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LEGAL ASPECTS OF PRICING IN REGULATED INDUSTRIES

ERRA Legal Regulation Working Group

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LEGAL ASPECTS OF PRICING IN REGULATED INDUSTRIES

(PRINCIPLES, METHODS)

ERRA LEGAL REGULATION WORKING GROUP

Presented:

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1. General Provisions

The tariff that is formed in the commodity when the state influences it by means of applying economic and/or prescriptive measures is a regulated measure the application of which is controlled by the state.

Governmental measures related to regulation of tariffs can be of legislative, administrative and judicial nature. In all countries the valid legislation sets rules that govern relations between market participants and the state. Adopted laws create legal basis for relations between economic entities, and between them and the state in the field of tariff setting. Authorized state bodies carry out administrative activity on tariff regulation. In case of violation of laws defaulting parties can be held liable.

The state sets tariffs for products classified in laws as products regulated by the state. In addition to direct tariff setting, state regulation also includes approval of cap values of profitability of manufacturing of certain types of products.

In the field of natural monopolies, there are special participants, who include consumers and subjects of the very natural monopolies; and the state regulation is the main form of their coordination.

The need of such regulation is conditioned, first, by the monopoly position of service providing enterprises. That is, the state has to restrain unreasonably high monopoly prices, which a producer is most likely to set, and subsequent decrease in the volume of production. The second aspect that is closely related to the first one is that fluctuations of prices in the fields of natural monopolies can differently, and also negatively, affect the population.

One of the main methods for regulation of activities of natural monopolies is price regulation that is carried out by means of setting prices (tariffs) or their cap levels.

Regulation means that legal acts that comply with requirements of public economic development set rules for behavior of entities, mode of their operations; it also means determination of measures aimed at enforcement of set rules, including liability measures; protection of rights and interests of subjects of regulated relations.

Tariffs of natural monopolies, while being an important component of the economic price mechanism, are set both for various types of services of production and consumption nature and for works.

The subject of the report includes legal aspects of the tariff policy in the field of natural monopolies of the state as one of the levers of the state regulation.

Materials from questionnaires filled in by ERRA member countries: Russian Federation, Georgia Ukraine Kyrgyz Republic Romania Bulgaria Montenegro Bosnia and Herzegovina Croatia Kosovo Latvia Hungary Turkey Serbia Mongolia, and Kazakhstan were used in preparation of this report; we express our appreciation to regulators who took part in the survey.

1.1. Legal framework of the price regulation

The nature of methods of legal regulation is determined based on the set borders of regulated relations; issuance of relevant normative acts that determine rights and obligations of subjects of relations; relations between market participants and the state, granting authorities to the participants, determining liability measures in case of violation of legal norms.

Regulation of relations that appear in the field of activities of natural monopolies is based on the method of imperative regulation that is characteristic only for the state represented by its bodies that touches upon only legal norms and that is enforced by the state.

In ERRA member countries that took part in the survey, the current legal basis of the state tariff regulation is comprised of legal acts:

- National laws On Natural Monopolies
- Industry specific laws
- Laws on the regulator, as well as by-laws and by-laws issued by the regulator.

Country	National Laws On Natural Monopolies	Special laws on regulators	Industry specific laws
Russian Federation	On Natural Monopolies		<ul style="list-style-type: none"> • FZ of 14.04.1995, No. 41-FZ “On the state regulation of tariffs for electricity and heat in the Russian Federation” • FZ of 26.05.2003, No. 35-FZ “On Electricity” • FZ of 30.12.2004, “On fundamentals of regulation of tariffs of utility complex

			organizations”
Georgia		The Law of Georgia on National independent regulatory bodies, Adopted on July 22, 2003	Law of Georgia “On Electricity and natural gas”
Ukraine	“On Natural Monopolies”		“On Electricity” “On combined generation of heat and power (cogeneration) and use of waste energy potential”, “On prices and pricing”, “On heat supply”.
Kyrgyz Republic	“Law on Natural and Allowed Monopolies in the Kyrgyz Republic”		Law “ On Energy”, “On Electricity”,
Romania			Law “On gas”
Bulgaria			Law “On Energy”
Montenegro			Law “On Energy and regulation of tariffs for electricity”
Bosnia and Herzegovina			The Law of Bosnia and Herzegovina “On transmission of electricity” that governs relations between the system operator and the regulator.
Croatia			Law On Energy No. 68/01 and 177/04, Law on regulation of activities in the energy sector (Official Gazette, No. 177/04)
Kosovo		The Law on energy regulator	Law On Energy
Latvia		The law “On utility services regulators”	- The Law on electricity market, the Law On Electricity
Hungary			The Law on

			regulation of electricity market, the Law On gas
Turkey			Law “On regulation of tariffs in the electricity market”
Serbia			The Law On Energy
Mongolia			The Law on energy of Mongolia, 2001; The Law on renewable energy of Mongolia, 2007

Specifics of the legislation of Latvia, Kosovo and Georgia are availability of separate laws on the regulator.
(Annex 1.)

Regulation in the sphere of natural monopolistic relations and unbundling of competitive and natural-monopolistic types of activities is done in the framework of national laws On Natural Monopolies (Kazakhstan, Russia, Kyrgyzstan, and Ukraine) and industry specific laws in relevant fields that serve as basics for tariff regulation.

In all countries in question services provided in the power sector are classified as monopolistic. However, classification of other types of regulated services as monopolistic services on a legal basis significantly differs in the relevant countries. For example, industry specific and national laws on natural monopolies of Kazakhstan, Russia, and Ukraine contain exhaustive lists of natural monopolistic services:

Russian Federation	Article 4 of the Federal Law “On Natural Monopolies”	transmission of oil and oil products through main pipelines; transmission of gas through pipelines; railroad transportation; services of transport terminals, ports, airports; services of generally available electric and postal communications; services on transmission of electricity; services on operational-dispatch control in the power sector; services on transmission of heat; services on use of infrastructure of internal waterways
Kazakhstan	Article 4 of the Law “On Natural Monopolies”	On transportation of oil and products of oil refining through main pipelines; On storage, transmission of gas or gas condensate through main and/or distribution

		<p>pipelines, operation of gas distribution installations and distribution gas pipelines related to them;</p> <p>On transmission and/or distribution of electricity;</p> <p>On generation, transmission, distribution and/or supply of heat;</p> <p>On technical dispatch of sale to networks and consumptions of electricity;</p> <p>Main railroads;</p> <p>Access ways;</p> <p>Air navigation;</p> <p>Ports, airports;</p> <p>Telecommunications provided there is no competitive communication operator due to either technological impossibility or economic inexpediency of provision of this these types of services, except for universal telecommunication services;</p> <p>On property rent or use of cable sewage and other assets that are technologically related to connection of telecommunication networks to telecommunication networks of public use;</p> <p>water and/or sewage systems;</p> <p>public postal services.</p>
Ukraine	Article 5 of the Law “On Natural Monopolies”	<p>transmission of oil and oil products through pipelines;</p> <p>transmission of natural and oil gas through pipelines and its distribution;</p> <p>transmission of other substances through pipeline transport;</p> <p>transmission and distribution of electricity;</p> <p>use of railroads, dispatch services, railway stations and other infrastructure objects that ensure movement of railroad transport of public use;</p> <p>air traffic control;</p> <p>communication of general use;</p> <p>centralized water supply and water disposal;</p> <p>centralized heat supply;</p> <p>specialized services of transport terminals, ports, airports, according to the list determined by the Cabinet of Ministers of Ukraine.</p>

Structures of national laws on natural monopolies in Kazakhstan, Ukraine and Russia and main notions used in them are similar in their entirety.

For example, lists of spheres of activities set by laws on natural monopolies in Kazakhstan and Russia have similar areas of functioning of natural monopolies:

- transmission of oil and oil products through main pipelines;
- transmission of gas through pipelines;
- services of transport terminals, airports and ports;
- postal services;
- transmission of electricity;
- transmission of heat;
- operational-dispatch control in the power sector.

Differences in determining fields of natural monopolies is that in some countries natural monopolies include only services on transmission and distribution, and in other they include also supply. For example, the legislation of Russia in the field of energy classifies as natural monopolies only services on transmission of heat and electricity. In Kazakhstan, besides services on transmission and/or distribution of electricity and heat, natural monopolies also include services on heat supply, while services on power supply in Kazakhstan are in the competitive market. (Annex 2, appendix 2).

