

**HUNTON &
WILLIAMS**

**HUNTON & WILLIAMS
USAID UKRAINE**

**ENERGY LEGAL, REGULATORY
AND MARKET REFORM PROJECT**

Prepared for:



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7th QUARTERLY REPORT
DECEMBER 2001 –
FEBRUARY 2002

**HUNTON AND WILLIAMS - USAID UKRAINE
TASK ORDER OUT-EEU-1-800-99-00033-00
ENERGY LEGAL, REGULATORY AND MARKET REFORM PROJECT**

7th QUARTERLY REPORT: DECEMBER 2001 – FEBRUARY 2002

OUTLINE OF 7th QUARTERLY REPORT

This report summarizes the conditions found and results achieved for the period from December 2001 through February 2002 (7th Quarter), the current status of work, and anticipated activities in the near to medium term. Starting with this Report we also discuss activities related to CBM or to Fuels Markets as part of Part G, Other Activities.

For this 7th Quarterly Report we also add a special discussion in Part B.2. assessing our progress to date against project Benchmarks as established in our original and revised project contracts.

This report consists of the following sections:

- **Part A** Outline Of Project Purpose And Focus Of Work.
- **Part B** Overview Of The Current Status Of The Project.
- **Part C** Relationship With Counterparts.
- **Part D** Support Of The Privatization Effort.
- **Part E** Activity For International Privatization Task Force And Donor Community.
- **Part F** Training and Study Tour Program.
- **Part G** CBM, Fuel Research and Other Activities.
- **Part H** Main Project Activities Register
- **Part I** Register Of Activities at NERC Office
- **Annex A** Documents Translated In Course Of Work With The NERC
- **Annex B** Documents Translated In Course of Other Work
- **Annex C** List of Letters Sent By The Project To Government Agencies
- **Annex D** List of Other Documents Produced By Our Staff.
- **Annex E** Computer Equipment Purchases For Counterparts
- **Annex F.** Structure of Market Model Computer Programs
- **Annex G:** Preliminary Results From Market Operations Analysis

A. OUTLINE OF PROJECT PURPOSE AND FOCUS OF WORK

Hunton & Williams has been awarded Indefinite Quantities Contract EEU-I-99-00033-00 (the “IQC”) by the United States Agency for International Development (“USAID”) through which USAID awarded Task Order OUT-EEU-I-800-99-00033-00 (the “TOR”) to Hunton & Williams to provide certain legal, regulatory and wholesale electricity market advisory services in support of Ukraine’s energy sector privatization program (the “Project”). To those ends, we are expected to, and successfully do, work with diverse counterparts within the Government of Ukraine (“GOU”) as well as coordinate our activities with the international donor community.

We continue to summarize the work as principally serving three functional headings, working to:

- ***Strengthen the independence and functionality of the power sector regulator*** – presently the National Electricity Regulatory Commission (“NERC”);
- ***Improve the operation and governance of the wholesale electricity market*** (“WEM”); and
- ***Ensure the success of GOU’s energy sector privatization program*** in concert with USAID contractor Deloitte Touch Tomatsu (“DTT”) – the USAID contractor with primary responsibility to advise the State Property Fund of Ukraine which conducts the privatization of all state entities as the agent of the government.

To achieve each of these goals, we actively work with all GOU counterparts – the Verkhovna Rada of Ukraine (the “Verkhovna Rada”), NERC, the Ministry of Fuel and Energy (“MFE”) and Energorynok State Enterprises (“Energomarket”) – to identify the impediments to achieve our goals, develop precise mechanisms to remove those impediments and then implement those mechanisms.

Specifically, to strengthen NERC, we are implementing the following initiatives:

- Renewing efforts to pass legislation that provides political and financial independence and establishes standards for regulation of the energy sector by NERC.
- Continuing to make the NERC tariff methodology responsive to the privatization effort and current market realities. In the 7th Quarter we assisted NERC to implement tariffs for the remaining oblenergos privatized in April 2001, including providing NERC with detailed analyses of diverse technical tariff issues.
- Developing a transparent mechanism for modifying the NERC-established algorithm that controls the flow of funds through the WEM. As a result of our working intensively with the NERC, the Energomarket and the WEM Board working committees, the Cabinet of Ministers issued a transparent procedure for modifying the flow of funds.

To improve operation and governance of the WEM, in the current period we have been working in the following areas:

- Improving operations within the existing WEM structure to allow for transparent functioning of the existing WEM framework established through the Members' Agreement.
- Preparing the WEM to become a fully functioning true market. Hunton & Williams has worked in this area by participating in the "WEM Commission" as representative on behalf of the Donor group, providing intense staff participation in the "WEM Working Group," doing the daily work to develop the concept, and providing the actual staff and support office for the "Commission Secretariat" that assures the proper preparation and flow of documents for the WEM Commission. The issues being addressed include bilateral contracting, market rules, pricing settlement and payment procedures, improving information technology within Energomarket and metering in the Wholesale Electricity Market. The WEM Commission will decide whether legislation is needed or whether improvements can be completed without legislation.

To ensure the success of GOU's energy sector privatization program, we undertook the following in the 7th Quarter of project activity:

- Worked closely with the NERC to implement the tariff procedure and continue effective processing of applications for a tariff increase under the new methodology;
- Participated in the USAID-sponsored USEA "Genco Summit" by presenting analyses of problems that must be solved in the WEM, and analysis of the impacts of alternative scenarios for doing so;
- Regularly met with existing and potential strategic investors to share our knowledge on legal and regulatory issues impacting the energy sector, and to work out strategies for addressing legal and regulatory issues strategic investors face within the Ukraine WEM environment;
- Supported the International Privatization Task Force created by GOU and the international donor community – consisting of USAID, the European Bank for Reconstruction and Development ("EBRD"), the International Monetary Fund ("IMF") and the World Bank (the "Task Force") - through drafting joint documents and implementing the action items emerging from Task Force meetings.
- Worked with DTT to coordinate efforts among the international donor community to ensure a common focus on and support of an acceptable outcome for GOU's energy sector privatization.

B. OVERVIEW OF CURRENT STATUS OF THE PROJECT

B.1. SUMMARY OVERVIEW OF 7th QUARTER

The design and implementation of the Hunton and Williams project remains as summarized in the December 2000 Inception Report, which was also our Second Quarterly Report. The early phases of our project were dominated by issues of NERC independence and the relationships of the NERC to privatization. The period from June 2001 through the present has been dominated by issues of wholesale market functioning governance, and has involved work with all our counterparts.

The 7th Quarter saw the appointment by the Government of a “WEM Concept Commission,” for which the Deputy head and effective working chairman was NERC Commissioner Kotko, and on which our project economist, Ilka Lewington, sits as a representative of the Donor Community. Thus H&W is working intensely at three levels of this body. On the highest level, we represent the Donors at Commission meetings (that take place each 3 weeks). We also meet regularly with Commissioner Kotko to discuss management of the Commission process and schedule. Within the Working Group, that meets daily to conduct the actual labor of the Commission, we have essentially full time participation from two to four members of our legal and economist staff. Finally, our staff also provides the primary functional support for the Secretariat of the Commission. The Secretariat assures the proper completion of working documents and their circulation to Working Group of Commission members, as appropriate.

The work of the WEM Concept Working Group so far has focused mainly on the basic working document – a table of problems of the current WEM functioning, and an analysis of the reasons for such problems. H&W has provided the main input for this document, based on the analysis undertaken by H&W last autumn. During intense discussions, which lasted for over a month, H&W was able to achieve recognition at the Working Group level, as well as at the Commission level, that the major problems of the WEM lie in the areas of pricing, lack of competition, and administrative interference.

Hunton & Williams continued to work extensively with the NERC to implement the NERC Tariff method. The NERC process requires a fixed time limit for the complete review and decision on each application, including an open public hearing process. Government interference delayed implementation of the previously approved tariffs, pending development of a mitigation procedure. Since then, we have helped assure that the required implementation, including mitigation, has taken place.

B.2. ASSESSMENT OF COMPLETION OF PROJECT OBJECTIVES TO DATE

B.2.1 Purpose of this Discussion

The Hunton & Williams contract for this project is a “performance” contract, which has general objectives and specific “Benchmarks” which seek to measure the achievement of those objectives. The contract objectives have been constant through the contract term,

but the Benchmarks have been changed. This Part B.2. discusses our view of whether and the extent to which, we have achieved the general objectives and the specified Benchmarks.

B.2.2. Contract Statement of Performance

The required performance of this contract is stated at its Part D as follows:

“The contractor shall make best efforts to achieve the results of the ‘Ukraine Energy Regulatory and Legal Support’ program which are: the creation of a sound regulatory, legal and market development bases [sic: basis] in which soon-to-be-privatized oblenenergoss can operate effectively and profitably without undue government interference”

To emphasize that the purpose of the project was performance, within Contract Part E “Reporting,” it is stated “USAID emphasizes that this project is not a report writing exercise.” Therefore, we have undertaken to organize and perform our work to achieve results, not for production of documents. Except for reports to USAID, such as this one, all of our written materials and other activities are created in relationship to production of some specific result. While our purpose is not for us to produce documents, per se, in many cases the measure of the result of our work is production of a document issued by the Government or the Parliament. However in other cases our result can only be measured by the perception of an action taken (or avoided) by the Government or the Parliament.

Our initial contract of May 2000 contains four Benchmarks, which were replaced in June 2001 by three Benchmarks. Thus the May 2000 Benchmarks guided our performance for the first approximately 14 months, and the June 2001 Benchmarks have guided our work since that date. We organize the discussion below by the specified Benchmarks.

As summarized by the first Benchmark of May 2000, there are essentially two general tasks, related to NERC functioning and related to WEM functioning. We thus separate our discussion by those topics.

B.2.3. Performance Against NERC-Related Benchmarks

B.2.3.1 Statement of NERC Related Benchmarks

The May 2000 Benchmarks related to NERC were:

- 1) *Support for passage of legislation pertaining to the wholesale electricity market and to strengthening the legal basis for NERC.*
- 2) *Support for NERC functionality and independence as measured by:*
 - a) *NERC revenues deriving from monthly license assessment at an appropriate level;*
 - b) *NERC Reports at a Presidential Level;*
 - c) *Commissioners are not dismissed for political reasons prior to term expiration.*

In addition, it was clear that a major implied May 2000 Benchmark, related to achieving actual investor participation, was to provide investors with an opportunity to “operate profitably.” This necessarily required developing an appropriate retail transmission and supply tariff.

These Benchmarks were replaced in June 2001 by this text:

a) Successful implementation of NERC-approved tariff methodologies.

b) Passage of a NERC law that strengthens the legal independence. If feasible, attempt to introduce a Constitutional Amendment to insure NERC’s exemption from central budget funding. (June 2001)

B.2.3.2. Evaluation of Achievement of NERC-Related Benchmarks:

Support for a NERC Law: May 2000 Benchmark 1 was a major focus in our first year. We assisted the Verkhovna Rada’s Fuel and Energy Complex Committee (FEC Committee) to mediate between competing drafts of a NERC Law, combine them into a single Draft Law, and to successfully pass the Draft NERC Law at First Reading. We then assisted the FEC Committee with drafting a Second Reading draft law, which had to reflect the comments of members of the Verkhovna Rada, while still meeting substantially all of the criteria for such laws as defined by USAID – DC staff. We assisted the FEC to bring such a draft to a second reading. The Second Reading vote however did not occur until well into the second year of our contract. In February 2002, the Verkhovna Rada failed to pass the law at Second Reading. Although there was no opposition, abstention by a major block of the Communist Members, for reasons not directly related to the NERC Law, meant the law did not have a sufficient majority. The status of the law thus reverts to one of a new Draft Law. Both the NERC and the FEC have expressed interest in reviving the law and passing it in the coming session, probably as part of a package of laws on “European Integration”. Evaluation: the initial results were highly successful, and literally complied with the May 2000 Benchmark. But the final result, as defined by June 2001 Benchmark b) is not yet achieved. We believe it remains highly feasible to pass such law before the term of our contract expires.

NERC Funding: May 2000 Benchmark 2 a) was probably never a proper phrasing of the problem. Fees paid by licensees were probably already sufficient, before our contract was signed, to pay the full operating costs of NERC at a reasonable level. The difficulty instead is to assure that these revenues are actually made available to the NERC. Therefore, the revised June 2001 Benchmark b), second sentence, is a much more accurate appraisal of the problem. We believe it may be possible to propose such a Constitutional Amendment, and in fact in December 2000 a member of the Hunton & Williams project team (Paul Ballonoff) was appointed to a Parliamentary working group for that purpose. However that body is not expected to meet until the NERC Law related to political independence has first passed. Evaluation: this objective is not achieved, and its

achievement is less likely in the contract term than is passage of a law on NERC political independence.

Design and Implement Tariffs Acceptable to Investors. This implied purpose of the May 2000 Benchmarks, and the specific implementation required by June 2001 Benchmark a), have been achieved. After intense work with the NERC between November 2000 and April 2001, an acceptable tariff method was issued by NERC. This helped induce meaningful bids by investors. In July and August 2001, we worked with the NERC to develop and issue a transparent procedure for implementation of this method. Between September 2001 and end November 2001 we worked intensely with the NERC (including by supporting separate efforts by the Donors to influence the Cabinet), to assure that the method was in fact implemented by December 1, 2001, including assisting NERC with development and implementation of mitigation measures. The December 1, 2001 implementation date was only 30 days past the date by which it was required to be implemented under the NERC procedure. Since December, NERC has treated tariff issues within the published procedure timeframe. Evaluation: successfully achieved to date.

NERC Reports at a Presidential Level This result defined by May 2000 Benchmark 2 b) was achieved by issue of the Presidential Decree "Issues of the NERC," No. 1167/200, 30 October 2000. However, while this nominally meets the Benchmark, we doubt it meets the functional purpose for which it was intended. This is because, despite this "reporting" requirement, constitutionally the NERC remains a "body of central executive power", and therefore, responsible to the Cabinet of Ministers. Thus, there are only two ways to achieve actual political independence for the NERC – by a Constitutional amendment, or by a properly constructed law (since under the Constitution the Cabinet must follow the law). Evaluation: while the nominal purpose has been achieved, the substantive purpose requires that the June 2001 Benchmark b) as to a NERC Law, be also achieved. We believe this is likely during our contract term.

Non-dismissal of NERC Commissioners for Political Reasons Achievement of this May 2000 Benchmark 2 c) is also embodied in the passage of a NERC Law. The draft law to date provides strong protection against removal of a Commissioner, since it requires both a "no-confidence" vote by the Parliament in that Commissioner, and a subsequent removal by the President. It should also be noted that despite the political difficulties experienced between NERC and the government over the implementation of the tariff methodology (the commitment to which had been made by the previous government) no Commissioner was dismissed. We believe this in part reflects the increased professionalism that may result, in part, from the manner of our assistance to them. But as achieving full protection requires passage of a NERC Law, this objective is subsumed into June 2001 Benchmark b). Evaluation: achievement of this Benchmark is likely during our contract term, by passage of a NERC Law.

B.2.4. Performance Against WEM-Related Benchmarks

B.2.4.1 Statement of WEM-Related Benchmarks

The May 2000 Benchmarks that related to the WEM were:

- 1) *Support for passage of legislation pertaining to the wholesale electricity market and to strengthening the legal basis for NERC.*
- 3) *The number of days the Energomarket is in an Emergency status shall be gradually reduced to zero over the contract period (as a result of the elimination of the central account).*
- 4) *Investors can engage in bilateral contracts.*

Note that Benchmark 3) also relates to NERC, which actually declares the emergencies, but is classified here for convenience since the algorithm also related to the WEM.

