

## LEGAL REGULATION OF COMPETITION AT ELECTRICITY RETAIL MARKETS

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### ABSTRACT

The article considers some features of the competitive relation formation in the electric power industry, a major economy sector. In particular, the paper analyzes the electricity retail market operation and the need for competition promotion, it is associated there with a wide range of consumers, which adds high social significance to the effective operation of relations emerging in this area. The author concludes that the retail electricity market needs to increase private funds and decrease state participation, which will contribute to a wider range of service consumers. The article considers some special aspects on how to ensure the dominant position of power supply companies, as well as defines main barriers for business entities to enter retail electricity markets. It also reviews the best foreign practices that regulate energy retail companies (by the example of the Nordic countries) and offers some options of legal receptions in this area. Moreover, it analyzes the Russian legislation novelties in the field of competition at the electricity markets, in particular, the tariff regulation of electricity distributors by the method of reference costs. Also, the article specifies some proposals on how to improve the legislation that regulates competitive relations at the electric energy market within the National Competition Development Plan.

**Keywords:** electric energy market, FAS Russia, dominant position, tariff regulation, energy retail companies, electricity distributors, lighting equipment users

### 1. INTRODUCTION

The study aims to research the competition legal regulation at retail electricity markets in order to draft recommendations on how to improve the legal regulation and identify existing problems. The formation of competitive relations at any product market that operates within the market relation is an important factor for sustainable business development, which directly impacts the state's economy efficiency in general and the quality of services provided. Russian transit to a market economy generated the "entrepreneurial management style" characterized by such an important factor as competition between business entities when producing goods, performing work, or rendering services, in the electric power industry, inter alia [1]. However, some aspects of the electricity retail market have led to global violations of competition principles, which resulted in overstated electricity tariffs. To take steps to solve this issues, the Government of the Russian Federation adopted the Resolution No. 863 "On Amendments to Certain Acts of the Government of the Russian Federation Regarding the Introduction of Guaranteeing Suppliers' Sales Markups Using the Comparative Method and Declaration that Subparagraph 2, Paragraph 11 of the Resolution of the Government of the Russian Federation No. 1178 dated December 29, 2011 is no Longer in Force" on July 21, 2017. The Resolution was the first document in Russian legal space to introduce the concept of the guaranteeing supplier reference costs, which is understood as an eco-

nomically reasonable specific value of costs associated with performance of regulated activities by the guaranteeing supplier, defined by the comparative method and established for expense items. In other words, this standard served as a measure to deter price competition at the market. The unified costs method is mainly used to encourage electricity retail companies to increase their efficiency.

The research applied general scientific methods, such as analysis, modelling, and comprehensive approach. Moreover, specific scientific methods were used, i.e. legal modelling and legal comparison.

## 2. MAIN RESULTS

The methodology of the research is based on the application of the dialectical method of cognition, which allows us to study objective economic laws and patterns in their interrelations and interdependencies. Theoretical constructions in the article are considered using general scientific and particular methods of selective research. The factual base is based on the legislative and regulatory legal acts of the Russian Federation, statistical and analytical reports on the research topic. Revenues of electricity retail companies are currently calculated by the method of "costs-plus": the markup is directly proportional to costs, including the purchase price of electricity at the wholesale market. So, it is more profitable for electricity retail companies to pay more for electricity; saving, on the contrary, leads to reduced tariffs and revenues. It is not yet profitable for suppliers to optimize their operating costs (rentals, remuneration, etc.), which also contribute to the tariff amount. The new method proposed by FAS outlines the markup of an electricity retail company to be calculated upon standardized costs of 1 kWh. However, if the company reduces its costs against the standard, it will be able to keep saved funds. The purchase price of electricity at the wholesale market will directly affect the consumer price; in this context, the cheaper the electricity is for the guaranteeing supplier, the more customer-attractive its services will be [2]. According to FAS Russia, when the standard is introduced, the costs of distributor companies will consist of two components: constant component (costs) to be determined by the method of reference costs and an alternating component to be determined based on the company's investment program approved by the regional government. FAS estimated the amount of funds

saved by consumers during three years due to the new calculation method at 12.7 billion roubles. Considering the fact that the reference costs for energy companies are set at the nation-wide level, it is also advisable to take into account the electricity market, since regional consumption varies (Table 1). However, according to SO UPS JSC, electricity consumption in Russian Unified Power System amounted to 1039.7 billion kWh in 2017, which is 1.3 % above the consumption volume in 2016. In general, electricity consumption in Russia amounted to 1059.5 billion kWh in 2017, which is 0.5 % higher as compared to 2016. Excluding February 29, 2016, electricity consumption by the national UPS and Russia in general increased by 1.6 % and 0.8 % respectively.

