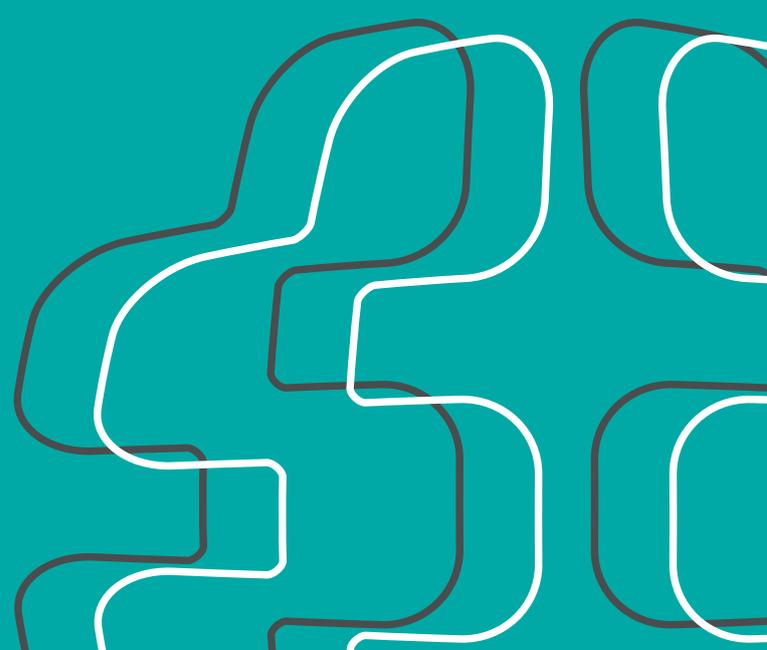


National Energy and Public Utilities Regulatory Commission (NEURC)

ASSESSMENT
REPORT

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CONTENTS

/4/ Summary

/7/ Assessment Table

/9/ INSTITUTIONAL PRINCIPLES

/9/ Independence

/9/ Budget and accountability

/10/ Changes in the composition

/11/ Informal political pressure

/11/ Relations with the regulated sector

/12/ Recommendations

/13/ Accountability

/13/ Reports and approvals/ inspections

/13/ Accountability to consumers, the sector, the public

/13/ Financial aspects and audit

/14/ Implementation of the Rules of Ethics

/14/ Recommendations

/15/ Transparency

/15/ Publication of decisions

/15/ Effectiveness of consultations

/16/ Responses to requests for information

/17/ Predictability

/17/ Consistent and well-substantiated regulation

/17/ Adaptation to changes

/18/ Recommendations

/20/ REGULATION PRACTICE

/20/ Tariffs and prices

/20/ Economic efficiency

/21/ Periodicity of revisions

/22/ Recommendations

/23/ Market monitoring and licensing

/23/ Power to impose fines for law violations

/24/ Transparency of the criteria for obtaining/ revoking licenses

/24/ Protection of consumers, handling of complaints

/25/ Recommendations

SUMMARY

Since its creation in 1994, the scope of powers of the National Energy and Public Utilities Regulatory Commission (NEURC) has been constantly expanded. The National Energy and Public Utilities Regulatory Commission (the "NEURC" or the "Commission"), the currently operating functional successor to the National Electricity Regulatory Commission (NERC), now performs regulation in the fields of electricity, oil and gas, heat supply, centralized water supply and water drainage, and domestic waste disposal in accordance with Ukrainian laws, including the Law of Ukraine "On the National Energy and Public Utilities Regulatory Commission" (the "Law")¹, effective since 26 July 2016.

The NEURC is independent in the exercise of its powers from any other governmental authority, local self-government authorities, business entities, political parties, public associations, or trade unions. The Commission's members, officers and their close relatives may not be members of the governing bodies of business entities operating in the fields of energy and public utilities ("business entities") or own directly or indirectly any corporate rights therein and are also subject to the restrictions and requirements set by anti-corruption laws. Thus, in particular, the NEURC's members and officers declare their property, income and expenses.

The Law envisages the Commission's financial independence which is expected to take effect starting from 2018. The NEURC will be financed with regulation charges to be paid by business entities to the special fund of the State Budget and to be used solely for the Commission's needs. In accordance with the Law, control over the targeted use of funds by the Commission will be exercised on common terms applicable to other State Budget funds administrators.

The appointment procedure and the requirements set for the NEURC's members meet the requirements of the EU Third Energy Package. However, there exists a threat to the rotation of the Commission's members as envisaged by the Law, because members of the tender commission for selection of candidates for the NEURC's members have not yet been appointed either by the President, or the Verkhovna Rada, or the Government. It is advisable that the Law should be amended to prevent the blocking of this process. The Law may also require alignment with the Constitution of Ukraine (or introduction of amendments thereto) in this context.

The NEURC's statutory functions and powers in electricity and natural gas markets are in line with requirements of the EU Third Energy Package. Part of the relevant secondary legislation is currently being developed, in particular in accordance with the phased implementation of a new market model as envisaged by the Law of Ukraine "On the Electricity Market"².

Pursuant to the Law, the NEURC has approved its Rules of Professional Ethics³. However it is advisable that a special procedure should be established for reporting on compliance with these Rules.

The NEURC's Head annually presents annual and financial reports to the Verkhovna

Rada of Ukraine, but no feedback procedure is currently envisaged in the context of such reporting. It is advisable that the laws should be amended to increase the NEURC's accountability to the Verkhovna Rada and that the contents of the report should be expanded and its preliminary discussion with the public should be implemented.

The transparency of the NEURC's work is high. The Commission's official website⁴ posts in advance the agenda of its meetings, all its draft decisions with their substantiation, its plans and reports on inspections of business entities, the minutes of its meetings, its adopted decisions (including the structure of the set tariffs of natural monopolies), its annual report, etc. The website also contains information for consumers. The Commission's meetings are broadcast online, with an archive of their video recordings available.

