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Regulation of Prices and Tariffs Established for Generating Companies in the Wholesale Electricity and Capacity Market

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Аннотация

The article deals with legal issues of pricing on the wholesale electricity and capacity market (hereinafter referred to as the WECM). The author reviews doctrinal approaches to price and tariff setting for generating companies, regulatory control, and judicial practice. The problem of determining the price for electricity and capacity transmission services rendered to generating companies is noted. Special attention is paid to the issue of defining the criteria of economic reasonableness of price bids submitted to the WECM. Proposals on the content of the methodology for determining the compliance of price bids with the economic reasonableness requirements are formulated. The research was conducted with the financial support of the Russian Foundation for Basic Research as part of scientific project No. 20-311-90034.

Ключевые слова: energy law, legal status of generating companies, price regulation in the electric power industry

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¹ A number of scientific researches [1] focuses on the issues of pricing on the wholesale electricity and capacity market (hereinafter referred to as the WECM), however, it would be wrong to think that this topic has been fully studied. Rapidly changing laws and an increasing number of court proceedings focused on regulated price (tariff) setting disputes as well as violations of pricing procedures by generating companies in the wholesale electricity and capacity market detected by the antimonopoly authority show that the study of this issue is relevant.

² The wholesale electricity and capacity market differs from other energy markets significantly: specific commodities (electric power and capacity) are traded on this market; NP Market Council Association has formed an unparalleled system of contracts; private law relations are heavily influenced by public law regulation.

³ Specific features of pricing should be mentioned separately.

⁴ For example, A.N. Varlamova [2] proposes to divide prices on the wholesale electricity and capacity market into three independent groups based on the applied contractual structure:

⁵ 1. The price is set based on approved tariffs. This group includes regulated contracts, must-run generation, and trade in electricity and capacity at free (unregulated) prices to compensate for losses in power grids.

⁶ 2. The price is set upon mutual agreement of the parties. This group includes electricity and capacity trading at free prices as well as electricity trading in amounts corresponding to deviations.

⁷ 3. The price is determined by bids. This group includes competitive selections of day-ahead price bids, competitive selections of bids for system balancing, and competitive capacity auctions.

⁸ Taking into account the regulation in force, this list can be supplemented with a group of prices, when an extra charge established by a regulation is imperatively added to the price.

⁹ For example, as per clause 119 of the Wholesale Market Regulations, [3] since 2015 the price for the capacity of nuclear power plants sold via competitive capacity auctions shall include funds needed to ensure the safe operation of these plants. [4] The amount of the said extra charge is determined by the Federal Antimonopoly Service of Russia. So, an extra charge in the amount of the funds needed to properly maintain power generation facilities is added to the price determined by way of bidding.

¹⁰ In this regard, the point of view shared by V.F. Popondopulo, O.A. Gorodov, and D.A. Petrov [5] is worth mentioning. The scholars propose to establish an extra charge to be added to the equilibrium wholesale market price to determine the price of electricity produced at qualified generating facilities operating based on renewable energy sources in order to support generating facilities operating based on the use of renewable energy sources. The said extra charge shall be calculated based on the need to achieve the target volumes of generation and consumption of electricity produced at

qualified generating facilities operating based on the use of renewable energy sources established as per the key areas of the state policy for improving the energy efficiency of the electric power industry.

¹¹ Let's review the first category, the regulated prices (tariffs) on the wholesale electricity and capacity market, in more detail. The provisions on regulated prices (tariffs) on the wholesale electricity and capacity market are stipulated in Art. 23.1 of the Law on the Electric Power Industry as well as in Section II of the Basic Principles of Pricing and include the following groups of regulated prices (tariffs):

- ¹² - prices (tariffs) on the wholesale market (clause 2 of Art. 23.1);
- ¹³ - prices (tariffs) for services rendered on the wholesale market (clause 4 of Art. 23.1).

¹⁴ The price (tariff) system also includes payment for technological connection to power grids and/or standardized tariff rates that determine its amount.

