

PN-ACE-946

101406

**UKRAINE NATIONAL ELECTRICITY
REGULATORY COMMISSION
LEGAL ASSESSMENT OF NERC AUTHORITY**

**NIS Institutional Based Services Under the Energy
Efficiency and Market Reform Project
Contract No CCN-Q-00-93-00152-00**

**Ukraine Power Sector Reform
Delivery Order No 18**

Final Report

Prepared for

U S Agency for International Development
Bureau for Europe and NIS
Office of Environment, Energy and Urban Development
Energy and Infrastructure Division

Prepared by

Hagler Bailly
1530 Wilson Boulevard
Suite 400
Arlington, VA 22209-2406
(703) 351-0300

September 25, 1998

BEST AVAILABLE COPY

CONTENTS

Table of Contents

Executive Summary

Documents

NERC Tariff and Market Authority

- 1 Memorandum from Svetlana Golikova to NERC Commissioners, "Interaction between NERC and the Market Board," dated Sept 25, 1997
- 2 Memorandum from Svetlana Golikova to P Shapiro, D Wolcott, "Electricity Retail Tariffs for Residential Customers," dated Sept 2, 1997
- 3 NERC's Working Body request to Hagler Bailly, July 6, 1998, No 06-39-06/148
- 4 Memorandum from J Stanfield to S Vyshynsk , "Reply to Letter No 06-39-06/148 of 6 July 1998," dated July 28, 1998
- 5 Presented to Energy Efficiency Work Group "Proposals for Improvement of Current Electricity Tariff System in Ukraine," J Stanfield, S Petrov, dated April 22, 1998
- 6 Recommendation Electricity Tariff from Program Secretariat, dated May 6, 1998
- 7 Conference on Introducing the System of Determining the Retail Electricity Tariff Pursuant to the Law of Ukraine "On Electricity Sector," July 7, 1998 Presentations
 - ▶ "Legal Aspects of Wholesale Electricity Market Activity Electricity Law," by S Golikova
 - ▶ "Investment Into Ukraine's Power Sector," by V Didyk
 - ▶ "Issues For The Round Table," by I Yegorchenko
- 8 Memorandum from I Yegorchenko to I Gorokhova, "Finiteness of subsidy amount," dated June 23, 1998
- 9 Memorandum from I Yegorchenko to S Vyshynsky, "Comments on the Draft Procedure for Control of Licensees' Compliance with Conditions and Rules of Carrying Out the Licensed Activity," dated August 28, 1997

Energomarket Members Agreement and NERC Authority

- 1 Memorandum from K Yemelyanov to H Thornber and L Dulnev, "Comments on PWG-25 draft of 08 04 98 "Sale and Agency Agreements," dated Aug 20, 1998
- 2 Memorandum from Svetlana Golikova to Chairman Buttsio, Commissioner Goncharova, Commissioner Gridasov, "Energomarket Members Agreements Modifications and Amendments," dated 06/03/ 1998
- 3 Memorandum from K Yemelyanov to D Wolcott, J Stanfield, S Golikova, "Meeting on Issues of Energomarket Members' Agreement," dated June 9, 1998
- 4 Memorandum from S Golikova to V Boiko, L Dulnev, D Wolcott, J Stanfield, "Comments on "Amendments and Supplements to the Energomarket Members Agreement" based on the Working Group meeting of the WEM Board of November 11, 1997," dated Nov 12, 1997
- 5 Memorandum from K Yemelyanov to D Wolcott, J Stanfield, S Golikova, "Meeting on Issues of Energomarket Members' Agreement," dated 07 09 1998
- 6 Compare table of the Working Group draft Energomarket Members' Agreement, August 3, 1998
- 7 "The Legal Conclusion as to the Compliance of a Draft Contract of Wholesale Electricity Market Members to the Ukrainian Legislation," by the Law Firm Aktive, Sept 1, 1998

Laws and Decrees

- 1 Memorandum from S Golikova to P Shapiro, R Archer, D Wolcott, H Thornber, "Electricity Law, the Second Reading," dated July 12, 1997
- 2 Memorandum from S Golikova to Distribution "Electricity Law, Final Reading," dated October 27, 1997
- 3 Memorandum from S Golikova to R Archer, P Mulligan, "Practical Implementation of the Law of Ukraine "On Electricity sector," dated February 24, 1998
- 4 Memorandum from S Golikova to R Archer, P Shapiro, "Passed Act on Electricity Sector," dated Nov 27, 1997
- 5 Memorandum from S Golikova to P Shapiro, R Archer, D Keith, A Streicher, D Wolcott, H Thornber, "Natural Monopoly," dated August 25, 1997
- 6 Comments on March-July 1998 Presidential Decrees regarding economic issues

EXECUTIVE SUMMARY

This paper is prepared in satisfaction of the following portions of Delivery Order 18

- ▶ NERC Deliverable number 6 “Legal assessment of NERC authority to perform its principal regulatory functions, including setting and oversight of tariffs and monitoring market fraud,” with its underlying Statement of Work items I C(2) and I C(3), and
- ▶ Legal and Policy Support Statement of Work item IV A (2) “Provide comments on draft amendments and modifications to the Wholesale Electricity Market Members’ Agreement,”

Hagler Bailly assisted the National Electricity Regulatory Commission (NERC) and the Energomarket State Enterprise in numerous facets of these overlapping issues. Documents created by Hagler Bailly in the course of providing this assistance make up the main body of this report and follow this Executive Summary. For the purposes of this report, Hagler Bailly’s assistance has been segmented into three categories.

NERC Tariff and Market Authority

- ▶ Difficulties in interactions between NERC and the Energomarket Board, the primary example being that NERC orders were sometimes ignored. Hagler Bailly recommended steps to eliminate these problems.
- ▶ NERC’s legal authority over tariffs.
- ▶ Mergers, acquisitions and other reorganizations by licensees.
- ▶ Regulation of micronets.
- ▶ The Energy Efficiency and Energy Saving Work Group, of which NERC is an active member, developed over the course of many months and issued a Recommendation on Electricity Tariffs. Hagler Bailly’s advisors to NERC were the primary authors of this document, and presented the Recommendation at the meeting of the Program to Promote Sustainable Development in Ukraine.
- ▶ The restructuring of the electric power sector has raised issues in other agencies which regulate some aspect of electric power companies. The primary issue is how to

levy value added taxes on electric power companies Hagler Bailly therefore recommended, organized and led a Round Table Conference on these issues for officials of the Ministry of Finance, the Ministry of Economy, the Anti-Monopoly Committee and the Ministry of Energy

Energomarket Members Agreement and NERC Authority

The Energomarket Members Agreement (EMA) was drafted by western consultants, and it was adopted by Ukrainian power sector officials before these officials became sophisticated in modern methods of regulating the electric power sector Therefore, the EMA contained some elements which did not fully fit in Ukraine Moreover, two years had passed since the EMA was originally adopted, so that changes needed to be made Accordingly, the Energomarket Board formed a Working Group to revise the EMA Hagler Bailly was an active member of the Working Group, both as representatives of NERC and as western and Ukrainian experts The Working Group met an average of two times per week for six months The memoranda and reports contained in this section resulted from Hagler Bailly's activities in this Work Group

Laws and Decrees

There are three groups of memoranda and reports in this section

- ▶ Electricity Law, enacted October 1997 (see also the presentation by S Golikova in the seminar under NERC Tariff and Market Authority)
- ▶ Natural Monopolies Law, which has been through two readings in the Supreme Rada but has not yet been enacted
- ▶ Presidential Decrees

NERC TARIFF AND MARKET AUTHORITY



MEMORANDUM

To Z Butsio, L Goncharova, A Gridasov
CC D Wolcott, J Stanfield, D Heman, H Thornber, L Dulnev,
S Vyshinskiy, E Samborskaya
From Svetlana Golikova
Date 25-SEP-97
Subject Interaction between NERC and the Market Board

Recently the circumstances that sometimes result in misunderstandings between NERC and the Market Board have occurred. In some cases the Board ignores NERC letters and does not meet the requirements of the Commission. To regulate the relations between NERC and the Market Board I suggest that NERC issues an order containing the following

1 Agenda

At its meetings the Board takes the decisions on whether to include this or that issue to the Agenda of the next Board Meeting. At the period between monthly Board Meetings the following persons have a right to make the suggestions as to the Agenda

- Voting and Non-Voting Directors
- Market Members
- Market Banker and Market Auditor
- The Head of Energomarket State Enterprise
- The Head of the Secretariat (within the authority of the Secretariat, including the applications of potential Market Members on joining the Market)
- Consultants

Primarily the Agenda stipulates the consideration of issues related to the compliance with the previous Board decisions reflected in the relevant NERC orders

The applications of other legal or physical persons to the Board are generalized by the Secretariat and included into the Agenda (Section "Miscellaneous") in case if these issues are within the competence of the Market Board

The suggestions on the issues to be included into the Agenda of the next Market Board meeting are to be submitted, as a rule, three working days prior the Board meeting. The Agenda is approved by the Board at the beginning of each Market Board meeting

2 Preparation to the Market Board meeting

Since the Board establishes the Working Groups (further referred to as WG) related to the issues considered according to the Agenda, the following procedure of decision making is offered

- The Board takes a decision stipulating the task for the Working Group (persons constituting the group and its Head are appointed by the Market Board)
- The Board decisions are approved by NERC
- According to its authority¹ the Working Group has meetings, discusses the issues and submits its proposals as to draft Market Board decisions. The Secretariat of the Board (Secretariat staff is present at the Working Group meeting with the purpose to take notes for the Minutes of the Meeting) types the Minutes and Working Group draft decisions and submits them to Voting and Non-Voting Directors, the Head of the Working Group and other interested persons, consultants including, not less than two working days prior the Market Board meeting. The Head of the Working Group has to be present at the Market Board meeting.

3 The submission to NERC of draft Market Board decisions

The Board Secretariat has to not less than two working days prior the Market Board meeting submit to NERC the draft decisions (including the issues to be discussed by the WG) related to the following

- amendments to the Market Members Agreements as well as to its Appendices
- system that insures the Market operation
- any issue that influence the rights and obligations of the licensees - the Market Members
- civil and legal relationships among the Market Members
- admission of new Market Members
- rights and responsibilities of the electricity consumers

The decisions taken by the Market Board Executive Committee² to be sent to NERC not more than three working days after the Executive Committee meeting, but not later than the date when Market Board starts its meeting. The Agenda of the Executive Committee meeting is to be sent to NERC one working day prior the date of the Executive Committee meeting.

4 Participation in the Market Board meetings

The Non-Voting Director, being an official Commission's representative, is directly appointed by NERC. The Chairman of the Commission may impose on any Commissioner the functions of the Non-Voting Director. The Working Body representatives and consultants are present at the Board meetings, however they can not fulfill the functions of the Non-Voting Director.

The Non-Voting Director takes part in the Executive Committee meetings. NERC draws consultants in the work of the Market Board.

The Market Secretariat has to reflect in the Market Board Minutes the speeches of the Non-Voting Directors related to the decisions that are put to the vote

¹ The Provisions of the Working Groups are to be approved by the Board and attached to the Agreement

² Since the Agreement does not stipulate such a body but in practice it works it is necessary to clarify the authorities of the Executive Committee

5 Submission of the Market Board decisions for NERC's approval

According to the Market Members Agreement, within five days after the Market Board meeting the Board Secretariat submits for NERC's approval the decisions taken by the Market Board that relate to issues stipulated in items 2 and 3 of the present memo and the other ones. The decision is drawn up as an extract from the minutes, contains the number and other attributes of the Market Board Minutes, voting results and suggestions of the Non-Voting Directors in case if they differ from the decision taken by the Board.

The Market Board decisions related to the issues stipulated in items 2 and 3 of the present memo have to be agreed with NERC. According to item 15.1.2 of the Market Members Agreement, NERC has to inform the Board about its decision within ten days.

6 Approval of the Market Board decisions

According to the Presidential Decree of March 14, 1995 and Market Members Agreement the Commission is the state body *that observe the compliance with the Electricity Market Rules*. It means that any order issued by ESE Board and related to the activity of the ESE as

- Settlement System Administrator (item 7.2.5 of the Market Members Agreement)
- Market Funds Administrator (item 15.2.1 of the Market Members Agreement)
- the body implementing the functions of the centralized dispatch administration (according to item 4 of the Wholesale Electricity Supply License)

has to be agreed with NERC according to the standard procedure.

The Market Board decisions related to the issues reflected in items 2 and 3 of the present memo are to be agreed with NERC.

NERC issues relevant *Orders* approving the Board decisions. In case if NERC does not agree with the Board decision it issues the *order* containing the grounds for non-approval (references to legal and normative acts, licenses, Market Members Agreement and Market Rules, etc.)

The orders related to the Board decisions are to be sent to the Board Secretariat that informs Market Members, the ESE and other interested persons about them. According to item 15 of the Provisions about NERC approved by the Presidential Decree of March 14, 1995, the decisions taken by NERC are to be complied with.

7 Appellation of NERC decisions

NERC decisions (orders) may be appealed according to the standard procedure to the Antimonopoly Committee or to the court depending on their authority.

Since only the legal person can be claimant in the court, and the Board is not the one, according to the Board decision both the licensee and ESE, being the legal person, may appeal NERC decision to the court. In that case ESE will act on behalf of the Market Members.

Basically, the suggested system of preparation, consideration and approval of the Board decisions is aimed at the fact that all the disputes between the Board and NERC will be settled directly by the parties.

For NERC to deal more efficiently with the mentioned issues it will make sense to establish the separate Energomarket division constituting of highly qualified energy experts, economists and lawyers



MEMORANDUM

To P Shapiro, D Wolcott
Cc M Madland, A Parinov, J Stanfield, J Moran
From Svetlana Golikova
Date 2 September 1997
Subject Electricity Retail Tariffs for Residential Customers

New residential tariffs were approved by the NERC Executive Order No 337 of May 15 1997 which was registered with the Ministry of Justice on June 3, 1997 By its Order No 428 of 07 01 97 NERC made relevant amendments to its Order No 337 (registered with the Ministry of Justice 07 17 97) which stipulated that new residential tariffs would be effective from August 1, 1997

The legislation of Ukraine provides for the following procedure of the state registration of normative and legislative acts

- 1 According to the Decree of the President of Ukraine dated 3 October 1992 all normative acts shall be subject to the state registration in the Ministry of Justice of Ukraine and become effective 10 days following the date of their registration if a later date of effectiveness is not provided
To enforce the Presidential Decree dated 3 October 1992 the Cabinet of Ministers Resolution No 731 of 28 December 1992 approved the Procedure on the State Registration of Normative Acts of Ministries and Other Executive Bodies which stipulated that the Ministry of Justice shall keep the State Register and register normative acts within 15 days (in the complicated cases - up to 25 days)
- 2 The Decree of the President of Ukraine dated 10 June 1997 established a formal procedure of publicizing the normative and legal acts and their coming into force This Decree stipulates that the normative and legal acts should be published in the official editions (Offitsiyniy Visnyk of Ukraine "Vidomosti of Verkhovna Rada of Ukraine newspaper 'Uriadoviy Courier) and only after their official publication in these editions publication in other mass media is possible
- 3 The Ministry of Justice shall be under obligation to publish the normative and legal acts in the 'Offitsiyniy Visnyk of Ukraine '

In order to implement the CM Order No 14902/22 of 24 July 1997 On Suspension of Activities to Increase Electricity Tariffs NERC issued 31 July 1997 the Executive Order No 559 On Suspension of the NERC Executive Order No 337 and No 428

According to Vyshynskiy information 27 August 1997 the NERC Executive Order No 559 of 31 July 1997 was registered with the Justice Ministry This means that the official suspension of new tariffs will take place on 7 September 1997

C:\Common\NERC\Tariffs\MEMO_GolikShapiro_rcsid.doc\T Maidan

Such situation with the suspension of the NERC Executive Orders Nos 337 and 428 results in the fact that new electricity tariffs are valid from 1 August 1997 till 7 September 1997

Several Oblenergos (Donetsk, Kharkiv, Crimea) already applied to NERC with request to clarify the situation, since the local mass media published in August the NERC Executive Order No 337 and thus the public became aware of new electricity tariffs

Besides, the Oblenergos are concerned that the tax inspection authorities may demand collections under the new tariffs in August because the new rates have been valid within the entire month

In view of the above said it would be reasonable that NERC should provide clarification on these matters

NATIONAL ELECTRICITY REGULATORY COMMISSION OF UKRAINE

S Vyshynsky, Deputy Director
Licensing and Pricing Department

Hagler Bailly

July 6, 1998

No 06-39-06/148

The Licensing and Pricing Department of the NERC's Working Body is requesting Hagler Bailly to render a consulting assistance in respect of issues arising in the course of licensing entrepreneurial subjects that follow

- 1 How should the NERC react when a monopolist in an activity is divided to form two entities as legal persons? What are the consequences of such processes? Does a newly set up entity need to be licensed or is there a possibility for it to operate under a single joint licence which has already been issued before?
- 2 What are the ways of licensing micronets created after restructuring such sectors which have never been subordinated to Minenergo, and whose major activity is operation and maintenance of electrical networks which they possess or are in charge of? Is it necessary to take into account that some of them carry out activities in electricity supply and others do not? What pricing system should there be in such cases and how should a customer connected to such networks be protected?
- 3 Is it necessary to license entrepreneurial subjects (consumers) which transmit (and also sometimes supply) electricity as a result of the state policy which existed earlier and which was aimed at electricity supply to industrial centres, using their networks and installations? If so, should the same requirements apply to any such entrepreneurial subjects in respect of their licensed activity as to other licensees subordinated to Minenergo or should a new (simplified) license be created? What is the principle for setting a retail electricity price for a consumer (subconsumer)? How should interests of all subjects such as an oblenergo, a transmitting consumer and a subconsumer which operate under this scheme be kept in balance?
- 4 There is a need to define the term "sales" over the period when the tax privilege in respect of VAT on electricity sales transactions is in force
 - an oblenergo sells electricity to a consumer,

- a main consumer sells or resells electricity to a subconsumer? What is liable to VAT in this case?
- 5 How do subsidy certificates suggested by Hagler Bailly consultants so as to create a possibility to compensate oblenergos' losses resulting from electricity supply to those consumers which enjoy payment privileges comply with the present law of Ukraine?
- 6 How should the NERC act while determining whether liquidation, reorganisation in the form of a merger, privatisation, etc complies with the Conditions and Rules for Carrying Out Licensed Activities?
- 7 What are the peculiarities of licences for activities carried out using leased installations when leased property is being privatised?

The Licensing and Pricing Department would greatly appreciate if consulting materials could be received before July 20, 1998

S Vyshynsky
LPD Deputy Director

MEMORANDUM

To S Vyshynsky
From J Stanfield
Date 28 July 1998
Subject Reply to Letter No 06-34-06/148 of 6 July 1998

This memorandum contains our proposals in reference to the issues raised in your letter of July 6, 1998

1 Regarding the issue of possible implementation of entrepreneurial activity by the power sector entities on the basis of a common license we would like to advise that according to the CL 4 of the Act of Ukraine "On Entrepreneurship" a license is a permission issued to a certain entity on condition this entity acts in compliance with the rules of carrying out entrepreneurial activity (in Ukraine there is a principle of issuing licenses only to a particular body) the transfer of licenses to other legal and physical bodies being forbidden. In line with that one legal body can act on the basis of one license

If reorganization of a monopolistic entity took place in the form of separation then the entity that was separated shall keep the old licenses without changes. A new separated entity will have to get a new license since it is a new legal person and subject to the Act of Ukraine "On Entrepreneurship" relative to prohibition to transfer licenses to other legal person

Redrawing of a license is possible only in case of changing an address or a name of a legal entity (if the change of a name is related to reorganization). This means that a legal entity keeps its status but its organization form or the form of ownership has been changed or separation from it of a new entity or merging with other legal body takes place. That is reorganization can take forms of merging, separation or transformation (change of identity). Other kinds of reorganization require applying for a new license for a new legal person

If reorganization of a monopolistic entity took place by dividing it, then the entity which held the license does not exist any longer it was liquidated and hence new entities have to get new licenses for all respective kinds of activity

If a monopolistic entity was liquidated and its property was transferred to the entity which operated this property and new entities were created on the basis of this property then according to p 7 of Cl 4 of the Cabinet of Ministers Resolution No 316 of May 17 1994 "On Procedure for Issuing Licenses to Entrepreneurial Entities for Carrying out Particular Kinds of Activity" a license becomes ineffective after an entrepreneurial entity stopped its activity

For example

In line with the Decree of the Minister of Energy of Ukraine the national joint stock electrical company Ukrenergo is being created. The company is being created on the basis of the NDC. From the legal viewpoint this means that both status and the name of the NDC is being changed. This is a kind of reorganization accompanied with the change of the name. According to p 12 of Article 4 of the Act of Ukraine 'On Entrepreneurship' in case of such changes a licensee has to apply for redrafting the license it held before the reorganization. The next provision of the minister's decree stipulates reorganization of Ukrelectroperedacha by means of merging it with Ukrenergo. The result of such merger is actual liquidation of the licensee

Ukrelectroperedacha and that is why Ukrenergo shall have to get a new license for carrying out electricity transmission by high voltage networks. As a result of forming Ukrenergo it has to redraft the license of the NDC on the wholesale supply because of changing the name and to get a new license for carrying out electricity transmission.

2, 3 Legal aspects of pp 2,3 are the following

In line with Cl 4 of the Act of Ukraine 'On Entrepreneurship' only those kinds of activity which are specified in this Act are subject to licensing. Cl 1 of this Act stipulates that entrepreneurship is systematic activity at one's own initiative and risk aimed at production of commodities, fulfillment of tasks, providing services and trading with the purpose of generating profit. If such activity is implemented without the mentioned purpose or in order to satisfy one's own needs, this is not considered as entrepreneurship and is not subject to licensing. This is notified in paragraph 2 p 3 of the Letter of Arbitration Court No 01-8/453 of June 26 1995.

In case of generating profit from electricity transmission this activity shall be liable to licensing since Article 4 of the Act of Ukraine "On Entrepreneurship" considers electricity transmission irrespective of volumes, qualitative features of networks as licensed kind of activity. The Electricity Law of Ukraine makes exception regarding necessary licensing only for entrepreneurial entities involved in electricity generation of specified volume (p 4 Article 13).

Resolution of the NERC No 30 of July 31 1996 'On the Procedure of Issuing Licenses for Carrying Out Entrepreneurial Activity on Electricity Transmission by Local Networks' also envisages that the activity on electricity transmission by local networks which belong to entrepreneurial entities and are operated by them solely for their own needs is not subject to licensing.

The same Resolution of the NERC provides for electricity transmission volume (10 m kWh per year) above which it is necessary to get a license. The authority to set up this volume is within NERC's competence in line with p 4 (6) of the Provisions on the National Electricity Regulatory Commission of Ukraine which were approved by the Presidential Decree No 335/9 of April 21 1998 which stipulates that the NERC with consideration for legislation shall determine the factors below which entrepreneurial entities are allowed to carry out their activity without licenses. If the electricity transmission volume by these networks was lower than one mentioned above then in

1996-1997 entities' activity was not licensed. But this exclusion became ineffective on January 1, 1998 (which was approved by Resolution of the NERC No 1157 of December 18, 1997 'On Establishing the Term of Licensing of Entrepreneurial Activity on Electricity Transmission by LVN') and that is why activity on electricity transmission is not licensed due to the lack of features of entrepreneurial activity or when activity on electricity transmission is done solely for entity's own needs.

Besides, licenses are issued to the power sector entities which are involved in such kinds of activity as generation, transmission and supply of electricity. The Electricity Law of Ukraine treats all entrepreneurial entities involved in electricity generation, transmission and supply as power sector entities, irrespective of their business affiliation and forms of ownership. Hence, the legislation of Ukraine does not envisage any difference between licensed entities with consideration for their administrative affiliation. Whether Minenergo's entity or independent commercial or other legal entity is being licensed is not important; it is the kind of activity that is liable to licensing.

Proposals regarding customers which have sub-customers (micronets)

In principle, Conditions and Rules of licenses on transmission of electricity by local electricity networks put no difficulties for issuing such licenses to all entrepreneurial entities engaged in this kind of activity. The problem is the existence of a great number of entities that make the issuance of standard licenses and control over the licensed activity practically impossible.

We propose such actions on regulation of activity in electricity transmission and supply at the regulated tariff of micronets:

1. To work out precise classification of types of 'complex customers'. In classification the following should be taken into account:

- a) necessity to receive subsidy certificates (availability of residential customers and agricultural entities among the electricity customers)
- b) possibility of direct connection to the main and interstate networks
- c) level of voltage and number of connections to the network of oblenergo
- d) location of one or several oblenergos in the territory
- e) number of customers and micronets of lower levels
- f) financial standing of companies, technical state of networks,
- g) availability of skilled staff for operation with Energomarket,
- h) types of activity

2. To study the number of customers of each type with different volumes of internal consumption and supply to micronets.

3 To determine for each type of customers limit values of consumption or supply for which licensing is a must (so as would be feasible for the NERC to license and regulate some limited number of entrepreneurial entities)

4 To lay down procedures and rules for transfer of transmission lines to oblenergos

5 To work out procedures on cases when such free transfer is obligatory (in this case possible is the demand of an entrepreneurial entity to cover his costs of maintenance of networks over a period of one year)

- a) bankruptcy,
- b) impossibility because of financial problems to maintain networks in good technical state,
- c) systematic violation of Electricity Usage Code,
- d) systematic violation of rules on servicing residential customers

6 Licensing variants

- Special license for electricity supply at regulated tariff allowing the electricity to be purchased not from the Wholesale market
- Standard licenses issued to entrepreneurial entities the volume of supply of which exceeds the limits set for relevant category (e.g. for "complex customers" located in the territory of several oblasts such limits will be lower as compared with those set for "complex customers" located in the territory of one oblast)
- Regulation in respect of small "complex customers" following the Electricity Usage Code and rules specially developed (where it is necessary to envisage sanctions for violation) These rules will be different from Conditions and Rules of a license and won't stipulate obtaining of a special permit

7 To collect regularly information on the number of "complex customers" of various categories and size adjust methods of their regulation

8 Regulation of prices is the most difficult problem. In our opinion electricity supply at regulated tariff shall be effected only under a license standard or simplified. Without a license a relatively small complex customers can carry out activity only in electricity transmission

9 Any approach should envisage recovery of costs. These are two major approaches

- Adding a special tariff "of complex customers" to oblenergo tariffs,
- Including costs of 'complex customers' in uniform oblenergo tariff

10 If only two levels of voltage are available, applying the retail tariff formula to "complex customers" may result in considerable increase in the retail price as

compared with the price set for the similar oblenergo customers. So it is proposed that the use shall be made of four levels of voltage, including the additional level of voltage for residential customers, to take into account costs of maintenance of internal networks in apartment buildings.

11. Final recommendations may be given only after studying a specific situation, namely, the number of "complex customers" of various categories, structure of costs of such customers, as well as real tendencies in this issue (for example, how many networks of such customers can be in fact transferred to oblenergos, how many relevant entrepreneurial entities were privatized or are subject to privatization, what a situation is in respect of social entities of such privatized companies, what a technical state of networks is).

12. Selection of variants in some aspects is purely political (for example, whether the similar customers may have different tariffs depending on their pattern of connection, whether oblenergo transmission networks and transfer of social entities to communal ownership will be encouraged in every possible way). Given specific data, consultants could analyze economic implications of different variants selected.

13. We propose starting, together with the NERC, systematic study of the situation in respect of "complex customers" – collection of statistical data which makes it possible to submit specific recommendations.

4. Any sale of electricity shall not be liable to VAT over a validity period of exemption of electricity sales from VAT. Sales shall be understood according to the Law of Ukraine "On Value-added Tax" as any operations which are effected under agreements on purchase/sale, barter, supply and other civil agreements which stipulate transfer of property rights to commodities for compensation irrespective of terms of its giving, as well as operations related to free procurement of commodities. Proceeding from the above, there is no difference for the Law whether oblenergo sells electricity to customer or major customer resells electricity to sub-customers – all that shall be considered as sales to be liable to VAT. Subject to taxation shall be electricity sales. Taxpayer shall be each electricity seller which is obliged to deduct and remit to the budget taxes to be paid by the buyer. It is marginal cost of electricity, i.e. the difference between the price at which a licensee purchases electricity and at which it sells electricity, that shall be liable to 20% tax rate.

5. Subsidy Certificates enforced by Resolutions of the NERC. On Procedure of Issuing Subsidy Certificates # 701 # 703 of 28 May 1998 are one of the methods of state regulation of prices and tariffs. The NERC shall participate within its authority in laying down Market Rules and pursuing tariff policy. Market Rules shall be set by Market Members since they are independent entrepreneurial entities and pursuant to Article 15 of the Law of Ukraine "On Entrepreneurship" the state shall establish its relations with them on the basis of price policy and pricing rules. And Subsidy Certificates are part of the price formation in the WEM and are therefore legal.

A subsidy certificate is in its economic form no different from current practice in the electric industry and many other industries. For example, today Vinnvtsaoblenergo is

charged a different price at wholesale than Zaporyzhiaoblenergo is charged. This constitutes a subsidy provided by the customers of Zaporyzhiaoblenergo to the customers of Vinnytsaoblenergo. A subsidy certificate would perform this same function, by charging Vinnytsaoblenergo a different price at wholesale than Zaporyzhiaoblenergo is charged. The form this different price takes is a refund of a portion of the payments made by the oblenergo during the prior month. Therefore perhaps NERC could rename the subsidy certificates "refund certificates."

It is imperative to note that without subsidy certificates (or refund certificates) the market structure established in the electric sector in Ukraine cannot work. If an oblenergo is required to serve some subset of its customers at a price below cost, then by definition it loses money on those sales. In order to make a normal reasonable profit, it must either (a) make higher than normal profits on some other subset of its customers by charging them a price higher than the cost of serving them or (b) have its losses paid for by some third party. Option (a) would not be fair to the other customers of the oblenergo, because they would be forced to pay at a local level for a subsidy imposed at a national level. In addition, in practice the highest subsidies (in Hryvna per MWh) under option (a) would be paid by customers in high cost oblenergos who already were being charged a higher than average price. Option (b) is the subsidy certificate program.

6. As to the NERC role in consideration of issues on reorganization, liquidation and privatization of electric power entities, its authority is set out in par. 3, Section 2, Article 12 of the Law of Ukraine On Electricity Sector and Item 4 (10) of Provisions on the National Electricity Regulatory Commission of Ukraine approved by Decree of the President of Ukraine No. 335/98 of 21 April 1998. The NERC shall determine the compliance of liquidation, reorganization in the form of mergers, consolidation or participation in corporations, as well as purchasing or take-over of more than 25 % of shares or assets of entrepreneurial entities with conditions and rules for carrying out licensed activity. This means that impact of the NERC on the said processes is effected only through the licensing mechanism. Licensees shall inform the NERC about the above mentioned actions and if negative effects are likely to occur, the NERC can terminate or cancel the license. While terminating the license, the NERC may determine the method and time to bring entities or their actions in compliance with the requirements for licensed activity.

Information about the United States on this issue

The Federal Energy Regulatory Commission in the United States follows what we believe is a sensible policy towards mergers and acquisitions. FERC's jurisdiction over mergers is provided in Section 203 of the Federal Power Act:

No public utility shall sell, lease, or otherwise dispose of the whole of its facilities subject to the jurisdiction of the Commission, or any part thereof, of a value in excess of \$50,000 or by any means whatsoever, directly or indirectly, merge or consolidate such facilities or any part thereof with those of any other person, or purchase, acquire, or take any

security of any other public utility, without first having secured an order of the commission authorizing it to do so

In ruling on whether a merger is acceptable, FERC considers seven factors

- 1 The effect of the proposed merger on operating costs and rate levels
- 2 The contemplated accounting treatment
- 3 The reasonableness of the purchase price
- 4 Whether the acquiring utility has coerced the to-be-acquired utility into accepting the merger
- 5 The effect of the proposed merger on the existing competitive situation
- 6 Whether the consolidation will impair effective regulation either by the FERC or the appropriate state regulatory authority
- 7 Whether the merged companies can be operated economically and efficiently as a single entity

In operation, FERC concentrates on factors 1 and 5

Utilities merging in the United States always assert that they merging because their combined operations will operate at lower cost and thereby benefit consumers by lowering their prices. While it is debatable whether these assertions are in fact true in the absence of compelling evidence that the opposite is true or that competition will decline (factor 5) and therefore the reduced operating costs will not benefit consumers, FERC will authorize the merger.

In Ukraine, a merger between any two oblenergos would tend to reduce operating costs. Generally, the oblenergos in Ukraine are much smaller than the minimum efficient scale of distribution companies. That is, by merging the oblenergos could enjoy economies of scale, reducing their average operating costs. Even more economically beneficial would be a merger between an oblenergo and a micronet, as the typical micronet is far too small and economically inefficient.

Competition can be affected by a merger. Suppose for example that two of the four thermal generating companies in Ukraine were to apply to NERC for authority to merge their operations. In such a case, it could well be that competition could be severely impaired, raising the price generating companies could charge (in the absence of the fuel constraints that Ukraine temporarily is suffering today) which in turn would raise the price paid by retail consumers. If it seemed likely that the price charged to retail electricity consumers would rise significantly as a result of the merger, then NERC should reject the merger. In the case of merging oblenergos, there may be an exception, in the case of the largest oblenergos such as Dniproblenergo and Zaporhyzhiaoblenergo, to the general rule that mergers of oblenergos would be beneficial. This is because their market share after merger could be so large that they might be able to exert monopsony power to manipulate the wholesale electricity market. Analysis of competition is somewhat complex, and will not be discussed in detail in this memorandum.

7 If in the process of privatization a new owner of assets will be a person that was the lessee of these assets, then the lessee (now a new owner) shall inform the NERC about this and its license shall remain unchanged since it does not terminate its type of activity under a license granted except cases when in the process of privatization its name or location have been changed In this case its license is be redrafted

If the lessee uses the equipment in privatization of which it does not participate, then under its lease agreement it can use it further by re-signing it with a new owner or, if such conditions are not stipulated in the agreement, shall make a new lease agreement Permit (license) shall be issued to the lessee for the type of activity as such, and not for type of activity carried out on leased equipment

**COMMENTS ON "PROPOSALS FOR IMPROVEMENT
OF CURRENT ELECTRICITY TARIFF SYSTEM IN UKRAINE"**

Jim Stanfield and Sasha Petrov, Hagler Bailly

April 22, 1998

1 Real-time pricing and curtailments

- Paper correct that
 - current system of administrative curtailments is inefficient
 - a price-based system of curtailments should be used instead
- In any proposed wholesale pricing or curtailment system, the following constraints must be observed
 - The costs incurred by and revenues received by Energomarket for energy purchases and sales should be equal
 - The costs incurred by and revenues received by an oblenergo for the energy portion of its cost of sales should be equal
 - The Energomarket rules, the licenses issued by NERC, and the Electricity Law must be adhered to
- A problem The ratio between peak and off-peak prices which the paper calculates as necessary to eliminate administrative curtailments is about 10-to-1. The ratio at wholesale between peak and off-peak prices under today's Energomarket rules is far less than 2-to-1. As a consequence, a 10-to-1 ratio would require several administrative decisions that would interfere in the operations of Energomarket
 - The "correct" peak and off-peak prices
 - Reallocation of Energomarket costs between peak and off-peak generation
 - Reallocation of Energomarket revenues between peak and off-peak suppliers
- Proposed solution a market-based system under which customers could voluntarily be curtailed in return for monetary compensation paid by those retail customers that are not curtailed
- Second potential problem the increasing block tariffs and demand charges which the paper recommends are difficult (though not impossible) to reconcile with the Energomarket concept

2 Environmental surcharge

- An environmental surcharge is perfectly acceptable in principle
 - Consumers should pay the full cost of their consumption
 - The costs of pollution are now external to the price charged for electricity
- Damages from pollution are difficult to calculate
 - Whether there is any health effect from high voltage transmission lines is not clear, but the preponderance of the evidence is that there is not
 - For the other three sources of pollution
 - What are the health effects?
 - What is the monetary value of those health effects?
- Problems with the paper's proposal
 - Charging all electricity customers in an oblast the same environmental surcharge discriminates
 - In favor of persons who live in the oblast but who are unaffected by the pollution
 - Against persons who live in neighboring oblasts but who are affected by the pollution
 - An Independent Electricity Supplier may have customers in more than one oblast, so that charging it different prices for different customers would be an administrative burden
 - The paper provides no penalty on the source of the pollution or any other incentive to the polluter to reduce the pollution level
- Alternatives
 - A tax per unit of pollutant emitted by a plant with the tax levied on the plant
 - Tradable rights to units of the pollutant
- There must be a proposal concerning the distribution of the money collected by the environmental surcharge



PROGRAM TO PROMOTE
SUSTAINABLE DEVELOPMENT IN UKRAINE

ПРОГРАМА "СПРИЯННЯ СТАЛОМУ
РОЗВИТКОВІ В УКРАЇНІ"

Energy Efficiency and Energy Saving Work Group

Ref ENR Mtg9/Tariff rec/a eng
To EEES Work Group members
From Program Secretariat
Date 6 May 1998

**Recommendation
Electricity Tariffs**

Executive Summary

The Cabinet of Ministers' recent approval of the Financial Recovery Plan for the Power Sector of Ukraine (FRP) provides a valuable opportunity to address pressing electricity tariff issues in the context of a comprehensive power sector reform program. Success of the Plan requires implementation of tariff structures that are market oriented, consistent with existing law, and which can be implemented in accordance with time deadlines set out in the plan. In order to meet these criteria, the Energy Efficiency and Energy Saving Work Group recommends (i) implementing retail tariffs according to the Regulated Tariff Supply License previously introduced by the National Energy Regulatory Commission (NERC), and (ii) implementing wholesale electricity tariffs according to the Energomarket rules. Further, the Work Group re-emphasizes its previous recommendations that voluntary demand curtailment mechanism be put in place in Ukraine and that wholesale and retail metering programs be implemented with the proceeds of the World Bank Electricity Market Development Project (EMDP) loan, should it be reinstated.