Practically all of the Commission's decisions are adopted at its meetings held in the form of open hearings, while its draft regulatory decisions and, following the adoption of the Law, its draft decisions concerning tariffs (prices) and investment programmes are subject to preliminary public discussion. The adoption by the Commission of the Procedure for Public Discussion of the NEURC's Draft Decisions⁵ on 30 June 2017 has created necessary conditions for ensuring an effective process of consultations, but the Commission should take steps to engage all interested parties, first of all consumers, and improve its interaction with them.

The political and social reaction of society to some of the NEURC's decisions shows that at least these particular decisions are not sufficiently substantiated. In particular, the substantiation of regulatory decisions and their impact analysis should

be improved and a mechanism should be implemented to track the effectiveness of the Commission's decisions. In order to improve the predictability of the Commission's work, it is advisable that a three-year strategic plan for the development of regulation should be prepared.

The NEURC monitors markets on the basis of periodical reports and other information submitted by business entities. At present, the scope of such monitoring should be substantially widened in accordance with the laws reflecting requirements of the EU Third Energy Package. In order to enhance the effectiveness of regulation, an IT system needs to be developed and implemented to collect, retain and process regulation-related information.

Tariffs are set by the NEURC according to its approved procedures (methodologies), usually annually, and may be revised in certain circumstances, including at the Commission's initiative. "Cost plus" remains the principal tariff regulation method. However, RAB regulation is used for the gas transmission operator. The Commission has also approved a RAB regulatory framework for electricity distribution and transmission operators.

The NEURC issues licenses to business entities operating in the fields of energy and public utilities and exercises control over their licensed operations. The Commission may impose fines and use other measures of influence (impose administrative penalties on business entities' officers, withdraw funds from tariffs, revoke licences, etc.). It is advisable to amend the laws governing peculiarities of the licensing of natural monopolies in the fields of energy and public utilities.

1 <http://zakon3.rada.gov.ua/laws/show/1540-19>

2 <http://zakon3.rada.gov.ua/laws/show/2019-19>

3 <http://www.nerc.gov.ua/index.php?id=25868>

4 <http://www.nerc.gov.ua/>

5 <http://www.nerc.gov.ua/index.php?id=26157>

At present, the NEURC considers appeals from citizens and provides information upon requests in accordance with the general legislation. The Law envisages a separate procedure for reviewing consumers' complaints and settling disputes between business entities, which procedure is currently being developed. There is the need to speed up the adoption of the Law of Ukraine "On the Energy Ombudsman", the adoption of which is envisaged by the Law and which will, among other things, substantially enhance the protection of small-scale consumers (first of all, households).

Analysis of the NEURC's work in 2016 and the first six months of 2017 shows that the adoption of the Law of Ukraine "On the National Energy and Public Utilities Regulatory Commission" has generally positively affected the Commission's activities, in particular in terms of their transparency and openness. At the same time, however, there remain many aspects of the NEURC's work that need to be improved, such as, first of all, its reporting procedures, better quality and substantiation of its decisions, protection of consumers.

ASSESSMENT TABLE



Moderately satisfactory



Good



Good practice



N/A

Ukraine, National Energy and Public Utilities Regulatory Commission (NEURC)	2016	2017 (the 1-st six months)	Responsible parties	Urgent Measures (2017)
INSTITUTIONAL PRINCIPLES				
Independence				
<i>Budget and accountability</i>			Verkhovna Rada	
<i>Changes in the composition</i>			President, Verkhovna Rada Cabinet of Ministers	To secure rotation of the NEURC's members as envisaged by the Law by appointing members of the tender commission for selection of candidates for the Commission's members
<i>Informal political pressure</i>			Verkhovna Rada Cabinet of Ministers	
<i>Relations with the regulated sector</i>			NEURC	
Accountability				
<i>Reports and approvals/ inspections</i>			Verkhovna Rada NEURC	NEURC – to improve its annual report (to expand its contents) and implement its preliminary discussion with the public
<i>Accountability to consumers, the sector, the public</i>			NEURC	NEURC – to make information on the results of its monitoring of markets available on its website
<i>Financial aspects and audit</i>			Verkhovna Rada Cabinet of Ministers	
<i>Implementation of the Rules of Ethics</i>			NEURC	
Transparency				
<i>Publication of decisions</i>			NEURC	Cabinet of Ministers of Ukraine – to ensure timely publication of the NEURC's decisions in the Uriadovyi Kurier newspaper

 Moderately satisfactory

 Good

 Good practice

 N/A

Ukraine, National Energy and Public Utilities Regulatory Commission (NEURC)	2016	2017 (the 1-st six months)	Responsible parties	Urgent Measures (2017)
INSTITUTIONAL PRINCIPLES				
<i>Effectiveness of consultations</i>			 NEURC	NEURC – to improve the completeness and the quality of the substantiation and impact analysis of its decisions, to implement the engagement of representatives of political parties, trade unions and other civil society institutions in the discussion of decisions affecting the population
<i>Responses to requests for information</i>			 NEURC	NEURC – to expand the list of information subject to publication in the form of open data
Predictability				
<i>Consistent and well-substantiated regulation</i>			 NEURC	
<i>Adaptation to changes in the environment</i>			 NEURC	
FUNCTIONING				
Tariffs and prices				
<i>Economic efficiency</i>			 NEURC	
<i>Periodicity of revisions</i>			 NEURC	NEURC – to implement substantial monitoring of the effectiveness of its adopted decisions
Market monitoring and licensing				
<i>Power to impose fines for law violations</i>			 NEURC	
<i>Transparency of the criteria for obtaining/revoking licences</i>			 Verkhovna Rada  NEURC	
<i>Protection of consumers, handling of complaints</i>			 Verkhovna Rada  NEURC	

Ukraine established its energy regulatory authority, the National Electricity Regulatory Commission (NERC), in 1994, one of the first in Europe. Since then, the Commission has changed its name three times and has been set up anew two times. The Commission's initial scope of regulation covered only the electricity industry, in 1998 it was expanded to cover also the oil and gas complex, in 2005 – certain issues relating to the regulation of tariffs for heat energy, in 2014 – heat supply, centralised water supply and water drainage, and in 2016 – domestic waste disposal.

