ORDINANCE ON REGULATING THE PRICES OF NATURAL GAS

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CHAPTER ONE

GENERAL PROVISIONS

Article 1. (1) This ordinance determines the methods of regulating the natural gas prices, the rules for their formation or setting and modification, the rules for provision of information, for submission of rate applications and for approval of prices.

(2) The ordinance sets the mechanisms for compensating the costs incurred to meet the public obligations under the Energy Law.

Article 2. The following prices are regulated as per the procedure of this ordinance:

1. the prices of natural gas sold by the Public Provider to gas distribution companies, Public Retailers and large consumers connected to the transmission network;
2. the prices of natural gas sold by Public Retailers to captive consumers or to other Public Retailers;
3. the prices for natural gas transfer over the gas transmission network;
4. the prices for natural gas transfer over the gas distribution networks;
5. the prices for natural gas storage;
6. the prices for connection to the gas transmission network;
7. the prices for connection to the gas distribution networks.

Article 3. For fulfillment of its authorities related to price regulation the State Commission for Energy Regulation (the Commission) carries out regular regulatory reviews which include:

1. analysis and assessment of reported and forecast information provided by the energy companies;
2. approval of estimated revenue requirements of the energy company, including economically justifiable costs of the licensed activity and rate of return on capital;
3. approval of prices based on forecast quantities;
4. in the cases of regulation under Art. 4, para. 1, sub-paragraph 2 – setting the duration of the regulatory period and the values of the factors, on the basis of which the prices are changed during the regulatory period.

Article 4. (1) The Commission applies the following basic methods of price regulation:

1. “The rate of return on capital” (“cost-plus”) price regulation, where the Commission approves prices and monitors on an ongoing basis the actual values of the revenue requirements of the energy company and their components. The regulatory review is not shorter than one year. Follow-up regulatory review is carried out at the initiative of the Commission or of an energy company in case of substantial deviations between

approved and actual costs and/or return. In the course of the regulatory period, the prices may be changed due to circumstances which could not have been foreseen at the time of approval of the prices.

2. “Net present value” price regulation, where the energy company sets an uniform price or prices for each year of the regulatory period, equal to the period for which the Commission has approved the respective company’s investment program. Prices are adjusted on annual bases depending on the difference between forecasted and actual sales of natural gas and forecasted and actual implementation of the respective investment programs.
3. Incentive-based regulation, where the regulatory period is from two to five years:
   a) The “price cap” regulation, where the Commission approves prices of the energy company for the first year of the regulatory period and adjusts them at the end of every year of the regulatory period by an inflation factor, from which is deducted an efficiency improvement factor for the energy company according to the following formula:

$$P_t = P_{(t-1)} \times (1 + I - X)_t ;$$

where:

P are prices for the first year of the regulatory period;

I inflation index for a prior period, which influences the costs of the company;

t the rate period /time index/;

X efficiency improvement factor;

   b) The “revenue cap”, where the Commission sets annual revenue requirements for the energy company for the first year of the regulatory period and adjusts these at the end of every year of the regulatory period by an inflation factor, from which is deducted an efficiency improvement factor for the energy company, and by differences between estimated and actual indicators for prior rate periods, such as changes in the natural gas sales, number of consumers, costs of purchased natural gas according to the following formula:

$$R_{ev_t} R = R_{ev_{(t-1)}} R \times (1 + I - X)_t \pm Z ;$$

where:

$R_{ev}R$ are the annual revenue requirements of the energy company;

I inflation for a prior period that influences the costs;

t the rate period;

X efficiency improvement factor;

Z differences between estimated and actual indicators.

(2) In addition to the methods under paragraph 1, the Commission applies performance based indicators (quality of energy, quality of service), where the recognized revenue requirements

of the energy company are linked with achievement of targets set by the Commission. Revenues, respectively prices, thus set are based upon the achievement of indicators, beyond those related to the cost of service provided by the energy company.

Article 5. (1) The accounting of the energy companies is carried out and the financial statements are drawn up in line with the provisions of the Accountancy Act and the applicable accounting standards.

(2) For the purposes of regulation, the energy companies maintain accounting in accordance with Article 37 of the Energy Law.

(3) The accounting rules for regulatory purposes are adopted with a decision of the Commission.

