



Regulatory Partnership Program between the National Association of Regulatory Utility Commissioners of U.S. and the National Commission for Energy State Regulation of Ukraine

*The Eighth Visit in the framework of the Partnership Program*

# Recent Ukrainian NERC updates in the regulatory sphere

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# Main challenges confronted by NERC

- Improvement of rate regulation of natural monopolies – moving to methods of incentive regulation of electricity and gas distribution companies
- Dealing with issues of connection to electricity and gas distribution networks
- Compliance in renewable energy development
- Reforms in the electricity market – moving to a bilateral contracts market and balancing market
- Reforms of the natural gas market according to the Law of Ukraine On the Functioning of the Natural Gas Market
- Improvement of the quality of services provided to electricity and natural gas consumers
- Energy efficiency (in the long term)



# Main changes in the legislation

## Three laws adopted:

- On Making Changes and Amendments to the Law of Ukraine “On Natural Monopolies” (regarding the implementation of incentive regulation);
- On Making Changes and Amendments to Some Laws of Ukraine on Network Connection Fees for Natural Monopoly Subjects;
- On Making Changes and Amendments to the Law of Ukraine “On Electricity” (on stimulation of production of electricity from alternative energy sources)

## Preparation to the second reading by the Verkhovna Rada of Ukraine of:

- Draft Law on the Basics of Functioning of the Electricity Market in Ukraine

## Considered at Verkhovna Rada:

- Draft Law of State Energy Regulation in Ukraine



# *Improvement of Rate Regulation for Natural Monopolies*



# Main principles of incentive regulation

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- Minimum intervention – moving to long-term regulation
- Stimulate investments – setting a fair rate of return on investment
- Take into account service quality indicators in the rate-making methodology and implementation of quality standards
- Stimulate efficiency raising (decrease monitored costs, decrease electricity losses in networks etc.)



## Development of the regulatory framework for incentive regulation of natural monopolies in the energy sector (1)

Throughout 2013, various steps were taken to introduce incentive rate-making for the purpose of raising the efficiency and upgrade of electricity distribution companies' fixed assets.

NERC has adopted basic regulations for incentive regulation of electricity distribution companies:

- Procedure for determination of the regulator asset base for subjects of natural monopolies in the energy sector
- Procedure for determination of the required revenue obtained from electricity supply activity conducted at a regulated rate under incentive regulation
- Procedure for calculation of retail rates for electricity, power transmission rates for local power networks, electricity supply rates at a regulated rate under incentive regulation



## Development of the regulatory framework for incentive regulation of natural monopolies in the energy sector (2)

- Procedure for rate-making for electricity supply licensees conducting their activity at a regulated rate and/or electricity transmission by local power networks under incentive regulation
- Procedure for allocation of assets, expenses and revenue among activities of electricity supply licensees that operate at a regulated rate and/or power transmission by local power networks
- Procedure for determination of the required revenue obtained from power transmission by local power networks under incentive regulation
- Procedure for submission, determination and approval of economic coefficients of standard technological electricity losses
- Decision on application of incentive regulation
- Decision on the setting of long-term regulation parameters for the purpose of incentive regulation



# *Regulation of network connection*





# Regulation of network connection (1)

On January 01, 2013, the Law of Ukraine came into force On Making Changes and Amendments to Some Legislative Acts of Ukraine Regarding Fees for Connection to Networks for Subjects of Natural Monopolies

**The Law regulates relations in the sphere of connection of electric facilities to power networks and of gas consumption system to gas networks, particularly in relation to:**

- Procedure of connection;
- Connection cost;
- Financing sources (connection fee, reimbursable financial assistance, investment licensees programs).

Connection to power networks of **generation facilities** using alternative energy sources is financed from:

- investment programs for transmission licensees - 50%;
- reimbursable financial assistance - 50% (repayment term – not more than 10 years)



## Regulation of network connection (2)

**Pursuant to the Law, NERC has developed and adopted regulatory acts regarding the connection of:**

➤ **power facilities to power networks:**

- Rules for connection of power facilities to power networks
- Methodology of calculation of electric facility connection fees for their connection to power networks.
- Standard connection fees for 2013
- Procedure of financing electric facility connection to power networks (awaiting approval)

➤ **gas consumption facilities (gas supply):**

- Procedure of granting access and connection to the Single gas transportation system of Ukraine;
- Standard contracts on connection to gas networks;
- Procedure of calculation of connection fees for clients that seek connection to gas networks;
- Standard contracts (between owners and gas transportation or gas distribution enterprises) for:
  - economic management of the Single gas transportation system of Ukraine;
  - use by the components of the Single gas transportation system of Ukraine;
  - operation of components of the Single gas transportation system of Ukraine;
- Standard connection fees for 2013.