The currently operating National Energy and Public Utilities Regulatory Commission (the "NEURC" or the "Commission") was set up by a decree of the President of Ukraine on 27 August 2014¹ to replace the two liquidated commissions, the National Energy Regulatory Commission and the National Public Utilities Regulatory Commission.

Until 2016, the Commission operated under regulations approved by the President. The Commission has had its independent status since its establishment in 1994, first as an independent non-departmental permanent authority and then as a central executive authority with a special status, a collective governmental body.

26 November 2016 became the effective date of the Law of Ukraine "On the National Energy and Public Utilities Regulatory Commission" (the "Law"), which defined the Commission's legal status, objectives, functions, powers, and the procedure for exercising the same. In accordance with the Law, the NEURC performs state regulation in the fields of energy and public utilities through legal regulation, licensing, tariff and pricing policy formation and implementation, state

control and other measures of influence, other means provided by laws.

Some of the Commission's functions and powers associated with the regulation of electricity markets, natural gas markets, etc. are defined by the laws of Ukraine, in particular by the Laws of Ukraine "On Natural Monopolies", "On the Electricity Market", and "On the Natural Gas Market".

The Law has taken into account the requirements for the regulatory authority's independence in line with the respective provisions of the EU Third Energy Package and, in particular, has cancelled the requirement for approval of the NEURC's decisions by other governmental authorities (except where such approval is required by economic competition protection laws) and their registration with the Ministry of Justice of Ukraine.

BUDGET AND ACCOUNTABILITY

In accordance with the Law, the NEURC is a public-law legal entity and a permanent independent collective governmental body operating on a standalone basis independently from any other governmental authority, local self-government authorities, business entities, political parties, public associations, or trade unions.

Governmental authorities and local self-government authorities, business entities, political parties, public associations and trade unions are prohibited from interfering in the state regulation process, and in accordance with the law, any illegal influence on the NEURC's work leads to administrative and criminal liability.

In accordance with the Law, the NEURC interacts with the Cabinet of Ministers of Ukraine and central executive authorities in the context of development and implementation of Ukraine's economic and social development programmes, special-purpose state programmes, the Government's regulatory acts and with the Antimonopoly Committee of Ukraine and financial control authorities in the course of monitoring and investigations in the energy and public utilities markets.

In accordance with the Law, the NEURC must be financed with regulation charges paid to the special fund of the State Budget of Ukraine by business entities. Regulation charges may not be withdrawn and may be used only to finance the Commission's operations. In 2017, however, the Commission is financed according to the old scheme, from the general fund of the State Budget.

CHANGES IN THE COMPOSITION

Except for the period of 2006 to 2010 when the Commission's members and heads were appointed by the Cabinet of Ministers of Ukraine, they were appointed by decrees of the President of Ukraine. The number of the Commission's members changed from three in 1995 to five in 1998 and then to seven in 2011. At present, in accordance with the Law, the NEURC must be composed of seven members, with the Commission's Head to be elected every two years by the Commission's members by secret vote.

The Law provides for a competitive procedure for selecting candidates for the NEURC's members. The tender commission must be composed of two members nominated by the President, two members nominated by the Verkhovna Rada (upon submission from dedicated committees) and one person nominated by the Cabinet of Ministers of Ukraine (upon submission from the Energy and Coal Industry Minister) and is deemed competent to operate upon approval of at least four of its members. The competition must be open, the process must be transparent. The requirements for candidates and the time frames for the review of bids are

set by the Law. The President may appoint the Commission's members from the list prepared by the tender commission from among the highest ranking candidates (two candidates per position).

The Law provides for the rotation of the NEURC's members, including the initial rotation of all of the Commission's members within 18 months after the effective date of the Law². On 21 May two members of the NEURC were dismissed, with the next two members to be dismissed before 26 November. However, as of 1 September 2017, no members of the tender commission for selection of new members of the NEURC had been elected yet, and this can make it impossible for the Commission to exercise its powers starting from 26 November.

The Law provides that the NEURC's members may be elected for two terms and contains an exhaustive list of the circumstances when their powers may be earlier terminated. The same provisions existed before the adoption of the Law in the Law of Ukraine "On Natural Monopolies" and the regulations on the Commissions. In fact, however, throughout the entire history of the Commissions, only two members of the Commission worked at least one full term (six years). This was mainly explained by the change of power in the country, but even in the NEURC's current composition its five members were changed in 2014-2015 for reasons unknown to society (upon their voluntary resignations).

In accordance with the Law of Ukraine "On Public Service", the NEURC's officers, who have the status of public servants, are appointed on a competitive basis. The current salary level in the Commission is non-competitive, and this results in a high staff turnover rate affecting, among other things, the quality of drafted decisions. The Law provides for a substantial rise in the salaries of the Commission's members and officers, which is expected to take effect from 2018.

INFORMAL POLITICAL PRESSURE

Even before the adoption of the Law, the Commission, just like its predecessors, was de jure independent in its decision-making. The Law has considerably increased its independence and liability for its breach. In particular, now a member of the Commission may not be a member of a political party, be a member of the governing bodies of a political party or have any contractual relations with any political party during a period of at least three months before application for participation in an open tender competition for appointment to a position in the Commission.