(4) The rules under paragraph 3 constitute a Uniform System of Accounts (USOA) for regulatory purposes which ensure standardized approach in the accounting system of the energy companies.

(5) The format and contents of financial statements are an integral part of the USOA.

(6) The energy companies apply USOA through a Chart of Accounts adopted by the Commission.

(7) The financial statements for regulatory purposes are accompanied by reports and additional information as to demonstrate compliance with all provisions of this ordinance and with performance indicators relating to the quality of service.

(8) The Commission issues mandatory guidelines about the format and contents of the information needed for pricing purposes.

(9) The rules under para. 3,6 and 7 are amended at the initiative of the Commission or upon proposal of the energy companies.

(10) The rules are to be applied as from the beginning of the calendar year which follows the date of their adoption or their amendment.

Article 6. (1) The Commission may approve the prices of natural gas by components:

1. commodity charge in BGN per 1000 standard cubic meters natural gas;
2. capacity charge in BGN per hourly maximum delivery of natural;
3. delivery/supply charge in BGN per consumer.

(2) The prices for connection to the networks may be indicated in leva per one connection or per connected customer.

(3) The energy companies are allowed to negotiate, propose and apply prices lower than the prices approved or prices determined by the Commission provided that this does not result in cross subsidization.

Article.7 (1) The Commission sets indicators for quality of energy and quality of service for each licensed activity and their annual target levels.

(2) The indicators for quality of energy and quality of service are elements of the license.

(3) For the purposes of price regulation, achievement of each of the target indicators is a measurement for the overall performance of the licensed activities by the energy company.

Article 8. (1) The Commission adjusts the revenue requirements of the energy company for every rate period within the regulatory period depending on the performance against the indicators for quality of energy and quality of service during the preceding year.

(2) If for a given rate period the energy company's average energy and service quality performance falls short of the target indicators, the corresponding performance level is reflected as reduction of the revenue requirements for the next rate period.

CHAPTER TWO

FORMATION OF PRICES

SECTION I

PRICE FORMING ELEMENTS

Article 9. (1) The annual revenue requirements for the respective licensed activity include costs subject to approval by the Commission, and a return on the invested capital, and are calculated according to the following formula:

$$R_{ev}R = C + (RAB \times RR_c);$$

where:

$R_{ev}R$ are the annual revenue requirements;

C the allowed annual costs of operation for the licensed activity;

RAB the Regulatory Asset Base;

RR_c the rate of return on capital for the regulatory period.

Article 10. (1) The types of costs, which are directly connected to the licensed activity and may be included in the revenue requirements, are determined according to the rules under Article 5.

(2) The allowed level of costs under para. 1 is approved by the Commission.

(3) The Commission requires that the energy company submits a justification of all or some of the costs, as well as of the relevance of these costs to the performance of license conditions.

(4) The prices could include costs resulting from meeting public service obligations including those related to security of supply.

(5) For the purposes of price regulation, the Commission will not allow the recovery of the following costs in rates:

1. costs related to natural gas sales to eligible consumers;
2. costs not related to the performance of licensed activity;
3. costs which the Commission reasonably considers as not in the best interest of the consumers, or those that are not needed for performance of the licensed activity;
4. costs related to the transit of natural gas;
5. taxes paid in relation to the corporate income taxation of profit.
6. penalties and/or fines imposed by governmental bodies or by the Commission, as well as interest for deferment, default and other payments related to non-performance under concluded contracts.

Article 11. (1) The costs of the energy companies recognized by the Commission resulting from imposed public service obligations are recovered through the prices for all consumers.

(2) The total level of costs recognized by the Commission, that are related to public service obligations are included with their respective share into the annual revenue requirements of the energy companies providing natural gas transmission and distribution services.

(3) The costs under para. 2 are recovered as part of the cost of service by all consumers of natural gas based upon their metered consumption.

(4) If the actual revenues of an energy company are different than the forecast level of revenues to cover the costs related to public service obligations, the difference is reflected into the allowed revenue requirements of the energy company for the following year.