The revised June 2001 Benchmarks related to the WEM are:

- c) *Successful evolution of WEM laws and policies to 1) reduce or eliminate emergency status and associated funds diversion; 2) permit Oblenergo owners that pay for electricity to enjoy normal commercial banking practices (e.g. selection of their own bank); 3) Permit greater decentralized purchasing from the WEM in the context to be established by generation privatization policy and a continued philosophy of cash only payment.*

B.3.4.2. Evaluation of Achievement of WEM Related Benchmarks

Reduce or eliminate declarations of emergency. Efforts to achieve the May 2000 Benchmark 2000 3) and June 2001 Benchmark c)1) have been a major focus of the Hunton & Williams project activity. They occupied a significant fraction of the time of the two resident attorneys that have been on the project, and a significant part of the time of our attorney in our NERC office. We have worked intensely with the NERC, the working levels of the Cabinet of Ministers, and working groups of the WEM Board and the WEM Board itself, to achieve this Benchmark. On February 19, 2002 the Cabinet issued "Interim Procedure for Introduction of Changes to the WEM Algorithm and Monitoring over its Fulfillment," No. 200, which achieves many of the principal technical measures we had employed to seek this result. (See Part C.2.11 for more details). We believe that Resolution 200 will significantly limit the frequency of changes in the Algorithm. Evaluation: Probably achieved in significant part, prospectively as of February 2002. Full implementation (reduction to zero) will require the practice of 100% cash payment to the market.

Full payment to allow for full supply: Implementation of June 2001 Benchmark c)2) requires that three changes take place in the WEM operations. The first and most

practical change is that the dispatch operator must understand this objective and carry it out. To that end our project staff met with the dispatch operators personally, and have achieved modest success in having them schedule power to actual payers, rather than simply curtailing all supplies irrespective of payment. Second, we have also pointed out, such as in our presentation to the USEA Genco Conference in January 2002, that full legal implementation of a rule that full payment allows full supply requires repeal of Cabinet of Ministers Resolution 441. At the International Privatization Task Force of February 20, 2002 the Minister of Fuel and Energy stated that the Cabinet has drafted a revision to Resolution 441 repealing all artificial constraints on demand for those oblenegos that pay in full. This, however, has not yet to our knowledge been issued. Finally, to meet full demand requires the generators be able to buy sufficient fuel to produce the required output. For this, significant liberalization of the fuels market is probably required. Part G of this 7th Quarterly Report details our research to identify exactly what must be done in fuels markets to remove government controls. Evaluation: Some measurable progress has been achieved. Removing government limits on demand we believe can be achieved within our contract term. However, in so far as this also requires liberalization of the fuels markets, we can make no prediction, nor do we currently have a specific mandate to work on this task.

Liberalized purchasing by market members: May 2000 Benchmark 4) was loosened slightly by June 2001 Benchmark c)3). However, achievement of either goal requires implementation of more elaborate revisions in the structure and operation of the WEM. This in turn requires achieving revisions to WEM operating regulations and/or a WEM Law, as described two paragraphs below. Evaluation: not yet achieved. Depends on outcome of WEM Concept Commission design and implementation (see below).

Continued cash only payment philosophy: Due to the political structure of the players in the WEM market, cash collection conflicts with achieving direct contracting, in the legislative environment that existed to date. That is, the June 2001 Benchmark c)3) conflicts in significant part with May 2000 Benchmarks 1) and 4), and is a principal reason why neither was achieved to date. The laws which have so far been voted in the Parliament (and which pre-dated our arrival here) achieve some form of direct contracting, but decimate any semblance of continued or transparent cash payment. Principally on this basis, this project, and the Donor community generally, have found it necessary to oppose passage of the WEM related laws currently in process. We have successfully been able to do so, to date, in large part by substituting a different process (the "WEM Concept Commission") as discussed in the next paragraph. Evaluation: Implementation of increased cash payment has been successfully achieved and the progress maintained, but at the expense of achieving other Benchmarks.

WEM operational improvement and WEM Concept Commission: Achieving May 2000 Benchmark 1 in so far as it relates to the WEM, May 2000 Benchmark 4), and June 2001 Benchmark c)3) have continually absorbed a significant part of the efforts of this project, as indeed was the intended design of the project. The superficially "easy" way to achieve these Benchmarks, to support passage of the pre-existing WEM Law at the Parliament, was inhibited by the cash payment goals, as described above. However, it was

also inhibited by diverse technical and political issues that must be resolved. Resolution of these has been a continuing focus for this project. Taking them roughly in time sequence, we have achieved as follows. First, when we arrived none of the affected parties was even willing to talk with each other in words (that translate to English) longer than 4 letters on this subject. It was necessary to unfreeze the process at all. We did this by preparing our own version of the then draft law, including several intentionally provocative suggestions, and inserting this draft (with the assistance of the FEC Committee) anonymously into the working process. This had the effect of giving the parties something new and unexpected to discuss, and moved the process off dead stop. In that draft, we also introduced the “radical” ideas that the changes in the WEM could take place over a staged process, defined by a normative document, and managed by the NERC. All those ideas are now widely accepted. The existing “WEM Concept Commission” (see Part C.6 below) was appointed by the Cabinet of Ministers to be under the effective control of the NERC, and is self-defined to implement a staged process of changes, to be embodied in normative documents of the NERC and of the Cabinet of Ministers. Next, numerous technical issues needed to be addressed. We have dealt with many of those to date (prior to formation of the WEM Concept Commission) including: cash flow issues, reduction of algorithm interventions, plans to improve metering (via an European Commission-funded project we helped to define), detailed improvements to many sections of the Market Members Agreement or its Annexes, and other processes. (The details of those are found in our current and previous Quarterly Reports usually at Part C.3 and its sub parts, but also to the extent they overlap issues involving the NERC, at Part C2 and its sub parts.) Finally, resolution of the remaining, and more substantive issues, has required achieving a mechanism by which they can be addressed, and placing Hunton & Williams in a position to influence the results of that mechanism. The mechanism which we helped to conceive and put in place is the “WEM Concept Commission”, currently a very active body under the administration of the NERC, and for which we sit on the executive body (the “Commission” itself) as representative of the Donors, on the daily working body as the most active participant, and on the Secretariat by providing actual control of the flow of documents. Evaluation: We have not yet achieved these Benchmarks, but we have made very substantial and demonstrable progress in doing so. We believe they are achievable within our contract term.

C. RELATIONSHIPS WITH COUNTERPARTS

C. 1. BACKGROUND

The TOR identifies four primary counterparts for the Project: NERC, the Energomarket, the Verkhovna Rada, and the MFE. The Memorandum of Understanding between the Government of the United States and the GOU, dated _____, (“MOU”) created the basis for establishing the relationships with the GOU counterparts identified in the TOR. We summarize our work to achieve Project goals with each GOU counterpart below.

C.2. NATIONAL ELECTRICITY REGULATORY COMMISSION

In 1996, in part through the diligent efforts of USAID, the President of Ukraine created NERC by decree as an independent energy sector regulatory commission. Supporting NERC's continued development and working with NERC to support GOU's privatization effort remains a key focus of our Project. Project relations with NERC are good, bolstered, in part, through our second Project office located within the NERC building. We meet with NERC counterparts daily and have routine meetings with the Chairman and other commissioners to discuss and coordinate on-going issues. As in prior quarters of the Project, four issues continue to dominate our work with NERC: the draft law on regulatory commission independence; tariff methodologies and rate design; due process; and the Wholesale Electricity Market algorithm. Significant issues on which we are currently advising NERC are briefly discussed below. In addition, our work in Wholesale Energy Market reform, through the "WEM Concept Commission", is taking place through NERC auspices, but is discussed separately in our discussion of market issues.

Related work with the NERC covers a wide range of advisory services, as described below, and as summarized in Part H, the NERC Activity Register, and Annex A the List of Documents Translated for NERC.

C.2.1. Regulatory Commission Law

The substance of the proposed law and efforts to date are summarized in our earlier Quarterly Reports at this Part C.2.1 and in Part C.5..

The current status of the NERC Law is that the Second Reading of this bill failed for lack of sufficient votes. There was no opposition, but large-scale abstentions by the Communist Members, who supported the law, caused failure of sufficient votes to pass the Law on Second Reading. The Party tactic appears unrelated to the NERC Law itself, except in so far as the law is one of several "reform" laws that the Communists began to boycott after the new Land Law passed in Fall 2001 over their severe objections.

The Verkhovna Rada Fuel and Energy Complex Committee (FEC Committee) has now classified the NERC Law as both a separate effort that can proceed on its own track via the FEC Committee, and also, as a part of the complex of laws that will address European Integration. We will continue working with both the NERC and the FEC Committee to pass the law in either form. To assure that we as Hunton and Williams, maintain a presence on the European Integration view of this law, we are now planning to bring our company expert on European Integration issues to Kiev for a "consulting advisory" this spring. (We use the term "consulting advisory" to describe our practice of bringing technical experts who present structured courses or lecture sessions to counterparts, and then also are available to them for direct private consultations on the selected topics. A consulting advisory visit is thus an opportunity to use a structured

format for a recognized expert reach a broader audience, and also providing a working atmosphere that tends to open doors.)

C.2.2. Tariff Setting Methodologies and Rate Design

Another critical issue for the success of GOU's privatization program is clarity in NERC's tariff setting methodologies and continued improvement of rate design. Completion of a suitable tariff method and its adoption by the NERC was a major achievement of the period March - May 2001. Since June 2001 Hunton and Williams has worked closely with NERC to implement the method. This resulted in implementation of the new method to be effective December 1, 2001 for each of the four newly privatized oblenergos that had applied for the method, and for the remaining two in 2002. Previous Quarterly Reports at Part 2.2 discuss the history of development of the new Tariff method. Other tariff related activities for the NERC are discussed next.

C.2.3 Draft Procedure for Other than Licensed Services.

The Hunton & Williams Project Office has been closely working with NERC on development of the procedure by which the licensees in electricity distribution and supply receive NERC consent for carrying out other than licensed activities. De-facto the aforementioned licensees carry out various activities at various markets. NERC should make sure that in doing so, the licensees observe license conditions and in no way abuse the interests of the customers. However, NERC existing regulations do not provide a clear and elaborate guidance to the licensees as to carrying out activities other than licensed. The work is on going.

C.2.4 Information on International Experience on Activities Allowed Within the Distribution Business.

NERC does not have an elaborate list of activities of the distribution and supply businesses in any of its regulations. Thus, in working on the draft procedure on other than licensed services, NERC faced a problem of treating certain activities as either "licensed", "related to licensed activities" and "other than licensed activities". Hunton & Williams Project Office was asked by the NERC to provide information on international experience as to the activities allowed as part of the electricity distribution business. A memorandum summarizing these activities, especially as practiced in England, was prepared and submitted to the NERC pricing and technical departments in January

C.2.5. Distribution Pricing.

NERC has been developing the regulations that would introduce four voltage classes within the distribution business instead of the presently existing two voltage classes. NERC requested Hunton & Williams to comment on methodological recommendations developed by NERC domestic consultants that provide guidance as to the allocation of costs of the distribution business to four voltage classes. Hunton & Williams criticized the approach of the proposed method, pointing out its major weaknesses. However, NERC has

issued an order by which this method will be tested on a particular distribution company and amended prior to its complete implementation. The work is on going.

C.2.6. Pricing for Nuclear Generators.

Hunton &Williams was requested by the NERC to comment on the draft tariff review procedure for nuclear generators, developed by NERC consultants. NERC currently does not have a formal procedure for review of the nuclear generators' tariff. Therefore the process of tariff review is neither transparent nor public. Hunton &Williams provided its comments and basically advised NERC not to approve the procedure as it contained considerable flaws that would prevent the review process from being fair and unbiased. The procedure has not been approved by NERC.

C.2.7. Assistance in Simulation Analyses.

Hunton &Williams has been assisting NERC on an ad hoc basis in the analysis of the impacts of application of the new tariff method and other pricing policies. It is important for the NERC to be able to estimate the outcome of various regulatory decisions, especially those that involve setting prices. The work is on going.

C.2.8. Depreciation Rate Analysis

In application of the new tariff method NERC faced a problem related to treatment of depreciation of the new investment in the tariffs. NERC considered two approaches for treating this item. The first one was to allow depreciation of new investment in the tariff prior to such investment being made, thus increasing the allowable cost and decreasing the rate base by this amount in the first year. The second approach was not to allow this item until the investment is actually made, thus decreasing the allowable cost and increasing the rate base by this amount in the first year. However, under the second approach this item would be included in the tariff as a cost during the next tariff review.

NERC realized that it was necessary to make a policy decision and consistently apply it in all rate cases. Thus, NERC requested Hunton &Williams to run simulation analyses based on the filing of a particular electricity distributor. The analysis illustrated both approaches under four different depreciation rate computation methods both in the short term and long term. Based on the outcome of this analysis NERC decided to apply the first approach as it resulted in smaller tariffs in the long run.

C.2.9. Due Process and Regulatory Procedure

A third issue that permeates our work with NERC is to assist NERC in devising a proper governance mechanism, injecting notions of due process, rule of law, and proper regulatory procedure into NERC's work so that NERC's activities reflect international standards. An important development in NERC process was evidenced by the "open hearing" process used by the NERC for the tariff methodology. At suggestion of Hunton and Williams, the NERC decided to schedule the treatment of the tariff method through an

open public hearing process. On its own initiative, in the previous quarters, the NERC also decided, and included into its Procedure for processing applications to change tariffs, that all such process be under open public hearings. By the end of the 7th Quarter, rate applications from all six new private companies under the new method have been subject to open public hearings, prior to the Commission accepting their content. We regard that as an important achievement of this project.

C.2.10. Algorithm Procedure

Hunton & Williams worked closely with the WEM Members (Kievoblenergo, Energoatom, Dniproenergo and Tcentrenergo), to draft an Algorithm Changing Procedure. In response to our efforts, at the working group meeting on IVKOR revision, Dniproenergo proposed to delete “CMU decisions and resolutions” from the list of grounds under which NERC might introduce changes to the WEM Algorithm. (As Hunton & Williams worked with these WEM Members, the WEM Members became independent advocates of Algorithm Procedure reform.) Changes proposed by Dniproenergo were approved by the working group and further by the WEM Board decision. In spite of these efforts, NERC reintroduced those grounds for changes, which were then approved by the General Meeting of the WEM Members. Subsequently NERC again sought Cabinet of Ministers approval for a Procedure governing algorithm change.

On February 19, 2002, CMU adopted an "Interim Procedure for Introduction of Changes to the WEM Algorithm and Monitoring over its Fulfillment" (CMU Resolution No. 200). CMU Resolution No. 200 follows Hunton & Williams' ' recommendations regarding: (i) the requirement to justify financial consequences for the parties due to introduction of changes to the WEM Algorithm; (ii) conducting an analytical test (by NERC) to determine the economic viability of any proposed WEM Algorithm modification prior to implementation; and (iii) deleting the CMU “instructions” as a condition for introduction of changes to the WEM Algorithm. We believe Resolution No. 200 will thus significantly limit the frequency and form both of declarations of emergency, and also, changes to the algorithm.

C2.11. Procedure for Declaration of Emergency Situations on the WEM

Hunton & Williams worked actively with NERC and the respective WEM Board working groups to reduce emergency declarations on the WEM. (In working on this issue, Hunton & Williams conferred with insurance companies in Ukraine to understand better existing, private coverage of emergency events at utilities.) In particular, Hunton & Williams worked on draft Procedure for Declaration of Emergency Situations on the WEM. As a result, the list of criteria for declaration of emergency situations on the WEM was reduced in comparison with the effective Procedure.

During the work on the Procedure, we advised against passage of those provisions of the new language of Annex No. 9, which created additional risks to oblenergos by re-introduction of possibility that oblenergos might have to contribute to emergency fund re-allocations. Hunton & Williams sent a letter to NERC and the WEM Board, expressing

reservations about that development. On February 8, 2002, the General Meeting of the WEM Members appeared at first to have accepted our proposed revisions. But, using dubious procedure, the WEM Board then refused to present the results of the first vote. As a result, the General Meeting approved the Procedure for Declaration of Emergency Situations on the WEM in the language prepared by the working group, which allowed broader declarations, and which placed oblenergos at greater risk for loss of revenue.