As regards making tariffs economically justified, in 2015 the NEURC took steps to considerably raise prices and tariffs for the population, in particular tariffs for electricity, gas, heat and water. These steps were sharply criticised by both politicians and society, with doubts cast on the legitimacy of the Commission itself. At the end of 2016, the parliamentary faction of the political party *Batkivshchyna* applied to the Constitutional Court of Ukraine seeking recognition of some provisions of the Law as unconstitutional. By its ruling of 4 April 2017,³ the Constitutional Court refused to institute constitutional proceedings because the application failed to meet relevant statutory requirements. On 21 December 2016, the Constitutional Court also instituted proceedings⁴ in a case based on an application by the Supreme Court of Ukraine seeking recognition as unconstitutional of some statutory provisions concerning the NEURC, in particular provisions of the Laws of Ukraine "On Natural Monopolies", "On the Electric Power Industry", "On State Regulation in the Field of Public Utilities", "On Drinking Water and Drinking Water Supply", Decrees of the President of Ukraine No. 694 "On the National Energy and Public Utilities Regulatory Commission" dated 27 August 2014 and No. 715 "On Approval of the Regulations on the National Energy and Public Utilities Regulatory Commission" dated 10 September 2014. A considerable number of experts find that the arguments concerning the unconstitutionality of the procedure for

electing and appointing the NEURC's members are well-reasoned.

The media have reported on the participation of certain politicians in demonstrations near the NEURC's building, in particular concerning plans to change the methodology for calculating tariffs for gas distribution services, but some experts think that this is explained not so much by the possible political pressure, but by the quality of the Commission's respective decisions.

RELATIONS WITH THE REGULATED SECTOR

In accordance with the Law, the NEURC's members and officers, as well as their affiliated persons, may not be members of the governing bodies of business entities or own directly or indirectly business entities or corporate rights therein. The NEURC's members and officers may not act as attorneys of third parties in the context of the Commission's affairs or use it or the NEURC's other officials and property for party or personal interests, and they are also subject to the restrictions and requirements set by the Law of Ukraine "On Prevention of Corruption" (concerning the prohibition to use their official powers for the purpose of obtaining illegal benefits for themselves or other persons, receiving gifts, etc.).

The Law provides that during two years after termination of his or her powers, a member of the NEURC may not have any employment or other contractual relations with any business entity. The same restriction for the period of one year applies to the Commission's officers in accordance with the Law of Ukraine "On Prevention of Corruption".

1 <http://zakon3.rada.gov.ua/laws/show/694/2014>

2 <http://zakon3.rada.gov.ua/laws/show/78/2017>

3 <http://zakon3.rada.gov.ua/laws/show/v004u710-17>

4 <http://zakon3.rada.gov.ua/laws/show/v082u710-16>

RECOMMENDATIONS

- THE PRESIDENT, THE PARLIAMENT AND THE CABINET OF MINISTERS OF UKRAINE SHOULD ENSURE ROTATION OF THE NEURC'S MEMBERS IN ACCORDANCE WITH THE LAW BY APPOINTING MEMBERS OF THE TENDER COMMISSION FOR SELECTION OF CANDIDATES FOR THE NEURC'S MEMBERS AND ENSURING ITS PROPER WORK;
- AMENDMENTS SHOULD BE DRAFTED AND INTRODUCED TO THE LAW IN ORDER TO PREVENT BLOCKING OF THE WORK OF THE TENDER COMMISSION FOR SELECTION OF CANDIDATES FOR THE NEURC'S MEMBERS;
- AMENDMENTS SHOULD BE DRAFTED AND INTRODUCED TO THE CONSTITUTION AND LAWS TO DEFINE THE STATUS OF THE NEURC AND THE POWERS OF GOVERNMENTAL AUTHORITIES TO APPOINT THE COMMISSION'S MEMBERS.

REPORTS AND APPROVALS/INSPECTIONS

The Law provides that annually before 1 April, the NEURC's Head must submit and present at a sitting of the Verkhovna Rada of Ukraine an annual report on the Commission's activity and a report on the use of funds. In accordance with the Law, the Commission's annual report, the draft and approved versions of its budget and its report on compliance with such budget must be published on the Commission's website. The report is approved by the NEURC at open hearings, but without public consultations. It is advisable that the Law should also set forth the procedure for assessment of the Commission's annual report and work by the Verkhovna Rada of Ukraine.

Since 2015, the NEURC's annual report has considerably improved from the point of view of its clearness, but it has lost some important information, such as actual data on the number and cost of connections to networks, data on the consideration by the Commission of requests for information and appeals from citizens, etc.

ACCOUNTABILITY

TO CONSUMERS, THE SECTOR,

THE PUBLIC

The NEURC provides access to information and provides information upon requests in accordance with [the Law of Ukraine "On Access to Public Information"](#). In accordance with the law, response to a request must be provided not later than five business days after the day of receipt of such request (up to 20 business days where a large amount of information is to be provided, upon prior notice to the requesting party). In 2016, the Commission processed 821 such requests.

Appeals (proposals, applications and complaints) from citizens are considered by the Commission in accordance with the Law of Ukraine "On Citizens' Appeals" (up to 15 calendar days, up to one month and up to 45 calendar days, depending on the complexity of the issue).

In accordance with the Law, the NEURC informs the public about its plans and the results of its work and holds public consultations and public hearings on important issues. Pursuant to the Law, the NEURC also has the Public Council as a permanent consulting and advisory body created in order to engage citizens in the implementation of state policy on regulation of activity in the fields of energy and public utilities.

FINANCIAL ASPECTS AND AUDIT

The Law provides that the only source of the NEURC's financing is regulation charges paid by business entities to the special fund of the State Budget. The rates of regulation charges are annually approved by the Commission on the basis of the estimated amounts of required financing and are quarterly revised on the basis of the respective approved methodology.

The Commission independently plans its budget to be approved by the Parliamentary Budgetary Committee (the budget must be submitted by 1 June, and the Committee's decision must be adopted by 1 July). The draft budget adjusted according to the respective reservations is then submitted to the Ministry of Finance for its incorporation in the State Budget. After the State Budget comes into effect, the budget is approved by the Commission.