As for natural monopolistic services provided in the utility sphere (Law of the Republic of Kazakhstan “On Housing Relations”), such services include water supply, sewage and heat supply, for which tariffs are set in accordance with the legislation on natural monopolies; and this is the main difference in regulation of such services with Russia, where tariffs for such services are regulated by the state in accordance with the Federal Law of the Russian Federation “On fundamentals of regulation of tariffs of utility complex organizations” that is not applicable to natural monopolistic services.

The law of the Kyrgyz Republic “On natural and allowed monopolies in the Kyrgyz Republic” does not define spheres of activities of natural monopolies. In accordance with the Regulation on the State Registry of subjects of natural and allowed monopolies of the Kyrgyz Republic approved by Decree of the State Commission under the Government of the Kyrgyz Republic on anti-monopoly policy of December 5, 2001, No. 61, a State Registry of subjects of natural and allowed monopolies of the Kyrgyz Republic was introduced for the purpose of exercising the state control over economic entities’ compliance with the antimonopoly legislation.

It has to be noted that in Kazakhstan the list of regulated services (goods, works) upon the proposal of the authorized body is approved by the Government (Decree of the Government of the Republic of Kazakhstan of March 14, 2006, No. 155 “On approval of the List of regulated services (goods, works) of subjects of natural monopolies”).

Similarly, the law of the Russian Federation “On Natural Monopolies” states that the List of goods (works, services) of subjects of natural monopolies, prices (tariffs) for which are regulated by the state, and the procedure for state regulation of prices (tariffs) for these goods (works, services) that includes principles of pricing and rules of the state regulation and control are approved by the Government of the Russian Federation.

In more details the system of legal relations in natural monopolistic spheres is set in by-laws, adopted norms and main provisions of laws that serve as a legal basis for them.

Thus, when implementing the regulatory laws, government decrees, industry regulations that determine the procedure for carrying out certain types of activities, methodological orders and instructions are adopted.

The legal basis of the current tariff setting methodology in the field of natural monopolies in Kazakhstan are by-laws that determine the procedure for determining costs that are taken into account in the calculation of prices (tariffs) for production and provision of services by subjects of natural monopolies, procedure for procurements by subjects of natural monopolies of goods, works and services, costs associated with which are taken into consideration when approving tariffs, procedure for presenting, reviewing and introduction of prices (tariffs) for goods, works and services of subjects of natural monopolies and other.

According to Article 4 of the Federal Law of the Russian Federation “On Electricity” normative legal acts in the field of the state regulation of relations in the power sector are adopted in accordance with federal laws by the Government of the Russian Federation and by federal executive power bodies authorized by them.

Similarly, in Kazakhstan, functions of the authorized body include control and regulation of activities in the sphere of natural monopolies, it also has the right to develop and approve by-laws that are binding for state bodies and subjects of natural monopolies (item 1, Article 13 of the Law of the Republic of Kazakhstan “On Natural Monopolies”).

With respect to prices for electricity and heat in Russia there is the federal law of 26.03.2003 “On Electricity” and “On the state regulation of tariffs for electricity and heat in the Russian Federation”, and in other sectors – “On gas supply in the Russian Federation”, “On communications”, “On federal railway transport” etc.

In Russia the main by-law developed in accordance with federal laws “On the state regulation of tariffs for electricity and heat in the Russian Federation” and “On Electricity” is Decree of the Government of the Russian Federation of February 26, 2004, No. 109 “On pricing with respect to electricity and heat in the Russian Federation”, which determines the main principles and methods of regulation of tariffs (prices) for electricity and heat and for relevant services. In addition, in the gas sector there is Decree of the Government of the Russian Federation of December 29, 2000, No. 1021 “On the state regulation of prices for gas and tariffs for services on its transmission in the territory of the Russian Federation”. Decree of the Government of the Russian Federation of September 13, 1999, No. 1158 “On ensuring compliance with economically justified principles of pricing for products (services) of subjects of natural monopolies” determines principles of pricing in the field of natural monopolies; Decree of the Government of the Russian Federation of September 13, 1995, No. 997 “On the state regulation of prices (tariffs) for products (services) of

subjects of natural monopolies” sets the procedure for regulation of prices (tariffs) for products (services) of subjects of natural monopolies.

At the same time, at present, there are no decrees of the Government of the Russian Federation on regulation of certain spheres of activities of subjects of natural monopolies, in particular, in transport (services of ports, airports, transport terminals, and there is no base for regulation of transportation of oil through main pipelines and for railroad transportation). That means that at present only processes on regulation of tariffs for electricity and heat, for transmission of gas through main pipelines and regulation of wholesale prices for gas are prescribed in details.

The legal framework for natural monopolies includes laws and other normative acts that are adopted not only by federal state power bodies, but also by constituents of the Russian Federation on issues that are in their exclusive competence or under joint control with the Russian Federation. This right of constituents of the Russian Federation is recorded in Article 76 of the Constitution of the Russian Federation, constitutions and charters of constituents of the Russian Federation.

In Kyrgyzstan the decree of the Government that determines methods of regulation and formation of costs for subjects of natural, state and allowed monopolies is Decree of the Government of the Kyrgyz Republic of July 17, 2003, No. 445 “On approval of the Regulation on the procedure for determining prices (tariffs) for goods (works, services) of economic entities that are regulated by the state”. The Regulation is applicable to subjects of natural, state, allowed monopolies and serves as a basis for determination of the method of regulation and determination of costs for those entities. However, there are no methodologies for tariff setting.

Therefore, on the basis of legal acts that determine tariff regulation the state ensures adoption of decisions on introduction of the state regulation of prices and tariffs in industries that belong to natural monopolies where development of competition is impossible or inefficient for the purpose of prevention of overpricing and overshooting of tariffs by subjects of natural monopolies for their products, and in order to prevent reduction of volumes of their production, coordinate activities of executive power bodies on price regulation, approve lists of products, goods and services, prices for which are subject to be regulated in the internal market.

In many countries, within the government, or in some special bodies there are expert committees that include well-known specialists, representatives of the general public that consult state bodies on the issues of tariffs and express their opinions on draft laws that touch upon tariff setting issues (annex 3, The appendix 3).

For example, in Romania, ANRE Regulatory Committee gets assistance from the Advisory Board consisting 11 members appointed by the Decision of the Prime-Minister of Romania based on proposals of the President of ANRE; it represents major organizations, associations and companies in the Romanian energy sector. In addition, for the purpose of ensuring transparency of the decision-making process within the structure of procedures set in order to design legal actions, Law No. 52/2003 requires authorized bodies to announce through their web-sites and to publish in mass media relevant information.

In Ukraine regulated subjects and their public organizations have the right to participate in elaboration of regulatory documents, give comments and proposals with respect to published drafts, can participate in open discussions of issues related to regulatory activities. This right is specified in the law of Ukraine “On fundamentals of the state regulatory policy in the sphere of economic activities” of September 11, 2003, No. 1160.

In Latvia, suppliers of regulated utility services and their public organizations take part in the process of drafting the legislation in regulated spheres. Meanwhile, the form of interaction differs from participation in public hearings.

Also in Hungary, prior to discussion of laws in the Parliament, they are coordinated with consumer protection organizations, with subjects of natural monopolies. In addition, decrees elaborated by regulatory bodies also have to comply with the coordination process before the final proposal is sent to the Ministry. Detailed rules of settlement and price application have to be prepared by the regulator. In this process the regulator has to take into account opinion of consumer protection organizations, and opinion of organizations that represent interests of clients and persons that hold patents.

In Serbia, the legislation adopted by AERS has to undergo the process of public consultations with all stakeholders. It is done in the following way. Draft documents are placed on the Internet site, and opinions of all interested parties on these drafts are taken into consideration while working on the final version of documents.

Similarly, in the Republic of Kazakhstan, public organizations have the right to take part in elaboration of laws and by-laws. For this purpose on the web-site drafts are published so that all interested parties could discuss them. Meanwhile, the regulator has to coordinate with associations and unions of legal entities drafts of all legal acts that touch upon interests of entrepreneurs; and this is stipulated in the law.