Subsequently, the Cabinet of Ministers issued Resolution No. 200, an Interim Procedure for Changing the Algorithm. The final document did not implement all of what our project has sought, but did make substantial changes. Principal among these is that, under the Procedure, the Cabinet of Ministers can only request changes to the Algorithm, upon issue of a "Resolution", and not simply by an "Instruction". As a result, changing the algorithm should be more difficult, because the administrative procedure required for an Instruction is simply the act of one Minister issuing the document. A Resolution, by contrast, requires prior preparation and internal review, as well as concurrence by the Cabinet itself. Resolution 200 also requires, as we have advocated for more than a year, that prior to recommending any declarations that affect funds, that the impact of the declaration be studied, and that any reallocation of funds requires a specific statement of how funds will be repaid. Resolution 200 was also deficient, especially in that it still allows any level of Cabinet of Ministers role in requiring declarations of emergency. While it would be difficult to divorce the Cabinet of Ministers completely from the process (because of the present state of NERC authority and independent), Resolution 200 nonetheless does represent a substantial improvement on the previously followed (and previously not formally defined) process.

C.2.12. Conditions under Which Regulated Suppliers have the Right to Carry out Other Than Licensed Types of Activity

The Law of Ukraine "On Natural Monopolies," article 14, stated that the NERC should be entitled to impose conditions, for natural monopolies, regarding their entrepreneurial activities falling outside the sphere of their natural monopoly activities in case these activities have an impact on the natural monopoly market. At the present moment NERC does not have such any procedure for imposing such conditions. NERC receives a lot of requests from Licensees for permission to carry out other than licensed types of activities. Thus, it was important to establish defined requirements, which should be met by licensees in order to let them carry out other than licensed types of activity. At the present moment, the Antimonopoly Committee and Ministry of Fuel and Energy are considering a draft Procedure.

Hunton & Williams continues advising NERC on the list of services, which are considered as licensed services for electricity supply at a regulated tariff and electricity transmission through local networks. It is important to separate the services for which NERC should give consent, and for which it should not. We have worked intensely with internal committees of the NERC on rafting appropriate regulations. In November, we also provided NERC with a study regarding the treatment of similar issues by foreign jurisdictions.

C2.13. Oblenergo Insurance Issues

On October 4, 2001, the Verkhovna Rada passed amendments to the Insurance Law, which make obligatory in particular “insurance of transmission lines and conversion equipment of electricity transmitters against the damage incurred due to natural calamities or man-made disasters and against illegal acts of third persons.” According to that Law, the Cabinet of Ministers of Ukraine is required to establish procedures and rules for compulsory insurance, including prototype agreements, special conditions for the compulsory insurance licensing, amounts of insurance premiums and maximum insurance rates and actuarial calculation methodology. As a result, the CMU instructed NERC to draft the relevant normative documents. The NERC then requested USAID assistance to comply with this task. Hunton & Williams did not believe it has the appropriate expertise to do this task, and advised USAID that we would cooperate with the USAID-sponsored Commercial Law Center should they undertake it. This path was adopted by USAID.

We therefore held meetings with the representatives of the NERC and with the Commercial Law Center concerning drafting of relevant normative documents. Hunton & Williams Project Office provided the Commercial Law Center with the data on oblenergos’ transmission lines damages and their repair works’ cost for the period of 5 years. The object of the data review was to define the tasks and level of effort required to complete the analysis and to prepare recommendations.

Hunton & Williams Project Office participated in the special working group, consisting of the representatives of insurance companies, the Ministry of Fuel and Energy, the Ministry of Emergency Situations and NERC. Work has already commenced on the drafting of rules, procedures and a Charter of Insurance Associations respecting the creation of compulsory insurance for transmission lines and related equipment.

C2.14. Regulatory Policy Law

The Regulatory Policy Law intends to set out principles for state regulatory policy implementation, the authority of bodies empowered to implement state regulatory policy, preparation and review of regulatory acts, etc. The Regulatory Policy Law as drafted would limit the rights of NERC, by limiting NERC independent decision making authority. It would super-impose a subordinate body of the Cabinet of Ministers over NERC with the ability to set NERC policies. In order to eliminate the harm the Regulatory Policy Law might do to NERC’s authority, if passed, it would be necessary to amend the Regulatory Policy Law to exempt NERC from the supervening authority of the Law. Thus, the Hunton & Williams Project Office analyzed the Regulatory Policy Law and provided NERC and the Verkhovna Rada Fuel and Energy Committee with specific recommendations. The FEC Committee staff agreed that the NERC can and should be exempted, and agreed to amend the Regulatory Policy Law to say that the Natural Monopoly Law, the vehicle used to define the “NERC Law”, should govern NERC policies. The draft Regulatory Policy Law did not receive sufficient votes in the just completed session of the Verkhovna Rada, hence died at first reading, but also risks revival by its supporters in futures sessions.

C.2.15. Moratorium Law

The Moratorium Law, or Law of Ukraine “On Introduction of Moratorium on Compulsory Sale of Assets, was passed on 29 November 2001 by the Verkhovna Rada passed, including Presidential proposals for amendments thereto. The amendment removed a phrase that would have prevented privatization of energy sector assets while the Moratorium was in effect. This language was also opposed by the Donor group, with our assistance (See 5th and 6th Quarterly Report). Hunton & Williams” received an oral request from NERC to prepare an impact study of that law. The Project prepared the requested legal analysis and submitted it to NERC. The purpose of the Moratorium Law is to assure that energy sector assets can not be “stripped” from operating companies before the companies can be sold in proper privatization processes. See also, Part C.7.1. (discussing our common analysis with another USAID project of a Draft Law which would have lifted the Moratorium). In that event, in cooperation with the Donor Community and the USAID, we assisted to write a letter, send by the European Bank to the appropriate Committees at the Verkhovna Rada, opposing the Draft Law. Subsequent to receipt of that letter, that law was defeated, and the Moratorium remains in place.

C2.16. Law on Restructuring Fuel Supplier Receivables

Commissioner Kotko asked Hunton & Williams to research the legal possibility of passing a law that could restructure the generating companies’ debts to fuel suppliers and other creditors. Hunton and Williams lawyers performed the requested research, which together with a brief case study of similar Ukrainian laws, was submitted to NERC.

C2.17. Implementation of the Electricity Tax Mechanism

NERC, as well as the Donor group, requested that Hunton & Williams investigate the electricity tax lien mechanism adopted on 16 November 2001 by the Cabinet of Ministers of Ukraine Resolution No. 1505. That Resolution classified electricity as movable property, which meant that the sale of electricity is subject to Resolution No. 941 of Cabinet of Ministers of Ukraine “On the procedure for execution of movable property that is subject to a tax lien to pay off the tax debt of the tax payer (except individuals – subjects of entrepreneurial activity) and sale of such property” adopted on 22 June 1998.

The purpose of Resolution No. 1505 is to mandate the sale of electricity subject to a tax lien in order to recover unpaid taxes from energy sector enterprises. Due to the nature of the tax lien, the tax authority has a preferential right to receive the funds from the sale of electricity that is subject to a tax lien. The procedure established by the Resolution is currently widely utilized at the power stations.

In our opinion, such seizures are illegal. According to the law of Ukraine “On Electricity,” electricity is deemed to be consumed as soon as it is generated. Therefore the data reflected on the meter at the power station indicates the volume of consumed electricity but not the volume of electricity available at the power station. As a result, it is

impossible to “seize” electricity at the moment of production in order to foreclose on a tax lien..

Hunton & Williams therefore advised NERC to oppose the creation of a tax lien on electricity. NERC adopted our advice and did oppose this concept in its recommendation to the Cabinet of Ministers.

C.3. ENERGOMARKET

Our work with Energomarket has continued on several fronts, particularly: (a) as assistance to improving internal procedures; (b) as assistance in working through issues emerging due to privatization of the oblenergos, such as power purchase contract and procedures for determining volume allowance for electricity purchases; and (c) as participation in working groups established by the WEM Board to address a wide range of problems of the current WEM functioning,

C.3.1 Wholesale Electricity Market Agreement

Under the law of Ukraine “On Electricity” the Wholesale Electricity market is established on the basis of Wholesale Electricity Market Agreement. Such agreement was entered into between the WEM participants in 1996 specifying the rights and obligations of the WEM participants, parties to the agreement, General Meeting, WEM Board and order of admission and exit to WEM.

Since the text of the agreement and its Annexes needed to be brought into conformity with the applicable legislation of Ukraine and to reflect the current activity of the WEM participants, the WEM Board on 22 November 2001, decided to establish a working group to introduce editorial changes into the Wholesale Electricity Market Agreement (“WEM Agreement”).

Hunton & Williams joined the working group consisting of NERC, the Energomarket, representatives of oblenergos (including AES Kyivoblenergo) and generating companies. This working group met daily for the period of two weeks during December 2001, and submitted proposed amendments to the General Meeting that took place on 8 February 2002 for its approval. The proposed amendments relate to the definition section, the procedure for re-election of voting directors between the Annual General Meetings, introduction of changes and amendments to WEM Agreement and Annexes of WEM Agreement, the procedure of admission and exit to/from WEM members, etc.

As required by the law of Ukraine “On Electricity”, the text with the proposed amendments will come into effect and thus become binding for all WEM participants upon its approval by Ministry of Fuel and Energy of Ukraine, Antimonopoly Committee and NERC.

C. 3.2. Market Rules, IVKOR, Emergency Situations and Commercial Metering

The Annexes to WEM Agreement that are considered to be an integral part of the agreement (WEM Rules, IVKOR, Instruction on Commercial Metering, Instruction on Emergency Situation and Instruction on procedure of carrying out settlements) have been under review by specially assigned groups. See further discussion below and also in the previous section on NERC activities.

C.3.3 Metering Issues

Comprehensive and accurate metering are essential pre-requisites to implementing two key goals of our Project: to establish a properly functioning billing and invoicing system for the existing WEM, and to move towards bilateral contracting among WEM Members. In this context, Hunton & Williams is working with two relevant working groups: a) the Working Group that prepares the introduction of a Central Metering System Administrator – an entity (currently lacking) that would assume responsibility for the accurate and timely processing of the WEM metering data; and b) the Working Group that prepares necessary amendments to Schedule 10 of the WEM Agreement (Instruction on metering). For both groups we commented on proposed documents (such as Provisions for the Central Metering System Administrator) and conceptual decisions (such as the idea of appointing Energomarket as Central Metering System Administrator, and thereby moving the task of dealing with metering from currently Ukrenergo to Energomarket).

C.3.4 Information Technology Support

Our discussion of purchases of equipment for counterparts now appears as Annex E to this report.

C.3.5. Metering Procedures Working Group

Hunton & Williams provides general advice to the working group established by the WEM Board for the revision of the “Metering Procedures in the Ukraine WEM” (Schedule 10 in the WEM Members’ Agreement). The Working group is represented by specialists from gencos, discos, MFE, Energomarket, NEC “Ukrenergo”, and presided over by the NERC. The task of the Working group is to reorganize and put in order the metering procedures, in line with the latest developments of metering issues in the Ukraine WEM: newly developed Regulations for the Head Metering System Operator of the Wholesale Electricity Market of Ukraine; start-up of the project for the replacement of the meters in the WEM (financed from the TACIS fuel gap project), which will allow for hourly metering at all WEM trading points. Participants of the Working group encountered difficulties and had arguments about splitting the losses at the delimitation points between power plants and the national grid of Ukraine. Hunton & Williams provided a consultation paper on the treatment of transmission losses in foreign markets, mainly based on the experience of the former UK Pool and under the NETA. The work is on-going. The General meeting of the Ukrainian WEM Members of February 8, 2002 charged the

Working Group to finalize revision of the “Metering Procedures” and submit the final version for the approval by the WEM Board.

C.3.6. Market Rules Working Group

Hunton & Williams provides general advice to the working group established by the WEM Board for the revision of the “Market Rules” (Schedule 2 to the WEM Members’ Agreement). The Working group is represented by specialists from gencos, discos, MFE, NERC, NEC “Ukrenergo”, and presided by Energomarket. This Working Group only recently restarted its work after about two years stoppage. The work is on-going, but slowly because of the wide spectrum of problems in the WEM that shall require some conceptual decisions on the higher levels.

C.3.7. Market Structure Modeling

In association with its analysis of possible reforms to the Wholesale Market, and to better work with all counterparts, Hunton & Williams has developed a set of computer analysis tools for the operation and structure of the power market. We have created two inter-related sets of analyses of the WEM) the “dispatch analysis”, and the “financial analysis.” For Mode details about these programs, see Annex F. In brief:

- The dispatch analysis is an assembly of technical data on actual production and technical and economic capacities of production by the thermal generating plants of Ukraine. The dispatch analysis is so-named since one result is to create a simulated stack order for thermal plants based on either economic or technical efficiency.
- The financial analysis looks at overall behavior of the WEM, including total profitability of generating companies, cost structures of those companies (but especially of the thermal companies), and various financial or economic measures of market behavior or company performance. The financial analysis looks at effects of alternative policies on WEM price, on generating company fuel costs, and on system marginal prices, and allows comparisons between and economic analysis of WEM market structure and pricing rule options.

Preliminary results of our analysis of WEM market structure and operational efficiency were presented to USAID in early March 2002. Results related to the impact of proposed WEM redesigns were presented to the USAID-sponsored United States Energy Association (USEA) Genco conference in January 2002. Further results were presented to USAID in a presentation summarized here in Annex G.

C.4. MINISTRY OF FUEL AND ENERGY

We continue to work with the Ministry of Fuel and Energy (MFE) as required on critical issues. The analysis required for the metering project for example, was conducted as a joint effort by the MFE, Ukrenergo (the high-voltage network company subordinated to MFE), the Energomarket, and H&W.

C.4.1 Sector Policy and WEM Structure

See our discussions of the WEM Concept Commission at C.6.

C.4.2 Sector Debt

While analysis of and solving the sector debt is not a defined task of Hunton & Williams, those issues are inextricably tied to issues of primary concern to our project. Therefore, we have in any event found it necessary to work on sector debt issues. Throughout the project we have therefore regularly researched possible solutions to the sector debt, and discussed these with USAID as well as with our counterparts in the Ministry of Fuel and Energy, the Energomarket, the FEC and the NERC.

C.4.2.1 Debt Analyses Completed in 7th Quarter

In the course of our modeling work on WEM pricing, we realized that some methods of pricing can lead to revenues adequate, in connection with other devices, to fully remove the sector debt within 5 years, with modest effect on the WEM and on the retail average total cost of electricity (using also a so-called “dominant” scenario for all studied changes). We therefore summarized this analysis as Part 5 of the Quantitative Analysis of WEM design options that we delivered to USAID in December 2001. USAID then asked us to present this analysis to the power sector at large, especially to the Gencos, by offering the results publicly at the USEA Genco Summit (see C.4.3 below) in January 2002. We also delivered the written version of the analysis to our counterparts at the NERC, at the Energomarket, and at the Ukrenergo. Subsequent to completion and deliver of that analysis, we continued study of WEM pricing issues, including efficiency of dispatch. In February we therefore delivered a briefing to USAID showing the cost of inefficient dispatch of the thermal plants. In that briefing we presented an analysis that showed that in the “dominant” scenario of the earlier analysis, debt could be resolved with essentially no net impact on WEM nor retail price, or indeed could even occur while WEM and retail prices were reduced.

