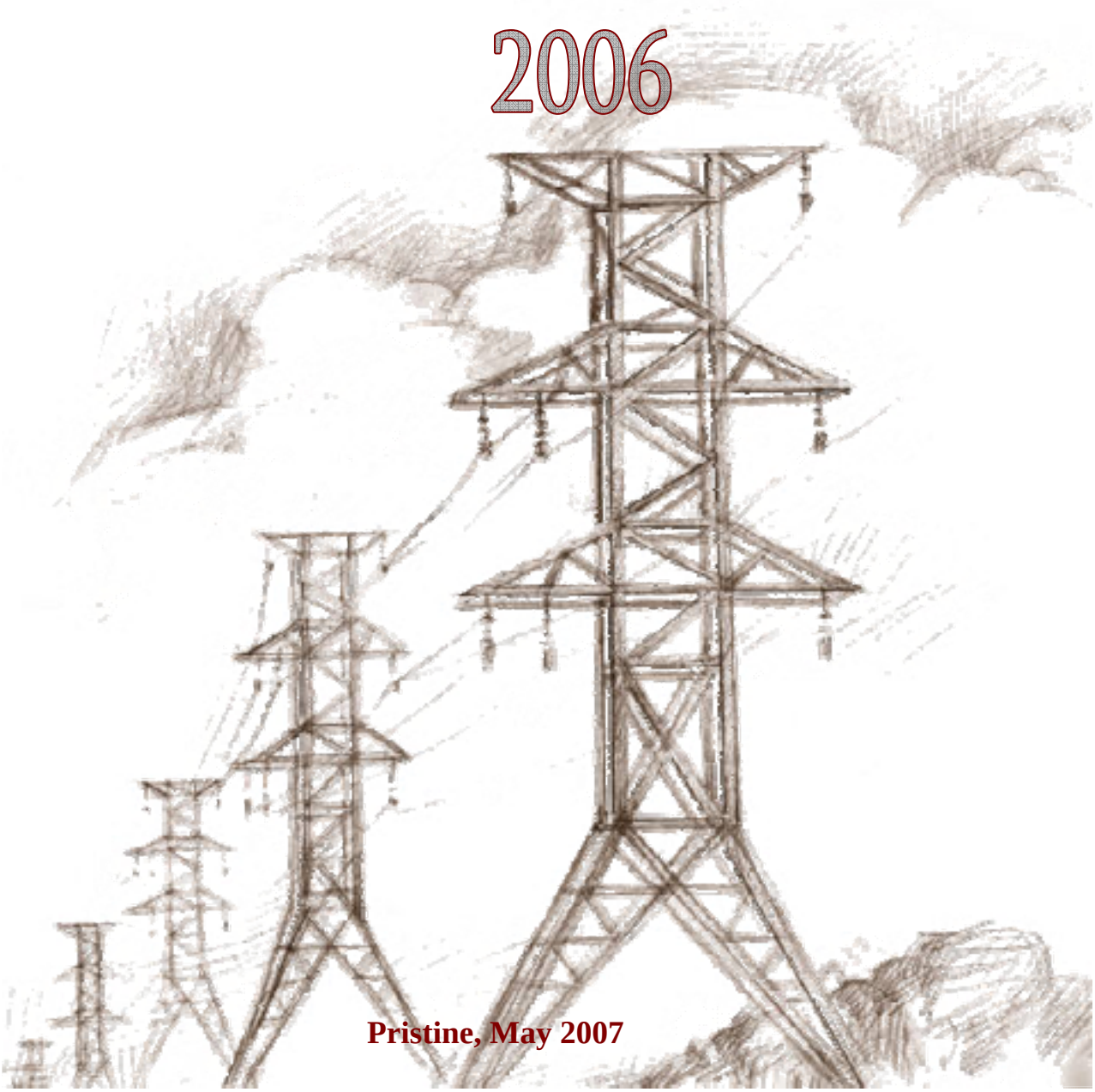
Energy Regulatory Office
Zyra e Rregullatorit per Energji
Regulatorni Ured za Energiju

Hamdi Mramori Street No 1, Prishtina – Kosovo
Tel: +381 (0)38 247 615 ext. 101, Fax: +381 (0) 38 247 620 E-mail: info@ero-ks.org
www.ero-ks.org

ANNUAL REPORT

2006



Pristine, May 2007

FOREWORD BY THE CHAIRMAN

It is with pleasure that i present the annual report of the Energy Regulatory Office (ERO) which includes 2006 fiscal year to the Assembly of Kosovo.
This is the third consecutive report made by ERO. As an independent agency ERO regulates and oversees key operating functions of enterprises within the energy sector, such as: electricity, gas and central heating.

ERO activities for 2006 were supported by the Kosovo Consolidated Budget, UNMIK Pillar IV and energy enterprises regulated through annual taxes and charges. Henceforth, operational costs shall be entirely paid by the users and benefiters of ERO services and not by the taxpayers.

Foreign consultancies for the development of certain projects and increasing staff capacities were financed by donors.

2006 was an important year for the Energy Market in Kosovo. Activities were accelerated on all fronts for the creation of conditions and a suitable environment for an open and competitive energy market that would attract the best investors to become involved in this sector, all this pursuant to the European Energy Directives and Treaty for the Energy Community of South-East Europe which was also signed by Kosovo.

During 2006 the unbundling of KEK and the creation of an independent Transmission System Operator (KOSTT) occurred. Grid and Metering Codes and interim Market Rules were approved. 25 Licenses were issued to national and international energy enterprises active in the electricity and district heating sectors of Kosovo. One of the most important activities was the undertaking of the first Price Review in the Electricity Sector which absorbed ERO's main efforts for the best part of 2006 and which resulted in designing the first truly unbundled tariffs for electricity in Kosovo.

In the same year, Kosovo published an international tender for the opening of a new lignite mine as well as for building a new power generating capacity of up to 2100 MW. This shall be one of the newest investments in generation in all of SEE region, a region this that already began experiencing a very hard energy supply situation.

It is with pleasure that I report that, in all these developments, ERO played an important role by developing and approving mechanisms and codes for the energy market, by performing Public Consultations, by monitoring Licensed Enterprises and by approving incentive based tariffs for the sectors of energy and central heating.

At the beginning of 2007, the transfer of responsibilities from ERO to the locals was completed with the successful completion of the first ERO Chairman term according to the provisions of energy sector legislation.

I would like to thank all of my colleagues for their endeavors and steadfast commitment to successfully meet their enormous responsibilities and obligations. It is with regret that I have to mention that at the beginning of 2007 ERO lost some of its best professional staff due to some misunderstandings regarding the budget and salaries. Otherwise, ERO has a healthy budget which shall enable the fulfillment of the business plan, therefore, I believe that this difficulty may be addressed and overcome with the Assembly of Kosovo so that ERO would have the possibility to hire better human resources.

ERO supports its works on the good and trustworthy cooperation of all energy sector stakeholders: consumers, organizations, enterprises and authorities, and it remains dedicated to protect the economic wellbeing of energy consumers in Kosovo by providing a healthy, competitive and efficient energy industry.

Regards,

Dr. Ali Hamiti

Chairman of ERO Board

LIST OF CONTENTS

LIST OF FIGURES AND TABLES

Table 8.2. Total ERO expenses for the year 2006 in percentage

LIST OF ABBREVIATIONS

ANRE	Autoritatea Nationala de Reglemantare in domeniul Energei (Romanian Energy Regulatory Authority)
ANMR	Agency of the Republic of Kazakhstan for Regulation of Natural Monopolies
ATC	Allocation Transfer Capacity
CLRP	Clean-up Land Reclamation Project
CPD	Customer Protection Department
CBT	Cross Border Trade
CEER	Council of European Energy Regulators
ČEZ	Electricity supply / Trade License Company (Czech Republic Company)
DH	District Heating
DHC	District Heating Company
DHU	District Heating Units
DNO	Distribution Network Operator
DSO	Distribution System Operator
EAR	European Agency for Reconstruction
EC	Energy Community
ECSEE	Energy Community in South East Europe
EFT	Energy Financing Team
EGL	Elektrizitats Gesellschaft Laufenburg
EMS	Elektro Mreža Srbije (Serbian Electricity Network)
EOI	Expression of Interest
ERC	Energy Regulatory Commission of the Republic of Macedonian
ERE	Enti Rregullator i Sektorit të Energjisë Elektrike (Albanian Electricity Regulatory Authority)
ERGEG	European Regulators Group for Electricity and Gas
ERO	Energy Regulatory Office
ERRA	Energy Regulators Regional Association
ESMS	Energy Supply and Market Structure
EU	European Union
FAO	Fiscal Affairs Office
GIS	Generation Investment Study
GWh	Giga Watt hour
HPP	Hydro Power Plant
HSE	Holding Slovenske Elektrane
IBRD	International Bank Reconstruction and Development
ICMM	Independent Commission of Mines and Minerals Board
IDA	International Development Association
IFC	International Finance Corporation (World Bank Group)
ITC	Inter-TSO Compensation
ITSMO	Independent Transmission System and Market Operator
JSC	Joint Stock Company
KCB	Kosovo Consolidated Budget
KEK	Korporata Energjetike e Kosovës (Power Corporation of Kosovo)
KESH	Korporata Energjetike e Shqipërisë (Power Corporation of Albania)
KOSTT	Kosova Operator System for Transmission and Trade
KTA	Kosovo Trust Agency

KW	Kilo Watt
KWh	Kilo Watt hour
LLD	Legal and License Department
LPTAP	Lignite Power Technical Assistance Project
LPTA	Lignite Power Technical Assistance
MEF	Ministry of Economics and Finance
MEM	Ministry of Energetic and Mining
MESP	Ministry of Environment and Spatial Planning
MIGA	Multilateral investment Guarantee Agency (World Bank Group)
MLSW	Ministry of Labor and Social Welfare
MO	Market Operator
MW	Mega Watt
MWh	Mega Watt hour
NARUC	National Association of Regulatory Utility Commissioners
NA	Not Applicable
OCGC	Operational Codes Governance Committee
OM	Operation Manual
PAD	Project Appraisal Document
PISG	Provisional Institutions of Self-Government
PMU	Public Municipal Utility
POE	Publicly Owned Enterprise
PPA	Power Purchase Agreement
RAB	Regulatory Asset Base
REBIS	Regional Balkans Infrastructure Study
RoR	Rate of Return
SEC	South East Europe Customer
SEE	South East Europe
SEEER	South East European Energy Regulators
SEETEC	Southern Europe Electrical System Technical support Project
SETSO	South East European Transmission System Operator
SO	System Operator
S.R.O	Electricity supply/Trade license company “EZPADA” (Czech Republic Company)
SW	South West
TA	Technical Assistance
TF	Task force
TUOS	Transmission Use of System
TPA	Third Party Access
TPP	Thermo Power Plant
TSO	Transmission System Operator
UCTE	Union for the Co-ordination of Transmission of Electricity
UNMIK	United Nations Interim Administration Mission in Kosovo
USAID	United States Agency for International Development
WACC	Weighted Average Cost of Capital
WRF	World Regulatory Forum

CHAPTER 1

REVIEW OF DEVELOPMENT IN THE POWER SECTOR DURING 2006

During 2006 the biggest achievement in the energy sector is undoubtedly the unbundling and incorporation of the independent Transmission System and Market Operator KOSTT, from the vertically integrated company, KEK.

KEK businesses currently encompass: lignite mines, generation of energy, distribution and supply.
KOSTT owns all transmission assets and responsibility for operation of system & market (in full compliance with the requirements of ECSEE Treaty).
With the conditions placed in the grid code the system operator plays an essential role in physical balancing, in accordance with the Market Rules. However, TSO uses these commercial rules for trading ancillary services, and in the capacity of agent it administers the mechanism of balancing where trade members (known as Trading Parties), trade balancing energy. The main role of Market Operator is the responsibility for organizing and administering energy trading, and financial settlement of payments to producers, suppliers and eligible consumers. It has also the capacity of "Owner" of Market Rules.

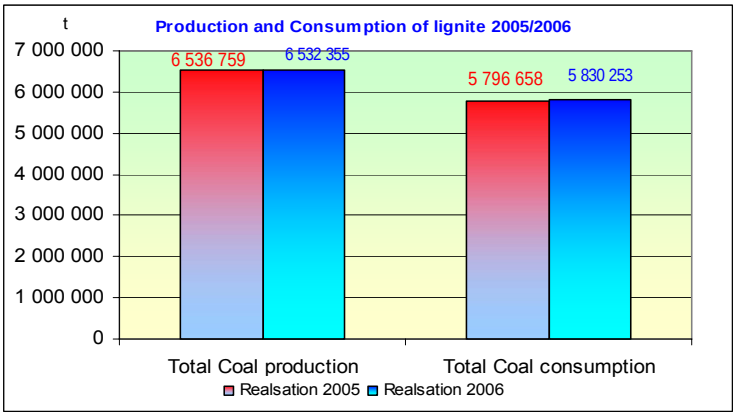
1.1 Lignite Mining

The main source of energy in Kosovo is lignite. 98% of Lignite mining is devoted to the production of electric energy in KEK, while the produced energy is 100% depending from the supply of lignite. The main resources of lignite are located in two big basins, named "Kosova" and "Dukagjini" with good quality of exploited reserves with low content of sulphur and good concentration of lime. Estimated exploitable lignite reserves are of 11-14 billion tons. For the moment two "open cast" mines of lignite are operational (Bardh and Mirash), which supply the generation units of electricity in KEK with 6.5 million tons in a year. Final estimates provide signals that until 2012 these mines will completely drain, due to a considered drop from the drag out since 2009. This issue is alarming and emphasizes the need for investment in a new lignite mine which should start functioning in 2009.
Financed by EAR, feasibility studies have been undertaken for a new mine in "SW Sibovc".
Since big investments are needed for this enterprise, efforts are put to find an investor from the private sector.

Table 1.1 Table as below presents production and consumption of lignite 2005/2006

Production & Consumption of Lignite	Realization 2005	Balance 2006	Realization 2006	Realiz/Balance 2006	Percentage 2006/2005
Total Coal production	6 536 759	7 100 000	6 532 355	92.01%	99.93%
Total Coal consumption	5 796 658	6 415 047	5 830 253	90.88%	100.58%

Figure 1.1 Production and consumption of lignite 2005/2006



1.2 Production and consumption of electricity

Production of electricity from KEK, as mentioned above is based completely on lignite and comprises approximately 98% of yearly production of electricity. The other part of production is covered from HPP "Ujmani" and "embedded plants" HPP "Lumbardhi" and "Radavci".

Table 1.2 Table below presents capacity data for thermo and hydro production units

Unit	Years of Construction	Designed Capacity	Operational Capacity	
			Gjenerator	System
A1	1962	65	35	32
A2	1964	125	-	-
A3	1970	200	135	120
A4	1971	200	135	120
A5	1975	210	115	110
TPP Kososva A		**800**	**420**	**382**
B1	1983	339	290	265
B2	1984	339	280	260
TPP Kososva B		**678**	**570**	**525**
J.S.C. Kosova Coal	1970	25 + 16		
HPP Ujmani	1981	2 * 17.5	35	35
HPP Lumbardhi	1957/2005	2 * 4.04	8.08	8.08

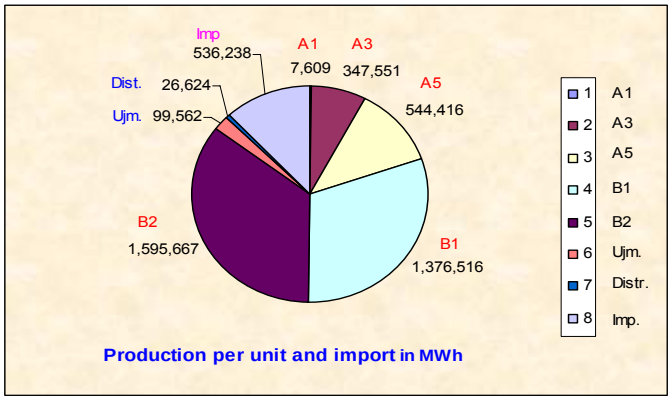
Total produced energy in 2006 is 3 996 GWh, almost equal with the produced energy in 2005. It has been achieved 95% of energy balance for 2006, which had a value of 4 200 GWh.

