HEINRICH BÖLL STIFTUNG
KYIV
Ukraine

E-PAPER

What is in store for Ukraine: decarbonization or monopolization?

OLEG SAVITSKY

Published by Heinrich Boell Foundation, Kyiv-Ukraine Office
May 2020

Short background on electricity market restructuring in Ukraine

On 1 July 2019 Ukraine has started the roll-out of its liberalized electricity market model, in accordance to its international obligations under Energy Community Treaty, Association Agreement with the EU and the agreement on the Conditions for Future Interconnection with ENTSO-E.

Consistency and quality of new electricity market model was undermined from the beginning by the rush to launch it before the expiry of the authority of the Groysman's government after the defeat of president Petro Poroshenko by Volodymyr Zelensky. Previously, under Groysman and Poroshenko rule, Ukraine's richest man oligarch Rinat Akhmetov was enjoying exceptionally high profits for his DTEK energy company, secured by Rotterdam+ coal pricing scheme.

Outgoing politicians in their final days have distorted electricity market reform, excluding state owned nuclear power plant operator Energoatom and (in lesser extent) large hydro dam operator Ukrhydroenergo from the emerging competitive market by introducing Public Service Obligation: a duty to sell electricity at regulated low cost to the state enterprise „Guaranteed Buyer". This provided a way to subsidize low prices for households, while leaving lucrative part of consumer base – industry and businesses – to be reaped by DTEK monopoly, especially in Burshtyn Energy Island – where over 90% of electricity is produced by DTEK.

DTEK conglomerate also holds 25% of renewable generation capacities in Ukraine, with a number of vast wind parks and two large solar farms 200 MW each, constructed in 2019 to reap the exceptionally high feed-in tariff for solar power.

The growing monopoly arrangement in late 2019 was damped only by electricity imports. Independent traders started to import electricity from Slovakia and Hungary to Burshtyn Energy Island (BEI bidding zone, synchronous with ENTSO-E), and from Belarus and Russia to Ukraine's main system (UES bidding zone). Electricity imports created competition on the market and allowed to keep in check wholesale electricity prices.

Availability of cheap electricity imports from Belarus and Russia was particularly important for energy intensive electrometallurgical plants, owned by Igor Kolomoysky – Akhmetov's long standing rival, who seems to be losing the political power battle once again.

By early 2020 due to competitive price dynamics and surge in electricity production from renewables, which was unaccounted for in the hasty launch of the reform, liberalized electricity market in Ukraine, even in its distorted and limited form, became uncomfortable for DTEK.

COVID-2019 pandemic as smokescreen

On 4 March 2020 in the course of abrupt reshuffling of the government, former DTEK employee Denys Shmyhal became prime minister of Ukraine. In 2018-2019, Shmyhal was in charge of 2,3 GW Burshtyn thermal power plant (director of operations) – the cornerstone of DTEK's monopoly in the western part of Ukraine, the main source of electricity export capacity to EU and the poster child of carbon leakage.

On March 15 and a few days thereafter, solar and wind electricity generation exceeded coal for the first time in Ukraine. This predictable fact (in 2019 Ukraine added 4,5 GW of solar and wind capacities) came rather as surprise for many people in the power sector, who were not taking renewables seriously. On March 26, renewables output reached 3,4 GW. At this time coal was running at 2,4 GW. Thereafter renewables output continues to grow due to seasonal increase of insolation, displacing coal from daily load coverage. Combined with the exceptionally warm winter in the context of the climate change, this resulted in huge stranded volumes of steam coal sitting idle near mines and power plants.

With 4,5 GW of renewables (mostly solar) added to Ukraine's power system in 2019 and currently reduced electricity demand due to economic effects of COVID-19 quarantine measures, coal-fired power generation is becoming increasingly stranded.

On 27 March 2020 DTEK declared a default on foreign loans, blaming the COVID-19 pandemic and overproduction of coal. This comes at the time, when DTEK holds monopoly on steam coal mining and controls large part of thermal power generation. Just two month earlier, in January 2020, the company's owner Rinat Akhmetov purchased the most luxurious villa at French Riviera for 200 million USD.

Nearly at the same time (end of March) the new government led by Denys Shmyhal proposed a rearrangement of the electricity market. The proposal includes placing additional burden at state-owned nuclear power plant operator Energoatom, which can further distort competition in favor of DTEK. On 8 April national energy regulatory commission (NKREKP) banned electricity imports from Russia and Belarus, effectively ruling out electricity import trading companies from market competition.

On 28 April planned electricity balance for 2020 was adjusted by Ministry of energy and environmental protection, prescribing load reduction for nuclear power plants and scheduling long offline/idle periods for a number of units, opening more space for coal power plants to operate.

