

# NATURAL MONOPOLIES IN THE ENERGY SECTOR OF THE ECONOMY: LEGAL ISSUES OF REFORMATION

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*The market relations based on competition laws established during the last quarter of the century and the accumulated experience inevitably require the elaboration of new development plans and the adjustment of the existing legal regulation. The introduction of some exceptions in the laws stipulates specific further “recalibration” of the basic as well as special regulation. The Energy Strategy of Russia until 2035 defining the aims, priorities and areas of the development of the power industry of the Russian Federation emphasizes the need for a structural diversification within which the significance of liquefied natural gas will be raised, the carbon-based power industry will be supplemented with the non-carbon-based one, the decentralized power supply will be added to the centralized one. The discussed plans of the competition development in Russia are still not widespread beyond the Strategy. The review of the list of natural monopolies in the power industry makes it obvious that their current essential reformation aiming at demonopolization is highly improbable due to their technical and economic characteristics. Thus, it appears that in the near future, taking into account the established technical and economic conditions in which natural monopolies exist, the adjustment of their operations in terms of securing market conditions can be connected with the adjustment of the regulation of the tariff setting mechanism and the legal “localization” of the non-discrimination principle in relation to the operations of specific natural monopolies.*

**Keywords:** energy law, legal position of natural monopolies in the power industry, antimonopoly regulation, tariff regulation, gas infrastructure expansion.

The development of the market economy in Russia is constantly facing with the problems of the establishment of new legal regulation institutions, which primarily refers to the digital economy sector and at

the same time is facing with the necessity to adjust the basic legal regulation branches created in the early days of the establishment of the market relations. The latter includes the issue of the regulation of operations of natural

monopolies in the power industry in terms of competition law. The underlying act on natural monopolies applicable, *inter alia*, in the energy sector is Federal Law No. 147 of August 17, 1995, *On Natural Monopolies*. Such a quick adoption of the law on natural monopolies may seem rather strange in the country, where the legal system has been based on non-market relations for almost eighty years, and where the establishment of a new economic model has just started. The adoption of Federal Law No. 147 *On Natural Monopolies* essentially meant the introduction of specific restrictions and/or a special regime for the application of the law on competition being a fundamental legal ground for building the Russian market economy. At first glance, the law on natural monopolies may seem premature provided that there is no experience of application of basic laws ensuring the existence of a competitive environment. However, the adoption thereof in the Russian Federation is quite understandable. The Russian legislator tried to take into account the existing foreign experience, primarily, the experience of the USA and the European Union. The rules for the regulation of natural monopolies in these countries emerged out of the general antimonopoly regulation based on the Sherman Act of 1890 and the Clayton Act of 1914 in the USA, [1] and Article 82 of the Treaty of Rome. [2]

Judging from the comparative law standpoint, one may conclude that the USA and the EU courts, relying on the said acts that have established the general principles of unacceptability of market monopolization, taking into account the differences between the American case law and the European judicial practice, have cultivated the admissibility of the existence and operation of natural monopolies. According to the estimation of foreign experts, the modern approach to the determination of natural monopolies was worded by William J. Baumol in the second half of the 1970s. According to the general rule, a natural monopoly is the sole company in a branch where one company can manufacture goods to satisfy the market demand at a lower cost per unit than two or more companies, or is a particular branch is avoided by or impossible to survive for other players. [3]

Based on the approaches tested by the foreign practice, there are grounds to word the national principles of acknowledgment of admissibility of natural monopolies considering the obvious economic, political, and legal peculiarities of Russia. They are rooted in the Soviet period when a number of branches of the economy including the power industry were initially built with a focus on centralization in terms of management and attraction of financing. This primarily refers to the power supply industry. The idea of the utmost centralization of production is manifested in the nuclear industry. Later on, the pipeline transport has become a program development vector for the hydrocarbon sector.