The results of the questionnaire show that in ERRA countries the general public is involved in discussions of documents related to regulation, except for Mongolia.

1.2. Goals of the tariff regulation

The state regulation of prices in natural monopolies is aimed at achievement of the following goals and resolution of the main tasks:

- Achieving the balance between interests of consumers and those of subjects of natural monopolies (private and public). This goal born in mind when justifying the list of goods, works, services, prices for which are subject to legal regulation, when choosing types and methods of regulation;
- Protection of interests of consumers of goods and services against unjustified increase of tariffs and against violations of set tariff setting rules;
- Determining tariffs for various groups of consumers on the basis of real costs;
- Ensuring sustainable and economically efficient functioning of subjects of natural monopolies;
- Setting economically justified level of regulated tariffs. This level has to be determined by the level of economically justified costs and by getting weighted average profit;
- Creation of economic conditions under which enterprises of natural monopolies find it profitable to reduce costs, to introduce new techniques and technologies, to improve efficiency of use of investments;
- Leveling or differentiation of tariffs in certain regions in order to ensure their rational development (in Russia).

These goals are determined by laws (annex 4, appendix 4):

Country	National laws on Natural Monopolies Laws on regulators Industry-specific laws
Russian Federation	<p>Goals and objectives of the state regulation of tariffs: State regulation of tariffs is done for the following purposes:</p> <ul style="list-style-type: none"> Protection of economic interests of consumers against monopolistic increase of tariffs; Creation of the mechanism of coordination of interests of generators and consumers of electricity and heat; Creation of competitive environment in the power energy complex in order to increase efficiency of its functioning and minimization of tariffs; Creation of economic incentives that ensure use of energy efficient technologies in production processes; <p>Providing to legal entities – generators of electricity (capacity) irrespective of their organizational-legal forms of the right of equal access to the wholesale market (article 3 of FZ of April 14, 1995, No. 41-FZ).</p>

Georgia	<ul style="list-style-type: none"> a) protection of consumers monopoly prices; b) possibility for licensees, importers, commercial system operator and suppliers to cover their expenses that include cost of fuel acquired at the economically justified price, operating costs, payment of the principal and interests on loans taken as working capital, expenses related with getting a license for relevant activities, and regulatory costs. At the same time, the tariff has to envision reasonable and fair level of returns on capital investments, which has to be sufficient to attract investments for the purpose of rehabilitation and development of the industry; c) fostering growth of financial revenues of the licensee, importer, commercial system operator or supplier, reduction of expenses on maintenance through improvement of efficiency of operations and management provided the licensee, importer, commercial system operator or supplier comply with provisions of the legislation and (or) license in terms of the service quality (9.06.2006 3292 from September 1, 2006); d) fostering economic efficiency growth by setting short-term and long-term cap prices in power and natural gas sectors and by forecasting price dynamics taking into consideration possible excess or deficit of electricity; e) possibility for licensees, importers or suppliers to repay economically justified expenses, including expenses incurred in order to get a relevant license, and regulatory costs, as well as expenses related to membership in the power market (taken 9.06.2006 3292 from September 2, 2006); f) takes into account main directions in the politics of Georgia with respect to priorities of categories of consumers of electricity and natural gas. At the same time, it does not restrict the right of a licensee, importer, commercial system operator or supplier to require payment of the cost of its services and to terminate services in case of non-payment g) takes into account the state policy in the field of tariff benefits specifying that it is impossible to subsidize tariff benefits for any consumer category at the expense of a licensee, importer, commercial system operator, supplier or any other consumer category (9.06.2006 3292 from September 1, 2006);
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	h) reflects different cost of services for different consumer categories
Ukraine	<ul style="list-style-type: none"> • protection of consumers against unjustified increase of tariffs; • creation of a mechanism of optimal balance of economic interests of a generator, on one hand, in terms of ensuring receipt of sufficient funds for expansion of reproduction, and on the other – of consumers in terms of ensuring competitiveness of products and the level of social protection; • creation of conditions for a generator that promote optimization of tariffs on the basis of improvement of efficiency, use of new techniques, modern technologies and logistic solutions in order to ensure proper level of security, to reduce costs and improve economic feasibility of investment projects; • ensure a possibility of short-term and long-term forecasting of changes in levels of tariffs.
Kyrgyz Republic	The goal of activities of the regulator and its tariff policy is to ensure adequate revenues, so that energy enterprises could develop and expand, and to prevent excessive monopoly benefits and discrimination of consumers, and also to ensure balance of interests of consumers and generators in terms of prices of tariffs for energy
Romania	According to Article 98 (1) of Law “On gas” No. 351/2004: the system of prices and tariffs for natural gas has to ensure: <ul style="list-style-type: none"> a) development of competition in the natural gas market, development of the security of its supply; b) return on investments; c) energy savings on the level of final consumers; d) opening of new resources and development of available natural gas reserves; e) improvement of the quality of natural gas and services provided to consumers.
Bulgaria	Ensuring balance between interests of clients and interests of energy companies.
Montenegro	Fair tariffs based on objective criteria set by the Agency
Bosnia and Herzegovina	<ul style="list-style-type: none"> - impartiality, transparency and prevention of discrimination; - promotion of efficient performance of regulated companies and transmission network users; - promotion of mechanisms for energy efficiency improvement; - establishment of sustainable relations in the electricity market and sustainable conditions for investors in the energy sector; - promotion of transmission network development for ongoing improvement and maintenance of the quality of

	supply.
Croatia	Improvement of energy generation efficiency, competitiveness and management, including expanded use of renewable energy sources.
Kosovo	Setting transparent procedure for tariff regulation based on the free market principles; <ul style="list-style-type: none"> - transparent activities of service providers based on public service obligations; - setting on the basis of tariff methodologies of reasonable and fair prices for regulated services; - maintenance of balance of interests of consumers and energy enterprises; - taking appropriate measures for strengthening social-economic unity; - security of services and supply of electricity by means of building transmission network infrastructure, including compatibility; - protection of interests of consumers by means of transparent and open access to information with respect to estimates and tariffs.
Latvia	<ol style="list-style-type: none"> 1) provision of high quality, ongoing and safe services by utilities at economically reasonable prices (tariffs); 2) promotion of efficient and sustainable development of utility enterprises that guarantees rates of return compatible with prevailing economic conditions; 3) development of economically justified competition in regulated sectors.
Hungary	Safe supply of electricity at the lowest costs. Efficient use of generation, storage, transmission and distribution facilities, as well as sources of purchase, taking into consideration specific features of the natural gas integrated system.
Turkey	- the goal of regulation should present principles and procedures that govern preparation, expert testing, evaluation, modification and approval of regulated tariffs in the electricity market. Regulation includes criteria for preparation of tariff proposals Turkish Electricity Transmission Co. Inc, Turkish Electricity Trading and Contracting Co. Inc.
Serbia	Expansion and development of the energy market on principles of non-discrimination and efficient competition, guarantee of security of energy service provision and equality of clients
Mongolia	The goal of the tariff regulation is to set system of prices and tariffs, which allows supply of energy at lowest possible costs and ensures adequate rate of return.
Kazakhstan	The Law of the Republic of Kazakhstan “On Natural Monopolies”: determination of legal framework for the state control and regulation of activities in the natural monopolistic spheres; achievement of balance of interests of consumers and subjects of natural monopolies (Article 1); emergency

	<p>regulatory norms taken by the authorized body in order to protect lives, health of citizens, property of physical persons and legal entities, and also protection of environment (Article 3 item 25)); prevention of infringement of rights and lawful interests of consumers of regulated services (goods, works) of a subject of the natural monopoly, or constraining economically justified transition of the relevant commodity market from being natural monopolistic to becoming a competitive market (Article 18-1); prevention of interruption or significant decrease in volumes of provided regulated services (Article 18-3)</p> <p>The Law of the Republic of Kazakhstan “On Electricity”: maximal satisfaction of consumer demand for energy and protection of rights of participants of the electricity and heat market by means of creation of competitive conditions in the market that guarantee to consumers the right to choose supplies of electricity and heat; ensuring safe, reliable and stable functioning of the power complex of the Republic of Kazakhstan; unity of management of the power complex of the Republic of Kazakhstan as it is especially important life support system for economic and social complexes of the country (Article 3)</p>
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1.3. Principles of the state tariff regulation

Principles of regulation differ depending on a lot of procedural factors.