As a consequence of all this, Akhmetov's DTEK can incrementally gain control over the whole electricity sector and dismantle nascent liberal electricity market reform, crush the emerging massive renewable energy deployment, artificially extend the lifetime of depreciated coal assets and strengthen the electricity market monopoly.

Ukrainian civil society concerns, views and proposals

The greatest concern is the revision of the 2020 state budget, performed by Shmyhal's government in April to adjust for COVID-19 pandemic.It has resultedin dramatic cuts in governmental spendingfor environmental protection and energy efficiency measures, while expanding subsidies for the coal sector.

Ukrainian civil society organizations emphasize the need for long-term and systematic planning of the energy sector restructuring and continued public spending for energy efficiency, air pollution control and other environmental measures. Ukraine should not waste the opportunity to accelerate the decarbonization of the energy sector and the fight against climate change. Effectively this necessitates a well-organized coal phase-out and the dismantling of the electricity market monopoly.

Significant reduction of greenhouse gas emissions, transition to de-centralized renewables, digitalization and introduction of new energy efficient technologies are possible and necessary in Ukraine. Implementation of these measures could be the key to a just economic recovery after the crisis. Ukrainian green NGO's argue that this year's budget review must not be the first taste of a new state policy that ignores environmental protection and promotes extended coal use.

Civil society demands that the proper financing of environmental and energy efficiency measures should be restored in the 2021 budget. Priority should be given to comprehensive and just energy transition in an overall decarbonization framework in national policymaking.

Such a framework and justification for ambitious nationally determined contribution to the Paris Agreement was developed in 2019 by civil society organizations and independent experts. They've come together to develop a 2030 roadmap for Ukraine to propose feasible decarbonization goals and sectoral strategies, that allow Ukraine to significantly reduce greenhouse gas emissions in all major economic sectors by 2030 and pave the way for complete decarbonization by 2050.

The 2030 Climate Goals Roadmap includes quantitative targets for five sectors: energy, buildings, transport, waste and one subdivides sector, which includes agriculture, forestry and land use. The goals have been developed based on an analysis of the legal framework, international examples and best practice, and the experience of public and leading experts, within these sectors.

Transparent and effectiveclimate and energy governance in Ukraine requires public participation, which should be an integral part of drafting national strategic documents, such as the integrated National Energy and Climate Plan by 2030 which is due to be developed and submitted to Energy Community Secretariat by September 2020 by the Ukrainian government.

Complementary historic background: How extractive colonial attitude of European private capital towards Ukraine laid the foundation for current crisis

European private banks were systematically funding carbon leakage and heavily engaged in loans for coal sector. In period of 2005-2013 Deutsche Bank, Uni Credit Bank and ING Bank were the largest investors in the fossil fuel industry in Ukraine, providing numerous loans for DTEK, supporting the rise of the dirty energy monopoly owned by Ukrainian infamous oligarch.

Between 2010 and 2013, DTEK energy company strategically increased its coal production and power generation. This included DTEK's acquisition of two coal-fired power plants in western Ukraine (Burstyn TPP and Dobrotvir TPP) and resulted insignificant increase of their output, allowing expansion of electricity exports to Hungary, Slovakia, Romania and Poland. However, the cheap electricity from Burstyn and Dobrotvir TPP's which EU businesses and households have received has resulted inincreased greenhouse gas emissions and toxic air pollution in Ukraine.

Financing from European commercial banks has been central to this export of carbon intensive, coal-based electricity from Ukraine to the EU. In 2013 Deutsche Bank, together with Raiffeisen Bank, Erste Group, UniCredit Austria and the Russian Gazprombank, granted a structured pre-export financing loan for DTEK, providing $375 million for export-oriented activities. But soon this capital became trapped and threatened by unintended consequences of „black gold" rush.

In 2014 military conflict in Donbass region has damaged a significant part of DTEK's mining assets, which along with other factors was driving DTEK bankrupt. On 13 March 2015 DTEK posted a full-year net loss of 19 bn hryvnia (US$833m) after a net profit of 3bn hryvnia (US$161m) in the previous year.By February 2016 DTEK became officially default, failing to provide principal payments to private banks for loans totaling 528 million USD.

This situation created space for another round of grand political corruption in Ukraine. In March 2016 to provide increased revenue flows for defaulted DTEK conglomerate Rotterdam+ coal pricing scheme was introduced by national energy regulator with management appointed by president Petro Poroshenko, spiking the electricity prices for non-household customers (industry, commerce, services) and further drowning Ukraine's war-stricken economy. In return for such beneficial „regulatory service" part of DTEK corporate shares were transferred to Invest Capital Ukraine, a holding company associated with Petro Poroshenko. This scheme allowed DTEK to pay out debt to European private banks, thanks to Rotterdam+ banks got their money with only slight delay.

This is how Ukrainian citizens with little knowledge of that unwillingly bailed out Deutsche Bank and other European private Banks, which supported and funded the rise of Akhmetov's coal empire.