# *Promotion of renewable energy*



# Changes in the regulatory framework on alternative energy

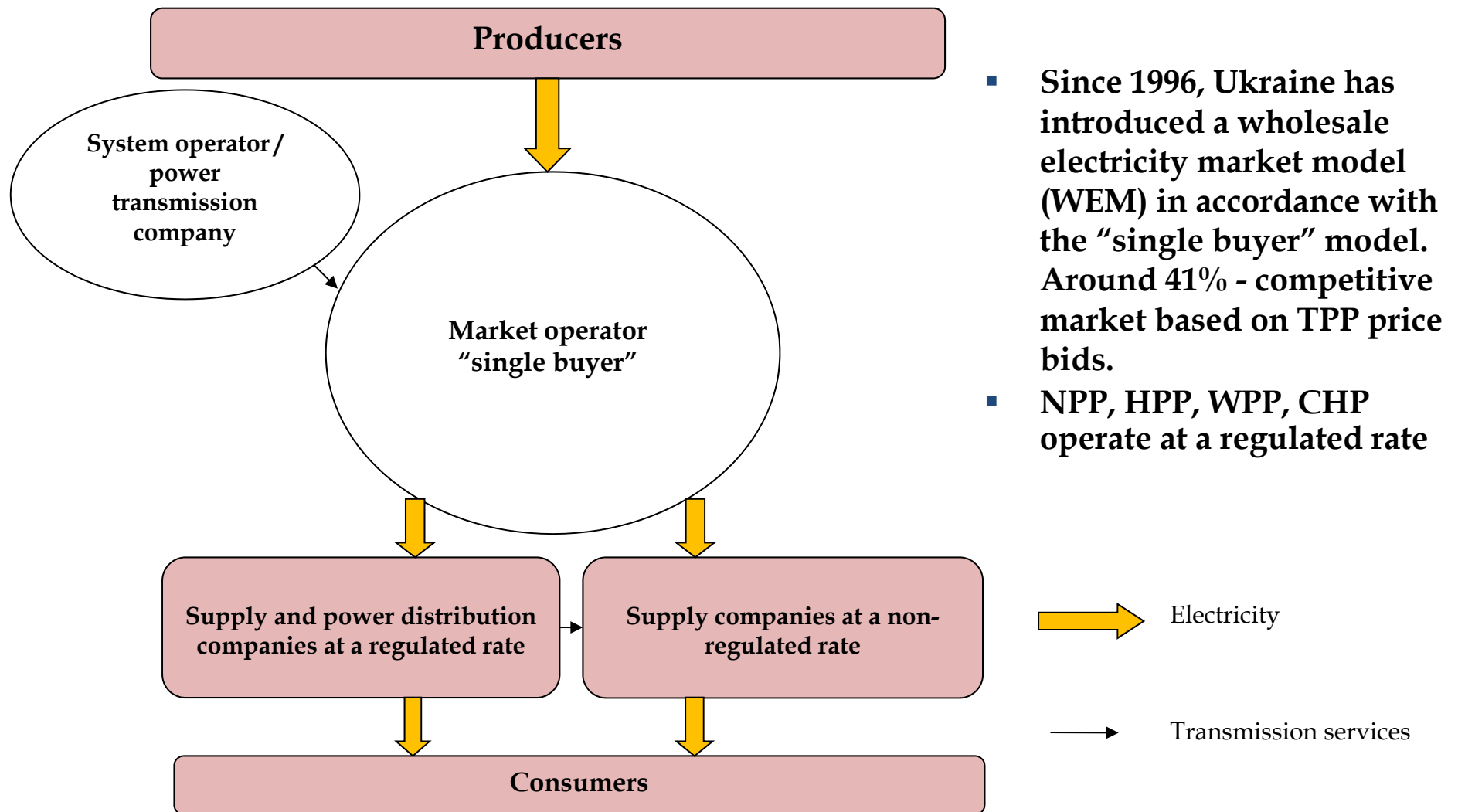
- Changes and amendments made to the Procedure for Establishment, Revision and Termination of the Green Rate for Economic Entities related to parallel granting of an electricity generation license and a green rate;
- Adoption of the Procedure for Determination of the Size of the Local Component for Electric Facilities including already commissioned power plant construction stages (start-up facilities) that generate power from alternative energy sources (except for blast-furnace and coking gas);
- For the purpose of regulatory settlement of the procedure of sale of electricity generated from solar radiation by energy facilities (generation facilities) of private households the following act swere developed:
  - Procedure of Sale, Accounting and Settlement for Electricity Generated from Solar Radiation by Energy Facilities (Generation Facilities) of Private Households;
  - changes and amendments to the Rules for Electric Power Usage for the Population;
  - changes and amendments to the Terms and Rules for Entrepreneurial Activity Related to Power Supply at a Regulated Rate;
  - changes and amendments to the Procedure for Retail Rate-making for Power Supplied to Consumers (except for the population and localities) by Power Supply Licensees at a Regulated Rate.