Article 12. (1) The regulatory asset base (RAB) for the assets which are directly related to the licensed activity is the recognized value of the assets on which the energy company earns return on its invested capital. The RAB is calculated according to the following formula:

$$RAB = A - CG - D + WC + INV;$$

where:

RAB the Regulatory Asset Base;

A the recognized value of used and useful assets;

CG the value of assets acquired through gratuitous transfer or constructed with resources of users;

D the accumulated depreciation for the past period of asset used to perform the licensed activity;

WC the working capital requirement;

INV the forecast average nominal amount of investments approved by the Commission, which will be invested during the regulatory period, in the cases of regulation under Article 4, para. 1. item.3.

Article 13. (1) The rate of return on capital for the regulatory period is equal to the estimated weighted average cost of capital (WACC). The WACC is the approved rate of return on debt and on equity for the energy company, weighted according to the share of each of these financing sources in the approved target capital structure.

(2) The rate of return on capital is estimated on a real, pre-tax basis from the following formula:

$$RR = C_{EP} \times \left(\frac{RR_{EQ}}{1 - \frac{TR}{100}} \right) + C_{DP} \times RR_{D}$$

where:

RR is the rate of return on capital, before taxation;

C_{EP} the equity portion of capital;

RR_{EQ} the rate of return on equity, after taxation;

TR % the corporate profit tax rate in compliance with the Corporate Income Tax Act, %;

C_{DP} the debt portion of capital;

RR_D is the rate of return on debt;

SECTION II

ALLOCATION OF REVENUE REQUIREMENTS BY CONSUMER GROUPS

Article 14. (1) The energy company proposes to the Commission for approval the consumer groups separated into similar patterns of consumption and/or by other characteristics.

(2) The prices for each separate consumer group may be different if justified by the cost-of-service study.

Article 15. (1) The prices for the initial pricing period are initial prices and are based upon the cost-of-service study presented by the energy company where the costs are justifiably allocated to each consumer group.

(2) The initial prices for transfer of natural gas over the transmission and distribution networks are formed based upon justified allocation of costs to each consumer group. The level of technological costs approved by the Commission is included in the cost of service.

Article 16. (1) The tariff prices are designed to reflect the costs of providing the service by the energy company.

(2) The tariff prices may include components: a commodity charge, a capacity charge and a charge for delivery or for supply.

(3) The energy company demonstrates in its tariff filing that each of the price components is justified and can be properly accounted for in the calculation of the final prices.

SECTION III

FORMATION OF PRICES

Article 17. (1) The prices of natural gas when sold by the Public Supplier to the Public Retailers and to captive customers connected to the transmission network are based upon the annual revenue requirements in accordance with Article 9 and upon the cost of service pursuant to Article 15.

(2) The prices may include the components: a capacity charge, a commodity charge and a charge for delivery.

(3) The price of natural gas at the entrance of the gas transmission network shall be formed by the Public Supplier as the average weighted value on the basis of quantities of natural gas requested for the following quarterly period from imports and from local extraction companies and their respective prices.

(4) The periodical adjustments of the price of natural gas under para. 3 reflects the conditions set in the trade agreements under which the Public Supplier purchases natural gas for the domestic market.

Article 18. (1) The price for the transmission service is based upon the annual revenue requirements in accordance with Article 9 and upon the cost of service pursuant to Article 15.

(2) Revenues from natural gas storage for the needs of the transmission company are allocated to the revenue requirements for the transmission of natural gas activity.

(3) The price may include the components: a capacity charge and a commodity charge.

(4) The transmission company is allowed to recover, through the transmission price, the approved level of technological costs associated with natural gas transmission.

Article 19. (1) The prices of natural gas when sold by a Public Supplier to captive customers connected to the distribution networks or public retailers are based upon the annual revenue requirements in accordance with Article 9 and upon the cost of service pursuant to Article 15.

(2) The prices may include the components: a capacity charge, a commodity charge and a charge for supply.

Article 20. (1) The price for distribution of natural gas over the distribution network is based upon the annual revenue requirements in accordance with Article 9 and upon the cost of service pursuant to Article 15.

(2) The price may include the components: a capacity charge and a commodity charge.

(3) The Natural Gas Distribution Companies are allowed to recover, through the price for natural gas distribution, the levels of technological costs determined by the Commission for the respective distribution network.