The NEURC's draft budget, the Budgetary Committee's decision, the approved budget and the report on compliance therewith must be made public within the time frames stipulated by the Law. As of today, information about the NEURC's budget for 2018 has been published on the Commission's website pursuant to the Law for the first time¹.

The Law sets forth the general procedure for controlling the proper use of funds by the Commission, just like for any other State Budget funds administrators (The State Treasury Service, the State Audit Service, the Audit Chamber of Ukraine).

IMPLEMENTATION OF THE RULES OF ETHICS

Pursuant to the Law, the NEURC has approved its Rules of Professional Ethics, which apply to the Commission's members and officers and which contain, among other things, requirements for meetings of the NEURC's members with representatives of the regulated entities, the obligation to notify the NEURC's members and officers of any conflicts of interests arising in the course of performance of their official duties, etc.

In accordance with the Law of Ukraine "On Prevention of Corruption", the Commission's members and officers annually file declarations of their property, income, expenses and financial liabilities. Declarations of the Commission's Head and members are published on its website.

¹ <http://www.nerc.gov.ua/?id=26487>

RECOMMENDATIONS

- AMENDMENTS TO THE LAW SHOULD BE DRAFTED AND ADOPTED IN ORDER TO ENHANCE THE COMMISSION'S ACCOUNTABILITY TO THE VERKHOVNA RADA OF UKRAINE
- THE NEURC SHOULD TAKE MEASURES TO IMPROVE ITS ANNUAL REPORT (TO EXPAND ITS CONTENTS) AND INTRODUCE ITS PRELIMINARY DISCUSSION WITH THE PUBLIC
- THE NEURC SHOULD DEVELOP A PROCEDURE FOR REPORTING ON COMPLIANCE WITH ITS RULES OF ETHICS

PUBLICATION OF DECISIONS

Before the Law was adopted, some of the NEURC's decisions concerning certain issues relating to the operation of the Wholesale Electricity Market and the gas market had been adopted at closed hearings. At present, pursuant to the Law, all of the NEURC's decisions (other than those containing secret information) must be adopted at its meetings held in the form of open hearings. The procedure for holding meeting is set forth in the Commission's Rules of Procedure¹ published on the Commission's website. Anyone, including media representatives, may take part in open hearings. The NEURC's meetings are broadcast online. Pursuant to the Law, access to the archive of the recordings of meetings is available during one year on the Commission's website.

All of the NEURC's decisions (except for parts of decisions that contain secret information) are published on the Commission's official website within five business days after their adoption. Decisions on the approval of tariffs of natural monopolies are published together with their structure.

Decisions having features of regulatory acts and decisions concerning the setting of tariffs for the products (services) of natural monopolies and prices (tariffs) for the population enter into effect on the next day after the date of their publication (within 15 days after their adoption) in the official gazette *Uriadovyi Kurier*, unless the decision itself provides for a later effective date, but not earlier than the date of official publication of the decision. De facto, the 15-day period set for publication of the Commission's decisions in *Uriadovyi Kurier* is often breached, and this considerably slows down the regulation process.

In accordance with the Law, the NEURC also publishes on its website the following information:

- agenda of the Commission's meetings with all draft decisions together with

their substantiation, received reservations and proposals (not later than three business days before the date of the meeting),

- minutes of the Commission's meetings (within five business days after the meeting),
- annual plans of inspections of business entities (five days before the beginning of the respective year),
- reports on inspection of business entities together with relevant explanations and substantiation (prior to their consideration at the meeting), etc.

As regards the scope of information whose publication is required by the Law, results of the quarterly monitoring of energy and public utilities markets are currently missing on the Commission's website (in particular, due to the absence of an approved procedure for such monitoring).

The NEURC's website contains information for consumers broken down by the areas of regulation (electricity, natural gas, heat, cold water supply, domestic wastes), information for the public, news, etc. The website is well-developed, and based on the results of 2016, the NEURC came second for the openness of its website among other Ukrainian central executive authorities in the ranking prepared by the Regional Press Development Institute.

EFFECTIVENESS OF CONSULTATIONS

Before the adoption of the Law, in accordance with the general Law of Ukraine "On Basic Principles Governing State Policy on Business Regulation", the NEURC's draft regulatory acts had to be published (not lat-

er than one month prior to their adoption) for the purposes of receiving and reviewing reservations and proposals from individuals and legal entities, their associations, and also had to be approved by the State Regulatory Service of Ukraine. No mandatory discussion of the submitted reservations and proposals was required by the law, and the Commission usually held no such discussion. Occasionally, the Commission even adopted decisions without regard to the reservations and proposals from interested parties in the absence of any valid arguments, and this drew fair criticism from business entities and the public.

The Law has cancelled the requirement of approval of the NEURC's decisions by other governmental authorities, but stipulates measures aimed at enhancing the transparency of the Commission's decision-making process, and in particular:

- sets forth a special procedure for drafting decisions having features of regulatory acts, which procedure provides, in particular, for publication of the submitted reservations and proposals and for their obligatory consideration with the participation of the persons who have submitted such reservations and proposals, and
- envisages public discussion of the NEURC's draft decisions on matters relating to the setting of prices (tariffs), approval of investment programmes (at the location where business entities provide their services), and other matters (if necessary).

On 30 June 2017, the NEURC approved the Procedure for Holding Public Discussion of the NEURC's Draft Decisions, which complies with the requirements of the Law and creates necessary conditions for a truly effective process of consultations with the interested parties. From the standpoint of business entities in the context of matters related to the setting of prices (tariffs) and approval of investment programmes, the new procedure is even overloaded (contains unnecessary stages of discussion).

Regardless of the existing discussion procedures, draft decisions, which affect the population and which result in a rise in end tariffs (prices), encounter a lack of understanding and rejection by society. Among other things, this can be explained by the non-participation of representatives of such consumers in the consideration of draft decisions and, accordingly, the impossibility of a constructive dialogue in search for a balanced decision.