In 2017, electricity generation in Russia amounted to 1073.6 billion kWh, which is 0.2 % higher than in 2016. Russian UPS power plants produced 1053.7 billion kWh, which is 0.5 % higher than in 2016. Electricity generation by Russian UPS and Russia in general increased by 0.8 % and 0.5 %, respectively, excluding the impact of the leap years extra day.

As far as the electricity market is concerned, it should be noted that this market constitutes a system of relations forming a strategically important economy sector. That is why the state is to create a legal mechanism that will help to protect both market players' interests and public interests. In 2003, there was a reform in the electric power sector motivated by anticipated shortage of generating capacity: consumption boosted impressively; power generating equipment grew out-of-date and was in bad state, while there were no incentives and mechanisms for the construction and equipment update. In 2008, energy generating companies, most of them subsidiaries of RAO UPS of Russia, were acquired by private investors (including foreign ones) during the restructuring of RAO UPS of Russia JSC. Together with generating assets, they also received obligations to implement the investment program (construction and modernization of generating assets) specified in the capacity supply agreements (CSA). Along with the industry's restructuring, there also was a market transition reform, which resulted in a gradual transition from fully regulated pricing to market electricity pricing.

A characteristic feature of electricity retail markets is the presence of guaranteeing suppliers that

**Table. 1. Electricity Consumption and Industrial Production Growth According to Russian Statistical Agency**

Regions	Industrial production growth in 2015 (operational data), %	Memo: electricity consumption increase in 2015, %	Regions	Electricity consumption growth in 2015, %
<b>Top-5 by fall</b>				
Chukotka Autonomous Okrug	-14.2	n/a	Republic of Mordovia	-9.1
Primorsky Krai	-12.5	1.9	Kurgan Region	-4.6
Republic of North Ossetia-Alania	-10.1	-1.3	Volgograd Region	-4.6
Kaluga Region	-9.1	-0.4	Tomsk Region	-4.2
Amur Region	-9.0	1.1	Nizhny Novgorod Region	-4.0
<b>Top-5 by growth</b>				
Tula Region	+9.4	-0.3	Stavropol Krai	+3.7
Bryansk Region	+13.3	-0.7	Republic of Ingushetia	+4.0
Sakhalin Region	+13.8	n/a	Republic of Dagestan	+5.4
Republic of Altai	+2.6	n/a	Republic of Kalmykia	+6.3
Rostov Region	+54.6	0.7	Republic of Tyva	+6.5

exercise significant influence and act as sellers. However, the natural monopoly segment is operated by distribution companies, which dominant position is presumed by law. Accordingly, the vast majority of violations in the electricity (capacity) retail market is due to the dominant position abused by market participants [3].

According to Federal Law No. 35-FZ dated March 26, 2003 “On Electric Power Industry” [4] (hereinafter, the Law on Electric Power Industry), the retail electricity market actors are as follows:

1. Electric energy consumers;
2. Electric energy suppliers (electric sale companies, guaranteeing suppliers, electric energy producers, who are not eligible to operate at the wholesale market);
3. Regional grid operators rendering electricity transmission services;

4. Operational & dispatching control actors serving the electric power industry and performing the specified management at retail markets.

In addition, the Law on Electric Power Energy specifies that entities engaged in lightning, inter alia, are free to choose their counterparty to the purchase & sale contract or electricity supply contract; a distribution company is not entitled to refuse to enter into an electricity transfer service contract basing on the choice of electricity from a particular supplier made by an electricity consumer. This provision of the Law is the basic principle underlying the competitive relations formation at the electricity retail market.

The Federal Antimonopoly Service (hereinafter, FAS Russia) is the agency authorized by the Government of the Russian Federation to exercise antimonopoly control over electricity markets by:

reviewing monitoring data of electricity (capacity) prices; verification of economic and technological justification of actions taken by an electric power industry actor; conducting scheduled and unscheduled inspections on compliance with the antimonopoly legislation, inter alia, detection of electricity (capacity) prices gouging, consideration of claims against violation of antitrust legislation by electric power industry actors, and other information obtained in accordance with the established procedure; detection of price-gouging at the wholesale and/or retail markets, etc. It should be noted that many countries widely exercise state control, for example Brazil [5]. As a result of its activities, FAS Russia found out that, as for 2017, the electricity (capacity) retail markets in all constituents of the Russian Federation were characterized by high concentration and undeveloped competition. This leads to the fact that entities operating, for example, in the lighting segment, are not able to choose a supplier they need. Consequently, we can speak about the inability to create conditions for a competitive environment and service quality improvement.

