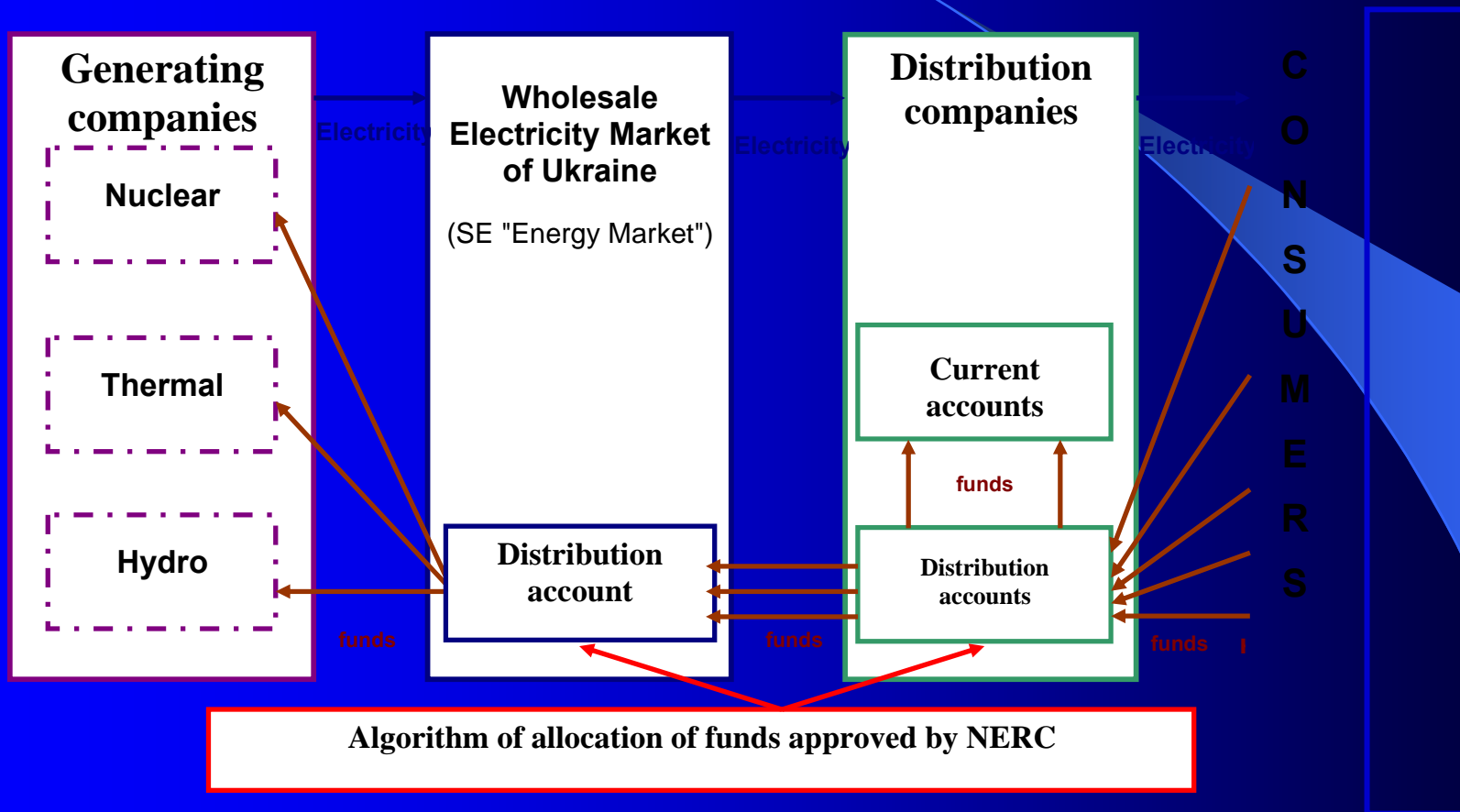




State Regulation of Activities of Entities in the Fuel and Energy Complex of Ukraine

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Outlay of the wholesale electricity market of Ukraine in accordance with the Law of Ukraine "On electricity sector"





NATIONAL ENERGY REGULATORY COMMISSION OF UKRAINE

Status of the Commission

Established on December 8, 1994.

- NERC is a state regulatory body in the sphere of natural monopolies in the fuel and energy complex, a central body of executive power with a special status, subordinate to the President of Ukraine.
- In 1997, NERC's functions were supplemented by regulation of economic entities in the area of production and sale of oil and gas, transmission and distribution of natural gas, transportation of oil, oil products and other substances through pipelines.
- Decisions of the Commission are mandatory for licensees.



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Authorities of NERC Commissioners, staff of the Commission

- The Commission exercises its authorities through the Chairman and four Commissioners who have equal rights; the decisions are made by the majority of votes of attending Commissioners.
- Work of the Commission is supported by the structure that includes functional offices and departments.
- NERC has its chapters in the Autonomous Republic of Crimea and in all regions of Ukraine.



Main objectives of the Commission:

- regulation of activities of subjects of natural monopolies in the fuel and energy complex;
- participation in formation and implementation of the policy related to functioning of electricity, gas, oil and oil products markets;
- Promotion of competition in the sphere of electricity generation and supply, production, storage and sale of gas;
- Implementation of pricing and tariff policies;
- Balancing of interests of subjects of natural monopolies and of their consumers, protection of consumer rights;
- Coordination of activities of state bodies;
- Issuance of licenses, control over compliance with license terms.