C.4.2.2. Current View of Debt Solution

Based on the above analysis and our prior work, as of the 7th Quarter, we believe that the sector debt, far from being an unmanageably large problem as often painted, is actually quite tractable and resolvable by means probably already within the tools of the Government. This can occur if the Cabinet of Ministers, supported by other agencies, were to adopt the appropriate resolutions and implement them as follows:

- (1) write down or off-set all debts that can be removed by administrative means;
- (2) restructure debts of the oblenergos to the Energomarket, which have not yet been restructured, in the same proportion to the oblenergo plant in service as was done for the “first six”;
- (3) require that the State Reserve, the Gencos and the Energomarket implement up-stream restructuring of debt up to the total amount of debt held by the State Reserve against

- Generators, including to complete the restructure up the line of amounts related to the restructured debt for the six oblenegos privatized in April 2001;
- (4) pass on the benefits of the restructured Nafotgas debt to Russia, to participants in the Energomarket in form of restructured debt of market members for fuel supplies;
 - (5) authorize a special cost component in the WEM fees, to be paid to Generators and marked for repayment of that portion of their debt to fuel suppliers that resulted from the currency devaluation of 1998/1999 - which is a cost that was not previously charged to any consumers;
 - (6) request the NERC investigate the relationship between the level of capacity-availability fees paid for generation and the ability of generators to pay off remaining debts, and adjust the capacity fee as appropriate, consistent with good economic pricing practices;
 - (7) instruct that all state tax authorities with creditor claims on energy companies desist from initiating any claim in court for recovery of that debt, at least until all of steps (1) through (6) have been completely implemented;
 - (8) instruct that all Government owned or controlled companies or entities, including the State Material Reserve, who are creditors of any Government owned or controlled energy company, desist from initiating any claim in court for recovery of that debt, at least until all of steps (1) through (6) have been completely implemented;
- Note that items (7) and (8) mean “maintain the Moratorium Law in force” until the oblenegro and Genco privatizations are completed.

C.4.3. USEA Genco “Summit”

On February 6 and 7 2002 the USEA held a “Summit for Electric Power Generation in Ukraine”. This conference was sponsored by USAID to draw the attention of the Mintopenegro and the Mintopenegro Gencos to problems of the economic future of the industry, including both market redesign issues and privatization. Ten of our staff attended, including two that made presentations. Paul Ballonoff presented “Economic Scenarios of Electricity Sector Development”, while Ilka Lewington presented “WEM Development - Directions and Practical Steps”

The “Economic Scenarios” presentation was given at the request of USAID, and was based on a 25 page research paper previously written by Hunton & Williams, comparing the expected results of different forms of possible WEM redesign, as well as other choices affecting the structure of the generation industry. The presentation noted that desirable redesigns of the market should allow all plant types (thermal, nuclear, hydro) to be profitable or at least break even, should occur at minimal cost to consumers, and should allow elimination of the sector debt in a meaningfully short time frame. The presentation demonstrated that these objectives can all be met by a so-called “dominant” scenario. In the dominant scenario, prices for hydro and nuclear are set at break-even, the K2R4 plants are not finished, the capacity factors for existing nuclear plants are increased, and the capacity availability fee paid for thermal plant availability is roughly doubled. If that all is done, then as well, that part of the sector debt that is not otherwise written off, off-set or restructured, can be fully retired within 5 years by the Gencos themselves. The presentation also showed that the various redesigns of the WEM which Hunton & Williams has considered can each produce a profitable thermal industry, but that the greatest

expected profits, hence greatest expected value at privatization of the thermal companies, occurred also in the dominant scenario.

The presentation on “WEM Development - Directions and Practical Steps” utilized the work H&W had undertaken over the past 6 months (reported on in the previous Quarterly Report) and which had developed concepts for necessary changes to the currently functioning WEM. First it was emphasized that we propose a phased approach for tackling the problems of the current WEM operation and for moving forward to a more competitive and more liberal power market. The envisioned prospective model, to be reached after a transitional period of 2-4 years, would be in line with the worldwide trend away from obligatory Pools and towards a mix of bilateral contracts and residual spot market. Most of the presentation focussed specifically on the transitional period. The presentation looked at the issues to be addressed in the transition period – such as removal of the Single Buyer system, changes in bidding and pricing rules, settlement and payment issues and market governance issues – in the context of types of change, and in the context of who could work out and implement the changes. Thus the presentation provided our view on suggested steps.

C.5. VERKHOVNA RADA

The Project design assumed relationships with the Verkhovna Rada and, in particular, with the FEC Committee. Based on priorities proposed by the FEC Committee and our ability to meet those priorities within the Project scope of work, we devised a legislative program focused on ensuring a more successful privatization and post-privatization operation of the power sector. To meet our legislative efforts, we maintain biweekly working meetings with the FEC Committee to discuss and address issues related to one or more laws related to the energy sector. The FEC Committee also invited Hunton & Williams’ participation in four “task forces” or topical sub-committees addressing the following broad topics: NERC independence, wholesale electricity market, sector policy, and privatization. We have also been invited to work with them on oil and gas policy and regulatory issues, but due to resource constraints and policy directions from USAID, we have elected not to work on those topics. Below we describe specific legislative initiatives for which we are advising the FEC Committee.

C.5.1. NERC Law

The current status of our work on the NERC Independence Law is summarized in Part C.2.1. The history of this work is described in detail in our December 2000 Inception Report and Second Quarterly Report.

C.5.2 Wholesale Electricity Market Law

One of the fundamental tasks of our Project is to improve the functioning of the wholesale market, and in this context we are engaged in process of improving the legal underpinning of the WEM. Recently this area of activity has assumed major importance

and it stretches across our work with all our counterparts. Therefore, a description of current work on a WEM Law or WEM concept is given separately under C.6. .

C.5.3 Energy Sector Policy Bill

Consistent with our previous advice, the draft Energy Sector Policy Law failed to pass the second in February 2002, reading and is thus now removed. The FEC Committee intends to redraft a law starting in the next quarter. We expect to meet with the FEC staff in April 2002, after the elections, to discuss the content of such law. We have also arranged that when NERA consultant Andrej Juris is here sometime in 1 2002 for the Time of Use Rates training-advisory session (see Part F.2) he will also meet with the FEC Committee staff on sector policy issues. (NERA authored a study which we commissioned to them on the inconsistencies of the prior raft, which we provided to the FEC in Spring 2001, and which was probably useful in helping to defeat the prior draft.)

C.5.4. GOU Bankruptcy Related Draft Law

To improve the laws related to the compulsory sale of assets, as required by the Moratorium Law, the Cabinet of Ministers submitted to the Verkhovna Rada a draft law on introduction of changes and amendments to the Laws of Ukraine “On Enforcement Proceedings” and “On Solvency Restoration or Recognition the Debtor as a Bankrupt,” (Draft Law). These revisions, if adopted, would have led to cancellation of the Moratorium Law.

Hunton & Williams’s preliminary evaluation of the Draft was that it did not meet the purposes of the Moratorium Law, and might negatively influence the energy sector. We distributed our preliminary evaluation among the Donors, and other USAID projects, which supported our concerns. On 21 February Hunton & Williams also met with Verkhovna Rada FEC Committee Staff on the Draft Law. After discussion of our comments, the representatives of the Staff agreed to submit our comments to the MPs

After preliminary evaluation of the Draft Law, Hunton & Williams drafted a letter to the Verkhovna Rada and GOU opposing adoption. The letter was signed by representatives of the Donor organizations and sent by the EBRD to the Verkhovna Rada FEC Committee and on Economic Policy Committee, and to the GOU.

Consistent with our advice, the Draft Law failed to pass a second reading vote in early March 2002.

C.6. WORK WITH ALL COUNTERPARTS ON WEM REFORM

C.6.1 Prior Developments

Continuing the classification described in our 5th and 6th Quarterly Reports, our WEM reform work has 3 main directions. The first direction is the involvement in the ongoing process of improving the functioning of the WEM in its current form. This work,

In ten first meeting, The Commission also established a Secretariat, whose task is to coordinate all document flows of the Work Group and of the Commission. Hunton and Williams also provides the effective body of this Secretariat (Vica Dodonova and Anna Ryzhova), supported also by the staff and facilities of our project office at the NERC. Hunton & Williams has also provided the WEM Concept Commission Secretariat office within the NERC building with a computer.

For the period of the WEM Concept working group functioning, Hunton & Williams presented the following documents for its consideration: list of existing WEM problems and their causes (this document was accepted by the working group as a basis for the follow-up development); analysis of international experience of electricity markets' development and possibility of introduction of such experience in Ukraine; substantive comments to the draft structure of the WEM Concept and to other discussed documents.

The Working Group, as well as the Commission itself, is made up of all the stakeholders of the process of WEM reform. Hunton & Williams supports this set-up as the only one that will achieve the necessary broad support for a reform path and ensure its implementation in practice. At the same time, the initial weeks of discussions showed the difference in attitudes and understanding of the different stakeholders, and the need for substantial knowledge transfer in order to make all stakeholders capable of constructive dialogue. The Hunton & Williams team on the Working Group carries the largest burden in terms of this knowledge transfer, being the party that has substantial experience of solutions adopted in other countries and also the party that cannot be implicated in subjectivity. In the following quarter, this work will continue to demand large resources. For specific advice on certain aspects of pricing issues we plan to use the help of Ivan Adams, who had prepared a major analysis of the WEM reform issues in the previous Quarter.

C.7. OTHER WORK WITH OTHER USAID PROJECTS

C.7.1. Bankruptcy Related Issues

In December 2001 state agencies and commercial creditors of the "Dniproenergo" generating company attempted to put this company into sanation or bankruptcy. Consequently, the creditors filed a suit with the court and commenced bankruptcy proceedings against the "Dniproenergo," which is going on. The bankruptcy process is being held under the moratorium on forced sale of state energy companies' assets introduced by the Moratorium Law.

Under existing circumstances in the energy sector the "Dniproenergo" bankruptcy scenario might happen with other energy generating companies. Therefore, Hunton & Williams has been extensively analyzing the peculiarities, possible threats and consequences of pre-trial sanation and bankruptcy proceedings of the "Dniproenergo." The results of our analyses have been discussed at regular Donors' Meetings with Donor organizations and other USAID projects.

In preparation of the “Dniproenergo” bankruptcy case analysis and drafting the letter on the GOU Draft Law, Hunton & Williams also co-operated with the USAID sponsored Commercial Law Center. On 11 and 12 February we held two joint meetings and exchanged with written documents and oral ideas regarding the contents of the letter on the GOU Draft Law. Both projects agreed that the said draft law need changing and may not be passed in present version. On March 7, the Draft Law was in fact defeated at the Verkhovna Rada. See also, 5th and 6th Quarterly Reports, Section C.5.1.

D. SUPPORT OF THE PRIVATIZATION EFFORT.

D.1 OVERVIEW OF H&W PRIVATIZATION ACTIVITIES

USAID’s primary privatization advisor to the State Property Fund is DTT. Nevertheless, Hunton & Williams is directly assisting the privatization effort, while continuing our focus of developing the legal and regulatory support to both prepare and sustain Ukraine’s power sector for privatization. We thus work closely with DTT on several privatization related activities.

We continue with these general activities:

- We reviewed, commented in detail on, and proposed alternative drafts to, various instruments of the privatization process, including CabMin resolutions, tender notices, draft presidential decrees, and other materials.
- We have met on many occasions with DTT, separately, and with DTT jointly with USAID, to discuss issues of privatization strategy for oblenergos and for generation companies, and have provided detailed comments on drafts of these strategies.
- We work with DTT to offer our advice to the NERC on lifting market share restraints in NERC regulations.
- We worked with DTT to advise the State Property Fund on issues related to the purchase and sale agreement, and on problems of assuring performance of government (and investor) obligations through a partial risk guarantee (from the World Bank or EBRD), and on similar purely contractual devices.
- We continued to routinely provide DTT and others in the Donor community with English-translated copies of laws and other normative acts, such as for use in its privatization web site, or for reference as issues develop.
- We worked jointly with the NERC and investors to develop a NERC tariff procedure to implement the new tariff, thus to support the privatization process.
- We regularly meet with potential and actual strategic investors to explore their views and privatization participation requirements, passing relevant information to DTT and incorporating the same into our work.

D.2 IMPLEMENTATION OF CABINET OF MINISTERS RESOLUTION No.133-p

The Hunton & Williams project monitors implementation by government agencies of CMU Resolution No. 133-p “On the System of Arrangements to Create Favorable Conditions for the Development of Energy Sector” of 7 April 2001. Our regular updates on the status of Resolution 133-p are provided to DTT and in turn to the Donor group. Thus see Part E.1 for more detail.

D.3 LEGAL ANALYSIS OF WAYS TO RESOLVE INVESTOR RISKS

In the upcoming round of privatization of the energy supply companies in Ukraine, non-fulfillment of the obligations undertaken by the Government in Resolution No.133-p continues to present risks for the potential strategic investors. The application of such instruments as a partial risk guarantee or introduction of state cross-obligations to the purchase and sale agreement were considered from the legal point of view to resolve the issues of the investor’s risks in the next round of privatization. The acceptability of a partial risk guarantee is very conditional and depends on the mechanism of its performance, existence of the parliament’s authorization for its application and availability of funds for its indemnification.

Thus, absent such mechanisms, Hunton & Williams believes that the most appropriate way to enforce the fulfillment of the obligations undertaken by the Government in the process of privatization is the incorporation of relevant provisions in the purchase and sale agreement of the block of shares and introduction of responsibility for violation of such obligations. This idea as presented by Hunton & Williams was supported in general by the Legal Department of the State Property Fund of Ukraine. The next step will be the development of the details of its implementation and consideration of the issues of Government’s responsibility for violation of obligations undertaken under purchase and sales agreement. We look forward for further cooperation with SPF on these and other issues.

D.4 TENDER CONDITIONS IN THE UPCOMING ROUND OF PRIVATIZATION

Currently we are examining the legal aspects of the pre-qualification criteria for strategic investors, pre-conditions of participation and the problem of full disclosure of bidders’ ownership at the tender stage. The objective of this activity is to propose improvements to relevant provisions of the Ukrainian legislation. We have previously provided detailed comments on pre-qualification criteria to DTT on their oblenergo privatization strategy.

E. ACTIVITY FOR INTERNATIONAL PRIVATIZATION TASK FORCE AND DONOR COMMUNITY.

As previously mentioned, GOU and the principal international donor agencies in Ukraine – EBRD, IMF, the World Bank and USAID – created an international energy Task Force to tackle problems with the Ukraine power sector. The decisions of the Task Force routinely shape and guide the directions of our Project. Within the Task Force, USAID plays a key role directing Task Force activities, including drafting concept papers summarizing the group consensus (or seeking to attain such consensus). The working body of the International Task Force is the weekly “Donor Meeting”, in which Hunton & Williams is a normal participant. Hunton & Williams regularly reports to the Donor Meeting on matters in its areas of competence.

E.1. STATUS OF IMPLEMENTATION OF RESOLUTION NO. 133-p

The project performs continuous update of the matrix on the implementation by the Government of Ukraine of the Cabinet of Ministers Resolution No. 133-p “On the System of Arrangements to Create Favorable Conditions for the Development of Energy Sector” of 7 April 2001. (The “Comfort Letter” of the previous sale of oblenergos). These are provided to DTT for use in its briefings to meetings of the International Task Force on these issues.

The most significant obligations, such as non-interference in disconnection activities of the privatized electricity supply companies, full and timely payments for electricity consumed by the budgetary organizations, payments for privileges and subsidies, performance of the inventory and registration of rights to land plots have been executed by the Government only in part. A number of regulatory acts issued by the Verkhovna Rada and the Cabinet of Ministers of Ukraine still indirectly limit the ability of the electricity supply companies to disconnect non-payers. Due to non-payments for electricity consumed by military units, budgetary organizations, state enterprises, the electricity supply companies are induced to finance payments to State Enterprise “Energorynok” from the outside sources.

Partial payments and delays in payments of privileges and subsidies take place. In its new Resolution No. 95 CMU has approved the Temporary Procedure of transfer of subvention for privileges and subsidies from the state budget to local budgets. The sources for privileges and subsidies payments will be Naftogaz payments to budget for gas transit and rent payments for gas production. Money on privileges and subsidies are to be transferred from local budgets to transit accounts of oblenergos, opened in Prominvestbank, and further directed through the State Enterprise “Energorynok” and generating companies to gas suppliers. Naftogas and other gas suppliers should open accounts in the State Treasury to which money on privileges and subsidies will be transferred. Details of payments shall be clarified by the NERC. Thus, this scheme presents in fact an offset for gas suppliers, who make payments to budget on gas transit and rent and receive these money back as payments for privileges and subsidies. These sources might be insufficient,

so additional sources should be determined as it was done last year. Time needed for clarification and implementation of the Temporary Procedure can result in prolongation of delay in payments of subsidies and privileges. However, the Government by the end of December 2001 made full settlements for the year 2001 on electricity consumed by the budgetary organizations.