# *Energy market reforms*



# Simplified model of the current wholesale electricity market of Ukraine





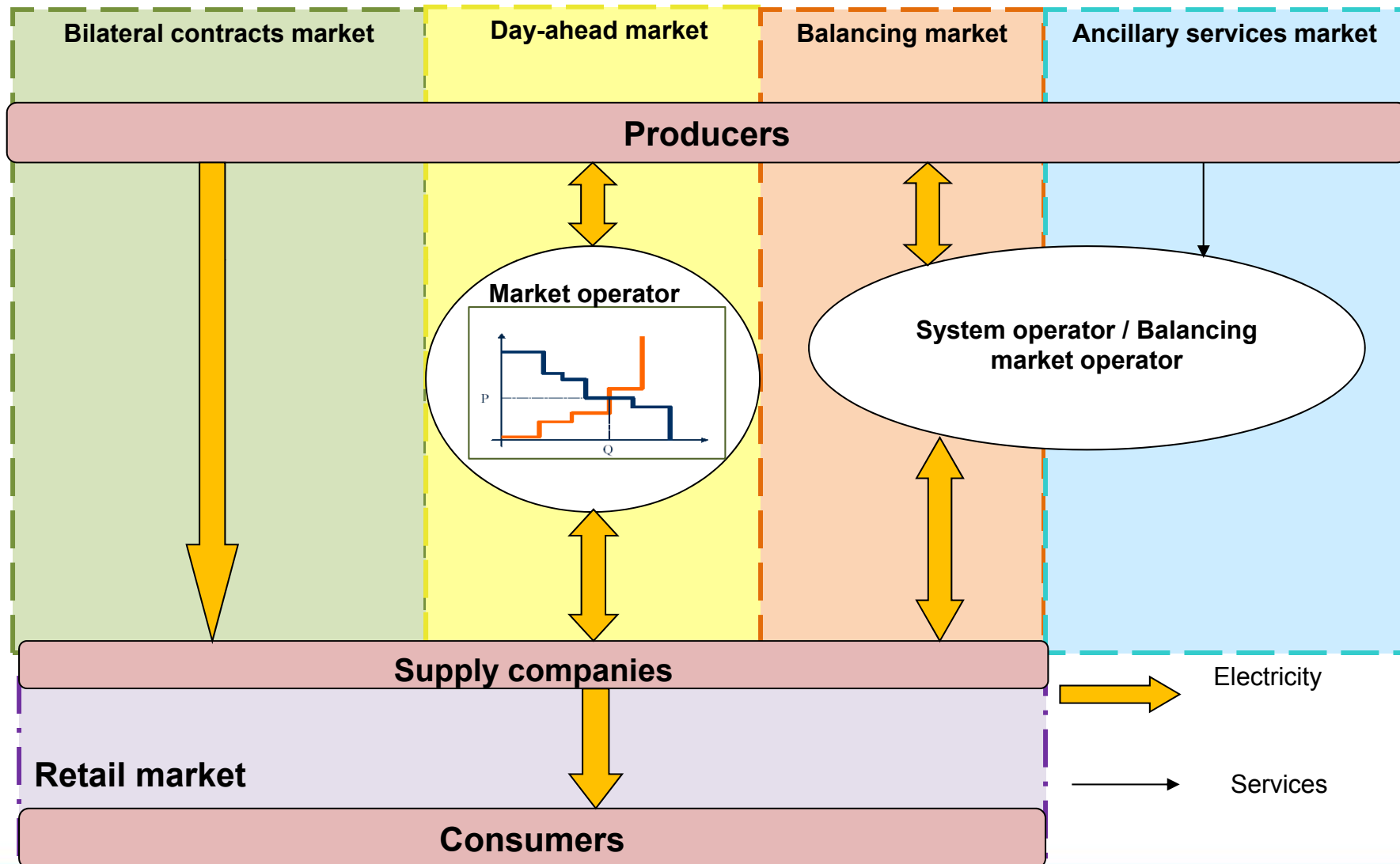
## Drawbacks of the current market model