Introduction

The Energy Efficiency and Energy Conservation Work Group¹ early on identified the absence of

¹ The Work Group comprises representatives of a number agencies and organizations that are directly involved in power sector issues several of which are or have been engaged in independent efforts to address tariff issues. Government agencies include the National Electricity Regulatory Commission (NERC) the Ministry of the Economy the Ministry of Energy, the State Committee on Energy Conservation and the State Committee on

Energy Efficiency and Energy Saving Work Group
c/o Environmental Policy & Technology Project
4 Bohomoltsia Street 3rd Floor Kyiv 252024 Ukraine
Tel (044) 247 5634 247-5635 Fax (044) 247-5638

Робоча Група з енергоефективності та енергозбереження
при Проекті Екологічної Політики і Технологій
Україна 252024 Київ вул Богомольця 4 3-й пов
Тел (044) 247-56-34 247-56-35 Факс (044) 247 56-38

transparent, rational, market-based tariffs as among the most significant obstacles to energy efficiency in Ukraine. The complexity of the tariff problem, as well as the economic and financial crisis facing electricity producers and consumers, make tariff setting and implementation among Ukraine's most difficult energy problems.

The Cabinet of Ministers recently took a positive step toward dealing with the tariff issues, and with the crisis in the power sector as a whole, by approving the Financial Recovery Plan for the Power Sector of Ukraine (FRP).² The FRP requires a number of power sector reforms, including implementation of market-based retail tariffs³ and wholesale tariffs based on Energomarket Wholesale Market Rules.⁴

Background

Ukraine's power sector crisis is due, in part, to the fact that electricity revenues do not cover the costs of system operations, creating a shortage of revenues to purchase fuel, make repairs, and invest in new technology and equipment. Despite the power system's overall capacity to generate power in excess of the country's needs, the system experiences severe imbalances during peak demand hours, especially during the winter months. To alleviate the electricity deficits that result from these imbalances, and to maintain the stability of the system, the National Dispatch Center and local electric companies (oblenergos) regularly impose mandatory curtailment through forced partial load disconnection, whereby entire residential districts, large industrial enterprises and public utilities are involuntarily disconnected from the electrical network. Nationwide, revenue losses resulting from mandatory curtailment run into the hundreds of millions of dollars per year. Implementation of a rational tariff structure which reflects the actual cost of energy generation and transmission is a key element to establishing sustainability and economic viability in Ukraine's restructured power sector.

The cost to produce one kilowatt hour (kWh) of electricity fluctuates greatly with the time of day and season.⁵ Under the rules of the Energomarket State Enterprise (Energomarket), oblenergos will carry out settlements with the Energomarket Pool on an hourly basis. These fluctuations are therefore reflected in the wholesale electricity price within the Pool. However, end consumers' (i.e., the oblenergos' customers') retail tariffs are not, in practice, based on Energomarket Pool prices.

The National Energy Regulatory Commission (NERC) is charged under the Law of Ukraine

Geology. Non-government organizations include the Institute of Energy Conservation and Energy Management of the National Technical University of Ukraine, USAID power-sector restructuring contractor Hagler Bailly Consulting, and the Association of Independent Energy Suppliers of Ukraine. In particular, extensive work has been carried out in the area of tariff reform by representatives of the Institute of Energy Conservation and Energy Management of the National Technical University of Ukraine, including Work Group members A. Prakhovnik and V. Nakhodiv. The Institute's research and assistance to the Work Group has been very valuable in preparation of these materials.

² Cabinet of Ministers Resolution No. 508, 8 April 1998.

³ FRP, paragraph 5.

⁴ FRP, paragraph 6. The Rules are set out in Schedule 2 of the Energomarket Members Agreement.

⁵ See the attached Cost Structure chart for the cost elements of tariffs in 1977.

"On the Electricity Sector" (Law on Electricity)⁶ with regulation of electricity tariffs. Prior to implementation of the Electricity Law, this authority was granted to NERC under a Presidential Decree⁷. Pursuant to this authority, NERC established the Regulated Tariff Supply License which sets out retail tariff formulas⁸. These formulas provide for time-of-use tariffs. One of the factors in the formula is the licensee's hourly Energomarket price for electricity⁹. (In the case of customers that are not metered, the licensee's average monthly price is used.)

Although the Regulated Tariff Supply License was promulgated in August 1996, the formula is not currently being applied by electricity suppliers. Rather, retail tariffs are currently set under either the one-zone or the two-zone tariff system¹⁰. Under the one-zone tariff, which applies to consumers with installed capacity of up to 750 kilo-volt amperes (kVA), a fixed rate per kWh is paid for actual electricity consumed, regardless of the time of day or season. Under the two-zone tariff, which applies to consumers with installed capacity of more than 750kVA, consumers pay for actual electricity consumed (the "consumption component"), as well as for the declared maximum capacity they have committed themselves not to exceed during the system's peak hours (the "capacity component"). In either case, there is no direct connection between the supplier's wholesale price and the retail price.

The Financial Recovery Plan

The FRP was developed pursuant to a Presidential Decree¹¹ and Instructions to the Cabinet of Ministers¹² to address the financial crisis in Ukraine's electricity industry. The FRP identifies a number of specific actions, as well as the responsible agency or agencies, deadlines, and expected results in each of six areas:

Cost Reduction - Limits non-cash transactions, reduces electricity costs and introduces competition in fuel procurement.

Retail Tariffs - Introduces market-based retail and wholesale tariffs and limits preferential tariffs and privileged customer classes.

Collection of Current Accounts - Mandates service disconnection, where consistent with the law, for defaulting customers, prohibits excess electricity supply to budget organizations, increases transparency and reliability of payment mechanisms, and imposes penalties for late payment.

Collection of Arrears - Introduces mechanisms to reschedule debt and write off uncollectible arrears, provides for legal enforcement of claims for arrears, and sets up a financing mechanism for budget agencies to pay off arrears.

Privatization - Requires management of state shares of privatized companies by non-state structures, and requires transfer to investors of controlling interests in oblenegos and fossil

⁶ No 575/97-VR, October 16, 1997, Section III, article 11.

⁷ No 213, 14 March 1995.

⁸ Registered with the Ministry of Justice, 8 August 1996. The formulas in the license apply to tariffs for all customers except residential. A copy of the formulas is attached.

⁹ Regulated Tariff Supplier License, Section 3.8.

¹⁰ NERC has also issued a three-zone tariff for consumers with three-zone metering equipment, which applies to a relatively small number of consumers.

¹¹ Presidential Decree No 21, 21 January 1998.

¹² Instructions to Cabinet of Ministers No 32, 19 January 1998.

generating plants

Management - Charges the Financial Recovery Commission with implementing the FRP, requires performance monitoring to demonstrate progress on benchmarks to the World Bank, and seeks reinstatement of Electricity Market Development Project (EMDP) loan and reallocation of a portion of the proceeds to finance electricity meters

The FRP, which represents a viable opportunity for Ukraine to begin overcoming the power sector crisis, includes target dates for implementation of each prescribed action. The success of the FRP, as is the case with any comprehensive plan, will depend in part on the timely execution of its component parts. The Work Group endorses the FRP and hopes the political will exists to see that the responsible parties discharge their obligations according to the schedule.

An additional incentive to adhere to the FRP implementation schedule is that the FRP requires the Ministry of Energy and the Ministry of the Economy to draft an appeal to the World Bank to reinstate the EMDP loan based on the initial performance of the FRP. Early success in meeting FRP objectives could therefore lead to financial support for additional energy sector reforms.

As stated above, tariffs present among the most complex issues facing the energy sector. Among the highly qualified energy sector professionals serving on the Work Group, differences of opinion arose on many of these issues. There is consensus, however, that keeping to the time frame of the FRP is critical and, therefore, that submitting recommendations that can be timely implemented and that do not require time-consuming procedural changes is of great importance.

Wholesale Tariffs

The FRP states that the National Dispatch Center, under the control of NERC, is to determine amounts due from all electricity suppliers and to all generators according to the Energomarket State Enterprise (Energomarket) Rules.¹³ The Energomarket Rules create an hourly wholesale spot market for electricity resources, which is operated by Energomarket. Under this system, each thermal generator¹⁴ submits a daily bid stating how many units of electricity it is willing to produce, and the price at which it is willing to produce those units, during each hour of the following day. After ranking the generators' bids in increasing cost order, Energomarket computes the least financial cost of meeting the estimated demand for each hour. Energomarket pays the same price per unit to all generators whose production is purchased during a given hour.

Retail Tariffs

As to tariffs at the retail level, the FRP requires "[t]ransition to market-based retail tariffs according to the Electricity Law and the NERC issued licenses while providing for a single tariff for the population in the entire territory of Ukraine."¹⁵

The Electricity Law grants NERC the exclusive right to issue licenses for electricity generation.

¹³ FRP paragraph 6

¹⁴ Nuclear and hydropower generators are paid a contract price and do not participate in the hourly wholesale spot market.

¹⁵ FRP, paragraph 5

transmission and supply,¹⁶ and stipulates that retail electricity prices shall be formed by electricity suppliers according to the *Conditions and Rules for the Right to Carry out Entrepreneurial Activity in Electricity Supply*¹⁷

As previously mentioned, the retail tariff formula set out in the Regulated Tariff Supply License factors in the licensee's hourly Energomarket wholesale electricity price,¹⁸ thereby bringing retail tariffs under control of market forces rather than administrative ones, which is a primary objective of both the FRP and the Electricity Law

Another factor bringing retail prices under market forces is the existence of Independent Electricity Suppliers (IESs) IESs buy power from Energomarket at the hourly market price calculated according to the Energomarket Rules and resell the electricity to retail customers An IES pays the Local Electric Company in whose territory the customer is located a fee for the use of the LEC's facilities The IES's retail price is not regulated by NERC or any other governmental entity but rather by market forces

For the reasons discussed above, the Work Group endorses the requirements in the FRP to (i) implement wholesale tariffs in accordance with the Energomarket Rules and (ii) implement retail tariffs in accordance with the Electricity Law and NERC Licenses

Demand Shifting

There have been questions expressed as to whether Regulated Tariff Suppliers License tariff formula will bring about an adequate shift in load from peak to non-peak hours One group that has looked at the problem suggests that a ratio of 10:1 between maximum and minimum tariff levels may be necessary to bring about the degree of shift in demand necessary to avoid administrative demand curtailment¹⁹ The ratio between high and low rates under the Regulated Tariff Suppliers License formula will rarely exceed 1.5:1

While there may be merit in the position that a substantial price differential is needed, implementation of a 10:1 peak to off-peak ratio (or any ratio other than that established through the retail tariff formula in the Regulated Tariff Supply License) could not be implemented without abandoning the market-controlled principle on which the formula is based Moreover, the formula in the Regulated Tariff Supply License is not conducive to modification to bring about higher peak to non-peak tariff ratios, and administratively increasing the ratio would lead, in turn, to the need to make additional administrative determinations, further reducing the extent to which the tariff structure is market based In addition, it would be necessary to introduce mechanisms and legislative bases for making these decisions and to assign responsibility for the decisions These steps would delay implementation of the tariff structure and make it difficult or impossible to comply with the time frames established in the FRP

¹⁶ Electricity Law article 13

¹⁷ Electricity Law article 17

¹⁸ Registered with the Ministry of Justice, 8 August 1996 The formulas in the license apply to tariffs for all customers except residential

¹⁹ It has been noted that the question of the peak to off-peak tariff ratio becomes insignificant under normal economic conditions and relatively stable electricity demand

An alternative to administratively manipulating the ratio of peak to off-peak tariffs is to bring about load shifting through voluntary demand curtailment (VDC). The Work Group previously recommended implementing VDC in Ukraine. As explained in that recommendation,²⁰ VDC is designed to avoid the need for administrative curtailment through a market-based mechanism that allows consumers to "sell" their privilege of purchasing electricity during peak load to consumers who are willing to pay a premium to continue receiving electricity during those periods. This mechanism is consistent with, and can be implemented in conjunction with, the retail tariff formula set out in the Regulated Tariff Supply License. The Work Group therefore recommends implementing VDC, in conjunction with the NERC license tariff scheme to address the need to shift load from peak to non-peak periods.

Electricity Metering

Among the most significant obstacles to the success of a modern tariff structure is the lack of electricity meters designed for time-of-day and hourly tariff applications at both the wholesale and retail market levels. Under current economic conditions, purchasing such equipment is beyond the means of many consumers.

The Work Group recommends that the initial approach to this problem be through application of World Bank loan proceeds to procurement of metering equipment. The FRP calls for an appeal to the World Bank to reinstate the EMDP loan that was suspended last year.²¹ The World Bank EMDP loan provides \$70 million for metering at the wholesale market level.

The Work Group recommended that a previous draft of the FRP be amended to provide that a portion of the undisbursed EMDP loan be reallocated toward metering at the retail market level. The final version of the FRP includes such a provision, which states that the appeal to the World Bank for EMDP loan reinstatement should include "a request for reallocation of loan proceeds for acquisition of metering and communication technology required to implement hourly tariffs and voluntary demand curtailment."²²

Environmental Surcharges

Work Group members note that the tariff formula set out in the Regulated Tariff Supply License does not contain an environmental protection component. The environmental impact of electricity generation and transmission must be viewed as a part of the actual cost of the electricity which should therefore be included in tariffs. While it does not endorse a particular mechanism for implementing an environmental surcharge at this time, the Work Group notes that any such surcharge should be transparent, fair, equitable, and based on demonstrable, accepted scientific principles.

Conclusion

The complexity of the problems in the areas of tariff setting and implementation, combined with

²⁰ See the attached recommendation *Encouraging "Voluntary Demand Curtailment" of Electricity Consumption*.

²¹ Approximately \$241 million of the original loan remains undisbursed.

²² FRP paragraph 23.

the financial and economic crisis in the power sector, have resulted in differences among experts as to how the problems should be solved, and in lengthy delays in implementing a market-based tariff system in Ukraine's restructured power sector. The recently-enacted Financial Recovery Plan for the Power Sector presents an opportunity for NERC, the Ministries of Energy, Finance, and Economy, and other entities involved in energy sector reform, to implement a comprehensive, unified approach to bringing about financial recovery in the sector.

Key to the success of this approach are adhering to the applicable legislation and underlying market principles, and satisfying the deadlines set out in the FRP. While there exist several meritorious approaches to tariff issues, the Work Group believes the approach which best meets these requirements is implementation of retail tariffs under the Regulated Tariff Supplier license formula, and implementation of wholesale tariffs in compliance with the Energomarket Rules. These formulas are already part of Ukraine's power sector legislation, and they provide for a scheme that is market oriented with a minimum of administrative oversight. Moreover, these tariff structures are conducive to implementation of a voluntary demand curtailment mechanism to alleviate the need for forced load curtailment and they satisfy the need to tie retail tariffs into the wholesale electricity prices.

Finally, the Work Group emphasizes that the FRP, alone, cannot bring about economic recovery in the power sector. Additional measures should be concurrently addressed, including (i) creating stable tariff structures for coal, gas, and thermal energy, as well as for electricity, (ii) reducing non-payment for energy at all levels of the economy, and (iii) implementing economic mechanisms, such as those set out in the Law on Energy Conservation, to create incentives to conserve energy.

**CONFERENCE ON INTRODUCING THE SYSTEM OF
DETERMINING THE RETAIL ELECTRICITY TARIFF
PURSUANT TO THE LAW OF UKRAINE
"ON ELECTRICITY SECTOR"**

**Legal Assistance
of Wholesale Electrical Market Activity
Electricity Law**

Svitlana Golikova

Consultant, Inc. and GMP International Consultant

Supported by

U.S. Agency for International Development

07.07.98

Main Provisions of the Electricity Law of Ukraine

- ▶ The Electricity Law was adopted by Verkhovna Rada of Ukraine on 16 October 1997 and put into force on 20 November 1997. The Law stipulates legal, economic and organisational principles of activity in electricity production, transmission, distribution and utilisation, ensuring the energy safety in Ukraine, competition and protection of consumer and the sector employee rights
- ▶ The Law defines electricity and heat as commodities intended for trading. Before, electricity production and trading had been attributed to the service category
- ▶ The electricity purchase and wholesale shall be carried out in the Wholesale Electricity Market of Ukraine operating on the basis of Agreement. The functioning of any other wholesale markets in Ukraine shall be forbidden

Wholesale Electricity Market Status

- ⇒ The Wholesale Electricity Market of Ukraine is a market created by economic entities for electricity trading based on the agreement
- ⇒ The Agreement shall stipulate the objective and terms of activity, rights, liabilities and responsibilities of the parties to the Agreement. The Agreement shall be coordinated with Minenergo, NERC and Antimonopoly Committee of Ukraine
- ⇒ The Law defines a notion of the "Wholesale Electricity Market Member" – these are electricity generating and electricity distribution companies
- ⇒ Every entity carrying out an entrepreneurial activity in electricity production and supply shall have the equal access to the Wholesale Electricity Market of Ukraine
- ⇒ The Market Rules are an integral part of the Agreement, which establishes a load schedule procedure for generating companies, rules for the wholesale electricity market pricing, etc

Economic Entities Involvement in *Wholesale Electricity Market Activities*

- ⇒ Having an appropriate license issued by NERC and signing the Wholesale Electricity Market Agreement shall be compulsory for carrying out activities in the Wholesale Electricity Market
- ⇒ Utilities that have received licenses for generating electricity from NERC shall sell the electricity in the Wholesale Electricity Market. The only exception is the electricity generated at CHPs, which are a part of the energy supplying company, to be consumed within the territory of carrying out licensed activities. Tariffs for the electricity generated at such utilities to be consumed within the territory of carrying out licensed activities shall be regulated by NERC.
- ⇒ Every participant of the Wholesale Electricity Market is a Party to the Agreement. There could be more Parties to the Agreement than Market Members. For example, NDC and Ukrelectroperedacha are not the Market Members, while they are the Parties to the Agreement as far as they provide services to other Members.

Main Changes To Be Made To Wholesale Electricity Market Agreement

- ⇒ Relations between the generating companies and the Market Settlement System Administrator shall be based on selling electricity to the Wholesale Market under the Agreement of the Commission. The generating companies shall be regarded as electricity owners until the moment the electricity has been sold to the regulated tariff or non-regulated tariff suppliers. Settlement System Administrator shall sell electricity on behalf of his own and is obliged to protect the rights of generating companies, including the handling of claims and complaints against the suppliers in debt.
- ⇒ The issue of the Energomarket legal status, as provisioned by the Financial Recovery Plan for the Power Sector of Ukraine (Cabinet of Ministers Order No 508 of April 18, 1998), needs to be resolved.
- ⇒ Market Rules and Amendments shall be brought into conformity with the Agreement.
- ⇒ It is suggested that the procedure for resolving disputes among the Market Members shall be legalized, with bringing the disputes to the Market Arbitrage Commission consideration.

Main Changes To Be Made To Wholesale Electricity Market Agreement

- ⇒ Delimitating functions of state regulation and state administration in the power sector is the main principle of the sector and the wholesale market activity. A state regulatory body in the power sector is the National Electricity Regulatory Commission of Ukraine (NERC)
- ⇒ NERC takes part in establishing and enforcement of a single state policy of the Wholesale Electricity Market development and operation, the power sector pricing and tariff policy, regulation of natural monopolies and adjacent markets operation, regulation of settlements in the wholesale electricity market, etc

**CONFERENCE ON INTRODUCING THE SYSTEM OF
DETERMINING THE RETAIL ELECTRICITY TARIFF
PURSUANT TO THE LAW OF UKRAINE
"ON ELECTRICITY SECTOR"**

Investment Into Ukraine's Power Sector

Valentin Dmyk

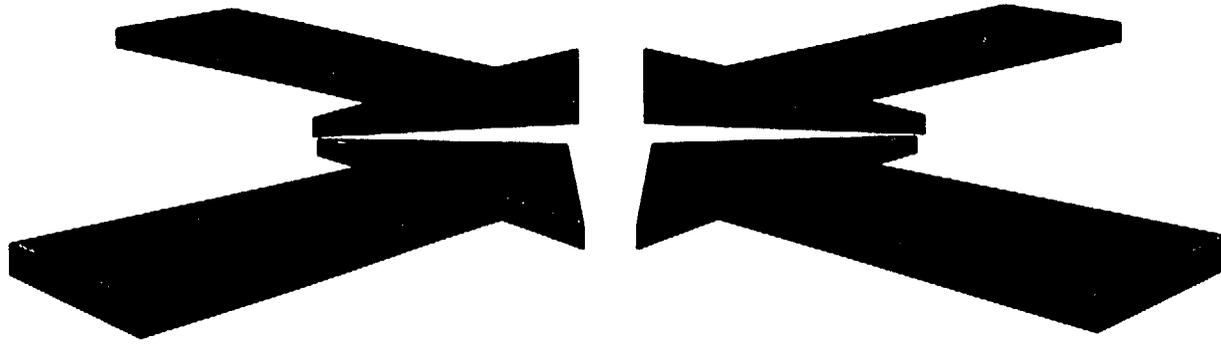
Advisor

Harbor Bally, Inc. and SMP International Consultants

Supported by

U.S. Agency for International Development

07.07.98



Investment Into Ukraine's Power Sector

Valentin Didyk, Advisor

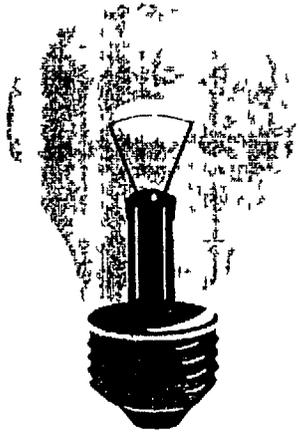
The Cabinet of Ministers approval of the Resolution On Investment Regulation Concept In the Transition Economy once more emphasized the priority investment into the fuel and energy complex of Ukraine.

The Plan for Financial Recovery of Ukraine's Power Sector, that has been recently approved, envisages certain measures to improve the current situation in the sector.

Resolution of difficult social problems connected with the introduction of market-based tariffs.

Political decision-making related to Chernobyl NPP.

On-going privatization (though not so smooth) of the power sector.



However, the events taking place in the power sector now give a 5-10 year perspective of the energy complex in Ukraine.

The State of Ukraine's Power Sector

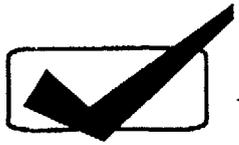
Most of the TPP capital assets were put into operation in 60-70-ies;

- ▶ 98 of 104 generating units have exhausted their life cycle,**
- ▶ 66 units - their service life,**
- ▶ 39 units turned the obsolescence limit in the world power industry.**

The equipment of most hydro power plants have worked 20 through 40 years and need to be replaced and rehabilitated to improve their life characteristics.

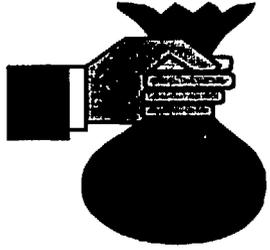
The 4 new units of NPP are at various construction stages and require substantial funds to put them into service.

The extent of the electric networks requiring the replacement and reconstruction is constantly growing in line with substations that have to be repaired.



Ukraine's Power Sector Structure

- ▶ **Ukraine's power sector is a complex technical and technological system.**
- ▶ **The total installed generating capacity of power plants is 53.9 million kW,**
- ▶ **with thermal power plants (TPP) accounting for 36.4 million kW (67%),**
- ▶ **nuclear power plants (NPP) - 12.8 million kW (24%),**
- ▶ **hydropower plants (HPP) - 4.7 million kW (9%).**
- ▶ **In Ukraine, over 1 million km of electric networks and some 3 thousand km of heat networks are in operation.**
- ▶ **The thermal power sector includes the 104 power generating units of 150-800 MW installed at the 14 TPP and 3 CHP.**
- ▶ **The nuclear power sector includes the 15 power generating units of 440-1000 MW installed at the 5 NPP.**

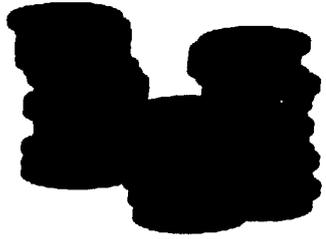


Ukraine's Power Sector Operation

Table. Generation and Demand Balance to 2010, billion kWh

	1990	1991	1992	1993	1994	1995	2000	2005	2010
Generation	298.5	278.6	252.5	229.9	202.9	193.9	249.4	266.5	280.6
Demand		264.4	247.9	228.8	201.9	191.0	244.4	256.5	270.6
Export	28.1	15.4	5.8	2.7	1.6	4.1	5.0	10.0	10.0

The Cabinets of Ministers Resolution "On Complex Measures for the Implementation of the National Energy Program" of 07.10.97 needs to be specified.



Problems

The current problem of generating and distribution companies is the lack of funds due to:

- ▶ **long use of non-banking settlements (offsets and notes)**
- ▶ **inability of companies to collect payments¹,**
- ▶ **inadequate tariffs from the perspective of profit and expenditures,**
- ▶ **excessive costs based on many factors, including barter transactions and ineffective company management.**

¹ In 1997, the bank payments for electricity amounted 16% The electricity debt as of April 14, 1998 was Hr2 185 149 thousand



The long-term problem is a slow investment process within the sector.

The “National Program for Ukraine’s Power Sector Development to 2010” (adopted by VR in May 1996)

Stage 1 (to 2000) - reconstruction of TPP power units of total capacity 4300 MW

- ▶ 15-25 years increase in service life of 200, 300 and 800 MW units,
- ▶ development of new technologies of coal burning in the arched furnace boilers and boiling bed combustion,
- ▶ reconstruction of gas and mazut power units of 300 and 800 MW equipped with gas turbine superstructure,
- ▶ reconstruction of steam turbine units to improve technical performance and economic indicators,
- ▶ putting into service one power generating unit at both Khmelnytsky NPP and Rivne NPP,
- ▶ This stage also envisages the 220-750 kV networks development, and reconstruction and updating of the existing rural and urban distribution networks of 0.4-150kV

2 Stage (2001-2010) - reconstruction of TPP of total capacity 22500 W:

- ▶ further reconstruction and updating of TPP;
- ▶ introduction of new technologies using boiling bed combustion furnaces;

3 Stage (from 2010) - putting into service new power units of total capacity 3275 W:

- ▶ using new technologies;
- ▶ creation of “mine-TPP” complexes,
- ▶ creation of TPP waste processing complexes;
- ▶ creation of enterprises for NPP fuel elements production;
- ▶ creation of enterprises for NPP waste processing and disposal.

Resources

- ▶ The capital investments to 2010 into generating companies alone were expected to amount² 34.667 billion karbovanets.
- ▶ Presently, TPP management expectations of the modernization scale are more moderate. According to TPP management, the estimated cost of works for Tsentrenergo modernization is at least \$500 million, Zakhidenergo - \$570 million, Donbasenergo - \$1000 million.
- ▶ The “National Program for Ukraine’s Power Sector Development to 2010” requires from \$1.5 billion to \$2.5 billion annually for renovation of existing TPP alone.

² Under the Complex Program of Renovation and Development of Ukraine’s Fuel and Energy Industry to 2010. The Program was adopted in 1992. Data are in 1984 prices.



Financial Sources

- ▶ **Credits**
- ▶ **Direct investments, including investor funds in the course of privatization**
- ▶ **Own funds**

Credits

At present, the real essential source of the sector financing are credits of the World Bank, EBRD and foreign commercial banks.

They planned the crediting of the following projects:

Rehabilitation of Dnieper Chain Hydropower Stations (WB credit of \$114 million);

Energomarket Development Project (WB credit of \$317 million);

Zmiiv TPP Reconstruction Project (a DM126.6 million credit of German banks KFW and West LB);

Starobedshev TPP Reconstruction Project (a USD113.2 million credit of EBRD).

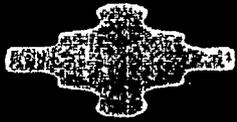
Note that before only a little part of these funds had entered Ukraine which might be explained by many complex reasons.

Funds Returned from Privatization. Direct Investments

- ▶ **Darnitsa TPP Reconstruction Project (\$115 million) may be considered as a direct foreign investment.**
- ▶ **The funds that are expected to invest in privatization:**
for the strategic investor the investment into Oblenergo state joint stock companies must be not less that 100% of the market value of the company assets, and not less than 50% in generating companies.
- ▶ **The state-owned blocks of shares are expected to be transferred to the strategic investor.**
- ▶ **The privileged blocks of shares for the 14 Oblenergo have been reduced, due to which the amount of shares for selling at stock exchanges will be increased.**

Though the analysis of the industry branches priority from the perspective of the potential investor based on the profitability, promising development and investment risks until recently have placed the power sector among branches having low investment attractiveness in line with the coal industry³, the results of the thorough study of the power sector development options, however, are quite optimistic: the power sector has good economic prospects for the development. Thus, there is no ground to think of political obstacles that could hinder the objective electricity pricing. Undoubtedly, a justified price increase will result in growing of cash flows into the sector.

³ According to the analysis, certain industry branches have been divided into the four groups. The first group includes the branches of the priority investment attractiveness: non-ferrous and ferrous metal industry. The second group includes the branches of potentially high investment attractiveness: the oil producing and gas industries. The third group includes the branches of medium investment attractiveness: the chemical and oil and chemical industries, and the branches of low investment attractiveness like the oil and power industries belong to the fourth group.



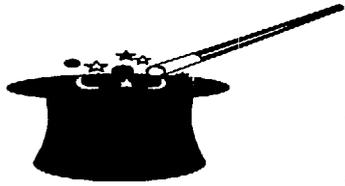
The average residential and industrial tariffs are respectively as follows:

- ▶ **in Poland - 6.5 and 5.7 cents,**
- ▶ **in Hungary - 5.0 and 2 cents,**
- ▶ **in Greece - 10.5 and 7.5 cents,**
- ▶ **in Great Britain - 11.7 and 9.5 cents,**
- ▶ **in France - 15.2 and 7.8 cents,**
- ▶ **in Austria - 15.5 and 9.8 cents,**
- ▶ **in Germany-19.5 and 12.0 cents.**



In estimating the cost of energy companies, the index of capitalization per production capacity unit, even under a spring production decline, is 2-3 times lower as compared to similar Russian companies, and it has to be increased by 10 times to reach that in Western Europe.

Consequently, if an appropriate privatization tactics is used, the shares of energy companies could be not only a subject to stock exchange speculations, but a real instrument for attracting capital.



Internal Resources

Total investments into all power utilities envisaged by the Minenergo of Ukraine for 1998 equal Hr2.663.266 thousand. The source of investments is profits and depreciation charges made by economic agents.

Profits received from introduction of new average retail electricity prices such as \$0.05/ Wh for residential customers and \$0.04/ Wh for industrial customers are envisaged to be used for investment purposes. This is likely to raise the average profitability⁴ of generating companies to 7% and of energy supplying companies to 4%.

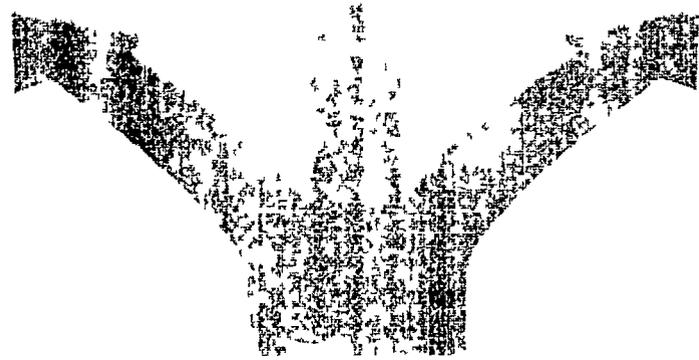
⁴ Profitability in the power sector is typically defined as the ratio of profits to cost

Table 1. Gencos' Profits in 1997

Gencos	Production, kWh thou	Sales, Hr thou	Balance Profit, Hr thou	Payments Budget, Hr thou to	Net Profit, Hr thou
DONBASENERGO	21 355 923	1 152 975	125 080	20 060	105 020
DNIPROENERGO	18 794 400	1 112 162	107 100	19 188	87 912
ZAKHIDENERGO	13 311 076	712 014	97 259	36 289	60 970
TSENTERENERGO	17 731 218	1 147 220	45 626	12 226	33 400

Table 2 Suppliers' Profits in 1997

Oblenergo	Sendout, kWh thou	Sales, Hr thou	Balance Profit, Hr thou	Payments to Budget, Hr thou	Net Profit, Hr thou
Vynnytsiaoblenergo	2 273 163	165 037	-5 267	278	-5 545
Volynoblenergo	1 013 152	73 791	-1 405	302	-1 707
Dniprooblenergo	25 449 778	1 688 374	29 289	10 881	18 408
Donetskoblenergo	23 057 936	1 763 109	-40 364	3 122	-43 486
Zhytomyroblenergo	2 152 606	130 516	2 393	1 557	836
Zakarpattiaoblenergo	1 034 259	77 231	-14 890	181	-15 071
Zaporizhiaoblenergo	11 248 365	510 426	4 962	2 341	2 621
Kyivenergo	4 807 201	748 861	141 949	42 510	99 439
Kyivoblenergo	2 896 120	205 929	-452	347	-799
Kirovohradoblenergo	2 538 210	153 143	1 691	476	1 215
Krymenergo	3 945 379	309 595	-20 206	898	-21 104
Lvivenergo	3 167 691	283 957	2 868	2 782	86
Luhanskoblenergo	10 479 759	928 063	-12 577	4 694	-17 271
Mykolaivoblenergo	2 260 042	207 007	-12 468	357	-12 825
Odesaoblenergo	4 117 930	374 847	-17 201	2 830	-20 031
Poltavaoblenergo	4 719 993	320 214	19 898	7 009	12 889
Prykarpattiaoblenergo	1 944 877	135 262	6 306	2 904	3 402
Rivneoblenergo	1 898 052	106 426	29	528	-499
Sevastopolenergo	710 474	61 594	9 347	2 264	7 083
Sumyoblenergo	2 177 611	153 705	3 728	3 126	602
Ternopiloblenergo	1 308 142	85 984	-13 847	71	-13 918
Kharkivoblenergo	6 032 460	728 457	6 609	16 918	-10 309
Khersonoblenergo	2 515 256	187 480	-38 787	378	-39 165
Khmelnyskoblenergo	1 931 366	150 743	-522	194	-716
Cherkasyoblenergo	3 119 377	282 142	2 679	3 442	-763
Chernivtsioblenergo	928 670	73 988	-14 565	136	-14 701
Chernihivoblenergo	2 115 905	171 614	4 936	5 221	-285



National Energy Investment Priorities:

- **ensuring current and future energy sector viability,**
- **keeping up the production force in ensuring the production efficiency.**

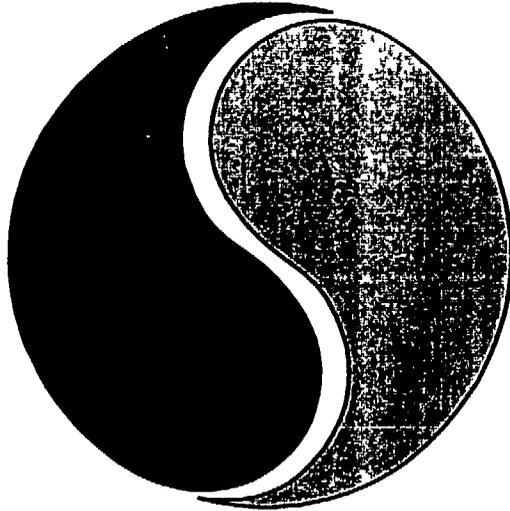


The investor's tactics is based on:

- **efficient profit-making, and in the high-risk zones like Ukraine, on most prompt and maximum return values.**
- **selection of the entities with best perspectives for their development and the highest investment efficiency.**



The enterprise attractiveness for the investor infers high indicators of working capital, margin of profit, financial reliability and assets liquidity.

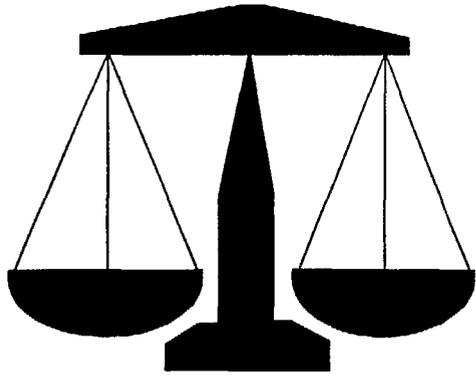


The priorities of the nation (which is the largest investor and the owner of entities that are subject to investment) and of the private investor are not the same due to reasons conditioned by the difference in approaches to the expected results of owners of financial resources and owners of entities that are subject to investment.

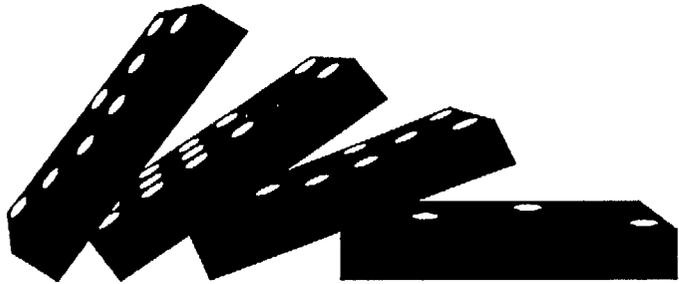


The main factor for the efficient development of the power sector is an appropriate strategic planning based on the national priorities and interests of the private investor which have to be coordinated basically.

Nationwide reforms in a particular branch of the industry - the power sector - need to be connected with the nation development strategy.



The energy potential of the nation has to be aimed at the efficient national industry from the perspective of the energy demand, i. e, the restructuring needs to be carried out simultaneously in investment attractive branches, namely, non-ferrous and ferrous metal industries, and oil production and gas industries.



Strategic planning has to be a basis in selecting appropriate actions under the existing uncertainty within the sector, electric utilities and their affiliates.

The sector financial strategy based on the flow of capital has to become an element of the general strategy in line with marketing, pricing and structural elements and consistent with the company level. The company objective has to be agreed with the sector tasks and ensure the reduction of risks in keeping security values, or the profitability growth without risk increase. This has to be a utility strategy basis and to ensure an analysis of economic factors in the national economy and in the sector itself, sales forecast, making up an estimate of costs for equipment purchase and repairs, capital

costs estimate, and financial sources analysis. The company production plans have to be based on optimum capital expenditures, reasonable working capital values, and considered dividend policy. The forecast of cash flows will allow the companies to make an estimate of future cash proceeds and expenditures ensuring quite attractive corporate indicators. The real events going on in the power sector has to be coordinated through the project management methods envisaging the structuring of large technical and financial events at the sector level into the minor ones at the company level and lower, and an estimate of resources (cash, material, time, labor force, etc.) for each minor event, putting the events and resources according to the time schedule with further optimization of the resources, strict control over the plan conformity with the actual situation, with further timely and efficient adjustment.