The NERC has approved new tariffs for Kirovogradoblenergo and decreased the tariff for Khersonoblenergo, which still is not paying 100% to the State Enterprise "Energorynok". The new tariff methodology allows the privatized oblenergos to cover costs of land inventory through the tariff. We believe the NERC should consider the provisions of the new Land Code while approving tariffs.

E.2 IMPROVEMENTS IN PAYMENTS OF PRIVILEGES AND SUBSIDIES

Considering the delays and problems in payments of privileges and subsidies, Hunton & Williams made and provided to the SPF legal research on the possibility of mutual offset of tax payments of the electricity supply companies to state and local budgets and the indebtedness of budgets on privileges and subsidies granted to the population and on payments for electricity consumed by budgetary organizations. This type of offset is also viewed as a possible remedy for failure to comply with payments in the Purchase and Sale Agreements.

E.3. REMEDIES FOR FAILURE TO COMPLY WITH OBLIGATIONS UNDERTAKEN UNDER PSA BY THE GOVERNMENT AND INVESTORS

Hunton & Williams provided the SPF with a research on possible legal instruments to ensure fulfillment of the cross obligations undertaken by the State and an Investor - the remedies for failure to comply with these obligations in the Purchase and Sale Agreements (PSA) of the block of shares of the electricity supply companies. The cross obligations and liabilities are supposed to compose a separate (the second) block of obligations in the Purchase and Sale Agreement of the block of shares. The main attention was paid to the contents and nature of the cross obligations, and, accordingly, to the possible remedies for failure to comply.

Since certain electricity supply companies privatized by strategic investors in April 2001 are not fulfilling obligations undertaken in their purchase and sale agreements, in particular, Khersonoblenergo is still failing to make full payment in money of electricity purchased, H&W prepared for the Donors' group memo on the remedies available to the Government to bring investors of the privatized electricity supply companies to account for failure to fulfill obligations undertaken under the purchase and sale agreements.

E.4 ANALYSIS OF PRE-QUALIFICATION CRITERIA

For the purposes of establishment in the next tenders on privatization of electricity supply companies the legally consistent pre-qualification criteria, H&W performed a number of researches aimed at evaluation of the legal aspects of the criteria discussed at the

weekly Donors' meetings. The goal of these researches was not to consider policy options, but to provide explanations on the legal possibilities of introduction of the criteria proposed. The results of the research performed brought H&W to the conclusion that to find a real strategic investor it is necessary not only to establish proper pre-qualification criteria, but also strong pre-conditions of participation. The pre-condition of participation in pervious tenders were poorly developed, in particular, requirements on disclosure of ownership of bidders and entities, with which it is in control relations. This happened mainly due to weak language of the legislation on consortia participation in tenders and absence of a strong requirement as a tender condition to provide information on the source of capital, assigned for purchase. Summaries of this research were provided to DTT and participants of the Donors' meetings.

E.5. PARTIAL RISK GUARANTEE: LEGAL OBSTACLES IN IMPLEMENTATION

For more clarity and precise understanding of the legal obstacles in implementation of the partial risk guarantee, H&W prepared for the members of the Donors' Group a slide presentation "Partial Risk Guarantee: Legal Obstacles in Implementation", which addresses issues requiring political consent from the VR and those having legal and legislative difficulties for introduction of the partial risk guarantee.

E.6. WEM CONCEPT COMMISSION REPRESENTATION

Hunton & Williams' market economist Ilka Lewington was nominated by the Donor group as their representative on the WEM Concept Commission. Details of the WEM Concept Commission are discussed at Part C.6.

F. TRAINING AND STUDY TOUR PROGRAM

Hunton & Williams developed a focused training program to support Project objectives. Rather than the traditional training consisting of courses and lectures, we devised a series of five, week-long training programs. Each program consists of a one day traditional lecture by a consultant in a particular area, followed by four days of hands on training and discussion with each of our GOU counterpart agencies. The purpose of the exercise is to impart a common vocabulary and to discuss a common set of issues among the counterparts. The topics are selected to emphasize particular aspects of our substantive program: regulatory law, basics of regulation, tariffs and rate design, power pools and generation pricing.

F.1 STUDY TOURS AND COUNTERPART TRAVEL SPONSORED BY H&W

(Discussion moved from Part G.2). There was no counterpart travel to conferences or study tours sponsored by Hunton and Williams in the 7th Quarter.

F.2. PLANNED TRAINING IN FUTURE QUARTERS

In the next Quarter Hunton & Williams intends to hold a number of training courses requested by NERC.

F.2.1 Time of Use Rates Course

Training in Time of Use Tariffs was scheduled for March 2002, but upon request of the trainers (NERA) has been postponed until later in 2002. This course will be delivered by NERA (Andrej Juris) and cover the following major issues:

- Economic reasons for application of TOU rates at the wholesale energy market and for ultimate customers,
- Types of TOU rates applied in the wholesale market and for ultimate customers (hourly, seasonal). Relation to availability of generation capacity,
- Market structure preconditions that have to be observed in application of the TOU rates,
- Examples of how TOU rates are applied under different market structures that have different pricing.

F.2.2. Regulatory Capital Structures Course

Training in Regulatory Capital Structure is planned for late spring of 2002. Our intention is to invite current or former FERC staff experts to deliver this course and cover the following issues:

- Interest cost, equity cost for ownership capital, how to measure what it should be,
- Why the regulator cares about return on equity, cost of debt, and total cost of capital
- The weighted average cost of capital; how to compute it, and what uses it has to the operator of the utility, and what concerns it causes the regulator,
- Doctrines of regulatory rate base, especially “used and useful”. Why the regulatory rate base may be and usually is different from the total capital derived from all sources of capital.

F.2.3. European Integration Training Advisory

The proposed NERC Law has been classified by the Verkhovna Rada as, in part, an issue of European Integration. As well, aspects of the Wholesale Energy Market design (concept) are also affected by European integration (EC Energy Directive) issues. Thus to move both processes and especially to assure our continued participation in the NERC Law we plan to bring the Hunton and Williams expert in European Integration, (Steve Horvath of our London office) for a 3 days training- advisory on European Integration issues, especially regulatory transparency. This will probably be scheduled for May or early June. Steve Horvath has previously worked with this project presenting talks and seminars on regulatory independence and WEM market design, on behalf of the FEC Committee.

F.2.4. Regulatory Procedures Course.

Training for the NERC in FERC Procedures, and Regulations has been initially scheduled for early summer 2002, to be delivered by FERC senior attorney Bill Froehlich, who has previously delivered two other courses for this Project in Ukraine, and for other USAID projects in this region.

F.3. TRAINING IN 7th QUARTER

The NERC recently approved a new tariff method for electricity distribution companies, which is based, in part, on the rate of return approach to regulation. As a result, the form and content of the regulatory accounts needed to be revised to accommodate changes of the new method.

Thus, training in Regulatory Accounting, in the format of a “training advisory” was delivered by Mr. David C. Jones, CPFA, FCCA (UK) of the International Law Institute, was quite relevant for the NERC. The following major issues were covered by the course:

- The Idea of a Regulatory System of Accounts. Who Creates Them? Why, and What They Contain,
- The Accounting Framework. Accountability. Generally Accepted Accounting Principles,
- How Regulatory Accounts Relate to Utility Accounts and Tax Accounts,
- Recovery of Capital Costs (Briefly): Depreciation on Assets. Return on Equity,
- Regulatory Depreciation Methods. Which Ones Are Used? When and Why,
- The Inclusion of the Proper Component for “Return” into The Revenue Requirement,
- The Balance Sheet. Assets and Liabilities. Capitalization. Accumulated Retained Earnings,
- How and Why to Construct a “Revenue Requirement.”
- Net Income or Cash Flows, and other.

List of Regulatory Accounting Course Participants		
#	Name	Position / Department
1.	Vasyl G. Kotko	Commissioner
2.	Yuri I. Kiyashko	Commissioner
3.	Victor T. Merkushev	Commissioner
4.	Lubov G. Goncharova	Commissioner
5.	Sergey C. Volos	Pricing Policy Department
6.	Petro P. Petrenko	Financial-Analytical Department
7.	Leonid S. Simonenko	Head of Technical Department
8.	Yuriy Fedorov	Financial-Analytical Department
9.	Valeriy I. Tsaplin	Deputy Head of Financial-Analytical Department
10.	Olga V. Zbrodova	Pricing Policy Department
11.	Aleksey G. Grineev	Financial-Analytical Department
12.	Alexander V. Goncharov	Financial-Analytical Department
13.	Natalia S. Borovik	Information Support and Public Relations

State Material Reserve as a storage of goods purchased for the state needs, its governance by the SMRC; and (2) SMRC legal ability (as of a creditor) to initiate thermal Genco bankruptcy and liquidation proceedings; legality of requirements on SMRC participation in Genco debt restructuring and outline of current situation with debt restructuring of Gencos; ways to remove the SMRC from binding fuel supplies to Gencos; degree of SMRC authority over fully privatized Gencos, if the SMRC is not taken out of fuel supply activity completely.

G.2.3 Structure Of Ukrainian Fuel Market.

This research outlined all existing fuel supplies by type of fuel, to thermal Gencos; identified all entities (whether state or private or foreign) which participate in the fuel market; discussed requirements of their entry to the fuel market established by the Ukrainian state.

G.2.4 Limitations on Energy Purchases

Currently even those oblenergos who have paid in full can not always purchase from the wholesale electricity market as much electricity as they need. At the same time current legislation (mainly Cabinet of Minister Resolution No. 441, 24 March, 1999 "On the Prompt Measures to Stabilize Financial Status of Enterprises of Electricity Industry") authorizes "Ukrenergo", as a WEM dispatcher, to take forcible operative-dispatch measures for violation of administratively set electricity consumption levels by oblenergos. Second, the Energomarket does not participate in calculations of amounts of electricity allowed to be released to oblenergos and, as a result, can not guarantee energy supply in amounts declared by oblenergos. Thus this on-going research addresses: (1) Ukrenergo powers to regulate oblenergo energy purchases; (2) correlation of electricity generation with limitation of electricity consumption; (3) WEMMA requirements on quantity of energy purchases.

G.2.5. Government Legal Ability to Affect Thermal Genco Privatization.

The research analyses current powers of the Cabinet of Ministers, the Ministry of Fuel and Energy, the State Property Fund, and other state bodies which can be exercised during adoption of a decision on privatization, development of privatization plans (plans of shares' distribution), establishment of privatization terms, approval of competition conditions, etc., for Gencos.

G.2.6. CBM Experience Survey and Conference

Consistent with the written request from Project CTO we have organized a survey of interested entities in the experience of CBM development in Ukraine to date. At the end of February, the survey was sent by e-mail, fax and regular mail to as many entities as we could identify who have worked in or expressed an interest to work in, Ukraine in CBM or CMM. We expect to receive replies in March and April, and to write the analysis by the end of 8th Quarter. We expect to present the conference on the results in mid-July 2002.

In December 2001 we finished a proposed "Final Report" for the CBM Support Project. The Report was not yet accepted pending completion of the CBM Survey and analysis and use of its results.

PART H: REGISTER OF MAIN PROJECT ACTIVITIES, DECEMBER 1, 2001 TO FEBRUARY 28, 2002

	Subject	Date	Author	Working Group participation and other activities		
				Date	Title	Participants
	Tariffs					
	<ul style="list-style-type: none"> Analysis of impacts of increase in distribution margins of 4 oblenergos 	3-7 December, 2001	Y. Antonova			
	<ul style="list-style-type: none"> Analysis of impacts of various WEM pricing scenarios on tariffs for customers Analysis of the draft procedure for additional services that oblenergos can provide to their customers 	10-14 December, 2001	Y. Antonova			
	<ul style="list-style-type: none"> Analysis of the draft procedure for additional services that oblenergos can provide to their customers Analysis of the method for computation of oblenergos' tariffs proposed to the NERC by the "Ukrseleproekt" institute 	17-21 December, 2001	Y. Antonova			
	<ul style="list-style-type: none"> Analysis of the draft procedure for review of the tariff for electricity produced by the nuclear generators 	24-28 December, 2001	Y. Antonova			
	<ul style="list-style-type: none"> Review of tariff filings Analysis of the impact of costs paid by customers as apart of the tariff returned on investment and depreciation 	4-15 February, 2002	Y. Antonova	23 January, 2002	NERC open hearing on no-purpose usage of funds according to cost items of approved tariffs by Poltavaoblenergo, Lvivoblenergo and Zaporizhyaoblenergo.	L. Surzhenko, Y. Antonova

	Subject	Date	Author	Working Group participation and other activities		
	<ul style="list-style-type: none"> Comments to the Draft NERC Procedure on services other than licensed 	11-15 February, 2002	Y. Antonova	20 February, 2002	NERC open hearing on the issue of approving the distribution margins computed under the new tariff method for the regional supply company "Kirovogradoblenergo"	Y. Antonova
	1. Preparation of depreciation models upon NERC request	18-22 February, 2002	Y. Antonova			
	2. Spreadsheet to calculate the impact of application of the new tariff methods to the 12 oblenergos to be privatized	18 February-1 March, 2002	Y. Antonova			
	3. Review of the Kyivenergo's proposed method of cost separation	25 February-1 March, 2002	Y. Antonova			
	Regulatory issues					
	<ul style="list-style-type: none"> Summarizing the horizontal merger guidelines 	24-28 December, 2001	Y. Antonova			
	<ul style="list-style-type: none"> Research and analysis of legal issues related to WEM Governance under NETA mechanism in the UK. 	21-25 January, 2002	V. Dodonova			
	<ul style="list-style-type: none"> Analysis of the world experience of WEM functioning in terms of application of that experience in Ukraine 	25February-1 March, 2002	A. Ryzhova, V.Dodonova			
	Improvement of current WEM					
	<ul style="list-style-type: none"> Analysis of the data of the averaged performance of the thermal power units in Ukraine 	3-7 December, 2001	V. Raschepkin			
	<ul style="list-style-type: none"> Drafting conditions under which the licensee has the right to carry out other types of entrepreneurial activity 	10-14 December, 2001	L. Surzhenko			

	Subject	Date	Author	Working Group participation and other activities		
	<ul style="list-style-type: none"> Drafting list of assumptions for theoretical modeling of the load duration curves and price duration curves Modeling of incremental costs for the bids of the generators to the Ukrainian WEM 	10-14 December, 2001	V. Raschepkin			
	<ul style="list-style-type: none"> Report on IVKOR WG meeting about introduction of changes approved by the WG to IVKOR 	20 December, 2001	L. Surzhenko	19 December, 2001	NERC working group on IVKOR	L. Surzhenko
	<ul style="list-style-type: none"> Calculation of the weight coefficient for units' heat-rate and own needs to adapt theoretical data to the actual data of units' performance 	17-21 December, 2001	V. Raschepkin			
	<ul style="list-style-type: none"> Memo on Luganskoblenergo's debt to ESE 	24-28 December, 2001	L. Surzhenko			
	<ul style="list-style-type: none"> Report on the WEM Board meeting 	28 December, 2001	L. Surzhenko, V. Dodonova			
	<ul style="list-style-type: none"> Programming the economic dispatch order for the thermal power units 	24-28 December, 2001	V. Raschepkin	27 December, 2001	WEM Board meeting	L. Surzhenko, V. Dodonova
	<ul style="list-style-type: none"> Research on the additional services of oblenergos 	8-11 January, 2002	L. Surzhenko			
	<ul style="list-style-type: none"> Analysis of the shortcomings of NERC standing order for purpose of introducing changes to the WEM algorithm 	8-11 January, 2002	L. Surzhenko	H.		
	<ul style="list-style-type: none"> Consideration of the proposed amendments into WEM Law 	14-18 January, 2002	V. Dodonova	16 January, 2002	NERC WG on metering issues	I. Lewington, V. Raschepkin
	<ul style="list-style-type: none"> Analysis of the role and authority of the State Material Reserve Committee in the process of gencos' debt restructuring, bankruptcy and liquidation process 	14-18 January, 2002	A. Ostrovskaya	I.		
	<ul style="list-style-type: none"> Research on additional conditions to licensing conditions Review of draft conditions under which licensee has the right to carry out other types of entrepreneurial activity besides licensed ones 	21 January – 01 February, 2002	L. Surzhenko			