¹⁵ The list of prices (tariffs) provided in Art. 23.1 of the Law on the Electric Power Industry is exhaustive as per clause 5 of the Article. This means that new types of prices (tariffs) should only be introduced by amending Art. 23.1 of the Law on the Electric Power Industry. At the same time, a number of prices (tariffs, extra charges to prices) on the wholesale market may be set according to paragraph 3 of clause 2 of Art. 23.1 of the Law on the Electric Power Industry based on Russian laws in the manner prescribed by the Government of the Russian Federation. [6]

¹⁶ Thus, Decree of the Government of the Russian Federation No. 1178 dd. December 29, 2011, and Decree of the Government of the Russian Federation No. 1172 dd. December 27, 2010, provide additional lists of prices (tariffs) and extra charges in the electric power industry subject to government regulation.

¹⁷ In addition to prices (tariffs) for electricity and capacity on the wholesale market, prices (tariffs) for services rendered by organizations ensuring the operation of the technological and commercial infrastructure of the wholesale electricity (capacity) market as well as by other electric power industry entities are subject to government regulation.

¹⁸ Technological infrastructure organizations include the organization managing the unified national (all-Russian) power grid.

¹⁹ The organization managing the unified national (all-Russian) power grid renders electricity transmission services to consumers being wholesale market participants. In the process of electricity transmission, there are situations when a generating company becomes a consumer of electricity transmission services. Such situations are possible when generating equipment is stopped, but a certain amount of power is required to keep it operational (electricity consumption for own needs of a plant).

²⁰ As per clause 49 of the Rules for Non-Discriminatory Access to and Provision of Electricity Transmission Services approved by Decree of the Government of the Russian Federation No. 861 dd. December 27, 2004 (hereinafter referred to as Rules No.

861), a special procedure for the calculation of payment for electricity transmission services is established for electricity producers being WECM participants.

²¹ For instance, under the above clause of Rules No. 861, the cost of transmission services is determined based on the excess of electricity consumption for own needs over the standard value of consumption for own needs.

²² As per clause 7 of Art. 33 of the Law on the Electric Power Industry, Trading System Administrator, JSC (hereinafter referred to as ATS, JSC) renders a wholesale electricity and capacity trading service to WECM participants, inter alia, determines consumption volumes (quantity) for WECM participants, therefore it is easy to calculate consumption volumes exceeding the standard rate. At the same time, there is a problem with price determination for such services.

²³ Based on the above wordings, a generating company becomes a consumer of electricity transmission services only if it exceeds the standard consumption rate for its own needs. At the same time, the standard rate is set in such a way that the standard rate for own needs is not exceeded in ordinary conditions.

²⁴ It is possible to exceed the standard rate in an extraordinary situation, which is not predictable. At the same time, if a generating company consumes electricity and actually uses a grid operator's services to get it, the services shall be paid. Currently, in order to calculate the cost of their services, grid operators use the calculation procedure for regular consumers stipulated in Rules No. 861. However, generating companies do not consume as regular consumers.

²⁵ In this regard, it is particularly important to develop a regulation and govern the procedure for calculating the services a grid operator renders to a generating company being a WECM participant.

²⁶ The next block includes prices determined upon mutual agreement of the parties. Although the prices are determined upon mutual agreement of the parties, there are certain specifics in their determination.

²⁷ As per clause 180 of the Wholesale Market Regulations, the price for capacity in long-term bilateral contracts for a new regulation period shall not exceed the maximum level of regulated prices (tariffs) annually established by the federal executive authority in charge of tariff regulation.

²⁸ The freedom of generating companies in determining the price of a free bilateral contract is not only limited by the will of the counterparty (buyer) but is largely restricted by the requirements of the law, which means that the price so determined cannot be deemed free.

²⁹ The third block includes prices determined based on bids of parties to electricity sale and purchase relations.

³⁰ As an example, we review pricing under capacity supply contracts (hereinafter referred to as CSCs) and capacity supply contracts of qualified generating facilities operating based on renewable energy sources (hereinafter referred to as RES CSCs). According to the Wholesale Market Regulations, capacity prices under these contracts are calculated by the commercial operator as per the wholesale market trading system

accession agreement and the wholesale market procedures based on the rules for determining such prices set by the Government of the Russian Federation, namely:

³¹ - for CSCs: the Rules for Determining the Price of Capacity Sold under Capacity Supply Contracts and the Rules for Calculating the Capacity Price Component that Ensures the Compensation of Capital and Operating Costs (Decree of the Government of the Russian Federation No. 238 dd. April 13, 2010);

³² - for RES CSCs: the Rules for Determining the Price of Capacity of Generating Facilities Operating Based on RES (Decree of the Government of the Russian Federation No. 449 dd. May 28, 2013).