Principle of objectivity and lawfulness of tariff regulation is that legal regulation of activities of economic entities has to rely on objective regularities and real opportunities. Activities of economic entities have to be carried out in strict compliance with requirements of the legislation that ensures tariff regulation. This principle cannot be implemented without clear work of mechanism of holding subjects liable for unlawful behavior. In addition, the state has to ensure lawfulness of legal acts, lawfulness of activities of state power bodies, whose competence includes setting and monitoring of application of regulated tariffs. Establishment in normative acts of rules that do not comply with the said principle can lead either to non-fulfillment of these rules due to the lack of possibilities, or to slowing down of forward motion in public development. Following the principle of objectivity, normative acts determine the mechanism of setting economically justified level of prices that ensures recovery of economically justified costs and getting profits. In addition, this principle is shown in stability and predictability for economic entities of the state tariff policy.

One of the main principles of achieving balance of interests of consumers and those of subjects of natural monopolies is granting to consumers equal access rights to regulated services (goods, works). Therefore, there is no differentiation between state-owned and private enterprises in the field of commercial conditions for getting access to raw materials and other resources in the field of natural monopolies.

Principle of publicity of legal regulation of tariff setting contributes to better justification of decisions that are made with respect to activities of regulated entities, thus, attracting consumers to the process of discussion and determination of the size of tariffs.

Provisions that reflect general approaches to regulation are contained in the legislation of countries, in particular, in articles 5, 6, 7 of the law of the Republic of Kazakhstan “On Natural Monopolies” (“Restrictions of activities of subjects of natural monopolies”, “Rights of a subject of the natural monopoly” and “Duties of a subject of the natural monopoly”), articles 7, 8 of the law of the Kyrgyz Republic “On Natural and Allowed Monopolies in the Kyrgyz Republic” (“Restrictions of activities of subjects of natural and allowed monopolies”, “Duties of subjects of natural and allowed monopolies”), Article 8 of the law of the Russian Federation “On Natural Monopolies” (“Duties of subjects of natural monopolies”).

In general, it has to be noted that provisions of these articles are aimed at ensuring transparency of activities of subjects of natural monopolies, regulation of their activities and protection of rights of consumers, which boils down to the requirement:

- to provide equal conditions to consumers of goods manufactured in the conditions of natural monopolies (except for provision of benefits to certain categories of consumers in accordance with the legislation);
- to ensure quality of services for consumers taking into consideration prices set by the regulator that supervises activities of subjects of natural monopolies;
- to apply efficient production methods and technologies;
- to submit to the regulator that supervises activities of subjects of natural monopolies reports on their activities.

The main tariff setting principle contained in the named laws states that tariffs or their cap levels for regulated services (goods, works) of a subject of the natural monopoly approved by the authorized bodies have to be not lower than the value of costs needed to provide these regulated services (production of goods, works), and have to take into consideration possibilities of getting profits that would ensure efficient functioning of a subject of the natural monopoly.

In addition, principles of regulation are stipulated in industry-specific laws (annex 5, appendix 5).

Thus, principles and methods of the state regulation and control in the power sector are set in Article 20 of the law of the Russian Federation “On Electricity” (ensuring unity of technological management of the Unified Energy System of Russia, reliable and safe functioning of the Unified Energy System of Russia and technologically isolated territorial power systems; efficient management of state property in the power sector; achievement of balance of economic interests of suppliers and consumers of electricity; ensuring affordability of electricity and heat for consumers and protection of their rights; ensuring social protection of citizens of the Russian Federation against unjustified increase of prices (tariffs) for electricity and heat; creation of necessary conditions for attraction of investments for the purpose of development and functioning of the Russian power system; development of the competitive electricity market and restriction of monopolistic activities of certain entities in the power sector; ensuring non-discriminatory access to subjects of natural monopolies in the power sector and to services of the wholesale market trading system administrator; maintenance of elements of the state regulation in the power sector where there are no conditions for competition or where they are limited; ensuring access for consumers of electricity to information on functioning of the wholesale and retail markets, and also on activities of power sector entities) and article 2 of the law of the Russian Federation “On the state regulation of tariffs for electricity and heat in the Russian Federation” (setting economically justified tariffs (prices, fees for services) for electricity and heat and/or their cap values).

In the Kyrgyz Republic, Article 21 of the law of the Kyrgyz Republic “On Electricity” (prices have to reflect full cost of generation, transmission and distribution of heat or electricity, including costs associated with production and technical maintenance, recovery of capital costs, attraction of investments and rate of return; changes in prices should not cause unexpected economic difficulties for generators or consumers; discrimination while providing services and in tariffs is prohibited, as well as in terms of the quality of services; all consumers of the same group with similar consumption characteristics served by one distribution company

have to get equal tariffs and services; tariffs for each group of energy consumers reflect full cost of provision of services; subsidies of one group of consumers by the other are prohibited; tariffs are set in such way so that they reflect the difference in cost of provision of services in different times of the year, and also different types of services or services of different quality, when consumers have a possibility to choose).

In Hungary tariffs have to include return of justified investments, costs of efficiently working persons that have a patent, as well as profits needed for long-term operations.

The Law of Mongolia “On Energy” (Article 26, paragraph 26.2): Tariffs have to be based on real costs of operations; costs have to be assigned to various consumers classes in accordance with their requirements; tariffs have to allow for regulation of energy consumption; tariffs have to guarantee sufficient revenues of persons that hold a patent in order to maintain their financial viability;

According to the principle of diversity and legal equality of forms of ownership and equal protection of all forms of ownership, the legislation cannot set any preferences or restrictions for these or those forms of ownership, for entities that carry out entrepreneurial activities using property that is in the state or private ownership. Therefore, rules related to tariff regulation have to be applied by all economic entities irrespective of the form of ownership based on the goal of achieving balance of private and public interests.

Public nature of the system of tariff regulation is ensured by necessary methodological and information interaction between certain elements of this system: procedures for monitoring, preparation and review of applications for revision of tariffs, their approval and entering into force. Openness of the process of formation and approval of tariffs promotes better justification of decisions made in pricing.

2. Tariff design

2.1. Types of tariffs

In accordance with the national legislation regulators determine (set) prices, tariffs or their cap levels; set cap level of profitability, set the size of the sales mark-up; determine consumers that have to be served obligatory and set the minimal level for their provision if it is impossible to meet fully their demand for goods produced (sold) by a subject of the natural monopoly taking into consideration the need to protect rights and lawful interests of citizens, to ensure security of the state, protection of nature and cultural value, other measure envisioned by national legislations of counties.

In addition to usual types of tariffs approved for a certain period of time, or for indefinite periods, regulation is done by means of setting:

Cap levels of tariffs (except for Georgia, Ukraine, Kyrgyz Republic, Montenegro, Bosnia and Herzegovina);

Investment tariffs (except for Georgia, Ukraine, Kyrgyz Republic, Bulgaria, Latvia, Mongolia);

Compensatory tariff (except for the Russian Federation, Ukraine, Kyrgyz Republic, Montenegro, Bosnia and Herzegovina, Latvia, Hungary (in the power sector), Mongolia) (annex 6, appendix 6, 6-1, 6-2, 6-3).

Kazakhstan also uses a value that is determined as a temporary decreasing ratio, which is set by the authorized body and is applied to the tariff (price, rate) for the purpose of protection of interests of consumers and those of a subject of the natural monopoly (Article 15 of the law of the Republic of Kazakhstan “On Natural Monopolies”).

The very notion of “tariff” defined in the **Kazakh** Law envisions monetary value of the cost of regulated services (goods, works) of a subject of the natural monopoly approved by the authorized body. If necessary, regulation of monopolies is done by approval of the cap level of tariffs (prices, rates) that is a maximal value of tariffs (prices, rates) for the medium-term or long-term period.