	Subject	Date	Author	Working Group participation and other activities		
	• Analysis of electricity and capacity consumption limitations, and generation allocations' regulation under the CMU Resolution 44	21 January – 01 February, 2002	A. Ostrovskaya			
	• Data for the analysis and modeling of the merit order dispatch of the Ukrainian TPU	21-25 January, 2002	V. Raschepkin			
	4. Memo on the treatment of the transmission losses in the networks adjacent to the power plants in the other electricity markets 5. Collection and analysis of the statistic data on the operation of the coal mining industry in relation to the use of the fuel at thermal power plants	28 January - 01February, 2002	V. Raschepkin	J. 30 January, 2002	WEM Board meeting	V. Dodonova, V.Raschepkin, I.Lewington
	• Research on the prevention of claims to oblenergos for emergency situations appearance	4-8 February, 2002	L. Surzhenko	8 February, 2002	WEM Members General Meeting	I. Lewington, V. Dodonova, L. Surzhenko, A. Ryzhova
	6. Draft letter to CoM regarding draft CoM algorithm changing procedure 7. Memo on CoM resolution on algorithm changing procedure K.	18-22 February, 2002	L. Surzhenko			
	8. Analysis of the general structure of energy fuel market in Ukraine. Legal display and actual situation. 9. Analysis of data on genco's operations and dispatch including analysis of how fuels markets constrain generation.	18-22 February, 2002	A. Ostrovskaya			
	10. Review of the Kievenoenergo's method on services other than licensed L.	18-22 February, 2002	Y. Antonova	28 February, 2002	WEM Board meeting	I. Lewington, L. Surzhenko
	11. Memo on the Cabinet of Ministers Resolution # 200 12. Summary on the Cabinet of Ministers Resolution # 200	25February-1 March , 2002	L. Surzhenko			

	Subject	Date	Author	Working Group participation and other activities		
	13. Preparation of current structure of coal, gas, and mazut supplies to thermal gencos. 14. Analysis of data on gencos' current shortcomings in bidding and dispatch.	25February-1 March, 2002	A. Ostrovskaya			
	15. Memo on description of models of the economic dispatch of the TPP in Ukraine 16. Analysis of the issues of fuel prices for generating companies.	25February-1 March, 2002	V. Raschepkin			
	WEM Law and WEM reform					
	<ul style="list-style-type: none"> Report on the amendments proposed to be included into the WEM Agreement 	17-18 December, 2001	V. Dodonova	3-14 December, 2001	NERC working group on Introduction of editorial changes into the WEM Agreement	L. Surzhenko, V. Dodonova
	<ul style="list-style-type: none"> Research on the procedure on re-election of voting directors between the annual General Meetings 	19-20 December, 2001	V. Dodonova	12 December, 2001	SE "Energomarket" working group on Market Rules Revision	V. Raschepkin
	<ul style="list-style-type: none"> Research and analysis of the amendments proposed to be included into the WEM Agreement 	24-28 December, 2001	V. Dodonova	M.		
	<ul style="list-style-type: none"> Preparation of the WEM Concept structure according to the UK model 	11-15 February, 2002	V. Dodonova	7 February, 2002 - present	WEM Concept Working Group	I.Lewington, P. Ballonoff
	<ul style="list-style-type: none"> Comments to the WEM Concept table containing problems in the energy sector 	18-22 February, 2002	V. Dodonova, V. Raschepkin, A. Ryzhova			
				28 February, 2002	WEM Concept Interagency Commission session	I.Lewington, A. Ryzhova, V. Raschepkin
	Laws and related issues					
	<ul style="list-style-type: none"> Survey on Moratorium Law Memo on Possibility to pass the Debt Restructuring Law 	3-7 December, 2001	A. Ryzhova			

	Subject	Date	Author	Working Group participation and other activities		
	<ul style="list-style-type: none"> • Memo on Sanation Procedure for the state owned JSCs • Study on the “Dniproenergo” proposed sanation and related issues 	10-14 December, 2001	A. Ryzhova			
	<ul style="list-style-type: none"> • Memo on the “Dniproenergo” proposed sanation • Research of application of sanation of the generating companies 	17-28 December, 2001	A. Ryzhova			
	<ul style="list-style-type: none"> • Summary on the Debt Restructuring Law idea 	17-21 December, 2001	A. Ryzhova			
	<ul style="list-style-type: none"> • Analysis of the introduction changes into Bankruptcy Law required by Moratorium Law 	8-11 January, 2002	A. Ryzhova			
	<ul style="list-style-type: none"> • Summary on Dniproenergo bankruptcy case 	8-11 January, 2002	A. Ryzhova			
	<ul style="list-style-type: none"> • Analysis of the issues of bankruptcy, sanation and liquidation of energy companies 	14-18 January, 2002	A. Ryzhova			
	<ul style="list-style-type: none"> • Memorandum on liquidation of the generating companies • Study on the sanation by the Article 53 of Bankruptcy law • Research of contractual relationships in the WEM 	21-25 January, 2002	A. Ryzhova			
	<ul style="list-style-type: none"> • Comments of the CMU’s amendments to the Laws on Bankruptcy and Enforcement Proceedings 	28 January - 01 February, 2002	A. Ryzhova			
	<ul style="list-style-type: none"> • Analysis of the Regulatory Policy Law 	4-8 February, 2002	L. Surzhenko			
	<ul style="list-style-type: none"> • Draft letter to VR FEC Committee regarding abolition of the CoM draft law “On amendment to the bankruptcy law” 	11-15 February, 2002	A. Ryzhova	12 February, 2002	NERC Working Group regarding drafting of the Normative Documents for Implementation of Insurance Law	L. Surzhenko

Subject	Date	Author	Working Group participation and other activities		
17. Memo on the analysis of the Regulatory Policy Law 18. Comments on CoM Draft resolution on algorithm changes procedure	11-15 February, 2002	L. Surzhenko			
Direct Privatization support					
<ul style="list-style-type: none"> Issues of CoM resolution # 133-p implementation Power privatization matrix 	3-7 December, 2001	K. Mokanu			
<ul style="list-style-type: none"> Memo on liabilities in PSA 	10-21 December, 2001	K. Mokanu			
<ul style="list-style-type: none"> Research on the oblenergos' obligations 	24-28 December, 2001	K. Mokanu			
<ul style="list-style-type: none"> Memo on Possibility of application of mutual offset of tax payment and payments from budget 	8-11 January, 2002	K. Mokanu			
<ul style="list-style-type: none"> Analysis of the issue of release of potential investors from obligations imposed by tender conditions on previous sale 	14-18 January, 2002	K. Mokanu			
<ul style="list-style-type: none"> Analyses on pre-qualification criteria and pre-condition of participation in tenders 	21-25 January, 2002	K. Mokanu			
<ul style="list-style-type: none"> Pre-qualification criteria issues Oblenergos obligations under legislation 	28 January - 01 February, 2002	K. Mokanu			
<ul style="list-style-type: none"> Presentation "Partial risk guarantee: legal obstacles in implementation" 	18-22 February, 2002	K. Mokanu			
<ul style="list-style-type: none"> Memo on PSA requirement to investor on the number of employees Analysis of provisions of land code: new legal status of land plots of oblenergos 	25 February-1 March, 2002	K. Mokanu			
Information Technology					

Subject	Date	Author	Working Group participation and other activities		
			7 December, 2001	Presentation of newly supplied equipment for SE "Energomarket"	J. Weller, I.Lewington, I. Papazova, P. Gurin
			28 February, 2002	Signing of the contract on equipment supply for the NERC	P. Ballonoff, I. Papazova, P. Gurin
Energy Sector Situation					
<ul style="list-style-type: none"> Tax pledge scheme 	14-18 January, 2002	V. Dodonova			
Study Tours, Conferences, Overviews of international practice and Training					
Regulatory Accounting Seminar for the representatives of NERC	28 January - 01February, 2002				
Hearings in Ukrainian Union of Industrialists and Entrepreneurs on proposals to the WEM concept	30 January, 2002	Lewington, A. Ryzhova	N.		
Summit on Power Generation in Ukraine	6-7 February, 2002	P. Ballonoff, I.Lewington, Y. Antonova, V. Dodonova, A. Ryzhova, A.Ostrovskaya, V. Raschepkin, L. Surzhenko			

PART I: NERC ACTIVITY REGISTER NOVEMBER 27, 2001 TO FEBRUARY 28, 2002

#	Subject of the request / activity	Date Received	Form	Request / originated by	H&W disposition	Status	Notes/ Importance
22	Request to provide with a consultation regarding international practice of the bodies of state power regulation of the cost of auxiliary services, rendered by power supply and power transmission organizations, as monopolists on the territory of carrying out licensed activity, to customers (issuance of technical conditions, checking and replacement of metering devices, etc.).	Nov 27, 2001	In writing	L. Simonenko, Head of Technical Dpt.		On November 28 Provided with "Regulating Utility Affiliates: Challenges and Solutions" Memo, prepared by Ken Barry (H&W, Washington DC), dated October 5, 2001.	
22.1	Copy of the NERC Technical Dpt internal Letter, providing comments and analysis of the above Memo, indicating a need for more detailed research.	Nov 30, 2001	In writing	L. Simonenko, Head of Technical Dpt.		Considered	
23	<i>Request to carry out research of Ukrainian legislation to discuss whether the Verkhovna Rada may adopt a law on the generators' debts restructuring.</i>	Nov 27, 2001	Meeting of Paul Ballonoff with Commissioner Kotko	Commissioner Kotko		Memo regarding Law on Restructuring of the Energy Generating Companies' Debts prepared by Anna Ryzhova (provided to Commissioner Kotko on December 25, 2001)	Invited Commissioner Kotko to discuss the issue after he studies the Memo
24	Request to further research and analyze debt restructuring scenarios discussed at the meeting	Nov 27, 2001	See item 23	See item 23		1) Memo on Quantitative Assessment Of Wholesale Electricity Market Reforms And Related Issues 2) Supplements 1 & 2 to the above Memo provided to Commissioner Kotko on December 25,	The Memo and the Summary of the above Memo were provided to NERC Chairman at the meeting of December 11, 2001

#	Subject of the request / activity	Date Received	Form	Request / originated by	H&W disposition	Status	Notes/ Importance
						2001	(See item 25)
25	Request to provide information on countries with a single regulatory agency for several sectors	Nov 29, 2001	Orally	Commissioner Goncharova			On November 29 provided Commissioner Goncharova with Ukrainian translation of the List of such countries (research on the issue was carried out by Victoria Dodonova).
26	NERC Proposal to conduct a meeting for representatives of NERC H&W in December 2001	Nov 27, 2001	NERC Letter, signed by Prodan	Received from Oleg Ulyanenko (Deputy Head of Informational Support and PR Dpt)			On November 29 provided with a letter-response from Paul, proposing to organize the meeting on December 10 or 11 in order to involve Julia Weller to this meeting (Julia will be in Kiev for a week in December)
27	Question about financial contracts: if there is a definition of financial contracts in Ukrainian legislation and/or if financial contracts are allowed according to Ukrainian legislation.	Dec 5, 2001	Orally	Mrs.Boyko, Deputy Head of Energorynok Dpt and Vyshynsky, Head of Energorynok Dpt			On December 6 provided both with a copy of an overview document that was provided earlier to the ESE.
28	Meeting on organizational issues of H&W project cooperation with NERC.	Dec 11, 2001		NERC management			The meeting resolved to update the Scope of Work agreed upon with H&W and NERC on December 2000. H&W presented NERC Chairman with 1) List of documents, as well as a 2) booklet of all the hard copies of the documents provided to NERC within recent half-year period of project operation, 3)set of project

#	Subject of the request / activity	Date Received	Form	Request / originated by	H&W disposition	Status	Notes/ Importance
							registration information
29	Request to translate the materials that were obtained by the NERC representatives during their visit in the US, state of Ohio, regarding the issues of audit, management and protection of consumers' rights.	Dec 18, 2001	NERC Letter	V.Brynzyuk, Head of Informational Support and PR Dpt.		Translated into Ukrainian and provided to NERC on January 9, 2002	
30	Letter from Prodan asking to provide assistance to NERC in drafting normative acts pursuant to new law "On Insurance"	December 12, 2001	NERC Letter	Prodan, NERC Chairman		Responded with his letter of Dec 12, saying that USAID will provide requested assistance through Deloitte Touche Tohmatsu Commercial Law Center.	CC: Doug Powel, USAID; Justin Hall, CLC
30.1	Meeting of Darrel Brown (Commercial Law Center, CLC) and Paul B. (H&W) with Commissioner Kiyashko and NERC Financial-Analytical Dpt regarding the status of elaboration of normative documents pursuant to the new Law on Insurance.	Jan 24, 2002	Discussion	Originated by NERC / coordinated by H&W		Resolved to coordinate activities of the WG on elaboration of normative documents pursuant to the new Law on Insurance and CLC, and involve actuarial settlements expert to analyzing the WG products. H&W will provide its assistance as well.	
31	Comments for Mrs. Lagodyuk, head of NERC Pricing Dpt, regarding the "approach to formation of prices for all the services other than electricity transmission and supply services"	Dec 28, 2001	Discussion	Lagodyuk, head of NERC Pricing Dpt		Memo "Approaches to formation of prices for all the services other than electricity transmission and supply services" prepared by Paul B. (provided on December 28, 2001)	

#	Subject of the request / activity	Date Received	Form	Request / originated by	H&W disposition	Status	Notes/ Importance
32	Comments to the Draft Procedure for Adopting the Decisions on Tariff Changes and Approval for Electricity, Generated by Nuclear Power Plants (NPPs) of Ukraine	Dec 28, 2001	Discussion	Commissioner Kotko/ Cc: Voloshenyuk V.M., deputy head of the Dpt on regulating generating companies		Memo regarding the Draft Procedure for Adopting the Decisions on Tariff Changes and Approval for Electricity, Generated by Nuclear Power Plants (NPPs) of Ukraine prepared by Paul B. and Yelena Antonova (provided to NERC on December 28, 2001)	
33	Request to provide information on "additional services" rendered by electricity transmission companies as natural monopolists	Dec 28, 2001	NERC Letter	L. Simonenko Head of Technical Dpt		Memo by Yelena Antonova provided to Simonenko and Lagodyuk on February 1, 2002	See also items 22, 22.1
34	NERC request to provide with "Reporting Table" for the period of H&W project operation	Dec 11, 2001	Orally	Prodan. NERC Chairman		Prepared by Irina Kurstak and provided to Prodan on Jan 24, 2002	
35	Questions, asked by the Technical Dpt: How in the other electricity markets the transmission related transit of the electric power via the substations (open switch gears - OSG) is accounted for, who the transit volumes are attributed to, and which tariff are they included to?	Jan 16, 2001	Orally	L. Simonenko, Head of Technical Dpt, via Slava Raschepkin		On February 20 provided NERC Technical Dpt with the report "Treatment of Transmission Losses in the Former UK Pool and in the New Electricity Trading Arrangements", prepared by Slava. Later on same document was provided to NEC Ukrenergo, and to Zakhidenergo.	See also items 22, 22.1, 33
36	Letter (signed by Prodan and drafted by NERC Technical Dpt) regarding purchase of two servers for NERC IC. The letter is in response to H&W	Jan 22, 2002	NERC Letter	NERC Chairman / Technical Dpt / Energorynok Dpt		On February 28 the contract for purchasing the equipment was signed by H&W, NERC and the	See also items 3 (July 18, 2001) and 3.1 (Aug 20, 2001)