³³ The above pricing rules include variables that shall be taken into account by a commercial operator when determining the price under the contracts. In essence, in these rules, the Government of the Russian Federation has imperatively established the procedure for determining the contract price, and the parties to the contract may not change this procedure upon their agreement and/or change the components that make up the capacity price.

³⁴ One of the most pressing problems in the regulation of generating companies is that no economic reasonableness criteria for price bids submitted to the WECM have been defined yet. The Federal Antimonopoly Service of Russia was supposed to approve the methodology for determining the compliance of price bids with the economic reasonableness requirements by May 1, 2011, i.e., more than 10 years ago, but the regulation has not been approved up to this day.

³⁵ “Grey zones” preserved intentionally or unintentionally result in situations when the Federal Antimonopoly Service of Russia can determine the rules and acknowledge (when required) their violations by market players. Eventually, potential violators have vague guidelines on how to behave only when the Federal Antimonopoly Service of Russia exercises its function.

³⁶ The above problem became even more relevant following the proceedings in an antimonopoly manipulation case, where a generating company engaged in WECM activities appealed to the court seeking invalidation and cancellation of a decision and order of the Federal Antimonopoly Service of Russia in a case of violation of antimonopoly law.[7]

³⁷ The issue of determining facts of manipulation by wholesale market players has a substantial effect on the legal status of generating companies.

³⁸ A.N. Varlamova and V.A. Krasnova divide manipulation methods into two parts: manipulation of the volume of products sold and manipulation of prices. [8]

³⁹ According to these authors, the manipulation of volumes means the illegal withdrawal of generating equipment from the market for no objective reasons and in violation of legal requirements.

⁴⁰ The second method of manipulation involves the submission of economically unjustified price bids without capacity withdrawal.

⁴¹ One of the most problematic issues in establishing the fact of price manipulation is how to determine commodity market boundaries.

⁴² The procedure for determining the product and geographic boundaries of the commodity market is outlined in the Procedure for the Analysis of the Competitive Situation in the Commodity Market approved by Order of the Federal Antimonopoly Service of Russia No. 220 dd. April 28, 2010. However, this procedure does not fully address the specifics of such goods as electricity and capacity as reflected in court practice.

⁴³ We would like to discuss the court practice of resolving price determination disputes. Let us take a closer look at the dispute between the Federal Antimonopoly Service of Russia, Tatenergo, OJSC, and Generating Company, OJSC. The Federal Antimonopoly Service of Russia resolved that a group of entities, Tatenergo, OJSC, and Generating Company, OJSC, violated Part 1 of Art. 10 of the Law on Protection of Competition by manipulating prices on the wholesale electricity and capacity market in 2008 (resolutions the Federal Antimonopoly Service of Russia dd. April 27, 2010, in case No. 1 10/176-09 and dd. May 12, 2010, in case No. АГ/14405). However, when appealing the said resolutions, the courts of three instances concluded that the Federal Antimonopoly Service of Russia had incorrectly determined the boundaries of the commodity market, which became grounds for canceling the appealed resolutions (Judgement of the Moscow City Commercial Court dd. February 28, 2011, in case No. А40-109344/10-144-635, Ruling of the Ninth Commercial Court of Appeal dd. May 24, 2011, in case No. А40-109344/10-144-635, the Ruling of the Federal Commercial Court of Moscow District dd. September 2, 2011).

⁴⁴ To study the issue under consideration, it is very important to review the dispute initiated by T Plus, PJSC, to appeal the decision and order of the Federal Antimonopoly Service that found the Company to be in breach of antimonopoly laws by way of manipulating wholesale electricity and capacity market prices, which led to restriction of competition [9].