For the medium-term (more than 1 year up to 5 years) or long-term (more than 5 years) periods, the Kazakh legislation on natural monopolies envisions approval of *cap levels of tariffs* that represent maximal value of tariffs (prices, rates) for regulated services (goods, works) of a subject of the natural monopoly for the said periods. Meanwhile, the procedure for approval of the cap value of tariffs is determined by the authorized body. This procedure is applied in cases, when the applying subject of the natural monopoly meets the requirements set under that procedure.

In the **Russian** legislation the definition “*cap levels of tariffs*” is used with a somewhat different meaning.

Cap levels of tariffs for electricity and heat supplied by energy supply organizations to consumers, including cap levels of tariffs for the population, are set annually by the Government of the Russian Federation with separation of cap levels for the population until the State Duma of the Federal Assembly of the Russian Federation adopts in the first reading the draft federal law on the federal budget for the next fiscal year. The named cap levels of tariffs can be set by the Government of the Russian Federation with calendar breakdown by categories of consumers taking into account regional and other specifics (Article 23 of the law of the Russian Federation “On Electricity”). The period of validity of the set tariffs and/or their cap values cannot be less than one fiscal year, unless the federal law, decision of the Government of the Russian Federation state otherwise.

A specific feature of the Kazakh legislation on natural monopolies is that the authorized body sets an investment tariff, the notion of which, in addition to features that define a notion “tariff” also includes terms determined by the investment project. The difference between the tariff that could be changed within time frame determined by the legislation and the investment tariff is that the investment tariff is approved in the framework of one investment project and is valid until full recovery of the investments.

Prerequisites for setting investment tariffs are: ensuring development of regulated entities and upgrade of existing and creation of new assets for them. That requires from the state creation of favorable investment climate, creation of mechanisms for attraction of investments. In connection with that, in the field of natural monopolies a mechanism to promote investments is represented by setting of the investment tariff that allows exclusion of risks associated with the mechanism of tradition tariff setting.

The Kazakh legislation on natural monopolies envisions the procedure for coordination of investment programs and/or investment projects of subjects of natural monopolies, which determines appropriate criteria for the named programs and projects (Order of the Agency of January 27, 2003 No. 16-OD “On approval of the Instruction on reviewing and coordination of investment programs and/or investment projects of subjects of natural monopolies”).

Thus, investment programs and/or investment projects should meet the following criteria:

- 1) increase or maintenance of existing level of liquid cost of used fixed assets of the entity should be achieved only at the expense of capital forming costs (re-valuation of fixed assets during the period of implementation of the investment program and/or investment project can be done only in coordination with the authorized body);
- 2) minimization of financial-economic risks;
- 3) reduction of standard and/or excessive losses;

- 4) positive values of main financial-economic indicators of the project – internal rate of return, profits on used assets, discounted cash flows with the level of tariffs (prices, rates) for services of subjects within the framework of the forecast of cap growth of tariffs (prices, rates) for regulated services (goods, works) of subjects approved by the Medium-term plan of social-economic development of the Republic of Kazakhstan;
- 5) minimization of periods of recovery of investments, which has to be ensured by streamlining of the scheme of borrowing and repayment of borrowed resources, by reduction of production costs, diversification of production for the purpose of its maximal utilization in accordance with the market demand and availability of solvent demand;
- 6) increase of the volume and quality of provided regulated services (goods, works);
- 7) complex measures aimed at reduction of the level of receivables of consumers of regulated services (goods, works) of the subject in case it exists.

Meanwhile, in the Kazakh legislation on natural monopolies there are no restrictions for setting the investment tariff for industries. The Agency developed methodologies for calculation of investment tariffs in the energy, telecommunications and oil and gas sectors.

In the Russian Federation the procedure for coordination of investment programs of subjects of natural monopolies in the power sector is in the competence of the Government of the Russian Federation (Article 21 of the law of the Russian Federation “On Electricity”) similarly to provisions of Article 5 of the law of the Russian Federation “On the state regulation of tariffs for electricity and heat in the Russian Federation”, in accordance with which the Government of the Russian Federation or the federal executive power body in the field of tariff regulation exercises control over use of investment resources that are included in the tariffs that are regulated by the state according to the procedure set by the Government of the Russian Federation (Decree of the Government of the Russian Federation of 19 January, 2004, No. 19 “On approval of the Rules for coordination of investment programs of subjects of natural monopolies in the power sector”).

According to Article 6 of the law of the **Kyrgyz Republic** “On Natural and Allowed Monopolies in the Kyrgyz Republic”, the Anti-monopoly body exercises control over investments of a subject of natural and allowed monopolies in production (sale) of goods with respect to which in accordance with the present law regulation is not applicable, and which comprise more than 10 percent of the value of owner’s equity of the subject of the natural and allowed monopoly according to the latest approved balance sheet; in addition, one of duties of subjects of natural and allowed monopolies is to provide projects of investments (Article 8).

According to the **Kazakh legislation** on natural monopolies in case a subject of the natural monopoly causes losses to a consumer by means of unlawful increase of tariffs (prices, rates) or their cap values and/or by means of including in the tariff (price, rate) or its cap level the cost of actually not executed works, non-targeted use of depreciation funds envisioned in the tariff budget, deviation of execution of cost items by more than five percent from approved amounts, the authorized body has to

make a decision on approval of the *temporary compensatory tariff* to compensate consumers for losses.

Meanwhile, the revenue taken to justify the level of new tariffs (prices, rates), is decreased by the amount of groundlessly received revenues taking into consideration the refinance rate of the National Bank of the Republic of Kazakhstan as of the date the decision was made less amounts already compensated by the subject of the natural monopoly to consumers of its regulated services (goods, works).

In Russia in case of causing losses by actions (omissions to act) of a subject of the natural monopoly that violate the federal law “On Natural Monopolies”, including those from increase of a price (tariff) to another economic entity, these losses are subject to be compensated by the subject of the natural monopoly in accordance with the civil legislation (article 17). Similar norms are present in the Ukrainian legislation (article 19 of the Law of Ukraine “On Natural Monopolies”).

Also for the purpose of protection of interests of consumers and those of a subject of the natural monopoly **in Kazakhstan**, the authorized body sets a temporary decreasing ratio – a value that is applicable to the tariff (price, rate).

Approval of the temporary decreasing ratio to the tariff is made on the basis of the Rules in various fields of operations of natural monopolies approved by the authorized body, upon the request from a consumer who encloses substantiating documents, provided the consumer paid 100 % his/her current liabilities and there are no payables due. Temporary decreasing ratio comes into effect from the first day of the month for a certain period of time but not more than for one calendar year, except for some cases specified in the rules.

In accordance with item 54 of the “Basics of Pricing with respect to electricity and heat in the Russian Federation (approved by Decree of the Government of the Russian Federation of February 26, 2004, No. 109) executive power bodies of constituents of the Russian **Federation** dealing with the state regulation of tariffs prior to adoption of the law on the budget of a constituent of the Russian Federation for the next fiscal year set the following in the retail market:

1	Regulated tariffs (prices) for electricity (capacity) supplied by suppliers of last resort, energy supply organization, whose consumers include also population, including regulated tariffs (prices) for the population within the framework set by the Federal Service for Tariffs
2	Tariffs for heat generated by power plants that co-generate electricity and heat within the frameworks set by the Federal Service for Tariffs for marginal (minimal and/or maximal levels of regulated tariffs (prices) for the said heat
3	tariffs for heat, except for tariffs for heat generated by power plants that carry out combined generation of electricity and heat within the framework of minimal and/or maximal cap levels of tariffs for heat set by the Federal Service for Tariffs
4	Sales mark-up of suppliers of last resort. The size of such mark-up is determined taking into consideration specifics set in the Rules for functioning of retail electricity markets during the transition period of reforms in the powers sector in item 57.1 of “Basics of Pricing”
5	Regulated tariffs (prices) for electricity (capacity) generated by power plants that

are used to generate and supply electricity (capacity) in the retail market

In accordance with item 2 of decree of the Government of the Russian Federation of December 29, 2000, No. 1021 “On the state regulation of prices for gas and of tariffs for its transmission in the territory of the Russian Federation”, notions “price for gas”, “tariffs for services on transmission of gas”, “payment for supply services” are defined as a system of price rates at which settlements for supplied gas are carried out, services on its transmission or acquisition are provided and in accordance with item 5, the state regulation of wholesale prices for gas and tariffs for services on its transmission through main gas pipelines for independent organizations is done prior to converting to the state regulation of tariffs that are uniform for all gas suppliers for services on transmission of gas through main gas pipelines in the territory of the Russian Federation.