#	Subject of the request / activity	Date Received	Form	Request / originated by	H&W disposition	Status	Notes/ Importance
	FCCA (UK)					Dpt, Financial - Analytical Dpt, and Technical Dpt. Also included one-by-one discussions with interested NERC people	
39	Request to comment on the new Law "On Alternative Energy Sources" that was passed by the Rada and vetoed by the President. Specifically, Mrs. Boyko asked to answer the following question: "Is there international practice of having a separate regulatory body for generation, transmission and distribution of electricity generated from alternative (non-conventional) energy sources?"	February 4, 2002	Orally	Mrs. Boyko, Deputy Head of Energorynok Dpt		On Feb 4 Paul B. responded with an e-mail message, saying that usually there is only one regulatory body that deals with pricing for all forms of natural monopoly type energy. Paul asked to provide with English translation of the Law. Formal reply will be provided to NERC after Julia Weller provides her view on the issue and H&W Librarian in DC researches other country experience, to make sure such dual authorities do not exist. On Feb 8 and 11 Paul provided additional comment to the NERC response to Energy Conservation Committee.	NERC is preparing a letter to the State Committee on Energy Conservation to confirm NERC's earlier strong comments against the law.
40	Request to research the experience of different countries regarding decommissioning funds. The issue is how one makes sure that the right amount of funds is accumulated over a	February 4, 2002	Orally	Commissioner Kotko via Ilka L.		Ilka L. is working on this request. Also asked Julia Weller to provide relevant information, using H&W librarian in DC.	In the context of NERC and Energoatom's work with EBRD for the preparation of K2R4 loan

#	Subject of the request / activity	Date Received	Form	Request / originated by	H&W disposition	Status	Notes/ Importance
	reasonable timeframe, but also that these funds are safe and cannot be misused.						
41	Assistance in slides preparation for R. Lagodyuk, head of Pricing Policy Dpt. "Tariff Design System in Ukraine Electricity Sector"	February 13, 2002	Discussion	R. Lagodyuk, head of Pricing Policy Dpt.			Yelena Antonova worked with R.Lagodyuk to prepare the slides
42	Request from NERC to help buying office supplies "to provide for day-to-day NERC staff activities"	Earlier discussions finalized on February 14, 2002	List of office supplies	Commissioner Goncharova			On February 15 Paul responded saying that H&W has no budget to purchase supplies for counterparts.
43	Terminology question from Financial and Analytical Dpt: <i>"single cash out price"</i>	February 18, 2002	Orally	Mr.Tsaplin			The meaning of the term in the context of NETA introduced in GB was explained by Slava R.
44	Request to comment on the new draft of Regulatory Policy Law.	Dec 13, 2002	Discussion	Commissioner Goncharova			On February 15 provided Commissioner Goncharova with a detailed Memo, commenting on the new draft of Regulatory Policy Law, prepared by Lilya Surzhenko.
45	Assistance in multi-agency Task Force on the WEM Concept		Discussion	NERC, International donor community			On February 4 provided proposed agenda and list of current WEM problems to Commissioner Kotko (prepared by Ilka L.) Participated in the Task Force meetings starting February 7, 2002. H&W staff participates in regular Working meetings, is acting

#	Subject of the request / activity	Date Received	Form	Request / originated by	H&W disposition	Status	Notes/ Importance
						as part of the Secretariat to provide organizational support to the Task Force. Ilka L. works as an official representative of the International Donor community in the Task Force.	
46	NERC request to pay their annual fee for NERC membership in ERRA	Feb 21, 2002	NERC letter	Chairman Prodan		Feb 21 Paul responded with an e-mail message, saying that we think USAID will not allow us to pay this fee. But promising to check with USAID again. On Feb 27 Paul responded with his final message, confirming the previous one and saying: when USAID is able to support regional association activities, they do so via the NARUC budget. Paul's message delivered to Commissioner Goncharova. The latter said she might follow Paul's advice and contact NARUC.	

PS. Due to the temporary technical problems with e-mail and Internet connection, NERC asked H&W office at NERC to assist in processing e-mail correspondence. On February 9 NERC office server was set to have "NERC Guest" email account. H&W office at NERC met day-to-day requests from NERC Dpts on translating NERC e-mail messages into English, sending and delivering messages addressed to NERC Commissioners, NERC Dpts.

**ANNEX A: DOCUMENTS TRANSLATED
AT HUNTON AND WILLIAMS NERC OFFICE
DECEMBER 2001 – FEBRUARY 2002**

Summarizes 32 Documents Translated

DATE	NAME OF THE DOCUMENT	Available In English And / Or Ukrainian
3 December 2001	NERC Technical Dpt internal Letter, providing comments and analysis of H&W Memo on regulating utility affiliates, indicating a need for more detailed research.	English
4 December 2001	Letter-response to Prodan	English & Ukr
6 December 2001	National Energy Regulatory Commission of Ukraine Study Tour “Electricity markets - estimating forward prices and the effect of changes” – Presentation by Ivan Adams	English & Ukr
7 December 2001	NERC Letter regarding December 11 meeting	English
7 December 2001	Table – attachment	English
10 December 2001	Quantitative Assessment Of Wholesale Electricity Market Reforms And Related Issues	English & Ukr
13 December 2001	H&W Memo “Ukrainian Legal Framework for Financial Contracts”	English & Ukr
14 December 2001	Letter of Zaporiz’ka Oblast State Administration to the President of Ukraine; and NERC Letter to the Ministry of Fuel and Energy regarding same issue	English
18 December 2001	Procedure for Adopting the Decisions on Tariff Changes and Approval for Electricity, Generated by Nuclear Power Plants (NPPs) of Ukraine (starting from section 9 through the end)	English
19 December 2001	NERC Letter - Request to translate the materials that were obtained by the NERC representatives during their visit in the US, state of Ohio, regarding the issues of audit, management and protection of consumers’ rights.	English
20 December 2001	Draft Law of Ukraine “On Amendments to Certain Legislative Acts”	English
21 December 2001	Comparative Table to the Draft Law of Ukraine “On Amendments to Certain Legislative Acts”	English
24 December 2001	Supplement 1 to Quantitative Assessment Of Wholesale Electricity Market Reforms And Related Issues	English & Ukr

DATE	NAME OF THE DOCUMENT	Available In English And / Or Ukrainian
25 December 2001	Supplement 2 to Quantitative Assessment Of Wholesale Electricity Market Reforms And Related Issues	English & Ukr
10 January 2002	Reporting Table "Work Progress According to the Scope of Work Approved by H&W and NERC (as of December 2000) Within "Ukraine Energy Regulatory, Legal and Market Development Support" Project /Reporting Period: May 2000 – December 2001)"	English & Ukr
8 January 2002	Letter-request from L.Simonenko, asking to provide information on additional services rendered by electricity transmission companies as natural monopolists	English
9 January 2002	Draft Letter-response to NERC regarding computer needs assessment and status	English & Ukr
9 January 2002	Letter-response to L.Simonenko, regarding his request to provide information on additional services rendered by electricity transmission companies as natural monopolists	English & Ukr
14 January 2002	Comparative Table to the WEM Law (translation of proposals of the President of Ukraine)	English & Ukr
18 January 2002	Thesis of the Concept of Ukraine Wholesale Electricity Market (WEM) Reforms and Organization of its Operation (Golikova's concept)	English
25 January 2002	The Crown E/E Company. Accounting, Financial Analysis & Cost Recovery. Slides by David C. Jones	English & Ukr
31 January 2002	"Tariff rate setting techniques". Slides by David C. Jones	English & Ukr
5 February 2002	Parts 5, 6 and 8 of the new law "On Alternative Energy Sources" adopted by the Rada on July 5, 2001 and vetoed by the President of Ukraine	English
6 February 2002	Paul's presentation at the Summit for Electric Power Generation in Ukraine dtd February 6-7, 2002	Ukrainian
11 February 2002	Aggregation Rules	English
12 February 2002	List of problems of the current Ukraine WEM	English
13 February 2002	Draft CMU Resolution On Ensuring Tax Payments to the State Budget	English
15 February 2002	List of office supplies requested by NERC	English
21 February 2002	NERC letter, requesting assistance from H&W in paying NERC annual fee to ERRA	English
27 February 2002	English translation of the table for WEM Concept Task Force	English
28 February 2002	Invitation to Renewable Energy Summit, to be held 22nd -24th April 2002 in London.	English & Ukr

DATE	NAME OF THE DOCUMENT	Available In English And / Or Ukrainian
28 February 2002	<u>Invitation to “Energy and Gas 2002” Conference to be held in April 19-22 in Brussels</u>	English & Ukr

22 January 2002	WEM Concept. I. Lewington's presentation	English & Ukr
28 January 2002	Presentation "Public Utility Regulation"	English & Ukr
29 January 2002	Presentation "Determination of Net Revenue Requirements"	English & Ukr
29 January 2002	CoM Resolution # 441_99	English & Ukr
30 January 2002	NERC Resolution on Licensing other types of Activity	English & Ukr
4 February 2002	NERC Resolution # 90_02	English & Ukr
9 February 2002	Regulatory Policy Law Analysis	English & Ukr
10 February 2002	Presentation of WEM Development – Directions and Practical Steps	English & Ukr
11 February 2002	Memo to Kievenoergo on Emergency	English & Ukr
12 February 2002	Regulatory Policy Law Analysis	English & Ukr
15 February 2002	List of Problems of the Current WEM	English & Ukr
18 February 2002	Table of Comparison for "Bankruptcy Law" Bill	English & Ukr
21 February 2002	WEM Concept Structure	English & Ukr
25 February 2002	Positive Experience of WEM Operation	English & Ukr
26 February 2002	CoM Resolution #200 on Emergency Procedure	English & Ukr
25 February 2002	List of Problems Preventing WEM from Working Efficiently	English & Ukr

**ANNEX C: LETTERS SENT TO GOVERNMENT AGENCIES
DECEMBER 2001– FEBRUARY 2002**

#	Title	Author	Signed by	Date
1	H& W letter to the Head of NERC Y. Prodan Re: new language of the Annex 9 to WEMMA	L. Surzhenko	P. Ballonoff	12 December, 2002
2	H&W letter to the Minister of Fuel and Energy V.Gaiduk Re: common work plan of the Ministry of Fuel and Energy and Hunton & Williams' "Legal, Regulatory and Market Reform" project	P. Ballonoff	P. Ballonoff	25 December, 2002
3	H& W letter to the Director of "Rivneoblenergo" M.Razumov Re: changes and amendments to the Annex 9 to WEMMA	L. Surzhenko	P. Ballonoff	5 February, 2002

**ANNEX D: LIST OF INTERNAL PROJECT PRODUCTS
DECEMBER 2001– FEBRUARY 2002**

YELENA ANTONOVA – TARIFF SPECIALIST, PROJECT COORDINATOR

DATE	PRODUCT
05 December 2001	Monthly financial report, format 2
07 December 2001	The impact of increase in Energoatom tariff on the WEM price and retail tariffs
10 December 2001	Plan of training activities for the NERC
26 December 2001	Daily financial report
26 December 2001	Monthly financial report, format 1
26 December 2001	Monthly financial report, format 2
28 December 2001	Comments to the draft procedure for review of the nuclear generators' tariffs
08 January 2002	Detailed outlines of training courses for NERC
16 January 2002	Draft internal procedures document
23 January 2002	Monthly financial report, format 2
31 January 2002	Daily financial report
31 January 2002	Summary of the activities of the distribution business in UK
01 February 2002	Monthly financial report, format 1
01 February 2002	The impacts of various wholesale price scenarios on the retail prices for customers
04 February 2002	Daily financial report
04 February 2002	Monthly financial report, format 2
09 February 2002	Summary of the case related to purchasing of software by oblenergos
14 February 2002	Summary of the accounting procedures for the Romania Project Office
15 February 2002	Comments to the draft procedure on other than licensed services
19 February 2002	Spreadsheet illustrating the impact of treatment of depreciation of the new

	investment on tariff for customers
21 February 2002	Computation of the country wide electricity tariffs on USAID's request
26 February 2002	Spreadsheet for application of the new tariff method to the 12 obleneregos to be privatized in the second batch and its effect of the country wide tariffs.

ANNA RYZHOVA – ATTORNEY

DATE	PRODUCT
6 December 2001	White paper: Explanation to the Moratorium Law
6 December 2001	Memo on Law on Fuel Suppliers' Receivables Restructuring
O. 12 December 2001	Restoration of the Debtor's Solvency by the Pre-Court Sanation
P. 19 December 2001	Summary on Law on Fuel Suppliers' Receivables Restructuring
Q. 20 December 2001	Summary on Law on Fuel Suppliers' Receivables Restructuring in Ukrainian
R. 27 December 2001	"Dniproenergo" Generating Company's Sanation
11 January 2002	Summary on "Dniproenergo" Generating Company's Bankruptcy Proceedings: Risks and Possible Solutions
16 January 2002	Liquidation of Company v. Bankruptcy Proceedings
18 January 2002	Specific Role of the Ministry of Fuel and Energy, Ministry of Economy, the Arbitration (Bankruptcy) Manager, and Creditor Committee in the Sanation and Bankruptcy of Energy Generating Companies
21 January 2002	Overview of Sanation of the Thermal Generating Companies
31 January 2002	Legal Requirements to drafting of the CMU's Documents
11 February 2002	Preliminary Evaluation of the Draft Law of Ukraine "On Introducing Changes to Certain Laws of Ukraine"
S. 14 February 2002	Letter to the VR Regarding Abolition of Amendments to the Bankruptcy Law
8 November 2001	Report on the meeting of the Debt Restructuring working group
26 November 2001	Report on the meeting of EBRD Donors' meeting
12 February 2002	Slides to the WEM Concept

11 January 2002	Memo on possibility of mutual offset of tax payments of the electricity supply companies to state and local budgets in Ukrainian
25 January 2002	Summary on Pre-qualification Criteria and Pre-conditions of Participation
31 January 2002	Summary of CMU Resolution N 95 of January 28, 2002
5 February 2002	Memo on the number of customers as pre-qualification criteria in the next tenders
14 February 2002	Remedies for failure to comply with obligations undertaken by investors in PSA
18 February 2002	133-p Up-date (as of February 20, 2002)
25 February 2002	Partial Risk Guarantee: Legal Obstacles in Implementation (in slides)

LILIYA SURZHENKO - ATTORNEY

DATE	PRODUCT
4 December 2001	Minutes of the WEM Board held on 22 November 2001
5 December 2001	Brief Report of the working group meeting on Annex No. 9 held on November 29, 2001
12 December 2001	Letter to the NERC Commissioner Mr. Prodan concerning draft Annex No. 9 to the WEM Members Agreement
16 December 2001	NERC Regulations Shortcomings for purposes of introducing changes to the WEM Algorithm
18 December 2001	Brief Report of the meeting of the IVKOR working group held on December 18, 2001
24 December 2001	Memo on PJSC "Luganskoblenergo's Debt to the Energomarket"
28 December 2001	Draft Procedure for Giving Consent by the NERC to a Regulated Supplier for the right to Carry out Other than Licensed Types of Activity
11 January 2002	Minutes of the WEM Board held on 27 December 2001
18 January 2002	Brief Report of the Meeting Regarding Approval of the Draft Procedure for Giving Consent by the NERC to a Regulated Supplier for the right to Carry out Other Than Licensed Types of Activity
24 January 2002	Response to the comments of Darrell Brown regarding Transmission Line Insurance Memorandum

5 February 2002	Letter to the PJSC "Rivneoblenergo" concerning the proposal to authorize CMU to declare emergency situations on the WEM
11 February 2002	Analysis of the Regulatory Policy Law for whether, and if so, how, it might affect the authority of the NERC, and if so, how to eliminate such effect
11 February 2002	Brief Report of the Working Group Meeting Regarding Drafting of the Normative Documents for Implementation of Insurance Law
18 February 2002	Report on Status of Emergency Situations Issue
25 February 2002	Memo on CMU Resolution No. 200 "Interim Procedure for Introduction of Changes to the WEM Algorithm and Monitoring over its Fulfillment"
27 February 2002	Summary on CMU Resolution No. 200

VLADYSLAV RASCHEPKIN - TECHNICAL SPECIALIST

DATE	PRODUCT
4 December 2001	Wholesale Electricity Market Prices In Ukraine
13 December 2001	HYDRO IN UKRAINE, a note on the hydropower structure and operation
10 January 2002	Hourly loads of TPP, typical weekdays 2001
10 January 2002	Modeling Of Economic Dispatch Of The Thermal Power Units In The Uwem; Some Additional Notes On Where To Find The Information On The Excel Data Tables To Create Input Data Files For Turboc++ Program. [Manuals For Modeling Program]
22 January 2002	System Reserve, Necessary To Cover Accidental Deviations Of The Load. (the note)
29 January 2002	How losses at the level of generation and HV transmission are treated in setting the WEM price (the note)
1 February 2002	Payments of thermal power industry to coal industry for coal consumed by TPP's (the note)
5 February 2002	Treatment of Transmission Losses in the Former UK Pool and in the New Electricity Trading Arrangements

ANNEX E: EQUIPMENT PURCHASES FOR COUNTERPARTS

ANNEX E.1 PURCHASES OF EQUIPMENT FOR THE ENERGO MARKET

Hunton & Williams, pursuant to its IQC EEU-I-99-00033-00 in October 2001 conducted a tender and on 26th November 2001 supplied the computer hardware described in the table below for Energomarket State Enterprise. The total amount of the purchase without VAT is 49 382,60 USD. Payment was made after the VAT exemption procedure.