Table 1.3 Production of electricity comparing with the balance of 2006

Unit	Realization 2005	Balance 2006	Realization 2006	Realiz/Balance 2006
A1	64 542	0	7,609	0.00%
A3	- 2 775	384,468	347,551	90.40%
A4	- 1 167	0	-1,046	0.00%
A5	584 350	310,704	544,416	175.22%
TPP Kososva A	644 950	695,172	**898,529**	129.25%
B1	1 476 759	1,610,988	1,376,516	85.45%
B2	1 767 575	1,756,950	1,595,667	90.82%
TPP Kososva B	3 244 334	3,367,938	**2,972,182**	88.25%
J.S.C. Kosova Coal	778	25,000	0	0.00%
HPP Ujmani	109 682	88,000	99,562	113.14%
HPP Distributive	0	24,354	26,624	109.32%
Total Production	3,999,744	4,200,464	**3,996,897**	95.15%
Intake (Imp.+Exch.)	490 632	685,600	536,238	78.21%
Offtake (Exp.+Exch.)	225 965	210,700	252,527	119.85%

Note: Negative values for A3 and A4 are due to realization since these units had energy expenses for reparation

Figure 1.2 Production of electricity per unit and imports in MWh



Gross consumption has been realized in a value of 4 281 GWh or 92% of balance, whereas net distribution has been realized 2 046 GWh or 89% of balance. Eligible consumers, internal and Kosova Coal have spent 107 GWh which is 26% compared with the balance in a value of 410 GWh. This is basically due to unrealized plan of Feronikeli for consumption of electricity.
The consumption of electricity is calculated to be realized under the regime of average load shedding 5:1 implementing ABC method and with the tendency that consumers of A category be supplied with the normal state of 24:0, those of B – 5:1 and category C – 4:2 or with remained electricity. This in generally has been realized except in emergency cases.

Consumption of electricity compared with the balance of year 2006

Table 1.4 Consumption of electricity compared with the balance of year 2006

Unit	Balance 2006	Realization 2006	Realiz/Balance 2006
	MWh	MWh	
Bruto Consumption	4,651,045	4,281,400	92.05%
Neto Distribution	2,294,060	2,045,870	89.18%
Trepca	59,900	29,347	48.99%
Feronikeli	152,200	2,759	1.81%
Sharri	54,300	48,038	88.47%
KEK internal consumers	126,500	25,274	19.98%
WDG+Kosova Coal	17,000	1,774	10.44%

1.3 Import and export of electricity

Depending on production and consumption in monthly and daily basis, in the balance of 2006 is foreseen the import of electricity in the value of 685.6 GWh and export in a value of 210.7 GWh.

Realization of import and export with contracts is made based on published tenders by KEK and approved by ERO, while exchanges (intake and off take) are realized according to the request and capability. Thus, the imports under contract was 393 GWh, while the exports under contract was 80 GWh, while as an exchange were imported 143 GWh and exported 172 GWh. It is worth mentioning that the price of imports has a tendency to increase.
Total import (contract + exchange) is 536 GWh or 78% of balance for 2006, while exports reached 253 GWh or 120% of balance. Below is the table and diagrams with import, export, as well as import prices per month. Weighted average price of import is 54.87 €, while of export is 40.75€.

Import, export and exchange 2006.

Table 1.5 Import, export and exchange 2006

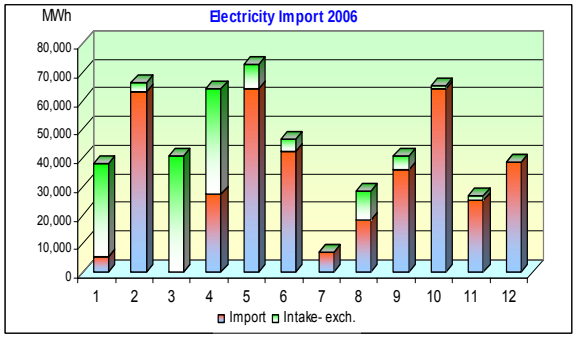
Month	Balance 2006	Offtake- exch.	Intake- exch.	Export	Import	Price
	MWh	MWh	Mwh	MWh	MWh	€
1	-116,500	3,100	32,190	0	5,730	64.26 €
2	-112,300	3,300	3,080	0	63,352	52.19 €
3	-43,500	4,220	40,962	0	0	0.00 €
4	-24,000	12,858	37,297	0	27,280	51.56 €
5	-78,000	3,250	8,260	0	64,480	47.38 €
6	-37,700	12,898	4,230	0	42,432	52.58 €
7	100,400	36,356	0	67,864	7,200	38.90 €
8	110,300	25,650	9,905	12,308	18,460	45.06 €
9	-87,000	38,069	4,720	0	36,000	58.94 €
10	-36,500	14,968	1,000	0	64,182	59.84 €
11	-60,200	14,276	1,540	0	25,450	63.46 €
12	-89,900	3,410	0	0	38,488	65.20 €
Total	**474,900**	**172,355**	**143,184**	**80,172**	**393,054**	**54.87 €**

Note: Negative values in balance column present the import while those positive present the export.

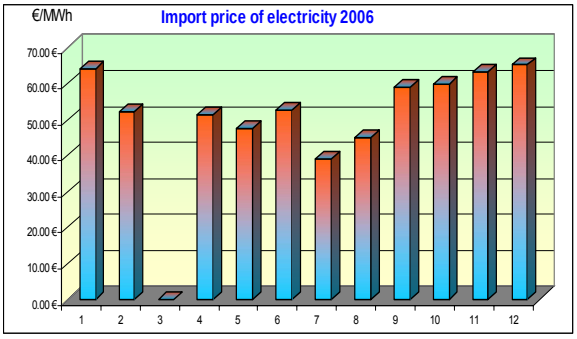
Diagrams of import and exchange of energy with the import price

Figure 1.3 a) Electricity import 2006; b) Import price of electricity 2006

a)



b)

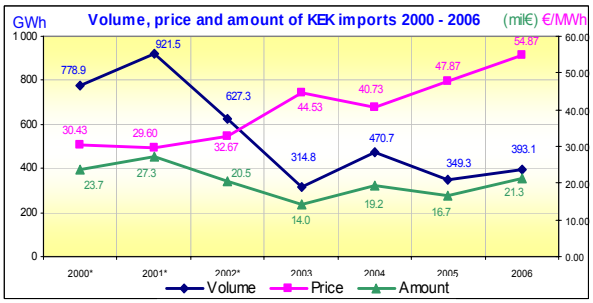


Import trends 2000-2006 have had oscillations but in general the volume shows a sensitive decline, whereas prices show increase, while the paid value is in the approximate same level during years.

Imported energy during years 2000-2006 and prices

Table 1.6 Imported energy during years 2000-2006; **Figure 1.4** Prices of energy during 2000 - 2006

KEK Import	Volume	Price	Amount	Amount
Year	*MWh*	*($)€/MWh*	*€*	*mil Euro*
2000*	778 870	30.43	23 701 412	23.7
2001*	921 485	29.60	27 276 960	27.3
2002*	627 265	32.67	20 491 605	20.5
2003	314 794	44.53	14 016 421	14.0
2004	470 660	40.73	19 170 646	19.2
2005	349 335	47.87	16 723 315	16.7
2006	393 054	54.87	21 566 342	21.3
Total	**3 855 463**		**142 946 699**	**143**



1.4 KEK's non-technical losses

Energy losses are unavoidable in power systems. Energy losses are usually divided in the "technical" losses as consequence of the laws of physics and "non-technical" caused by non accuracy of measurements, tampering of meters and theft of electricity. In the case of Kosovo an additional amount of the non-technical losses are caused by customers residing in the Serb enclaves. KEK has no access in order to read the meters and send the bills. In the normal situation of course it is the technical losses that are prevailing but in the case of Kosovo it is the non-technical losses that are much more.

The amount or percentage of the technical losses is depending to the level of development and conditions of the transmission and/or distribution networks. As far as technical losses are

concerned for Kosovo, they are high compared to the case of developed power systems and networks but in this item they aren't subject of review.

Attention has to paid to the non-technical losses which are very high in Kosovo and for the time being they appear to be first priority on improvement of the financial viability of the power sector.

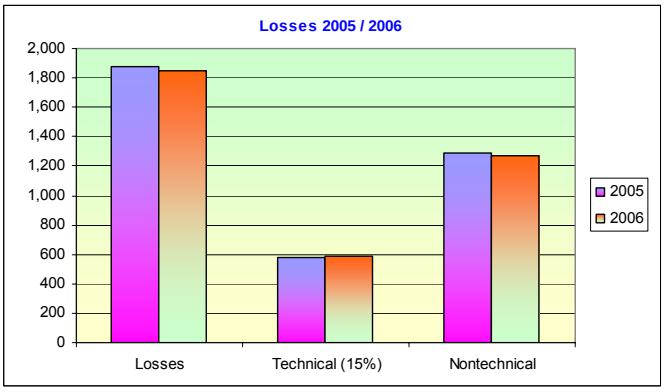
In the chart below is shown the statistical figures of overall losses and in particular the non-technical losses.

Table 1.7 Overall Losses; technical losses and non-technical losses

Year/Descritpt.	2005			2006				
GWh	Total electr. into distrib.	Electr. Billed	Total losses	Planned	Total electr. into distrib.	Electr. Billed	Total losses	%
Losses	3,883	2,010	1,873	1,833	3,896	2,046	1,850	98.97
Technical (15%)			582	619			584	100.34
Nontechnical			1,291	1,214			1,266	98.06

Percentage in the chart is expressing the comparison of achieved losses 2006/2005

Figure 1.5 Overall Losses; technical losses and non-technical losses



The amount of 1200 up to 1300 GWh of "Non –Technical" losses is extremely large for a system with total energy demand of the order of 4 TWh per year and is the overriding main constraint in transforming KEK towards a financially viable company. Assuming an average price during the year 2006 in the level of 5.12 c€/kWh respectively 51.00 €/MWh the **loss of revenue was between € 61 to 66 mil. per year that presents roughly 37-40% of the expected KEK's revenue for 2006.**
Referring to numbers outlined in the chart above there is no any improvement in the year 2006 compare to 2005.Therefore no pozitive results of any taken measures by Management or simply the Management has ignored problem of very high "non-technical losses".

1.5 KEK's restructuring/incorporation of KOSTT

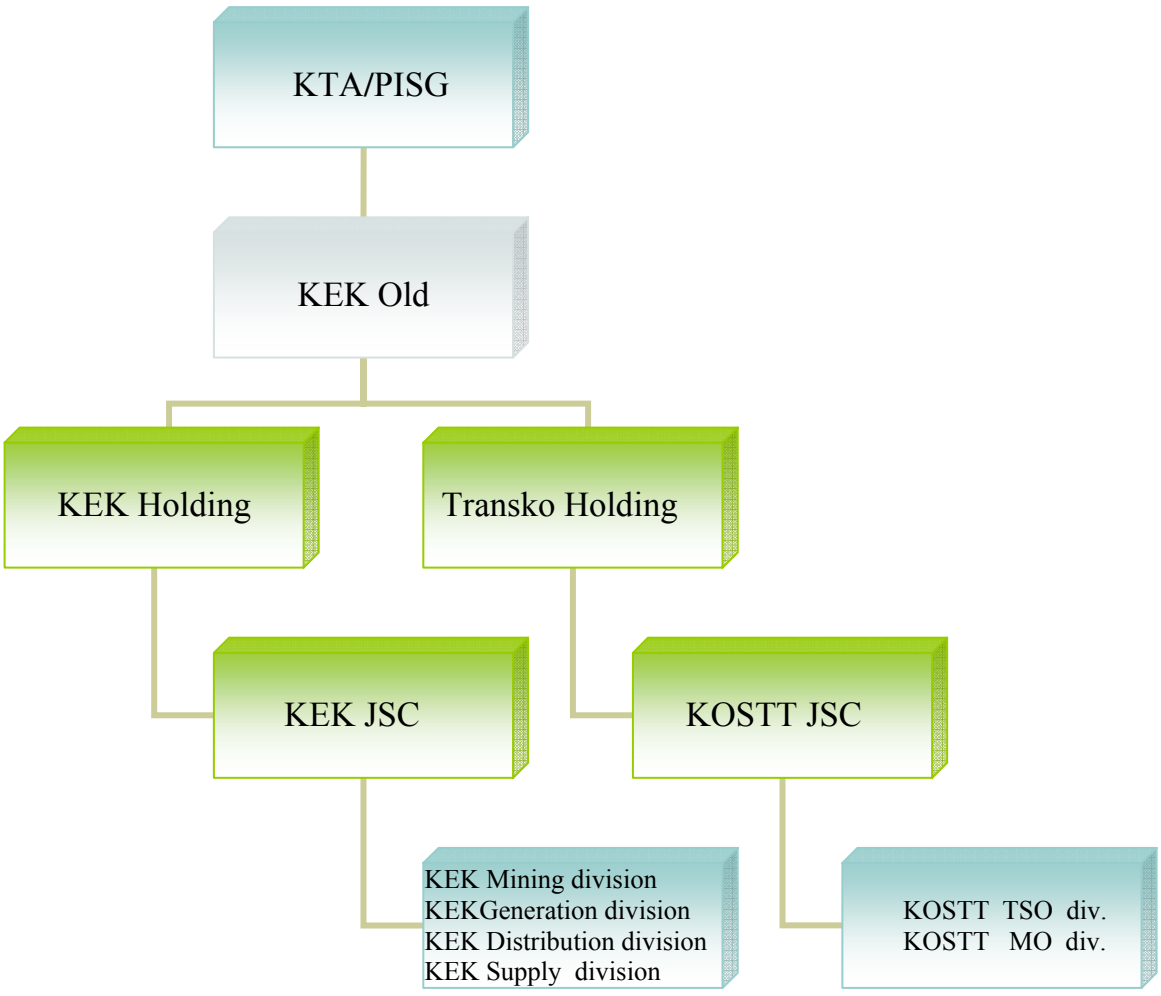
Pursuant to its international obligations derived from ECSEE Treaty the government of Kosovo (PISG) adopted an Energy Strategy that calls for the unbundling and restructuring of the old

vertically-integrated sector dominated by the Public power corporation KEK, and creation of an independent Transmission System Operator in compliance with the requirements of Chapter IV of the European Directive 2003/54/EC.

Restructuring of KEK should be considered as part of overall restructuring of the power sector in Kosovo and as one of the main requirement for the development of power market and the future privatization plans of the government.

The process of restructuring of the KEK and unbundling was done concurrently with the process of incorporation of the new companies as it was immediate requirement to establish a corporate structure of the industry. In the chart below is shown the new structure of the incorporated and unbundled industry from a vertically integrated form into two Joint Stock Companies (JSC).

Figure 1.6 KEK unbundled structure



The newly established companies have to maintain also the unbundled structure and account unbundling within their respective internal organizations.

The structure of the KOSTT JSC as Transmission System and Market Operator (asset owning and operating Transmission Company - TSO and MO) has completed the process of required sector unbundling, but KEK JSC may continue in the future the unbundling process in case the government determine this as strategic goal.
KOSTT was established on 1st January 2006 by the decision taken by Board of KTA but real commercial operation was commenced from 1st July 2006. Establishment of KOSTT as separate Transmission System and Market Operator from vertically integrated company is the first precondition of any Electricity Market development. This company with appropriate regulatory framework should be capable to ensure transparent and fair Third Party Access (TPA) to all market participants. Moreover KOSTT appears as very important link of the chain in the further restructuring of remaining parts of KEK (unbundled) and ensuring the entrance of newcomers in the Kosovo electricity market either as generators or suppliers.

It is very important in the short-term that KOSTT achieves his full operation capacity in order to meet all requirements by the users of transmission services. Such development has to be happen mainly in the two directions:

- Increasing the capacity building and training of staff (has already started with donors' support) and;
- Significant improvement (rehabilitation – new investments) of transmission infrastructure capacity.

KEK JSC has to continue the process of unbundling as it is stipulated by article 49 of the Law on Energy Regulator or by any other governmental strategic approach that has to be in full compliance with Law on Electricity and other applicable in the Kosovo that in the meantime may deemed as necessary. An unbundled structure of KEK has to be completed as soon as possible in order to create conditions to increase the company's efficiency with final target to reach the desired financial viability.

CHAPTER 2

REGULATORY DEVELOPMENTS DURING

2.1 Secondary Legislation adopted in 2006 and foreseen for 2007

In 2006 Energy Regulatory Office continued with issuance and adoption of the secondary legislation (Rules and Decrees) in order to fulfill its mandate and complete the regulatory framework for energy sector in Kosovo as envisaged by the Law on Energy Regulator. Rules which were issued by Energy Regulatory Office were prepared with support of "technical assistance projects" funded by USAID and EAR (European Agency for Reconstruction).
A process of Public Consultation was followed for each individual Rule or Decree issued by ERO. Each draft rule is initially published on ERO's website and sent for comments to all different energy sector stakeholders (energy enterprises, ministries, donors and different associations). ERO has established an e-mail address for responses and all comments were collected and processed by the legal department of ERO. Some few weeks after initial publication of the draft rule ERO announces a public hearing where rule is presented in detail. Comments that are received from stakeholders are also published on the web site and they are considered in the draft rule subject of the public hearing. Comments received on the public hearing are also considered as well as comments received after public hearing. In few weeks time after public hearing, ERO announces a public session of the Board for adoption of the rule. On public session initial comments received from all stakeholders are read as well as justification for inclusion or non-inclusion of each individual comment in the Rule. After consideration and discussion of the comments and draft itself the Board of ERO votes on adoption of the Rule. Rule is then published on the web site in its final version. This procedure was followed for adoption of all rules.