**What is a connection between
investments and tariffs?**

Calculations of electricity supply tariff

Item	Specification	Unit measurement	of Base period	Forecast period
1	<u>Basic data</u> Electricity volume supplied to group 1 customers	\hat{A}'_{n1}	MWh	
2	Electricity volume supplied to group 2 customers	\hat{A}'_{n2}	MWh	
3	Electricity supply expenditures			
5	Complexity coefficient	\hat{E}, \hat{a}_1		
1	<u>Calculations results</u> Electricity supply tariff for group 1 customers	\hat{O}'_1	UAH/MWh	
2	Electricity supply tariff for group 2 customers	\hat{O}'_2	UAH/MWh	
	Revenue from group 1 customers	$\hat{O}'_1 * \hat{A}'_{n1}$		
	Revenue from group 2 customers	$\hat{O}'_2 * \hat{A}'_{n2}$		

Report and forecast data of entrepreneurial entity licensed activity

Data specification	Customers Group I			Customers Group II		
Electricity volume thous KWh						
Gross income from licensed activity						
Gross expenditures including						
Cost of products or services including						
production services raw and support materials fuel labor costs						
other costs including						
<i>% for the bank credit</i>						
Balance profit from licensed activity						
Profit Tax						
Net profit						
Current profit expenditures including						
deductions to reserve (insurance) fund and for statutory fund increase						
production development and investments						
social development						
incentives						
dividends to shareholders						
bank loan payment						
other						
Profitability of licensed activity (net profit and cost ratio) %						
Electricity supply tariff Hr/mWh						

Execution of investment expenses activities in

(years)

	Investment expenses, thousands of hryvnias	Plan			Fact		
		1-st investor	2-nd investor	3-rd. investor	1-st investor	2-nd investor	3-rd investor
1	Pre-investment research						
2	Land plot						
3	Structures (buildings)						
4	Infrastructure						
5	Technical documentation						
6	Construction & installation works						
7	Equipment						
8	Installation & start-up						
9	Personnel training						
10	Marketing, contracting						
11	Working capital						
12	Total						

Execution of investment expenses activities in

	Investment expenses, thousands of hryvnias	the first quarter	the second quarter	the third quarter	the fourth quarter
1	Pre-investment research				
2	Land plot				
3	Structures (buildings)				
4	Infrastructure				
5	Technical documentation				
6	Construction & installation works				
7	Equipment				
8	Installation & start-up				
9	Personnel training				
10	Marketing, contracting				
11	Working capital				
12	Total				

Sources of financing in (year)

Sources of financing, thousands of hryvnias	Plan		Fact	
	1 year	2 year	1 year	2 year
1 (Own) capital				
2 Attracted capital				
3 State subsidies				
4 Loans from Ukrainian banks				
5 Direct foreign investment				
6 Financial foreign investment				
7 Portfolio foreign investment				
8 Technical assistance (grants)				
9 Loans from foreign banks				
10 Loans from international financial institutions				
11 Other				
Total				

Invested capital returned

Invested capital returned	Plan		Fact	
1 (Own) capital invested	199_	199_	199_	199_
2 (Own) capital returned				
3 Return on capital invested				
4 (Own) capital returned plus return on capital invested				
5 Attracted capital				
6 Dividend pay-outs				
7 Attracted capital plus dividends				
8 Bank loans				
9 Loan repayment				
10 Interest on bank loans				
11 Loan repayment plus interest on bank loans				

Plan of licensed activity by months in 199_ , thousands of hryvnias (simplified structure)

Data specification	Jan	Feb				Dec
Electricity volume, thous KWh						
Gross income from licensed activity						
Gross expenditures, including						
Cost of products or services, including						
production services, raw and support materials, fuel, labor costs,						
other costs, including						
<i>% for the bank credit</i>						
Balance profit from licensed activity						
Profit Tax						
Net profit						
Current profit expenditures including						
deductions to reserve (insurance) fund and for statutory fund increase						
production development and investments						
social development						
incentives						
dividends to shareholders						
bank loan payment						
Investment costs						
Cash flow in licensed activity						
Cumulative cash flow in licensed activity						
Net profit, NPV for (period), discount rate %						
Internal profit rate, %						
Assets profitability, %						
Investment profitability, %						



MEMORANDUM

To Irina Gorokhova, Department of Licensing and Pricing, NERC
From Irina Yegorchenko
Date 6/23/98
Subject Finiteness of subsidy amount

Finiteness of Subsidy Amount for the Case of Previous Period Calculation

Assumptions.

Wholesale market price without subsidy, quantity of electricity sold at market price without subsidy, quantity of electricity sold at subsidized price and subsidized price are constant

Notations.

P - Wholesale market price without subsidy taken into account,

S_n - Subsidy surcharge for the month n, which will be added to the wholesale market price in the month (n+2),

PS_n - Wholesale market price with subsidy surcharge in the month n

$$PS_n = P + S_{n+2},$$

T - Set price for privileged consumers,

E - Total amount of electricity sold for the month,

ET - Amount of electricity sold for the month at the set price for privileged consumers,

M_n - Amount of money to be collected in the month n

$$M_n = E * PS_n,$$

MF_n - Amount of money actually collected in the month n (both at the market price with subsidy surcharge and at the set price, on condition of 100% collection)

$$MF_n = (E - ET) * PS_n + T * ET,$$

Σ_n - Total amount of subsidy for the month n

$$\Sigma_n = M_n - MF_n$$

Calculation of the subsidy surcharge S_n for the month n that will be added to the market price in the month (n+2)

$$S_n = \Sigma_n / E = (M_n - MF_n) / E = \{E * PS_n - (E - ET) * PS_n - T * ET\} / E$$

$$= \{ET * PS_n - T * ET\} / E = ET * (PS_n - T) / E = ET * (P + S_{n+2} - T) / E$$

$$= (P - T) * ET / E + S_{n+2} * (ET / E)$$

We have a recurrent formula for the dependence of S_n from S_{n-2}

$$S_n = (P - T) * ET/E + S_{n-2} * (ET/E)$$

$$S_n = (P - T) * ET/E + S_{n-2} * (ET/E) = (P - T) * ET/E + \{(P - T) * ET/E + S_{n-4} * (ET/E)\} * (ET/E)$$

$$= (P - T) * ET/E + \{(P - T) * ET/E + \{(P - T) * ET/E + S_{n-6} * (ET/E)\} * (ET/E)\} * (ET/E)$$

In the first and the second month starting from introduction of subsidy certificates the subsidy surcharge is equal to 0 We get the formulae for the subsidy surcharge in the month n

$$n = 2k$$

$$S_n = (P - T) * \sum_{k=0}^n (ET/E)^{k/2}$$

$$n = 2k+1$$

$$S_n = (P - T) * \sum_{k=0}^n (ET/E)^{k/2}$$

or in the general case

$$S_n = (P - T) * \sum_{m=1}^n (ET/E)^{[m/2]}$$

where $[m/2]$ is the integer part of $m/2$

When n tends to infinity, the subsidy surcharge tends to

$$S = (P - T) * \sum_{n=1}^{\infty} (ET/E)^{[n/2]} = (P - T) * \frac{ET/E}{1 - (ET/E)}$$

For the reference the formula for the sum of infinite geometric sequence with the factor less than one

$$s = \sum_{k=1}^{\infty} q^k = \frac{q}{1 - q}$$

If ET/E less than one, or ET (amount of electricity sold for the month at the set price) is less than E (total amount of electricity sold for the month), the value of the subsidy surcharge will be finite However, it may be very large if ET is not considerably less than E



MEMORANDUM

To Sergei Vyshinsky
Cc Jim Stanfield, Dick Hemen
From Irina Yegorchenko
Date August 28, 1997
Subject Comments to the Draft Procedure for Control of the Licensees' Compliance with Conditions and Rules of Carrying Out the Licensed Activity (8/26/97)

We provide you with comments to the Draft Procedure for Control of the Licensees' Compliance with Conditions and Rules of Carrying Out the Licensed Activity

As to Paragraph 1 3

“ if the third party has reasonable grounds”

I believe that some description of reasonable grounds would be needed (availability of documents etc)

As to Paragraph 3 3

“ depending on the degree of violations revealed”

The text suggested

“Depending on the degree of violations revealed the authorized employees

- 1) register and send materials to the Commission, or
- 2) send notices to the licensee on violation of Conditions and Rules with indication of the term for its rectification themselves ”

It is unclear in the text of the Draft Procedures which options may be depending on the degree of violations

As to Chapter 4

It is appropriate to indicate exact terms for consideration and decision-making

As to Paragraph 5 1

It is appropriate to mention who will carry out the check if the licensee's activity is related to the territory of several local offices (railways, gencos, large independent suppliers, NDC etc)

As to Paragraph 5 6

It is appropriate to indicate to whom and under what conditions these materials can be given

1. General Provisions

- 1 1 Procedures for Control of the Licensees' Compliance with Conditions and Rules of Carrying Out the Licensed Activity are developed on the basis of the Provisions on NERC, approved by the President's Decree of 3/14/95 #213 and according to Conditions and Rules of Carrying Out the Licensed Activity
- 1 2 Review of the licensed activity of business entities which have obtained licenses at the National Electricity Regulatory Commission of Ukraine (NERC) is carried out by representatives of NERC according to Chapter 4 of Conditions and Rules of Carrying Out the Licensed Activity of Electricity Generation, Transmission and Supply (referred below as Conditions and Rules) and according to the present Procedures
- 1 3 NERC may start a review of the licensed activity of the licensee at its own initiative or after a complaint of any third party, if the third party has reasonable grounds
- 1 4 NERC monitors compliance of licensees with Conditions and Rules, analyzes reports submitted by licensees and may at any time check the licensed activity or accounting files of the licensee, and also to ask assistance of other competent bodies in such checks

2. Working Out and Approval of Schedules for Review of the Licensed Activity of Licensees. Types of Reviews.

- 2 1 NERC carries out reviews of the licensed activity of a licensee according to a plan or beyond the schedule
- 2 2 Planned reviews of the licensed activity are carried out by authorized persons (Local Offices of NERC) according to annual schedules of reviews, approved by NERC and developed by the Department of Local Offices, which should include all licensees
- 2 3 Schedules for planned reviews have to be worked out taking into account schedules of checks of the licensees by local departments of the Antimonopoly Committee
- 2 4 NERC carries out reviews beyond the schedule of the licensed activity of licensees when complaints and requests from licensees, electricity consumers, representatives of Antimonopoly Committee, Minenergo, etc are considered, and also in the cases when NERC or NERC's Local Office received information on a violation of Conditions and Rules of carrying out the licensed activity committed by a licensee

Reviews beyond the schedule by representatives of a Local Office or by representatives of a department of the Working Body of NERC may be carried out at request of the Chairman of NERC or Commissioners, on the basis of analysis of the reporting data and in other cases

3. Authority of NERC Representatives During Reviews of the Licensed Activity of the Licensees.

3 1 According to the Paragraph 4 1 of Conditions and Rules of Carrying Out the Licensed Activity NERC and its authorized agents have the right of access to the licensee's territory and to its equipment and documents for inspection of its licensed activity

3 2 Review is carried out on the grounds of a letter issued by NERC, which should contain a list of authorities of NERC representatives

The licensee shall render necessary assistance to NERC in the course of inspection of its licensed activity

3 4 Depending on the degree of violations revealed the authorized employees have to register and send material to the Commission

4. Procedures for Carrying Out Reviews of the Licensed Activity of Licensees

4 1 During a planned or beyond the schedule review of the licensed activity of licensees an authorized representative of NERC acts within the framework of his/her authority according to Conditions and Rules of Carrying Out the Licensed Activity

Results of a review are registered by an act in two copies which are to be signed by an authorized representative of NERC and by a representative of the licensee In the case of violations of Conditions and Rules having been revealed the paragraphs or chapters, which the licensee has violated, should be adduced in the act The act may contain also other comments and suggestions as to carrying out the licensed activity One of the copies is to be sent to NERC

4 2 A copy of the notice on violation of Conditions and Rules is included into the licensee's file by the Department of Licensing and Pricing

4 3 Departments of Local Offices and of Licensing and Pricing prepare a file on violation of or non-compliance with Conditions and Rules for consideration by the Commission

4 4 The Commission considers the file on violation of or non-compliance with Conditions and Rules and makes the relevant decision with setting the term for elimination of these violations

4 5 The Secretariat sends the Resolution or the Order of the Commission to the licensee The copies of the Resolution or the Order are given to the department which have prepared the file for the Commission's consideration and to the relevant Local Office of NERC

1 General Provisions

- 1 1 Procedures for Control of the Licensees' Compliance with Conditions and Rules of Carrying Out the Licensed Activity are developed on the basis of the Provisions on NERC, approved by the President's Decree of 3/14/95 #213 and according to Conditions and Rules of Carrying Out the Licensed Activity
- 1 2 Review of the licensed activity of business entities which have obtained licenses at the National Electricity Regulatory Commission of Ukraine (NERC) is carried out by representatives of NERC according to Chapter 4 of Conditions and Rules of Carrying Out the Licensed Activity of Electricity Generation, Transmission and Supply (referred below as Conditions and Rules) and according to the present Procedures
- 1 3 NERC may start a review of the licensed activity of the licensee at its own initiative or after a complaint of any third party, if the third party has reasonable grounds
- 1 4 NERC monitors compliance of licensees with Conditions and Rules, analyzes reports submitted by licensees and may at any time check the licensed activity or accounting files of the licensee, and also to ask assistance of other competent bodies in such checks

2 Working Out and Approval of Schedules for Review of the Licensed Activity of Licensees Types of Reviews

- 2 1 NERC carries out reviews of the licensed activity of a licensee according to a plan or beyond the schedule
 - 2 2 Planned reviews of the licensed activity are carried out by authorized persons (Local Offices of NERC) according to annual schedules of reviews, approved by NERC and developed by the Department of Local Offices, which should include all licensees
 - 2 3 Schedules for planned reviews have to be worked out taking into account schedules of checks of the licensees by local departments of the Antimonopoly Committee
 - 2 4 NERC carries out reviews beyond the schedule of the licensed activity of licensees when complaints and requests from licensees, electricity consumers, representatives of Antimonopoly Committee, Minenergo, etc are considered, and also in the cases when NERC or NERC's Local Office received information on a violation of Conditions and Rules of carrying out the licensed activity committed by a licensee
- Reviews beyond the schedule by representatives of a Local Office or by representatives of a department of the Working Body of NERC may be carried out at request of the Chairman of NERC or Commissioners, on the basis of analysis of the reporting data and in other cases

3 Authority of NERC Representatives During Reviews of the Licensed Activity of the Licensees

3 1 According to the Paragraph 4 1 of Conditions and Rules of Carrying Out the Licensed Activity NERC and its authorized agents have the right of access to the licensee's territory and to its equipment and documents for inspection of its licensed activity

3 2 Review is carried out on the grounds of a letter issued by NERC, which should contain a list of authorities of NERC representatives

The licensee shall render necessary assistance to NERC in the course of inspection of its licensed activity

3 4 Depending on the degree of violations revealed the authorized employees have to register and send material to the Commission

4 Procedures for Carrying Out Reviews of the Licensed Activity of Licensees

4 1 During a planned or beyond the schedule review of the licensed activity of licensees an authorized representative of NERC acts within the framework of his/her authority according to Conditions and Rules of Carrying Out the Licensed Activity

Results of a review are registered by an act in two copies which are to be signed by an authorized representative of NERC and by a representative of the licensee. In the case of violations of Conditions and Rules having been revealed the paragraphs or chapters, which the licensee has violated, should be adduced in the act. The act may contain also other comments and suggestions as to carrying out the licensed activity. One of the copies is to be sent to NERC.

4 2 A copy of the notice on violation of Conditions and Rules is included into the licensee's file by the Department of Licensing and Pricing

4 3 Departments of Local Offices and of Licensing and Pricing prepare a file on violation of or non-compliance with Conditions and Rules for consideration by the Commission

4 4 The Commission considers the file on violation of or non-compliance with Conditions and Rules and makes the relevant decision with setting the term for elimination of these violations

4 5 The Secretariat sends the Resolution or the Order of the Commission to the licensee. The copies of the Resolution or the Order are given to the department which have prepared the file for the Commission's consideration and to the relevant Local Office of NERC

5 Monitoring Elimination of Violations of Conditions and Rules of Carrying Out the Licensed Activity and Compliance with Resolutions or Orders of the Commission on Elimination of Violations

5 1 Monitoring of the licensee's compliance with resolutions or orders of NERC on elimination of violations of Conditions and Rules is carried out by the Local Office of NERC on the territory of which the licensee is located

The Secretariat controls the term of compliance with resolutions or orders of the Commission

5 2 The relevant Local Office of NERC reviews the reasons for non-compliance of the licensee with a resolution or an order of NERC on elimination of violation of Conditions and Rules. If the licensee failed to prove his case then the Local Office prepares a new file for Commission's consideration

5 3 The Commission considers files prepared by departments of the Working Body of NERC or by a Local Office of NERC on non-compliance with a resolution or an order of NERC and can set a new term for elimination of violation of Conditions and Rules, and the Secretariat sends a written notice on that to the licensee. The copy of the notice is sent to the department or to the Local Office of NERC which have prepared the file for the Commission's consideration

5 4 If the licensee cannot eliminate violation of Conditions and Rules in time because of justified objective reasons and informs NERC on that in writing, the Commission may postpone the term for elimination of violation of Conditions and Rules, and the Secretariat sends a written notice on that to the licensee. The copy of the notice is sent to the department or to the Local Office of NERC which have prepared the file for the Commission's consideration

5 5 In the case when the licensee complies with a resolution or an order of NERC on elimination of violation of Conditions and Rules the licensee sends a written notice on that to NERC and to the authorized representative of NERC who reviewed the licensee

NERC confirms the licensee's compliance with a resolution or an order of NERC on elimination of violation of Conditions and Rules, and the Secretariat sends a written notice on that to the licensee. The copy of the notice is sent to the department or to the Local Office of NERC which have prepared the file for the Commission's consideration

5 6 All materials relevant to reviews of the licensed activity should be kept in the licensee's file

5 Monitoring Elimination of Violations of Conditions and Rules of Carrying Out the Licensed Activity and Compliance with Resolutions or Orders of the Commission on Elimination of Violations

5 1 Monitoring of the licensee's compliance with resolutions or orders of NERC on elimination of violations of Conditions and Rules is carried out by the Local Office of NERC on the territory of which the licensee is located

The Secretariat controls the term of compliance with resolutions or orders of the Commission

5 2 The relevant Local Office of NERC reviews the reasons for non-compliance of the licensee with a resolution or an order of NERC on elimination of violation of Conditions and Rules. If the licensee failed to prove his case then the Local Office prepares a new file for Commission's consideration

5 3 The Commission considers files prepared by departments of the Working Body of NERC or by a Local Office of NERC on non-compliance with a resolution or an order of NERC and can set a new term for elimination of violation of Conditions and Rules, and the Secretariat sends a written notice on that to the licensee. The copy of the notice is sent to the department or to the Local Office of NERC which have prepared the file for the Commission's consideration

5 4 If the licensee cannot eliminate violation of Conditions and Rules in time because of justified objective reasons and informs NERC on that in writing, the Commission may postpone the term for elimination of violation of Conditions and Rules, and the Secretariat sends a written notice on that to the licensee. The copy of the notice is sent to the department or to the Local Office of NERC which have prepared the file for the Commission's consideration

5 5 In the case when the licensee complies with a resolution or an order of NERC on elimination of violation of Conditions and Rules the licensee sends a written notice on that to NERC and to the authorized representative of NERC who reviewed the licensee

NERC confirms the licensee's compliance with a resolution or an order of NERC on elimination of violation of Conditions and Rules, and the Secretariat sends a written notice on that to the licensee. The copy of the notice is sent to the department or to the Local Office of NERC which have prepared the file for the Commission's consideration

5 6 All materials relevant to reviews of the licensed activity should be kept in the licensee's file

**CONFERENCE ON INTRODUCING THE SYSTEM OF
DETERMINING THE RETAIL ELECTRICITY TARIFF
PURSUANT TO THE LAW OF UKRAINE
"ON ELECTRICITY SECTOR"**

Issues For The Round Table

Iryna Egorchenko

Manager, Bally, Inc. and CMP International Consultants

Supported by:

U.S. Agency for International Development

07.07.98

Issues for Discussion

Calculation of the profit tax

- 1 Separate accounting for different kinds of the licensed activity is necessary for regulation of tariffs, but the separate tax accounting is not necessary
- 2 Subsidy certificates for compensation of losses related to electricity supply to the privileged consumers, some groups of residential consumers and agricultural producers, to electricity suppliers at regulated tariff

The role of price inspections with respect to pricing control in the electrical power industry

- 1 The retail prices at which electricity is sold by a regulated tariff supplier, are calculated according to the Electricity Law and Conditions and Rules of Electricity Supply at the Regulated Tariff
- 2 Independent electricity suppliers are licensed, and prices at which they sell electricity are not subject to price regulation or control
- 3 The control of prices at which electricity is sold by principal consumers to subconsumers

Suggestions

- 1 Do not apply VAT on electricity or any parts of its cost until development and adopting of the relevant normative documents
- 2 Create a special working group for preparation of normative documents on VAT payments for electricity with participation of the Ministry of Finance, State Tax Administration and National Electricity Regulatory Commission
- 3 Alternatives for VAT Calculation
 - Calculate and pay VAT for the total cost of electricity only at the supply level (to final consumers), taking into account the effective legislation. In this case the zero VAT rate for fuel should be taken into account, that would require complex calculations
 - Fix annually or monthly percentages of electricity sales to residential consumers (that is not subject to VAT) for generating companies, main and interstate network and local network (these percentages will be different for each level because of technological losses)

3. Problems with VAT payments by generating companies

3 1 There will be no VAT for electricity sold to residential consumers, but it is very difficult to separate the portion of electricity to be sold to residential consumers at the level of generating companies

3 2 The total state of the economy created the situation when generating companies receive cash payment for only 6-10% of the cost of electricity they produce. The payment of VAT even for the really added value (10-15% of the cost of electricity transmitted to the network) will result in the serious decrease of cash available to the generating companies

2. Problems with VAT payments for electricity transmission

2.1 Both at the level of main and inter-state network, and at the level of local networks it is very difficult to separate electricity for consumption by residential consumers

2.2 Now it is required to pay VAT on electricity transportation by oblenenergo network for suppliers at non-regulated tariff. Such transportation is regarded by tax authorities as service. But the cost of this transportation presents an inseparable part of the cost of electricity that is not subject to VAT. VAT payment creates an unfair situation for suppliers at non-regulated tariff with respect to competition.

Issues for Discussion

Calculation of VAT for electricity

1. Problems related to electricity supply

Considerable number of electricity consumers are subconsumers of others - principal consumers. Costs of these principal consumers for transmission and supply of electricity have to be compensated.

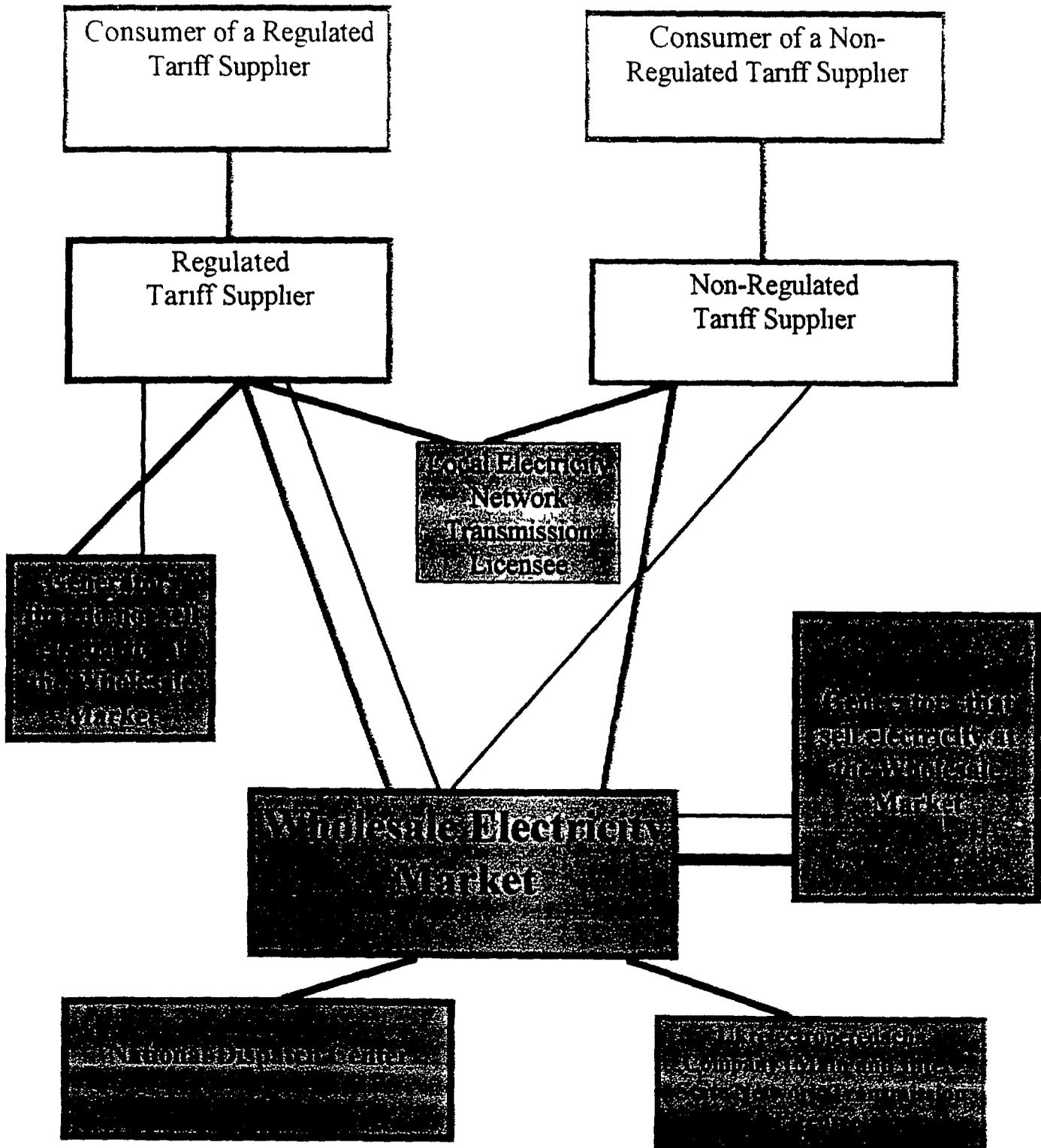
1.1 Can such compensation be regarded as payment for an additional service subject to VAT.

1.2 A portion of electricity purchased by a principal consumer is purchased for his own purposes, and another portion - for consumption by subconsumers among whom there are as a rule some residential consumers. It is unclear how VAT should be calculated in this case. Because of technological losses of electricity in the network it is very difficult to separate portion of electricity consumed by residential consumers at lower levels, from electricity used by other (non-residential) consumers. Such separation will require development of special procedures and normative documents.

Issues for Discussion

Calculation of VAT for Electricity

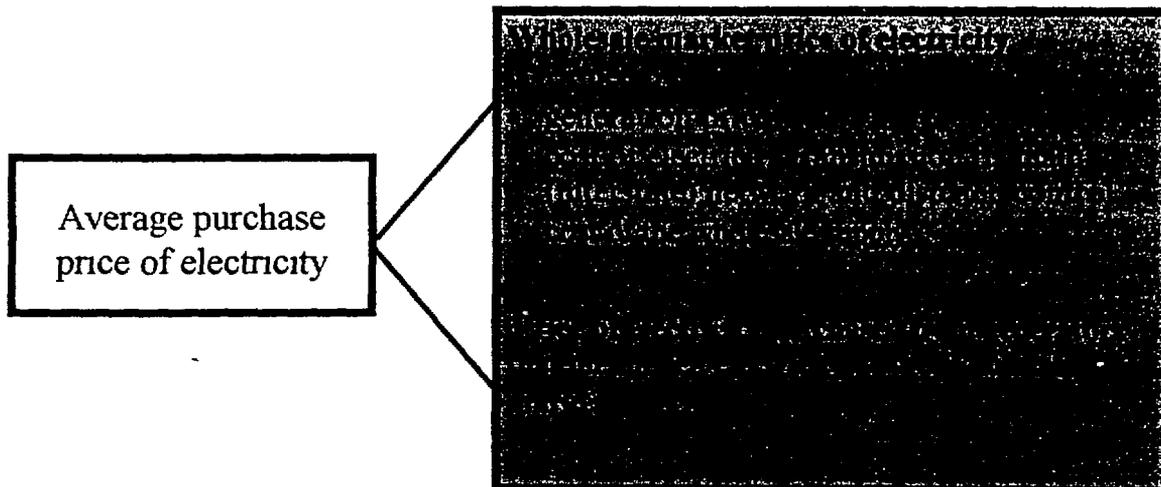
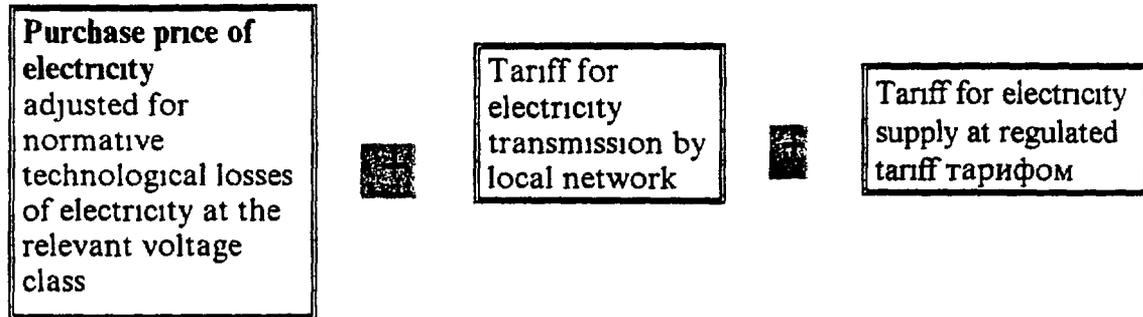
Structure of payments for electricity



Issues for Discussion

Calculation of VAT for Electricity

Structure of the electricity price
(for the regulated tariff supplier)



**ENERGOMARKET MEMBERS AGREEMENT
AND NERC AUTHORITY**

MEMORANDUM

TO H Thornber L Dulnev
CC D Wolcott J Stanfield A Goncharenko, S Golikova
FROM K Yemelyanov
DATE August 20 1998
SUBJECT Comments on PWG-25 draft of 08 04 98 "Sale and Agency Agreements"

This is in the follow-up of comments related to the development of relationship in the Wholesale Electricity Market based on Sale and Agency Agreements

Regarding concerns that the generating companies will start suing the suppliers, it should be reminded that according to Section 35 of the Civil Code of Ukraine (CCU), the agency agreement is performance by one Party (the Agent) on its behalf but in the interests and for a compensation of the other Party, of any legal actions. Such legal actions according to the proposed by the Working Group draft of modifications and amendments to the Wholesale Electricity Market Members' Agreement, include

- to receive electricity from the generators and sell it to the suppliers,
- to carry out claiming and suing work in the interests of Parties to the Agreement

The literal construction of the proposed modifications implies that the above legal actions are interrelated and therefore binding for both the generators and Agent. This means that if the generating company claims on its own it will violate the Agreement (except for the cases where the Agent does not carry out claiming work at all)

As for collecting the road tax from NDC the charge will certainly decrease as it will be charged on the funds NDC receives as payment for its services rather than the gross cost of electricity sold by it as it is being done currently. With regard to the argument on the road tax imposed on the cost of services for high voltage electricity transmission it was also collected though from another legal entity. When Ukrenergo is set up, ESE Ukrelektoperedacha will be wound up and calculation of the road tax on services will in no way impact the wholesale market price.

The main adverse effect from the electricity sale arrangement based on the present sale agreement where NDC receives the property right for electricity, is the following:

Under the Agreement, the responsibility of NDC as the purchaser of electricity, to the generating companies is restricted solely by funds on the WEM allocation account. This means that the generating company can not claim or sue NDC for failure to pay for electricity sold as the liability to pay arises from the moment the funds are transferred by the suppliers to the WEM account. This also makes it impossible for the generating

Hagler Bailly

company to defer tax payment, as the company according to the present agreement is not legally entitled to sue (because its rights are not violated) As a result, the power generators are not claiming against NDC inasmuch as, according to the present Agreement their rights are not violated by the National Dispatch Center NDC does not sue the suppliers because knows that nobody will claim against it and funds that it receives to the WEM current account will be sufficient to live The suppliers (oblenergos) make no calculations required to purchase electricity and do not sue their consumers because NDC brings no respective actions against them Oblenergos' cash demands are satisfied though providing their networks to Independent Suppliers It looks like nobody except for generating companies is concerned by cash collection

Regarding payment of the state tax for bringing an action to the Court of Arbitration the state will never give it up firstly because this is money that supports courts of Ukraine and secondly the exclusion in one case may prove to be systematic in the whole system This relates to the state tax payment defer for a period through the end of the court's trial of a case This will entitle the generating companies to appeal to the court and suspend their tax commitments In order to completely solve the problem of the national duty payment, it is required to envisage "the creation of the standing Court of Arbitration (non-state court) in the pending Act "On the Basis for the Wholesale Electricity Market Operation "

Acting legislation of Ukraine provides an opportunity for the prosecutor to appeal to the court (without paying the state tax) According to Article 2 of the Arbitration and Procedural Code of Ukraine the prosecutor appeals to the court in the interest of the state In the application it should be indicated the body authorized by the state which performs relevant functions in dispute relationship This means that the state body (in this case it may be only the nominal owner of a state enterprise – Minenergo) has to appeal to the prosecutor with the motion for the appeal to defend the interests of one state enterprise against another one with share belonging to the state (Minenergo) This is hard to imagine Moreover the matter on prosecutors' appealing in order to defend the state's interests is rather questionable and is being considered by the Constitutional Court of Ukraine

The statement that the Ukrenergo's tax burden will increase in the course of transition from the sale to agency arrangement has no legal grounds VAT will be paid not as a result of changes of the scheme of relationship between the WEM members, but due to introduction of VAT for electricity sale transactions, from 01.01.99 The VAT sum under agency will be paid only with regard to the compensation amount received by Ukrenergo for performing functions as the Agent and the statement saying that if sale arrangements remained, these funds would be received by the generators, has no legal grounds

Hagler Bailly



MEMORANDUM

To Chairman Buttsio, Commissioner Goncharova, Commissioner Gridasov
CC D Wolcott, J Stanfield, P Mulligan, A Parinov, H Thornber, L Dulnev
From Svitlana Golikova
Date 06/03/98
Subject Energomarket Members Agreement Modifications and Amendments

Over the last three months the Hagler Bailly consultants have been taking part in activities designed to change and amend the Energomarket Members Agreement. The preliminary work has been completed by May 25 1998 and all relevant materials have been referred to the Working Group and the Minenergo's senior management.

As the Agreement related work has lasted for a long time it has been deemed necessary to incorporate recent changes in the present Ukrainian law and primarily the Cabinet of Ministers Resolution 508 of April 18 1998 "On Approving Ukrainian Power Sector Financial Recovery Plan".

Among the issues of primary importance stipulated in the Plan is the transfer of the Energomarket Funds Administration function from NDC to the newly created "Energomarket Enterprise which should be implemented by July 1 1998 (Minenergo, NERC and NDC share the responsibility for its implementation).

Despite numerous remarks made by the consultants in respect of non-compliance of the suggested Agreement modifications and amendments with the Cabinet of Ministers Resolution 508 of April 18 1998 the issue of transferring the Energomarket Funds Administration function from NDC to the 'Energomarket' Enterprise has not been settled yet.

I deem it reasonable to suggest that you, Mr. Chairman, in your capacity of the Working Group Co-chairman and Mr. Bondarenko, the Working Group Co-chairman on the part of Minenergo, make the decision to urgently revise the current version of the Energomarket Members Agreement to incorporate the recent modifications and amendments and bring it in line with the present law of Ukraine.

In my view, the issue of transferring the Energomarket Funds Administration function from NDC to the "Energomarket" Enterprise needs to be settled as soon as possible as the Draft Modifications and Amendments to the Energomarket Members Agreement will be referred for consideration to the Minenergo's Balance Commission on June 6, 1998 and reviewed at the Energomarket Board Meeting on June 9, 1998.

On the part of Hagler Bailly we are prepared to continue working on the Agreement and assist NERC in any possible way.

Yours sincerely,
Svitlana Golikova

MEMORANDUM

TO D WOLCOTT, J STANFIELD, S GOLOKOVA
CC H THORNER, L DULNEV
FROM K YEMELIANOV
DATE JUNE 9, 1998
SUBJECT MEETING ON ISSUES OF ENERGO MARKET MEMBERS' AGREEMENT

A meeting on reviewing the Draft Changes in and Amendments to the Energomarket Members' Agreement was held under the chairmanship of Z Buttsio, Chairman of the NERC, in the NERC building on June 8, 1998. Those present at the meeting were representatives of the NERC and representatives of the NDC, led by M Rachin, and representatives of Hagler Bailly Consulting.

The meeting was called because of the difference in opinions between NDC and some lawyers proposed by the Working Subgroup. M Rachin does not agree with wording of those clauses of the Agreement that stipulate the possibility to transfer the function of the MFA and SSA from the competence of NDC to a third party (enterprise "Energomarket"). His remarks are that the provisions of these clauses can be interpreted as such that empower the WEM Board to transfer the function of MFA from NDC to a third party thus separating it from the function of the SSA. It was proposed to make wording of these clauses identical. M Rachin and WEM's Chief Accountant expressed their opinion that functions of the MFA and SSA should be united into one function and be called Market Financial Operator. Besides an opinion was expressed on the behalf of NDC that while uniting the NDC and SEC "Ukrelektroperedacha" into the state enterprise "Ukrenergo" it would be good to separate from its structure subdivisions which are today engaged, in NDC, in servicing WEM and to set up enterprise "Energomarket" on their basis. In this case, enterprise "Energomarket" shall be given the functions of Commissioner, Market Funds Administrator, Settlement System Administrator Secretariat and conduct of complaints and claims that is, enterprise "Ukrenergo" retains functions of Dispatcher and Network Owner.

T Shapovalova, Chief Accountant of Energomarket, suggested that the scheme of electricity purchase/sale be reviewed on the basis of a commission contract. She proposed the scheme by which electricity purchase/sale will be carried out only by Generators and Suppliers. The NDC (enterprise "Energomarket") will service this purchase/sales, determine the wholesale price, prepare load schedules, etc., that is, will fulfill the same function as it does today. In this case, electricity shall be purchased not in a centralized way through the NDC, but on the basis of multilateral agreement on joint activity. Accounting of joint activity will be effected by the NDC. WEM's funds administration will be carried out by the Market Banker as a trustee, and movement of funds will be managed by WEM's Financial Operator. Enterprise "Energomarket" will be responsible for conduct of complaints and claims and operation of Secretariat.