In the Kyrgyz Republic, in accordance with the Instruction on application of tariffs for electricity and heat, approved by decree of the Executive Council of the State Energy Agency under the Government of the Kyrgyz Republic of November 25, 2002, No. 191-p, three types of tariffs are set: one-part tariffs that determine the cost of one kilowatt-hour (kWh) of active electricity sold to a consumer; two-part tariffs that determine the cost of one kilowatt-hour (kWh) of highest capacity announced by the consumer that participates in maximal load of the grid and the cost of one kilowatt-hour (kWh) of consumed active electricity and differentiated seasonal tariffs that are applied to consumers that have seasonal type of production activities (from April to October, inclusive).

2.2 Mechanisms for approving tariffs

Ways and methods of the state regulation of prices in different states are influenced by national and climatic factors, by raw materials and political conditions.

The procedure for filing tariff setting applications, their examination by authorized bodies, as well as timeframe for making decisions by authorized bodies differ significantly and are governed by legal acts and procedures for reviewing tariffs. The procedure for submission of applications for approval of tariffs, their examination by authorized bodies, and also terms for making decisions by authorized bodies in ERRA countries significantly differ from country to country and are defined by normative legal acts and tariff reviewing procedures (annex 7, appendix 7).

Thus, in such countries as the Russian Federation and Turkey applications for approval of tariffs are submitted during a certain calendar period (annually by May 1, annually by the end of October).

Prior to expiry of the tariff the application is submitted: in the Kyrgyz Republic 6 months before the expiry date. In Bulgaria this period is 3 months, and in Kosovo – 2 months.

In the Republic of Kazakhstan, Montenegro and Latvia application for approval of tariffs is submitted 90 days before they come into effect.

In Mongolia 30 days before filing an application to the regulatory body, a company has to publish draft tariffs in mass media.

Examination of draft tariffs is also done within terms set in the legislation.

The state regulation of prices in Turkey and Russia is done, as a rule, once a year by means of setting new tariffs instead of the ones that were applied during the previous period.

Setting of tariffs for a certain period of time ensures certainty with respect to future cash flows of regulated entities, and that decreases risks for investments: during the regulatory period the regulated entity can lower costs and to spend saved money at its discretion; besides, economic certainty increases for consumers of services provided by regulated entities (annex 7, The appendix 7-1).

Significant changes in expenses on production as a result of inflationary processes and increase of prices for fuel, raw materials, supplies, services, new data on tariffs, including errors in approving tariffs, changes in the market situation, or extraordinary events can serve as a basis for revision of tariffs both at the initiative of the regulator, and at the initiative of a company. It has to be noted that revision of approved tariffs by the regulator is not applied in Georgia, Bulgaria, Kosovo, and Turkey. Tariffs are not revised in the Russian Federation (for electricity and heat), Croatia, Serbia either (annex 8, appendix 8).

In **Kazakhstan** approval of tariffs, tariff estimates and determination of the procedure for approval of tariff estimates, tariffs (prices, rates) or their cap values; determination of the procedure for submission of draft tariff estimates, tariffs (prices, rates) or their cap values, procedure for approving the temporary compensatory tariff, the temporary decreasing ratio for regulated services of subjects of natural monopolies are in the competence of the authorized body.

At the legislative level a twelve month period of validity of tariffs for regulated services (goods, works) of subjects of natural monopolies is set, as well as frequency of approval of tariffs (prices, rates) or their cap values and tariff estimates for regulated services (goods, works) of a subject of the natural monopoly – not more than once every twelve months. Meanwhile, the said periods of validity and frequency are not applicable to cases when tariffs (prices, rates) and tariff estimates are approved for regulated services (goods, works) according to the simplified procedure.

Provisions of the Law clearly stipulate specific terms:

- examination by the authorized body of draft tariffs (prices, rates) and tariff estimates of subjects of natural monopolies within fifty five days from the time a subject of the natural monopoly files an application (item 3 of Article 17), i.e. a decision on approval of tariffs is made after fifty five days;
- sending to the subject of the natural monopoly a decision of the authorized body on approval of tariffs (prices, rates) not later than thirty five days before they come into effect (item 2 of Article 18);
- putting into effect of new tariffs (prices, rates) and tariff estimates from the first day of the second month following the month when tariffs (prices, rates) were approved (item 3 of Article 18).

Therefore, terms for submission of applications for approval of tariffs (prices, rates), tariff estimates by subjects of natural monopolies based on the aforementioned provisions of the law cannot be less than ninety days before the date of putting into effect of tariffs (prices, rates), which is envisioned in item 2 of Article 16 of the Law.

In the Russian Federation the decision is made on the basis of the analysis of activities of a particular subject of the natural monopoly taking into consideration the motivating role of regulatory methods. Herein justification of costs is assessed and the following is taken into account:

- costs of production (sale) of goods, including salaries, cost of raw materials and supplies, overhead expenses;
- taxes and other payments;
- cost of fixed production assets, need of investments required for their reproduction and depreciation charges;
- forecasted profit from possible sale of goods at different prices (tariffs);
- remoteness of certain groups of consumers from the place of production of goods;
- relevance of quality of produced (sold) goods to the consumer demand;
- state subsidies and other state support measures.

In accordance with the Rules for the state regulation and application of tariffs for electricity and heat **in the Russian Federation**, approved by decree of the Government of the Russian Federation of February 26, 2004, No. 109, tariffs and/or their cap values are put into effect from the beginning of the subsequent year for the period not less than one year, except for cases, when decisions of regulators aimed at bringing decisions that were made earlier on setting of tariffs or their cap values into compliance with the legislation of the Russian Federation, and also at decisions of regulatory bodies on setting of tariffs for organizations with respect to which there was no state regulation before. The procedure for setting and reviewing tariffs is also set by the rules and envisions the following:

Setting of tariffs and/or their cap values is done by the regulatory bodies by means of reviewing relevant cases.

By May 1 of the year preceding the regulatory period, organizations that carry out regulated activities have to submit to executive power bodies that are in charge of the state regulation of tariffs in constituents of the Russian Federation well-grounded proposals concerning setting of tariffs and/or cap levels of tariffs in accordance with Basics of Pricing.

By May 15 of the year preceding the regulatory period, executive power bodies of constituents of the Russian Federation dealing with the state regulation of tariffs have to submit to the Federal Service on Tariffs justified proposals concerning setting cap levels of tariffs in accordance with Basics of Pricing, and information on volumes of consumption of electricity (capacity) by the population during the current regulatory period.

Within two weeks from the date of registration, the regulator has to analyze the said materials, and sends to the organization that carries out regulated activities a notification on opening of the case on setting tariffs, the notification has to contain such information as: position, last name, first name, patronymic of the person who was appointed to be in charge of the case.

If regulatory bodies use the indexation method, tariff cases are not opened.

The Federal Service for Tariffs approves the order for examining cases on setting of tariffs and/or their cap values that envisions the procedure for registration, acceptance of review and issuance of refusals to review applications on setting of tariffs and/or their cap values, and also the procedure for coordination of decisions of executive power bodies dealing with the state regulation of tariffs in constituents of the Russian Federation on setting tariffs that exceed the maximal or that are lower than minimal levels set in accordance with the Basics of Pricing.

The regulatory body carries out expert testing of proposals on setting of tariffs and/or their cap values. The period for carrying expert testing is set by the regulator, but cannot exceed one month. The regulator appoints experts from its staff members. In cases defined in the rules for reviewing cases on setting of tariffs and/or their cap values, the regulator can decide that expert testing would be done by some third organizations (individuals).

A decision on setting of and/or their cap values is made at the meeting of the Board (Collegium) of the regulatory body.

Ten days prior to examination of the case of setting of tariffs and/or their cap values, an organization that carries out regulated activities is notified (with confirmation of receipt of the notification) on the date, time and place of the meeting of the Board (Collegium), and not later than one day before the meeting, the organization has to get familiar with the relevant materials, including the draft decision.