In 2006 Board of ERO adopted following Rules:

1. Rule on Dispute Settlement Procedure;
2. Rule on Licensing of Energy Activities in Kosovo;
3. Rule on Disconnection and Reconnection of Customers in energy sector in Kosovo;
4. Rule on General Condition of Energy Supply;

The following rules have been developed and discussed in a Public hearing in 2006 and are awaiting adoption:

5. Rule on Authorization Procedure for construction of new Generation Capacities;
6. Rule on Administrative Measures and Fines;
7. Rule on Confidentiality of Information;

On 14 February 2006 ERO held a Public hearing on draft Rule on Licensing of Energy Activities of Kosovo and Rule on Disconnection and Reconnection of customers in energy sector in Kosovo. On 24 February 2006 on the public session Board of ERO adopted both Rules.

On 14 March 2006 ERO held a Public hearing regarding the draft Rule on Authorization Procedure for construction of new Generation Capacities. This Rule is still not adopted due to amendments to the Laws on Energy Regulator and Energy (2004/8 & 2004/9) and explicit request by Ministry of Energy and Mining to ERO to desist from adoption of the Rule. Amendments to the two Laws still didn't pass by the Assembly and this has left a pending gap of Legislation in Kosovo regarding permitting and Licensing of projects for the construction of new Generating Capacity.

On 27 April 2006 ERO held a Public hearing on draft Rule on General Condition of Energy Supply, which was adopted on public session of the Board held on 28 June 2006.

On public hearing held on 4 October 2006 the Board of ERO issued 18 licenses for generation, distribution, transmission system operation, market operator, public supply and trading activities in electricity sector as well as generation, distribution and supply licenses in district heating sector. On a Public Session held on the 30th October 2006 Board of ERO discussed and voted to issue licenses to 3 more trading companies. In total up to date ERO has issued 21 licenses.

On 14 November 2006 the Board of Energy Regulatory Office held a Public Session to discus regarding the Rule on Administrative Measures and Fines, and to present for Public Consultation the Draft Rule on Confidentiality. It is expected that ERO will soon held a public session for adoption of these rules.

Furthermore during the year 2006 ERO issued several Decisions to KEK (Kosovo Energy Company) and district heating companies:

Decision D_12_2006	decision on withdrawal of the consent given to KEK on 5 June 2006 on export of electricity during July and August 2006
Decision D_13_2006	on approval of the weighted average cost of capital (WACC) to be applied under the first price review;
Decision D_17_2006	allowed Revenues for DH Termokos–Heating season 2006/2007
Decision D_18_2006	allowed Revenues for DH Gjakova–Heating season 2006/ 2007
Decision D_19_2006	for Approval of daily interest rate on KEK's debt (14.65 % annual rate);
Decision D_20_2006	on approval of Temporary Procedures for meter reading and billing of customers groups with installed maxi graph -Submitted by Supply & Distribution division of KEK;
Decision D_21_2006	to amend Decision No. D_10_2006 on 2 November 2006.
Decision D_22_2006	on approval of tariffs for DH Gjakova–heating season 2006-2007.
Decision D_23_2006	on approval of tariffs for DH Termokos JSC
Decision D_24_2006	on approval of tariffs for PMU Standard / DHU Termomit–Heating season 2006-2007
Decision D_25_2006	on approval of tariffs for PMU Zvecan–Heating season 2006-2007
Decision D_29_2006	on approval of allowed revenues for KOSTT and KEK for the regulatory period 2007-2009.
ERO_EC_002_06	the Status of Eligible Customer for the year 2006 to SHARR BETEILIGUNGS GmbH.

2.2 Licensing activities

One of the most important tasks of ERO as mandated by the Law, is to develop the Licensing criteria, issue licenses to the energy enterprises and to monitor licensing activities. License is a summary of relevant provisions that are based on: Law no. 2004/8 on Energy, Law no. 2004/9 on Energy Regulator, Law no. 2004/10 on Electricity, Law on District Heating, Rule on Licensing of Energy Activities in Kosovo, Rule on Disputes Settlement Procedures, Schedule of Fees and other rules adopted by Board of ERO.

License contains necessary conditions and obligations that the Licensee shall fulfill and for which will be monitored by ERO.

The Rule on Licensing of Energy Activities in Kosovo has envisaged that the enterprises that intend to perform energy and district heating activities should apply with to ERO Legal and Licensing Department for the licenses. ERO will issue their licenses within 90 days from the day of application. Interested parties may find the application form on ERO official webpage.. By 24 June 2006 ERO received 21 applications for the licenses in electricity and district heating and issued licenses. These licenses are published on ERO web site in the form of Licensing register that contains following licenses:

Electricity supply /Trade License to ČEZ" a.s. / Czech Republic;
Electricity supply /Trade License to HSEd.o.o. of Slovenia;
Electricity supply /Trade License to OstElektraGmbH of Germany;
Electricity Generation License to KEK JSC for TPP/ Kosovo A;
Electricity Generation License to KEKJSC for TPP/ Kosovo B;
Electricity Generation License to "Triangle General Contractors Inc" for HPP Lumbardh";
Electricity Generation License to POE "IberLepenci" for HPP "Ujmani";
Electricity Transmission System Operator License to KOSTT;
Electricity Market Operator License to KOSTT;
Electricity Distribution System Operator License to KEK J.S.C;
Electricity Public Supplier License to KEK J.S.C;
Electricity Supply /Trade License to KEK J.S.C;
Electricity Supply /Trade License to EFT AG/Switzerland;
Electricity Supply /Trade License to EGL AG /Switzerland;
Electricity Supply /Trade License to Ezpada S.R.O / Czech Republic;
Heat Generation License to POE "Termokos";
Heat Distribution License to POE "Termokos";
Public Supplier of Heat License to POE **"**Termokos";
Heat Generation License to POE "Gjakova DHC";
Heat Distribution License to POE "Gjakova DHC";
Public Supplier of Heat License to POE "Gjakova DHC".

In 2007 ERO will start with monitoring of the licensed activities. In mean time and in order to assist the licensee ERO has issued and published the Reporting Manual that sets forth the manner and form of reports that the licensee submits to ERO quarterly and annually. In early January 2007 ERO held a workshop with the licensee in order to explain and discuss the reporting requirement, forms of reporting and timing. By 30 February 2007 all licensees have submitted the annual reports and ERO is currently evaluating such reports.

2.3 Technical codes/governance of codes – allocation mechanism for transmission interconnection capacities

Pursuant to its obligations from ECSEE Treaty, Kosovo must liberalize its power sector and open it up to competition which eventually will encompass all final customers. The purpose of Power Sector reforms and restructuring that has happened worldwide in the last 15-20 years is of course to increase efficiency and productivity through the introduction of market discipline and competition. The final customer benefits from increased quality of service and security of supply while the market price provides the correct "economic signal" for investments and risk management.

Of paramount importance in introducing competition to a "Network Energy" sector, is the so-called "Third Party Access principle" (TPA), whereupon mechanisms are established for the fair and transparent access to monopoly networks to all market participants". Since networks' business in the power sector is a "natural monopoly" due to the very high sunk costs and economies of scale characteristics therefore there is need to ensure, to anybody who wants to generate/supply/consume electricity, to have transparent and equal access to the networks. The networks businesses (Transmission/Distribution) can therefore "unbundle" as separate activities from the competitive ones (Generation – Supply) and run independently as natural monopolies and under the TPA principle to facilitate the establishment of a competitive market in the sector. TPA mechanism consists of two fundamental constituent parts: 1) a methodology for Network Pricing (for the use of, connection and access to networks) and; b) rules that regulate the rights and obligations of parties with physical access to networks (Technical Codes).

Kosovo's legislation in Energy is fully compliant with the "Acquis Communautaire" and foresees the full unbundling of the sector (Chapter 10 of Law 2004/9 on the Energy Regulator). TPA principle is recognized by Kosovo's basic legislation (Law 2004/10 on Electricity - Articles 13.2 and 38.7) and is foreseen the development of the Technical Codes by Transmission System Operator (KOSTT) and approval of them by Energy Regulatory Office (ERO).

Law on Electricity stipulates regulatory approval for the following Technical Codes:

- Grid Code
- Metering Code
- Distribution Code
- Electricity Standard Code
- Electrical Equipment Code and
- Consumer Protection Code

ERO has reviewed and approved by its decision no: D_31_2007 by 30th January 2007 base on KOSTT submitted request by 20th and 28th December of 2006 the Grid Code and Metering Code, which now constitute secondary legislation in the energy sector of Kosovo. The remaining codes are under development by KOSTT.

By far the most important Technical Code in any restructured power sector is the Grid Code. The Grid Code is a legally binding single document that covers all the technical and commercial issues, procedures, rights and obligations and interfaces between the Transmission System Operators and all other users connected to the transmission grid. The following issues are treated in the grid code:

- planning and development of Kosovo's transmission system;

- connection to the Kosovo transmission system;
- operational planning that comprises: outages**,** system security assessment and demand forecasting, day-ahead scheduling process;
- balancing comprising**:** procedures and processes for dispatch for balancing, ancillary services, processes for the control of system frequency, arrangements for control of voltage and reactive;
- operation comprising: testing and monitoring**,** exchange of information under normal and abnormal conditions, procedures to allow work and/or testing to be carried out across a connection point, provision of contingency and restoration plans following total or partial shutdown of the system, demand control etc.
- procedures for dealing with unforeseen circumstances, disputes, derogations and amendments to the grid code are foreseen in the chapter of General Conditions.

As far as commercial procedures concerned of physical connection to the networks the Rule on General Condition of Energy Supply regulate that in the details.

The Metering Code provides the specifications and describes the metering facilities used for commercial purposes (settlement, etc) and required at all connection points between networks, between networks and generating units and at the supply points of customers. It defines the rights and obligations that each of the parties has vis-à-vis the metering facilities, especially those of the network operators, and including those of the regulator. It covers issues regarding the security of systems and the confidentiality of metering data. The Metering Code details the minimum standards for the measurement and recording of electricity (metered quantities) that will be used for settling electricity sales and purchases in the electricity market – including those necessary for trades that originate or terminate outside Kosovo. Moreover it sets out the provisions relating to the installation, testing, maintenance and operation of metering systems & facilities including associated communication links. The Metering Code also defines the accuracy requirements, the parameters to be measured and the maintenance and testing requirements.

The development and adoption of Grid Code and Metering Code for Kosovo marks an important milestone in the development of a competitive energy market.

Based on its mandate given in the Law on Energy Regulator, ERO has developed and approved (Decision D_31_2007 by 30th January 2007) the Governance Procedures for Technical/Operational Codes as requirement to administrate the above described Technical Codes. The Codes as well as the Rules constituting secondary legislation in our energy sector are all dynamic and "living" documents subject to modifications and changes that can be proposed by market participants and subject to final approval of ERO. The Governance Procedures for Technical/Operational Codes deal with:

- an appropriate industry body for periodical review and discussion of the Grid Code, Distribution Code, Metering Code, Electrical Standards Code, Electrical Equipment Code and Customer Protection Code;
- procedures for reviewing, discussing and submitting all suggested modifications and amendments to the Grid Code, Distribution Code, Metering Code, Electrical Standards Code, Electrical Equipment Code, Customer Protection Code which ITSMO (KOSTT),

DSO (KEK), ERO, or any Market Participant or any potential Market Participant may wish to submit to ITSMO (KOSTT) for consideration by the OCGC (Operational Codes Governance Committee established by Governance Procedures) from time to time.

Pursuant to its obligation under ECSEE Treaty Kosovo must comply with Regulation 1228/03/EC on "Conditions for Access to the network for cross-border exchanges in Electricity" which "inter alias" set in Article 6 the guidelines for providing fair and non-discriminatory access rights to market participants on the international interconnections. Kosovo's legislation is fully compliant to the European energy legislation on this matter. Pursuant to its mandate as provided by Article 25.1 of the Law on Electricity 2004/10, and Article 15.4 of Law on Energy Regulator, ERO has adopted (by its decision no D_33_200 dated 31st January 2007) the "Transmission Capacity Allocation Procedures" based on submitted proposal from KOSTT.

The operational procedures cover the methodology for the Allocation of Available Transfer Capacity on the international tie-lines with neighbouring countries through the process of explicit auctions (market based mechanism as required by Regulation 1228). KOSTT will arrange on a bilateral way all necessary arrangements with neighbouring TSO's. In case there is no agreement KOSTT will allocate the 50% of calculated ATC on the respective border. This mechanism will be in force until a regional "fully co-ordinated allocation mechanism" currently under development by SETSO, will come into place. Kosovo's TSO (KOSTT) albeit now ascending as full member of SETSO is still not party to the allocation mechanism because of Serbia's (EMS) opposition.

The adoption of Capacity Allocation procedures on Kosovo's interconnections is another major milestone achieved in 2006, which will facilitate competition and transparency in the wholesale market (imports/exports).

2.4 Interim market model

According to its national legislation Kosovo must implement an organized competitive market in its electricity sector (Articles 27 & 28 of the Law 2004/10 "on Electricity"). An organized market in the electricity sector is also the requirement of the European Energy Directives, compliance to which demands the Treaty establishing the Energy Community of South-East Europe (ECSEE). Such requirements are the separation of functions (TSO, MO, DSO, Gencos and Suppliers), establishment of the conditions for Third Party Access (TPA), the creation of Eligible customers (which necessitate efficient pricing in order to avoid cross-subsidies with captive customers) and choice of supplier, and the creation of Regional Markets. The reasoning for introducing market disciplines and competition in the energy sector is to improve economic efficiency through Rational pricing (marginal cost pricing) for efficient dispatch (Price shape - Cheap operating cost baseload capacity earning a contribution to fixed costs - Peaking capacity earning a rational contribution to fixed cost - Rational valuation for imports and exports, while for newly built generation and new participants it is required Cost-based revenue stream which reduces risk. Reasonable risk entices risk capital rather than reliance only on price guarantees and Risk environment that can support private capital only works with rational pricing. On the other hand Regional Markets are created to take advantage of economies of scale, diluting market power and the economic optimisation of Generation diversity (i.e. Base load lignite - Peaking hydro) while enhancing the Security of supply. Markets are about: Contractual delivery of energy - Financial risk transfer - Efficient pricing.

As reported on the Annual report of 2005, ERO was mandated by the Government to develop an appropriate Market Model for Kosovo and associated rules, task which was undertaken throughout 2005 and 2006. ERO deliberated in length with the assistance of its Consultants and on Public Consultation on the appropriate choice for a Market Model for Kosovo and finally decided on a Net Pool type of Model with Bilateral Contracts and real-time Balancing Mechanism. The choice for Net Pool was made on the basis that this type of Market can handle interconnector issues must easier and therefore is much more conducive to regional trading.

ERO therefore developed detailed market rules for a Net Pool model with real time balancing mechanism and a Capacity certificates mechanism to incentivise new built generation. On the same time and for the interim period ERO designed a "simulated Market Model" in order to simulate hourly "market prices" because of insufficient liquidity to drive full market, and to use the simulation to derive KEK generation wholesale transfer prices. The Market Rules described the role, rights and obligations and separation of functions for each entity Licensed by ERO (Transmission System Operator – TSO, Market Operator – MO, Distribution Network Operator – DNO, Generators, Suppliers including the Public Supplier and Eligible customers and the way energy, capacity and ancillary services was transacted, contracted, metered and settled. The role of the Market Rules is to describe the interaction between the price controls laws, parties, licences and codes.

The Market design principles are:

- energy, capacity and ancillary service markets;
- settlement;
- market operation and balancing mechanism;
- governance rules
- capacity certificates mechanism;

In The Annexes: it was described the Price setting models and the Contractual Agreements (Framework and Accession agreements).

In mid 2006 it became obvious that despite the quick progress achieved in the establishment and implementation of an independent Transmission System and Market Operator (KOSTT) the system infrastructure (mainly metering), system conditions in generation and mining, the fact that the only Eligible Customer opted for a long-term supply contract with the Public Supplier, but also regional issues (like the continuation of the exclusion of KOSTT from the CBT and CCA SETSO mechanisms), the full model could not be implemented and as a matter of fact there was no practical purpose in its full application. It has therefore been decided that ERO and KOSTT will jointly develop a more simplified version of the model namely the Interim Market Model T1, which could be in place and implemented by all Market Participants as of 1st April 2007 and in force for at least one year. The interim Market Rules contain five Chapters namely:

I. Preliminary clauses (Objective, scope, definitions and notation, Parties and Accounts, Accession to the Market Rules and Discontinuance, Operational communications, Metering requirements, Interconnector trading – follow regional rules);

II. System Operation (demand forecasting, generation forecasting, interconnector nominations;

III. Settlement (energy settlement calculation, third party data, KOSTT direct charges and dues, invoicing to third parties, invoicing and payments);

IV. Governance (operational procedures, modification of the MR, general provisions, access to the MR, notices & commencement date, force majeure, assignment & confidentiality provisions, liability, currency & jurisdiction);

V. Schedules (framework and accession agreements)

This Model is described in diagram 2.1 below while diagram 2.4.2 describes the financial flows.