Buttsio made conclusions on advantages and shortcomings of the current Agreement and proposed draft changes and amendments, having noted an advantage of the draft in respect of transfer of property right, tax payments, centralized conduct of claims and complaints

Other NERC's representative noted that any changes in the Agreement can't solve the crisis of payments in the power sector

K Yemelyanov



Memorandum

To Valentina Boiko Lev Doulnev David Wolcott, Jim Stanfield
CC Irina Yegorchenko Andrey Kononov
From Svetlana Golikova
Date November 12 1997
Subject Comments on Amendments and Supplements to the Energomarket Members Agreement based on the Working Group meeting of the WEM Board of November 11 1997

- 1 Amendments to the Agreement regarding the name of the Energomarket State Enterprise contradict the Law of Ukraine No 613\96 - BP of 18 December 1996 "On Ratification of the Agreement of Guaranty between Ukraine and EBRD" (the Ukraine Electricity Market Development Project) Presidential Decrees No 244\94 of 21 May 1994 and No 853\97 of 19 August 1997 the cabinet of Ministers Resolution No 816-p of 2 November 1994 the Terms and Rules of Entrepreneurial Activities on Wholesale Electricity Supplies and EMA For instance the Presidential Decree of 19 August 1997 called for creation of the Energomarket State Enterprise to operate as a despatch centre for the Ukrainian integrated power system and provide for operations of the wholesale electricity market as *per the wholesale electricity market members agreement*
- 2 #2 2 (To the Preamble) of Amendments and Supplements this cannot be accepted since NIC in accordance with the Terms and Rules for electricity supplies by main and interstate grids (Items 2 3 and 2 5) and EMA shall interact with the Energomarket State Enterprise as per a separate agreement which should exist between ESE and NEC Terms and conditions of such an agreement must be coordinated with NERC
- 3 #3 2 (To Part 1 Introduction) of Amendments and Supplements this cannot be accepted (see Item 1 of the Comments) Implication of the term of "Energomarket State Enterprise" should be provided in compliance with the Presidential Decree of 19 August 1997 Item 2 'a' wherein it is set out that ESE shall operate as *a despatch centre for the Ukrainian integrated power system and provide for operations of the wholesale electricity market as per the wholesale electricity market members agreement*
- 4 #3 3 (To Part 1 Introduction) of Amendments and Supplements the existing Agreement specifies the term of "subsidiary" though what was meant was "affiliated company", that is a holding company or a daughter enterprise
- 5 The Agreement does not specify the terms such as "debtor" and "debt" as their use is common to international practice The term of "penalty" may be used if penalty sanctions are legally specified for all consumer groups including residential consumers
- 6 The Subject of the Agreement and obligations of Energomarket members as in Amendments and Supplements Item 2 1 Explanation should be given to why other parties of the Agreement will exist in addition to the market members

- 7 NDC's responsibilities. This is the most complicated item that was always bringing misunderstanding among the Working Group members. Because the Law "On Electric Power" adopted by the Supreme Rada after the third reading construes "energy" as a commodity' and the relations between WEM members and customers must be based on the provisions of the purchase-and-sale agreement, the role of ESE should be clarified in terms of these relations.
- 8 Unfortunately, until now, there is a misunderstanding between WEM members in the issue of treating ESE as a Buyer of electricity from generators and simultaneously as a Seller of electricity, or *whether it shall operate as an agent in electricity purchase and sale agreement between generators and suppliers*. Members of the Board cannot strictly define legal relations between generation and supply. This issue has become particularly important after issuance of the Law of Ukraine "On Income Tax of Enterprises" of 05/22/97. According to Article 12.1.1 of this Law, enterprises can reduce the value of the revenue for the reporting period for the value of the shipped goods if a Buyer of these goods delays a tax payment without agreeing it with the tax payer. This reduction is possible if delay of the payment for the shipped goods exceeds 30 days from the date set up in the Agreement terms and the tax payer appealed to the court (arbitration court) regarding payment collection from such a Buyer.
- 9 It makes no sense for electricity generators to make any of the arbitration exceptions without appealing to the court, since in this case they should pay taxes for the full value of electricity sold to the market regardless of whether they have received the money or not.
- 10 The effective Tax and Civil Law does not envisage such types of wholesale purchase and sale agreements according to which electricity purchase and sale are effected in the Wholesale Electricity Market. In other words, there are no exceptions which would allow a tax payer in person of electricity generator to regulate a doubtful or bad arrears which have occurred through no fault of generators.
- 11 NDC has been proposed to introduce changes to the Agreement which would turn electricity purchase and sale relations between Generators and ESE, and ESE and Suppliers into direct relations between Generators and Suppliers. Unfortunately, the proposed changes do not consider the effective provisions of the Agreement where ESE cannot be relieved from the obligations to purchase electricity from Generators and sell it to Suppliers.

11\12\97\MW\nick\amenema.doc
OS_tdubovik\Common\NERC\Comments\Nov 13 97

MEMORANDUM

TO D WOLCOTT, J STANFIELD, S GOLOKOVA
CC H THORNER, L DULNEV
FROM K YEMELIANOV
DATE 07 09 98
SUBJECT MEETING ON ISSUES OF ENERGO MARKET MEMBERS' AGREEMENT

A meeting on reviewing the Draft Changes in and Amendments to the Energomarket Members Agreement was held under the chairmanship of Z Buttsio, Chairman of the NERC in the NERC building on June 8 1998 Those present at the meeting were representatives of the NERC and representatives of the NDC led by M Rachin and representatives of Hagler Bailly Consulting

The meeting was called because of the difference in opinions between NDC and some lawyers proposed by the Working Subgroup M Rachin does not agree with wording of those clauses of the Agreement that stipulate the possibility to transfer the function of the MIA and SSA from the competence of NDC to a third party (enterprise "Energomarket") His remarks are that the provisions of these clauses can be interpreted as such that empower the WEM Board to transfer the function of MIA from NDC to a third party thus separating it from the function of the SSA It was proposed to make wording of these clauses identical M Rachin and WIM's Chief Accountant expressed their opinion that functions of the MFA and SSA should be united into one function and be called Market Financial Operator Besides an opinion was expressed on the behalf of NDC that while uniting the NDC and SEC 'Ukrelektropredacha' into the state enterprise 'Ukrenergo' it would be good to separate from its structure subdivisions which are today engaged in NDC, in servicing WEM and to set up enterprise 'Energomarket' on their basis In this case enterprise "Energomarket" shall be given the functions of Commissioner Market Funds Administrator, Settlement System Administrator Secretariat and conduct of complaints and claims that is enterprise 'Ukrenergo' retains functions of Dispatcher and Network Owner

T Shapovalova Chief Accountant of Energomarket suggested that the scheme of electricity purchase/sale be reviewed on the basis of a commission contract She proposed the scheme by which electricity purchase/sale will be carried out only by Generators and Suppliers The NDC (enterprise 'Energomarket') will service this purchase/sales, determine the wholesale price prepare load schedules, etc that is will fulfill the same function as it does today In this case electricity shall be purchased not in a centralized way through the NDC, but on the basis of multilateral agreement on joint activity Accounting of joint activity will be effected by the NDC WEM's funds administration will be carried out by the Market Banker as a trustee and movement of funds will be managed by WEM's Financial Operator Enterprise "Energomarket" will be responsible for conduct of complaints and claims and operation of Secretariat

Buttsio made conclusions on advantages and shortcomings of the current Agreement and proposed draft changes and amendments, having noted an advantage of the draft in respect of transfer of property right tax payments centralized conduct of claims and complaints

Other NERC s representative noted that any changes in the Agreement can't solve the crisis of payments in the power sector

K Yemelyanov

Draft of 3 August 1998

Changes have been made in the EMA version of 13 July 1998 as follows

Strikethrough - text to be deleted or transferred to relevant Clauses

Highlight - changes and amendments to version of 13 July 1998 also text transferred

The rest text remains unchanged as compared with version of 13 July 1998

Lec printer\L Gorbunova\EMAAgreement\EMArev3Aug 1doc

2 Objectives and Members Obligations

2.1 General Objectives This Agreement defines the rights, obligations and responsibilities of the Market Members, parties to this Agreement, the General Meetings, the Energomarket Board and the procedures for Market Members to join and leave this agreement

2.2 Specific Objectives The objectives of this Agreement are to

2.2.1 provide a set of rules and procedures for the operation of a transparent and fair system of trading electricity which shall

(a) quantify the financial obligations of Suppliers in purchases of electricity from the ESF,

(b) quantify the financial obligations of the ESE in the purchase of

General Provisions

2.1 This Agreement defines the general principles of organization and operation the management system and infrastructure of the WEM, the procedure for market participation the rights, the duties and responsibility of the Parties to this Agreement as well as other matters relevant to the WEM activity

Under this Agreement ~~the NDC shall act as~~ a Commission Agent and shall make a commitment on its behalf and on the instruction of the Generators which act under this Agreement as the Consignors to sell electricity of appropriate standard quality to the Suppliers, the terms the price and the amount thereof being determined by the Rules of the Wholesale Electricity Market by the present Agreement and other Addenda thereto ~~The NDC being a Commission Agent shall not appropriate electricity as its property~~

2.2 The objective of this Agreement

2.2.1 To establish the rules and the procedure for transparent and fair system of business *relationship in* trading electricity which shall

(a) determine the financial obligations of electricity Suppliers in purchasing electricity from the ~~NDC as a~~ Commission Agent

(b) determine the financial and other obligations of the Commission Agent ~~NDC~~ in taking electricity supplies from the Generators under

102

electricity by it from Generators,

(c) quantify the financial obligations of the ESE, Generators and Main and Interstate High Voltage Network Operators as appropriate in respect of the provision of Ancillary Services,

(d) quantify the financial obligations of the ESE in respect of the Main and Interstate High Voltage Network Operators and the recovery of those costs from Market Members, and

(e) ensure the establishment, maintenance and efficient operation of the Market Operating System

2.2.2 cause all Parties to this Agreement to exercise their authority specifically to encourage

- (a) the efficient production of electricity,
- (b) the efficient consumption of electricity,
- (c) the efficient transmission of electricity,

(d) international trade with Externally Interconnected Operators where economic and beneficial to consumers of electric energy in Ukraine, and

(e) optimal investment in new plant and other assets and the refurbishment of existing plants and assets including transmission networks

2.2.3 keep under review and promote the implementation, administration

the commission contract for sales thereof

(c) determine the financial obligations of the Despatch Operator NDC, Generators and an enterprise which is owned by Main and Interstate High Voltage Networks Operators as appropriate in respect of the provision of Ancillary Services,

(d) determine financial obligations of the NDC as Market Funds Administrator and Settlement System Administrator to the enterprises which own Main and Interstate High Voltage Networks and the recovery of the costs thereof by Market Members

(e) ensure the development, establishment, maintenance and efficient operation of the Market Operating System,

(f) determine the financial responsibility of the Parties to this Agreement for the consequences of non-performance of their obligations

~~2.2.2 to be omitted (see Cl 2.2.5)~~

2.2.2 To take into consideration and secure respective balance of interests of existing and potential Generators and Suppliers of electricity as well as of electricity consumers by means of implementation and improvement of the rules, systems and agreements stipulated in the Agreement

~~2.2.3 take into consideration and secure respective balance of interests of existing and potential Generators and Suppliers of electricity as well as of electricity consumers by means of implementation and improvement of the rules systems and agreements stipulated in the Agreement~~

~~2.2.4 to be omitted~~

~~to add the following Clause~~

103

and development of the rules, systems, and agreements referred to in this Agreement in a way which takes into account, and balances, the respective interests of actual and potential Generators and Suppliers and of final consumers of electricity

2.2.4 in the interpretation and implementation of this Agreement, and in the resolution of any disputes arising hereunder, due regards shall be had for the objectives of this Agreement set forth in Clauses and 2.2

2.3 Each Market Member shall be obliged from and after the Effective Date to

2.3.1 sell all output from each of its Generating Blocks (less own requirements at each plant) to the ESE pursuant to this Agreement. Plants of sendout capacity less than 20 MW are not required to sell their output to the ESE, and

2.2.3 The Agreement is also concluded with a view of the following

- (a) Receiving profit by Market participants*
- ~~*(a)-(b) Optimization of the electricity price to be in conformity with cost on the basis of Market participants competition and absence of access restrictions for participation in the WEM,*~~
- ~~*(b)-(c) optimization of generation to improve efficiency of the sector operation and electricity consumption,*~~
- ~~*(c)-(d) creation of conditions for inflow of domestic and foreign investments,*~~
- ~~*(d)-(e) promotion of the power sector stabilization/creation of the financially secured and profitable power sector,*~~
- ~~*(e) receiving profit by Market participants*~~

2.3 Responsibilities of the Parties

Each Market Member shall be obliged from and after the Effective Date

2.3.1 to sell via the ~~NDC~~ as the Commission Agent, under the terms and conditions of the Agreement all the electricity which

- (a) is output from each of its Generating Blocks except electricity*
 - *generated by combined heat power plants which are subdivisions of the Suppliers for consumption in the territory of carrying out licensed activity,*
 - *for own needs of each plant,*
 - *generated at the plant with installed capacity and volumes of sendout below the limit values*

(b) exported to Ukraine from abroad with the aim of selling it in Ukraine

2.3.2 to purchase all electricity in demand from the ~~NDC~~ as the Commission Agent on the terms of this Agreement excluding the electricity traded via the ~~NDC~~ the wholesale market according to C1.2.3.1(a)

104

2.3.2 purchase all energy required by it from the LSE under the terms of this Agreement, **excepting only energy not sold to the ESE pursuant to Clause 2.3.1**

2.4 Exclusions The terms of this Agreement specifically exclude

2.4.1 the existing normative documents which cover the rules of operation of the High Voltage system in Ukraine as amended from time to time

2.4.2 the financial settlement of any financial contracts between Generators and Suppliers Any such contracts shall not conflict with this Agreement in any way

3 **Enrgomarket State Enterprise Responsibilities**

The specific responsibilities of the ESE under this Agreement from and after the Effective Date shall include the following

3.1 The LSE shall purchase all electricity from Generators on the basis of this Agreement, Bilateral Contracts, and on terms and conditions agreed with Externally Interconnected Operators

3.2 The ESE shall be responsible for the conduct, administration,

To add

2.3.3 to provide electrical networks for electricity transmission on the terms of this Agreement

2.4 Exclusions The terms of this Agreement specifically exclude

2.4.1 the existing normative documents *regarding* the rules of operation of High Voltage System in Ukraine as amended from time to time

2.4.2 financial settlements between electricity Generators and electricity Suppliers pursuant to any other agreements The terms of such agreements shall not contradict this Agreement

3 ~~NDC's~~ **Commission Agent's Responsibilities and Rights**

The specific responsibilities of the ~~NDC~~ **Commission Agent's** under this Agreement from and after the Effective Date shall include the following

3.1 purchase of electricity from Generators on a commission basis under this Agreement

~~3.2 estimation and calculation of payments to Generators and~~

501

estimation, and calculation of payments to Generators

3.3 Purchase of Main and Interstate High Voltage Network services on behalf of those receiving such services. The purchase of Main and Interstate High Voltage Network Services shall be on the principle of Economic Purchase

3.3.1 The ESE shall enter into High Voltage Service Agreements with all owners of Main and Interstate High Voltage Network facilities in Ukraine. Each High Voltage Service Agreement shall define unambiguously the moneys which The ESE shall pay to the owners of the Main and Interstate High Voltage Network facilities for their use and any Connection Charges to be made in respect of individual Market Members and how the costs of such agreements shall be recovered from Market Members, and

3.3.2 The ESE shall recover the costs of Connection Charges made in respect of any individual Market Member's connections to each Main and Interstate High Voltage Network through a separate charge made directly to the relevant Market Member. The method for determining the charge for connection shall be agreed with the NERC. Such charges shall be based on the Connection Register maintained by the relevant Main and Interstate High Voltage Network Operators as defined in its High Voltage Service Agreement

~~Supplier~~

~~3.3 indemnification of Main and Interstate Main and Interstate High Voltage Network service costs under this Agreement and Bilateral Agreements to be made from the WEM's account~~

~~3.3.1 The NDC shall enter into High Voltage Service Agreements with enterprises which own Main and Interstate High Voltage Networks in Ukraine. Each specific High Voltage Service Agreement shall define unambiguously amounts which NDC shall pay to such enterprises from the WEM's account for the use of the networks. Charges for connection of each individual Market Member shall be paid directly by this Member to the Networks' owner. The procedure for calculating the size of the above payments shall be approved by the NERC.~~

~~3.3.2 to be deleted (see Clause 3.3.1)~~

~~To be supplemented as follows~~

~~3.3¹ If Suppliers fail to perform their obligations, Generators shall bind under this Agreement the Commission Agent NDC to collect and provide the required proofs, and to bring a claim and/or a suit against the Suppliers pursuant to the effective legislation. The Commission Agent and such Suppliers shall reconcile the amounts of debt for each month and draw up an appropriate reconciliation statement.~~

~~3.3² In purchasing/selling the electricity from or to the Supplier, the NDC shall be entitled with the following rights:~~

~~to demand payment from the Supplier for the electricity received to the WEM's account,
to terminate sales of electricity to Suppliers in the event of their non-~~

3.4 The ESL will be responsible for

3.4.1 the purchase of Ancillary Services pursuant to the Market Rules

3.4.2 the conduct of all trade with Externally Interconnected Operators
In carrying out trade with Externally Interconnected Operators the ESE shall ensure that it is conducted in accordance with the principle of Economic Purchase

3.5 Sales of Electricity to Suppliers

3.5.1 The ESL will sell all electricity to Suppliers necessary to meet their load demands defined as follows

(a) for Independent Electricity Suppliers the direct metered hourly load of their consumers after adjustment for losses at low voltage of each relevant local network operator

(b) for Local Electricity Suppliers, net hourly metered load after deducting any purchases made from plant of less than 20MW and deducting any Consumer Load served by Independent Electricity Suppliers in that territory

3.5.2 The ESL shall sell energy according to the mechanism described in the Agreement to Suppliers at the Supplier Connection Point incorporating all the ESL's justified costs related to their licensed activities, Ancillary Service and Main and Interstate High Voltage Network Service provision

payment for the electricity received

~~3.1 The VDC shall be also responsible for~~

~~3.1.1 the purchase of Ancillary Services pursuant to the Market Rules~~

~~3.1.2 the conduct of all trade with Externally Interconnected Operators. In carrying out trade with Externally Interconnected Operators the VDC shall ensure that it is conducted in accordance with the principle of Economic Purchase;~~

~~3.5.3.2 sales of electricity to Suppliers~~

~~3.5.1.3.2.1 The VDC, as the Commission Agent shall sell all electricity to Suppliers to meet their demand only on the basis of their orders financially secured the procedure of executing and submitting of which is specified in the Market Rules~~

(a) for Independent Electricity Suppliers at the wholesale market price to be determined by the Market Rules

(b) for Local Electricity Suppliers (- in the amount of net hourly metered supplies- to be deducted) at the wholesale market price to be determined by the Market Rules less electricity supplied by Independent Suppliers

~~3.5.2. The VDC~~ *3.2.2 The Commission Agent shall sell electricity at the grid supply points of the Supplier taking into account all ~~NDC's~~ justified costs of the Commission Agent, Despatch Operator, Market Funds Administrator, Settlement System Administrator related to the licensed activity Ancillary Services and Main and Interstate High Voltage Network Services in compliance with the mechanism described in the Agreement*

107

3.5.3 The ISE shall be responsible for collection of payments by Suppliers in accordance with the Market Funds Administration Procedure

~~3.3.2 3.2.3 In purchasing, selling the electricity from or to the Supplier, the VDC Commission Agent shall be entitled under this Agreement with the following rights:~~

- to demand payment from the Supplier for the electricity received to the WEM's account
- to terminate sales of electricity to Suppliers in the event of their non-payment for the electricity received

~~3.3.3 3.3 If Suppliers fail to perform their obligations, Generators shall bind under this Agreement, the Commission Agent to collect and provide the required proofs and to bring a claim and/or a suit against the Suppliers pursuant to the effective legislation. The Commission Agent and such Suppliers shall reconcile the amounts of debts for each month and draw up an appropriate reconciliation statement.~~

~~3.3.3 The VDC shall make provisions for collection of payments from Electricity Suppliers for purchased electricity in the amounts specified in Clause 2.3.1 (b) 3.5.1 to be then transferred to the account of the wholesale market and then distributed in compliance with the Market Funds Administration Procedure.~~
~~3.6 the planning and promotion of development of Main and Interstate High Voltage Networks and conclusion of appropriate Agreements.~~

3.6 Planning of the Main and Interstate High Voltage Network and additional High Voltage Service Agreements, in particular

(a) the annual development of the Ten Year Statement, setting out the planned development of the Main and Interstate High Voltage Network over the next following ten years according to the provisions of the High Voltage System Operating Guidelines, and

~~3.6.1 the annual development and adjustment of the Ten Year Statement setting out the planned development of the Main and Interstate High Voltage Networks and its annual adjustment over the next 10 years according to the provisions of the High Voltage System Operating Guideline.~~

(b) negotiating and entering into High Voltage Service Agreements for the construction of any necessary additional Main and Interstate High Voltage Network Operator assets. The ISE shall enter into any such High Voltage Service Agreement in accordance with the principles of Economic Purchase.

~~3.6.2 the short-term planning of the production and reserving of the capacity, prompt adjustment of the electricity production and supply in Ukraine and repaying of Generators costs of maintenance of~~

3.7 The ESE shall agree the technical specification for any new connections to the existing Main and Interstate High Voltage Network

~~relevant third~~

~~3.7 The NDC shall agree the technical specification for any new connections to the existing Main and Interstate High Voltage Networks~~

~~3.8 The NDC shall present at the request of the Party to the Agreement concerned information on the availability and amount of debtor and creditor indebtedness for a month (or other period of time) and from the start of the year~~

PART II - MARKET COMPONENTS

4 Market Membership

4.1 Conditions of Market Membership Each Market Member agrees to abide by all the terms of this Agreement and the Market Rules relevant to that Market Member

4.2 Rules for admission of new Market Members

4.2.1 Candidates for market membership shall apply to the Board in a form specified by the Board. The Board shall not unduly discriminate against any candidate in considering its application to become a Market Member

4.2.2 Any candidate seeking to become a Market Member shall demonstrate to the Board that it meets the following criteria

(a) the candidate shall possess a License for the activity in which it wishes to become a Market Member,

PART II ORGANISATIONAL AND LEGAL FRAMEWORK OF THE WHOLESALE ELECTRICITY MARKET

4 Market Membership

4.1 *Conditions of Market Membership*
Each Market Member agrees to abide by all the terms of this Agreement and the Market Rules

4.2 Rules for admission of new Market Members

4.2.1 Candidates for market membership shall submit to the Board their applications *and attachments to them* in a form specified by the Board. The Board shall not unduly discriminate against any candidate in considering its application to become a Market Member

4.2.2 Any candidate seeking to become a Market Member shall demonstrate to the Board that it meets the following criteria

(a) *the candidate shall possess a License for the activity in which it wishes to become a Market Member,*

(b) the candidate shall have provided all reasonably required information to the Board and that such information is correct in all material respects,

(c) the candidate is registered as a subject of entrepreneurial activity as set by existing legislation,

(d) that with effect from the date of its admission as a Party it accedes to the Agreement in accordance with its terms, and

(e) that such a candidate satisfies such other requirements (if any) as the Board may from time to time prescribe (whether before or after receipt of the candidate's application), provided that such other requirements have first been notified to the NERC and the NERC has not within three months (or such shorter period as the NERC may in any case approve) after receipt of such notification notified the Board that it disapproves of them

4.2.3 Within 30 days of the receipt of all requested information the Board shall notify the candidate that either

(a) that the candidate is to be admitted as a Party, in which event the provisions of Section shall apply. The Board shall notify the candidate of any Advance Payment requirements which shall be a condition of its becoming a Supplier Market Member, or

(b) its application has been rejected including a written statement of which of the criteria in 4.2.2 above formed the basis of that rejection

4.2.4 If the candidate is accepted the Secretariat shall prepare a Membership Accession Agreement of the standardized form set out in Schedule 6. The candidate shall have 28 days in which to sign the Membership Accession Agreement after which time it shall be deemed to

(b) the candidate shall in due time have provided all reasonably required information to the Board and that such information is full correct and objective

~~(c) to be deleted~~

~~(d) (c) that with effect from the date of its admission as a Market Member it accedes to the Agreement in accordance with its terms, and~~

~~(e) (d) that such a candidate satisfies such other requirements (if any) as the Board may from time to time prescribe (whether before or after receipt of the candidate's application), provided that such other requirements have first been notified to the NERC and the NERC has not within three months (or such shorter period as the NERC may in any case approve) after receipt of such notification notified the Board that it disapproves of them~~

4.2.3 Within 30 days of the receipt of all requested information the Board shall notify the *applicant* that either

(a) *its application for the Market Membership has been satisfied*, in which event the provisions of Clause 4.1 shall apply. The Board shall notify the *applicant* of any Advance Payment requirements which shall be a condition of its becoming a Supplier Market Member, or

(b) its application has been rejected including a written statement of which of the criteria in 4.2.2 above formed the basis of that rejection

4.2.4 *If its application for the Market Membership is satisfied, the Secretariat shall present to the applicant this Agreement which shall be signed by the applicant within two weeks from the date when the Board has made a decision to admit the applicant as a Market Member. The authorized representative of the applicant shall sign this Agreement within the term specified in this paragraph and shall affix the*

have lapsed

4.2.5 In the event of any dispute over the Board's refusal to admit a New Member (although not on the terms of the Membership Accession Agreement), a reference would be made to the NERC, who will make a decision

4.2.6 Existing Market Members shall undertake the process in 4.2.2, 4.2.3 and 4.2.4 above when entering into a licensed activity which is different from the basis of their existing Market Membership. However, the process shall be restricted only to those elements which have changed since the commencement of their existing Market Membership

4.2.7 A new Market Member which is undertaking new activity shall be allocated zero votes until there is sufficient data for votes to be allocated according to Section 4.4

4.2.8 A new Market Member shall choose which of the Voting Directors within its Class shall represent its interests at the Board Meetings

4.3 Rules for Market Member Resignation

enterprise's seal without any terms and reservations, after which time it shall assume the rights and obligations as stipulated in this Agreement

4.2.5 In the event of any dispute over the Board's refusal to admit a New Member, a reference would be made to the NERC, who will make a decision. *The NERC's decision in this respect which meets the requirements of the applicant as to its admission as a Market Member shall be binding to the Board*

4.2.6 *When entering into a licensed activity which is different from the basis of its Market Membership the Member shall undertake the process in 4.2.2, 4.2.3 and 4.2.4 above*

In this event any such Member which is undertaking new activity shall be allocated zero votes until there is sufficient data for votes to be allocated according to Clause 4.4

~~4.2.7 to be deleted (see Clause 4.2.6)~~

~~4.2.8~~ 4.2.7 *A new Market Member shall choose which of the Voting Directors within its Class shall represent its interests at the Board Meetings, and shall notify the Secretariat about it in writing within seven days after signing this Agreement*

4.3 Rules for Market Member Withdrawal

A Market Member may withdraw from Market Membership

- *voluntarily at one's own desire,*
- *compulsorily in the event of imposition of sanctions on it due to its failure to fulfill its obligations under the Agreement,*
- *in the event when this Agreement becomes ineffective*

4.3.1 *Voluntary Withdrawal*

A Market Participant shall be entitled at any time to withdraw from

4.3.1 A Market Member shall be entitled at any time to resign from Market Membership by delivering a Resignation Notice to the Secretariat of the Board and such resignation shall take effect 28 days after receipt of the Resignation Notice by the Secretariat

4.3.2 A Market Member may not resign from Market Membership (and any Resignation Notice delivered pursuant to Clause 4.3.1 shall be ineffective) unless as at the date its resignation would otherwise become effective all sums due from such Market Member under this Agreement have been paid in full including any administrative costs incurred as a result of the withdrawal of such a Market Member

4.3.3 Without prejudice to any other clauses in this Agreement, at the same time as a person's resignation as a Market Member becomes effective under Section such person shall also cease automatically to be a Party. The Party shall be released and discharged from its obligations and liabilities under this Agreement as a Market Member, and each of the other Parties shall be released and discharged from its obligations and liabilities under this Agreement to such a person

Market Participation by delivering a Withdrawal Notice to the Secretariat of the Board. Such withdrawal shall take effect 28 days after receipt of the Withdrawal Notice by the Secretariat. The Secretariat shall notify of such Withdrawal all Parties to this Agreement and relevant governmental agencies

~~4.3.2 to be deleted~~

~~4.3.3 to be omitted~~

~~To add~~

~~4.3.2~~ *4.3.2 In case a Participant withdraws from the WEM and terminates the present Agreement it shall retain its obligations to the other Parties to the Agreement as well as obligations of the other Member at the moment of secession from the WEM. Such obligations shall remain effective until they are met. The rights of the Member which has left the WEM related to electricity generation, supply and purchasing from the market shall cease*

~~4.3.3~~ *4.3.3 Compulsory Withdrawal (this Clause has been prepared based on Clause 18)*

(a) A Market Member shall be in default of this Agreement and may be expelled from Market Membership and shall be subject to sanctions as stipulated in this Agreement or present law if

- it has failed to fulfill any financial obligations including the provision or replenishment of the compulsory Advance Payment,
- it has failed to pay any compulsory payment within five working days after the date determined under this Agreement,
- it has failed to comply with any other terms of this Agreement and has not remedied them within a period of time as determined by the Board

115

(b) On the instruction of the Board, the NDC Commission Agent shall serve a Default Notice on *such Market Member*

(c) If the NDC Commission Agent serves a Default Notice on a Market Member and the matter on which the Default Notice was served has not been resolved within five calendar days of the issue of that notice, then the Board shall be entitled to take precautionary measures such as *to issue an instruction*

- to suspend selling electricity to the Defaulting Market Member,
- to disconnect the entire load of the Defaulting Market Participant if connected to ~~High Voltage or Interconnection~~ the Main or Interstate High Voltage Network,
- to disconnect the relevant part of the load if such default relates to a specific consumer or a group of consumers

(d) Also the Board shall be entitled to instruct the Main and Interstate High Voltage Network Operator under the terms of the High Voltage System Operating Guidelines to take the necessary steps to implement the above instructions of the Board

(e) The Board shall have the right to make a decision to expel the Defaulting Market Participant from Market Participation and dissolve this Agreement with it provided that the Defaulting Market Participant has not taken any steps to remedy the situation that arose

(f) The *compulsory withdrawal* of the Defaulting Market Member from Market Membership shall become effective after *the relevant Board decision* has been agreed upon with the NERC. *Such withdrawal shall not remove any obligations of the Defaulting Market Member to any other Parties to this Agreement and any obligations of such other Parties to the Defaulting Market Member accrued prior to its withdrawal. Any such obligations shall remain in*

force until they are fulfilled. The rights of the Market Member expelled from Market Membership in respect of electricity generation, supply to or purchase from the Market shall be terminated

(g) Any suspension or termination of a Market Participant under the terms of this *clause* shall result in the suspension of its voting rights under this Agreement

(h) Market Membership shall be terminated as a result of promulgation of any law which terminates this Agreement or by consent of all Parties to this Agreement

4.4 Votes

Weighted Votes shall be allocated to Market Members as follows

4.4 Votes Weighted Votes shall be allocated to Market Members as follows

(a) each Market Member which is a Generator shall be entitled in that capacity to one vote for each GWh of Metered Generation sold to the market as measured as the average of the four most recent quarters, or the average of those quarters for which complete data is available if less than four,

(b) each Market Member which is a Supplier shall be entitled in that capacity to such number of votes as is equal to the Supplier's total GWh of Metered Demand purchased from the market as measured as the average of the four most recent quarters, or the average of those quarters for which complete data is available if less than four,

4.4.1 each Market Member which is a Generator shall be entitled in that capacity to one vote for each GWh of Metered Generation sold to the market as measured as the average of the four most recent quarters, or the average of those quarters for which complete data is available if less than four,

4.4.2 each Market Member which is a Supplier shall be entitled in that capacity to one vote for each GWh of Metered Demand purchased from the market as measured as the average of the four most recent quarters, or the average of those quarters for which complete data is available if less than four,

4.4.3 if the votes determined in 4.4.1 or 4.4.2 are not whole numbers, values less than 0.5 shall be rounded down and values greater than or equal to 0.5 rounded up to the next whole number,

4.4.4 Weighted Votes shall be re-calculated by the Secretariat five business days before each General Meeting based on the most current

(c) If the votes determined in 4.4 (a) or (b) are not whole numbers values less than 0.5 shall be rounded down and values greater than or equal to 0.5 rounded up to the next whole number,

(d) Weighted Votes shall be re-calculated by the Secretariat five business days before each General Meeting based on the most current available data.

available data.

~~As worded by the NDC~~

~~1.1 Each Market Member shall be given the number of votes at General Meetings as follows:~~

~~(a) Generators and other Consignors shall be given a thousand votes to be allocated between them in proportion to amounts of electricity supplied by them on the WEM through Delivery Points 1 for the last twelve months for which complete data are available as of the date of counting the number of votes.~~

~~(b) Suppliers shall be given a thousand votes to be allocated between them in proportion to amounts of electricity supplied by them from the WEM through Delivery Points 2 for the last twelve months for which complete data are available as of the date of counting the number of votes.~~

~~(c) If the votes determined in 5.6.2 (a) or 5.6.2 (b) are not whole numbers, values less than 0.5 shall be rounded down and values greater than or equal to 0.5 rounded up to the next whole number.~~

~~(d) The Parties to the Agreement which are not the Market Members shall not take part in voting at General Meetings.~~

5 General Meetings

5.1 At each Annual General Meeting, the Market Members shall be required to consider and resolve the issues listed below. All documents for discussion at the General Meeting shall be issued to all Market members at least 10 working days before the date of the General Meeting. Market Members should consider the following issues:

5 General Meeting

5.1 At the General Meeting each Market Member shall exercise its rights regarding participation in decision making on the issues of the WEM operation receiving information on Market operation. The Parties to the Agreement shall consider the decisions of the General Meeting made in compliance with the established order and within its authority to be obligatory for all the Parties to this Agreement.

All General Meetings of Market Members except the Annual General Meeting shall be considered as Extraordinary General Meetings. The Annual General Meeting shall be held within 4 weeks after 12 calendar months from the date of the previous Annual General Meeting.

5 1 1 a report prepared by the Board on the WEM and its operation during the immediately preceding year, which report shall include

- (a) a review of the operation of the Market Operating System,
- (b) a review of the operation of the Settlements System Administration and the Market Funds Administration,
- (c) a review of the activities of the Despatch Operator,
- (d) a review of the Settlement System Administrator and Market Funds Administrator's budgets,
- (e) such other information or matters regarding the operation of the WEM as the Board shall consider appropriate, including any proposed revision to this Agreement
- (f) any recommendation which the Board wishes to make which would be necessary or appropriate to give effect to any reported recommendation in (a), (b), (d),

5 1 2 a report prepared by the Market Auditor on the Market Rules and their operation during the immediately preceding period, which report shall include

- (a) a summary of the audits, reviews, tests and/or checks carried out by the Market Auditor on the Market Operating System,

Meeting

The following issues shall belong to the authority of General Meeting

5 1 1¹ introduction of changes and amendments to the WEM Agreement and to Schedules thereof,

5 1 1 approval of a report prepared by the Board on the WEM operation during the preceding year which shall particularly include

- (a) a review of the operation of the Market Operating System,
- (b) a review of the operation of the Settlements System Administrator and the Market Funds Administrator,
- (c) a review of the activities of the Despatch Operator pursuant to this Agreement,
- (d) a review of the Settlement System Administrator and Market Funds Administrator's budgets,
- (e) such other information or matters regarding the operation of the WEM as the Board shall consider appropriate, including any proposed revision of this Agreement,
- (f) any recommendation which the Board wishes to make which would be necessary or appropriate to give effect to any reported recommendation in (a), (b), (d),

5 1 2 approval of the report prepared by the Market Auditor which shall include

- (a) a summary of the audits, reviews, tests and/or *inspections* carried

9/1

(b) any recommendation which the Market Auditor wishes to make regarding the Settlement Procedures, and the Market Funds Administration Procedure,

(c) a report on the activities of the Despatch Operator, and

(d) such other information or matters which the Board may reasonably require or the Market Auditor shall consider appropriate

5 1 3 the election of Board Voting Directors pursuant to Clause 6 2 2, and

5 1 4 such matters as any Market Member present in person may wish to raise at such meeting, notice of which has been given to the Secretariat no later than seven days before the date of such meeting. However, failure by a Market Member to notify shall not prejudice the right of any Market Member to ask questions at such a meeting on any matter

5 2 General Meetings

The purpose of General Meetings and the matters to be decided at them shall be as set out in Clause 5 1. The following conditions shall apply in respect of such General Meetings

5 2 1 All business of Market Members in relation to this Agreement shall be transacted at General Meetings of Market Members. Market Members shall be entitled to Vote on those decisions stipulated in Clause 5 1

5 2 2 Calling meetings

All General Meetings of Market Members shall be called by 21 days' notice in writing

5 2 3 Notice of the General Meeting and an outline description of its proceedings shall be sent to all Market Members at that time. The Board

out by the Market Auditor on the Market Operating System,

(b) any recommendation which the Market Auditor wishes to make regarding the Settlement Procedures, and the Market Funds Administration Procedure,

(c) a report on the activities of the Despatch Operator, and

(d) such other information or matters which the Board may reasonably require or the Market Auditor shall consider appropriate

5 1 3 the election of Board Voting Directors pursuant to Clause 6 2 2,

5 1 4 such matters as any *Party to the Agreement* may wish to raise at the meeting, *written* notice of which has been given to the Secretariat *no later than (30) ___ days* before the date of such meeting. *Absence of such written notice shall not limit the rights of the Parties to this Agreement to raise any questions at the meeting*

5 2 Rules of General Meeting Procedure

The purpose of General Meetings and the matters to be decided at them shall be as set out in Clause 5 1

5 2 1 *All the documents to be discussed at the General Meeting shall be sent to all the Parties to the Agreement not later than 10 working days before the date of the General Meeting*

5 2 2 Calling meetings

All General Meetings of *the Parties to the Agreement* shall be called by (21)___ days' notice in writing

5 2 3 *Notice on time and place of the General Meeting as well as the agenda shall be sent by the Secretariat on the instructions of the*

17

shall inform the NLRC and its advisors of the dates of and agenda for the General Meeting. Representatives of the NERC shall also have the right to attend General Meetings.