Article 21. The prices under Articles 17 and 19 are adjusted every calendar quarter in line with the changes in the natural gas purchase prices.

Article 22. The price of storage is determined on the basis of annual revenue requirements in accordance with Article 9.

Article 23. (1) The price of storage is based upon the share of annual revenue from storage on contracts with customers in accordance with Article 15.

(2) The operator of the gas storage facility may determine uniform annual prices for storage.

Article 24. (1) The price for connection of consumers is determined by consumers groups depending on the requested maximum capacity and pressure level and the respective recognized costs for the group. The costs of additional equipment for connection at the request of the consumer are at his own expense.

(2) The prices for connection of a storage company, an extraction company or a distribution company to the network of the transmission company are individual and include the actual costs for building the facilities for connection to the network of the respective company.

CHAPTER THREE

PROCEDURE FOR SUBMISSION OF PROPOSALS FOR APPROVAL OF PRICES. PRICE APPROVAL, DETERMINATION AND CHANGING

Article 25. (1) The energy companies submit applications to the Commission in approved Sample Formats for approval of:

1. revenue requirements and prices, along with any related indicators and factors for their adjustment during the regulatory period;
2. change in the rate structure;
3. change in prices currently in effect;
4. other issues related to the Commission's authority in relation to price regulation.

(2) The applications under para. 1 are to be submitted not later than four months prior to expiry of the old rate period or coming into effect of the proposed change of enforced prices and/or tariff structures.

(3) The transmission company submits to the Commission proposals for prices in accordance with the changes of natural gas prices at the point of entry into the transmission network 20 days before the end of the period stipulated in art. 17, para. 4.

(4) An energy company for which the Commission applies "rate of return on capital" method of regulation is allowed to file in application for changing the approved prices before expiry of a rate period in which substantial increase of the estimated costs could not have been

foreseen at the time of approval of prices. The Commission with its decision on the respective application decides whether the circumstances or changing the price are there or not.

(5) When during the ongoing monitoring of current actual revenue requirements for the energy company the Commission identifies circumstances as stipulated in paragraph 3, it may issue instructions for the company to apply for changing the approved prices. If the company fails to follow the instructions, the Commission may change these prices by authority of its office.

(6) In case that the prices changed according to paragraph 5 impact the prices of other energy companies, the Commission may issue instructions to these companies to file an application for change of their approved prices. Upon non-fulfillment of the instructions, the Commission may change these prices ex officio.

Article 26. (1) The application and its attachments contain information about a 12-month reporting period referred to as test year for the purpose of reviewing all cost and revenue elements relevant to the setting of their respective levels for the next regulatory or rate period.

(2) The following documents are attached to the application:

1. audited certified financial statement with all its attachments, in line with the requirements of the Accountancy Act and the applicable Accounting Standards;
2. financial-accounting information for the test year, in accordance with Article 5, paras. 5, 7 and 8 for the test year;
3. technical-economic data, including monthly reports for the sales during the test year, as well as any other information related to the prices proposed for approval, which is required in accordance with Article 5, para. 8.
4. information by consumer groups for the test year, including number of consumers, energy sales, revenues and billing information;
5. other data considered relevant by the energy company in support to the submitted application or requested by the Commission;
6. a document for a paid fee for examination of the application.

(3) An energy company is allowed to adjust and submit separately, with justification, known and measurable cost and revenue elements from the test year, where the justification includes financial data and data about the activity. Each adjustment in the test year data must be supported by information which proves the need for the adjustment and may include:

1. new assets that will be useful and commissioned during the next rate period;
2. increase of the forecast number of consumers, which will result in extra costs for provision of the service;
3. increases of costs, which have not been accounted for in the test year;
4. changes in payables to the state (fees, taxes, etc.), which result in changes in the levels of costs or rate of return;
5. normalization of sales from the test year, for which extraordinary meteorological conditions have occurred, whenever these conditions have had an effect on the natural gas sales;
6. covering differences between forecast and actual directly pass-through costs from the previous period.

(4) The documents under the preceding paragraph are submitted to the Commission on paper media, signed and sealed by the energy company. The information under para. 2, sub-paragraphs 2, 3 and 4 is provided in electronic format as well.