⁴⁵ By its decision dd. May 4, 2022, the Moscow City Commercial Court satisfied the claim of T Plus, PJSC. The decision was verified and upheld by the courts of appeal and cassation.

⁴⁶ Due to an increase in the number of cases when the antimonopoly authority finds generating companies to be in breach of antimonopoly laws by manipulating wholesale electricity and capacity market prices, the criteria for determining whether the actions of a generating company constitute an antimonopoly law violation should be examined in detail.

⁴⁷ As per Art. 3 of the Law on the Electric Power Industry, the manipulation of wholesale electricity (capacity) market prices means economically or technologically unreasonable conduct, inter alia, using a dominant position on the wholesale market, which leads to a significant change in the wholesale market price (prices) for electricity and/or capacity, inter alia, by submitting unjustified overpriced or underpriced bids to sell or purchase electricity and/or capacity.

⁴⁸ A bid may be deemed overpriced if its price exceeds the price formed on the comparable commodity market or the price established on such commodity market earlier (for similar hours of the preceding day, for similar hours of the day of the preceding week, for similar hours of the day of the preceding month, the preceding quarter).

⁴⁹ As part of control over actions of wholesale and retail electricity market participants aimed at revealing electricity price manipulations on the wholesale and retail electricity (capacity) markets, as per clause 3.3 of the Administrative Regulations of the Federal Antimonopoly Service on Performing the State Function of Control over Actions of Wholesale and Retail Market Participants Aimed at Revealing Electricity Price Manipulations on the Wholesale and Retail Electricity (Capacity) Markets approved by Order of the Federal Antimonopoly Service of Russia No. 413 dd. June 26, 2012, the Federal Antimonopoly Service of Russia analyzes data on weighted average unregulated electricity prices on the wholesale electricity and capacity market determined based on the selection of price bids on the day-ahead market (hereinafter referred to as the DAM).

⁵⁰ Clause 20 of the Rules for Antimonopoly Regulation and Control in the Electric Power Industry approved by Decree of the Government of the Russian Federation No. 1164 dd. December 17, 2013 (hereinafter referred to as Rules No. 1164) stipulates that when manipulations of electricity and/or capacity prices on the wholesale market are revealed, the Federal Antimonopoly Authority shall verify whether there are criteria for significant electricity and/or capacity price (prices) change.

⁵¹ Clause 11 of Part 1 of Art. 10 of the Law on Protection of Competition prohibits actions (omission) of a business entity occupying a dominant position that result or may result in prevention, restriction, or elimination of competition and/or impairment of interests of other persons (business entities) in the field of entrepreneurship or an indefinite range of consumers, including manipulation of wholesale and/or retail electricity (capacity) market prices.

⁵² So, in order to qualify actions of a business entity as a breach of clause 11 of Part 1 of Art. 10 of the Law on Protection of Competition, the Federal Antimonopoly Service of Russia shall prove that:

⁵³ 1) the business entity occupies a dominant position in the market;

⁵⁴ 2) the business entity's conduct is economically and/or technologically unreasonable, inter alia, by way of submitting unreasonably overpriced bids;

⁵⁵ 3) these actions resulted in a significant change in the electricity price.

⁵⁶ According to Art. 25 of the Law on the Electric Power Industry, a regular monitoring system is in place on the wholesale and retail markets meant to timely prevent, detect, limit, and/or suppress actions (omission) that result or may result in preventing, limiting, eliminating competition and/or impairing the interests of electric power industry entities and electricity consumers, including the ability to manipulate wholesale and retail market prices; manipulations of wholesale and retail market prices, including by way of using its dominant position.

⁵⁷ Sub-clause “a” of clause 5 of Rules No. 1164 stipulates that the antimonopoly authority shall exercise antimonopoly control over the wholesale and retail markets by reviewing electricity (capacity) price monitoring data and verifying the economic and technological reasonableness of electric power industry entities’ actions.

⁵⁸ According to clause 11 of Order No. 378, manipulation is revealed when reviewing antimonopoly law violation cases, inter alia, by comparing the prices specified by wholesale market players in price bids with their actual costs of electricity generation during the specific hour, by comparing the volumes specified by a player with the possible volumes of electricity generation by plants based on the specifications of generating equipment, heating load restrictions, fuel supply, as well as taking into account the levels of maximum economically justified expenses for electricity generation (excluding capacity) differentiated by types of power plants as determined by the federal executive body in charge of tariff regulation.