Figure 2.1 Electricity Market

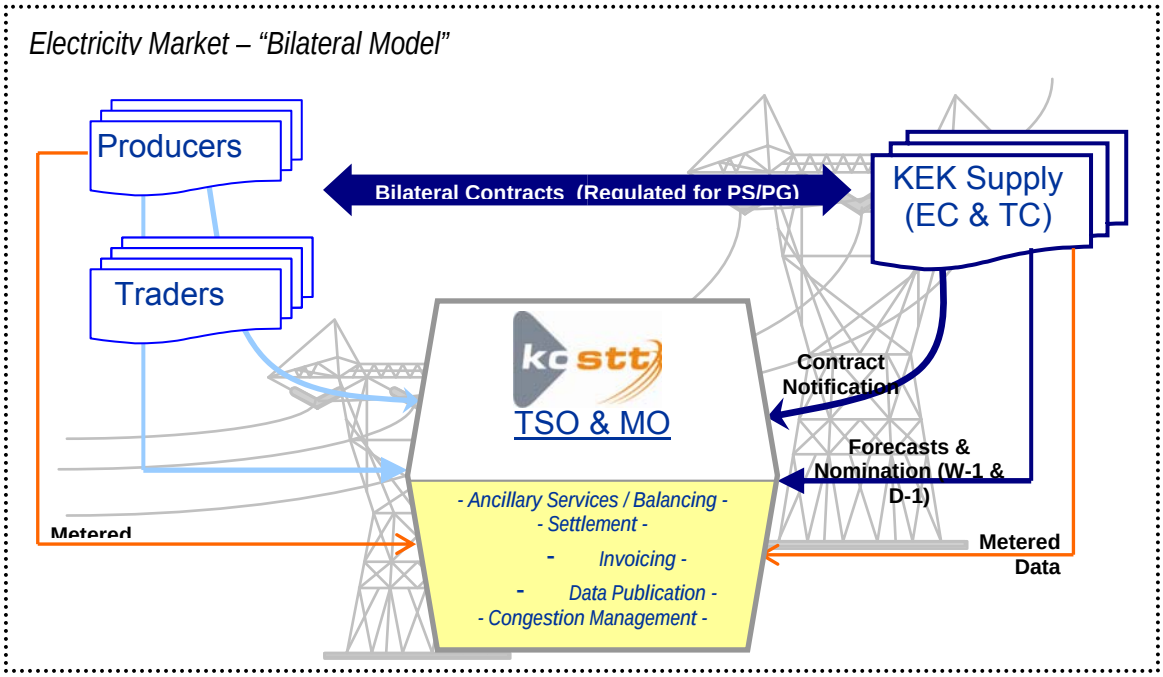
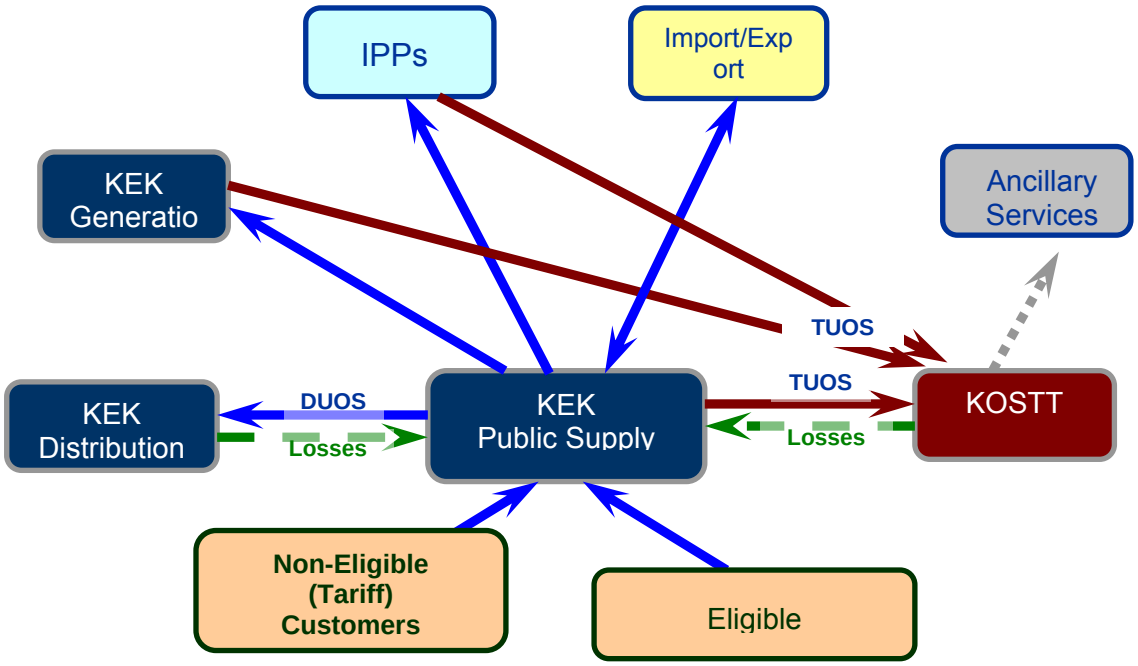


Figure 2.2 Financial Flows



In this simplified implementation of the Net Pool only two energy accounts will be kept: the **KEK** net energy position and the **KOSTT Transmission Losses** position. The **KEK** energy account will not be directly financially settled. However **KEK** will be responsible for maintaining a net zero energy position over time in accordance with the Grid Code. The Balancing Mechanism as well as the Capacity Certificates Mechanism are not in use in the interim model.

The settlement process does not currently use bids and offers and non-delivery charges nor does it create **Settlement Period** energy imbalance prices. The **Net Monthly Total Generation** is equal to the sum of the power station generation outputs flowing onto the transmission system in the month minus the associated unit transformer loads and station transformer loads at the commercial boundary between generation and transmission. For each **Generator** 'A' the **Monthly Generator Account Delivery** is equal to the sum of its generation flowing onto the **TS** in the month minus the associated power station loads unit transformer loads and station transformer loads at the commercial boundary between generation and transmission.

KEK is responsible over time for maintaining a net zero position on the **KEK Net Energy Position** account. To this end the **TSO** is required to schedule balancing flows in accordance with the regional arrangements and **KEK** will as appropriate generate, load-shed or arrange interconnector trades to meet the scheduled flows. Where **KEK** fails to balance and the **TSO** is forced to accept a **Balancing Trade, KEK** will be financially responsible for it.

For **Transmission Network Supplier Charge** charging purposes it is necessary to calculate the five highest hourly demands plus losses in the year. Note that demand plus losses is equal to minus generation minus net imports. Generation and interconnector flows are available automatically in 15 minute values while this is not necessarily true for demand

Invoices will be despatched once a month by the **MO** to **Trading Parties** and others**. Trading Parties** and others are required to clear all monies accrued for the preceding calendar month in accordance with the Settlement Timetable. Invoices will be despatched in respect of the following transactions:

a) **KOSTT** direct charges and dues

b) between **KEK Supply** and **KEK Generation**

c) between **KEK Supply** and **Importers**

d) between **Exporters** and **KEK Supply**

e) between **KEK Supply** and **Independent Generators**

f) between **KEK Supply** and **Eligible Customers**

g) between KEK Distribution and KEK Supply

CHAPTER 3

DEVELOPMENT OF NEW GENERATING CAPACITY (LIGNITE FIRED) AND ASSOCIATED MINE

3.1 The World Bank Lignite Power technical Assistance Project -LPTAP

3.1.1 Background

Historically, energy and mining were mainstays of the Kosovo economy, providing direct and indirect employment, sources of revenue, export earnings, and inputs to downstream industries. However, from being a contributor to economic growth, the power sector has become a drain on public resources. In addition, unreliable electricity supply has emerged as one of the main obstacles to growth as Kosovo continues to suffer from regular electricity black-outs, with average outages of 4 hours a day in 2005, down from 6 hours a day in 2002. Surveyed companies in Kosovo reported the lack of reliable electricity supply as the main barrier to their operations, leading to average losses of around 5 percent of sales (excluding the cost of purchasing and operating generators).

Kosovo's key energy resource is its extensive lignite deposits estimated at around 11 bil. tons extractable which are the most extensive in the whole area of SEE; On the other hand Kosovo has no gas importing infrastructure as yet, a very limited hydro potential and has no oil refinery and depends entirely on imported liquid fuels. Due to the extremely favorable over-burden ratio, relative high calorific value and low sulphuric content, Kosovo's lignite has been assessed by several pre-feasibility studies as the most economic (least cost) fuel for the development of new base-load generation in the whole area of SEE. .

KEK's available power generation capacities at the Kosovo A and B power plants are old and not adequate to meet the demand. At the same time, industrial demand is growing and a recently privatized mine (Ferronikeli) would need 100 MW of firm capacity from end 2007 onwards. This would place further strain on the demand-supply balance and more load shedding would further affect economic growth, or alternatively more costly imports (particularly taking into account the overall tight supply situation throughout SEE. Kosovo B plants (2 units installed in early 80's) have been rehabilitated with extended operating life of up to 2025. As for Kosovo A (5 units installed between 1964-1974), rehabilitation of three units (A3, A4 and A5 each with a 200 MW nominal capacity) to extend operating life by about 12 to 15 years is technically feasible; but since the cost of environmental compliance with EU standards would be costly, these units are not expected to be cost effective compared with a new power plant. The overhaul of these units for limited life extension until the new power plant becomes operational is deemed feasible. Further, there is a looming shortage of lignite supply from 2009 onwards since the existing mines (Bardh and Mirash) are nearing exhaustion and the start of development works at KEK's new mine (Southwest Sibovc field) has suffered delays due to lack of financing. Development of the SW mine is estimated to cost Euro 236 million over 7 years.

3.1.2 Government Strategy

UNMIK and PISG have collaborated in developing a comprehensive strategy[1] for the energy sector, which is intended to address the short- to medium-term issues and challenges, and put the sector on a path of long term growth and development in line with EU Directives and standards. The government's basic objective is to make energy sector self-financing and bring-in private sector as soon as possible. Recognizing that considerable lead time is required before investors can be selected, whereas there is urgent need for sustaining coal and electricity supply, the strategy allows for KCB and donor funded support during 2006-07. Key elements of the strategy are to "Strengthen KEK's finances" by improving billing and collections and reduce theft of electricity, and "Budgetary support priorities" for new mining activities.

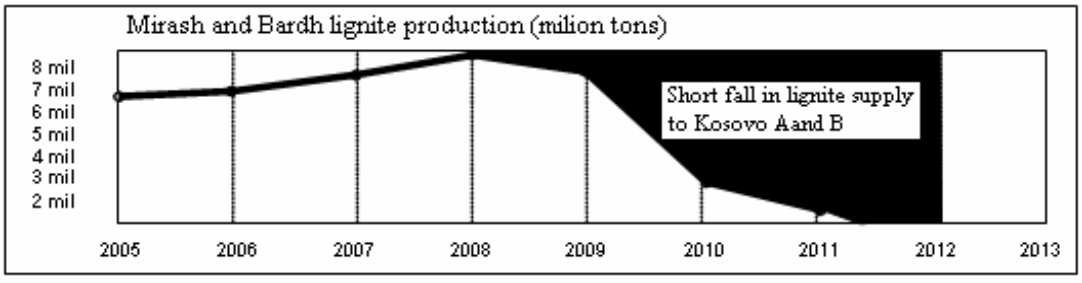
However by far the most important element of the strategy is the "Private sector investments": The government intends to attract private sector capital and expertise into lignite mining and power generation by offering the Sibovc mine (approx. 800 mil. tons extractable), including the Sibovc SW mine, for supplying KEK's power plants as well as build new capacity (Kosovo C) to supply domestic and regional electricity markets evolving under the ECSEE Treaty.

The process has begun in 2006 with support from World Bank and EAR, and an investment options review has begun and consultants identified feasible packaging of KEK's assets with new green field mine and power plant, which would be then be offered for bidding to qualified private sector investors through an open and competitive bidding process with the help of a transaction advisor. The government aims to adopt the high standards of environmental and social safeguards governed by EU Directives and accordingly develop its sector policy, legal and regulatory frameworks. Sector restructuring and reforms will also be pursued in line with ECSEE Treaty provisions, including liberalization to develop electricity markets.

3.1.3 Current Situation of Lignite Mines and Supply

All the lignite that is currently mined in Kosovo and used in power generation comes from two open-cut mines: Bardh and Mirash. The two mines have been in operation since 1958 and are nearly exhausted. At the projected rate of consumption of around 6.8 million tons per year, lignite production from the mines will begins to drop in the year 2008, as illustrated below.

Figure 3.1 Projected future production from Bardh and Mirash mines, *Source: KEK, MEM.*



Development of the Sibovc SW mine is essential to sustain fuel supplies to Kosovo A and B, after 2008 when the existing Mirash and Bardh mines begin to exhaust remaining reserves[2]. Failure to have the new mine operational by 2009 will lead to interruption in fuel supply and shut down of some or all power units. Significant investments will therefore be needed in mine development

[1] Energy Strategy and Policy of Kosovo, "(White Paper)" 2005-2015, July 2005
[2] Complementary Mining Plan for the Sibovc South West Mine, Steag Aril 2006

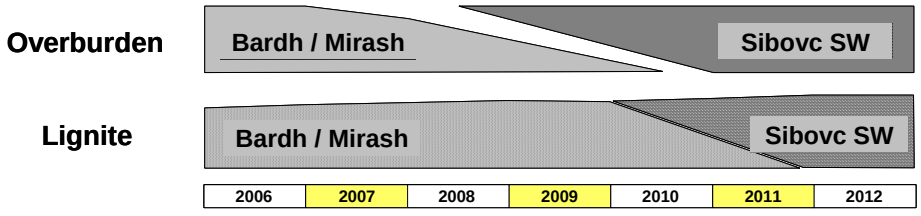
just to supply the existing power plants in Kosovo and to maintain current levels of electricity production.

Table 3.1 *Source*: Sibovc SW Mine Development Costs, Steag, May 2006

	2006	2007	2008	2009	2010	2011	2012	*Totals*
excavator, conveyor, stacker systems, a	0.6	28.6	51.4	54.8	21.5	16.5	9.4	*182.8*
power supply / infrastructure	0.7	3.9	12.3	7.8	5	2.1	1.1	*32.9*
land acquisition / resettlement / other	1.4	5.7	4.5	2.9	1.9	1.9	1.9	*20.2*
Totals	*2.7*	*38.2*	*68.2*	*65.5*	*28.4*	*20.5*	*12.4*	**235.9**

Development of the new mine requires concurrent major activities (a) engineering analysis and preparation of technical specifications for works, goods and services (b) rehabilitation of major mining equipment taken from the existing operations, (c) stripping of overlying material (overburden), and (d) development of supporting infrastructure. Planning for development of Sibovc SW should have begun in 2002 with preliminary engineering analysis and land acquisition. Major rehabilitation of equipment and earthworks should have begun in 2005. As such, development of the Sibovc SW is now eighteen months behind and moving towards a completion date that is fixed – lignite will be necessary in 2009 from this mine to sustain power generation. At this point, development of Sibovc SW mine should be viewed as an emergency action to sustain fuel supply to Kosovo A and B.

Figure 3.2



3.1.4 Donor Support

Technical Discussions, held during March 24-25 and June 20-22, 2006 conclude an International Development Association Grant (the Grant) for the Lignite Power Technical Assistance Project (LPTAP) between representatives of the United Nations Interim Administration Mission in Kosovo (UNMIK) and the International Development Association (IDA) at the offices of IDA in Pristina. The World Bank is providing support to the implementation of certain aspects of the Energy Strategy through the proposed LPTAP with grant funds of USD $8.5 million[3]. Project-LPTAP will help the Kosovo government to establish the enabling framework for qualified strategic investors to invest in new power plants and mines. In this context, the project aims to build local capacity to adopt and implement international guidelines on the social, economic and environmental aspects of sector development. By supporting the strategy, the World Bank Group (World Bank, IFC and MIGA), is playing a catalytic role in helping to attract world-class, private strategic investors to develop and utilize Kosovo's lignite resources in a transparent, environmentally and socially sustainable, and fiscally responsible manner. The LPTAP builds

[3] **F**inancing Agreement: (Lignite Power Technical Assistance Project) between UNITED NATIONS INTERIM ADMINISTRATION MISSION IN KOSOVO and INTERNATIONAL DEVELOPMENT ASSOCIATION.

upon the previous and ongoing Energy Sector Technical Assistance Projects (ESTAP I, II, and III), and EC-funded financial and technical assistance towards rehabilitation of power plants. This is complemented by a second grant (the Clean-up and Land Reclamation Project - CLRP, to be co-financed through bilateral support from other donors), which will support a pilot post-mining reclamation project that would build the capacity of environmental officials in this area through hands-on experience and make land available for alternative uses.