The market situation is complicated by the fact that a number of entities with the status of a guaranteeing supplier (i.e. those who sell electricity and must enter into electric power supply contracts or electric power purchase & sale (supply) contracts with any electricity consumer who contacts it or with any person acting in its own name or on behalf of the specified electricity consumer and wants to purchase electricity) occupy about 75 % at the electricity sale & purchase (supply) market in the relevant constituent entity of the Russian Federation, while in most regions their share is almost 100 %. However, the guaranteeing supplier is the only actor of the electricity wholesale market in a number of regions, and all other sales companies buy electricity from it. Some regions witnessed an increase of the market share of the guaranteeing electricity supplier, inter alia, due to the merging with supply companies.

The share of remaining electricity supply companies does not exceed 35 % at the electricity (capacity) retail markets. It also should be noted that electricity purchase & sale (supply) retail markets are potentially highly competitive markets, provided that electricity is sold by several sales entities located in the area of the guaranteeing supplier's operation and within the electric power system

of a respective supplier. This leads to violations of regional antimonopoly laws, which negatively affects the ability of many energy power companies to carry out lighting activities. For example, in January 2018 in the Kostroma Region, a case on the antimonopoly law violation was initiated following the requests from the Local Supply Entity (hereinafter, LSE) and the electricity consumer to completely restrict electricity supply to the transformer substation owned by the LSE. The consumer also claimed in its statement that the non-residential premises owned by the company had been disconnected from the electric power system without notifying the consumer. Based on the results of the case consideration, violations of Part 1, Article 10 of Law "On the Competition Protection" was detected in the actions of KSK PJSC and IDGC of Centre PJSC represented by the Kostroma branch and expressed as follows:

- KSK PJSC abused its dominant position by submitting an unreasonable notice of full restriction of electricity consumption in respect of the properties;

- IDGC of Centre PJSC abused its dominant position by unreasonably and fully restricting electricity consumption at the terminal point, i.e. the transformer substation owned by the LSE. The case materials established an unreasonable restriction of electricity consumption for the LSE, which was unable to conduct its business activities by implementing the technological connection of consumers to its electric power system [6].

As noted by FAS Russia, insufficient competition at electricity retail markets affects the availability of electricity for consumers, leads to overpricing, insufficient reliability of electric supply and a weak payment discipline.

High state intervention in the sector should be recognized as the main problem that hampers the development of competition at electricity retail markets [7]. As for the electric supply industry, the National Competition Development Plan should ensure free consumer choice of an electricity supplier. In this regard, it is interesting to explore the experience of the Nordic states, where the reforms, for example, in Norway, admitted small consumers to the market by introducing reference schedules drafted for them. The purpose of such schedules was to facilitate the electricity consumption accounting and forecast at a two-rate tariff. Moreover, consumers gained an opportunity to change suppliers with

no additional costs. In 1995, the Swedish electricity trade regulation and consumer protection rules were amended. From now on, the consumer can choose the electricity supplier on its own, when installing hourly meters [8].

Effective competitive relations in the electricity retail segment is an attribute of the world's leading economies, for example, the UK has the highest level of competitive relations and decreased business capitalization [9]. However, in most countries the largest actors make up the segment of "generating companies", for example, in Hungary and Italy, which ensures the market stability, but leads to overpricing and violates the rights of services consumers [9, 10]. The American States are greatly independent to ensure competition at the electricity retail market, but the country in general is also experiencing the "generating companies" problem [11].

From our point of view, competition at the electricity market will be prompted by the concept, which can provide direct access to retail consumers (including entities that provide lighting services) to wholesale electricity producers and ensure a direct payment for electricity through a system of contracts. Moreover, consumers should be able to change a sales company in a short time, if its quality of service is not satisfactory.

Also, as noted by Valery Seleznyov, Deputy Chairman of the State DUMA Energy Power Industry Committee, lifting the ban on electricity sales to distributors with a limited market share may enhance the development of retail markets and competition [7].

### 3. CONCLUSION

We believe that the adoption of the Federal Law "On Amendments to the Federal Law "On Electric Power Industry" and Certain Legislative Acts of the Russian Federation Related to the Electricity Sales Licensing" has hampered the development of the electricity retail market. The Law says that electricity sales must be carried out based on a license issued by the federal executive agency authorized by the Government of the Russian Federation. Energy sales entities are required to obtain a license no later than December 29, 2018. After this date, no activities without a license can be carried out. Consequently, these norms have generated new barriers to enter the electricity market. In particu-

lar, the Law provides for the following requirement: a license applicant must have no obligations to sell exclusively at the wholesale market all electricity (capacity) produced on the electricity (capacity) production facility (or a part thereof), including power plants, which operates within Russian Unified Power System, the installed generating capacity of which is equal to or greater than 25 MW and which will be or has been used for electricity sales activities. The analysis of the competitive environment of the electricity retail market demonstrated that the competition development is hindered by factors peculiar to all product markets in the Russian Federation. However, it should be taken into account that the competition at the market under consideration directly impacts the life quality of the population and Russian energy security. This is why the country's economy in general will benefit from the implementation of the analyzed measures to support competitive mechanisms.

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