⁵⁹ Thus, the calculation algorithm applied by the Federal Antimonopoly Service of Russia was based on the principle of using the weighted average specific fuel consumption for the total volume of electricity generation, i.e., without differentiating the volume of electricity into: 1) combined generation sold at “price-acceptance”; and 2) condensing generation sold at price bids.

⁶⁰ Clause 5 of Rules No. 1164 and clause 11 of Procedure No. 378 expressly stipulate that when evaluating the actions of a power industry entity for manipulation, the Federal Antimonopoly Service of Russia should analyze the technical specifications of generating equipment, heating load restrictions, specific fuel consumption used to calculate the cost of production, and the value of specific fuel consumption in condensing and co-generation modes.

⁶¹ This approach to the calculation of actual costs is inconsistent with industry-specific regulation and the DAM pricing procedure, which is based, among other things, on taking into account the technological features of power plants of different types.

⁶² According to clause 1 of Art. 2 of the Civil Code of the Russian Federation, entrepreneurial activities mean independent, activities carried out at own risk aimed at systematic profit earning from the use of property, sale of goods, performance of works, or rendering of services. It would be at least economically irrational for a generating company to perform its core activities of electricity generation without generating profit. However, the WECM regulations binding upon market players allow including profitability in bid prices. Thus, the Methodology of Verification of Electricity Sale Price Bids (Annex 5 to the Regulation on the Exchange of Information Between Wholesale Market Participants and the Federal Antimonopoly Service aimed at Revealing WECM Price Manipulations) [10] makes it possible to add profitability to fuel costs in price bids. At the same time, profitability is not limited by any values.

⁶³ The following arguments are included in the opinion of the Higher School of Economics (National Research University) [11] to support the inclusion of profitability in DAM price bids:

⁶⁴ - activities involving electricity sale on the wholesale market do not refer to regulated types of activities and are performed by electricity and capacity providers;

⁶⁵ - commercial organizations focus on profit as the main goal of their activities according to provisions of the Civil Code of the Russian Federation;

⁶⁶ - the Law on the Electric Power Industry and the Wholesale Market Regulations provide no criteria of economic and technological reasonableness of price bids for electricity sale on the DAM and restrictions on the possibility to include profitability in these price bids;

⁶⁷ - material terms and conditions of the Wholesale Market Trading System Accession Agreement, which are effective for all wholesale electricity and capacity market players and which, according to the Opinion of the Commission of the Federal Antimonopoly Service of Russia, together with the Federal Law on the Electric Power Industry and the Wholesale Market Regulations, define the principles of competitive selection of day-ahead price bids and the technological reasonableness of price bids, contain the Methodology of Verification of Electricity Sale Price Bids (Annex 5 to the Regulation on the Exchange of Information Between Wholesale Market Participants and the Federal Antimonopoly Authority Aimed at Revealing Wholesale Electricity and Capacity Market Price Manipulations, which is an appendix to the Wholesale Market Trading System Accession Agreement), which Market Council may use to verify prices in price bids of electricity providers and electricity generation costs in the absence of a methodology approved by the Federal Antimonopoly Service of Russia to determine whether price bids for electricity sale meet the economic reasonableness requirements. The above Methodology of Verification of Electricity Sale Price Bids expressly stipulates that it is possible to include profitability to fuel costs in price bids without limiting profitability by any values;

⁶⁸ - individual steps of price bids/sub-bids submitted as per the Price Bid Submission Regulations will be more expensive than the “actual fuel costs to generate 1 MW of electricity per hour by a specific generating plant” due to the requirements of paragraph 3 of clause 18 of the Wholesale Market Regulations since low fuel costs for generation in the heat-extraction mode are considered in the price-accepting bid, and cost-based price bids are formed for condensing generation with high fuel costs;