3.1.5 Project Management Structure of the LPTA Project

The project management structure is as following:

- The inter-ministerial and inter-institutional body, called Project Steering Committee (PSC)[4], as the highest level executive and decision-making body of the project, and is established based on the Executive Decision no.2006/6 issued by the Special Representative of the Secretary-General (SRSG) at March 17th 2006 in order to support management and supervision and ensure effective implementation of the LPTA project, as well for policy level intervention if needed.
- The Project Office (PO) is under the MEM subordination and located at MEM, see Fig.3.1.

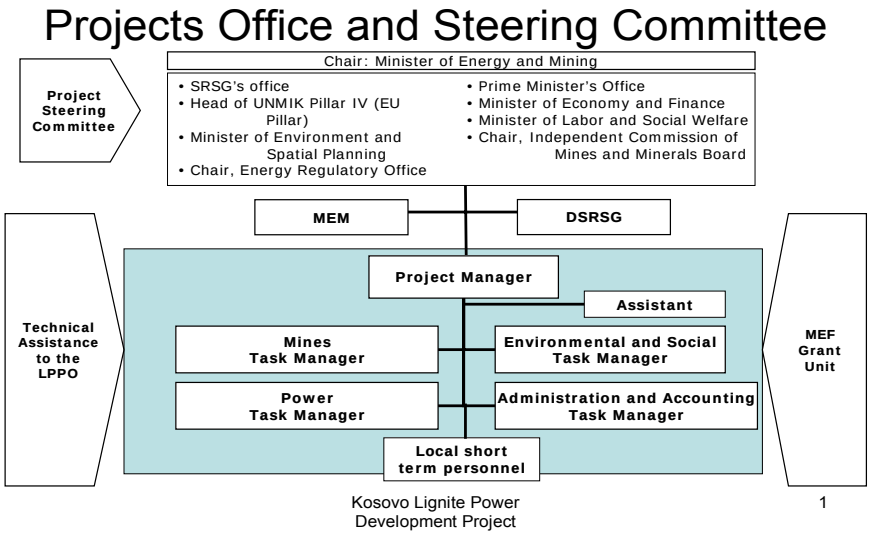
The PSC is set and functions during the entire duration of the project implementation with the same composition, resources and assigned tasks and responsibilities. The representation in the PSC is defined to ensure participation from all key ministries and agencies that have responsibility for one or more of the aspects of the project implementation. The representatives ensure that suitable staff from their ministry/agency will participate in PSC meetings. The Project Steering Committee (PSC) is chaired by the Minister of Energy and Mining or a designated person from his side and it comprised of other 9 (nine) members representing the Office of SRSG's, the Head of UNMIK Pillar IV, the Prime Minister Office, the Ministry of Finance and Economy (MFE), the Ministry of Labor and Social Welfare (MLSW), the Ministry of Environment and Spatial Planning (MESP), the Energy Regulatory Office (ERO), and the Independent Commission of Mines and Minerals Board (ICMM), and Kosovo Trust Agency (KTA). The four obligatory members (which hold veto power are MEM, MESP, ERO and ICMM).

The representation in PSC is designed to ensure full participation from the line-ministries and governmental agencies that have responsibility in one of the targeted domains through the project. All these institutions and governmental entities are responsible for the dully nomination of their suitable representatives from their key staff in the PSC. The PSC will be responsible for the coordination, supervision and monitoring of the Project Office proper functioning in order to ensure the proper implementation, ensuring compliance with Bank requirements. As an inter-ministerial and inter-institutional body the PSC will have a diversity of background, knowledge and experience, and competencies. The chairman of the PSC convenes meetings of the PSC as required. In order to carry out its functions, the PSC will meet in monthly working sessions and

[4] The SRSG's Executive Decision No. 2006/6 of 17 March 2006, pursuant to which the Project Steering Committee and the Project Office were established, has been amended, suspended, abrogated, repealed or waived so as to affect materially and adversely the ability of PSC and/or PO to perform any of their respective obligations, functions and/or responsibilities under the Project. In this way, the Chapter 8, of Law on Energy Regulatory Office of Kosovo, No 2004/9 has been partially derogated to the Project Steering Committee.

whenever necessary. The PSC in its plenary session or as a PSC sub-sets shall pass decisions made on the consensus basis reached among MEM, MESP, ICMM and ERO.

Figure 2.3



3.1.6 The LPTAP Project Objectives and Summary of Components, Implementation

The objectives of the LPTAP are to:

- Help PISG strengthen the enabling policy, legal and regulatory frameworks conducive to new investments in the energy sector; developing various policy, legal and regulatory instruments in the energy consistent with international good practices; and developing technical assistance for organizing bidding and negations leading to financial close on new sector investment;
- Assist PISG in a pilot transaction for attracting private investment into building new capacity for lignite thermal power generation guided by principals of environmental and social sustainability.

3.2 Expression of interest (EOI) and shortlist of qualified bidders (criteria, list)

Following its establishment the PSC issued on 15th of August 2006 an international call for the Expression of Interest (EOI) by qualified bidders who wished to participate in a private project for the development of a new lignite mining facility and associated new electric generating and transmission capacity and the rehabilitation of existing generators (called further "Project"). Project has the following components:

a. Construction of a new power plant 'Kosovo C' ("PPC") with an estimated installed capacity of up to 2100 MW and associated transmission capacity;

b. The development of a new coal mine for existing generation units (Sibovc SW) and development of a new mine (the Sibovc mine) for PPC; and

c. Rehabilitation of certain units of the existing power plant 'Kosovo A' ("PPA").

The international EOI was followed by an International Investors Conference which was held in Pristina on the 10th and 11th of October 2006. The Conference was met with great success as a big number of important utilities and private power projects developers expressed an interest and participated.

Following the international Investors Conference the PSC issued to the 10 consortia/companies which have responded to the call for EOI the four Eligibility Criteria for the "pre-qualification" of potential bidders. The four criteria were:

A Prospective Bidder must meet the following minimum criteria:

- has developed green field, coal or lignite fired electric generation projects, which are now either in construction or operation, totaling more than 2,500 MW;

- has raised more than € 2 billion of limited recourse project debt or through long term corporate financing as of November 30, 2006 in the energy and/or mining sector; or has a minimum of € 2 billion in free cash reserves, as stated in the year-end 2005 audited financial statements;

- has developed and is operating, as of November 30, 2006, mines producing more that 20 million tons per year of coal or lignite;

- has control of or operates one or more generation companies and/or concessions with an aggregate capacity of at least 10,000MW as of November 30, 2006

Four major international consortia have emerged (30 December 2006) as satisfying the four criteria and as a consequence have been short listed as "pre-qualified bidders" included into the further process. Those are:

a. RWE Power AG (Germany)
b. EnBW and Washington Group International (Germany/USA)
c. CEZ and AES (Czech/USA)
d. ENEL and SENCAP (PPC) (Italy/Greece/USA)

All Prospective Bidders has appointed a single representative and an alternate prior to submission of the Application for Pre-qualification for Bidding, indicating an address and telephone and fax numbers, to receive notices and other communication in connection with the application. Such representatives may be changed by the Prospective Bidder by written notice to MEM. The Prospective Bidders have participated in this process only after they have paid the Due Diligence Fee.

3.3 The technical advisors scope of work

On the same time PSC has proceeded with the procurement of the Consulting services for:

- Transaction Advisory Services;
- Legal Advisory Services;
- Social and Environmental Safeguards Advisory services;

The work of the Consultants will be funded through a grant made available to the Client by the World Bank.

By far the most important Adviser in the proces is the Transaction Adviser as he has to:

Purpose
To provide transaction advisory services and assisting the PSC of LPTAP in attracting private sector participation

Scope of work (in three phases):
Phase 1: Preparatory work

- review the market structure & take measures (structural, legal environmental etc.) to facilitate the transaction
- prepare final investment package (based on Options Analysis) & recommend short list of qualified bidder

Phase 2: Prepare Requests for Proposals (RFP) and Bidding

- prepare necessary documents to undertake a competitive & transparent bidding process – issuance of a RFP to approved short list bidders

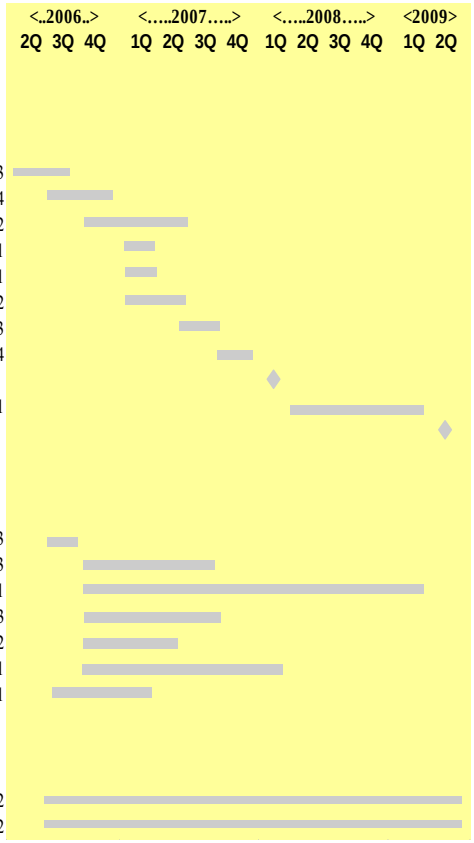
Phase 3: Negotiations and Closing

- Assistance in concluding negotiations with a successful bidder on mutually-acceptable, appropriate terms and conditions (in close cooperation with Legal Advisors)

The PSC has adopted a set of documents, like The Operations Manual (OM), Code of Behaviour and Code of Ethics, etc. The OM shows the principles, procedures and rules of implementation of the Lignite Power Technical Assistance and lays the foundation of and must be used in connection to a series of other primary documents, such as: Financing Agreement and Project Appraisal Document (PAD), Annual Work Plan derived from the Project Implementation Plan, the World Bank Guidelines with regard to procurement out of IBRD loans and IDA credits, issue of May 2004 etc. The Code of Behaviour and Code of Ethics is intended to guide the representatives of the Ministry of Energy and Mining, the LPTAP Project Committee (PSC) and the LPTAP Project Office (PO) who participate, at whatever stage and at whatever level of input, directly or indirectly, in the business process that has an element of procurement activity.

Table 3.2 Time frame of project implementation

LIGNITE POWER TECHNICAL ASSISTANCE PROJECT REVISED PROJECT IMPLEMENTATION PLAN June 2006	Start	End
Sibovc Mine and Power Plant Transactions		
Options Review (EAR funded)	2006/Q2	2006/Q3
Prokurement of Transaction Advisor	2006/Q3	2006/Q4
Preparation of data room	2006/Q4	2007/Q2
Roadshow and feedback from potential investors	2007/Q1	2007/Q1
Prequalification of potential investors	2007/Q1	2007/Q1
Development and Issuance of RFP*	2007/Q1	2007/Q2
Preparation and Submission of Competitive Proposals	2007/Q2	2007/Q3
Evaluation of Proposals and Negotiations with Preferred Bidder	2007/Q4	2007/Q4
Closing of Mine Developoment Contracts and Commencement of Mine Work	2008/Q1	
Financial Closing work on Kosovo C (and, possibly, Kosovo A), as required**	2008/Q2	2009/Q1
Closing of Power Plant Contracts and Commencement of Power Plant Work***	2009/Q2	
Subtotal of Donor Costs for the Option Review and Transaction Advisor		
Transaction Support Services		
Procurement of the Legal and Safeguard Advisors	2006/Q3	2006/Q3
Legal Diagnosis (including Resettlement Policy Framework)	2006/Q4	2007/Q3
Legal Implementation (including legal support for Transaction Advisors)	2006/Q4	2009/Q1
Prepare Environmental Baseline Monitoring Toolkit, and Collect Field Data	2006/Q4	2007/Q3
Prepare SESA	2006/Q4	2007/Q2
Develop Environmental Procedures, and Conduct Training in Procedures	2006/Q4	2008/Q1
New Power Plant Technical Analysis (EAR funded)	2006/Q3	2007/Q1
Subtotal of Donor Costs for Transaction Support		
Project Organization		
Project Office	2006/Q3	2009/Q2
Communication & Outreach Strategy	2006/Q3	2009/Q2



3.4 Studies to support the development of new generation capacities and related transmission

On the 13th of December, 2006 the European Agency for Reconstruction and Consortium appointed Consultants to undertake technical and economic studies to support the "development of new generation capacities and related transmission" The duration of the project is seven months from the commencement date. The commencement date has been set to January 15th, 2007. The studies to be executed by the consultant will serve as a base material or support the work of the transaction advisors in selection of an investor for that new generation capacity.

The first tasks are related to identification of potential electricity users and demand forecasts within SEE. The task also includes price modeling of the market. The consortium has selected the scenario number 5 of GIS regional least cost investment study, the most recent updated version by SEEC and earlier REBIS GIS version as main scenario. This scenario represents the expected development of the power plant park in SEE under the following assumptions:

- medium demand growth
- medium fuel prices
- CO_2 related expense € 20/ton of CO_2
- justified rehabilitation programme

This scenario was selected as the main scenario because it was not felt right to calculate a future without any CO2 burden in SEE, even if the regulations regarding CO2 reduction in SEE after

2012 are highly uncertain. The second task investigates the transmission system how the new generating capacity can be handled and exported from Kosovo. Another crucial issue is the maximum unit size which can safely be connected with the SEE transmission system. Based on the outcome of the market and transmission studies (three alternatives) regarding to unit size or plant technology will be developed. Their economic and financial viability is established by a financial model to be developed during the work. That model can then be used to test various contractual/financial structures of the new generation capacity. There will also be extensive environmental data collection and analysis in order to screen the potential plant sites as well as to provide basis for future work and EIA studies on the new plant.

CHAPTER 4

FIRST PRICE REVIEW IN THE ELECTRICITY SECTOR

(FOR REGULATORY PERIOD 2007 - 2009)

4.1 Background

ERO initiated its first review of electricity tariffs in March 2006. This was the first review of these tariffs since 2000, and the first time that ERO had exercised its powers to review and approve electricity tariffs.

The review followed the process for performance-based tariffs as set out in ERO's Rule on Principles of Calculation of Tariffs in the Electricity Sector (the "Pricing Rule") and the Tariff Methodology[5]. Under this approach, ERO initially determines allowed revenues to be recovered from regulated tariffs in each year by each licensee. The individual licensees then apply to ERO for approval of tariffs that recover these allowed revenues.

The regulated tariffs approved by ERO comprise:

- **Transmission use-of-system (TUOS), system operator (SO) and market operator (MO) charges applied by KOSTT JSC**. TUOS charges apply to all suppliers serving customers in Kosovo, but not to generators. SO and MO charges apply to both suppliers and generators and include the costs of Ancillary Services procured in and outside of Kosovo. No charges apply to energy transiting Kosovo, which instead should be paying a charge for the use of Kosovo's networks in accordance with a methodology established by ETSO/SETSO and as per the guidelines of regulation 1228/03/EC on "Inter-TSO compensation scheme (ITC).

- **Retail tariffs charged to non-eligible customers by KEK JSC's licensed Public Supply business ('KEK Public Supply')**. These comprise the costs of power purchases (from generators located in Kosovo and from imports), payments by KEK JSC to KOSTT JSC, the costs of KEK JSC's licensed Distribution business and an allowance for the costs of KEK Public Supply.

For the purposes of determining regulated retail tariffs, ERO is, therefore, obliged to determine allowed revenues to be recovered from non-eligible customers for:

- KEK JSC's mining business, which supplies KEK JSC-owned generators.
- KEK JSC's licensed Generation business (which owns and operates Kosovo A and Kosovo B).

- KEK Distribution.

[5] These documents are available from ERO's website.

In addition, ERO also needs to make assumptions as to the costs of imported power purchased by KEK Public Supply, revenues from exports of power, which reduce the revenue requirements of KEK Generation to be recovered from customers within Kosovo, and the costs of power purchases from non-KEK generators located in Kosovo.

At present, payments between KEK JSC's various licensed businesses are treated as internal transfers. With the commencement of the transitional wholesale electricity market KEK Generation will, as will other generators, earn revenues from sales under PPA's and invoice and be paid through the mechanisms established in the market rules. The charges applied by KEK Generation for sales to KEK Public Supply will be subject to approval by ERO. ERO also intends, in the near future, to approve separate charges to be applied by KEK Distribution[6].