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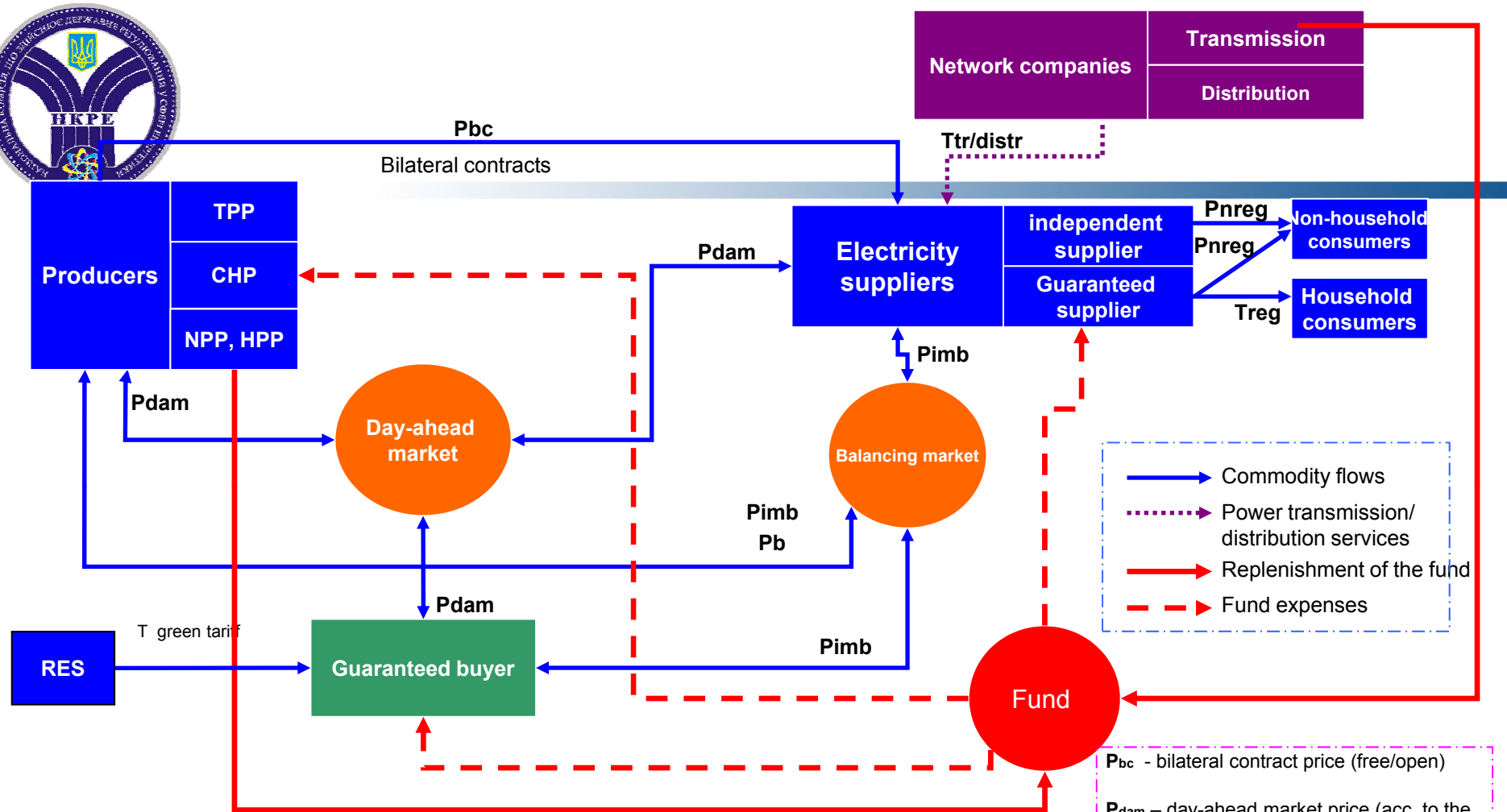
- Limited competition in power generation
- Limited competition in electricity sale
- Non-market price-making
- Insufficient predictability of market operation, unfavorable investment environment