In accordance with the Law, the NEURC's decisions may be appealed in court. The filing of appeals against decisions does not suspend their effect.

RESPONSES TO REQUESTS FOR INFORMATION

The NEURC's Annual Report for 2016² does not contain any information on the provision of information in response to requests or the handling of appeals from citizens. The Commission's website posts monthly reports on requests, but they contain only summarized information about the structure of such requests broken down by the requesting parties, the Commission's divisions responsible for response and the type of response. There are no details of the requested information, and furthermore, the reports show that more than half of the requests (sometimes 80%) result in the provision of the requesting parties with explanations of the law rather than the requested information. Therefore, there is no understanding of the quality of the Commission's work associated with its handling of requests for information and citizens' appeals.

The NEURC's website lists the sets of data subject to publication in the form of open data, but this list is rather limited.

¹ <http://www.nerc.gov.ua/?id=17211>

² http://www.nerc.gov.ua/data/filearch/Catalog3/Richnyi_zvit_NKREKP_2016.pdf

CONSISTENT AND WELL-SUBSTANTIATED REGULATION

The NEURC's decisions concerning the setting of tariffs (prices) and approval of investment programmes are adopted in accordance with the approved and previously published procedures (methodologies). According to these procedures, tariffs for business entities are usually revised and investment programmes are usually approved on an annual basis. The procedures provide for the possibility of revision of tariffs (adjustment of investment programmes) in certain circumstances, including at the Commission's initiative.

Decisions concerning the operation of the Wholesale Electricity Market (determination and adjustment of the budget of the wholesale electricity supplier (the market operator), the funds allocation algorithm, approval of tariffs for manufacturers operating with the use of price bids, etc.) are usually adopted on a monthly basis.

At present, the Law provides that all of the Commission's draft decisions must be published together with their substantiation and additional materials (the minutes of public hearings, etc.). In accordance with the Law, draft decisions having features of regulatory acts must also include their impact analysis, however both the substantiation and the impact analysis are mostly formal documents which do not provide the sufficient understanding of the reasons and the consequences of the adoption of such regulatory acts.

The NEURC's Annual Report contains the section "Key Priority Objectives for Next Year", which discloses plans to develop new (improve the existing) regulatory documents.

ADAPTATION TO CHANGES

Before 2017, in accordance with provisions of the Law of Ukraine "On Basic Principles Governing State Policy on Business Regulation", the NEURC tracked the effectiveness of its regulatory acts on a planned basis, even though such tracking was substantially formal. According to the available information, after the Law was adopted, this tracking was discontinued.

The NEURC is now working to improve its regulatory framework in line with the laws and its internal plans.

In accordance with the Law, any persons have the right to submit proposals to the Commission concerning the need to prepare (or revise) the Commission's draft decisions, and the NEURC must provide information about the results of their consideration within 30 days after the date of receipt of such proposals. However, there is a lack of such feedback experience as yet.

Over the past few years, the NEURC's decisions have become the subject of a great many claims, including those filed by business entities. As reported by the media, the Commission has lost a considerable number of such cases. Pursuant to the issued judgments, the Commission has adopted respective decisions.

The NEURC has access to up-to-date regulatory experience. In particular, the Commission cooperates with the US National Association of Regulatory Utility Commissioners (NARUC) and the Energy Community Secretariat in matters related to the reform of energy markets and takes part in the work of the Energy Regulators Regional Association (ERRA), etc. The Commission is also a ben-

eficiary of international technical assistance projects (Project TWINNING “Support the National Commission for State Energy and Public Utilities Regulation in the process of electricity market reform”, which is implemented together with the Slovak Regulatory Office for Network Industries (RONI), EU Project “Assistance to Ukraine in the process of implementation of energy sector reform in line with Ukraine’s international commitments”, Project “District Heating Regulatory Reform Support Program” (SIDA-World Bank), the USAID Municipal Energy Reform

Project), etc. Such cooperation is now mainly focused on the electricity market reform (following the entry into effect by the Law of Ukraine “On the Electricity Market” on 11 June 2017).

RECOMMENDATIONS

- THE CABINET OF MINISTERS OF UKRAINE SHOULD ENSURE TIMELY PUBLICATION OF THE NEURC’S REGULATORY ACTS IN THE URIADOVYI KURIER NEWSPAPER (OR AMEND THE LAW TO EXTEND THE LIST OF AUTHORIZED OFFICIAL PERIODICALS FOR PUBLICATION PURPOSES)
- THE NEURC SHOULD IMPROVE ITS DECISION-MAKING PROCESS, IN PARTICULAR BY:
 - IMPROVING THE COMPLETENESS AND THE QUALITY OF THE SUBSTANTIATION AND IMPACT ANALYSIS OF ITS DECISIONS
 - IMPLEMENTING SUBSTANTIAL MONITORING OF THE EFFECTIVENESS OF ITS ADOPTED DECISIONS HAVING FEATURES OF REGULATORY ACTS, AND
 - ENGAGING REPRESENTATIVES OF POLITICAL PARTIES, TRADE UNIONS AND OTHER CIVIL

SOCIETY INSTITUTIONS IN THE DISCUSSION OF DECISIONS AFFECTING THE POPULATION

- THE NEURC SHOULD MAKE EFFORTS TO MAKE ITS WEBSITE CONSISTENT WITH REQUIREMENTS OF THE LAW, IN PARTICULAR THOSE CONCERNING THE PROVISION OF ACCESS TO QUARTERLY INFORMATION ABOUT THE RESULTS OF MONITORING OF ENERGY AND PUBLIC UTILITIES MARKETS
- THE NEURC SHOULD EXPAND THE LIST OF INFORMATION SUBJECT TO PUBLICATION IN THE FORM OF OPEN DATA
- THE NEURC SHOULD DEVELOP A STRATEGIC PLAN FOR REGULATION DEVELOPMENT (FOR THREE YEARS), WHICH MUST IMPROVE THE PREDICTABILITY OF ITS ACTIONS AND THE PERCEPTION OF ITS DECISIONS BY BUSINESS ENTITIES AND SOCIETY.