Referring of the mentioned activity sectors to the special regulation fitted quite nicely into the economic and ideological system of the Soviet state and satisfied the demands of the economy from the technical standpoint. Thus, various monopolies have naturally formed in Russia by the time of shift to the new economy.

The establishment of competition-based market relations has shown that some monopolies could be reformed technically and institutionally based on the competition laws, but a number of structures including the ones in the power industry could not be reformed for technical and institutional reasons without a considerable loss in the economic efficiency. Such circumstances required special regulation. In these conditions, the legislator has opted for legalization of their status by declaring them “natural monopolies”. By 1995, this legal institution and term have become universally accepted in the majority of countries and adequately translated into different languages. However, the difference of the situation in Russia from the position of the legal regulation tasks was the fact that the legislator rather willfully defined the list of natural monopolies, where the energy ones included the entities and operations of oil and petroleum product transportation using main pipelines, gas transportation using pipelines, electric energy transfer services and heat energy transfer services, than determined the admissible grounds for legalization of particular monopolies.

The market relations based on competition laws established during the last quarter of the century and the accumulated experience inevitably require the elaboration of new development plans and the adjustment of the existing legal regulation. The introduction of some exceptions in the laws provides for a specific further “recalibration” of both the underlying and special regulation. It is no coincidence that peculiarities of the legal position of natural monopoly subjects in the power industry are reviewed as a separate course within the energy law study, while the challenging aspects of the legal regulation of relationships involving natural monopolies become a subject of legal research. [4]

The Energy Strategy of the Russian Federation approved by Order of the Government of the Russian Federation No. 1523-p of June 9, 2020, is based on the fact that “...The energy infrastructure of the Russian Federation based on the Single Energy System of Russia, the Single Gas Supply System, the system of main pipelines for oil and petroleum product transportation is one of the longest in the world and functions in different natural and climatic conditions from the arctic to the subtropical zone”. At the same time the Strategy defining the aims, priorities and areas of the development of the power industry of the Russian Federation emphasizes the need for a structural diversification where the significance of liquefied natural gas will be raised, the carbon-based power industry will be supplemented with the non-carbon-based one, the decentralized power supply will be added to the centralized one.

The discussed plans of the competition development in Russia are still not widespread beyond the Strategy. The general question that remains unanswered is what natural monopolies can already be reformed, what “legal instruments” are needed and in what legal acts the corresponding amendments should be introduced.

The review of the list of natural monopolies in the power industry makes it obvious that their current essential reformation aimed at demonopolization is highly improbable due to their technical and economic characteristics. These two factors are unbiased.

They may lose their natural monopoly attributes in the event of the origination of technical and economic opportunities that are reasonable and convenient for a consumer, in particular, alternative types and means of supply of the corresponding energy resources. The present day alternative delivery means of, for example, hydrocarbons are to such an extent different from the pipeline transportation that they can highly unlikely be viewed as competitors. [5].

Thus, in the current review of the natural monopoly reformation expediency, it should be taken into account that the subject of energy relations mentioned in the Law cannot have a reasonable alternative for the time being. Consequently, the reformation subject should not be a transformation of a natural monopolist into an ordinary market player, but optimization of its operations primarily for the consumer’s benefit. As a matter of fact, this article should dwell on amendments to the laws regulating the relations between natural monopolies and other energy market players.

Such regulation, contained primarily in by-laws, covers three groups of issues while preserving peculiarities for each of the power industry spheres: firstly, securing a non-discriminatory access to natural monopoly services; secondly, pricing and tariff regulation, information support of the market; thirdly, support of industrial standards and antimonopoly control. The third group refers to the public law regulation sector ensuring state regulation of specific power industry spheres.