# Simplified target power market model according to the draft Law on Basics of Functioning of the Ukrainian Power Market





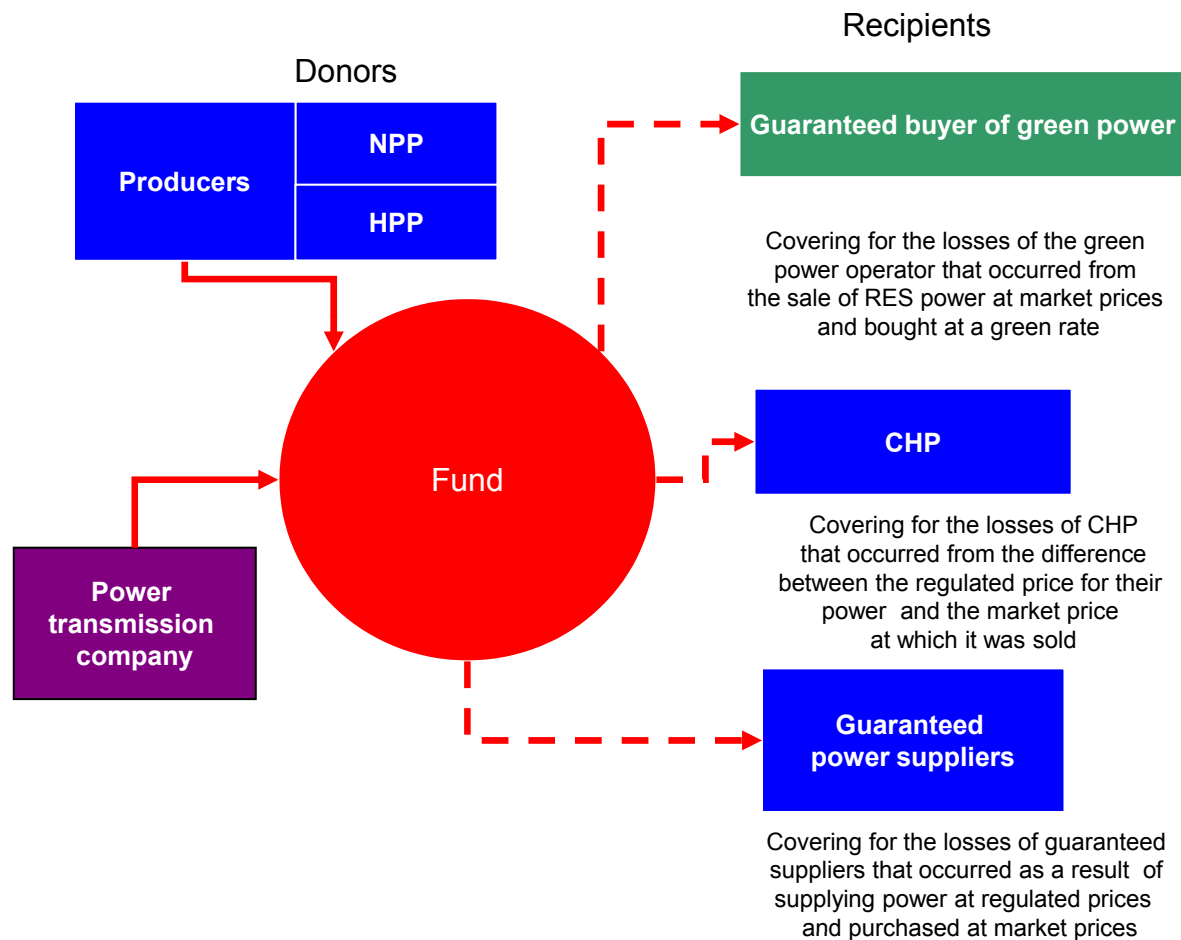


1. Electricity purchase-sale:
  - under bilateral contracts,
  - on the day-ahead market (DAM),
  - on the balancing market.
2. All electricity generated from renewable energy sources (RES), purchased by guaranteed buyer of green electricity at the green tariff;
3. For certain consumer categories (household consumers) power is supplied at a regulated rate, as before, by guaranteed suppliers.
4. Cost imbalance settlement fund (Fund) ensures financial balancing of guaranteed suppliers, guaranteed buyer of green power and power generators at CHPs

$P_{bc}$  - bilateral contract price (free/open)  
 $P_{dam}$  - day-ahead market price (acc. to the rules of the day-ahead market)  
 $P_b$  - balancing price (acc. to the market price)  
 $P_{imb}$  - imbalance price (acc. to market rules)  
 $T_{green\ rate}$  - green tariff  
 $T_{reg}$  - regulated retail power tariff  
 $P_{nreg}$  - non-regulated retail power price  
 $T_{tr/distr}$  - transmission and distribution tariffs



# Cost Imbalance Settlement Fund



## Main goal:

- prevent increases in electricity prices when power producers obtain additional revenue at NPP and HPP due to switching to market price-making;
- Meeting state guarantees on the purchase of RES power at a regulated rate;
- Ensuring the possibility of phasing-out cross-subsidies



## Additional provisions are proposed for the Draft Law:

- ensure non-discriminatory access to power networks (including unbundling of electricity distribution and supply);
- strengthen consumer rights protection and information support;
- regulation of the procedures of issuance of licenses for the construction of generation capacities and holding tenders for the construction of new generation capacities;
- organization of energy security monitoring;

**The Draft Law is generally aimed at adaptation of the European legislation related to the organization of internal power markets and cross-border trade**



# *Reforms of the natural gas market*



# Objectives of the reforms

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- Increase performance of the sector's companies
- Promote competition
- Increase the inflow of investments in the sector
- Ensure availability of free choice of suppliers for the consumers