The decision of the regulatory body is made according to the form approved by the Federal Service for Tariffs, and it includes:

- the size of tariffs and/or their cap values with breakdown by categories (groups) of consumers;
- dates of putting into effect of tariffs and/or their cap values;
- periods of validity of tariffs and/or their cap values with calendar breakdown.

Within one week from the date the decision was made on setting tariffs, the executive power body of a constituent of the Russian Federation dealing with the state regulation of tariffs has to communicate it to organizations that carry out regulated activities and submits a verified copy of this decision to the Federal Service on Tariffs according to the procedure approved by the Service.

The decision of the regulatory body on setting of tariffs and/or their cap values is published according to the set procedure.

Decree of the Government of the Russian Federation of October 20, 2003, No. 638 “On the system of reporting that is provided to the federal executive power body dealing with regulation of natural monopolies” states that on the basis of reporting data of entities, the format of which is approved by the executive power body in charge of regulation of natural monopolies (Order of the FST of Russia of February 10, 2006, No. 19-e/4 “On the system of reports submitted to the Federal Service on Tariffs by organizations that carry out activities in the field of regulated pricing in the power sector”) can revise decisions that were made or adjustments of the draft decisions in the field of the state regulation of tariffs in the power sector of the Russian Federation.

One of the functions of the State Energy Agency under the Government of **the Kyrgyz Republic** is approval of tariffs for electricity, heat and natural gas, as envisioned in the Law of the Kyrgyz Republic of October 30, 1996 “On Energy”. In accordance with Article 9 of this Law, the Executive Board of the State Energy Agency under the Government of the Kyrgyz Republic by its Decree of November 25, 2002, No. 191-p (in the version of Decree of the State Energy Agency of the Kyrgyz Republic of July 8, 2003, No. 129-P) approved the Instruction on application of tariffs for electricity and heat.

According to sub-item 1.1 of the Instruction, tariffs are set by the decree of the Executive Board of SEA and are applicable to electricity that is generated by power plants in the territory of the Kyrgyz Republic. In case of sale of electricity through wholesale consumer – resellers for all categories of sub-consumers (end-users) tariffs should not exceed tariffs that are approved by SEA.

The Regulation on the methodology of setting tariffs (prices) for paid services (works) approved by Decree of the Government of the Kyrgyz Republic of October 26, 2000, No. 637 regulates terms of examination and coordination of draft tariffs (prices) for services (works) by the State Anti-monopoly Body of the Kyrgyz Republic and its territorial bodies, which determines examination and coordination of submitted drafts of tariffs (prices) for services (works) within the period not exceeding 20 working days from the day all calculations and reference materials were submitted in full volume stipulated in the Regulation. Meanwhile, according to the draft price list of tariffs (prices) the number of items in which exceeds 20, the period of coordination is set to be up to 30 working days from the date all calculations and reference materials were received in full volume. Tariffs (prices) for paid services (works) are in effect from the date they were approved according to the procedure set in section II of the Regulation.

Besides, in accordance with item 25 of the **Law of the Kyrgyz Republic** “On Electricity” it is established that after enterprise and organizations submit all necessary documents and calculations for review, the State Energy Agency under the Government of the Kyrgyz Republic has to make a decision within one month. Documents concerning changes in tariffs that have been submitted for the second time have to be reviewed by the State Energy Agency under the Government of the Kyrgyz Republic not earlier than six months [after the first submission?]. As for the terms of notifications about changes in tariffs, Article 15-1 of this law states that any changes in tariffs for electricity has to be officially published in mass media at least one month before new tariffs come into effect.

3. Tariff setting specifics

Almost in all countries tariffs are designed based on the pricing method, under which a standard mark-up is added to the cost of a product. Under this method the price is determined by dividing fixed manufacturing costs by the expected volume of the product, which has to be sold and then variable unit costs are added, or by means of summing up all variable and fixed costs, subsequently dividing them by the total number of units of manufactured product. (annex 9, appendix 7).

According to Article 15-1 of the Law of the Republic of Kazakhstan "On Natural Monopolies", tariffs (prices, fees) or their cap values for regulated services (goods, works) of a subject of the natural monopoly approved by the authorized body should not be lower than costs needed to provide regulated services (manufacture goods, works), and should take into consideration a possibility to earn profits that ensure efficient functioning of a subject of the natural monopoly.

Meanwhile, the basic act that regulates setting of tariffs for regulated services of subjects of natural monopolies are Rules for the special procedure of determining costs, which are applied when approving tariffs (prices, rates) for regulated services (goods, works) of subjects of natural monopolies approved by the order of the Agency. This procedure envisions setting of tariffs on the basis of the following provisions:

- 1) regulation of costs that are included in the tariff (price, fee) or its cap value;
- 2) limitation of cost items of a subject of the natural monopoly within technical and technological norms of consumption of raw materials, materials, fuel, energy, and also standard technical losses;
- 3) setting a list of expenses that are not taken into account when setting a tariff (price, fee) or its cap value;
- 4) limitation of profit that is included in the tariff (price, fee) or its cap value;
- 5) coordination of applied methods of accrual of depreciation for fixed assets;
- 6) coordination of revaluation of fixed assets and areas of utilization of depreciation funds envisioned in the tariff budget of the subject of the natural monopoly.

In accordance with Article 13 of the law, the regulatory body applies non-discriminatory methodologies for calculation of tariffs (prices, rates) or their cap values for regulated services (goods, works) of subjects of natural monopolies.

For the purpose of implementation of this provision of the law, 18 methodologies have been developed and are applied on calculation of tariffs for regulated services in various sectors of natural monopolies, which determine the mechanism and procedure of calculation of tariffs for regulated services and which are applicable to all subjects of natural monopolies that provide these services irrespective of the forms of ownership.

Setting of the cap level of tariffs (prices, rates) is done on the basis of separate accounting of revenues, costs and used assets for each type of regulated services (goods, works) and for other activities of the entity as a whole.

Temporary compensatory tariff

In case actions of a subject of the natural monopoly were detected that caused losses to consumers, the authorized body determines the volume of actually provided regulated services (goods, works) and actually received revenues for the period when the subject of the natural monopoly committed violations (Order of the Chairman of the Agency of the Republic of Kazakhstan on regulation of natural monopolies and protection of competition of December 26, 2003, No. 341-OD “On approval of the Rules for approving temporary compensatory tariffs (prices, rates)”).

Design of the cap level of tariffs (prices, rates) is done on the basis of separate accounting for revenues, costs and used assets for each type of regulated services (goods, works) and for other activities of the entity as a whole (Order of the Chairman of the Agency of the Republic of Kazakhstan on regulation of natural monopolies of June 12, 2006, No. 149-OD “ On approval of the Rules for approving the cap level of tariffs (prices, rates) and tariff estimates for regulated services (goods, works) of subjects of natural monopolies” (Order of the Chairman of the Agency of the Republic of Kazakhstan on regulation of natural monopolies of September 30, 2005, No. 287-OD “On approval of the Methodology of calculation of the cap level of tariffs (prices, rates) for services (goods, works) of subjects of natural monopolies”).

Temporary decreasing ratio for the tariff

For each sector of natural monopolies methodologies of calculation of temporary decreasing ratios (6) are applied on the basis of calculation of economic efficiency and expediency of its application for the state, under which revenues obtained by a water supply organizations in case of using the temporary decreasing ratio has to cover costs needed to provide regulated services of the organization and consumer.

In the Russian Federation tariff design is based on the method of economically justified costs, which assumes calculation of regulated tariffs (prices) on the basis of the size of necessary gross revenue of the regulated organization from sale of each type of products (services) and estimated volume of production of the relevant type of products (services) for the estimated regulatory period in accordance with the Basics of pricing approved by Decree of the Government of the Russian Federation of February 26, 2004, No. 109.

Each time planned costs of natural monopolies for the next year, as well as planned investments and profits, including expected dividends to be paid to shareholders serve as a basis for determination of new tariffs.

Calculation of tariffs is done in accordance with methodological instructions approved by the Federal Service for Tariffs (Methodological instructions on calculation of regulated tariffs and prices for electricity (heat) in the retail (consumer) market, approved by order of the Federal Service for Tariffs of August 6, 2004 No. 20-e/2).