5.2.4 Extraordinary General Meetings may be convened either

(a) by a request from two or more members of the Energomarket Board, or

(b) by the Board, upon receipt of a request from Market Members holding together at the date of the request not less than 10 per cent of the Total Votes of all Market Members.

5.2.5 All General Meetings of Market Members other than Annual General Meetings shall be Extraordinary General Meetings. Each Annual General Meeting shall be held no later than 4 weeks after 12 calendar months following the previous Annual General Meeting.

5.2.6 Quorum

No business shall be transacted at any General Meeting of Market Members unless a quorum of Market Members is present at the time when

Market Board to the Parties to the Agreement, the NERC, the Minenergo, the Antimonopoly Committee. At the discretion of the Board, the Cabinet of Ministers, the Ministry of Economy, the Ministry of Finance, the Ministry of Social Protection and others may be informed about holding the General Meeting.

5.2.4 Extraordinary General Meetings may be convened either

(a) by request of Voting Directors which have not less than 20 % of the total votes or

(b) by the Board, upon receipt of a request from Market Members holding together at the date of the request not less than 10 per cent of the Total Votes of all Market Members. *In this case the Board shall not refuse to convene the meeting.*

~~5.2.5 to be omitted (see C15.1)~~

(c) time of calling Extraordinary General Meetings and sending required notices shall be reduced one thirds of the time stipulated in this Agreement.

To add C15.2⁺

~~5.2⁺~~

Agenda

~~5.2⁺~~ 5.2.5 *Proposals regarding the agenda*

All Market Members as well as state bodies, with which the Agreement shall be agreed on, shall have the right to put forward their proposals regarding the agenda not later than ___ calendar days before the date of the General Meeting. The agenda shall be approved by the Market Board not later than ___ calendar days before the date of the General Meeting, sent to the Market Members and published in mass media. Decisions on issues not included into the agenda shall not be taken.

5.2.6 Quorum

the meeting proceeds to business. A quorum consists of a meeting of Market Members present in person renting

(a) 67 per cent or more of the aggregate number of Weighted Votes to which all Generators are entitled under Clause 5.2.9 and

(b) 67 per cent or more of the aggregate number of Weighted Votes to which all Suppliers are entitled under Clause 5.2.9

5.2.7 Lack of quorum. If within half an hour from the time appointed for the General Meeting a quorum is not present, the meeting shall stand adjourned to the same day in the next week at the same time and place or to such other day and at such other time and place as the Board shall determine. All Market Members shall be notified of such an adjournment.

5.2.8 The Board Chairman shall be the Chairman of all General Meetings. The ISI shall undertake the role of Secretariat for such meetings.

5.2.9 Voting. All votes at General Meetings shall be as set out in Section 4.4.

Quorum shall be made up by the Market Members present at the General Meeting in the following proportion

(a) 67 per cent or more of the aggregate number of Weighted Votes to which all Generators are entitled under Clause 5.2.9, and

(b) 67 per cent or more of the aggregate number of Weighted Votes to which all Suppliers are entitled under Clause 5.2.9

5.2.7 Lack of quorum

If within *an hour* from the time appointed for the General Meeting a quorum is not present, the meeting shall stand adjourned to the same day in the next week, at the same time and place or to such other day and at such other time and place as the Board shall determine. All Market Members shall be notified of such an adjournment.

5.2.8 The Board Chairman shall be the Chairman of all General Meetings. ~~the NDC shall undertake the role of Secretariat for such meetings.~~

After opening the General Meeting the Parties to the Agreement shall elect the Presidium, Vote Counting Commission and Drafting Commission

5.2.9 Voting Procedure. All votes at General Meetings shall be as set out in Cl. 4.4.

5.2.9¹ Electing the Voting Director

A candidate for a position of the Voting Director shall be a person included into the list of candidates which are proposed by the Market Members. Each of the Market Members can propose any representative of its Class as a candidate to the Market Board. In order to enlist the candidates the Market Members shall submit their proposals to the Board Secretariat ___ days before the General Meeting. The number of candidates for the position of the Voting Director which may be proposed by a Member shall not be

restricted

The formed list shall be approved at the General Meeting

5 2 9² Before deciding on the candidates in each Class there can be held organizational or administrative arrangements meetings conferences, etc at the discretion of the Market Members

5 2 9³ Formatting and distribution of bulletins

The Secretariat shall prepare two kinds of bulletins i.e. a separate bulletin for each Class and shall submit them to the Vote Counting Commission at the meeting

To facilitate voting procedure the bulletins for electing the Voting Director of each Class shall be of different colors

5 2 9⁴ The bulletins shall include the following data

- the full name of the Market Member which takes part in voting*
- the number of votes the Market Member holds*
- space for inserting the name and surname of the candidate for the Voting Director*

5 2 9⁵ Each of the Market Member which holds weighted votes (vote) in its Class shall get a bulletin from the Vote Counting Commission which shall be respectively noted in the Registration List

The Market Member entitled to voting in two Classes shall get two bulletins for each class separately

The Member upon receiving the voting bulletins shall be obliged to check the data noted in them (the name of the member and the number of weighted votes it holds) In case of discrepancy the Market Member shall inform the Vote Counting Commission without delay

5 2 9⁶ The procedure for filling in the bulletins

Each of the Market Members holding at least one vote shall get the

inscribed bulletin which it shall fill in as follows

- from the submitted list of candidates it shall write down the name of the candidate it shall propose to the position of the Voting Director. The participant shall have the right to note in the bulletin only one candidate for which it shall vote. The split of votes between several candidates shall not be allowed.*

Filled in bulletins separately for each class shall be placed into an appropriate ballot box. A bulletin violating the terms set above shall be considered invalid.

5.2.9 Vote counting procedure

Vote counting shall be done by the Vote Counting Commission. The Market Board shall be comprised of five Voting Directors from the Generators Class and five Voting Directors from the Suppliers Class. The first five candidates which received the majority of voices out of the total number of candidates specified in bulletins of their respective Class shall be deemed elected Voting Directors with the term of service of one year. This shall be recorded by the Secretariat in separate minutes.

5.2.9⁸ The case of a tie

In case if two or more candidates get the same number of votes and this brings about the possibility for more than five candidates to constitute the Board there shall be additional voting for such candidates.

If less than five Voting Directors on any class are elected according to voting results the repeated voting shall be held. The repeated voting shall be arranged in compliance with the same rules as the basic voting.

5.2.10 Any Market Member entitled to attend and vote at any General Meeting of Market Members shall be entitled to appoint another person (whether a Market Member or not) as its proxy to attend, speak and vote in its place. Such a proxy shall be appointed for the duration of one General Meeting only and shall be valid only if notified to the Secretariat at least 2 days prior to such General Meeting. The Secretariat shall have the right to check the authenticity of any proxy. Market Members may make written notification of their voting intentions to the Secretariat in advance of the General Meeting as an alternative to appointing another person as proxy.

5.3 Appeals

A Market Member shall be permitted to appeal to the NERC in respect of any decision made at a General Meeting within 30 days of such a decision.

5.2.10 Any Market Member entitled to attend and vote at any General Meeting of Market Members shall be entitled to appoint another person (whether a Market Member or not) as its proxy to attend, speak and vote in its place. Such a proxy shall be appointed for the duration of

and if Market Members with aggregate Weighted Votes of more than 10 per cent of Total Votes agree to such an Appeal Those Market Members who wish to appeal shall notify the Board and the NERC in writing In considering an appeal of a proposed change to the Agreement the NERC shall have the right only to disapprove changes to the Agreement which have been subject to such an appeal The decision of the NERC on such an Appeal shall be final and it shall direct the Board and Market Members to act in accordance with that decision NERC will inform the Board and Market Members about their obligations in respect of any decision made as a result of an appeal within ten days

5.4 Decisions

Voting decisions at a General Meeting shall be on the basis of a simple majority of the Weighted Votes of those present In addition in relation to issues pursuant to 5.1.1 (b) and (f), 5.1.2 (b) and 5.1.4 (including proposed changes to the Energomarket Members Agreement) where Market Members' approval is required, a majority of 75 per cent of all Weighted Votes cast shall be required to approve any voting decision In the event of a tie the relevant matter for decision would be deferred until the next following General Meeting

one General Meeting only and shall be valid only if notified to the Secretariat at least 2 days prior to such General Meeting The Secretariat shall have the right to check the authenticity of any proxy Market Members may make written notification of their voting intentions to the Secretariat in advance of the General Meeting as an alternative to appointing another person as proxy

5.3 Appeals to the NERC

A Market Member shall be permitted to appeal to the NERC *within its authority* in respect of any decision made at a General Meeting, within 30 days of such a decision and if Market Members with aggregate Weighted Votes of more than 10 per cent of Total Votes agree to such an Appeal Those Market Participants who wish to appeal shall notify the Board and the NERC in writing In considering an appeal on a proposed change to the Agreement, the NERC shall have the right only to disapprove changes to the Agreement which have been subject to such an appeal The decision of the NERC on such an Appeal shall be final and it shall direct the Board and Market Members to act in accordance with that decision NERC will inform the Board and Market Members about their obligations in respect of any decision made as a result of an appeal within ten days

The appeals on issues which are beyond the authority of the NLRC shall be directed according to the current legislation

5.4 Decisions

Voting decisions at a General Meeting shall be on the basis of a simple majority of the Weighted Votes of those present In addition, in relation to issues pursuant to 5.1.1¹, 5.1.1 (b) and (f), 5.1.2 (b) and 5.1.4 where Market Members' approval is required, a majority of 75 per cent of all Weighted Votes cast shall be required to approve any voting decision *In the event of a tie the decisions relevant to matters stipulated by 5.1.1 (b) and (f), 5.1.2 (b) and 5.1.4 would be deferred until the next following General Meeting*

122

5.5 For a period of 1 year from the Effective Date of this Agreement it shall not be necessary to obtain Market Member approval of changes to the Schedules 2-8 of this Agreement. For the time that this Clause has effect it shall take pre-eminence over the relevant parts of Clause 5.4

5.4.1 In the event of a tie on decision on matters stipulated in Cl 5.1.1.1 due to the lack of quorum at the General Meeting, the voting of the Participants which failed to attend shall be held in written form. Such voting shall be held by written poll by the Secretariat among those participants absent from the General Meeting within the term of five days after the General Meeting. This may be done by means of fax communication with consequent confirmation of fax copies by original documents on voting. The Secretariat shall send the documents received while doing written poll to the Vote Counting Commission. The results of written voting shall be added by the Vote Counting Commission to the voting results at the General Meeting. If, while considering total votes 75 per cent of all Weighted Votes are for taking a decision on adopting changes and amendments to this Agreement the decision shall be considered adopted.

5.5 For a period of 1 year from the Effective Date of Changes and Amendments to this Agreement it shall not be necessary to obtain Market Members approval of changes to the Schedules 2-8 of this Agreement. For the time that this Clause has effect it shall take pre-eminence over the relevant parts of Clause 5.4

6 The Board

6.1 The Board shall serve as a representative of the Parties in the administration of this Agreement. It shall at all times conduct its affairs to include the objectives in Section 2. The Members have not hereby constituted a separate legal entity or association and the Board has no corresponding separate authority.

6.2 Constitution of the Board. The Board shall be constituted in the following manner:

6 The Board

6.1 The Board shall serve as a representative of the Parties in administration of this Agreement. *The Board Members have not hereby constituted a separate legal entity or association. The Board functions are determined in this Section.*

6.2 *Board Constitution Procedure*

6 2 1 There shall be 10 Voting Directors comprising

- (a) 5 Directors drawn from Generators,
- (b) 5 Directors drawn from Suppliers

6 2 1 The Board shall incorporate 10 Voting Directors - Chiefs of enterprises represented in the Board

- (a) 5 Directors drawn from Generators,
- (b) 5 Directors drawn from Suppliers

The Voting Directors shall be elected pursuant to Clauses 5 2 9 - 5 2 10 of this Agreement

6 2 2 The elections of Voting Directors shall be conducted as follows
(a) The Secretariat of the Board shall receive nominations from Market Members of candidates for the role of Voting Director within 5 days of the Annual General Meeting,

~~To be deleted~~
~~To be deleted~~

(b) At the Annual General Meeting Market Members shall cast en bloc their Weighted Votes for the nominee of their choice within their Class. The nominees recording the five highest votes in each Class shall be elected as Voting Directors to serve for a period of one year. In the event of a tie the nominees recording the five highest votes in that Class shall proceed to a further round until there are only five successful nominees,

~~To be deleted~~

(c) Market Members shall select one of the successful Voting Directors within their Class to act as their representative by notification in writing to the Secretariat. These Market Members shall constitute the Voting Director's Constituency and the Voting Director shall be required to represent their interests at Board Meetings. Market Members shall be free to change their Constituency at any time by notification in writing to the Secretariat.

6 2 2 Each Market Member shall commit one of the Voting Directors of its Class to represent its interests at meetings of the Board by notification in writing to the Secretariat. The Market Members can pass to the Group of other Voting Director of its Class by obligatory notification in writing to the Board Secretariat

6 2 3 Each Voting Director shall have the power to appoint in writing any person (who may be an existing Voting Director) to be his alternate and may at his discretion remove an alternate Voting Director so

6 2 3 Each Voting Director shall have the right
• no more than three times in succession to appoint any person as his representative in the Board by investing him with a power of attorney

124

appointed Voting Directors may only appoint an alternate 3 times during the year Any such alternate shall have the rights of the Voting Director at a Board Meeting

6 2 4 The Board shall include the following Non-Voting Directors

- (a) 1 representative of the ESE,
- (b) 1 representative from the NERC,
- (c) 1 representative of the Market Auditor,
- (d) 1 representative from the National Electricity Company,
- (e) 1 representative from the Ministry of Energy and Electrification,
- (f) 1 representative from GOSKOMATOM,
- (g) For a period of 1 year from the Effective Date of this Agreement, 1 representative of the Independent Suppliers**

6 2 5 The office of a Voting Director shall be vacated if

- (a) he resigns his office of his own volition by notice delivered to the Secretariat, or
- (b) the Market Member of which he is an employee becomes bankrupt, or

being drawn up in keeping with the set procedure having informed its Group of this,

- *in exceptional cases and only during the Board Meeting to pass his votes to other Voting Director within its Class by notification in writing to the Secretariat*

6 2 3¹ Each Voting Director shall be obliged, at the request of any member of the Group of this Voting Director, to supply relevant information on grounds for his voting on either issues at the Board Meetings, any other information on his participation in the Board work

6 2 4 The Board shall include without the right to vote (Non-Voting Directors)

- (a) a representative from the ~~ADC~~ Despatch Operator,*
- (b) a representative from the NERC,*
- ~~(c) a representative of the Antimonopoly Committee,~~*
- (c) a representative from the National Electricity Company
Ukrainian electricity company*
- (d) a representative from Minenergo,*
- (f) a representative from the Market Auditor,*
- (g) a representative from the Market Banker*
- (h) a representative from the Market Lawyer*

6 2 5 A Voting Director shall be released from his duties if

- (a) he resigns his office of his own volition by notice delivered to the Secretariat or*
- (b) the Market Member of which he is an employee becomes expelled from the*

125

*Unified State Register of enterprises and organizations of Ukraine (USREOU)
or in the event of cancellation of a license or*

(c) he becomes of poor health, or

(c) he becomes of poor health,

(d) he is found guilty by a Ukrainian Court of Law of any criminal act or
of gross negligence or

~~(d) to be deleted~~

(e) he does not attend [3] Board meetings

(d) he does not attend *personally* 3 or more Board meetings in succession

If a seat on the Board becomes a vacant the constituents shall elect a
replacement Voting Director

*Upon release of a Voting Director from his duties the Market Members the
interests of which this Voting Director represented on the Board shall elect a
replacement Voting Director before the next, after release meeting of the
Board*

6 2 6 The Market Member employing a Voting Director at the time of his
election shall be entitled to replace that Voting Director by written notice
to the Secretariat, or require the constituents of the Voting Director to
elect a new Voting Director

*6 2 6 In the event of withdrawal of a Voting Director from members of the
Board a new Voting Director shall be elected as follows*

*a) The Secretariat shall conduct an election of a new Voting Director for
which purpose it shall send within 5 days, voting bulletins of an
appropriate Class form to those Market Members that constitute the Voting
Group of a withdrawn Voting Director,*

*b) Prior to elections Members of the Voting Director Group to be withdrawn
shall have the right to hold consultations on possible candidatures for a
position of the new Voting Director*

*c) A Member of the Voting Director's Group shall fill in the Voting Bulletin to
be then signed by chief officer and stamped with a seal of the enterprise and,
within 3 day from the date of receipt, shall send it to the Secretariat*

*d) The candidate received a majority of Weighted Votes shall be elected a
new Voting Director*

*e) When calculating the Weighted Votes of the Voting Director Group the
Secretariat shall be guided by data on the Weighted Votes of the electors*

12

which have been known as of the date of holding the last General Meeting,

f) control over the right calculation of votes, a Working Group of three persons shall be created as determined by the Market Board

~~a Voting Director from an appropriate Class,
a representative of the NERC (as agreed upon),
a representative of Minenergo (as agreed upon)~~

g) The Secretariat shall cast the total of elections held and inform about election results the Board and members of Voting Director's groups as well as notify the parties concerned

6.3 Board Chairman

6.3.1 The Board Chairman shall be elected for a period of one year by the Voting Directors by a simple majority and may be changed at any time in the same way. In the event of a tie vote, the NERC representative shall cast a vote.

6.3.2 The Board Chairman may resign at any time giving written notification to the Secretariat. The Chairman shall remain in office until he is replaced. The Board shall consider any resignation at the next Board Meeting. If it is accepted the Board shall appoint a new Chairman under the arrangements described in Clause 6.3.1.

6.3.3 The Board Chairman shall be responsible solely for convening and conducting Board meetings and for conducting General Meetings. The Board Chairman shall exercise all such duties, responsibilities and powers impartially.

6.3 Board Chairman

6.3.1 The Board Chairman shall be elected from *the number of Voting Directors* for a period of one year by a simple majority *at the first Board Meeting after the General Meeting* and may be changed at any time in the same way. In the event of a tie vote *the Non-Voting Directors from Minenergo, NERC and Antimonopoly Committee* shall cast their vote.

6.3.2 The Board Chairman may resign at any time giving written notification to the Secretariat. The Chairman shall remain in office until he is replaced. The Board shall consider any resignation at the next Board Meeting. If it is accepted the Board shall *elect* a new Chairman under the arrangements described in Clause 6.3.1.

6.3.3 The Board Chairman shall be responsible solely for convening and conducting Board meetings and General Meetings, *as well as shall sign the Minutes of Board meetings and its Decisions*. The Board Chairman shall exercise all such duties, responsibilities and powers impartially.

127

6.4 Secretariat The NDC shall undertake the role of Secretariat for the Board. The Secretariat shall have responsibility for convening meetings of the Board, preparation and distribution of minutes and proceedings and any other administrative services as required from time to time by the Board. The costs of the Secretariat shall be recovered according to the Accounting Procedure in Schedule 5.

~~6.4 to be deleted (ref. to Clause 6.9)~~

6.4 Minutes and Decisions

~~6.4.1~~ 6.4.1 Minutes of Meetings

Each meeting of the Market Board shall be recorded in the minutes to be then signed by the Board Chairman and Secretary to the Meeting. The minutes shall be signed by Voting and Non-Voting Directors present at the meeting and the Market Lawyer. Voting and Non-Voting Directors shall have the right to make comments on the Minutes in writing.

The Minutes shall be permanently kept by the Secretary to the meeting. Each Party to this Agreement shall have the right to familiarize itself with any minutes.

6.4.2 Decisions

The Board shall make a Decision on issues being within its competence and under consideration at the Meeting. The Decision may contain a resolute paragraph of the Minutes. It shall be issued in the form of separate document to be signed by the Board Chairman of the WEM.

Decisions shall be permanently kept by the Secretary to the meeting. Each Party to this Agreement shall have the right to familiarize itself with any decision of the Board.

6.5 Board Meetings

6.5.1 Meetings of the Board shall be held at least monthly. Additional meetings of the Board as may be required from time to time shall also be convened by the Secretariat at the request of any 3 Voting Directors. Directors may participate by telephone.

6.5.2 No business shall be transacted at a meeting of the Board unless a

6.5 Board Meetings

6.5.1 Meetings of the Board shall be held at least monthly. *An Extraordinary Meeting* of the Board as may be required from time to time, shall also be convened by the Secretariat at the request of any 3 Voting Directors. Directors may participate *through technical communication facilities*.

6.5.2 No business shall be transacted at a Meeting of the Board unless a

128

quorum is present at the time the meeting proceeds to business Three Voting Directors appointed pursuant to Clause 6.2.1 (a) and three Voting Directors appointed pursuant to Clause 6.2.1 (b) present in person or by their respective alternates shall constitute a quorum

6.5.3 If within half an hour of the time appointed for holding any meeting of the Board, a quorum is not present, the meeting shall be adjourned to a time set by the Chairman no later than a week hence

6.5.4 Simple Majority Any question or matter arising at a meeting of the Board shall be decided by a simple majority of the votes cast at the meeting by Voting Directors On any such question or matter each Voting Director shall be entitled to one vote

6.6 Powers of the Board

6.6.1 General Power Unless stated otherwise in this Agreement the Board shall, as between itself and the Market Members in General Meeting, exercise overall supervision of the NDC in its operation of the Wholesale Electricity Market Arrangements, the Market Operating System and associated activities

6.6.2 Specific Powers

Except as otherwise provided in this Agreement, the powers duties and responsibilities of the Board shall, as between itself and the Market Members in General Meeting, include

(a) the specific powers, duties and responsibilities set out in this Agreement and its Schedules,

(b) the establishment of working groups of the Board Each working

quorum is present at the time the meeting proceeds to business *Three Voting Directors elected from Generators and three Voting Directors elected from Suppliers* present in person or by their respective alternates shall constitute a quorum

6.5.3 If within half an hour of the time appointed for holding any meeting of the Board a quorum is not present, the meeting shall be adjourned to a time set by the Chairman no later than a week hence

6.5.4 Any question or matter arising at a meeting of the Board shall be decided by a simple majority of the votes cast at the meeting by Voting Directors On any such question or matter each Voting Director shall be entitled to one vote

6.6 Powers of the Board

~~6.6.1 to be deleted~~

~~6.6.2 Specific Powers~~

~~The first paragraph to be deleted~~

a) the exercise of a regular control over the compliance with obligations related to each activities of the Secretariat, Market Despatch Operator Settlement System Administrator, Market Funds Administrator as specified in this Agreement

b) the establishment of *working groups accountable to the Board* Each working

group shall be composed of such persons (whether or not Voting Directors) and shall discharge such responsibilities as from time to time the Board considers desirable,

(c) monitoring on a regular basis each of the ESE's activities as specified in this Agreement and the Wholesale Electricity Supply License in the performance of its obligations,

(d) considering applications by candidates to be admitted as Market Members and to promptly admit all qualified applicants,

e) considering, amending, substituting, approving and disapproving changes to the Market Rules and associated procedures set out in Schedules 2-5 of this Agreement **subject to Clause 5.4 and Section 15**, and advising all affected parties of such changes,

(f) considering, revising, approving or disapproving all Budgets and authorities for capital expenditure prepared and submitted to it by the ESE,

g) instructing the Market Auditor to conduct audits, reviews, tests and checks and the monitoring and review of the operation of the Market Rules and deciding whether to propose to the Market Members in General Meeting for their approval the appointment or removal of the Market Auditor,

(h) overseeing the standards of Metering System,

(i) dealing promptly and efficiently with any dispute referred to it concerning Settlement or its operation (including with respect to data),

(j) if requested by the NERC, conveying any direction or request of the NERC to the ESE or any other Party or the Market Auditor,

group shall be composed of such persons (whether or not Voting Directors) and shall discharge such responsibilities the Board considers desirable *The Parties to this Agreement shall be obliged to promote the work of such groups*

c) the consideration of applications for participation in the Wholesale Electricity Market and admission of new Members to the market in compliance with the rules established by this Agreement

~~transferred to par e)~~

~~transferred to Section Transitional Provisions²²~~

d) the consideration of issues connected with the financing of the development of Integrated Power System of Ukraine- preparation of associated materials to be considered at General Meetings

e) instructions to the Market Auditor on audits and control of the operation of the Market Rules and development and submission of proposals on elections and removal of the Market Auditor at General Meetings,

~~to be deleted~~

f) control over the compliance with the Metering Procedure,

g) dealing promptly and efficiently with any dispute referred to it concerning Settlement or its operation (including with respect to data),

~~to be deleted~~

(k) appointing, remunerating and removing lawyers, bankers, valuers, brokers, accountants and other professional and specialist advisers to assist the Board or any of its sub-committees in the performance of its duties and responsibilities under the Energomarket Members Agreement,

(l) subject to any applicable confidentiality provisions, monitoring any litigation, arbitration or other proceedings affecting or which may affect the Energomarket Members' Agreement,

(m) appointing and removing the MFA and SSA as set out in Clauses 8.3 and 7.5 respectively,

(n) signing agreements which limit future actions of the Board and which delegate the authority of the Board,

(o) maintaining and publishing a Metering Procedure,

p) appointing a Disputes Committee as necessary,

(q) development of Agreed Procedures

h) appointment, release and determination of conditions for remunerating lawyers, bankers, brokers, accountants and other professional and specialist advisers to assist the Board or working groups in the performance of their duties and responsibilities under this Agreement

i) subject to any applicable confidentiality provisions, monitoring any litigation, arbitration or other proceedings affecting or which may affect this Agreement,

j) appointment and replacement of the MFA and SSA as set out in Clauses 8.3 and 7.5 respectively, as well as the executor of the Secretariat functions according to Clause 6.9.4

k) discussion of agreements between the Parties which limit future actions of the Board and which delegate the authority of the Board,

l) development of and making changes and amendments to the Metering Procedure

m) appointment and approval of a Dispute Committee,

n) development of Agreed Procedures,

6.7 Interaction between the Board and NERC on taking decisions of the Market Board

*6.7.1 Submitting draft decisions of the Market Board to the NERC
The Board Secretariat shall submit, not later than two working days before the Board meeting, to the NERC draft decisions (including issues to be discussed by the Working groups) related to
- changes in the Agreement and amendments to it
- efficient operation of the Market Operating System*

121

- any issues influencing the rights and obligations of licensees,
- civil-and-legal relations between Market Members,
- admission of new Market Members
- rights and obligations of electricity customers

6 7 2 NERC's participation in Market Board meetings

Apart from a Non-Voting Director from the NERC the Market Board meetings may be attended by staff of the NERC's Working Body, but they are not to act for a Non-Voting Director

6 7 3 Approval by the NERC of Market Board's decisions

All Instructions given by the Market Board on issues the consideration of which comes within competence of the NERC ~~NDC~~ shall be approved by the NERC in accordance with the established procedure The NERC shall pass, within a week, relevant resolutions on approval of the Market Board's decisions If the NERC disagrees with the decisions of the Market Board, it shall also pass a resolution stating the reasons for refusal of approval The Market Board's decisions shall come into force if, within a week, the NERC does not pass a resolution on disapproval of the Board's decisions The NERC's resolutions on Market Board meetings shall be sent to the Board Secretariat ~~Executive Committee~~ which will bring them to the notice of the Board members, the ~~NDC~~ Commission Agent and other parties concerned The NERC's decisions (resolutions) can be appealed, in keeping with the established procedure, to the Antimonopoly Committee or to the court within their competence

6 7 Expenses Each member of the Board and each member of any working group of the Board pursuant to Clause 6 2 and 6 6 2 may be paid his reasonable traveling, hotel and incidental expenses of attending and returning from meetings of the Board or any such working group and shall be paid all expenses properly and reasonably incurred by him in the conduct of the business of the Board Voting Directors shall be salaried for their time spent on Board related activity

138

Draft of 3 August 1998

Lec printer\L Gorbunova\EMAAgreement\EMArev3Aug-2 doc

Changes have been made in the EMA version of 13 July 1998 as follows

Strikethrough – text to be deleted or transferred to relevant Clauses

Highlight – changes and amendments to version of 13 July 1998, also text transferred

The rest text remains unchanged as compared with version of 13 July 1998

6 8 Appeals

6 8 1 Any Voting Director can instantly appeal a decision taken at a Board Meeting and request a Weighted Vote

6 8 2 In any Extraordinary General Meeting to reconsider a Board decision, decisions not covered by Clause 5 4 shall require a simple majority otherwise the terms of Clause 5 4 shall apply

6 8 Appeals (~~The Section has been restored without changes~~)

6 8 1 Any Voting Director can instantly appeal a decision taken at a Board Meeting and request a Weighted Vote

6 8 2 In any Extraordinary General Meeting to reconsider a Board decision, decisions not covered by Clause 5 4 shall require a simple majority otherwise the terms of Clause 5 4 shall apply

6 9 WEM Secretariat

6 9 1 The WEM Secretariat is a body which shall perform its functions on a permanent basis It shall consist of _____ persons The Secretariat shall be directed by the Secretariat Head

The Party to the Agreement which acts as the Secretariat shall set up a separate subdivision to perform solely these functions This separate subdivision shall act under this Agreement and the Provisions to be obligatorily approved by the Market Board

If the Parties to this Agreement are not satisfied by the way of performing the functions of the Secretariat , they may transfer these functions to other Party

6 9 2 Competence of the Secretariat

The Market Secretariat shall

a) prepare draft decisions of the Market Board, negotiate them with appropriate state administration bodies and parties concerned,

b) by order of the Board arrange and coordinate the work of Working Groups, be responsible for contacts with Market Auditor, Banker,

199

Changes have been made in the EMA version of 13 July 1998 as follows

Strikethrough – text to be deleted or transferred to relevant Clauses

Highlight – changes and amendments to version of 13 July 1998, also text transferred

The rest text remains unchanged as compared with version of 13 July 1998

Lawyer, Dispute Committee and advisers of the Wholesale Electricity Market of Ukraine,

- c) hold consultations with authors of letters and appeals to General Meetings, heads of working groups and commissions advisers,*
- d) consider data on licensees of the NERC and their applications for participation in the WEM, prepare relevant draft decisions to be considered by the Board and General Meeting*
- e) promptly within its competence consider expediency and feasibility to make changes in and amendments to the Agreement and normative documents in force that related to the operation of the WEM, as well as prepare relevant draft decisions of the Board,*
- f) be in charge of convening General Meetings, meetings of the Market Board and Working groups, preparing and distributing necessary papers agenda and minutes, conducting elections of Voting Directors,*
- g) bring the Board Decisions to notice of parties concerned, report to the Board on execution of its decisions and decisions of General Meetings,*
- h) be in charge of record keeping (including keeping of the minutes) and other services required to General Meetings and the Board,*
- i) on the instructions of the Board or according to set plan analyze the operation of the WEM and prepare papers on these issues to be considered at the Board Meetings,*
- j) keep the original Market Members Agreement and submit it to new*

Changes have been made in the EMA version of 13 July 1998 as follows

Strikethrough – text to be deleted or transferred to relevant Clauses

Highlight – changes and amendments to version of 13 July 1998, also text transferred

The rest text remains unchanged as compared with version of 13 July 1998

Market Member for signature

6 9 3 The Secretariat shall be subordinated to the Board and execute instructions of the Board and General Meetings in compliance with the decision of the minutes

6 9 4 Taking into consideration comments of the Parties to this Agreement the Board can appoint other Party to act as a Secretariat on the conditions specified by the Board and this Agreement, and this new Secretariat shall come into force after actual release of the former executor from its duties

6 9 5 Replacement of the executor of the Secretariat functions, irrespective of the reason for such replacement shall not affect the rights and obligations of the Parties

6 9 6 After appointing the next executor of the Secretariat functions, the former executor shall be obliged to hand over to a new executor the original of this Agreement, all Minutes, Decisions, other documents and records he kept as an executor of the Secretariat functions,

The costs of such transfer shall be determined on a basis to be agreed between the outgoing and successor executor of the Secretariat's function and the Board. Such costs shall be based on the current net book value of the assets transferred to the executor of the Secretariat's function and the reasonable costs of personnel training, acquisition of licenses, the costs and expenses of, or directly associated with this process

25

Draft of 3 August 1998

Changes have been made in the EMA version of 13 July 1998 as follows

Strikethrough – text to be deleted or transferred to relevant Clauses

Highlight – changes and amendments to version of 13 July 1998, also text transferred

The rest text remains unchanged as compared with version of 13 July 1998

Lec printer\L Gorbunova\EMAAgreement\EMArev3Aug-2 doc

7 The Settlement System Administrator

7.1 The ESE shall undertake the function of Settlement System Administrator for the duration of this Agreement unless the appointment is terminated by the Board pursuant to Clause 6.6.2

7.2 Responsibilities The Settlement System Administrator shall have the following general duties, responsibilities and obligations under this Agreement

7.2.1 compliance with Market Rules and Settlement Procedures,

7.2.2 provide back-up and security arrangements,

7.2.3 provide budgets and reports in compliance with the Accounting Procedure,

7.2.4 provide recommendations to the Board of changes to this Agreement, the Market Rules, or the Market Operating System,

7.2.5 implementation of all orders by the Board (and which have been approved by NERC in accordance with this Agreement) and the development of Work Programmes to facilitate them,

7.2.6 the maintenance of such records data and other information as the Market Auditor or the Board may, from time to time, reasonably deem necessary, and

7.2.7 any other responsibilities properly designated to it pursuant to this Agreement

7 Settlement System Administrator

7.1 ~~The NDC as a Commission Agent~~, shall undertake the function of Settlement System Administrator for the term of duration of this Agreement

7.2 *The Settlement System Administrator shall be obliged*

7.2.1¹ to make calculations and transfers of payments to Generators and Suppliers,

7.2.1 to comply with the Market Rules and Settlement Procedures,

7.2.2 to provide back-up and security arrangements,

7.2.3 to provide budgets and reports in compliance with the Accounting Procedure,

~~7.2.4 Transferred to Clause 7.4~~

~~7.2.5~~ 7.2.4 to implement all orders of the Board (which have been approved by NERC in accordance with the Clause 6.7 of this Agreement) and to develop Work Programs to facilitate the implementation,

~~7.2.6~~ 7.2.5 to maintain such records, data and other information that might be useful for the Market Auditor or the Board may, from time to time, reasonably deem necessary, and

~~7.2.7~~ 7.2.6 to perform any other responsibilities properly designated to it pursuant to this Agreement

130

Draft of 3 August 1998

Changes have been made in the EMA version of 13 July 1998 as follows

Strikethrough – text to be deleted or transferred to relevant Clauses

Highlight – changes and amendments to version of 13 July 1998 also text transferred

The rest text remains unchanged as compared with version of 13 July 1998

Lec printer\L Gorbunova\EMAAgreement\EMArev3Aug-2 doc

7.3 The Settlement System Administrator shall have the responsibility to ensure that the Market Operating System conforms to the Market Rules (as part of the ESE's responsibilities). The Settlement System Administrator shall be under obligation to notify the Board and the NERC immediately of any instances of an error.

7.4 The Settlement System Administrator shall purchase and sell energy as set out in the Market Rules, and its obligations incurred thereby consist only of complying with the Market Rules.

7.5 The Board may, after taking into account any views expressed by any Market Member, appoint a successor Settlement System Administrator on such terms as the Board sees fit, and its appointment shall take effect upon the actual resignation or removal of the incumbent. The appointment of a successor Settlement System Administrator shall be subject to the approval of the NERC within three months.

7.6 Termination of the appointment of the Settlement System Administrator for whatever reason shall be without prejudice to any accrued rights and obligations of the Parties.

7.7 Upon a successor Settlement System Administrator being appointed and accepting such appointment, the resigning or removed Settlement System Administrator shall

(a) transfer to such successor all copies of all software and hardware belonging to the Settlement System Administrator together with all associated rights,

7.3 The Settlement System Administrator shall have the responsibility to ensure that the Market Operating System conforms to the Market Rules. The Settlement System Administrator shall be under obligation to notify the Board and the NERC of any instances or an error urgently (*within the term not exceeding _____ hours*).

7.4 The Settlement System Administrator shall be entitled to submit to the Board proposals on changes to this Agreement, Market Rules, or the Market Operating System.

7.5 The Board may, after taking into account any views expressed by any Market Participants, appoint *another* Settlement System Administrator *on the terms determined by the Board and this Agreement*, and its appointment shall take effect upon the actual *release* of the System Administrator *from its duties*. The appointment of another Settlement System Administrator is to be approved by NERC within three months.

7.6 *Replacement* of the Settlement System Administrator for whatever reason shall be without prejudice to any accrued rights and obligations of the Parties.