The peculiarity of the first two groups lies in the fact that they are imperative instructions regulating the civil law relations between market players in a particular way. The price determination or the price determination procedure in the routine stream of commerce is a material contractual term, and the inadmissibility of any discriminations is an integral part of the institution of contractual freedom. In the conditions of a market free from monopoly, market players are at liberty to choose contractors as well as determine and approve a competitive price. The issues of securing the right to access services and goods and price approval become the burden

of consumers, rather than the regulator, in case of absence of any possible competition in a situation of a legally acknowledged natural monopoly of a specific economic entity. The Federal Antimonopoly Service of the Russian Federation performs the functions of the regulator in respect of all natural monopolies, but the price and tariff establishment mechanism has some peculiar features provided in different independent government decrees.

Thus, the following acts are in place in the power industry: Decree of the Government of the Russian Federation No. 861 of December 27, 2004, *On the Approval of the Rules for a Non-Discriminatory Access to Electric Power Transfer Services and Rendering of Such Services, the Rules for a Non-Discriminatory Access to Supervisory Control Services in the Power Industry and Rendering of Such Services, the Rules for a Non-Discriminatory Access to Services of an Administrator of a Wholesale Market Trading System and Rendering of Such Services, and the Rules for Technological Connection to Electric Power Networks of Power Receiving Devices of Electric Power Consumers, Electric Power Generation Facilities and Power Supply Network Objects Owned by Network Organizations and Other Persons*; and Decree of the Government of the Russian Federation No. 1178 of December 29, 2011, *On Pricing in the Field of Regulated Prices (Tariffs) in the Power Industry*.

The following acts should be singled out in the hydrocarbon power industry: Decree of the Government of the Russian Federation No. 980 of December 29, 2007, *On the State Regulation of Tariffs for Oil and Petroleum Product Transportation Services of Natural Monopoly Subjects*.

Regulation of the issues of **unacceptability of failure** is built on similar principles.

Decree of the Government of the Russian Federation No. 854 of December 27, 2004, (as amended on December 8, 2018) *On the Approval of the Rules for the Supervisory Control in the Power Industry* and Decree of the Government of the Russian Federation No. 1164 of December 17, 2013 (as amended on June 7, 2017) *On the Approval of the Rules for the Antimonopoly Regulation and Control in the Power Industry* are in place in the power industry.

The following acts should be singled out in respect of natural monopolies operating in the hydrocarbon power industry: Decree of the Government of the Russian Federation No. 90 of February 17, 2011, *On the Procedure for Connection of Oil Extraction Facilities to Main Oil Pipelines in the Russian Federation and Accounting of Oil Extracting Business Enterprises*; Decree of the Government of the Russian Federation No. 218 of March 29, 2011, *On Securing a Non-Discriminatory Access to Oil (Petroleum Product) Transportation Services of Natural Monopoly Subject Using Main Pipelines of the Russian Federation and the Annulment of Certain Acts of the Government of the Russian Federation*.

Thus, it appears that in the near future, taking into account the established technical and economic conditions in which natural monopolies exist, the adjustment of their operations in terms of securing market conditions can be connected to the adjustment of the regulation of the tariff setting mechanism and the legal “localization” of the non-discrimination principle in relation to the operations of specific natural monopolies.

Changes in pricing and tariff setting can be made by introduction of the corresponding amendments and supplements to civil laws and statutory acts establishing the Regulator’s competence as to the above issues. The rights of the Regulator and natural monopoly subjects should be guaranteed not only by judicial protection but also by the opportunity to refer to pre-trial mechanisms of solution of the arising disagreements.

The issue of the legal regulation of the gas infrastructure expansion to Russian consumers deserves special attention. V.V. Romanova notes that there are some gaps in the legal regulation of the gas infrastructure expansion, no clarity in the determination of the legal position of parties to the gas infrastructure expansion relationships or the procedure for their interaction, etc. [6] It should be kept in mind that the adopted gas infrastructure expansion programs have a chance to be successful if there is adequate legal regulation securing the consumer’s right to get connected to the existing gas supply network, and the right of a natural monopoly to act under an established fair tariff.

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