# Changes in the natural gas market

On July 24, 2010, the *Law of Ukraine* came into force on *Basics of Functioning of the Natural Gas Market* that defines :

- NERC competence in regulation of the activity of natural gas market subjects
- principles of free gas trading, protection of consumer rights and their choice of natural gas supplier
- obligations related to unbundling the functions of natural gas transportation, distribution and supply
- principles and approaches to ensuring non-discriminatory and transparent access to the Single gas transportation system of Ukraine and underground gas storages
- responsibility of natural gas market subjects for the violation of the rules of operation on the natural gas market and violation of contractual provisions



# Reforms of the “Naftogaz Ukraine” company

Reforms were launched for the “Naftogaz Ukraine” company – the biggest vertically integrated oil and gas state company of Ukraine carrying out exploitation of deposits, oil and gas production, their transportation, natural gas transit, as well as commercialization of oil products through its own network of gas station. The company’s enterprises produce more than 97% of gas and oil in the country

In May 2011, amendments were made to the Law of Ukraine on Pipeline Transportation related to reforms in the oil and gas complex of Ukraine

In accordance with the Decree of the Government of Ukraine, companies affiliates of “Naftogaz Ukraine” were reorganized in Public joint-stock companies:

- “Ukrtransgaz”
  - natural gas transportation;
  - natural gas transit;
  - natural gas storage;
- “Ukrgezdoobycha”
  - natural gas production;

In the process of reorganization:

- “Gaz Ukrainy”
  - Independent natural gas supplier (reorganization should be finalized before the end of 2013)

**Restructuring of NAK “Naftogaz Ukraine” is performed in accordance with the requirements of the EC 2003/55/EC Directive**



## *Improvement of the quality of services provided to electricity and natural gas consumers*





# Improvement of the quality of services provided to electricity and natural gas consumers

**NERC made changes to the Licensing Terms and Rules and adopted the following decisions:**

- On improving the quality of services provided to electricity consumers;
- On improvement of the quality of services provided to natural gas consumers;
- On ensuring the functioning of call-centers by economic entities that supply electricity at a regulated rate