7.7 Upon a successor Settlement System Administrator being appointed, the Settlement System Administrator *released from its duties shall*

7.7.1 transfer to the new Administrator all copies of all software and hardware it used to perform the functions of the Settlement System Administrator together with all associated rights,

7.7.2 make over to the new Administrator all records, manuals and data, and

Draft of 3 August 1998

Changes have been made in the EMA version of 13 July 1998 as follows

Strikethrough – text to be deleted or transferred to relevant Clauses

Highlight – changes and amendments to version of 13 July 1998, also text transferred

The rest text remains unchanged as compared with version of 13 July 1998

Lec-printer\L Gorbunova\EMAAgreement\EMArev3Aug-2 doc

(b) make over to such successor all such records, manuals and data and other information in the ownership or under the control of the Settlement System Administrator and provide such training and systems support as necessary

The costs of such transfer shall be determined on a basis to be agreed between the outgoing and successor Settlement System Administrator and the Board. Such costs shall be based on the current net book value of the assets transferred to the successor Settlement System Administrator and the reasonable costs of training, acquisition of licenses, the costs and expenses of, or directly associated with the removal of the outgoing Settlement System Administrator

other information in the ownership or under the control of the Settlement System Administrator and provide such *per sonnel* training and systems support as necessary

The costs of such transfer shall be determined on a basis to be agreed between the outgoing and successor Settlement System Administrator and the Board. Such costs shall be based on the current net book value of the assets transferred to the successor Settlement System Administrator and the reasonable costs of *per sonnel* training, acquisition of licenses, the costs and expenses of, or directly associated with the removal of the outgoing Settlement System Administrator

Draft of 3 August 1998

I ec printer 1 Gorbunova\EMAAgreement\EMAArev3Aug 2 doc

Changes have been made in the EMA version of 13 July 1998 as follows
Strikethrough text to be deleted or transferred to relevant Clauses
Highlight changes and amendments to version of 13 July 1998 also text transferred
The rest text remains unchanged as compared with version of 13 July 1998

8 Market Funds Administrator

8.1 The position of Market Funds Administrator shall be held by the ESE (or other Competent Third Party) unless the appointment is terminated by the Board pursuant to Clause 6.6.2 and shall have the following general duties and responsibilities under this Agreement

8.1.1 to comply with the Market Rules in respect of the operation of the Market Funds Administration Procedures

8.1.2 to ensure that all Market Members maintain their Advance Payments to the level specified under the Market Rules or such other level as may be determined from time to time by the Board,

8.1.3 to execute default notices as specified by the Settlement System Administrator and to convert any letters of credit forming part of a Market Member's Advance Payment to cash and apply such cash to any overdue payment obligations by a Market Member,

8.1.4 to maintain such records, data and information as may be reasonably required by the Market Auditor and the Board,

8.1.5 to keep under review and to make recommendations to the Board concerning any changes to the Market Funds Administration Procedures, appointment of a Market Banker or any change to the relevant parts of the Settlement Procedures,

8.1.6 to provide the Market Auditor and the Board data and other³⁸

8 Market Funds Administrator

~~8.1 The duties of the Market Funds Administrator shall be performed by a legal entity appointed by the Market Board. Should such duties be entrusted a legal entity that is not a Party to this Agreement, the NDC, on the instructions of the Board shall sign with such entity a separate agreement meeting the requirements of this Agreement.~~

The Market Funds Administrator shall be obliged

8.1.1¹ to open and keep an account of the Wholesale Electricity Market

8.1.2 to make provisions for collection of payments from Electricity Suppliers for purchased electricity in the amounts specified in Clauses 2.3.1, 3.2 to be then transferred to the account of the wholesale market and distributed in compliance with the Market Funds Administration Procedure,

8.1.1 to fulfill the Market Funds Administration Procedures in compliance with the Market Rules

8.1.2 to ensure that all Market Members maintain their Advance Payments to the level specified under the Market Rules or such other level as may be determined from time to time by the Board,

8.1.3 to execute default notices and communicate them to the Commission Agent according to his instruction, to handle letters of credit forming part of the Market Member's Advance Payment and to use these funds for any overdue payment obligations by a Market Member,

8.1.4 to maintain such records and keep data and information in accordance with the procedure established by the Market Board and the Market Auditor

8.1.5 to provide the Board recommendations concerning

• any changes to the Market Funds Administration Procedure,

12

Changes have been made in the EMA version of 13 July 1998 as follows
Strikethrough – text to be deleted or transferred to relevant Clauses
Highlight – changes and amendments to version of 13 July 1998 also text transferred
The rest text remains unchanged as compared with version of 13 July 1998

9 Central Despatch

9.1 This Agreement envisages that the ESE will provide centralized despatch management of power plants and the Main and Interstate High Voltage Network. The main tasks of which are

(a) the development of schedules for the operation of power plants and networks in such a way so as to provide reliable and continuous supply of electricity

(b) provide stability of the network

(c) operate Ukraine's electricity system in the most efficient modes

(d) to manage any system emergencies and technological problems during the generation, transmission and distribution of electricity, and

(e) maintain the economic interests of Generators and Suppliers

9.2 The rights and obligations of the ESE in respect to this activity are defined in existing normative documents

9 Central Despatch

9.1 This Agreement envisages that the NDC-Despatch Operator will perform the centralized despatch management of the *integrated power system of Ukraine*. The main tasks of the management are

9.1.1 planning and operational control of Ukraine's power plants capacities

9.1.2 planning and control of the maintenance of the operational regime of the integrated power system of Ukraine providing its stability

9.1.3 operating Ukraine's electricity system in the most efficient modes,

9.1.4 preventing emergency situations and mitigation of their consequences within the power system of Ukraine through maintaining necessary balance of generation and demand

9.1.5 *maintaining the balance of economic interests of electricity Generators and Suppliers*

9.2 The rights and obligations of the ~~NDC~~ Despatch Operator *in respect to the centralized despatch control* are defined by active legislative documents and instructions as well as by this Agreement

From the date of signing this Agreement the Despatch Operator shall be responsible for

9.2.1 Entering into High Voltage Service Agreements with enterprises which is owned by Main and Interstate High Voltage Networks in Ukraine. Each specific High Voltage Service Agreement shall define unambiguously amounts

oh

Draft of 3 August 1998

Lee printer I Gorbunova\EMAAgreement\EMArev3Aug 2.doc

Changes have been made in the EMA version of 13 July 1998 as follows

Strikethrough - text to be deleted or transferred to relevant Clauses

Highlight - changes and amendments to version of 13 July 1998 - also text transferred

The rest text remains unchanged as compared with version of 13 July 1998

the Market Funds Administrator shall pay to such enterprises from the WEM's account for the use of the networks. Charges for connection of each individual Market Member shall be paid directly by this Member to the Networks' owner. The procedure for calculating the size of the above payments shall be approved by the NERC,

9.2.2 Indemnification of Main and Interstate Main and Interstate High Voltage Network service costs under this Agreement and Bilateral Agreements to be made from the WEM's account,

9.2.3 Purchasing of Ancillary Services pursuant to the Market Rules,

9.2.4 Carrying out of trade with Externally Interconnected Operators,

9.2.5 In carrying out trade with Externally Interconnected Operators, the Dispatch Operator shall ensure that it is conducted in accordance with the principle of Economic Purchase,

9.2.6 Planning and promotion of development of Main and Interstate High Voltage Networks and conclusion of appropriate Agreements,

9.2.7 Development of the Ten Year Statement setting out the planned development of the Main and Interstate High Voltage Networks and its annual adjustment according to the provisions of the High Voltage System Operating Guideline,

9.2.8 Short-term planning of the production and reserving of the capacity, prompt adjustment of the electricity production and supply in Ukraine and repaying of Generators costs of maintenance of reserve units,

Draft of 3 August 1998

Lec printer I Gorbunova\EMAAgreement\EMArev3Aug-2 doc

Changes have been made in the EMA version of 13 July 1998 as follows

Strikethrough – text to be deleted or transferred to relevant Clauses

Highlight – changes and amendments to version of 13 July 1998, also text transferred

The rest text remains unchanged as compared with version of 13 July 1998

9 2 9 Adjustment of the technical specifications for any new connections to the existing Main and Interstate High Voltage Networks,

9 2 10 Distribution of electricity according to the schedule made by the Settlement System Administrator, except cases specified in Cl 9 1 4

PART III - MARKET PROCESSES

PART III – MARKET PROCESSES

10 Metering

10 Metering

10 1 The Board shall maintain and publish a Metering Procedure for use with the Market Rules. Such Metering Procedure shall meet the relevant Metering Standards.

10 1 Electricity metering shall be carried out according to the Metering Procedure. The Procedure shall be approved by the Board.

10 2 Each Metering System shall be the responsibility of a designated Meter Operator. Each Meter Operator shall comply with the Metering Procedure. The operator of any Metering System shall be responsible for the quality of the data acquired from it. The Settlement System Administrator is hereby authorized to use the same as may be permitted pursuant to this Agreement and may only release such data to others to the extent set out in the Market Rules. The Settlement System Administrator shall bear no liability for metering inaccuracies.

10 2 The operation of the Metering System of the wholesale electricity market shall be the responsibility of the Metering System Administrator and Registered Metering System Operators. An operator of any Metering System shall be responsible for availability and completeness of metered data. The Settlement System Administrator shall have the right to access to metered data in compliance with this Agreement and may release such data to others only to the extent set out in the Market Rules. The Settlement System Administrator shall bear no liability for metering inaccuracies.

10 3 Any Party wishing to become an operator of a Metering System shall make an application to the Settlement System Administrator using the procedure set out in the Metering Procedure.

10 3 Any Party wishing to perform the functions of Metering System Operator shall apply for permission to the Metering System Administrator according to the procedure set out in the Metering Procedure.

10 4 Any Dispute over the accuracy of any metered data shall be resolved by the Board.

10 4 Any Dispute over the accuracy of any metered data shall be resolved by the Metering System Administrator. If such disputes are not settled, they shall be submitted for consideration of the Board.

10 5 The Settlement System Administrator shall incur no liability as a result

~~10 5 to be deleted~~

117

Draft of 3 August 1998

Changes have been made in the LMA version of 13 July 1998 as follows

Strikethrough – text to be deleted or transferred to relevant Clauses

Highlight changes and amendments to version of 13 July 1998 also text transferred

The rest text remains unchanged as compared with version of 13 July 1998

Lec printer\L Gorbunova\EMAAgreement\EMArev3Aug-2 doc

of its failure to gain access to a Metering System for inspection purposes
The Market Member restricting the access of the Settlement System Administrator shall incur the liability

11 Cost Recovery

11.1 The provisions of the Accounting Procedure (Schedule 5) shall apply

11.2 The ESL shall be entitled to recover costs incurred by contract only if those contracts have prior approval of the Board

12 Testing of and Access to the Market Operating System

12.1 The Settlement System Administrator and Market Funds Administrator shall arrange for such tests of the Market Operating System as are from time to time ordered by the Board or the Market Auditor and shall submit the results of all such tests to the Board and the Market Auditor and the NERC at its request

12.2 The Settlement System Administrator and Market Funds Administrator shall ensure that at all times each has in full force and effect proper arrangements for the maintenance of (and the prompt rectification of defects in) the relevant parts of the Hardware and Market Software and upon reasonable request of the Board, shall supply evidence reasonably satisfactory to the Board of the existence and nature of such arrangements

13 Market Audit and Appointment of the Market Auditor

11 Cost Recovery

11.1 The costs related to the WEM operation shall be recovered in compliance with the Accounting Procedure set out in Schedule 5 to this Agreement

11.2 The ~~NDC~~ Commission Agent shall be entitled to recover costs incurred by contracts only if those contracts have been concluded *according to the Board instruction and approval*

12 Testing of and Access to the Market Operating System

12.1 The Settlement System Administrator and Market Funds Administrator shall arrange for such tests of the Market Operating System as are from time to time ordered by the Board or the Market Auditor and shall submit the results of all such tests to the Board and the Market Auditor and the NERC at its request

12.2 The Settlement System Administrator and Market Funds Administrator shall ensure that at all times each has in full force and effect proper arrangements for the maintenance of (and the prompt rectification of defects in) the relevant parts of the Hardware and Market Software and, upon reasonable request of the Board, shall supply *information* reasonably satisfactory to the Board of the existence and nature of such arrangements

13 Market Audit and Appointment of the Market Auditor

147

Draft of 3 August 1998

Changes have been made in the EMA version of 13 July 1998 as follows

Strikethrough – text to be deleted or transferred to relevant Clauses

Highlight – changes and amendments to version of 13 July 1998, also text transferred

The rest text remains unchanged as compared with version of 13 July 1998

Lec-printer\L Gorbunova\EMAAgreement\EMArev3Aug 2 doc

13 1 Contractual appointment and removal The Board shall within 60 days after the Effective Date appoint a firm of accountants to carry out

13 1 1 annual audits of the calculations and allocations performed by the relevant parts of the Market Operating System, such audits to be carried out at such time or times as shall be agreed between the Settlement System Administrator and the Board,

13 1 2 annual audits of the activities of the Market Funds Administrator in operating the Market Funds Procedure, including calculations and allocations performed by the relevant parts of the Market Operating System and associated information systems, such audits to be carried out at such time or times as shall be agreed between the Market Funds Administrator and the Board,

13 1 3 tests and/or checks on new items or versions of Market Software or other elements of the Market Operating System,

13 1 4 reviews of Agreed Procedures as required from time to time by the Board,

13 1 5 a review every three years of the scheduling and despatch process defined in the High Voltage System Operating Guidelines,

13 1 6 investigations of any particular areas of concern which may have been indicated to it by the Board or by any Market Member if at the Member's expense, and

13 1 Contractual appointment and removal *of the Market Auditor*
With the purpose of carrying out annual audits the Board shall choose an auditing firm and instruct the ~~NDC~~ Commission Agent to conclude the Contract with it The Market Auditor shall make

13 1 1 annual audits of the calculations performed by the relevant *constituent* parts of the Market Operating System, such audits to be carried out *within terms* as shall be agreed between the Settlement System Administrator and the Board

13 1 2 annual audits of the activities of the Market Funds Administrator in operating the Market Funds Procedure, including calculations and allocations performed by the relevant *constituent* parts of the Market Operating System and associated information systems, such audits to be carried out *within terms* as shall be agreed between the Market Funds Administrator and the Board,

13 1 3 tests and/or checks on new items or versions of Market Software or other *constituent parts* of the Market Operating System,

13 1 4 proposals on improving the legal base of the WEM Wholesale operation,

13 1 5 checks over the compliance with the High Voltage System Operating Guidelines in respect of scheduling generation and despatch

13 1 6 *consideration and suggestion of proposals* on any particular areas of concern which may have been indicated to it by the Board, *in particular the those related to the efficient operation and entrepreneurial activity of the Parties and*

104

Draft of 3 August 1998

Changes have been made in the EMA version of 13 July 1998 as follows

Strikethrough – text to be deleted or transferred to relevant Clauses

Highlight - changes and amendments to version of 13 July 1998 also text transferred

The rest text remains unchanged as compared with version of 13 July 1998

13.1.7 audits, reviews, tests and/or checks of such other matters as are otherwise designated under this Agreement for reference to it and, where not so designated, such other audits, reviews tests and/or checks as the Board may from time to time reasonably require (having regard, in particular, to any disruptive effect on the business and operations of the Parties) Upon request of the Board, the Market Auditors shall assist in the preparation of Work Programmes. The Audit shall be carried out annually, or more frequently if required by the Board

13.2 The Board and the NERC shall have the right at any time (after consultation with the Market Funds Administrator and the Settlement System Administrator) to propose (and the Market Members in General Meeting shall decide upon) the termination of the contract of any firm of accountants appointed as Market Auditor by it but the Market Members shall ensure that there shall at all times be a Market Auditor

13.3 The scope of work to be conducted by the Market Auditor shall be in accordance with the terms of this Agreement and as determined from time to time by the Board after due consultation with the Market Auditor

13.4 All reports of the Market Auditor shall be sent to the Board the NERC and all Market Members

13.5 The LSI and the Parties shall provide access to all data, processes personnel and computer systems necessary for the Market Auditor to carry out its duties in full

13.6 The costs of the Market Audit shall be recovered as per the Accounting Procedure

13.1.7 Upon request of the Board, the Market Auditors shall assist in the preparation of Work Programs. The Audit shall be carried out annually, or more frequently if required by the Board

13.2 The Board and the NERC shall have the right (after consultation with the Market Funds Administrator and the Settlement System Administrator) to propose the General Meeting of Market Members the termination of the contract of any firm of accountants appointed as Market Auditor. The Market Members shall ensure that there shall at all times be a Market Auditor

13.3 The scope of work to be conducted by the Market Auditor shall be in accordance with the terms of this Agreement and as determined from time to time by the Board after due consultation with the Market Auditor

13.4 All reports of the Market Auditor shall be submitted to the Board and the NERC and *the Parties of the Agreement upon their request*

13.5 The ~~NDC~~ Despatch Operator, Commission Agent, Settlement System Administrator Market Funds Administrator and the Parties shall provide access to all *information*, personnel and computer systems necessary for the Market Auditor to carry out its duties in full

13.6 The costs of the Market Audit shall be recovered as per the Accounting Procedure (*Schedule 5 to the Agreement*)

13.7 Market Auditor's Rights

The Market Auditor shall be entitled to attend and speak at meetings of the Board and at General Meetings. The Market Auditor shall be entitled to resign upon giving prior notice to the Board (the period of such notice (if any) to be as set out in the terms of its appointment). Should the Market Auditor resign the



Draft of 3 August 1998

Changes have been made in the EMA version of 13 July 1998 as follows
Strikethrough – text to be deleted or transferred to relevant Clauses
Highlight – changes and amendments to version of 13 July 1998 also text transferred
The rest text remains unchanged as compared with version of 13 July 1998

13.7 Market Auditor's Rights The Market Auditor shall be entitled to attend and speak at meetings of the Board and at General Meetings. The Market Auditor shall be entitled to resign upon giving prior notice to the Board (the period of such notice (if any) to be as set out in the terms of its appointment). Should the Market Auditor resign, be removed from office or not be reappointed the Market Auditor shall have the right to communicate directly with Market Members if it believes there are matters which should be brought to their attention as a condition precedent to its appointment.

13.8 Confidentiality

The Market Auditor shall enter into a confidentiality agreement as a condition precedent to its appointment of such form as may be required from time to time by the Board. The Market Auditor shall have the right to receive all information from Market Members relevant to the performance of its duties.

14 Notification of Defects

14.1 Each Market Member undertakes to notify promptly in writing the Settlement System Administrator, Market Funds Administrator, other Market Members, and the Board of any defects of which it is or becomes aware in the Market Software or any other aspect of the Market Operating System and to provide such further information as may reasonably be required by the Settlement System Administrator or Market Funds Administrator to identify, isolate and correct such defect. The Board shall notify any such defects to the NERC.

PART IV - ADAPTATION

Market Auditor shall have the right to communicate directly with Market Members if it believes there are matters that should be brought to their attention as a condition precedent to its appointment.

13.8 Confidentiality

The Market Auditor shall enter into a confidentiality agreement as a condition precedent to its appointment of such form as may be required from time to time by the Board. The Market Auditor shall have the right to receive all information from Market Members relevant to the performance of its duties.

14 Notification of Defects

14.1 Each *Party to this Agreement* undertakes to notify promptly in writing the Settlement System Administrator, Market Funds Administrator, other Market Members, and the Board of any defects of which it is or becomes aware in the Market Software or any other aspect of the Market Operating System and to provide such further information as may reasonably be required by the Settlement System Administrator or Market Funds Administrator to identify, isolate and correct such defect. The Board shall notify any such defects to the NERC.

PART IV – ADAPTATION

Draft of 3 August 1998

Changes have been made in the EMA version of 13 July 1998 as follows

Strikethrough – text to be deleted or transferred to relevant Clauses

Highlight – changes and amendments to version of 13 July 1998, also text transferred

The rest text remains unchanged as compared with version of 13 July 1998

15 Amendments and Conflicts

15 Procedure of Making Changes and Amendments to the Agreement and Settlement of Conflicts that may arise in this connection

15 1 Amendments

15 1 Amendments

15 1 1 Any amendment to this Agreement shall be made only with the approval of Market Members through a vote taken at the General Meeting or through their written consent if not present at such a General Meeting

15 1 1 Any changes and amendment to this Agreement shall be made by the Market Members through a vote taken at the General Meeting according to the Clauses 5 4 5 4 1 Changes and amendments made according to such procedure are obligatory for each Party signing the Agreement

15 1 2 The NERC shall formally approve any amendment to the terms of this Agreement Such approval will be granted within a ten day period Any rejection of a proposed amendment shall be in writing setting out the reasons for such a decision and sent to the Board

15 1 2 Within the terms set by the Law changes and amendments to this Agreement shall be agreed with central executive authorities managing the power sector, the NERC, the Antimonopoly Committee

15 1 3 If any Party refuses to execute an amendment approved by NERC and Market Members together holding 75 per cent of Weighted Votes within 10 working days, the Agreement shall automatically be terminated and replaced by a new amended agreement among the concurring Parties The non-concurring Parties shall be deemed to have resigned according to Clause 4 3 except that any amounts due to or from these Parties will be carried over to the new agreement Amendments approved by NERC and Market Members pursuant to clauses 15 1 1 and 15 1 2 will be included in the text of the Agreement

~~15 1 3 to be deleted~~

15 1 4 For a period of 1 year from the Effective Date of this Agreement it shall not be necessary to obtain Market Member approval of changes to the Schedules 2-8 of this Agreement For the time that this Clause has effect it shall take pre-eminence over Clause 15 1 1

~~15 1 4 to be deleted (see Transitional provisions)~~

Draft of 3 August 1998

Changes have been made in the EMA version of 13 July 1998 as follows

Strikethrough – text to be deleted or transferred to relevant Clauses

Highlight – changes and amendments to version of 13 July 1998, also text transferred

The rest text remains unchanged as compared with version of 13 July 1998

15 2 Conflicts in the event of any inconsistency or conflict

*15 2 Conflicts related to inconsistency of the documents
In the event of any inconsistency of different documents and in connection with
this the Parties of the Agreement shall acknowledge that*

15 2 1 the provisions of any License shall prevail over this Agreement,

15 2 1 the provisions of any License shall prevail over this Agreement,

15 2 2 the provisions of this Agreement shall prevail over the Market Rules, and

*15 2 2 the provisions of the Schedules to this Agreement should comply with
provisions of the Agreement, and if not consistent, the provisions of the
Agreement shall prevail over the Schedules,*

15 2 3 the Market Rules shall prevail over the Market Operating System

~~15 2 3 to be deleted~~

The Parties shall use all reasonable endeavor promptly to secure the elimination of such inconsistency or conflict

The Parties shall use all reasonable endeavors promptly to secure the elimination of such inconsistency or conflicts connected with inconsistencies

15 3 The Parties shall endeavor to ensure that this Agreement and the High Voltage System Operating Guidelines remain consistent

15 3 The Parties shall endeavor to ensure that this Agreement and the High Voltage System Operating Guidelines remain consistent

16 Wholesale Electricity Market Arrangements and Reviews

16 Wholesale Electricity Market Legal Base and Reviews

16 1 The Parties to this Agreement acknowledge that the provisions of the Market Rules and other elements of the WEM shall be subject to change over time. The Parties undertake with each other to use all reasonable means (including, where appropriate, through their representation on the Board) to adapt these arrangements as required to meet the objectives set out in Clause 2

16 1 The Parties to this Agreement acknowledge that the provisions of this Agreement, the Market Rules and other Schedules to the Agreement shall be subject to periodic change when necessary

16 2 The Board shall be required to undertake a full review of the operation of the Agreement according to the Clauses 16 2 1 and 16 2 2, to assess

16 2 The Board supervising the execution of this Agreement according to this Clause shall consider the issues on necessity to make changes to the Agreement

28

Draft of 3 August 1998

Changes have been made in the EMA version of 13 July 1998 as follows

Strikethrough – text to be deleted or transferred to relevant Clauses

Highlight – changes and amendments to version of 13 July 1998, also text transferred

The rest text remains unchanged as compared with version of 13 July 1998

whether the principal objects and purpose set out in Clause 2 are being or could be better achieved The dates for review are

and Schedules in order to assess the achievement of the principal objectives of this Agreement

The Agreement shall be revised

16 2 1 those dates falling 12 and 24 months after the Effective Date and bi-annually thereafter, and

~~16 2 1~~ *once a year during two years since the Effective Date*

16 2 2 such other date(s) as the Market Members in General Meeting may from time to time determine

~~16 2 2~~ *to be deleted*

16 3 Reports Promptly, (and in any event within one month) after each review date, the Board shall prepare or cause to be prepared a written report of its review which shall set out

16 3 *Revision Reports*

Promptly, (and in any event within one month) after each review date, the Board shall prepare a written report which shall set out

16 3 1 the scope of the review conducted,

16 3 1 the scope of the review conducted,

16 3 2 the matters reviewed and the investigations and enquiries made,

~~16 3 2~~ *to be deleted*

16 3 3 the findings of such review,

~~16 3 3~~ 16 3 2 the findings of such revision,

16 3 4 the recommendations (if any) as to the changes to be made to the Energomarket Members' Agreement, the Market Rules and Market Operating System so as to achieve or better to achieve the principal objects and purpose set out in Clause 2,

~~16 3 4~~ 16 3 3 the recommendations on changes to be made *to the Market Rules and other Schedules to the Agreement*

16 3 5 the effect which any such recommendation referred to in Clause 16 3 4 would, if implemented, have on the role of the Market Auditor under this Agreement and any comments of the Market Auditor may have on any such recommendation,

~~16 3 5~~ 16 3 4 *the effect anticipated if changes recommended by the Market Auditor are implemented*

Draft of 3 August 1998

Lec-printer\L Gorbunova\EMAAgreement\EMArev3Aug-2 doc

Changes have been made in the EMA version of 13 July 1998 as follows

Strikethrough – text to be deleted or transferred to relevant Clauses

Highlight – changes and amendments to version of 13 July 1998, also text transferred

The rest text remains unchanged as compared with version of 13 July 1998

16 3 6 the financial effects (if any) which any such recommendation referred to in Clause would, if implemented, have on Market Members, and

~~16 3 6~~ 16 3 5 the financial effects which any such recommendation referred to in Clause ~~16 3 4~~ 16 3 3 would, if implemented, have on *the Parties to the Agreement*, and

16 3 7 such other matters as the Board shall consider appropriate

~~16 3 7~~ 16 3 6 the other matters, *the decisions of which the Board shall consider expedient*

The Board shall notify each Party, the Market Auditor, and NERC of any such review and provide them each with a copy of the Board's report accordingly

The Board shall notify each Party, the Market Auditor, *appropriate state authorities and other parties concerned* of any such review and provide them each with a copy of the Board's report accordingly

Changes have been made in the EMA version of 13 July 1998 as follows

Strikethrough – text to be deleted or transferred to relevant Clauses

Highlight – changes and amendments to version of 13 July 1998, also text transferred

The rest text remains unchanged as compared with version of 13 July 1998

17 Force Majeure and Emergency Procedures

17.1 Where the ESE or any other Parties (the "Non-Performing Party") is unable to carry out all or any of its obligations under this Agreement by reason of Force Majeure the non-performing Party's duty to carry out those specific obligations shall be suspended for a period equal to the Force Majeure provided that the suspension of performance is of no greater scope and of no longer duration than is required by the Force Majeure in respect of the suspension of the Non-Performing Party's obligations

(a) the Non-Performing Party gives the Board (which shall promptly inform the other Parties, the Market Auditor and the NERC) prompt notice describing the circumstance of Force Majeure, including the nature of the occurrence and its expected duration, and continues to furnish daily reports with respect thereto during the period of Force Majeure, and

(b) the Non-Performing Party uses all reasonable efforts to remedy its inability to perform and to mitigate the effects of such Force Majeure

17.2 Discussions

As soon as practicable after the occurrence of the Force Majeure the Non-Performing Party shall discuss with the other affected Parties how best to continue its operations and give effect to its obligations so far as possible in accordance with this Agreement. If such Force Majeure continues for a period in excess of 90 days, the Board shall review whether the Non-Performing Party should cease to be a Market Member

17.3 Burden of Proof The Non-Performing Party shall have the burden

17 Force Majeure and Emergency Procedures

17.1 In case when any Party (the "Non-Performing Party") is unable to carry out all or any of its obligations under this Agreement by reason of Force Majeure the non-performing Party's duty to carry out those specific obligations shall be suspended for a period equal to the Force Majeure provided that the suspension of performance is of no greater scope and of no longer duration than is required by the Force Majeure in respect of the suspension of the Non-Performing Party's obligations

(a) the Non-Performing Party *during the first 24 hours after occurrence of such circumstances* gives the Board (which shall promptly inform the other Parties, the Market Auditor and the NERC) prompt notice describing the circumstance of Force Majeure, including the nature of the occurrence and its expected duration, and continues to furnish daily reports with respect thereto during the period of Force Majeure, and

(b) the Non-Performing Party uses all reasonable efforts to remedy its inability *to carry out activities* and to mitigate the effects of such Force Majeure

17.2 Discussions

As soon as practicable after the occurrence of the Force Majeure the Non-Performing Party shall discuss with the other affected Parties how best to continue its operations and give effect to its obligations so far as possible in accordance with this Agreement. If such Force Majeure continues for a period in excess of 90 days, the Board shall review whether the Non-Performing Party should cease to be a Market Member

17.3 Burden of Proof

The Non-Performing Party shall have the burden of proof for establishing the

Changes have been made in the EMA version of 13 July 1998 as follows
Strikethrough – text to be deleted or transferred to relevant Clauses
Highlight – changes and amendments to version of 13 July 1998 also text transferred
The rest text remains unchanged as compared with version of 13 July 1998

of proof for establishing the existence, and impact on its obligation of Force Majeure

17.4 In the event of a system emergency, declared by the Cabinet of Ministers, the Minister of the Ministry of Energy and Electrification of Ukraine acting through the ESE, may temporarily suspend the despatch, determination of the Wholesale Market Price and load management arrangements of the WEM and manage them by direct order. This order shall lapse when the system emergency terminates. Market Members who incur uncompensated costs in responding to such emergency may apply to the Board for compensation, which shall in turn be included in the Wholesale Market Price.

PART V - Legal Terms & Conditions

18 Default

18.1 A Market Member shall be in default of this Agreement if
18.1.1 the relevant Advance Payment has not been provided, maintained and replenished as required,

18.1.2 it has failed to pay any outstanding sum determined under this Agreement within 5 working days of the due date

18.1.3 it has failed to comply with any other terms of this Agreement capable of remedy which has not been remedied within a reasonable period of time to be determined by the Board or

existence, and impact on its obligation of, Force Majeure

17.4 In the event of an *integrated power system of Ukraine* emergency, declared by the Cabinet of Ministers, the Minister of the Ministry of Energy and Electrification of Ukraine, acting through the ~~NDC~~ Despatch Operator, may temporarily suspend the despatch, determination of the Wholesale Market Price and load management arrangements of the WEM and manage them by direct order. This order shall lapse when the system emergency terminates. Market Members who incur uncompensated costs in responding to such emergency may apply to the Board for compensation, which shall *consider the inclusion of these costs in the Wholesale Market Price*

PART V - Legal Terms and Conditions

18 Liability of the Parties

~~111 Provisions 18.1-18.2 of the acting Agreement are transferred to provision 4.3.2 of the Draft of changes and amendments 111~~

18.1 Substantiation and forms

18.1.1 *Legal liability in accordance with this Agreement means material and other liability for non-fulfillment or undue fulfillment of obligations by each of the Parties according to the Agreement*

18.1.2 *Debtor is a Party to this Agreement which did not fulfill its obligations according to the Agreement or fulfilled them in undue order and is considered to be in default of this Agreement according to provision*

~~4.3.2~~ 4.3.3

18.1.3 *Obligations emerge and responsibility comes into force as follows*

a) *the Generators are responsible before the Suppliers for non-execution of the load schedule prepared by the Settlement System Administrator on*

152

Draft of 3 August 1998

Changes have been made in the EMA version of 13 July 1998 as follows

Strikethrough - text to be deleted or transferred to relevant Clauses

Highlight - changes and amendments to version of 13 July 1998 also text transferred

The rest text remains unchanged as compared with version of 13 July 1998

18.1.4 it has been declared bankrupt under Ukrainian Law

The ESE shall have sole responsibility for serving a Default Notice on instruction of the Board

18.2 If the LSL serves a Default Notice on a Market Member and the matter on which the Default Notice was served has not been resolved within 5 calendar days of the issue of that notice, then the Board may take any of the following enforcement actions

18.2.1 to suspend sales to the Defaulting Market Member,

18.2.2 to place a block on all bank accounts of the Defaulting Market Member,

- based on bids under the Market Rules,*
- b) the Suppliers shall be responsible before the Commission Agent, or electricity Generators for non-payment or untimely payment for electricity purchased from*
 - c) the Suppliers shall be responsible before the Commission Agent or the Generators for non-performance of the declared electricity purchase under the Market Rules,*
 - d) the Commission Agent shall be responsible before the Consignors for improper execution of functions by the Commission Agent within the relevant system of payments to its account from the WEM account*
 - e) the ~~ADC~~ Despatch Operator ~~as the Dispatcher~~ of the Integrated Energy System shall be responsible for non-fulfillment of the load schedule developed by the Settlement System Administrator except cases when such non-fulfillment is caused by the need to prevent emergencies in the Ukraine's Integrated Energy System and liquidate their consequences under the Market Rules*
 - f) the Market Funds Administrator before the Parties to the Agreement for untimely or improper administration of funds received to the WEM account within the relevant system of payments to its account from the WFM account*

18.2 Claim and complaint presentation procedure

18.2.1 If a Debtor does not pay to ~~ADC~~ for electricity purchased by it, the Generators in their interests shall oblige the Commission Agent to serve a claim to such Debtor requiring to pay off the debt, and notify the Board of the Wholesale Electricity Market about this

18.2.2 If the Debtor agrees to the claim he shall send his reply to the claim to ~~ADC~~ the Commission Agent within the term provisioned by the current

153

Draft of 3 August 1998

Changes have been made in the EMA version of 13 July 1998 as follows
Strikethrough - text to be deleted or transferred to relevant Clauses
Highlight - changes and amendments to version of 13 July 1998 - also text transferred
The rest text remains unchanged as compared with version of 13 July 1998

Lec printer:L.Gorbunova\EMAAgreement\EMArev3Aug 2 doc

18.2.3 to disconnect the entire load of the Defaulting Market Member if connected to the Main and Interstate High Voltage Network, or

18.2.4 to disconnect the relevant part of the load in Section 18.2.3 if such default relates to a specific consumer or group of consumers or

18.2.5 to in turn instruct the Main and Interstate High Voltage Network Operator under the terms of the High Voltage System Operating Guidelines to take the necessary steps to implement the instructed disconnection in Clause 18.2.3 or 18.2.4,

18.2.6 Termination with consent of the NERC of the Defaulting Market Member as defined under this Agreement

18.3 Sharing of risk Each Market Member (other than the Defaulting Market Member) shall be severally liable for its Contributory Share of all sums (including all relevant taxes) which the Defaulting Market Member is required to pay in respect of its electricity purchased from the FSE as determined under the Market Rules. **The Contributory Share shall be determined by the Market Funds Procedure.** The Defaulting Market Member is required to pay a penalty equivalent to an interest charge on all

legislation, in which he shall express his agreement with the claim
18.2.3 *If the Debtor does not agree with the presented claim, he shall send his reply to the claim within the term provisioned by clause 18.2.2 whereby he shall list justified reasons for his disagreement with the claim requirements*

In case of Debtor's disagreement with the claim requirements or if his reply is not available the Commission agent shall submit the dispute to the Arbitration Commission of the Wholesale Electricity Market

18.2.4 The Arbitration Commission shall accept and consider a matter according to the Dispute procedure and make a decision

If such decision satisfies the Parties to the dispute, it is the subject to execution under the current legislation

If the Arbitration Commission decision does not satisfy a Party to the dispute, it may apply to the Arbitration Court of Ukraine

In this case, the Commission Agent shall pay from its settlement account the state tax based on the charges of interested persons to be protected by the claim. The cash collections to pay the state tax and their return shall be carried out according to MFP

18.3 Mechanism for liability scope determination

18.3.1 *Monthly electricity volume obtained from the Wholesale Electricity Market its cost and calculation of forfeit penalty shall be listed in the claim sent by ~~NDC~~ the Commission Agent to the Debtor. Electricity volume obtained but unpaid by the Supplier shall be determined based on data presented by the Chief of Commercial Metering and by the Market Fund Administrator. Not only banking but other forms*

154

Draft of 3 August 1998

Changes have been made in the EMA version of 13 July 1998 as follows
Strikethrough - text to be deleted or transferred to relevant Clauses
Highlight - changes and amendments to version of 13 July 1998 - also text transferred
The rest text remains unchanged as compared with version of 13 July 1998

sums owed which as incurred between the due date and the eventual payment date

18.4 Exclusion of certain types of loss subject to Section 18.3 and except where any provision of this Agreement provides for an indemnity neither the Defaulting Market Member nor any of its officers, employees or agents shall in any circumstances whatsoever be liable to any of the other Parties for

18.4.1 any loss of profit, loss of revenue, loss of use, loss of contract or loss of goodwill or

18.4.2 any indirect or consequential loss or

18.4.3 loss resulting from the liability of any other Party to any other person except as provided in Sections 18.1 and 18.3

18.5 The Defaulting Market Member shall fully indemnify the Dispatch Operator and any other user affected against all liability, loss or damage which it may incur through disconnection

of debt payment shall be taken into the account

~~18.4 Transferred to provision 19.1.2~~

18.4 Rules to determine Supplier's debt to the Generator

18.4.1 Determination of Supplier's debt to a specific Generator shall be carried out in terms of the following formula: $C = (a / \sum) \cdot B$

where C is the debt sum of Supplier against whom the claim (action) is brought for electricity purchased from the ADG, the Commission Agent before the Creditor who has brought this claim (action)

B is the total sum of the debt to the ADG Commission Agent for purchased electricity of the Supplier against whom the claim (action) is brought

λ_n is a coefficient of Supplier's (B) debt to Generator (a) that is determined by

$$\lambda_n = a / \sum$$

\sum is the total debt sum due to be paid to all Creditors from the account of the Wholesale Electricity Market

$$\sum = a_1 + a_2 + a_3 + \dots + a_n \text{ where}$$

a_1, a_2, \dots, a_n are the sums due to be paid to each Creditor

a is the total debt sum due to be paid from the Wholesale Electricity Market's account to the Generator who has presented the claim (action)

18.5 Sharing of risk

18.5.1 Each Market Member (other than the Defaulting Market Member) shall be severally liable for its Contributory Share of all sums (including all relevant taxes) which the Defaulting Market Member is required to pay in respect of its electricity purchased from the ESE Commission Agent as determined under the Market Rules. **The Contributory Share shall be determined by the Market Funds Procedure.** The Defaulting Market Member is required to pay a penalty equivalent to an interest charge on all sums owed which as incurred between the due date and the eventual payment

15

Draft of 3 August 1998

Changes have been made in the EMA version of 13 July 1998 as follows

Strikethrough – text to be deleted or transferred to relevant Clauses

Highlight – changes and amendments to version of 13 July 1998, also text transferred

The rest text remains unchanged as compared with version of 13 July 1998

18 6 Any suspension or termination of a Market Member under the terms of this Section shall not remove or reduce in any way its rights and liabilities under this Agreement accrued prior to such suspension or termination

18 7 Any suspension or termination of a Market Member under the terms of this Section shall result in the suspension of its voting rights under Sections 5 and 6 of the Energomarket Members' Agreement

19 Limitation of Liability

19 1 Subject to Clause 19 3 each Party agrees and acknowledges that no Party shall be liable to any of the other Parties for loss arising from any breach of this Agreement other than for any loss directly resulting from such breach and which at the date of this Agreement was reasonably foreseeable as likely to occur in the ordinary course of events from such a breach

date

18 5 2 The Defaulting Market Member shall fully indemnify the ~~NDC~~ Commission Agent, Despatch Operator and any other *Parties* affected against all liability, loss or damage which it may incur through disconnection

18 6 Any suspension or termination of a *Party* under the terms of this Section shall not remove or reduce in any way *its* rights and liabilities under this Agreement accrued prior to such suspension or termination

~~18 7 TRANSFERRED TO CLAUSE 4 3 2~~

19 Limitation of Liability

19 1 The Commission Agent shall not be responsible before Generators for Suppliers not meeting their liabilities according to this Agreement but shall receive the rights and become responsible before the Suppliers in electricity trading relations

The ~~NDC~~ Commission Agent shall not be liable for any costs or losses either actual or potential incurred by any Market Member as a result of errors or omissions in the Market Operating System. However, any Market Member may report any such error or omission to the Board who may determine whether any action is required to rectify this error