⁶⁹ - the requirements for the economic reasonableness of electricity sale price bids, which should have been determined by the Federal Antimonopoly Authority in coordination with the Ministry of Economic Development and Trade of the Russian Federation and the Ministry of Energy of the Russian Federation, have been approved neither for the period under consideration (February to April 2019) nor to date. It means that the antimonopoly authority has not defined clear criteria for price bid reasonableness and has provided electricity and capacity providers with a certain freedom in developing pricing strategies;

⁷⁰ - the draft orders of the Federal Antimonopoly Service of Russia on the approval of the Requirements for the Economic Reasonableness of Electricity Sale Price Bids and the Methodology for Determining the Compliance of Electricity Sale Price Bids with the Economic Reasonableness Requirements stipulate that it is possible to include profitability in price bids;

⁷¹ - according to the 15 largest generating companies’ reports, the analysis of the practice of including profitability in price bids submitted by electricity providers on the

day-ahead market showed that all generating companies enjoyed electricity generation profitability from 2.7 to 88% as of the end of 2019. These figures include loss sales of a portion of electricity on the wholesale market at regulated tariffs as well as profitable sales of electricity on the wholesale market at free prices. Thus, in view of these components, the weighted average profitability of electricity generation was 33.5%.

⁷² In this case, the court reasonably concluded that the comparison of price bids submitted on the DAM with the approved electricity tariffs was incorrect due to the incomparability of these values. According to clause 11 of Procedure No. 378, the prices specified by wholesale market players in their price bids shall be compared with the actual costs of electricity generation during a specific hour in view of the levels of maximum economically justified costs of electricity generation (excluding capacity) differentiated by types of power plants as determined by the federal executive authority in charge of tariff regulation. Order No. 1725/18 approves no levels of maximum economically justified costs of electricity generation (excluding capacity) differentiated by types of power plants.

⁷³ This means that market players cannot effectively manage their risks. Electricity providers can at any time be found guilty of violating certain rules known only to the regulator, therefore it is advisable to bring up the issue of approval of the methodology for determining the compliance of price bids with the economic reasonableness requirements by the Federal Antimonopoly Service of Russia or development of price bid compliance criteria as part of antimonopoly compliance, but to do so an experimental legal regime or a transitional period is needed to test the results and exclude the prosecution of generators that applied these criteria.

⁷⁴ The methodology for determining the compliance of price bids with the economic reasonableness requirements should include the following:

⁷⁵ - activities involving sales of electricity on the wholesale market are competitive, therefore the price should be market-based and should not be subject to regulation;

⁷⁶ - activities involving sales of electricity on the wholesale market are performed by commercial organizations which, according to the Civil Code of the Russian Federation and their constituent documents, pursue profit-making as the main goal of their activities, therefore the methodology should not limit business entities in earning reasonable profit;

⁷⁷ - currently, the Law on the Electric Power Industry and the Wholesale Market Regulations stipulate no criteria for economic and technological reasonableness of price bids for electricity sales on the DAM and restrictions on the possibility to include profitability in these price bids, therefore the methodology should eliminate this gap;

⁷⁸ - the methodology should be developed in view of principles of competitive selection of day-ahead price bids and technological reasonableness of price bids according to the Methodology of Verification of Electricity Sale Price Bids (Annex 5 to the Regulation on the Exchange of Information Between Wholesale Market Participants and the Federal Antimonopoly Authority Aimed at Revealing Wholesale Electricity and

Capacity Market Price Manipulations, which is an appendix to the Wholesale Market Trading System Accession Agreement);

⁷⁹ - the methodology should resolve the issue of whether it is possible to include profitability in price bids submitted by electricity providers on the day-ahead market.

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Abstract

The article deals with legal issues of pricing on the wholesale electricity and capacity market (hereinafter referred to as the WECM). The author reviews doctrinal approaches to price and tariff setting for generating companies, regulatory control, and judicial practice. The problem of determining the price for electricity and capacity transmission services rendered to generating companies is noted. Special attention is paid to the issue of defining the criteria of economic reasonableness of price bids submitted to the WECM. Proposals on the content of the methodology for determining the compliance of price bids with the economic reasonableness requirements are formulated. The research was conducted with the financial support of the Russian Foundation for Basic Research as part of scientific project No. 20-311-90034.

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