

**HUNTON &
WILLIAMS**

HUNTON AND WILLIAMS

USAID UKRAINE

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

ILKA LEWINGTON

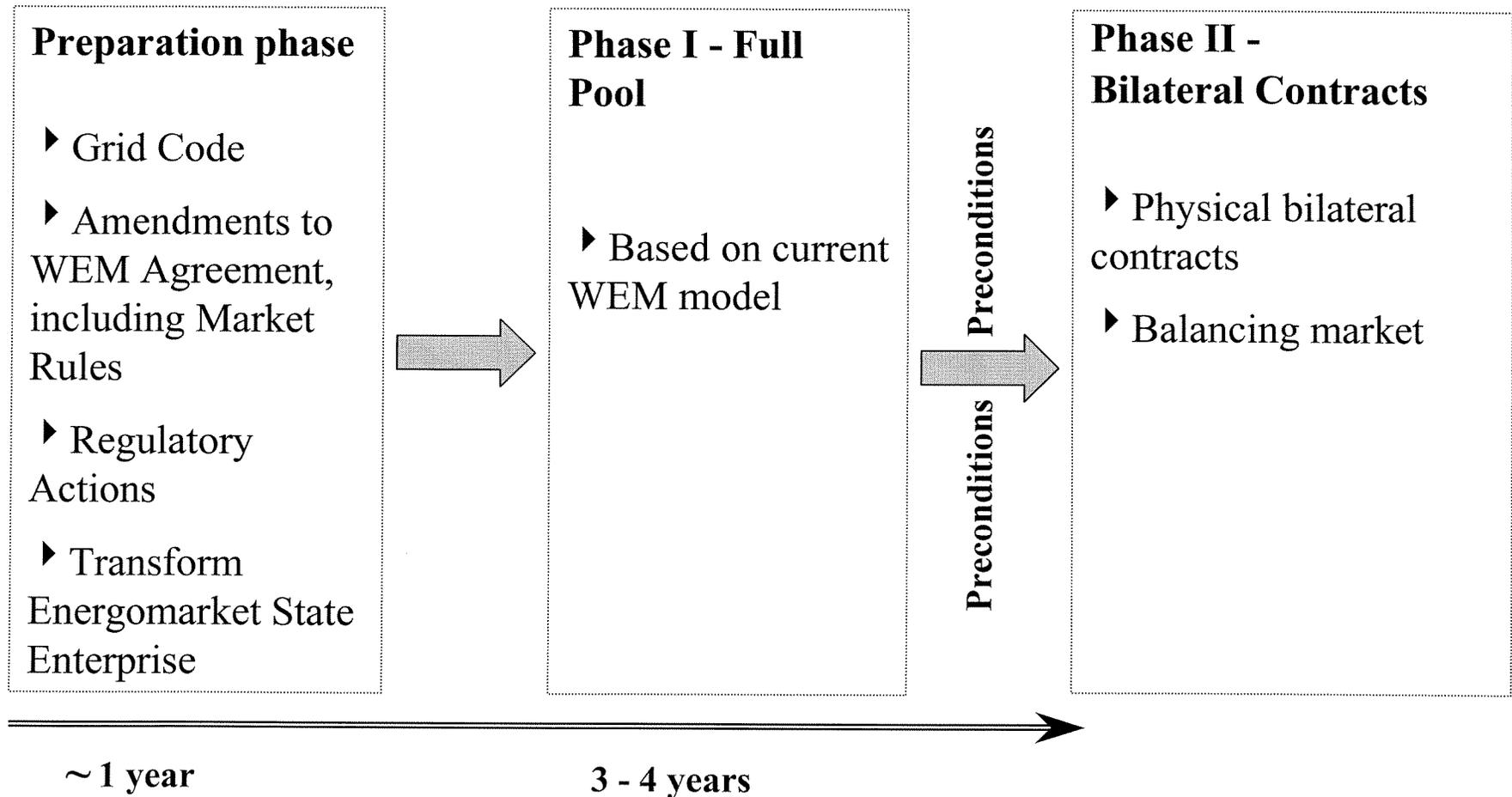
Hunton & Williams
February 2002

**WEM Development - Directions
and Practical Steps**

Introduction : H&W's WEM Work

- Participation in working groups related to Standard contracts, WEM Agreement, Instructions
- Analysis of WEM Law adopted by VR and vetoed by the President of Ukraine
- Preparation of own Draft Law and Proposals for a WEM Development Concept
- Participation in official working group on the functioning and development of the WEM