~~NDC~~ Market Funds Administrator's obligation to pay for energy purchased from Generators under this Agreement shall be strictly limited to the funds available to it on the market account pursuant to the Market Funds Administration Procedure (Schedule 4)

156

Draft of 3 August 1998

Changes have been made in the EMA version of 13 July 1998 as follows

Strikethrough – text to be deleted or transferred to relevant Clauses

Highlight – changes and amendments to version of 13 July 1998, also text transferred

The rest text remains unchanged as compared with version of 13 July 1998

19 1 1 Subject to Clause 19 3 each Party agrees and acknowledges that no Party shall be liable to any of the other Parties for loss arising from any breach of this Agreement other than for any loss directly resulting from such breach and which at the date of this Agreement was reasonably foreseeable as likely to occur in the ordinary course of events from such a breach

19 1 2 Exclusions on certain types of loss

Subject to Clause 19 3 and except where any provision of this Agreement provides for an indemnity, the Defaulting Party in any circumstances shall not be liable to any of the other Parties for

~~19 1 3~~ a) any loss of profit, loss of revenue, loss of assets, loss of contract or loss of goodwill

~~19 1 4~~ b) direct or indirect losses,

~~19 1 5~~ c) any loss resulting from the liability of any other Party to any other person except as provided in Clauses 18 1 and 18 3 of this Agreement,

~~19 1 6~~ 19 1 3 The Defaulting Market Member shall fully indemnify the Despatch Operator and any other user affected against all liability, loss or damage which it may incur through disconnection

19 2 Exclusion of certain types of loss subject to Clause 19 3 and except where any provision of this Agreement provides for an indemnity, neither the Party liable nor any of its officers, employees or agents shall in any circumstances whatsoever be liable to any of the other Parties for

19 2 Exclusion of certain types of loss

subject to Clause 19 3 and except where any provision of this Agreement provides for an indemnity, neither the Party liable nor any of its officers, employees or agents shall in any circumstances whatsoever shall be liable to any of the other Parties for

19 2 1 any loss of profit, loss of revenue, loss of use, loss of contract or loss

157

Draft of 3 August 1998

Changes have been made in the EMA version of 13 July 1998 as follows

Strikethrough – text to be deleted or transferred to relevant Clauses

Highlight – changes and amendments to version of 13 July 1998, also text transferred

The rest text remains unchanged as compared with version of 13 July 1998

of goodwill, or

19 2 1 any loss of profit, loss of revenue, loss of contract or loss of goodwill

19 2 2 any indirect or consequential loss, or

~~19 2 2 TO BE DELETED~~

19 2 3 loss resulting from the liability of any other Party to any other person except as provided in clauses 19 1 and 19 3

19 3 In particular

~~19 3 Transferred to Clause 19 1~~

(a) Nothing in the Agreement shall be interpreted as meaning that the ESE, in its capacity as purchaser and seller of energy under the terms and conditions of this Agreement, is in turn liable for any liabilities of any Market Member whatsoever

~~19 4 TO BE DELETED~~

~~19 5~~ 19 3 *Enforcement of the Agreement*

(b) The ESE shall not be liable for any costs or losses, either actual or potential, incurred by any Market Member as a result of errors or omissions in the Market Operating System or by any of its staff if it had been demonstrated to have followed Good Industry Practice. However, any Market Member may report any such error or omission to the Board who may determine whether any action is required to rectify this error

If one or more Clauses of this Agreement is found to be invalid unlawful or otherwise unenforceable, the others shall remain in effect

(c) The ESE's obligation to pay for energy purchased under this Agreement is strictly limited to the funds available to it pursuant to the Market Funds Administration Procedure (Schedule 4 hereto)

19 4 Death and personal injury Nothing in this Agreement shall exclude or limit the liability of any party for death or personal injury resulting from the negligence of the Party or any of its, employees or agents

19 5 Survival Each of the Clauses in this Clause shall

Draft of 3 August 1998

Changes have been made in the EMA version of 13 July 1998 as follows
Strikethrough – text to be deleted or transferred to relevant Clauses
Highlight – changes and amendments to version of 13 July 1998, also text transferred
The rest text remains unchanged as compared with version of 13 July 1998

19.5.1 be regarded as a separate contract term, and if one or more of such Clauses is found to be invalid, unlawful or otherwise unenforceable, the others shall remain in effect, and

19.5.2 survive termination of this Agreement

20 Term and Termination

20.1 Term This Agreement shall have no fixed duration

20.2 Suspension of Market Member's voting rights a Market Member's voting rights shall be suspended only in the circumstances and to the extent specified in Clauses 4.3 and 18

20.3 Termination as a Party A Market Member shall cease to be a Party only

20.3.1 in the circumstances and to the extent specified in Clause 4.3, or

20.3.2 in the circumstances and to the extent specified in Clause

20.4 Termination of the Agreement This Agreement may be terminated by a unanimous resolution of Market Members in General Meeting and the prior written consent of the NERC has been obtained or automatically as set out in Clause 15.1.3

21 Insurance

21.1 Insurance requirements for the ESE subject to the availability at

20 Term and Termination

20.1 Term This Agreement shall have no fixed duration

~~20.2 TO BE DELETED~~

~~20.3 TO BE DELETED~~

~~20.4~~ **20.2 Termination of the Agreement**

This Agreement may be terminated by a unanimous resolution of Market Members at the General Meeting with the prior written consent of the NERC or automatically for a Party rejecting changes and amendments to this Agreement accepted by 75% of the all Members

21 Insurance

21.1 Upon instruction of the Board ~~AND~~ the Commission, Agent may

159

Draft of 3 August 1998

Changes have been made in the EMA version of 13 July 1998 as follows
Strikethrough – text to be deleted or transferred to relevant Clauses
Highlight – changes and amendments to version of 13 July 1998, also text transferred
The rest text remains unchanged as compared with version of 13 July 1998

reasonable cost in Ukraine, the ESE shall acquire the following insurances

insure risks connected with ensuring WEM operation according to Ukrainian legislation

21.1.1 insurance with respect to loss or damage to any aspect of the Market Operating System equivalent to its replacement cost, and

~~21.1.1 TO BE DELETED~~

21.1.2 professional indemnity insurance of an amount agreed by the Energomarket Board

~~21.1.2 TO BE DELETED~~

21.2 Costs All premiums and other sums of money payable for all insurances in this Clause shall be recovered in accordance with the Accounting Procedure

21.2 Costs
Any costs related to insuring procedures complying with this Clause shall be recovered in accordance with the Accounting Procedure

21.3 Application of proceeds the ESE shall use all reasonable means to make and collect claims promptly and make all payments towards making good the loss and fully repairing the damage or meeting the relevant liability

21.3 Application of proceeds
The ~~NDC~~ *Commission Agent* shall use all reasonable means to make and collect claims promptly and make all payments towards making good the loss and fully repairing the damage or meeting the relevant liability

21.4 Information requirements the ESE shall promptly supply the Board upon request with an insurance broker's certificate satisfactory to the Board confirming that cover has been effected in respect of the insurances referred to in this Clause and giving reasonable details of the terms and conditions of such insurances

21.4 Information requirements
~~NDC~~ *The Commission Agent* shall promptly supply the Board upon request *the insurance contract and other documents* confirming that cover has been effected in respect of the insurance referred to in this Clause and giving reasonable details of the terms and conditions of such insurance

22 Confidentiality

22 Confidentiality

22.1 Interpretation Data and other information which any Party is permitted or obliged to divulge to any other Party under this Agreement shall

22.1 *Market Members shall treat this Agreement and information received from other Members as confidential and shall undertake the measures*

Draft of 3 August 1998

Changes have been made in the EMA version of 13 July 1998 as follows

Strikethrough – text to be deleted or transferred to relevant Clauses

Highlight – changes and amendments to version of 13 July 1998, also text transferred

The rest text remains unchanged as compared with version of 13 July 1998

Lec printer\L Gorbunova\EMAAgreement\EMArev3Aug-2 doc

not necessarily be regarded as being in the public domain simply by reason of being so divulged

necessary to prevent the release of such information or its transfer to a third party, including addition of special provisions to the employment and other contracts

22.2 The Energomarket State Enterprise or any other Party shall not divulge any information to any Party to this Agreement or any other party any information on any Market Member except that which it is specifically required to publish under the terms of this Agreement or as requested by the NERC or in compliance with any order of the Government of Ukraine

~~22.2 TO BE DELETED~~

22.3 Use of information by the Energomarket State Enterprise The Energomarket State Enterprise may use any information or data supplied to or acquired by it from other Parties for the following purposes

~~22.3~~ *22.2 Release of mentioned information or transfer of rights for it to the third parties publication of the information received by the Members shall be carried out only upon the prior written consent of the Board*

22.3.1 the operation and planning of all Main and Interstate High Voltage Networks of Ukraine,

~~22.3.1 TO BE DELETED~~

22.3.2 the calculation of charges and preparation of offers of terms for connection to or use of any Main and Interstate High Voltage Networks of Ukraine

~~22.3.2 TO BE DELETED~~

22.3.3 payment for Ancillary Services provision, and

~~22.3.3 TO BE DELETED~~

22.3.4 the operation of the Market Rules

~~22.3.4 TO BE DELETED~~

22.4 General Confidentiality Conditions Each Party undertakes with each other Party (including the Energomarket State Enterprise) that it shall maintain the confidentiality of any Confidential Information except

22.3 Restrictions specified in Clause 22 shall not apply to
a) information generally known and available to public,
b) information that the Parties have at their disposal according to the effective legislation,

22.4.1 the exception in Clause 22.3, or

161

Draft of 3 August 1998

Changes have been made in the EMA version of 13 July 1998 as follows

Strikethrough – text to be deleted or transferred to relevant Clauses

Highlight – changes and amendments to version of 13 July 1998, also text transferred

The rest text remains unchanged as compared with version of 13 July 1998

22 4 2 to the extent permitted by this Agreement, or

22 4 3 with the prior consent in writing of the Party to whose affairs such information relates,

22 5 Exceptions to the confidentiality conditions are

22 5 1 any information already within the public domain,

22 5 2 if the provider of such information is required to make disclosure of the confidential information under any license, or law

22 5 3 dissemination of such information to the employees, directors, agents, consultants and professional advisers of the provider

22 6 Subject to the foregoing provisions of this Clause 22, the Energomarket State Enterprise may provide data and other information in the Market Rules to any person who is not a Party on request subject to a charge and shall maintain a record of the information given and those requesting it. The same conditions shall apply to any subcommittees which may be formed pursuant to any future Board decisions

- c) any information already within the public domain,
- d) dissemination of such information to the employees, directors, agents, consultants and professional advisers of the provider

22 4 The Consignor, Market Funds Administrator, Settlement System Administrator, Secretariat may provide data and other information according to the Market Rules to any other person who is not a Party on request subject to a charge and shall sign a document where such information is given

~~22 4 1 TO BE DELETED~~

~~22 4 2 TO BE DELETED~~

~~22 4 3 TO BE DELETED~~

~~22 5 TO BE DELETED~~

~~22 5 1 TO BE DELETED~~

~~22 5 2 TO BE DELETED~~

~~22 5 3 TO BE DELETED~~

~~22 6 TO BE DELETED~~

142

Changes have been made in the EMA version of 13 July 1998 as follows
Strikethrough text to be deleted or transferred to relevant Clauses
Highlight changes and amendments to version of 13 July 1998 also text transferred
The rest text remains unchanged as compared with version of 13 July 1998

23 1 Addresses Any, notice or other communication given by one Party to another, from the ESE or the Board to any Party, under this Agreement shall be addressed to the recipient and sent to the address, telex number or facsimile number of such other Party given in this Agreement for the purpose and marked for the attention of the Party's nominee as notified from time to time

23 2 Deemed Receipt Any notice or other communication to be given by any Party to any other Party shall be in writing and given by letter (delivered by hand or sent by post) or telex or facsimile, and shall be deemed to have been received -

23 2 1 in the case of delivery by hand, when delivered, or

23 2 2 in the case of telex, on the day of transmission, or

23 2 3 in the case of facsimile, on acknowledgment by the addressee's facsimile receiving equipment

23 1 *Notice Procedure*

Any notices in connection with this Agreement must be executed in writing in the Ukrainian language

23 2 *Any notices delivered by telegram, telex, and facsimile shall have legal force and be deemed effective documents. Notices may also be delivered by mail to the legal addresses of the Parties*

~~23 2 1 To be deleted~~

~~23 2 2 To be deleted~~

~~23 2 3 To be deleted~~

23 3 *The Members pledge to provide timely notification to other Members on any changes in their legal addresses*

23 4 *The receipt date for a Notice shall be deemed as follows*

(a) in the case of telegram, telex or facsimile, the business day following the sending date

(b) in the case of registered letter, the fourteenth day from the sending date

(c) in other cases the receipt date confirmed by the addressee

23 5 *The Notices shall be deemed received and known to the Members on the receipt date as per clause 23 4*

Changes have been made in the EMA version of 13 July 1998 as follows

Strikethrough – text to be deleted or transferred to relevant Clauses

Highlight – changes and amendments to version of 13 July 1998, also text transferred

The rest text remains unchanged as compared with version of 13 July 1998

24 Assignment

24.1 A Party shall not assign and/or transfer any of its rights and/or obligations under this Agreement

25 Waivers, Remedies not Cumulative

25.1 Waivers No delay by or omission of any Party in exercising any right, power, privilege or remedy under this Agreement shall impair such a right, power privilege or remedy or be construed as a waiver of it

25.2 Remedies not Cumulative The rights and remedies provided by this Agreement for breach of this Agreement to the Parties are exclusive and not cumulative

25.3 NERC's Rights For the avoidance of doubt the Parties acknowledge and agree that nothing in this Agreement shall exclude or restrict any of the rights, powers, privileges, remedies, duties and obligations of the NERC under the relevant legislation or any License

26 Severance of Terms

26.1 If for any reason whatever any provision of this Agreement is or becomes invalid, illegal or unenforceable or is declared as such by any court of Ukraine or the Government of Ukraine, the Parties will negotiate in good faith with a view to agreeing one or more provisions which may be substituted for the invalid, unenforceable or illegal provisions which provide an appropriate balance of the commercial interests of the Parties

26.2 If for any reason whatever, any provision of this Agreement is deemed invalid, the other provisions of the Agreement shall remain in

24 Assignment

24.1 A Party shall not assign and/or transfer any of its rights and/or obligations under this Agreement

25 Waivers, Application of Remedies

25.1 Waivers If a Party to this Agreement does not exercise its rights thereunder or use them to the full extent, this shall not be deemed a waiver thereof The Party may use the NDC rights on its own discretion at any moment

25.2 Application of Remedies The Parties to this Agreement recognize that in the event of any breach thereof they should be liable to the enforcement measures or other remedies stipulated by this Agreement or the provisions of the effective law

~~25.3 To be deleted~~

26 Severance of Terms

26.1 If for any reason (legal changes, statutory or court decision) whatever any provision of this Agreement is or becomes invalid, or is declared as such by court, the Parties will negotiate in good faith with a view to substitute such provisions or bring them into the compliance with the effective law so that they will provide an appropriate balance of the commercial interests of the Parties

26.2 If for any reason whatever, certain provisions of this Agreement are deemed invalid, the other provisions of the Agreement shall remain in

104

Changes have been made in the EMA version of 13 July 1998 as follows

Strikethrough – text to be deleted or transferred to relevant Clauses

Highlight – changes and amendments to version of 13 July 1998, also text transferred

The rest text remains unchanged as compared with version of 13 July 1998

force

27 Disputes Settlement

27.1 The Parties to this Agreement shall be subject to the following disputes procedures. A Disputes Committee shall be constituted, consisting of 3 individuals selected by the Board. The Disputes Committee shall meet monthly, or more frequently if required. Meetings of the Disputes Committee shall be convened by the Secretariat at the request of the Board or by any two or more parties to any dispute.

27.2 Any issue referred to the Disputes Committee ("Notified Issue") shall only have emanated from a Settlement Dispute, defined as being any disagreement concerning the payment to or from a Market Member as ordered by the Market Funds Administrator.

27.3 The Disputes Committee shall make decisions on the basis of a majority vote. It shall have access to all information it reasonably requires in relation to the relevant dispute and may request that information from the Parties to the dispute, the Settlement System Administrator, Market Funds Administrator, Market Auditor and Despatch Operator.

27.4 The Disputes Committee shall develop an Agreed Procedure in consultation with Market Members for the purpose of hearing disputes. Such an Agreed Procedure shall be put in place within one month of the Effective Date and shall be approved by the Board. All subsequent amendments to the procedure shall also be subject to the approval of the Board.

force

27 Disputes Settlement

Any disputes arising between the Parties from this Agreement or in connection therewith shall be resolved through negotiations.

27.1 *Should the Parties fail to reach an agreement, they shall resort to applying to the Disputes Committee constituted of the 3 persons selected by the Board. Meetings of the Disputes Committee shall be convened by the Secretariat at the request of the Board or a party to any dispute.*

27.2 *The Disputes Committee shall concern the disputes stemming from WEM Settlements and breaches of terms and conditions of this Agreement.*

27.3 *The Disputes Committee shall draw its conclusion to be approved on the basis of a majority vote and pass it for the Board's approval. It shall have access to all information it reasonably requires in relation to the relevant dispute and may request that information from the Parties to the dispute, the Settlement System Administrator, Market Funds Administrator, Market Auditor and National Despatch Centre.*

27.4 *The Disputes Committee shall develop a Dispute Settlement Procedure.*

105

Draft of 3 August 1998

Changes have been made in the EMA version of 13 July 1998 as follows

Strikethrough – text to be deleted or transferred to relevant Clauses

Highlight – changes and amendments to version of 13 July 1998, also text transferred

The rest text remains unchanged as compared with version of 13 July 1998

27.5 Any Notified Issue to be referred to the Disputes Committee shall relate to matters notified to the Board no later than 15 days prior to notification to the Disputes Committee. Such Notified Issues shall be reviewed by the Disputes Committee within 15 days of the date of the Notified Issue.

27.5 Any Notified Issue to be referred to the Disputes Committee shall be reviewed within 15 days of the dispute case registration date as stipulated by the Dispute Settlement Procedure.

27.6 Attendance at any meeting of the Disputes Committee shall be limited to 4 representatives of each Party involved in the relevant dispute, including their advisors.

27.6 When necessary, representatives of the parties to the relevant dispute or representatives of other Parties to the Agreement may be invited to the meetings of the Disputes Committee.

27.7 The decision of the Disputes Committee in respect of any Notified Issue can be appealed to the NERC within 5 days of the Disputes Committee's decision.

~~27.7 To be deleted~~

27.8 The costs of the Disputes Committee shall be recovered by the ESE through the Accounting Procedure.

~~27.8~~ 27.7 The costs of the Disputes Committee shall be recovered by the Settlement System Administrator through the Accounting Procedure.

28 Jurisdiction

28 Jurisdiction

28.1 Submission to jurisdiction subject and without prejudice to any other Sections of this Agreement, all the Parties agree that the courts of Ukraine are to have exclusive jurisdiction to settle any disputes which may arise out of or in connection with this Agreement and that accordingly any suit, action or proceeding arising out of or in connection with this Agreement may be brought in such courts.

All disputes remaining unresolved under the procedure established by this Agreement shall be resolved pursuant to the effective law of Ukraine.

~~To be deleted~~

28.2 Waiver each Party irrevocably waives any objection which it may

Draft of 3 August 1998

Changes have been made in the EMA version of 13 July 1998 as follows

Strikethrough – text to be deleted or transferred to relevant Clauses

Highlight – changes and amendments to version of 13 July 1998 also text transferred

The rest text remains unchanged as compared with version of 13 July 1998

have to any Proceedings in any court as referred to in this Section and agrees that a judgment in any Proceedings brought in the Ukrainian courts shall be conclusive and binding upon each Party *To be deleted*

28 3 Each Party which is not incorporated in any part of Ukraine agrees that if it does not have, or shall cease to have, a place of business in Ukraine it will promptly appoint the ESE (or such other person as shall be acceptable to the Board) to accept on its behalf any Proceedings in Ukraine *To be deleted*

29 Governing Law

29 1 This Agreement shall be governed by, and construed in all respects in accordance with Ukrainian law ~~29 To be deleted~~

30 Entire Agreement

30 1 As of the date first written above this Agreement sets for the full, complete and entire understanding of the Parties relating to the subjects addressed herein and it supersedes any prior Agreement, whether oral or written, related to the subjects addressed in the Agreement

30 2 All the ESE energy purchase and/or sale contracts with any Party are hereby canceled as of the Effective Date and are replaced by this Agreement

30 Entire Agreement

30 1 As of the date first written above this Agreement sets for the full, complete and entire understanding of the Parties relating to the subjects addressed herein and it supersedes any prior Agreement in respect of the *relations regulated* by this Agreement

30 2 All the ~~NDC~~ Commission Agent's energy purchase and/or sale contracts with any Party are hereby canceled as of the Effective Date and are replaced by this Agreement

31 Independent Legal Support to the Wholesale Electricity Market Activity

167

Draft of 3 August 1998

Changes have been made in the EMA version of 13 July 1998 as follows

Strikethrough – text to be deleted or transferred to relevant Clauses

Highlight – changes and amendments to version of 13 July 1998, also text transferred

The rest text remains unchanged as compared with version of 13 July 1998

- 31 1 The Board shall charge the ~~NDC~~ Commission Agent with concluding an agreement with the Market Lawyer who will provide the legal support to the WEM activity on a regular basis
- 31 2 The Market Lawyer's Responsibilities
 - 31 2 1 Unprejudiced estimate of lawfulness of the adopted decisions at the Board and General meetings
 - 31 2 2 The Market Lawyer shall carry out a comprehensive oversight of the Agreement execution, consider the infringements of the Agreement terms and conditions by Market Members and inform the Board about such infringements
 - 31 2 3 Consider changes and amendments to the Agreement, and submit the relevant conclusions to the Board and any interested parties
 - 31 2 4 Analyze the Arbitrage Committee proceedings and claims of Market Members
 - 31 2 5 Submit proposals on introduction of changes to the Agreement, Market Rules and Market Operating System aimed at achievement of the main objective and purposes of the Agreement
- 31 3 The Market Lawyer's Rights
 - 31 3 1 The Market Lawyer shall be entitled to attend the Board meetings and General meetings of Market Members
 - 31 3 2 The Market Lawyer shall be entitled to terminate the agreement, with advance notification of the Board within the terms stipulated in the agreement
- 31 4 Confidentiality When concluding an agreement with the Market Lawyer, the confidentiality observance shall be a compulsory condition of the agreement
- 31 5 The Market Lawyer expenses shall be covered according to the Accounting Procedure (Schedule 5)

Draft of 3 August 1998

Changes have been made in the EMA version of 13 July 1998 as follows

Strikethrough – text to be deleted or transferred to relevant Clauses

Highlight – changes and amendments to version of 13 July 1998 also text transferred

The rest text remains unchanged as compared with version of 13 July 1998

Lec printer\L Gorbunova\EMAAgreement\EMArev3Aug-2 doc

32 TRANSITIONAL PROVISIONS

The Law Firm
ACTIVE

Vul Prorizna 3
Suite 25
Kiev, 252001 Ukraine
Tel (380 44) 229-7742

September 01, 1998

Mr David Wolcott
Chief of the Party

HAGLER BAILLY, INC
Vul Esplanadna, 20
Floor 10
Kiev- 252023 Ukraine

Dear Mr Wolcott

As it was set forth by the contract as of 01 08 1998, # D-168-005-P-8-932, enclosed is the legal conclusion with regard to the Draft Contract on the Wholesale Market of Electricity in Ukraine

As a reminder, this is the first conclusion out of the series of the legal analyses we have to prepare for your consideration. The other conclusions will be submitted to you as it was agreed by the contract.

Should you have any questions please do not hesitate to contact us as soon as possible. We would be glad to make any clarification of the matter.

We hope that this conclusion will meet your expectations.

Sincerely

Mr Vladimir P Elmolin, Esq
President



**THE LEGAL CONCLUSION
AS TO THE COMPLIANCE OF A DRAFT CONTRACT
OF WHOLESALE ELECTRICITY-MARKET MEMBERS
TO THE UKRAINIAN LEGISLATION**

This conclusion has been prepared in accordance with the contract # D-168-005-P-8-932, dated 01 08 1998, supervised by *Hagler Bailly, Inc* Within the project of restructuring the power industry and legal reform in Ukraine This contract has its purpose to make a legal analyze and to submit our suggestions with regard to amendments and changes to the draft contract on Wholesale Electricity Market, to make the analysis of the corresponding laws of Ukraine which govern the activity in the power industry

Following the purpose of the contract # D-168-005-P-8-932, the legal conclusion has been made as to the compliance of a revised edition of the Draft Contract of the Members of the Wholesale Electricity Market to the Ukrainian legislation

This conclusion is one in the series of conclusions, made according to the above-mentioned contract, which has been contracted to prepare, and which will be submitted under the agreed time scheme

This conclusion contains sections following the problems analyzed

- 1 Introduction
- 2 On Status of Parties to the Contract and its Compliance to the Current Legislation of Ukraine
- 3 On Contractual Relations within Wholesale Electricity Market
- 4 On Audit of WEM and Selection of Market Auditor
- 5 On Dispute Resolution Procedure for Parties of the Contract
- 6 Miscellaneous
- 7 On Draft WEMM Contract, Prepared by the Firm "Factorial"
- 8 Summary and Proposals

I. INTRODUCTION

This conclusion is based on the analysis of the current legislation, which governs legal relations in the sphere of production, delivery, supplying and consuming of the electric power, as well as on common practice which has become custom on the Wholesale Electricity Market (WEM) of Ukraine

The following legislative acts has been used for this analysis

The Constitution of Ukraine, the Laws of Ukraine 'On property', 'On Enterprises in Ukraine', 'On Entrepreneurship', 'On Companies', 'On Limitation of Monopoly and Prevention of Unfair Competition in Commercial Activity', 'On Power Industry', 'On Auditing Activity' and the corresponding Decrees of the President of Ukraine, Resolutions of the Cabinet of Ministers of Ukraine (CMU), and Regulations of Ministry of Power Industry, the National Electricity Regulatory Commission (NERC) of Ukraine, and Instructions of the National Bank of Ukraine (NBU) in the sphere that regulates power industry

We have also made research of the laws of the Russian Federation and England

In this Legal Conclusion we use the terminology, which is used in the Law of Ukraine 'On Power Industry' and in a Draft Contract of Wholesale Electricity Market Members (WEMM), hereinafter referred to as a Draft Contract or a Contract

II. ON STATUS OF PARTIES TO THE CONTRACT AND ITS COMPLIANCE TO THE CURRENT LEGISLATION OF UKRAINE

In this section we analyze the Draft Contract from the point of view of its conformity to the Civil Code of Ukraine and Laws 'On Entrepreneurship', 'On Power Industry', 'On Enterprises in a part which defines a party to a contract as a subject of commercial activity The parties to a contract may be persons, which in their own names are

empowered to have tangible and intangible rights and bear the obligations. A party is not determined by its operational duties.

The Law of Ukraine 'On Power Industry' provides that parties to the Contract of WEMM are a Dispatcher, Generators, Deliverers and Suppliers (Buyers). The parties to the Contract (as in the Draft Contract) are a Principal (Generator), a Supplier, an Agent (the National Dispatcher Center of Ukraine, hereinafter referred to as NDC), a Dispatcher in its own name (NDC), an Owner (a company), which owns the high voltage and intergovernmental power grids (in this case it is a state-owned power company "Ukrelectroperedacha"), a Settlement System Administrator (NDC), a Market Funds Administrator (NDC), and the head of the commercial Accounting.

According to the above-mentioned legislative act, the Ministry of Power Industry (a central body of executive power responsible for the power industry) appoints a state company to operate as the Dispatcher (operational and technological management) of the united power grid of Ukraine. Currently this company, acting under the license, is NDC.

A company, which will have the rights and duties of the Administrators may be determined either by a contract or by law. In addition to this, it is legally and logically incorrect, if one company, in this case - NDC, acts as multiple persons. NDC cannot enter into any contract with itself, because this completely denies any liability.

Taking into the consideration that only legal entities can be parties to a contract, NDC as a legal entity, can sign amendments to a contract or to a new edition of a contract for it is one of its natural rights.

Besides that, the interpretation of the term "NDC" as the Settlement System Administrator, the Market Funds Administrator and the head of the Commercial Accounting is incorrect. In the Contract itself there is a stipulation that these activities can be transferred to an other company. Therefore we believe that it would be more proper while interpreting terms, to define only main features of these bodies without referring to the particular company. At the same time it is necessary to insert into a contract the rules of selection of such a company.

Based upon the principle of freedom to make a contract, the parties themselves can select a company, currently existing or newly formed, which may be responsible for the duties of Administrators.

Please make a note that in connection with creation of the state-owned National Energy Company "Ukrenergo" following the merger of the National Dispatcher Center of Power Industry (NDC) and the State Electric Company "Ukrelectroperedacha", changes should be made as to the parties to this contract

III ON CONTRACTUAL RELATIONS WITHIN WHOLESALE ELECTRICITY MARKET

In this section, employing applicable current legislation, which governs the sphere of application of these contracts, we analyze provisions of the Draft Contract from the point of view of their compliance to the law

Under the civil law of Ukraine, a contract of agency is a contract where one party (the Agent) has the authority given by the other party (the Principal) for a commission to undertake one or several acts in his own name for the principal's expenses

1 According to this Contract, which has been entered by the Agent with a third person, the Agent, not the Principal has rights and duties The Draft Contract provides the same The Agent (NDC), entering into the Contract with Suppliers (Buyers) has the rights to demand from the latter payments for the delivered electricity The Agent at the same time has duty to deliver electricity under the terms of the Contract

In addition to this, Section 18 of the Draft Contract, having determined the scope of liability established additional contractual liability of the Agent as well as the Principal for certain breaches of the Contract This is within the limits of current legislation, which provides possibility of establishment of liability either by a contract or by law

2 Property, which the Principal transferred to the Agent for sale or the Agent obtained for the Principal's funds, remains property of the Principal

The law supports provisions of the Draft Contract, which provide transfer of the electricity to the Agent without transfer of the ownership rights to the former NDC does not obtain the ownership rights for the electricity delivered by the Generators, NDC enjoys only the right to possess it

3 The Contract must be in writing, what is followed by the Parties Under the law there is only one requirement to the form of such contract it must be in writing Therefore, the Contract of WEMM is the contract of agency, provided that all conditions, required by the Civil Code of Ukraine are met

4 The Agent empowered to have all rights and all duties under the Contract, signed between him and a third party (the Draft Contract provides for a separate sales contract between the Agent and a Supplier (Buyer)

5 The Agent is not liable to the Principal for third party's fulfillment of the Contract, entered by the former for the latter's expense, with the exclusion when the Agent is held liable for third party's performance under the Contract (del credere) The Draft Contract contains the same provisions Nevertheless, this does not exempt the Agent from the obligation to demand payment from Suppliers for already delivered electricity

6 When a third party breaches the Contract with the Agent, the latter must without any delay inform the Principal about this fact, collect and secure necessary evidence The Principal in this case has the right, but in no way is obliged, to demand transfer of all right of the Agent against that third person under the contract

It is advisable to stipulate in the Draft Contract the right of the Principal to demand the transfer of rights only in case, if the Agent violated the procedure of initiating legal actions and bringing lawsuits This procedure has to be envisaged in the Contract and be executed as follows

If indebtedness of a Supplier exceeds a certain time period, set forth in the Contract, the Agent, having collected all evidence of the debt, shall inform about that the Generator When the Agent fails to perform or performed in an untimely manner the duty to initiate legal actions and to bring lawsuits, the Generator has the right to demand the transfer of the latter's rights to himself

The right may be transferred in the part, which corresponds to the value of electricity, the Generator has the ownership rights to, and which has already been delivered to the Supplier (Buyer) The size of this part shall be determined by the data received from the commercial accounting

according to the method of determination of liability as provided in the Paragraph 18 3 of the Draft Contract

The Draft Regulation on the Procedure of Initiating Legal Actions and Claims will be submitted in accordance with the agreement

IV ON AUDIT OF WEM AND SELECTION OF MARKET AUDITOR

Since the interpretation of the term "Audit" has been given in the Law of Ukraine 'On auditing activity,' and with the objective to bring the Draft Contract in compliance with this law, we believe that the term 'Market Auditing' should be read as follows

"Market Auditing is auditing of the public accounting, bookkeeping, source documents and other information with regard to the financial and economic activity of the Wholesale Electricity Market Members in accordance with the terms and conditions of the Section 13 of the Contract "

Also, the law does not require approval of the report or other official documents prepared by the Market Auditor The General Meeting may consider and take into an account but not approve the report, recommendations or any other official document, submitted by the Market Auditor Therefore, the Paragraph 5 1 2 has to be read as follows

"To hear a report of the Market Auditor"

Items 'a', 'б', 'в', 'г' of the paragraph 5 1 2 have to be deleted from the text of the Contract for the Market Auditor is not a Party to the Contract The relationship with the Market Auditor is to be governed by a separate agreement regarding to the rendition of the auditing services This agreement necessarily defines a scope of work and tasks of the auditor

V. ON DISPUTE RESOLUTION PROCEDURE FOR PARTIES OF THE CONTRACT

The form of legal relations, provided in the system of WEM, is not typical and rather specific type of the current business practice Therefore, the procedure for dispute resolution, arising out of this relationship requires its specific formula

The Draft Contract contains the procedure for legal actions and dispute resolution, which does not encompass all scope of legal relations, which may arise within WEM

The Agent, without approval of a Generator, based on a contract of agency itself, is already entitled to and must initiate legal actions and claims in case of violation of the contract Besides that, the procedure for legal actions and dispute resolution envisages bringing a lawsuit only within a sales contract, and other disputes are left outside the procedure

An Arbitration Commission included into the procedure does not guarantee settlement of disputes without involvement of the Arbitration Court Moreover, a waiver of the right to bring a claim in the Arbitration Court before the hearing of the dispute by the Arbitration Commission contradicts to the Arbitration Procedure Code The fact that the Parties subject themselves to the rulings of the Arbitration Commission only if they agree with its decision, means that the procedure is ineffective and will delay resolution of certain problems

VI MISCELLANEOUS

As we have already pointed out, the Draft Contract includes all necessary provisions, governing legal relations in the sphere of activity within WEM

At the same time it includes several provisions which make the Contract hard to understand For example, the Conducting Procedure of the General Meeting, its agenda, the rules of keeping and maintaining minutes and decisions of the General Meetings as well as some other provisions These provisions superfluously detail the contract in the part, which does not have essential meaning to its understanding For they are procedural and not substantial to the contract, these provisions shall be envisaged in separate supplements to it

VII ON DRAFT WEMM CONTRACT, PREPARED BY THE FIRM "FACTORIAL"

In this section we give comparative analysis of the Draft WEMM Contract, prepared by the working group (thereinafter the Draft Contract #1) and the Draft WEMM Contract, prepared by the firm "Factorial" (thereinafter the Draft Contract #2)

Having compared two drafts, we have come to the conclusion that the Draft Contract, prepared by the working group, is undoubtedly more complete, certain and such that encompasses all scope of legal relations, which arise or may arise among the Members of WEM

We analyzed in detail the negative sides of the Draft Contract # 2 It is necessary to note that the main disadvantage of it is an inadequate financial liability established for the Settlement System Administrator (SSA), the Market Funds Administrator (MFA), the Head of Commercial Accounting System (HCAS), the owner of the High Voltage and Intergovernmental Power Grid (HVIPG) and the Secretariat of the WEM Board (SB) for the breach of the contractual obligations, the Rules of WEM and other regulations The liability of the enumerated participants is limited by the personal liability of their employees in accordance to the labor law

Such form of liability is actually the discrimination of other participants of WEM Generators and Suppliers (Buyers) and contradicts to the current legislation The legal relations are governed by the civil law The liability of one company against the other may not be substituted by the liability of its officers that is governed by the labor law and regulates legal relations between employer and employees

Under the section 2, several companies, appointed by the Ministry of Power Industry, have duties of the Dispatcher, HVIPG, SSA, MFA, HCAS and SB We can agree with this only as to the duties of the Dispatcher and HVIPG, for this had been established by the law The law does not stipulate, however, who is to be responsible for other duties, which are in the interests of all participants Based on the principle of the freedom of contract, the parties themselves can select the person to be responsible for such duties It also relates to the Secretariat of the WEM Board, which is not the legal entity (a subject of commercial activity)

The Dispatcher, HVIPG, SSA, MFA, HCAS and SB are elements of the

infrastructure that supports the operation of WEM. Their profit is to be formed from a surcharge added to the wholesale price of the electricity in the amount, which must be approved by the National Electricity Regulatory Commission (NERC) and not by the Members to WEM. The reason why we draw your attention to "profit" is that the Draft Contract #2 does not allow to make a clear cut conclusion about the nature of non-profit activity of these bodies. Under the Ukrainian legislation, the regular commercial activity means, *inter alia*, that a corporation acts with the purpose of realizing the profit.

As it was said, NDC is engaged in commercial activity and therefore must be liable for a partial or total breach of the duties.

Under the Draft Contract #2, Suppliers (Buyers) are obligated to purchase electricity from the SSA, not from the Agent, although Suppliers have to sell it to the Agent. This pattern contradicts to the Contract and the current legislation.

The Draft Contract #2 does not provide the possibility of the rotation (change) of the MFA and the SSA and, correspondingly, there is no mechanism of application of such procedure.

The Draft Contract #1 as well as the current Contract, prohibits the parties to assign their rights and to delegate their duties to other persons. The Draft Contract #2 envisages such possibility provided the agreement of "interested parties." At the same time there is no clarification as to who is an "interested party."

Another negative side of the Draft Contract #2 is that the Paragraph 10.4 requires the parties to recognize superiority of the operational and dispatching instructions over the Contract. By this provision, the Parties are forced to accept any amendments and changes to the terms and conditions of the sales of electricity within WEM for they must follow these instructions. It is worth to note that, the Dispatcher issues such instructions unilaterally and without consent of the Parties to the contract.

VIII. SUMMARY AND PROPOSALS

In the whole, the text of the Draft Contract is in compliance with the

current legislation of Ukraine

The Draft Contract, including valid supplements to it, stipulates the purposes and terms of activity, rights, duties, and liability of the Parties, as well as a mechanism of operation of WEM. In general, the Draft Contract corresponds to the Law of Ukraine 'On Power Industry'

The Contract has to be signed by Parties, which have full legal power. Under the law, such Parties to the Contract can be legal entities (companies) which are Generators, Suppliers, and Deliverers of the electric power. Companies which will have duties of the Administrators and the Head of Commercial Accounting System, as well as the order of their selection has to be determined by the Parties to the Contract.