ECONOMIC EFFICIENCY

The Commission set tariffs in accordance with the Laws of Ukraine "On Natural Monopolies", "On the Electric Power Industry", "On the Electricity Market", "On the Natural Gas Market", "On Alternative Energy Sources", and the procedures (methodologies) approved by the NEURC.

ELECTRICITY

The NEURC sets tariffs for 40 electricity distribution and 37 electricity supply (at a regulated tariff) companies, 1 electricity transmission company, 5 HPP energy generating companies, 1 NPP energy generating company, 1 HEP (PSPP) energy generating company, 316 other producers, including producers from RES (as of January 1, 2017).

Tariffs for business entities are set according to the Cost Plus methodology (except for HPP generating companies for which tariffs are approved on the basis of calculations according to the Wholesale Market Rules, producers from RES for which tariff levels are prescribed by law, and non-regulated tariff suppliers operating on an arm's length basis). In general, the current procedures (methods) meet the requirements for ensuring financial stability of business entities and protection of consumers from monopoly prices, however they do not contain any incentives for improving operational efficiency, attracting investments, etc.

In 2013, pursuant to the Law of Ukraine "On Natural Monopolies", a regulatory framework was created for incentive based regulation for electricity distribution (energy supply) companies, which, in particular, provides for inclusion of the return on regulatory asset base in the tariffs, as well as incentivizing to improve the quality of services, reduce operating costs and electric-

ity losses in networks. The NEURC has been planning to implement this methodology from 2015, however such implementation was postponed each time. In July 2017, the similar methodology was adopted by the Commission for an electricity transmission company, however plans with respect to its implementation times are unknown.

The new market mechanisms to be implemented according to the Law of Ukraine "On the Electricity Market" provide for transition to the market principles of determining prices for energy generating companies from July 1, 2019 (except for producers from RES and CHPP for which special mechanisms are foreseen until 2030 and 2024 respectively). The Commission is empowered to approve all basic documents for the new market, in particular market regulations, "day ahead" market and diurnal market rules, commercial metering code and network codes.

The retail market currently features cross subsidization of consumers (primarily population) by other consumer categories, although the subsidization level has significantly decreased over the last years. From 2015, the NEURC has increased electricity tariffs for population more than 3.7 times (in five stages, including two in 2016 and one in 2017). Pursuant to the Law of Ukraine "On the Electricity Market", the NEURC has to ensure complete absence of cross subsidization between different consumer categories by July 1, 2019.

NEURC's decisions that cause rise in consumer tariffs draw severe criticism from the society. At least for the last year, some NEURC's decisions have been criticized not only by some experts and opposition politicians, but also by representatives of the parliamentary majority and even members of the Cabinet of Ministers of Ukraine. For

instance, according to mass media, at the Government session of August 9, the Ukrainian prime minister qualified the NEURC's decision on implementing incentive based regulation for electricity distribution companies as biased and unfair¹.

At the beginning of 2017, the NEURC's decision encountered acute reaction, related to the rates for connection to electricity networks, set according to the new methodology approved by the Commission. Following active discussions, the Commission's decision was adjusted and the provisions of the Law of Ukraine "On the Electricity Market" as to the connection were significantly amended in terms of the definition of the basic principles for calculating the connection fee.

NATURAL GAS

Pursuant to the Law of Ukraine "On the Natural Gas Market"², from October 1, 2015, the NEURC establishes tariffs only for natural monopolies - for natural gas distribution for 48 gas distribution companies and for gas transportation and storage for 1 gas transportation company. To determine tariffs for transportation services, the incentive based regulation methodology and the "input/output" tariff system are used, while for other tariffs - the Cost Plus methodology. Transition to incentive based regulation is foreseen for gas distribution companies, but there is no relevant regulatory framework approved by the Commission.

The Commission has also approved other regulatory documents as provided by the Law "On the Natural Gas Market" in particular the Code of Gas Distribution Networks and the Code of Gas Transportation Networks.

Even in such constricted, as compared with the electricity industry, field of powers,

some even generally progressive decisions of the NEURC are not taken seriously by the society. For instance, in 2017, such decisions included changes to the tariff calculation methodology for natural gas distribution services based on the connected capacity. Under pressure from politicians and public, in April the relevant NEURC's decision was canceled, and even the Commission's draft decision updated with the consideration of comments and proposals was actively resisted in June, so that the decision has not been adopted yet.

PERIODICITY OF REVISIONS

Pursuant to the procedures (techniques) approved by the NEURC, tariffs for business entities are revised on an annual basis. The procedures provide for the possibility of tariff revision in specified cases, including on the Commission's initiative.

Incentive based regulation involves long-term nature of regulation (first regulatory period - 3 years, then - 5 years). Nevertheless, the methodology provides for annual formula refinement and adjustment of tariffs taking into account the planned and actual inflation level, etc.

¹ <https://www.epravda.com.ua/rus/news/2017/08/9/627906/>

² <http://zakon3.rada.gov.ua/laws/show/329-19>

RECOMMENDATIONS

THE NEURC SHOULD SPEED UP ITS EFFORTS ON THE IMPLEMENTATION OF MODERN REGULATION METHODS (IN PARTICULAR, INCENTIVE BASED REGULATION FOR NATURAL MONOPOLIES WITH THE JUSTIFIED REGULATION PARAMETERS AND BENCHMARKING), ON THE IMPROVEMENT OF THE PROCESS OF CONNECTION TO ELECTRICAL NETWORKS (IN PARTICULAR, REDUCING THE CONNECTION "DEPTH"), DEVELOPMENT OF THE REGULATORY FRAMEWORK FOR THE NEW ELECTRICITY MARKET.

