden age of unconventional gas 97
7.1 Gazprom-Naftogaz gas supply and transit contract 106
7.2 Energy Community Treaty natural gas provisions....120
7.3 Extractive Industries Transparency Initiative 123
8.1 The Customs Union and its impact on Ukraine's refinery industry....144
8.2 IEA member countries oil stocks 147
9.1 Coal mine methane and coalbed methane 152
12.1 Renewable energy definitions 200
12.2 Green tariffs for biogas 205

pipelines. It is in the interest of both investors and the government to address this issue in a timely manner to avoid uncertainty in the legal and regulatory regime that may affect investment in oil field developments. This includes gathering pipes and low-pressure connection lines within the existing infrastructure.

DEVELOPMENT OF UNCONVENTIONAL HYDROCARBON RESOURCES

TENDERS

Ukraine holds sizable untapped reserves of unconventional oil and gas. The government has pursued vigorous legislative changes to amend existing regulations to make these reserves attractive for investors. For example, it has streamlined PSAs and in 2012 offered tenders for the Oleska and Yuzivska blocks and the Black Sea shelf under this regime allowing for the exploration and production of natural gas, shale gas, tight gas, coalbed methane, crude oil and oil and gas condensates for a 50-year period. These tenders are considered potential game-changers for the Ukrainian economy and have attracted high interest among international majors. Bidders included Royal Dutch Shell, TNK-BP, ExxonMobil and Eni.

The Oleska block, located in the western part of Ukraine, covers an area of 6 324 km^2. The minimum investments required at the exploration stage of this field are estimated to be USD 163 million and for the commercial production stage at USD 3.13 billion. The cost of the tender package for potential bidders was valued at USD 1.3 million and the winning bid was submitted by Chevron.

The Yuzivska block is in the eastern part of Ukraine with an area of 7 886 km^2. The minimum investments required during the exploration stage are estimated at USD 200 million and for the commercial production stage at USD 3.7 billion. Tender package cost for this field was USD 1.9 million and Royal Dutch Shell won the tender.

The Foros and Skifska areas are oil and gas fields on the Black Sea shelf, near the Ukrainian-Romanian border and the Crimean Peninsula respectively. Estimated recoverable reserves are 3 bcm/year to 4 bcm/year of natural gas at Skifska and 2 bcm/year to 3 bcm/year of gas at Foros.[10] The reserve depth of 10 000 m required a minimum investment of USD 200 million in the tender process. With a participation fee of USD 125 000, the cost of the tender package for the Foros area are USD 1.25 million and USD 1.5 million for Skifska. The term of the tenders are for 50 years and allow for natural gas, oil and oil condensate development. The tender was announced in June 2012. In August 2012, the government selected ExxonMobil and Royal Dutch Shell to lead development of the Skifska deepwater natural gas field offshore of the Black Sea, together with Romania’s OMV Petron and NJSC Nadra Ukrayny. No bids were submitted for the development of the Foros field.

The terms for the tender for the four areas require joint development at the exploration stage with 50% state partner participation. Shell and Chevron are required to set up a joint venture with the Ukrainian state partner (a joint venture between NJSC Nadra Ukrayny, the state mineral resources company, and SPK-Geoservice, a service company). SPK-Geoservice was chosen by the Ukrainian authorities to take a 10% minority share in

10. CMS Cameron McKenna, *www.documents.jdsupra.com/057856f0-739c-42ee-9062-10f5d4076453.pdf* (accessed 13 June 2012).

a partnership with NJSC Nadra Ukrayny for the multi-billion dollar shale exploration projects. Profit sharing terms at the commercial production stage require a minimum share for the state of 15% for Oleska, 16.5% for Yuzivska, and 20% for the Foros and Skifska areas. Details for state participation as well as the work programme and licence terms are negotiated with the government as part of the PSA agreement.

FISCAL STRUCTURE

The Tax Code of Ukraine sets royalty payments and subsoil use tax rates. Amendments to the Tax Code, in force from 1 January 2011, have raised royalty payments by 16% for natural gas and by 29% for oil and gas condensate. It also increased the level of subsoil use tax by 66% per tonne of oil and gas condensate and almost 90% per thousand cubic metres of natural gas.

Different ranges of royalty payments are set for natural gas production from offshore and onshore fields and for oil and gas condensates. For onshore production, the rates are differentiated based on the depth of production (below or above 5 000 m) and also between the supply to two categories of customers: residential and commercial/industrial. Oil and gas producing companies and joint ventures with a minimum of a 50% state interest have the statutory requirement to supply domestically produced natural gas to domestic residential, commercial and industrial customers.

The Tax Code fixes the base price of natural gas at USD 179.5/tcm. The methodology for calculating the royalty payment for domestically produced natural gas to residential customers is based on a multiplier, calculated by dividing the average customs value of natural gas imported into Ukraine during the previous reporting month by the base price.

In May 2012, the parliament approved a legislative proposal that would replace the existing royalty scheme for oil and gas extraction with higher mineral extraction taxes effective 1 January 2013. The proposed new tax on oil producers is linked to the Urals oil price and the tax on gas producers is tied to their sale price. Oil tax rates were set at 39% and 17% depending on reservoir depth (up to or below 5 000 m). For gas extraction, a wider range of tax rates was proposed. Companies whose gas is supplied to households face tax rates of 28% and 25% based on the 5 000 m depth threshold (but not less than Ukrainian hryvnia (UAH) 101.3 (EUR 10)/tcm from reservoirs above 5 000 m and UAH 89.45 (EUR 8.9)/tcm from reservoirs below 5 000 m). Offshore gas production is to be taxed at 15%, but not less than UAH 53.9/tcm. For other gas producers, rates of 17% and 9% were proposed based on reservoir depth (but no less than UAH 594.64/tcm from reservoirs above 5 000 m and UAH 18.34/tcm from reservoirs below 5 000 m). Companies operating under production-sharing agreements would be taxed at 2% for oil and 1.25% for natural gas.

If signed into law, the bill will have a mostly neutral impact on oil and gas producers such as Ukrnafta and JKX at current oil and gas prices, as the proposed taxes are close to what these companies currently pay (royalties plus mineral extraction tax). Yet the proposed minimum taxes on gas production are close to the rates implied by current gas prices, hence should gas prices for industrial consumers decline from their current level of USD 438/tcm (*e.g.* in case of revision of the gas contract with Gazprom), gas producers would still pay the same minimum rate, implying an increased amount of taxes in relation to revenues.