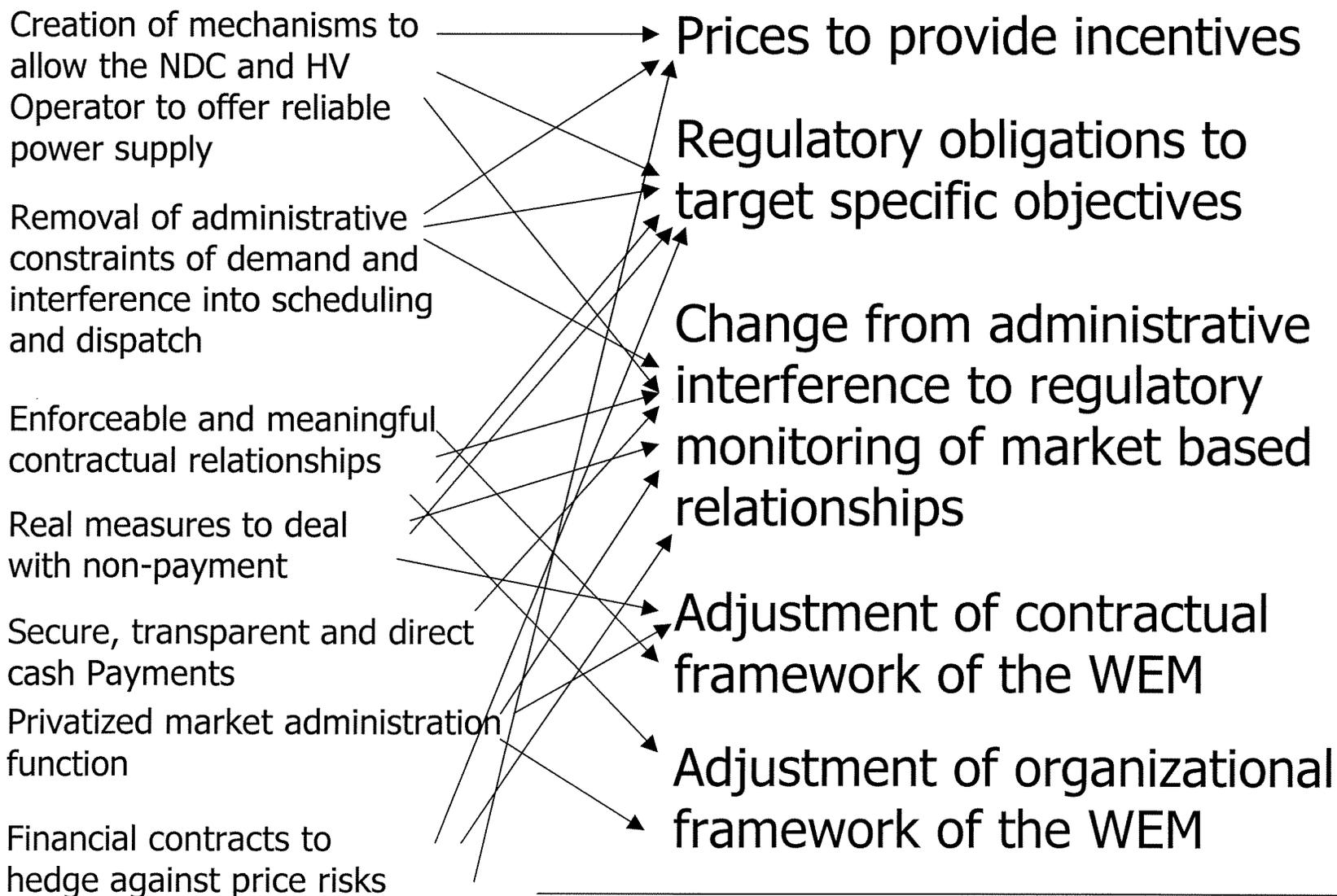
H&W WEM Development Concept: Phased reform of the WEM



Summary of Proposals for Phase I

- Removal of administrative constraints of demand and interference into scheduling and dispatch
- Creation of mechanisms to allow the NDC and HV Operator to offer reliability of power supply
- Enforceable and meaningful contractual relationships
- Real measures to deal with non-payment
- Secure, transparent and direct cash payments
- Privatized market administration function
- Financial contracts to hedge against price risks