Power supply companies are obliged:

- to provide consumers, on a yearly basis, through payment documents and the official web-site, information about the share of each energy source in the general consumption structure, their rights, approved prices;

- establish, within 1.5 years, fully functional call-centers for consumers having the following functions:

- round-the-clock quick (real-time) communication with consumers (telephone calls, e-mails),
- quick provision of information (power interruptions, settlement of bills, information on rates, connection, regulatory framework etc.).
- referral of requests to relevant divisions of the company etc..



# *NERC cooperation with NARUC/USAID*



# Regulatory Partnership between NERC and NARUC

The Regulatory Partnership program between NERC and NARUC that was resumed in 2010 is successful and brings a significant input into the institutional development of NERC.

This is the eighth visit.

Representatives of regulators from the states of Ohio, New-York, Missouri, Utah, Vermont, Wisconsin, Kentucky, Virginia, Columbia District, FERC, as well as American and Ukrainian utilities were involved in the cooperation process.

## **Main topics:**

- protection of vulnerable consumer categories;
- principles and methods of rate regulation and regulation of the quality of service;
- improvement of investment attractiveness of the sector;
- support to the development of renewable energy sources;
- competences, regulation and incentive experience in the sphere of energy efficiency;
- transparency, openness, information and publicity,
- procedure and experience of public hearings;
- fees for the connection to electric and gas networks etc.

The partnership allows NERC to have wide access to US practice of regulation and allows assimilating new methods and methodologies and broadening the understanding about international legislative and regulatory environment



# Black Sea Regulatory Initiative (BSRI)

In the framework of the Black Sea Regulatory Initiative (BSRI) for regulators in the Black Sea Region, NERC takes part in regional seminars and thematic technical workshops, as well as regulatory thematic study trips:

- **on issues of investment into renewable energy:**
  - Development of Principles of regulation aimed at promotion of RES
- **on issues of cross-border trade, market monitoring, and the role of energy efficiency regulation:**
  - Development of Principles of regulation aimed at harmonization of rules for cross-border trade, market monitoring and increase in the role of regulation



# Study programs on energy regulation

- Annual Regulatory Studies Program: Camp NARUC;
- Advanced Regulatory Studies Program Ratemaking Accounting and Economics;
- Practical regulatory training for the electric or natural gas local distribution (LDC) industries;
- The PURC/World Bank International Training Program on Utility Regulation and Strategy) (*NERC participants involved*);
- NARUC Utility Rate School (*NERC participants involved*)



# Energy Regulators Regional Association (ERRA)

ERRA serves as a platform for sharing information, best practices, and facilitates interaction between regulators - members of ERRA.

The ERRA rates data-base contains information on electricity and gas rates for ERRA member-countries starting from 1998.

## **NERC took part in ERRA events:**

- meeting of Chairs of National Regulatory Commissions;
- Licensing and Competition Committee;
- Tariff/Pricing Committee;
- Legal Regulation Working Group;
- Annual Investment Conference;
- thematic courses on energy regulation.

In 2010, ERRA introduced the “Certified Specialist in Energy Regulation” Certificate” awarded to the participants of ERRA courses. Since 2008, NERC employees took part in 14 study programs in the framework of ERRA.

Possibility to resume the funding of NERC’s participation in ERRA activities?



# Advisory support in the development of subsidiary legislation for the new power market

In the period of establishment of the Wholesale Electricity Market of Ukraine (the 1990s – beginning of 2000s), NERC enjoyed advisory support from consultants (Hagler Bailly, Hunton & Williams) funded by USAID;

This support was an essential precondition for successful reforms in the WEM and the development and adoption of a rate methodology with elements of incentive regulation for electricity distribution companies in 2001.

Currently, NERC faces the challenges of critical restructuring of the power market.

## **Implementation of a new power market model will require the development of a set of new by-laws**

*(according to preliminary evaluation – more than 100 acts):*

- market rules,
- technical codes,
- standard contracts,
- methodology of price and rate-making and a number of procedures,
- making changes and amendments to the current regulatory and legislative framework



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**Thank you for your time**

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