4.2 Principles

The principles governing regulated tariffs are laid down in Articles 46 and 47 of the Law on the Energy Regulator (No. 2004/09, promulgated 30th June 2004). These principles have been further refined and developed in the Pricing Rule and Tariff Methodology issued by ERO.

Among the most significant principles laid down in the Law on the Energy Regulator are that:

- prices shall be reasonable, non-discriminatory, based on objective criteria, and determined in a transparent manner.
- prices shall be primarily dependent upon the justified costs.
- prices shall take into consideration environmental and consumer protection concerns.
- prices for the individual groups of customers shall conform to the costs of delivery of electricity to those customers.
- cross-subsidies[7] of customer classes shall not be permitted.
- cross-subsidies of activities of integrated enterprises shall not be permitted.
- seasonal and time-of-use rates are permitted, with prices adjustable according to the cost of peak and off-peak service.

In the current difficult economic conditions faced by Kosovo, ERO has interpreted its duties with respect to customer protection as including:

- avoiding large price increases for customers with lower levels of consumption (who are assumed to include poorer households);

- avoiding large price shocks for individual customer groups and instead allowing a gradual adjustment to cost-reflective tariffs.

[6] No eligible customers are currently connected to the distribution network. Therefore, a delay in approving KEK Distribution charges does not impact on competition in the electricity market as no competing suppliers will need to seek access to this network.

[7] A cross-subsidy exists where prices to one customer group are below the costs of supplying them, with the difference being made up by charging another group of customers a price above the cost of supplying them.

During the process of preparation of the Tariff Methodology, ERO also adopted a number of other key principles, publicly consulted on at the time, and which are reflected in the Methodology and the final allowed revenues and approved regulated tariffs:
As KOSTT JSC and KEK JSC currently incur no financing costs associated with pre-2006 assets, no return is allowed on these assets. However, KOSTT JSC and KEK JSC do receive an allowance reflecting the costs of maintaining these assets in their current condition. In the event that, following the conclusion of final status arrangements, KOSTT JSC and KEK JSC become liable for debt service or other costs associated with these assets, then ERO will permit these costs to be passed through to customers.

- **KOSTT and KEK Distribution are liable for the costs of energy purchased to cover transmission and distribution losses**[8]. They are permitted to pass through an allowance for these costs, based on a target loss level determined by ERO, and retain the savings from any reduction in losses below this level (or pay the additional costs of any excess losses), thereby facing a strong incentive to cut losses.

- **KOSTT JSC and KEK JSC do not earn a return on new assets which are assumed to be funded from grants from donors or the Kosovo Consolidated Budget (KCB)**. A depreciation allowance is earned. On non-donor and non-KCB funded new assets, a commercial return is earned and the assumption is made that these are financed from a combination of retained earnings and new borrowing.

As is well-known, KEK JSC's performance on collecting billed revenues is very poor. In 2006, collection rates were around 65%. By comparison, collection rates in Bosnia-Herzegovina are reported[9] as 85% for industrial customers and 96% for household customers, in Macedonia as 73% for industrial customers and 82% for household customers and in Serbia as 87% for industrial customers and 93% for household customers. Although KEK JSC faces very major difficulties in increasing collections, there is clearly substantial scope for improvement.

On the grounds of equity, ERO determined that paying customers should not be expected to cover losses resulting from KEK JSC's failure to collect payment from other customers. Therefore, in the price review, no allowance was made for bad debts or uncollected but billed revenues. This creates a strong incentive on KEK JSC to increase collections. It also removes the need for tariff increases to cover non-collection, thus assisting affordability.

Finally, ERO expressed its preference for the use of multi-year price control periods (ie, fixing allowed revenues for a number of years ahead) where possible, in order to increase incentives for licensees to improve their efficiency and to provide greater tariff stability and predictability. However, ERO also recognised the difficulties in such an approach in an environment where many uncertainties exist over future electricity demand, the availability of supplies from KEK JSC's own generators and the availability and price of imports from other countries. ERO, therefore, adopted the following principles with respect to the use of multi-year price-control periods:

[8] The difference between metered energy entering and leaving the system. These losses include theft of electricity but exclude electricity billed but not paid for (collection losses).
[9] Data for all examples from Council for European Energy Regulators (11 May 2006), *Tariffs Benchmarking*, South-East Europe Regional Energy Market Support Project (C06-SEE-15-04). Data is for most recent available year (2004 or 2005).

- **The costs of operating, maintaining and investments in KOSTT JSC's transmission network and KEK Distribution's network are fixed for a three-year period** (2007-09). KEK Distribution's allowed costs are partially indexed to changes in demand and both sets of costs are indexed to inflation (using the EU harmonised consumer price index).

- **All other allowed costs, including the costs to KOSTT JSC and KEK Distribution of purchasing losses, are set on an annual basis**. However, in order to assist forward planning by the industry and its customers, ERO also publishes a three-year price path showing projected allowed revenues up to 2009.

4.3 Summary of process

4.3.1 Determination of allowed revenues

Throughout the review, ERO was assisted by two independent firm of consultants funded by World Bank and EAR respectively.

The determination of allowed revenues was based on responses to date requests prepared by ERO and its consultants and submitted to licensees. The responses received were subject to detailed analysis, including comparison of costs with international benchmarks and reviews of assumptions with licensees, the Ministries of Energy and Mining (MEM) and Economy and Finance (MEF) and the UNMIK Fiscal Affairs Office (FAO).

This process and, in particular, reaching agreement on assumptions regarding future subsidies available to the industry, were more extended that expected and led to a delay in approval of the allowed revenues from the originally targeted September 2006 date until December 2006. The final allowed revenues were approved on 21st December 2006 (Decision D_29_2006[10]).

4.3.2 Approval of regulated tariffs

Using the approved allowed revenues, ERO and its consultants prepared indicative transmission and regulated retail tariffs and provided these to licensees to support their applications for approval of new tariffs. Applications were to be received in early-2007 for review by ERO.

Given the delay in approving allowed revenues, ERO determined that the new tariffs would take effect from 1st April 2007, and would apply until 31st December 2007. The sum of revenues collected under existing tariffs for the first three months of the year and the new tariffs for the remainder of the year should equal the total allowed revenues approved by ERO.

As the review and approval of the new tariffs is to take place in 2007, it is not covered in this 2006 Annual Report.

[10] Available from ERO's website.

4.3.3 Timetable

The price review began with a public notification on 8th March 2006. Key dates over the review and approval process to end-2006 include:

14 March 2006	notification of price review published
26 May 2006	workshop on data requirements and timetable
10 June 2006	receipt of initial data submissions from KEK JSC and KOSTT JSC
June to September 2006	review and analysis of data submissions by ERO and consultants
28 July 2006	Publication of proposed cost of capital (allowed return) for KEK JSC and KOSTT JSC for comments
30 July 2006	public workshop on proposed adjustments to customer categories and tariff structures
12 September 2006	public workshop on proposed allowed revenues for KEK JSC and KOSTT JSC
20 September 2006	ERO Board Decision approving cost of capital for use in allowed revenues determination
October to November 2006	consultations on proposed allowed revenues with stakeholders including KEK JSC, KOSTT JSC, MEM, MEF and FAO
24 November 2006	provisional approval by ERO Board of allowed revenues for KEK JSC and KOSTT JSC and publication for comment, with deadline for comments of 4 December 2006
21 December 2006	ERO Board Decision approving allowed revenues for KEK JSC and KOSTT JSC

ERO emphasized the importance of public consultation in the review process. This has included the publication of key documents on its website for comment, the holding of public meetings as identified above and direct discussions with stakeholders including licensees, the Government and Parliamentary representatives.

4.3.4 Results

The final allowed revenues approved by ERO on 21st December 2006 are as follows.

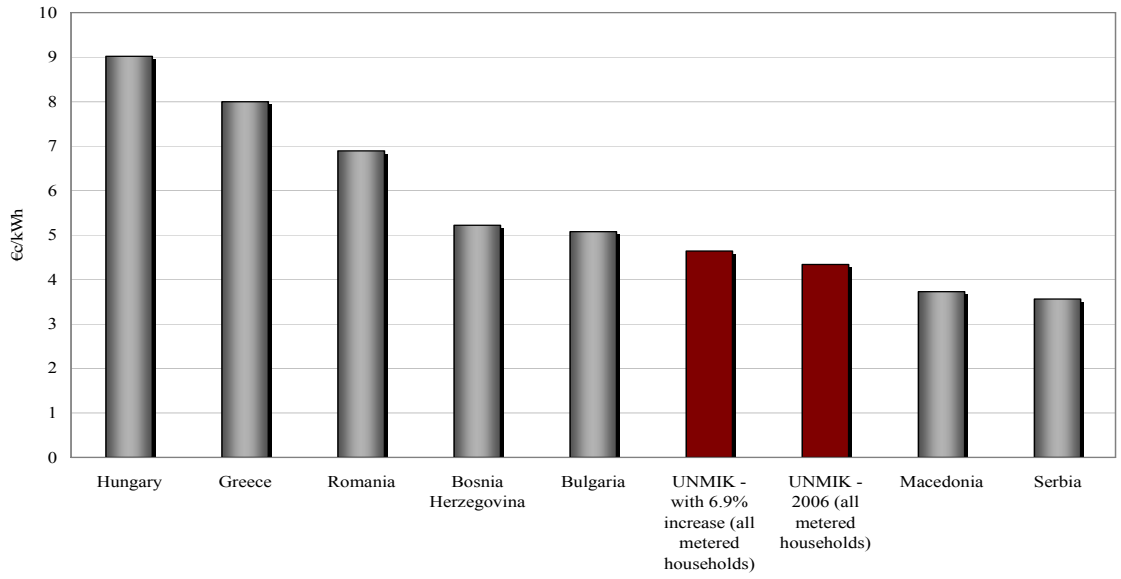
Table 4.1 Approved allowed revenues

	Approved 2007 €000s	Forecast 2008 €000s	Forecast 2009 €000s
KEK Public Supply (regulated retail tariff revenues)	141,899	148,796	158,690
KOSTT JSC (transmission charge revenues)	13,678	17,026	21,765

Assuming that actual demand in 2007 is equal to forecast levels, the resulting average regulated retail tariff in 2007 will be €c5.26/kWh. This is a 6.9% increase over KEK's reported average billed tariff in 2006, of €c4.92/kWh. It is important to note that the actual change in individual tariffs will vary from this average, due to the delayed introduction of the new tariffs (from 1st April 2007) and the rebalancing of existing tariffs towards a more cost-reflective structure that eliminates inter-customer cross-subsidies (as required by the Law on the Energy Regulator

A comparison of current Kosovo household tariffs with other countries in South-East Europe shows that these are towards the lower end in the region. This would remain the case, even after applying the resulting average increase implied by the allowed revenues approved by ERO. This is illustrated below. The actual change in household tariffs will, of course, also depend on the resulting changes in tariff structures proposed by licensees as reviewed and approved by ERO.

Figure 4.3 Average household tariffs in South-East Europe



4.3.5 Sources

UNMIK - KEK JSC (total revenues and energy billed to metered household customers in 2006)

Others:
Council for European Energy Regulators (11 May 2006), Tariffs Benchmarking, South-East Europe Regional Energy Market Support Project (C06-SEE-15-04). Data is for most recent available year (2004 or 2005).

CHAPTER 5

CONSUMER PROTECTION

5.1 Number and processing of complaints

Pursuant to the authority given under article 17.1 of the Law on Energy Regulator, the Board of the Energy Regulatory Office on a session held on 17 th January 2006 adopted the **Rule on "Dispute Settlement Procedures in the Energy Sector".**
Based on the provisions of this Rule all customers are entitled to bring their complaints regarding service provided by a supplier or distribution system operator, in the first place to such supplier before referring it to ERO.
Customer Protection Department (CPD) of ERO has been involved in tasks related to customer protection, analyzing the data received from KEK, focusing on customers' complaints, participating on reviewing KEK procedures on: Disconnection, Debt Settlement, Dispute Settlement, Charges, Fines etc, to ensure that the proposed procedures are non-discriminatory and all customers are treated equally.
Below is given the table with all the registered complaints from the Customer Care Department of KEK and also the table with the settlement complaints for the year 2006.

Table 5.1 Number of the registered complaints from the Customer Care Department of KEK in year 2006

	Unregister payment	Preliminary balance-wrong	Unrecieved bills	Over limit	Change of flat rates	Uncorrect reading	Unregular reading	Unaccurate meter	Request for repayment	Charged with Vat	PBF (RTK tax)	Others	Total
January	12	70	5	693	87	43	25	25	51	13	14	909	1947
February	12	49	2	854	177	72	691	42	59	2	22	1130	2608
March	23	64	5	869	193	62	247	27	110	3	21	1305	2929
April	14	52	3	972	184	68	445	55	61	2	13	1050	2919
May	18	67	0	755	153	91	254	11	55	3	17	928	2352
June	9	25	0	311	59	37	55	15	48	0	1	486	1046
July	8	5	3	215	47	35	42	8	22	0	10	180	575
August	3	20	1	203	30	35	33	21	43	1	12	211	613
September	13	40	3	311	98	57	41	16	62	1	6	681	1329
October	10	57	22	422	71	47	100	17	74	1	3	836	1660
November	21	56	13	569	160	53	27	26	82	3	8	1051	2069
December	5	59	1	381	46	28	20	20	46	0	11	694	1311
Total	**148**	**564**	**58**	**6555**	**1305**	**628**	**1980**	**283**	**713**	**29**	**138**	**9461**	**21358**

The "over limit" that is presented in the table, it means that the consumption above 800KWh that are consumed from the customers are calculated with different prices in a different season (low season and high season), to be more accurate the price of the KWh above 800 KWh is higher than the price of consumption below 800 KWh. Also to emphasize that the calculation for the over limit is different from the calculation for the energy presented in the bill.

Figure 5.1 Graphical presentation of the registered complaints from the Customer Care Department KEK in year 2006