Article 27. (1) Within one month before submitting the application to the Commission, the energy company will announce in the mass media its proposal for new prices or for a change of existing prices.

Article 28. (1) The Commission sets a date for holding an open session for discussion of the application for prices within 2 months after completing the examination of the application and announces it on its Web page and through a press release to mass media.

(2) Along with the announcement under the preceding paragraph, the Commission publishes the application along with a report regarding the case file by the respective official.

Article 29. Within 10 days as from the date of the open session, the Commission holds a closed session to approve the draft decision on the application and make a decision for implementing a public discussion under Article 14 of the Energy Act.

Article 30. (1) The draft decision includes:

1. the duration of the regulatory period for price cap or revenue cap regulation or net present value;
2. the revenue requirements;
3. the efficiency factor;
4. the value of the regulatory asset base for regulatory purposes;
5. the allowed rate of return on capital;
6. the consumer groups;
7. the tariff structure;
8. the tariff prices.

Article 31. Implementation of the procedure under Article 14 of the Energy Act starts by announcing the draft decision on the Web page of the Commission and through a press release to mass media.

Article 32. (1) After completion of the procedure for public discussion at a closed session, the Commission makes a justified decision.

(2) The decision is handed over to the applicant and is published on the Web page and in the bulletin of the Commission.

(3) The energy companies publish the approved prices in one central and/or one local daily newspaper within 7 days after receiving the decision of their approval by the Commission.

(4) The new prices take effect for the next month, unless a change in tariff structure is required. When the Commission makes a decision for a change in tariff structure, through its application the energy company may request setting a later date for the new set of tariffs to take effect. In this case, with its decision the Commission determines the date for commencing with the new tariff structure.

ADDITIONAL PROVISION

§ 1. Within the meaning of this ordinance:

1. “Test Year” is the preceding calendar year or a twelve-month period that precedes the application submission for which the energy company provides information about the licensed service and which is used as the basis to set rates.
2. “Rate of Return on invested capital” is the regulatory asset base multiplied by the rate of return on capital for the regulatory period.

3. “Efficiency improvement factor” is a target set by the Commission for improvement of the energy company efficiency.

4. “Cubic meter natural gas” is the quantity of natural gas contained in one cubic meter at temperature 20 C and pressure 101 325 Pa.

5. “Capacity” is projected or declared value of maximum consumption of natural gas for a unit of time.

6. “Revenue Requirements” is the revenue level required by the energy company to supply a specified level of service and earn an allowed rate of return.

7. “Rate of Return on capital” is return on invested capital, expressed as a percentage of that capital.

8. “Cost of Service Study” is a study of the costs of the energy company in providing the regulated services by consumer groups, in relation to the actual or estimated revenues collected from each consumer group under existing or proposed rates.

9. “Useful life” is the term, for which the Commission assumes that a given asset can be depreciated.

10 “Connection” includes all the activities, gas pipelines and equipment in compliance with the legal and technological requirements, ensuring direct connection from a technologically approved point of access to the exit of the managing/measuring device, used by a single customer or a group of customers.

11. “Regulatory Asset Base” is the value of the tangible and intangible assets that are both used and useful for the provision of the services within the licensed activities.

12. “Regulatory Period” is the period between two regulatory reviews.

13. “Capital Structure” is the proportion of relative shares of equity and debt in the capitalization of the energy company.

14. “Tariff structure” is a system of prices for sale of natural gas or for provision of service, the revenues from which correspond to the revenue requirements for the respective activity.

15. “Tariff price” is each individual price in the tariff structure.

16. “Charge for delivery or supply” is the price which reflects the costs of natural gas meter reading, billing and collection.

17. “Rate Period” is the period throughout which the rates remain unchanged by the Commission – usually a calendar year.

TRANSITIONAL AND FINAL PROVISIONS

§ 2. Upon entry into force of the Ordinance for the prices of transmission companies incl. the activities: transmission, distribution and storage of natural gas the “rate of return on capital” method of regulation is applied and for the distribution companies – the “net present value” method of regulation is applied.

§ 3. The Commission will adopt the unbundling accounting rules under Article 37, para 2 of the Energy Act within six months after entry into force of the Ordinance.

§ 4.The ordinance is adopted on the grounds of Article 36, para. 3 of the Energy Act.