Description	Part Number	Q-ty
Cisco Modular Router		
Cisco 3600 4-slot Modular Router-AC with IP Software	CISCO3640	1
2 10/100 Ethernet 2 WAN Card Slot Network Module	NM-2FE2W	2
8-Port Async/Sync Serial Network Module	NM-8A/S	1
8-to-16MB Flash Factory Upgrade for the Cisco 3600	MEM3600-8U16FS	1
32-to-64 MB DRAM Factory Upgrade for the Cisco 3640	MEM3640-32U64D	1
RS-232 Cable, DTE, Male, 10 Feet	CAB-232MT	8
Cisco 3640 Series IOS IP PLUS IPSEC 56	S364CL-12105T	1
Compaq Server		
ML350T01 P933-256 HP EURO	170476-021	1
256 Reg SDRAM DIMM133 ALL	TS256MCQ8278	2
18.2 GB Pluggable Ultra3 10K Universal Hard Drive (1")	142673-B22	3
Compaq Server		
ML350T02 P1000-256 M1 EURO	160247-421	1
9.1 GB Non Pluggable Ultra3 10K Hard Drive (1")	142672-B21	2
V570 Opal TCO99 EURO	228114-021	2
Other		
SuperStack 3 Switch 4400 Stacking kit	3C17227	1
SuperStack 3 Switch 4400 24-port 10/100	3C17203	3
SuperStack 3 Switch 4400 stack extender kit	3C17228	1
HP LaserJet 5000GN	C4112A	1

ANNEX E.2 EQUIPMENT PURCHASES FOR THE NERC

On request of the NERC Hunton & Williams applied to USAID for permission to purchase two servers for the NERC. The list of the computer equipment is given in the table below. The supply of the servers similar to previous supplies has the tender format, which was launched on February 15th 2002 by the invitation to three computer-supplying companies to submit their commercial offers for the specified equipment. On 28th February 2002 the contract was signed and the physical delivery is expected in 8 weeks starting from the signing the contract. The total amount of the purchase without VAT is 26 477,10 USD.

Description	Part Number	Q-ty
ML350T02 P1266 512 M1 EURO	225861-421	2
PIII 1266/133 ML3XX ALL	231117-B21	2
512 MB Memory Kit (DIMM, 1x512/133 MHz, SDRAM)	128279-B21	2
36.4 GB Pluggable Ultra3 10K Universal Hard Drive (1")	176496-B22	8
ML350 G2 HPRPS EURO	237046-021	2
Dual Channel, Ultra3, 64-bit PCI Smart Array 532 Controller ALL	225338-B21	2
V570 Opal MPR EURO	228114-022	2

ANNEX F: STRUCTURE OF MARKET OPERATIONS ANALYSIS COMPUTER PROGRAMS

As described in Part C.3.7 of the main Report, our model has two inter related sets of computer programs or spreadsheets. These are the “dispatch” model and the “financial” model, as described below.

Annex F.1 The “Dispatch” Model

The basis of the “dispatch” model is a set of two computer programs, one in Turbo C++ and the other, a data collection and analysis sheet, in Excel. The TurboC++ program is used to rank the thermal power units for economy dispatch. To date, the program has been run to rank the thermal power units in terms of their technical efficiency, and to find the theoretical economic stacking order. The work is on-going: some amendments to the input data for the modeling are necessary, further runs of the program may be needed for more extensive modeling of dispatch and forecast of price formation for the generators.

Annex F.2 The “Financial” Model, and Model Interactions

The financial analysis is computed by three related Excel spreadsheets: “Table Main-1-1”¹ (Main Sheet), “GencoStrategy-a-unconstrainedmarkets-Dispatch”² (Strategy Sheet), and the sheet “Comparative Ranks”³

The Main Sheet is the basic data source for analysis of plant use, plant efficiency, and plant stack order. It allows creation of simulated annual dispatch given a target annual total thermal output, and given the stacking order created by the “Dispatch” model. The amount of the target is computed on the Strategy Sheet, described below, and fed to the Main Sheet. Based on the stacking order from the Dispatch analysis, the Main Sheet models daily dispatch by four typical daily 24 hour periods: summer-winter-fall weekday, summer-winter-fall weekend day, winter weekday and winter weekend day. It simulates the resulting dispatch for each of these four periods for a base case and for a specifically defined alternative scenario, whose target loads are also provided by the Strategy Sheet.

The analysis of dispatch given a loading order thus also allows analysis of hourly and total fuel cost for each thermal plant, and of system marginal price, for each hour. This analysis also thus provides total fuel costs for each company, given the particular result of the indicated dispatch. The results (costs and prices) of these dispatch analyses for a given base case and given alternative scenario are then provided to the Strategy Sheet.

¹ The Main Sheet was derived from a sheet created and operated by Slava Raschepkin under the name “Table-Main-1” as part of the dispatch analysis, and was modified into the version “Table Main-1-1” used in the financial analysis by Paul Ballonoff.

² This sheet was created and operated by Paul Ballonoff

³ This sheet was created and operated by Paul Ballonoff.

The Strategy Sheet organizes the assumptions for, and outcomes of, a particular base case, and a specified alternative scenario. The sheet first computes the total volumes of thermal output that must be dispatched under the given assumptions and provides them to the Main Sheet. It receives in return from the Main Sheet the two sets of the four periods of daily dispatch patterns (winter/non-winter, weekday/weekend for each) for the base case and for the specified scenario. Using these, the Strategy Sheet then computes the annual cost consequences by company and other impacts of the base case and of the specified scenario. The Strategy Sheet presents impacts organized by the three technical generation types (nuclear, thermal and hydro). Within the thermal sub-sector, the Strategy Sheet also analyzes cost structures and profitability of the thermal generating companies separately. The Strategy Sheet thus also summarizes details of the fuel costs and total revenues of each company.

The Comparative Ranks sheet compares the results (in system costs and SMP) of the least cost dispatch in the base case, to the actual dispatch of a recent period. The sheet receives input from both the Strategy Sheet, and the Main Sheet. The Comparative Ranks sheet also analyzes some technical issues of market structure and effects on possible exercise of monopoly power, given the supply curve that results from pure economic dispatch.

The data provided by the dispatch analysis to the sheets above consists of two parts:

- (1) the dispatch analysis is the source for descriptive data on actual prices, plant types, plant capacities, and fuel prices, found in the Main Sheet; and
- (2) the dispatch analysis creates two versions of plant stack order: by price rank order (least cost dispatch taking to account both heat rate and fuel cost effects), and by technical efficiency (heat rate alone) rank order. Most subsequent analysis is done based on the least cost dispatch rank order. The technical efficiency rank order is also used in analysis of effects of the differences between actual dispatch and least cost dispatch. Documentation of data sources is found in the descriptions of the dispatch analysis. However, all data is based on actual plants, plant operation, fuel prices and SMP prices for the recent past periods, as collected for the Dispatch analysis sheets.

**ANNEX G: PRELIMINARY RESULTS
FROM MARKET OPERATIONS ANALYSIS**

**INSERT HERE AS ANNEX G THE MARCH 5 2002 SLIDES FOR OUR
PRESENTATION TO USAID OF OUR OPERATIONS ANALYSIS.**

**HUNTON &
WILLIAMS**



Prepared for:

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PAUL BALLONOFF

ANNEX G

7th QUARTERLY REPORT

March 5, 2002

HUNTON & WILLIAMS USAID UKRAINE

Briefing to USAID on Analysis of Thermal Company Dispatch and Related Issues

- I. What We Modeled**
- II. The Supply Curve For Thermal Power**
- III. Costs Of Inefficiency**
- IV. Structure Of The Thermal Industry**
- V. What Next**

I. WHAT WE MODELED:

EXISTING

**WEM Operations, Especially Nuclear, Hydro
And Thermal Plant Dispatch Ranks And Uses**

BUT

As If The Thermal Plants Bid Marginal Costs.

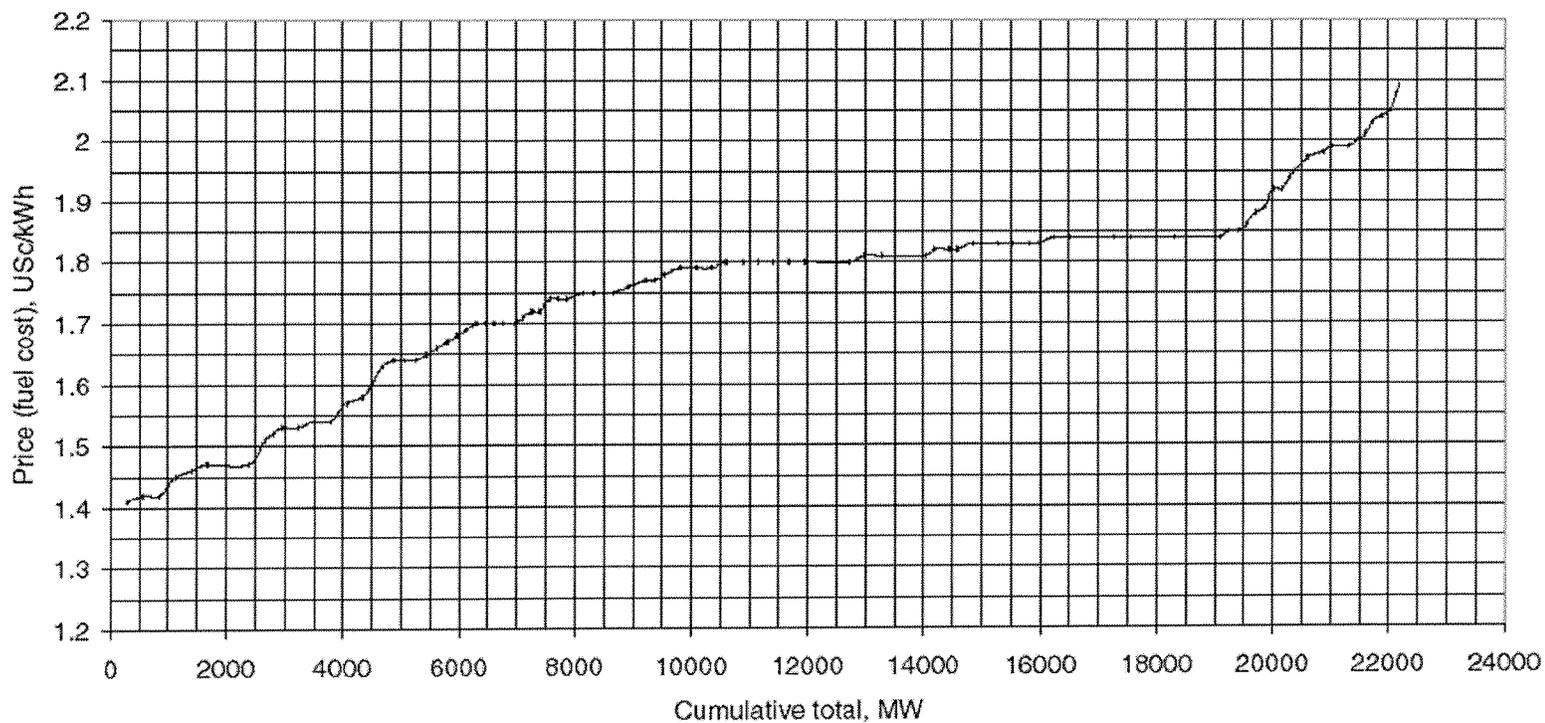
As If Thermals Were Dispatched by Pure Economy.

Transmission Constraints Ignored.

Technical Constraints (Mostly) Ignored.

II. RESULT: THE SUPPLY CURVE FOR THERMAL POWER

Ukraine Thermal Plant
Hourly Output Supply Curve
pure merit order economic dispatch



III. RESULT: COSTS OF INEFFICIENCY

	<u>As Practiced</u>	<u>Should Be</u>	<u>Excess Cost</u>	<u>Who Benefits</u>
Fuel Cost/kWh	1.74 cents	1.58 cents	0.16 cents or 9.1%	
Total Fuel Cost	\$1.128 million	\$1.025 million	\$103 million	Fuel Suppliers by \$103 million
Thermal Price To WEM/kWh	2.00 cents	1.73 cents	0.27 cents or 13.6%	
Total Revenue To Thermals	\$1.248 million	\$1.122 million	\$176 million	GENCOs by \$73 million
Total Excess Consumer Cost			\$176 million	Excess Cost to Consumers
Equivalent Energy Use	24.2 million eq. units	21.5 million eq. units	2.7 million eq. units or 12.5%	Fuel Suppliers and Fuel Shippers

WHY AREN'T THE MINERS PAID?

Annual Coal Industry Costs	6,090,900,000 UAH
Annual Coal Industry "Profits"	- 434,900,000 UAH
Annual Coal Industry Operating Costs	5,656,000,000 UAH
Salaries @ 15.5% Operating Costs	876,680,000 UAH
Social Costs @ 5.6 % Operating Costs	341,090,400 UAH
Total Cost of Labor	1,217,770,400 UAH
Costs Paid By Thermal Plants for Coal	3,060,624,844 UAH
Percent of Total Coal Industry Labor Cost Paid By Thermal Power Plants	
At 100% Cash Collection	250%
At 80% Cash Collection	201%

IV. STRUCTURE OF THE THERMAL INDUSTRY (AT LEAST COST DISPATCH)

	Market Share	\$ million Expected Annual Profit	US cents Average Cost/kWh
Zakhidenergo	16.2 %	5.51	1.67
Centrenergo	16.7 %	20.21	1.51
Dniproenergo	18.9 %	15.79	1.57
Donbassenergo	48.2 %	54.90	1.56
Donbass	19.8 %	18.92	1.56
5th Co.	28.4 %	35.99	1.54

IV. STRUCTURE OF THE THERMAL INDUSTRY: COMPETITIVE RISKS

Controlling Company	Supply Range Affected MW	SMP Increase Potential	
		> 2 %	> 5 %
Donbass (5th Co.)	0 - 1124	2.8 %	
Zakhid	2606 – 2946	4.1 %	
Dnipro	2947 – 4062	2.6 %	
Donbass (5th Co.)	4337 – 5617		5.7 %
Donbass	6300 – 7903	2.4 %	
Centre	21429 – 21725	3.8 %	
Centre	21725 – 22007	3.1 %	
Donbass (5th Co.)	22571 – 23316		6.5 %

V. WHAT NEXT

INSTITUTIONAL ISSUES

What's wrong and how to fix it

FUEL COST AND FUEL MIX ISSUES

Real vs. administered pricing

Fuel price and mix effects on merit order operations

Our vs. Stone and Webster Fuel Price Assumptions

OTHER

Support the WEM Work

Technical Constraints on Merit Order

Improve our Analysis