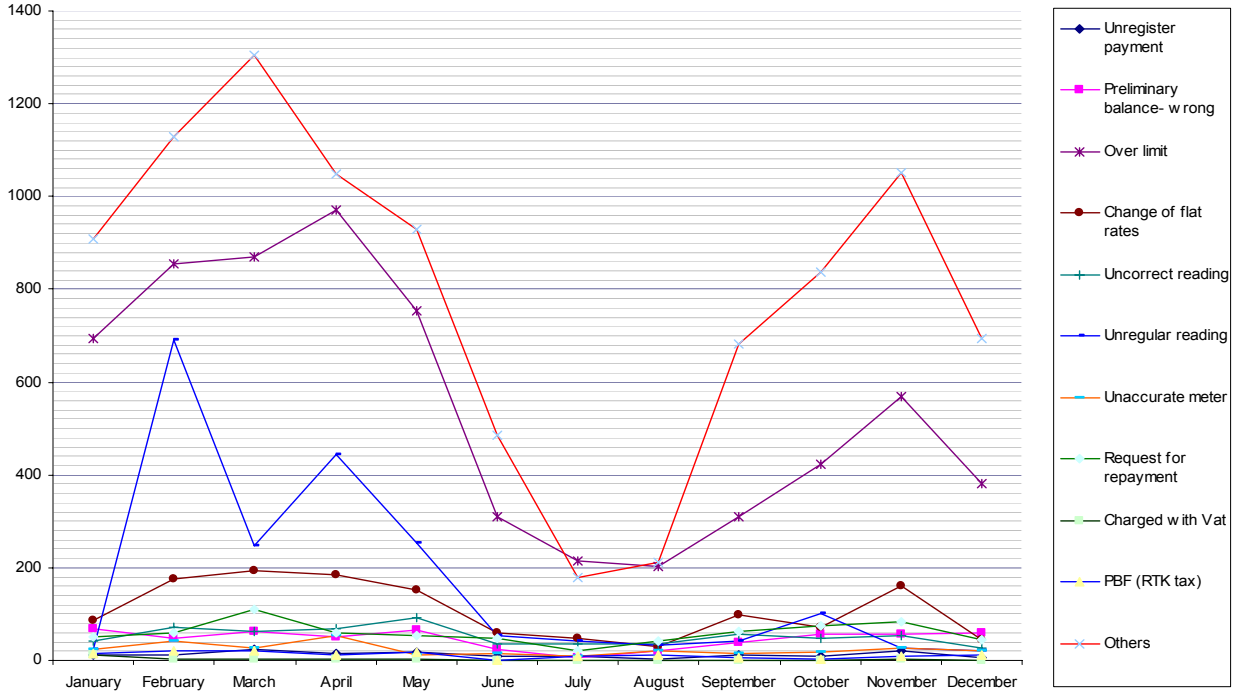
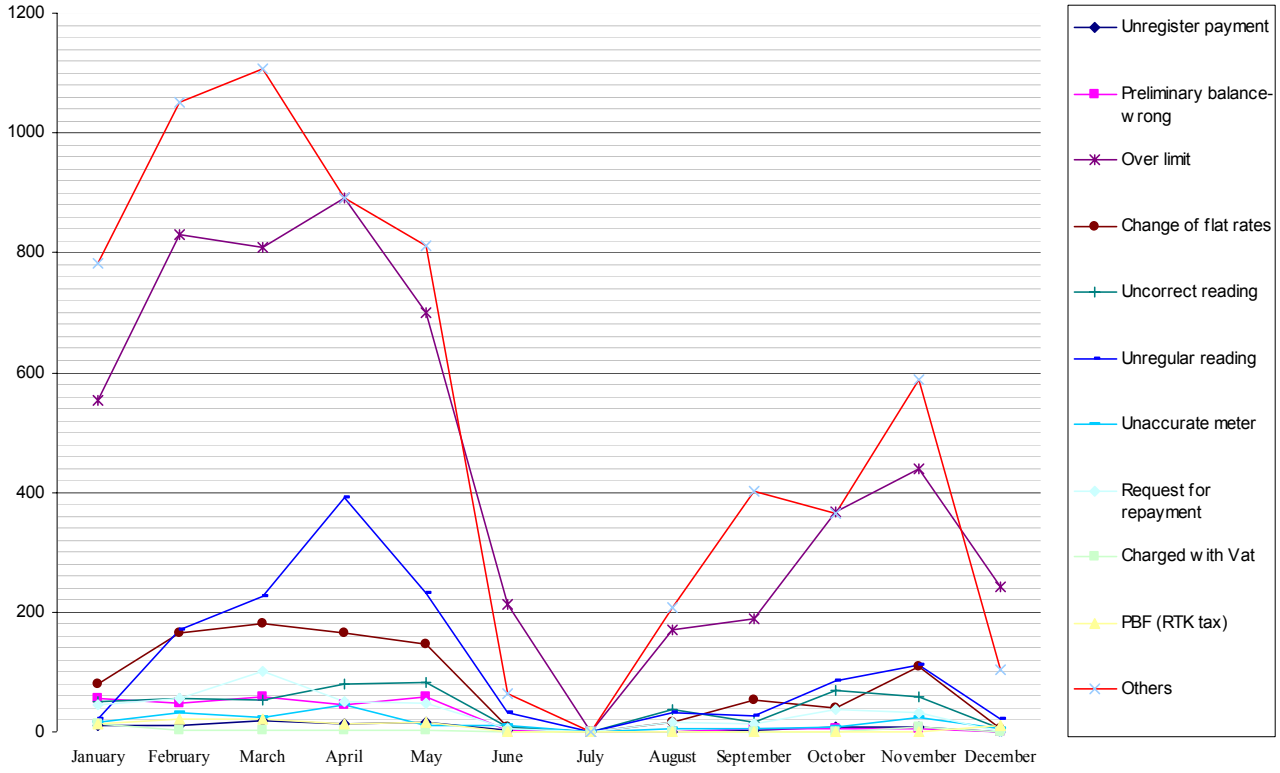


Table 5.2 Number of the settled complaints from the Customer Care Department of KEK in year 2006

	Unregister payment	Preliminary balance-wrong	Unrecieved bills	Over limit	Change of flat rates	Uncorrect reading	Unregular reading	Unaccurate meter	Request for repayment	Charged with Vat	PBF (RTK tax)	Others	Total
January	10	56	0	553	80	51	22	15	45	13	14	781	1640
February	10	49	0	829	164	57	169	31	56	2	22	1052	2441
March	19	58	0	808	180	54	226	23	101	3	21	1107	2600
April	13	46	0	891	165	81	390	45	50	3	13	892	2589
May	15	58	0	700	147	83	232	11	49	3	17	812	2127
June	3	2	0	213	9	9	32	10	5	0	0	64	347
July	0	0	0	0	0	0	0	0	0	0	0	0	0
August	0	0	0	171	15	37	33	4	16	0	0	208	484
September	2	6	0	189	54	17	26	4	13	0	0	402	713
October	8	5	0	367	39	68	85	8	37	1	0	364	982
November	8	5	0	440	108	58	111	24	31	7	0	588	1380
December	0	1	0	241	5	4	22	4	0	0	11	104	392
Total	**88**	**286**	**0**	**5402**	**966**	**519**	**1348**	**179**	**403**	**32**	**98**	**6374**	**15695**

Figure 5.2 Graphical presentation of the settlement complaints from the Customer Care Department KEK in year 2006.



Customer Protection Department of ERO under the provisions given in the Rule on Dispute Settlement Procedures in the Energy Sector have registered 52 customer complaints in the period 01/2006 until 03/2007. Customer's complaints can be categorized as following:

- 35 customer complaints registered in the CPD were domestic customers
- 13 customer complaints registered in the CPD were commercial customers
- 4 customer complaints registered in the CPD were industrial customers

Below you will find the table of the registered complaints from the Customer Protection Department (CPD) of ERO in the period 01/2006 until 03/2007.

Table 5.3 Registered complaints from the Customer Protection Department (CPD) of ERO in the period 01/2006 until 03/2007.

	Unauthorized consumption	Previous Debt	PBF (RTK tax)	Over limit	Maxigraph	Flat rates	Disconnection charges	Damage compensation	Others	Total
January	0	0	0	0	0	0	0	0	0	0
February	0	0	0	0	0	0	0	0	0	0
March	0	0	0	0	0	0	0	0	0	0
April	0	0	2	0	1	0	0	0	1	4
May	1	0	1	0	0	0	0	0	0	2
June	0	0	0	0	0	0	0	0	0	0
July	0	2	0	1	1	0	1	0	0	5
August	0	2	0	0	1	0	0	0	1	4
September	0	0	0	0	0	0	0	0	1	1
October	0	1	0	1	0	0	1	1	2	6
November	2	0	0	0	0	1	0	0	1	4
December	0	2	1	0	0	1	0	2	1	7
January	1	0	1	1	0	1	0	0	2	**6**
February	0	0	3	0	0	1	1	0	1	6
March	1	0	1	0	0	0	1	1	3	7
Total	5	7	9	3	3	4	4	4	13	**52**

Figure 5.3 Graphical presentations of the registered complaints from the Customer Protection Department of ERO in period 01/2006 until 03/2007

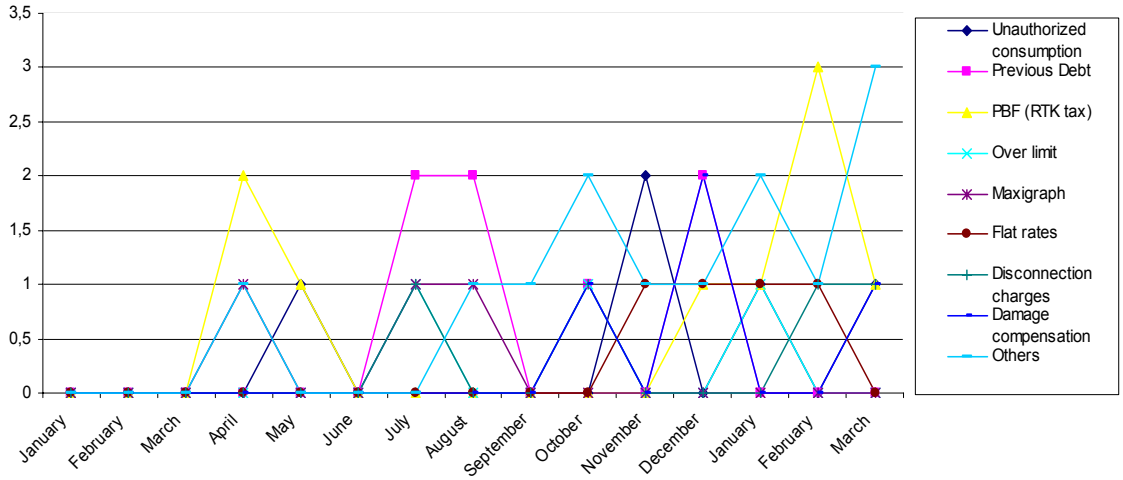
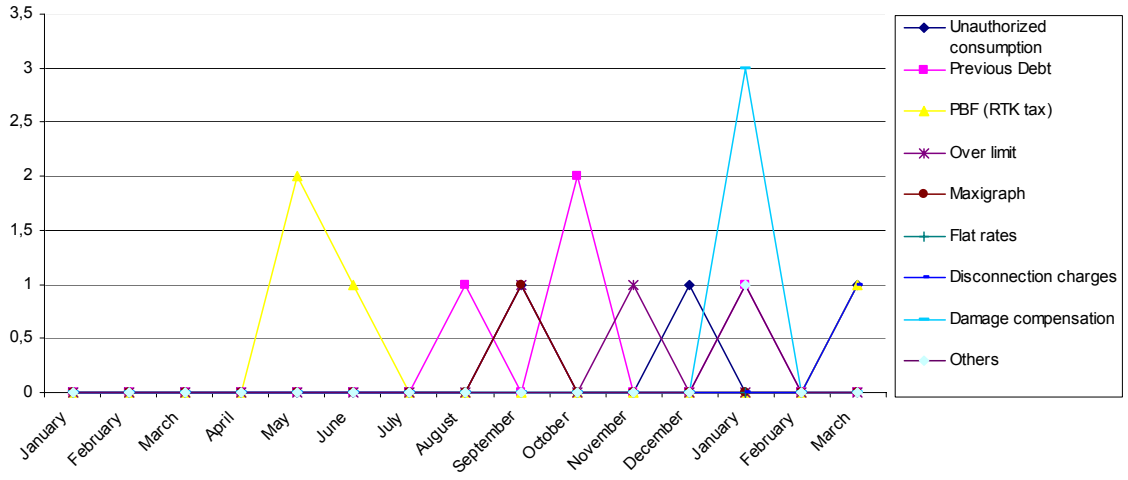


Table 5.4 Number of the settled complaints from the Customer Protection Department of ERO in period 01/2006 until 03/2007

	Unauthorized consumption	Previous Debt	PBF (RTK tax)	Over limit	Maxigraph	Flat rates	Disconnection charges	Damage compensation	Others	Total
January	0	0	0	0	0	0	0	0	0	0
February	0	0	0	0	0	0	0	0	0	0
March	0	0	0	0	0	0	0	0	0	0
April	0	0	0	0	0	0	0	0	0	0
May	0	0	2	0	0	0	0	0	0	2
June	0	0	1	0	0	0	0	0	0	1
July	0	0	0	0	0	0	0	0	0	0
August	0	1	0	0	0	0	0	0	0	1
September	1	0	0	1	1	0	0	0	0	3
October	0	2	0	0	0	0	0	0	0	2
November	0	0	0	1	0	0	0	0	0	1
December	1	0	0	0	0	0	0	0	0	1
January	0	1	0	0	0	0	0	3	1	**5**
February	0	0	0	0	0	0	0	0	0	0
March	1	0	1	0	0	0	1	0	0	3
Total	3	4	4	2	1	0	1	3	1	19

Figure 5.4 Graphical presentation of the settlement disputes from the Customer Protection Department of ERO in period 01/2006 until 03/2007.



From the 52 registered customer complaints from the CPD in the period 01/2006 until 03/2007, 19 of customer complaints were settled under the provisions of the Rule on Dispute Settlement Procedures in the Energy Sector.

Customer complaints that were settled from the Customer Protection Department in the period 01/2006 until 03/2006 were of all different categories:

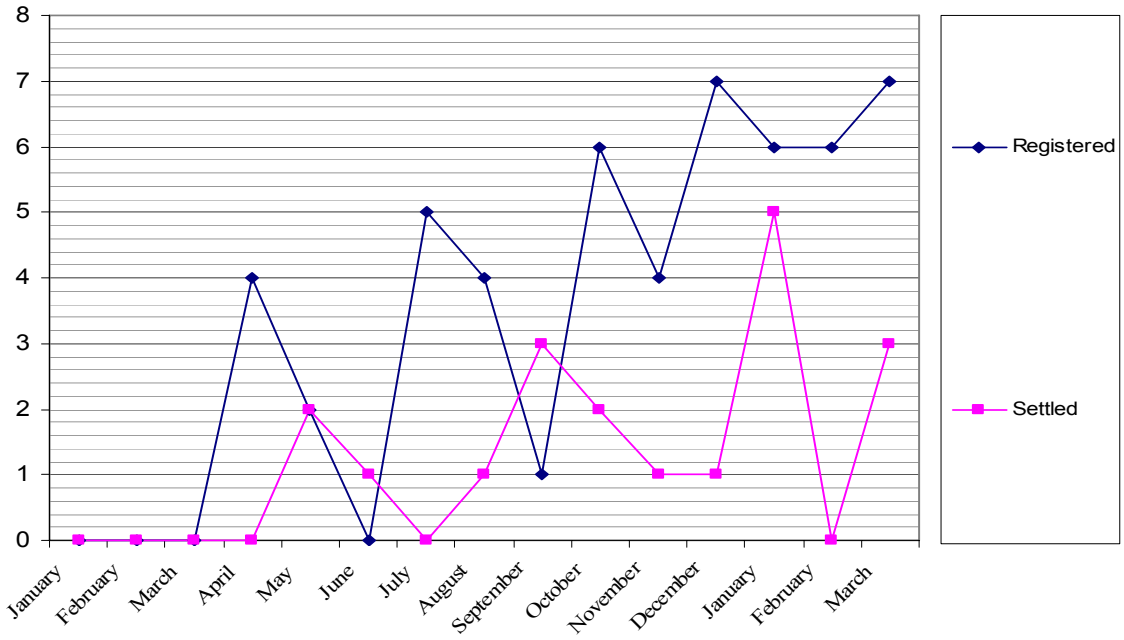
- 13 customer complaints registered in the CPD were domestic customer
- 4 customer complaints registered in the CPD were commercial customer
- 2 customer complaints registered in the CPD were industrial customer

Registered Complaints in the CPD in the period 01/2006 until 03/2007 were on different natures, where: unauthorized consumption, previous debt, PBF (RTK tax), over limit, maxigraph, damage compensation etc.
Below you will find the table with comparisons of the registered and settle customer complaints of the Customer Protection Department of ERO and also the graphic in the period 01/2006 until 03/2007.

Table 5.5 Comparisons of the registered and settle customer complaints of the Customer Protection Department of ERO and also the graphic in the period 01/2006 until 03/2007

	Registered	Settled
January	0	0
February	0	0
March	0	0
April	4	0
May	2	2
June	0	1
July	5	0
August	4	1
September	1	3
October	6	2
November	4	1
December	7	1
January	**6**	**5**
February	6	0
March	7	3
Total	**52**	**19**

Figure 5.5 Graphical presentation of the Comparisons of the registered and settle customer complaints of the Customer Protection Department of ERO and also the graphic in the period 01/2006 until 03/2007



From the 52 customer complaints that are registered in the CPD, 19 of the customer complaints are settled in the period 01/2006 until 03/2007. The other complaints that are registered in CPD and are not settled it means that they are or in the Alternative Dispute Resolution (ADR) based on the chapter 4 of the Rule on Dispute Settlement Procedures in the Energy Sector or that they are still on process.
From the 21 customer complaints that CPD has settle, from them:

- 8 customer complaints were refused
- 4 customer complaints were accepted
- 7 customer complaints were just information to the customers

The information that we give to the customers that are registered in the CPD it means that based on the article 32.1 of the Rule on Dispute Settlement Procedures in the Energy Sector the Energy Regulatory Office (ERO) doesn't have competencies for the contest before 2004, so these contest that are before 2004 after KEK response should address the court.

5.2 KEK monitoring report

The Energy Regulatory Office based on its mandate given by the Law on Energy Regulator 2004/09 (Article 54) has performed a monitoring of KEK, during 2006 (June), with the aim of incentivising KEK's performances. The objective of the monitoring was to evaluate:

- Implementation of Secondary Legislation (Rules, Decrees, Codes) adopted by ERO;
- Implementation of Decisions issued by ERO;
- Positive effects in the increase of billing and collection, respectively decrease of commercial losses; and
- Improvement on customer relations;

Another important objective was to evaluate the knowledge and comprehension within KEK's staff of Secondary Rules and Decisions adopted by ERO, provision of clarifications and the resolution of the eventual problems during the implementation phase.

ERO has evaluated the implementation and enforcement of the Secondary Legislation and disposition of decisions from KEK, analyzed the results, and concluded by giving instructions for future actions in application of regulatory framework as a need to increase the performance and customer satisfaction.