Areas of change



Prices to provide incentives

- Generation prices should recover costs
- SMP should result from competition for a place in the stack order
- Uplift should cover all costs of system constraints and forecast errors - but should be minimized using an incentive mechanism
- Capacity fee should provide incentive for availability
- Fees for ancillary services and reserves should recover costs for these services
- Price risk from market price fluctuations should be addressed through financial contracts

Regulatory obligations to target specific objectives

(In addition to pricing mechanism and competition)

Obligation to offer technically available capacity

Obligation to purchase sufficient ancillary services from market members

Economic purchase obligation for suppliers

Obligatory spinning reserve and frequency response with proper remuneration

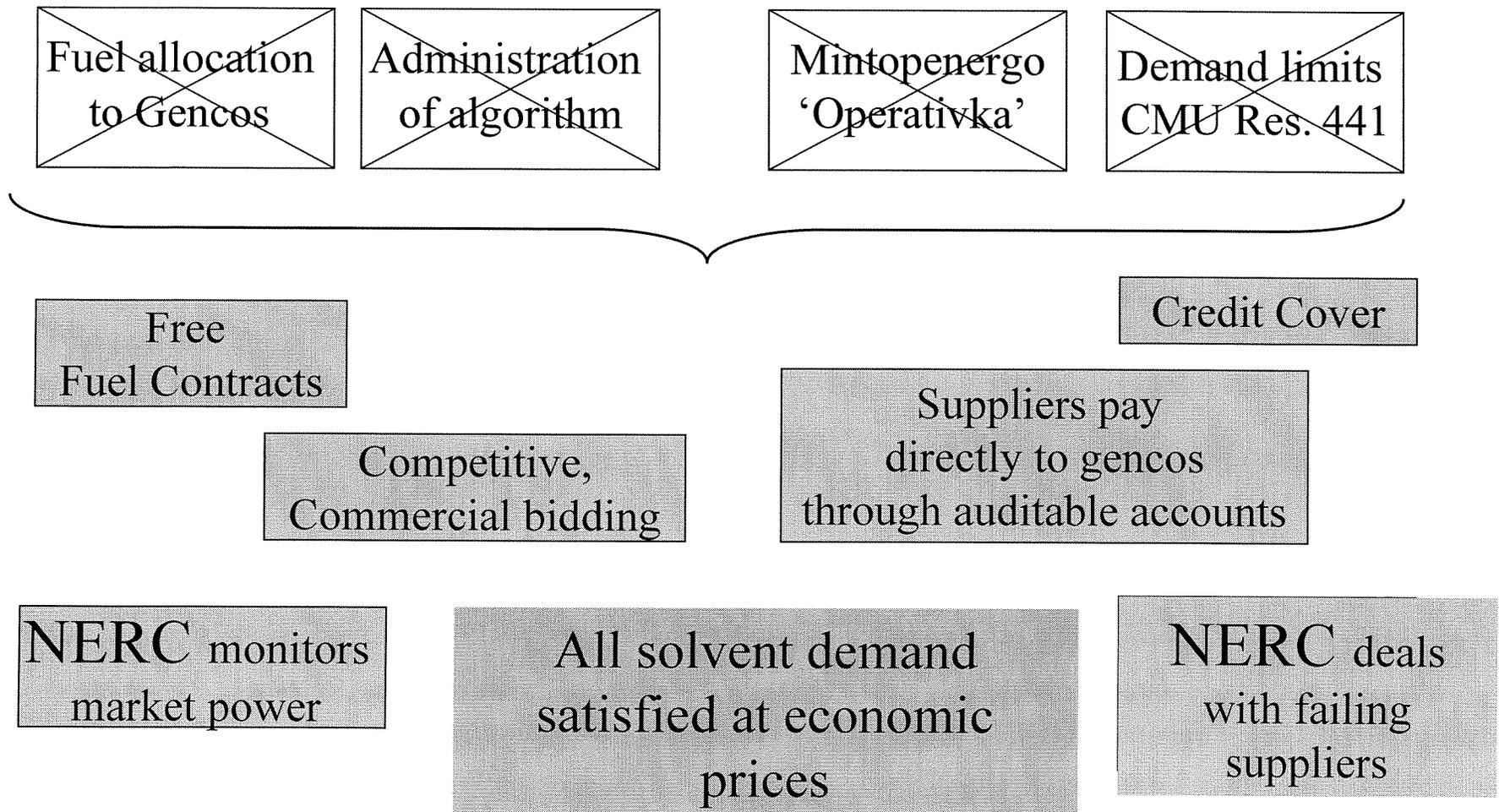
Cost covering prices for generation, services and value-based pricing for peaking plant