MARKET MONITORING AND LICENSING

All business entities should submit reporting to the NEURC on a systematic basis (monthly, quarterly, annual) in the prescribed form, as well as any other information required by the Commission to perform its functions. It is advisable to create an automated regulation database (databases), because the currently available information (in hard copy and electronic form) limits the possibility of its use.

Fines should be imposed following the results of inspections carried out by the NEURC pursuant to the Law of Ukraine "On the Basic Principles of State Supervision (Control) in the Area of Business Activities", taking into account the specifics as prescribed by the Law. According to the latter, licensees are reviewed by the NEURC according to the approved Licensing Activity Control Procedure by conducting on-site scheduled (not more frequently than once a year) and off-schedule inspections, as well as remote off-schedule inspections. Annual inspection plan is posted on the Commission's website before the beginning of each year.

POWER TO IMPOSE FINES FOR LAW VIOLATIONS

The Law and the field-specific laws determine the NEURC's powers as to imposing fines on business entities, in particular for violation of licensing conditions and laws, failure to provide or provision of inadequate or unreliable information, etc. The size of the fines is restrictive (up to UAH 1,700,000 in the electricity market, up to UAH 850,000 in the natural gas market). The NEURC

may also impose a fine up to 10% of the income (proceeds) on a respective vertically integrated entity or network operator (gas transportation system operator), if it fails to comply with the requirements for separation of activity types (according to the provisions of the Third Energy Package).

Fines should be imposed following the results of inspections carried out by the NEURC pursuant to the Law of Ukraine "On the Basic Principles of State Supervision (Control) in the Area of Business Activities", taking into account the specifics as prescribed by the Law. According to the latter, licensees are reviewed by the NEURC according to the approved Licensing Activity Control Procedure by conducting on-site scheduled (not more frequently than once a year) and off-schedule inspections, as well as remote off-schedule inspections. Annual inspection plan is posted on the Commission's website before the beginning of each year.

Actual control over the Commission with respect to specific complicated issues (substantiation of calculated subsidies, connection fee rates, etc.) is not currently possible due to the absence of the respective inspection methodology.

The licensing control procedure is currently reviewed by the NEURC in order to bring it into correspondence with the requirements of the Law.

190 scheduled and 25 off-schedule inspections were conducted by the Commission in 2016, with the total amount of imposed

finances of nearly UAH 10 million. The Commission also decides on the withdrawal of amounts of unused cash funds or those used out of accordance with the approved structure from the tariffs of business entities (in 2016 - UAH 1,174 million, including UAH 940 million in the electricity sector).

TRANSPARENCY OF THE CRITERIA FOR OBTAINING/REVOKING LICENSES

The NEURC carries out licensing of business entities in the energy and public utilities sector pursuant to the Law of Ukraine "On Licensing Activity Types" which determines the list of activity types that are subject to licensing, requirements for licensing conditions, list of information to be submitted when applying for a license, grounds for taking decisions on the refusal to issue a license, grounds for canceling licenses, etc. The license fee is equal to the size of one minimum wages in effect as of the day of issuing the license, and is not a barrier for entry of new market participants.

Pursuant to the Law, licensing conditions shall be approved by the NEURC taking into consideration the peculiarities prescribed by laws. Unfortunately, at the moment, the applicable legislation is in short of licensing peculiarities in the energy and public utilities markets, in particular with regard to the revocation of licenses for natural monopolies.

As of January 1, 2017, the NEURC had 402 licensees in the electricity sector, 95 - in the oil and gas complex, 703 - in the area of heat supply, 144 - in the area of centralized water supply. In 2016, the Commission issued 223 licenses (including 69 - in the electricity sector, 1 - in the oil and gas complex), revoked 82 licenses (including 31 - in the electricity sector).

PROTECTION OF CONSUMERS, HANDLING OF COMPLAINTS

Pursuant to the Law, the NEURC shall consider consumers' complaints for violation of their rights and interests by business entities, as well as resolve any disputes arising between business entities in the areas of energy and public utilities, according to the procedure approved by the Commission.

The draft Procedure for Settlement of Disputes between Business Entities has already been developed and published by the Commission to obtain comments and proposals from the stakeholders, while the Procedure for Handling Consumer Complaints is currently at the development stage.

At the moment, citizens' appeals to the NEURC are mostly complaints. The Commission handled 6,007 such complaints for 2016.

The Law provides for filing by the Cabinet of Ministers of Ukraine to the Verkhovna Rada, by July 1, 2017, a draft Law of Ukraine "On the Energy Ombudsman" which has to enhance significantly protection of consumers (first of all, household consumers), as well as to relieve the Commission from work with complaints, find out problem issues in the legislation for the purpose of further improvement, and reduce the "temperature" in the society.

As of September 1, the draft has not been submitted yet to the Parliament by the Government, however a members' of parliament draft law¹ on the same subject has been registered.

¹ http://w1.c1.rada.gov.ua/pls/zweb2/webproc4_1?pf3511=62448

RECOMMENDATIONS

- THE LAW OF UKRAINE “ON THE ENERGY OMBUDSMAN” SHOULD BE ADOPTED
- AMENDMENTS SHOULD BE DRAFTED AND ADOPTED TO THE LAW TO DEFINE THE PECULIARITIES OF THE LICENSING IN ENERGY AND PUBLIC UTILITIES MARKETS
- THE NEURC SHOULD DEVELOP AND APPROVE RESPECTIVE METHODOLOGIES FOR SEPARATE COMPLICATED ISSUES THAT ARE SUBJECT TO INSPECTION
- THE NEURC SHOULD IMPLEMENT AN IT SYSTEM FOR THE AUTOMATIC COLLECTION, RETENTION AND PROCESSING OF REGULATION-RELATED INFORMATION.