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Goal of regulation:

- Creation of efficient competitive environment;
- Liberalization and transparency of functioning of electricity markets;
- Improvement of the settlement system;
- Brining the legislation related to the fuel and energy complex in compliance with international standards.



Main principles of the state policy in the sphere of licensing:

- Ensuring equal rights, legal interests of all economic entities;
- Protection of rights, legal interests, lives and health of citizens, protection of environment and ensuring the state security. Ensuring equal rights, legal interests of all economic entities;
- Establishment of uniform procedure of licensing of activities in the territory of Ukraine;
- Setting a uniform list of types of activities subject to be licensed.
- *A license is a uniform document of a permissive type, which gives the right to carry out a certain type of activity, which is subject to restrictions according to the law.*



Licensing is an integral part of the state regulation, it's objectives are:

introduction of artificial restrictions for entrepreneurial activities,

promotion of competition at markets adjacent to monopoly markets,

protection of rights of consumers and entrepreneurs who use services of natural monopolies, by means of limiting monopoly power of entrepreneurs having a monopoly position.



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Types of activities subject to be licensed

a) *In the sphere of natural monopolies:*

- Electricity transmission and distribution;

b) *Adjacent markets:*

- Electricity generation within set limits;
- Electricity supply;



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- At present there are following licenses for carrying out entrepreneurial activity in the electricity sector:
 - wholesale electricity supply;
 - transmission of electricity through main and interstate networks;
 - generation of electricity;
 - transmission of electricity through local networks;
 - electricity supply at regulated tariffs;
 - electricity supply at non-regulated tariffs.



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Problems of licensing of main consumers

- A lot of licensees not having significant influence on the energy sector of the country would complicate operations of NERC (huge and unjustified spending of regulator's resources on control, tariff setting, etc.)
- Transfer of main consumers to the status of licensees would lead to increase in oblenenergo transmission tariffs



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Problems of licensing main consumers - Planned ways of solving them

- Setting on the legislative level indicators (annual volumes of transmission of electricity), below which owners of electric networks would be permitted to transmit electricity without licenses
- Making changes in license conditions, which would make licensed activities of small owners of networks for transmission of electricity to sub-consumers unattractive from the economic point of view, and would motivate sale (or rent out) of networks to regional energy supply companies – electricity transmission and supply licensees



The Commission sets:

- **Retail tariffs for electricity for residential consumers;**
- **Tariffs for transmission of electricity through main and distribution networks;**
- **Tariffs for electricity supply.**



Principles of formation of prices and tariffs:

- **State regulation for monopoly types of activities and free pricing in competitive sectors;**
- **Compensation of economically justified costs;**
- **Strict control over costs and protection of consumers from monopoly increases of prices and tariffs;**
- **Ensuring balance between economic interests of suppliers and consumers of energy resources.**

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- According to the requirements of the legislation on electricity sector, the procedure for setting retail tariffs for consumers in Ukraine is determined by Conditions and Rules of carrying out entrepreneurial activity related to supply of electricity at regulated tariff, and in accordance with the aforementioned Conditions and Rules is fully transparent, i.e. tariffs, as well as their main components, namely, tariffs for supply, tariffs for transmission of electricity are published in press 5 days prior to coming into effect.
- Approval of tariffs is done at open meetings of NERC according to the Procedure for setting or revising tariffs for licensees of electricity transmission through local networks and of electricity supply at regulated tariffs, approved by decree of NERC as of 01.08.2001 # 801. When considering issues of setting tariffs at the meeting, NERC invites stakeholders, representatives of executive power bodies, representatives of mass media. Not a single decision on increase of tariffs has been made without taking into account the opinion of local administrations.

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- Positive trends of reduction of retail electricity tariffs has been observed in the course of November – December 2004 almost in all regions of Ukraine.
- A negative factor in functioning of the wholesale electricity market still remains high level of cross subsidies from industrial consumers of electricity to residential.
- Tariffs for electricity for residential consumers remain unchanged from April 1999. At the same time in accordance with the Action Plan on Implementation of Long-Term Tariff Policy in the Wholesale Electricity Market of Ukraine, approved by Decree of the Cabinet of Ministers of Ukraine on 26.09.2001 # 451-p, gradual transfer of electricity tariffs for residential consumers is envisioned, so that the tariffs would cover full cost of electricity.
- In 2004, NERC initiated revision by relevant ministries and departments of the issue of gradual increase of tariffs for electricity for residential consumers. Introduction of new tariffs for electricity for residential consumers requires measures to increase social protection of the vulnerable consumers and corresponding increase in real revenues of citizens, and addressing of the issue of converting from providing benefits in electricity payments to the system of targeted support of low-income residential consumers.

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- When applying time differentiated tariffs consumers have a possibility to reduce expenses related to payment for electricity, as the purchase price of electricity at night hours comprises 30% from the level of current tariff. In 2004, consumers who have differentiated metering managed to reduce the cost of purchased electricity almost by 246 million hrivnas.
- To optimize costs for electricity consumers can also use other forms of satisfying electricity demand – to construct and use their own generating capacities (unit - plants), to rent or lease generating capacities (units of thermal power plants, CHPs) and purchase electricity directly from the wholesale electricity market for their own production needs, after getting a license to supply electricity at non-regulated tariffs.
- The Law of Ukraine “On Electricity Sector” grants consumers the right to demand from the supplier of last resort (i.e. operating in a certain territory) sale of electricity, the quality parameters of which correspond to indicators specified in the agreement on electricity use. For supplying electricity of improper quality the supplier is liable in the amount of 25% of the cost of such electricity.