Wholesale price of pool, adjusted by financial contracts

Reliability

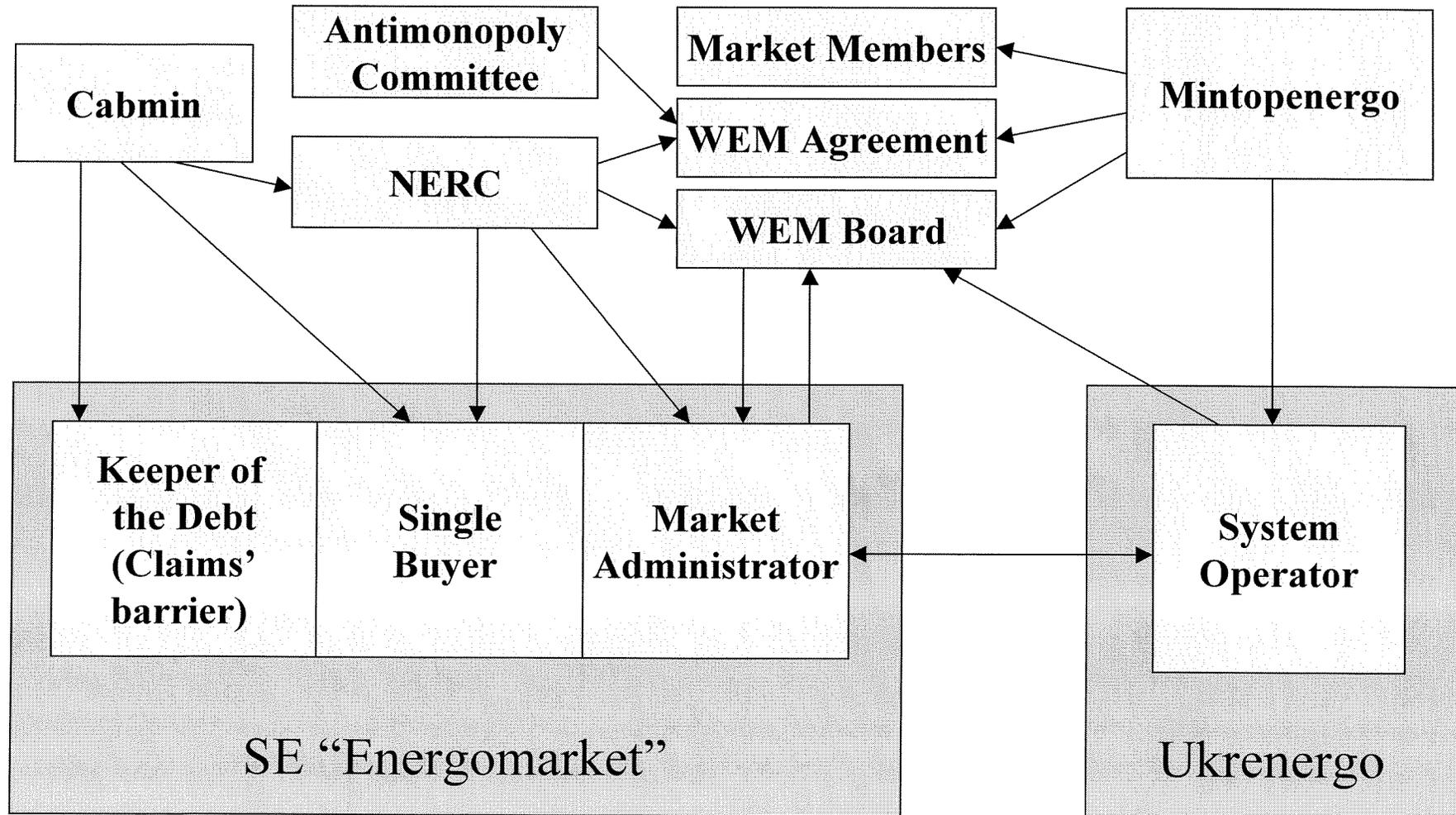
Economic Price

Change from administrative interference to regulatory monitoring of market based relationships



Market organization and governance

Current State



Contractual framework

Current State