Indexation methodology was determined by the Methodological instructions on indexation of cap (minimal and/or maximal levels of tariffs for products (services of organizations that carry out regulated activities, approved by Order of the FST of July 5, 2005, No. 275-e/4).

It is necessary to pay attention to certain specifics of regulation of the tariff setting process.

In accordance with item 5 of Article 18 of the Law of the Republic of Kazakhstan “On Natural Monopolies”, Order of the Chairman of the Agency of the Republic of Kazakhstan on regulation of natural monopolies and protection of competition of March 19, 2003, No. 80-OD approves Rules for approving tariffs (prices, rates) according to the simplified procedure.

This simplified procedure is applied when setting tariffs (prices, rates) for production of goods, works and/or provision of services by newly established subjects of natural monopolies irrespective of the forms of ownership.

A newly established subject of the natural monopoly has to submit to the authorized body an application for approval of tariffs (prices, rates) within 10 days from the moment of receiving the notification from the authorized body on inclusion of this entity into the Registry. The decision on approval of tariffs (prices, rates) is documented as an order of the regulator and is sent to the newly established subject of the natural monopoly not later than 15 days before the approved tariffs (prices, rates) come into effect.

Approved tariffs (prices, rates) come into effect from the date determined by the authorized body. A newly established subject of the natural monopoly has to inform consumers about introduction of tariffs (prices, rates) through official mass media not later than 10 before they [tariffs] come into effect.

In accordance with changes introduced in the Law on July 5, 2006, a notion “subject of the natural monopoly with small capacity” was introduced.

In Bulgaria, Bosnia and Herzegovina, Hungary, and also in Kazakhstan there are procedures of simplified regulation of subjects of natural monopolies (annex 10, appendix 9).

Specifics of the state regulation of subjects of natural monopolies with small capacity in Kazakhstan is simplification of procedures for approval of tariffs and exercising of control on the side of the authorized body, i.e. simplified regulation. Simplification of procedures of the state regulation of subjects of natural monopolies with small capacity is related to volumes of provided services and to requirements that are unacceptable to small capacity entities for provision of regulated services.

3.1. Public nature of the tariff regulation procedure

Public nature of the process of the tariff design is ensured by procedures for public hearings, by publications and presentation of reports to mass media, participation of experts and consumers in this process.

The public nature of the state regulation is expressed in accessibility of information on set and changed tariffs, on activities of commissions and other bodies related to review of generator's proposals to change tariffs, possibility for experts, representatives of consumers to participate in these commissions, openness of making decisions on issues related to tariff regulation, transparency of such information, its understandability and comparability with information on activities of economic entities, tariffs for good that are subject to the state regulation; possibility to exercise the state control.

In most countries public hearings are envisioned in the form of open meetings of the regulator, as well as it is envisioned that draft tariffs have to be published in mass media and on the Internet sites. Participants of public hearings are: regulatory bodies (organizers), representatives of state bodies, consumers and subjects of monopolies. In all countries comments and proposals of participants are non-binding, except for Montenegro and Turkey, where depending on the nature of the proposal, they can be binding for the decision-making by the regulator. On the legislative basis, public hearings are not envisioned in Croatia (annex 11, appendix 10).

In order to ensure better awareness and preparedness of participants of public hearings, the law of the Republic of Kazakhstan "On Natural Monopolies" envisions that after information on the date of conducting public hearings is published, the subject of the natural monopoly has to provide upon requests of participants of public hearings drafts of tariff estimates, tariffs for regulated services or their cap values, information on the reasons for increasing tariffs for regulated services or their cap values with economically justified calculations, and also information on the results of financial and technical expert tests.

This principle is also contained in provisions of the Law of the Republic of Kazakhstan "On Natural Monopolies" (hereinafter referred to as the Law) on prohibition to recognize as a commercial secret information contained in the tariff estimate on costs associated with acquisition and installation of devices for measurement of regulated utility services, and the mechanism of charging payments, acquisition and installation of devices for measurement of regulated utility services and on provided regulated utility services (goods, works) (sub-item 10) of item 1 of Article 5 of the Law), and also on the duty of the subject of the natural monopoly to inform consumers about changes in tariffs (prices, rates) or in their cap values not later than thirty days before they come into effect (item 4 of Article 18 of the Law).

Besides, the law envisions the duty of the subject of the natural monopoly to publish audit report and annual financial statements in periodicals (sub-item 7) of Article 7 of the Law).

At the same time, for the purpose of general accessibility and openness of information on activities of the regulator and of subjects of natural monopolies there is Agency's Web-site. By means of this Web-site citizens of the Republic of Kazakhstan could address the Agency with questions that interest them in order to get relevant explanations (information) from the Agency.

Such publicity procedures are regulated by the law of **Ukraine** "On Natural Monopolies", in accordance with item 3 of Article 9 of which the procedure of disclosure of information and open hearings with respect to changes of prices (tariffs) for goods of subjects of natural monopolies are determined by the bodies, which according to the Law of Ukraine "On Prices and Pricing" are in charge of approval or regulation of prices (tariffs).

According to the **Russian legislation** on natural monopolies the duty of the regulator is to inform through mass media on decisions made by regulatory bodies, on changes or termination of regulation of activities of subjects of natural monopolies, and also on inclusion into the Registry of subjects of natural monopolies or on exclusion from this Registry, on applied methods of regulation of activities of subjects of natural monopolies and on specific indicators and requirements to them from regulatory bodies that regulate natural monopolies (article 14 of the Federal Law "On Natural Monopolies"). In addition, bodies that regulate natural monopolies have to inform through mass media about all cases when entities were held liable for violation of the legislation on natural monopolies, and also on liquidation of bodies that regulate natural monopolies and on grounds for making such decisions.

Besides, in accordance with Articles 21 and 22 of the Federal Law "On Electricity", Decree was prepared by the Government of the Russian Federation of January 21, 2004, No. 24 "On approval of standards of disclosure of information by participants of the wholesale and retail markets of electricity", which sets requirements to the structure of information that is disclosed by participants of the wholesale and retail markets of electricity, except for consumers of electricity, and to the procedure, methods and terms for disclosure. Meanwhile, disclosure of information (annually not later than June 1) means that access to this information is provided to all interested persons irrespective of the purpose of getting this information. In accordance with item 3 of the said Standards, participants of electricity markets disclose information using the following means: publication in periodicals, where in accordance with federal laws and laws of constituents of the Russian Federation official materials of state power bodies are published; publication in electronic mass media; provision upon written requests from interested persons provided these persons cover expenses related to provision of the information.

According to item 9 of the Standards, this information includes:

- a) Annual financial (accounting) statements, as well as auditor's opinion (when in accordance with the legislation of the Russian Federation audit of

the participant of the electricity market was performed), unless the legislation of the Russian Federation states otherwise;

- b) Indicators of efficiency of use of capital – in case the method of calculation of economically justified level of profitability of the invested capital is used under the state regulation of tariffs for participants of the electricity market:
- The level of profitability of the invested capital set by the federal executive power body that regulates natural monopolies, with indication of the source of publication of the methodology for determination of the level of profitability of the invested capital;
 - Actual level of profitability of the invested capital used when carrying out regulated activities and justification of the reasons why it deviated from the level of profitability set by the federal executive power body that regulates natural monopolies;
- c) The statement on movements of assets that are taken into consideration by the federal executive power body that regulates natural monopolies when setting the level of profitability of the invested capital that includes:
- the book value of assets as of the beginning of the year;
 - the book value of assets as of the end of the year;
 - information on disposal of assets during the year;
 - information on receipt of assets during the year, including those due to revaluation, upgrade, reconstruction, construction and acquisition of new equipment.

Similar norm on informing by the regulator of subjects of natural monopolies on decisions made by the regulator is contained in Article 13 “On Natural and Allowed Monopolies in the Kyrgyz Republic”, in accordance with which the Anti-monopoly body has to announce – using mass media – its decisions on introduction, change or termination of regulation of activities of subjects of natural and allowed monopolies, and also on inclusion into the State Registry of subjects of natural and allowed monopolies, or about exclusion from it, on applied methods of regulation of activities of subjects of natural and allowed monopolies and on specific indices and requirements to them. The Anti-monopoly body has to announce – using mass media – all cases when subjects of natural and allowed monopolies were held liable for violation of the legislation on natural monopolies.