3 In connection with creation of the state-owned National Energy Company "Ukrenergo" following the merger of the National Dispatcher Center of Power Industry and the State Electric Company "Ukrelectroperedacha", changes should be made to list of the Parties to this Contract and initiative taken to introduce the changes to the Ukrainian legislation, which regulates this matter.

4 According to the Draft Contract, an inference can be made that relationship between parties is based on (1) a contract of agency between a Generator (Principle) and NDC (Agent) and (2) a contract of sales between NDC (Seller) and a Supplier (Buyer).

5 The WEMM Contract can be recognized as a contract of agency provided that all requirements set forth by the Civil Code Of Ukraine had been met (see section 5 of this Conclusion). At the same time the current legislation allows besides the WEMM Contract to conclude separate Contract of Agency between Generators and the Agent. The advantage of the separate contract is the possibility for more detailed stipulation of the rights and duties of parties.

6 The procedure on filing claims and lawsuits, envisaged by the Draft Contract, does not meet the requirements of the law. We suggest the following general scheme:

- (a) If indebtedness of a Supplier exceeds a certain time period, set forth in the Contract, the Agent, having collected all evidence of the debt, shall inform about that the Generator

(b) If the Agent fails to fulfill his tasks related to claims and legal actions, the Generator is entitled to demand from the Agent transfer of his rights against the Supplier in that part, which corresponds to the value of electricity, the Generator has the ownership rights to, and which has already been delivered to the Supplier (Buyer) The size of this part shall be determined under the data received from the commercial accounting according to the method of determination of liability as provided in the Paragraph 18.3 of the Draft Contract

(c) A Draft Regulation on Procedure of Initiation of Legal Actions and Claims will be submitted in accordance with the Contract # D 168-005-P-8-932

7 To simplify this procedure and to eliminate high expenses it would be proper to consider a creation of the Commercial Tribunal within the system of the electricity market All disputes, which may arise among the participants of the electricity market, shall be subject to its jurisdiction Appropriate Procedural Rules have to be drafted Currently, a draft law on the Commercial Tribunal is in the Verkhovna Rada at its second hearing

8 The provisions of the Draft Contract, which regulate auditing of WEM has to be brought in compliance with the Law of Ukraine "On the Auditing Activity"

A Market Auditor as well as a Market Banker, is an independent body, which serves WEM Therefore, we advise to design the selection procedure of the Market Auditor analogous to the selection of a Market Banker, and to make necessary changes to the Draft Contract

9 We propose also to move the provisions, which are procedural and not essential for the essence of the Contract, to appropriate supplements This will make the Contract more understandable to a reader and facilitate its utilization Our proposals as to the structure of the Contract will be given in accordance with the contract # D-168-005-P-8-932

LAWS AND DECREES



MEMORANDUM

To Pat Shapiro, Bob Archer, David Wolcott, Hod Thornber
CC Irina Aksyonova, Jim Stanfield, Lev Dulnev, Alan Streicher,
David Kerth
From Svetlana Golikova
Date JULY 12, 1997
Subject Electricity Law, the Second Reading

On July 9, 1997, the Verkhovna Rada adopted the Electricity Law in the Second Reading. The authors of the draft Law are members of the Verkhovna Rada Committee on Fuel and Energy Complex, Transportation and Communication and the Committee on Nuclear Policy and Nuclear Security. The draft had been amended substantially and differs from the one submitted to the Cabmin for the First Reading.

Arts 19-25-28 of the draft for the Second Reading have not been voted for. They stipulate norms concerning projecting, constructing and reconstructing of electricity industry sites and the rights, obligations and responsibilities of electricity suppliers and consumers.

Analysis of the most important articles of the Electricity Law of the Second Reading

Ownership Rights in the Electricity Industry

The draft Law coincides with the general privatization legislation and does not contain any norms limiting the percentage of state ownership for shares of electricity industry enterprises. At the same time, it stipulates that some kinds of property cannot be privatized, including the property ensuring the integrity of the unified energy system and centralized dispatching, high voltage and interstate electricity networks and property of R&D agencies of state importance. The list of the electricity sector sites that cannot be privatized shall be approved by Verkhovna Rada upon Cabmin submission.

State Bodies' Jurisdiction

The draft Law distinguishes the authorities of state bodies and local self-administration bodies related to the electricity sector.

The draft does not refer to any particular executive power body fulfilling state management over the sector. This is a substantial amendment and means that the Cabmin can change not only the name of such a body but also decide on what functions and rights it will have.

The draft also stipulates the main jurisdictions of the Power Plants and Networks Exploitation State Inspection and Electricity and Thermal Energy Consumption Supervisory State Inspection. The electricity supervisory state agencies' activities are regulated by the Cabmin.

The local executive power and self-administration bodies working with electricity industry enterprises can consider questions about the allocation of electricity sites on the territory subordinated to them, participate in working out and enforcing of measures related to electricity sites, and regulate thermal energy tariffs. The local executive power and self-administration bodies cannot intrude into the regulation of consumption regimes. The state regulation of activities in the electricity sector shall be fulfilled via granting permissions for different activities, tariff policy formation, and services quality control. NERC is the agency regulating the electricity sector activities from the side of the state.

The Main Tasks and Authorities of NERC

The draft stipulates that NERC regulates natural monopoly enterprises in the electricity sector and enterprises working in the related markets and fulfills other functions in accordance with the legislation.¹

NERC receives some rights concerning the wholesale electricity market, including

- participates in formation of the general state policy of the wholesale electricity market development and functioning,²
- participates in regulation of payments and making transactions at the wholesale electricity market,
- ensures enforcement of price and tariff policy in the electricity sector
- approves along with the Antimonopoly Committee and Minenergo the Wholesale Electricity Market Agreement conditions

The central executive power bodies (Minenergo) have the right to define which state enterprise will fulfill the functions of dispatching the unified energy system. Minenergo will also stipulate the structure of this state enterprise. Since the Centralized Dispatching envisages planning and quick-reacting management of the power plants' capacities, there are doubts that Minenergo, having the Law as a basis, will not intrude into NDC dispatching activities contrary to the Energomarket Rules.

The draft Law does not describe the procedure of establishing, activities and all the authorities of NERC because these issues are not subjects of the Law.

The draft Law assures NERC's rights concerning

- state regulation of electricity sector natural monopoly enterprises
- creation of competition in electricity generation and supply,
- protection of electricity and thermal energy consumer rights
- approval of Electricity Usage Rules,
- granting of Electricity Generation, Transmission and Supply Licenses and control over compliance with the License Rules and Conditions

¹ The criteria of putting an enterprise into the natural monopoly category must be stipulated in the Natural Monopolies Law or another legal act, for instance, in a Presidential Decree.

² This wording gives NERC broad authorities and possibilities to work with the Energomarket.

Comparing to the currently effective Presidential Decree of March 14, 1995, NERC would receive the following new rights

- to define whether reorganization (merger, etc), liquidation of participation in a corporation, and acquiring or alienation of a one-quarter share of assets (shares, etc) of an enterprise comply with License Rules and Conditions,
- to impose administrative penalties or property sanctions on legal persons and officers of enterprises, agencies, and organizations in accordance with the legislation ³

Wholesale Electricity Market

The draft stipulates that all purchases of electricity generated by power plants with capacity and volume of sales greater than marginal indices (except electricity generated by CHPs that are part of electricity suppliers, and intended for consumption on the territory where the licensed activities are fulfilled⁴) and all wholesale electricity sales shall be made at the Wholesale Electricity Market of Ukraine

Operation of any other wholesale electricity markets in Ukraine is forbidden

The Wholesale Electricity Market shall be created on the basis of an agreement with parties that are subjects of economic activities related to

- dispatching the unified energy system of Ukraine
- electricity generation at the power plants
- electricity transmission by high-voltage and interstate networks
- electricity supply by local networks ⁵

It is stipulated that the Energomarket Members Agreement shall be agreed with Minenergo NERC, and the Anti-Monopoly Committee

It is especially important that the Energomarket Rules receive a legal basis. The Rules according to the draft Law, are an integral part of the Agreement and define the mechanism of the Wholesale Electricity Market operation, the procedure of the load redistribution between the gencos, and electricity market price formation rules

The requirements on the Energomarket participants include the following

- all subjects of entrepreneurial activity dealing with electricity generation and supply have equal access to Energomarket and network services. Energomarket Members must have the appropriate Licenses
- electricity shall be sold and purchased in accordance with the Energomarket Rules
- gencos' electricity prices and wholesale prices shall be established in accordance with the Energomarket Rules

³ This means that the Administrative Code of Ukraine will be amended with norms stipulating the NERC's jurisdiction limits and penalties to be applied to the violators

⁴ This would result in extremely low electricity prices in Kyiv relative to the rest of Ukraine

⁵ If the parties of the Agreement are limited only to the above-mentioned, it excludes IESs from Energomarket. A company dealing with electricity transmission by high-voltage and interstate networks (Ukrelectroperedacha) co-operates with the NDC on the basis of a separate agreement since it is not now a party of the Energomarket Agreement

185

Electricity Tariffs Formation Principles

The draft stipulates the basic principles of wholesale and retail electricity tariffs formation

Unfortunately, the draft does not include a provision that electricity can be supplied at both regulated and non-regulated tariffs

Wholesale electricity tariffs formation will be fulfilled in the market in accordance with the agreement (it would be correct to state "in accordance with Energomarket Rules")

The draft envisages that retail electricity price shall be formed by the energy supplier in accordance with the Electricity Supply Rules and Conditions. Unfortunately, this wording is not correct and does not explain the essence of the electricity tariffs formation procedure.

First, there are RTS License Rules and Conditions and IES License Rules and Conditions. In the first case, the retail tariff (but not a price) equals the sum of the appropriate components, and in the second case, it is set right in the Electricity Supply Agreement concluded with the Customer and, therefore, would not be subject to regulation. In the draft Law, the term "energy suppliers" means participants of the wholesale electricity market purchasing electricity at the market in order to sell it to the customers. In reality, not all the suppliers are Energomarket Members, and this definition of "electricity supplier" may be misinterpreted in the future.

There are some shortcomings in the formulation of terms of "transmission fees" and "supply fees".

The draft stipulates that NERC regulates transmission and supply by LVNO fees. It would be more correct to put "LVNO and RTS fees shall be regulated by NERC".

The draft states that electricity suppliers' losses incurred from electricity supply to privileged residential customers shall be covered from the sources stipulated by the legislation on privileges. The draft does not mention subsidy certificates and the procedure of their issuance.

The draft includes a norm requiring that enterprises supplying electricity by networks which are not their property purchase electricity from the Energomarket and pay for usage of local networks. Electricity supply to such customers is fulfilled at the fees agreed by the parties while concluding the electricity supply agreement.

Conclusions

1. The draft Electricity Law is the first serious effort of the Ukrainian Parliament to envisage legally the power sector de-facto relationships in the electricity sector.
2. The draft establishes a legal basis for Energomarket's operation.
3. The draft gives NERC some authorities to regulate the Energomarket, tariff formation system, and Energomarket's settlement & financial system.
4. NERC gets rights to participate in the process of corporate creation, reorganization, and liquidation of the Licensees, and to administratively and financially penalize the Licensed activity violators.

5 Some shortcomings in the terms may lead to misinterpretation of the Law s articles

187



MEMORANDUM

To Distribution
CC
From Svetlana Golikova
Date October 27, 1997
Subject Electricity Law, Final Reading

On Oct 8, 1997, Verkhovna Rada of Ukraine adopted in the third (final) reading the Electricity Law of Ukraine. The Law has to be submitted to the Administration of Ukraine's President and will be put into force upon its signing and publication. The Law is expected to be published in the first part of November 1997.

There were some changes introduced to the Law as compared to the version of the Law submitted to the Rada for the second reading, which regards the following¹

- powers of state administration and state regulatory bodies
- establishment of the wholesale electricity market
- rights and responsibilities of electricity suppliers and consumers

The analysis of particular provisions of the Electricity Law of Ukraine is set forth below.

1 GENERAL

For the first time electricity has been included into category "goods" instead of "services," which can be sold and purchased under the contract of purchase (sale).

The wholesale electricity market, operating under the agreement, has been legalized.

2 OWNERSHIP RIGHT IN THE POWER SECTOR

As compared to the previous version, the Law envisions that in case of privatization of the power sector entities the Cabinet of Ministers of Ukraine upon submission of the State Property Fund shall adopt a decision on allotment of a package of shares to the state property.

The vague wording of the Law gives to the Cabinet of Ministers the right to keep the share parcels of energy enterprises in the state ownership for any period of time leaving the

¹ We have unofficial version of the Electricity Law.

establishment of the size of the state share packages to the discretion of the Cabinet of Ministers and the SPF

3 COMPEPENY OF THE STATE BODIES

An executive body authorized by the Cabinet of Ministers is responsible for the state administration in the Power Sector. Two structures have been established to carry out the state inspection of heat and electricity demand in the Power Sector

- State Energy Inspection on Heat and Electricity Demand
- State Inspection on Power Plant and Network Operation

At present the activities of both structures are regulated by the Resolution approved by the Cabinet of Ministers. These structures, being the units included into the NDC composition, are not independent legal persons.

Local executive authorities and administrations have the right to do the following

- agree the issues of location of the power sector entities on the subordinate territory
- participate in the development of complex plans of electricity supply to consumers
- participate in the development and introduction of measures on operation of the power sector entities in case of emergency
- regulate heat tariffs,
- promote the development of the power industry in the region

Local executive authorities and administrations shall not interfere in operational regulation of energy consumption schedules²

The state regulation of the power sector operation shall be carried out by NERC through issuance of licenses, formation of tariff policy and control over the quality of services

According to the Law NERC will retain all authorities adopted in the second reading (see my Memo of July 12, 1997, Section "Basic tasks and authorities of NERC")

4 POWER GRID MANAGEMENT

The Law stipulates that functions of dispatch (operation and technological) of the Power Grid of Ukraine should be carried out by a state enterprise subordinate to the central executive body which administrates the power sector (presently, this is Minenergo). Minenergo shall establish the structure of this state enterprise

Under this provision, Minenergo will have a sole right to establish a structure of the enterprise responsible for the energy system dispatch appoint and dismiss the manager of this

This Section is similar to that in the previous version (second reading)

enterprise, approve the enterprise charter, etc. The relevant NERC license forcing Minenergo not to create a structure inconsistent with economic principles of management in the power sector could serve as a counterbalance to the undivided authority of Minenergo.

Another positive factor may be also the fact that, under the adopted Law, any restructuring (merging, division, joining, etc.) and liquidation of licensed enterprises shall be agreed with NERC.

5 WHOLESALE ELECTRICITY MARKET

This section represents the revision adopted in the second reading. The Wholesale Electricity Market operates on the basis of the Agreement and the Rules which constitute an inalienable part of the Agreement. These documents must be agreed upon with Minenergo, NERC and the Antimonopoly Committee.

Notwithstanding the significant progress achieved in the legal regulation of the wholesale market operation, the Law (article 15) lists the parties to the Agreement the activity of which is connected with

- dispatch of the Power Grid of Ukraine
- electricity generation
- high-voltage electricity supply
- low-voltage electricity supply

Such interpretation of "parties" does not correspond to the current situation, namely:

- *SEC on the high-voltage electricity supply (SEC Ukrelektroperedacha is not a party to the Agreement (the Energomarket Member) and acts under a separate agreement between NDC and Ukrelektroperedacha*
- *Parties to the agreement are electricity suppliers which have a license for electricity supply at the non-regulated tariff, i.e. independent suppliers, whereas it is specified in the adopted Law that the parties to an agreement shall be electricity suppliers at the regulated tariff (mainly Ohlenergos)*

There is no direct prohibition in the Law for the independent suppliers to be a party to the Agreement, and there is also a set of other articles which may be interpreted in favor of independent suppliers as the members of the wholesale electricity market. Nevertheless, the differences between the existing Agreement and the norms of the Law may lead to the changes in the terms of agreement, especially as regards SEC Ukrelektroperedacha.

6 ELECTRICITY TARIFF FORMATION PRINCIPLES

This section of the Law represents the revision adopted in the second reading (see my memo dated July 12, 1997).

7 GUARANTEED ENERGY SUPPLY IN THE PERIOD OF EMERGENCY SITUATIONS, SPECIAL PERIOD OR STRIKE AT THE ENERGY ENTERPRISES

Hagler Bailly Consulting, Inc.

Filed in A Kolomyets/Common/Market documents/Golikova's memo

The new norms were incorporated in the Law (as compared with the second reading) which regulate emergency situations and strikes in the energy industry

Emergency circumstances in the power sector shall be, except the cases provided for by the legislation, a lack of fuel in the state reserve for reasons beyond control of the generating companies

The legislation means the Law of Ukraine "On the State of Emergency" which provides that in cases of natural hazard, accidents and catastrophe, epidemic and epizootic, infringement of the territorial integrity of the state etc Verkhovna Rada of Ukraine or the President of Ukraine subject to further approval of VR may introduce a state of emergency in the entire territory of Ukraine or in its certain regions

The Electricity Law of Ukraine envisages that in case of the introduction of a state of emergency in accordance with the Law "On the State of Emergency" energy supplying organizations should follow the orders of the bodies which exercise measures on the state emergency irrespective of the agreements concluded. Such amendment to the Electricity Law may be regarded as logic and rightful

At the same time an issue about the emergency in the power sector in terms of the insufficient lack of fuel in the state reserve remains unsettled. The Law does not make any provision as to the mechanism of implementation of this norm

The operation of the power industry under conditions of the "special period" (martial law) is regulated by the Law of Ukraine "On Mobilization Preparation and Mobilization"

The Electricity Law of Ukraine prohibits strikes at the energy sector enterprises in cases when they might lead to the violation of stability of the Power Grid of Ukraine or heat supply in the fall-winter period

8 OBLIGATIONS AND RESPONSIBILITY OF ENERGY SUPPLIERS

In general the Law stipulates the norms of responsibility and obligations of electricity suppliers provided for by the licenses but it also envisages a number of new provisions. It is provided for that

- energy suppliers pay to electricity customers a fivefold cost of the insufficient electricity supply in case of interruption of electricity supply through the fault of energy supplier (in compliance with conditions of the electricity use agreement)
- in case of supply of electricity with quality which is not within the quality limits specified in the contract on electricity use energy supplier shall pay a penalty in the amount of 25% of the cost of such electricity

The practical application of this norm may entail certain difficulties related to the lack of the appropriate electricity metering systems at the enterprises

9 OBLIGATIONS AND RESPONSIBILITIES OF ELECTRICITY CUSTOMERS

The Law provides that electricity consumption shall take place only under the contract with energy supplier, which might, obviously, lead to conclusion of contracts not only with industrial but with residential customers and will require considerable organizational and technical work

Responsibility of the customer (except the residential customers) is provided in cases

- electricity consumption exceeds the level specified in the contract (fivefold cost of the difference between the actually consumed electricity and electricity specified in the contract)
- contracted value of consumer's power is in excess (fivefold difference between the highest value power which is fixed during the accounting period and the contract value of power)

In terms of the legislative regulation of responsibility of consumers for the violation of contractual conditions of electricity supply¹ the procedure of charging the said amounts needs further regulation

The Law does not attribute these payments to the category of penalties and consequently they shall not be transferred to the budget. The Energomarket Rules must foresee the mechanism of allocating these amounts within the framework of this Agreement

The Law gives NERC the right to impose penalties on the licensees for violation of the licence conditions and evade or untimely implement the NERC decisions

Appeal against the actions of the state bodies regarding the imposition of penalties shall be made in court

10 ADDITIONAL PROVISIONS

As compared with the draft adopted in the second reading the Law incorporated the articles regulating the protection of power facilities and environment the definitions were provided to describe the peculiarity of operation in the power sector

The Law also covers participation of the subjects of power sector in international scientific and technical foreign and economic and other forms of international cooperation

The rules of international agreements to which Ukraine is a party prevail over the norms of this Law

¹ In article 28 of the Law the legal violation in the power sector include electricity consumption over the contract value while excess of the contracted power is not considered a violation though the same limit of responsibility is set for both of these

Verkhovna Rada was charged by CMU with preparation by 7 01 98 a draft Law of Ukraine On the Wholesale Electricity Market Operation” and bring the Government decisions to conformity with the Electricity Law

CONCLUSIONS

- 1 *The legislative grounds for the Wholesale Electricity Market operation have been laid down on the basis of the Agreement and the Market Rules*
- 2 *Division of power took place in the power sector between the state bodies of management (Minenergo) and regulation (NERC)*
- 3 *NERC authority has been extended in respect of the Wholesale Electricity Market of Ukraine*
- 4 *Responsibility of energy supplying enterprises and electricity customers was enhanced*
- 5 *Electricity was attributed to the category of goods which can be sold and purchased on the basis of the contract of purchase and sale*

UNRESOLVED PROBLEMS ARE AS FOLLOWS¹

- There is a need in interpretation of the Law with regard to the Energomarket Agreement since the differences have been made between the existing procedure and the Law wording
- Inaccuracy of some phrases may lead to the ambiguity of understanding (“emergency in the power sector suppliers of electricity through the networks which are not in their ownership” etc)
- There is a need in development and adoption of a set of legislative and normative acts to implement in practice provisions of the Law
- The Wholesale Electricity Market Members Agreement must be reviewed to consider the norms of the Electricity Law of Ukraine

Note For the purposes of analysis a copy of the unofficial text of the Law was used which was received through confidential channels

¹ This list is not complete and needs further development



MEMORANDUM

To Robert Archer, Paul Malligan
CC David Wolcott, Jim Stanfield, Mark Madland, Andrey Parinov
From Svetlana Golikova
Date 24 FEBRUARY 1998
Subject Practical implementation of the Law of Ukraine "On Electricity Sector"

The Law of Ukraine "On Electricity Sector" passed by the Verkhovna Rada of 16 October 1997, effective from November 20, 1997 is the first Ukrainian legislative act which defines legislative, economic and organizational foundations of activities in the field of electric power and regulates relations that are connected with the power generation transmission, supply, and utilization

The law, undoubtedly, is a progressive move in differentiation of authorities between the bodies of state management (Minenergo) and state regulation (NERC), establishment of a legislative background for the wholesale electricity market activity, tariff formation rights and responsibilities of power suppliers and consumers

However, to put the law into "full operation" it also requires not only drafting and passing the law on the wholesale electricity market and a number of statutes at the level of the Cabinet of Ministers but also to comprehensively approach the practical implementation of this law

Following is required to practically implement of the law in the following streamlines

- 1 Legal support to NERC in drafting draft laws on introducing modifications into laws of Ukraine in connection to the fact that electric power has been determined as "commercial output" rather than "a service"

In practice the meaning of this norm is as follows

- the definition of "commercial output" shall be governed by the civil law norms regulating products purchase and sale Seller's responsibilities for the commercial output quality, the Purchaser's responsibilities for the payment and reimbursement of damages incurred by the Purchaser for the payment delay etc
- enhancement of administrative responsibilities for violence in the field of power sector
- introduction of imposing criminal responsibility for electricity theft

In order to make these norms practically effective it is required to develop and submit for the Verkhovna Rada consideration the laws on the modification of separate articles of the Civil, Administrative and Criminal Codes of Ukraine as well as laws on taxation

- 2 *NERC's role in drafting laws on the wholesale electricity market and development of normative acts and methodological recommendations for NERC on regulation of licensees members of the wholesale electricity market activities*

The law has significantly expanded NERC's authorities in regulation of relations

between the WEM members, namely

- *participation in the formation and assurance of the implementation of the integrated state policy in the development and functioning of the wholesale electricity market*
- *participation in the regulation of the Wholesale Electricity market payment and settlement relations*



MEMORANDUM

To B Archer, P Shapiro
CC D Wolcott, A Streicher, D Keith, B Ichord, A Parinov,
M Madland, E Eastwood, H Thornber
From Svetlana Golikova
Date NOVEMBER 27, 1997
Subject Passed Act on Electricity Sector

On October 16, 1997 the Verkhovna Rada of Ukraine has adopted the Act of Ukraine on Electricity Sector. The Act has been signed by the President of Ukraine and became effective as of November 20, 1997.

In comparison with the version of this Act submitted to the Rada for the second reading, this Act has undergone several changes concerning the following:

- authorities of the bodies of state administration and regulation
 - organization of the Wholesale Electricity Market
 - rights and duties of electricity suppliers and consumers
- 1 For the first time the electric power, which is sold and purchased under the contract of purchase (sale), has been qualified as the category "goods" instead of the category of "services". The Wholesale Electricity Market operating under the agreement has been legalized.
 - 2 In case of privatization of the electricity sector entities, the Cabinet of Ministers of Ukraine upon the State Property Fund submittal shall adopt a decision to assign a block of shares in the state property.

The Act empowers the Cabinet of Ministers to keep the block of shares of the electricity sector enterprises in the state ownership for the time period to be established by the Cabinet of Ministers and the State Property Fund.

- 3 The state control in the electricity sector shall be carried out by the body of the executive power authorized for this task by the Cabinet of Ministers of Ukraine, i.e. the Ministry of Energy. The state regulation of the activity in the electricity sector shall be carried out by the National Electricity Regulatory Committee through the issuance of licenses, tariff policy formation and control over the qualities of service. It should be emphasized that the issues of liquidation, reorganization in the form of merger or acquisition, participation in amalgamations, as well as acquisition or alienation of more than twenty five per cent of (stocks shares) assets of the entities that got a NERC license shall be

agreed with NERC. This paragraph of the Act does not give the right to reorganize, for instance NDC, without the participation of NERC.

4. The Act sets forth that the functions of dispatch (operation and technological) control of the integrated power grid of Ukraine shall be carried out by the state company subordinated to the central agency of executive power carrying out regulation in the electricity sector (at present, the Ministry of Energy). The structure of this company shall be defined by Minenergo. This norm entitles Minenergo to define the structure of the company carrying out the dispatch control of the power grid, appoint and dismiss the director of this company, approve the statute of the company, and etc. The relevant NERC's license is in this case the "counter-measure" to the exclusive control of Minenergo as it prevents Minenergo from creation of such a structure that does not correspond to the economic principles of control in the electricity sector.
5. The Act is amended with the new norms regulating the emergency situations and strikes. *The emergency situation in the state is considered to be a situation when the fuel stock at the power sector facilities is depleted lower than the established norms or the reserve of water in water reservoirs is lower than the established ecological requirements.* The mechanism of implementation of such a norm shall be developed by the Cabinet of Minister or the supplementary provisions will be amended to the Act. On Emergency Situation. The Act of Ukraine on Electricity Sector prohibits strikes at the electricity sector facilities in the cases when they can result in breakage of the integrity of the integrated power grid of Ukraine or heat supply in winter and fall period.
6. The Act empowers NERC to impose penalties on the licensees for the infringements of license conditions, as well as for evasion of implementation or untimely implementation of decisions of the National Electricity Regulation Commission of Appeal of actions in regard to imposing penalty shall be carried out by court.
7. The Act stipulates that the entities of the electricity sector are entitled to participate in the international agreements, foreign economic and other forms of international cooperation. The rules of the international agreements where Ukraine constitutes a party shall prevail over the norms of this Act.
8. The Verkhovna Rada of Ukraine directed that the Cabinet of Ministers of Ukraine shall prepare
 - until December 1, 1997 submit for the consideration by the Verkhovna Rada of Ukraine the draft Act of Ukraine on peculiar features of state property privatization of fuel and energy complex enterprises
 - until December 1, 1997 submit for the consideration by the Verkhovna Rada of Ukraine proposals as for adjusting the legal acts of Ukraine in compliance with the Act of Ukraine 'On Electricity' provide for the overview and elimination by the ministries and other central bodies of executive power of Ukraine of the normative acts that contradict this Act.

- until January 1, 1998 work out normative acts as for establishment of lower limits for caloric value of coal supplied to the thermal electric plants,
- until June 1, 1998 work out and submit for the consideration by the Verkhovna Rada of Ukraine the draft Act of Ukraine on the Wholesale Electricity Market operation

The problems that still remain are the following

- It is necessary to start the development of the draft Act on the operation of the Wholesale Market of Ukraine
- It is necessary to work out and approve a set of legal and normative acts in order to implement in practice the provisions of this Act (namely, on the Emergency Situation Provisions on Minenergo, amendments and changes to the Provisions on NERC, i.e. to the Presidential Decree, formation of the 'Energomarket' state company on the basis of NDC property, and etc)
- The Wholesale Electricity Market Members Agreement should be reviewed with regard to the norms of the Act of Ukraine 'On Electricity Sector



MEMORANDUM

To P Shapiro, R Archer, D Keith, A Streicher, D Wolcott, H Thornber
CC J Stanfield, M Madland, L Dulnev, A Parinov
From Svetlana Golikova
Date AUGUST 25, 1997
Subject Natural Monopoly

On August 19 1997 the President of Ukraine has issued the Decree 'On Measures for State Policy Implementation in the Sphere of Natural Monopolies'. The purpose of this Decree is to improve the system of state regulation, including regulation of prices and tariffs in the sphere of natural monopolies, improvement of state property management efficiency and determination of peculiarities of privatization process in the sphere of natural monopolies ensuring public control over the natural monopoly entities' activities.

The practical side of the Decree is creation of National Transport and Communication Regulatory Commission as well as *imposing on NERC the functions of regulation of natural monopoly entities' activities in oil and gas mining and sale transportation and distribution of natural gas transportation of oil petroleum products and other substances by pipelines*

It is necessary to pay attention to the fact that the Decree was issued when the Draft Act 'On Natural Monopolies' (third edition) has been submitted for the consideration by the Verkhovna Rada.

Let us compare the main provisions of the Draft Act and the Presidential Decree.

Provisions of the Draft Act 'On Natural Monopolies'	Provisions of the Presidential Decree 'On Measures to Implement State Policy in the Sphere of Natural Monopolies'
<i>Agencies that regulate the natural monopoly entities' activities – National Commissions</i>	<i>Agencies that regulate the natural monopoly entities' activities – National Commissions</i>
Commissions shall be created liquidated (according to submittal by the President of Ukraine) and reporting to the Verkhovna Rada of Ukraine.	New Commission was created by the President of Ukraine. The Cabinet of Ministers was given directions as to prepare relevant amendments for the Acts of the President of Ukraine.
Provisions on the Commissions will be approved by the Verkhovna Rada of Ukraine.	The relevant amendments will be made to the Provisions of the NERC.
<i>Main Tasks and Functions of Commissions</i> <ul style="list-style-type: none">◆ price policy formation◆ licensing◆ public information	<i>Main Tasks and Functions of Commissions</i> <ul style="list-style-type: none">◆ price policy formation◆ licensing◆ public information

<p><i>Fields of the activities of natural monopoly entities</i></p> <ul style="list-style-type: none"> ◆ transportation of oil, petroleum products, natural gas (and its distribution), other substances by pipelines, ◆ electricity transmission and distribution, ◆ general purpose communication, ◆ air transport control, use of infrastructure facilities ensuring railway transport operation, ◆ special services of transport terminals, ports, airports 	<p><i>Fields of the activities of natural monopoly entities</i></p> <p><i>Same as in the Draft Act</i></p>
--	--

As it is seen from the table above the Presidential Decree practically does not change the Draft Act provisions. However, the main difference constitutes the fact that the President of Ukraine took authority to solely regulate the issue of new commission formation authority of the already existing NERC. The Commissioners (O Gridasov, L Goncharova), as well as some of the NERC's employees (S Vyshynsky, O Samborska, V Boiko) consider these particular provisions of the Decree as the most vulnerable spots. Many of them (L Goncharova, O Samborska) consider that the Decree can speed up the approval by the Verkhovna Rada the relevant Act that will entail the necessity to overview a set of provisions of the Decree of August 19, 1997 and respective coordination with the Verkhovna Rada both the authority of these or other commissions and candidates to the position of Chairman (Chairmen) and the Commissioners.

Commissioner Goncharova believes the President of Ukraine can direct his proposals on the Draft Act 'On Natural Monopolies' to the Verkhovna Rada in order to put them to the vote. He will fix in the Act the actual situation when the President directly creates and reorganizes commissions in regulation of activity of natural monopoly entities.

Thus, it is possible to suggest several variants of the decision on this issue:

1. The Verkhovna Rada adopts the Act 'On Natural Monopolies' in its final edition and while doing so:
 - ◆ formally agrees with the existence of two regulatory commissions, does not change their authorities, however, demands the approval. Provisions on the Commissions and approves the appointments to the Chairmen and Commissioners positions (existing or newly appointed)
 - ◆ does not agree with the existing authorities of the commissions and directs formation of new commissions and liquidation of the existing commissions
2. The President of Ukraine submits his proposals to the Verkhovna Rada on re-subordination to him the regulatory commissions, the Rada approves these proposals and introduces them into the Act that enables total avoidance of any conflict.¹

3 The President can impose a veto on the adopted Act

Apart from the mentioned above differences between the Decree and Draft Act, there is a set of the Decree provisions that are not reflected in the Act

The Decree stipulates a set of measures aimed at strengthening the role of the National Electricity Regulatory Commission

- ◆ implementation of the effective mechanism for formation of tariffs that reflect the actual costs of electricity generation, transmission and supply,
- ◆ elimination of give-and-take and address schemes of electricity supply and ensuring the electricity supply exclusively through the wholesale market,
- ◆ problem of payments solution and regulation of settlements for consumed electricity,
- ◆ non-profile enterprises separation from the entities of the natural monopolies the activity of which does not refer to the main one
- ◆ implementation of proper control over the financial activities of the natural monopolies entities separate balance sheets and separate accounting reporting in respect to the activities carried out at the natural monopolies markets

The Decree sets forth the formation of the Energomarket State Enterprise until August 1 1997 (?) in order to ensure dispatch control functions and the wholesale electricity market operation The Decree states non-interference of the executive power agencies into decision of economic issues being in NERC's jurisdiction

There is no direct indication in the Decree as for sources to be used for NERC and National Transportation and Communication Regulatory Commission (NTCRC) funding However, as during the process of NTCRC organization the direction was given to reduce budget allocations for maintenance of relevant executive power agencies one can think that funding of newly formed Commissions will be carried out not at the expense of the state budget, but by the analogy with NERC At the same time, the Draft Act 'On Natural Monopolies stipulates that funding of the Commissions must be provided at the budget expense

There is no direct indication in the Draft Act that the legal status of the Working Body of Commissions will be changed and they will get the status of state employees The Head of the NERC's Legal Department Ms Samborska informed me that at present the Commission has no grounds to change something in the Working Body of the Commission and NERC does not plan to change the status of its employees unless the appropriate legislation acts are in place

The Cabinet of Ministers was given 3 months to work out the set of documents regulating formation and operation of both the NERC and NTCRC Therefore one can expect that the Commissions will start to carry out their new functions already in 1998

¹ - In some mass media there were already some news that the Presidential Decree of August 19 1997 can be some political action in the subsequent inter-relations between the President and the Parliament

COMMENTS ON MARCH-JULY 1998 PRESIDENTIAL DECREES REGARDING ECONOMIC ISSUES

In addition to Hagler Bailly's 18 July 1998 comments on Ukraine Presidential Decrees, a complementary summary of economic legislation as related to the energy sector (power, coal, oil and gas) follows, as requested. This summary is based on the Presidential Decrees for March-July 1998 as well as the Rada's Resolutions (July 1998) that directly apply to the energy sector.

1 Presidential Decree of May 7, 1998, # 422/98, "On Provision of Timely Drafting of the 1999 State Budget of Ukraine" Paragraph 5 of this Decree envisages that the key objective of the budget policy for 1999 will be the establishment of conditions to overcome the state financial crisis, for which one of the objectives is *solving problems related to settlements between entities of entrepreneurial activity (primarily for electricity and raw energy materials consumed) and reducing barter transactions to improve the status of settlements to the budget*. The Ministry of Finance of Ukraine has to submit the draft of the 1999 state budget to the Cabinet of Ministers of Ukraine before 15 August 1998.

2 Presidential Decree of June 9, 1998, # 606/98, "On Decision of the Council for National Security and Defense of Ukraine" This is relevant to implementation of Presidential Decree #41 of 2 June 1998 "On Introduction of a Regime of a Strict Retrenchment of Budget Expenditures and Other State Expenditures. Measures to Ensure Collection of Budget Revenues and Prevention of Financial Crisis". It entitles the Cabinet of Ministers and the State Property Fund to implement in 1998 additional actions speeding up privatization for cash of large and investor-attractive enterprises including telecommunications, energy and civil aviation enterprises.

3 Presidential Decree of July 23, 1998, # 817/98, "On Actions Deregulating Entrepreneurial Activity," is aimed at reducing the interference of state bodies into entrepreneurial activities. Paragraph 11 provides that state bodies issuing licenses to carry out specific types of activity are *not entitled to make as a requirement for registration and license issue the transfer of funds on account of any budget or off-budget funds, entities, organizations and individuals*. This Decree applies to the NERC as a body regulating relationships in the power industry. According to Ms. Samborska (who heads NERC Legal Department) provisions of this Decree have been actively discussed in the Commission, however, no violations have been revealed.

4 Presidential Decree of July 4, 1998, # 736/98 "On Regulating the Process of Managing State Property," specifies the mechanisms for the management of state property entities. It directly applies to Action 17 of the Financial Recovery Plan for the power sector in terms of the selection of authorized persons to manage state stocks (shares) on a competitive basis. In compliance with this Decree, Oblenergos and generating companies subject to privatization must take out the word "state" from their names, renaming enterprises as open joint stock companies if state shares are less than 60%.

5 **Instruction of the President of Ukraine, #270/98, June 11, 1998, "On the Development Strategy of Power Exports,"** sets up the Interdepartmental Committee on electricity export matters, which consists of Mr Sheberstov, Energy Minister and Mr Gridasov, NERC Commissioner. The Committee has to submit to the Cabinet of Ministers its proposals on the strategy of power exports before 15 August 1998.

6 **On 22 July 1998 the Rada adopted in first reading a draft law which temporarily places a ban on increasing electricity tariffs for housing and public transport services, before discharging social payment debts to the population.** According to mass media, this law was adopted in one of the final meetings of the first session of the Rada. Unfortunately, official publication of the bill is not yet available.

7 **According to press accounts, the Rada adopted a law "On Prevention of Violations of Ukraine Legislation in the Course of Oil and Gas Sector Privatization."** This legislation prohibits transfer of the national joint stock company "NAFTAGAS (oil and gas) of UKRAINE" to state property which is utilized to provide for oil and oil products and natural gas transportation, storing and distribution and is not subject to be privatized due to its state-related significance. Ms Samborska, NERC Legal Department Head confirmed that the law has been adopted, although its official version has not been published yet.