Monitoring Report didn't presume to assess impact of implementation of regulatory framework on the issue of "non-technical" losses of electricity, since the Rule on General Conditions for Energy Supply was adopted later and during the monitoring it has not been taken into consideration. However the analysis and evaluation of received information and statistics has directed ERO to draw up instructions that may improve the KEK's performance.

With regard to the decisions taken by ERO particular attention in the monitoring process was paid to the ABC supply policy regime. Based on KEK's official request ERO has reviewed and by its decision (Decision D_08_2005 by 29th November 2005) has approved the ABC supply regime. To the idea of establishing a differentiated supply where main criterion is collection rate, ERO

positively responded but gave those conditions that have dynamic approach and over the time may remove reasons of applying the load shedding. KEK has failed to implement conditions as imposed by ERO's decision and paying customers in supply groups B and C have reason to be unsatisfied. The details of failures to implement given conditions in addition to the projected ABC supply regime are available in the Monitoring Report that has been published in ERO's official web page. During the monitored period and by cross-checking the statistical data, the implementation of ABC supply regime has created impression that was carried out with satisfactory discipline. But some recent information, (still not verified), led eventually to the conclusion that KEK's staff started to have failures in the fair implementation of load shedding as foreseen by this regime. ERO in the next monitoring report is going to review specifically this problem.

During the monitoring process and based on interviews with staff, statistics and data of the results about revenue collection rate, losses, disconnections and disputes with customers have identified important findings as outlined below:

- There is need for immediate implementation of all secondary legislation in order to achieve satisfactory results and increase the revenue collection rate, as well as improving the quality of service in power supply.

- An implementation of particular legislation requires the preparation of corporate policy and appropriate internal procedures that have to be followed by action plan.

- The partial implementation (whether is taken by entities mandated for that or any internal decision taken by utility) of any regulation or decision may compromise its intention and purpose.

- The extensive implementation of disconnection policy in the monitored period without proper implementation of requirements of dispute settlement procedures as approved by ERO, ABC policy conditions and identification and resolution of the issue of theft of electricity and tampering with the meters, has not brought satisfactory improvement to the revenue collection rate despite the fact that the number of disconnected customers was very considerable.

- Undertaken actions in order to increase the revenue collection rate didn't raise the customers' trust to KEK something that is proven by the increased number of good paying customers affected by disconnection.

The results together with findings have led to drawing up to the conclusions as below:

- Referring to the results from the monitoring report whose main purpose was to evaluate how and in what measure the regulatory framework is implemented (regulatory framework which strives to create the conditions for achieving better results and would reflect increasing of revenue collection than it is currently), ERO can state **that there have been some elementary initiatives on behalf of KEK and this is reflected by initial results.**

- Now that the regulatory legislation is completed and based on the fact that this legislation closes all relation processes between the offered service and customer, it is imperative that the momentum must be maintained for its full implementation.

- Interviews with direct executives demonstrate that **the regulatory framework is considered as an item of a great help for improving the relation with consumers and which would result in the decreasing of commercial losses and increasing of the revenue collection rate.** Implementation of the provisions of mentioned Rules would evidently decrease arbitrary behaviors in relation with customers.

Based on findings and conclusions described above the Board of ERO has issued instructions to KEK with certain deadlines and some initial actions of KEK are now evident but still the situation is far away from the path to significantly change things through proper implementation of the issued rules by Energy Regulatory Office.

The Monitoring report can be perused at www.ero-ks.org/Departments/Customer Protection

CHAPTER 6

DISTRICT HEATING

6.1 Overview of the developments in District heating sector in 2006

District heating sector in Kosovo still remains without any significant expansion and rather small in respect of estimated heat demand in Kosovo covering only about 5% of total heat demand. The sector is limited to four municipal utilities that cover municipalities of Prishtina, Gjakova, Mitrovica and Zvecan, and whose assets are under custody of KTA.

After completing the incorporation process – transformation into Joint Stock Companies with KTA being the only sharehoer by the end of 2005, in 2006 JSC Termokos and JSC Gjakova faced rather important challenging task in implementing the corporate governance as envisaged by final incorporation report and business plans respectively. The objectives and goals envisaged to be achieved for successful implementation of incorporation thus leading to successful functioning of companies on commercial basis include the following:

- build new and increase existing professional capacities of key management staff as well as other staff by a number training courses and continuous on-the-job training;
- implement new adopted organizational structure, which would reflect also accounting and organization unbundling of business activities in accordance with energy laws and regulations;
- improve financial situation – become financially self-sustainable business, that inter alia includes measures such as: i) collection of old debts and increase of collection rate by ca. 10% and 5% reaching in 2010 92% and 75% respectively for DH Termokos and DH Gjakova; ii) establishment and implementing of market strategy aiming to increase market share by connection or re-connection of existing building stock within or nearby district heating service area, and by expanding distribution network with new connections of new building blocks; iii) improvement of accounting and reporting systems by developing the computerized integrated management information system;
- improve customer service and develop service performance standards including reliable and quality heat supply at least-cost service for space heating and eventually to introduce hot-tap-water supply, updating customer database, creation of database at substation level that mostly implicates heat metering and switching from “normative tariff per square meter to metered energy consumption – based tariff, developing customer care policy etc;
- wise investments to be implemented with intention particularly to reduce generation and distribution losses, in order to assure customer satisfaction by providing reliable, sufficient heat supply as much as possible competitive and at least-cost service. In this respect to be developed and regularly maintained “operational database” consisting of records of metered fuel (mazut) consumption, generated heat, supplied heat, and losses. In order to assure cheap heat source, DH Termokos seriously considers the investment in co-generation, connection with power plant Kosovo B for which the feasibility study is completed;

Unlike JSC-ies Termokos and Gjakova, District Heating Units (DHU) Termomit and Zvecan still remained under integrated municipal utilities Standard in Mitrovica and Zvecan respectively.

Another important development in district heating sector in 2006 was the licensing of district heating companies by ERO. Actually, after receiving applications and evaluation of their correctness and completeness, on 4th of October 2006 ERO issued following licenses for each particular heat business activities:

Heat Generation License to District Heating Termokos JSC – duration: 15 years;
Heat Distribution License to District Heating Termokos JSC – duration 15 years;
Heat Public Supplier License to District Heating Termokos JSC – duration: 10 years;
Heat Generation License to District Heating Gjakova JSC – duration: 15 years;
Heat Distribution License to District Heating Gjakova JSC – duration: 15 years;
Heat Public Supplier License to District Heating Gjakova JSC – duration: 10 years.

It is to be noted that District Heating Termomit and Zvecan, even after several repeated requests by ERO, didn't apply for licenses and as a consequence these two companies remained un-licensed.

Criteria, conditions and obligations stipulated in each respective license is a tool for regularly and duly monitoring district heating companies in performing their heat related activities as per issued licenses.

6.2 Performance of District heating companies

District Heating in Kosovo consist of four district heating systems in Prishtina, Gjakova, Mitrovica and Zvecan, supplying heat only for space heating mostly for densely populated urban areas of the mentioned municipalities.

6.2.1 Fuel Consumption and Heat Generation

Heat generation is performed in central heating plants equipped with fuel oil boilers using in a large scale heavy fuel oil (mazut) and in a smaller scale light fuel oil (diesel), which fuels are imported with a price following stock market prices plus a premium for covering supplier's expenses. Below is presented fuel consumption and respective purchase prices for heating season 2005/2006 as reported by DHC-ies.

Table 6.1 Fuel Consumption and average purchase prices for heating season 2005/06

Company – DH System	Heavy fuel oil – mazut		Light fuel oil – diesel	
	Cons.(tons)	Aver.purch. price (€/ton)	Cons. (liter)	Aver. purch. Price (€/lit)
TERMOKOS - Prishtina	13,546.00	292.00	21,000	0.95
DH GJAKOVA	1,719.93	279.61	NA	NA
TERMOMIT - Mitrovica	NA	NA	NA	NA
DH Zvecan	NA	NA	60,000	1.00
DH Sector Total	**15,256.93**		**81,000**	

NA – Not Available (or Not Applicable)

Termokos heat generation facilities consists of the main boiler plant with installed supply capacity 116 MW – two heavy oil (mazut) fired boilers with 58 MW capacity each, and installed

reserve capacity – one reserve heavy oil boiler of 29 MW capacity (not in operation); and of two light fuel oil boilers at the hospital with total capacity of 14 MW (each boiler has 7 MW).
DH Gjakova heat generation plant has two heavy fuel fired boilers with a capacity of 20 MW and 18.6 MW, a total installed capacity of 38.6 MW. The smaller (18.6) MW boiler is out of order.

Termomit heat generation facilities consist of heat plant "Lisic Polje" equipped with only one operational heavy fuel oil fired boiler with nominal capacity of 9.3 MW, and the heat plant at hospital that possesses three operational very small heavy fuel boilers with a total capacity of 7.6. Heat generation in Zvečan is carried out by the heat plant equipped with two light oil fired boilers with a capacity of 800 kW each.

6.2.2 Heat Distribution

It is common for all four district heating systems that respective distribution networks covers parts of the towns with higher density of population / blocks of buildings. Distribution network consist of primary network up to the delivery (supply) point in the substation and the secondary network from the delivery (supply) point in the substation.

Termokos district heating distribution network has about 28 km primary pipeline trench length. The distribution network is over designed meaning that its distribution capacity is approximately 300 MW. Integral part of the distribution network is the pump & heat exchanger station located in the sunny hill and the 245 substations that are the split point between primary network and secondary network.

DH Gjakova distribution network comprises 13 km pipeline trench in total, of which 4 km is a newly constructed pipeline trench in year 2001, and about 1 km pipeline expansion in 2006, and about 101 substations as part of the network that divides primary and secondary network. Heat meters are installed in 42 substations.

Termomit distribution network consists of two separate parts. Main part of the network is connected to the heat plant "Lisic Polje", while the other one is connected to the heat plant at the hospital premises. Total length of pipeline trench is about 4.5 km.
Zvecan distribution network is very small with the length totaling 0.8 km

A summary of the technical characteristics of the DH systems, heat generation and supply data:

Table 6.2 Technical characteristics of District Heating Systems

Company (Town)	Installed Capacity [MW]	Operational Capacity [MW]	Distribution Network		Heat Generat. [MWh / year]	Heat Supply Custom Subst. [MWh/year]
			Trench Length [km]	No: Subst.	Season 2005/06	Season 2005/06
TERMOKOS (Prishtina)	2 x 58 = 116 1 x 29 = 29 2 x 7 = 14	2 x 58 = 116 2 x 7 = 14	28	245	136,348	108,580
Subtotal	159	130	28	245	136,348	108,580
DHC Gjakova	1 x 20.0 = 20.0 1 x 18.6 = 18.6	1 x 20 = 20	13	101	13,071	9,816
Subtotal	38.6	20	13	101	13,071	9,816
TERMOMIT (Mitrovica)	1 x 9.3 = 9.3 2 x 3.3 = 6.6 1 x 1.0 = 1.0	1 x 9.3 = 9.3 2 x 3.3 = 6.6 1 x 1.0 = 1.0	4.5	20	NA	NA
Subtotal	16.9	16.9	4.5	20	NA	NA
DH Zvecan	2 x 0.8 = 1.6	2 x 0.8 = 1.6	0.8	NA	NA	NA
Subotal	1.6	1.6	0.8	NA	NA	NA
Total	**216.1**	**168.5**	**46.3**	**366**	**149,419**	**118,396**

6.2.3 Customer Related Issues

Service supply

Actual supply service area covered by Termokos, for both residential, and commercial & institutional customer groups, amounts some 1,046,800 m^2 divided respectively between ca. 611,700 m^2 and 435,100 m^2. It supplies some 12,100 customers in total – 11,540 households, and 560 commercial & public customers.

Total estimated service supply area of DH Gjakova is 134,000 m^2. The share between residential, and commercial & institutional customer groups is approximately in the proportion of 45 – 55 % (or 61,000 m^2 and 73,000 m^2) respectively. It is to be noted that in the heating season 2005/2006 in reality supply service area was for residential customers 57,700 m^2 and for commercial & institutional 54,000^2 due to disconnections occurred.

Termomit service supply area covers both households, and commercial & public customer groups. Due to the bad condition of the network and secondary systems, household customers are not supplied during last season. The service supply area for commercial & institutional customer group is estimated at some 27,100 m^2.

Supply area of Zvečan includes only commercial & institutional customer group and is estimated at about 8,900 $m^{2.}$

Billing and Payment Collection

Due to the lack of implementation of heat metering, billing is performed in relation to the heating space (area in m^2) of each customer. There has been noted difficulties related to invoicing in terms of not achieving planned invoicing due to deduction of non-heating days caused by the breaks in the system (heat plant, network), still high water leakage rate (heating season 2005/2006 ended up with about 200 m^3/day losses - leakage) and an unreliable customer data base.
An average collection rate for the heating season 2006/2007 is estimated at the level of about 35% due to a set of various factors. Some of them are directly linked to the DH enterprise such as generation and supply performance, customer service, and billing & collection inefficiency. Other factors are linked to the overall economic and income situation of the population, such as affordability and willingness to pay, lack of housing administration, and uncertain legal measures in handling non-paying customers.

Table 6.3 Collection Rate DH companies in Kosovo for DH season 2005/2006

Heating season 2005/2006	Heating Space [m^2]	Tariff [€ / m^2]	Billing (VAT incl.) [€]	Collection [€]	Collection rate %
Termokos Prishtina					
Household	611,724	0.80	2,580,910	489,688	18.97
Commercial & Institut.	435,124	0.96	2,241,802	974,283	43.46
Total	**1,046,848**		**4,822,712**	**1,463,971**	**30.36**
DHC – Gjakova					
Household	57,739	0.85	286,385	66,287	23.15
Commercial & Public	57,000	1.26	448,810	201,119	44.81
Total	**111,739**	-	**735,195**	**267,406**	**36.37**
Termomit – Mitrovica					
Household	0	NA	NA	NA	NA
Commercial & Public	27,100	1.30	NA	NA	NA
Total	**27,100**		NA	NA	NA
DH Zvecan					
Household	0	NA	NA	NA	
Commercial & Institut.	8,889	1.23	60,319	51,000	84.55
Total	**8,889**		**60,319**	**51,000**	**84.55**

NA: Not Available (or Not Applicable)

6.3 District heating price review- heating season 2006/2007

6.3.1 Legal and Regulatory Framework for District Heating Price review

It is ERO's mandate, in accordance to the primary legislation – Articles 46, 47, 48 of the Law on Energy Regulator, to establish the tariff methodology, and approve the tariffs in the regulated energy sector. Therein is a set of broad principles calling for reasonable, justifiable and non-discriminatory principles under which the energy enterprises should recover all justified costs including reasonable return on their investments.

District heating sector in Kosovo in transportation and distribution of heat is classified as natural monopoly, while no competition exists for the time being in heat production and supply. Therefore the district heating tariffs are subject to approval by ERO.

Following its legal obligations and powers, on 2nd of May 2006 ERO announced commencement of district heating price review for the heating season 2006/2007, with main objective: realistic assessment of financial and technical information provided by DHC-ies in order for district heating tariffs to be cost reflective.

In this respect ERO issued two instructions:

- Temporary Instruction I_02_2006 on Regulatory Reporting of District Heating Enterprises, issued on 26th of April 2006, in which are determined procedures for submission of the regulatory reports, and the content of the regulatory reporting for DH season 2005-2006;
- Temporary Instruction I_03_2006 on Principles of Calculation of Tariffs and Prices in the District Heating Sector in Kosovo for the Heating Season 2006/2007, issued on 12th of June 2006, in which are determined procedures for submission and approval of tariffs, and sets the methodology for calculation of tariffs;

Contents of the Instructions

- Instruction I_02_2006 on Regulatory Reporting contains detailed description of the content of the information to be submitted within regulatory reporting regarding heating season 2005-2006, and the deadlines for submission. It also contains the detailed guidelines for completion of the regulatory statements. Accompanying annexes of the Instruction – Annex 1: Regulatory Statements; and Annex 2: Template for Auditor's Regulatory Report;
- Instruction I_03_2006, states in detail procedures for submission and approval of tariffs for DH season 2006/2007, and the tariff methodology applied. In addition, Instruction I_03_2006 also contained: Annex 1 – calculation of the Rate of Return (RoR) on RAB; and Annex 2 – Details for calculation of Tariff;

Tariff methodology

For the purpose of the formulation/calculation of tariffs and prices the Rate of Return (RoR) methodology (or so called cost plus) was applied. The RoR methodology defines the allowed cost that has to be recovered and the reasonable profit to be earned by the DHC, which is calculated by an allowed Rate of Return (RoR) on Regulatory Asset Base (RAB).

6.3.2 Price Review Process

In order for successful progress and completion of the price review process, ERO timely begin its preparation by issuing and publishing in its official web-site instructions and other relevant documents such as Announcement, Implementation Plan & Timetable etc. In addition, information meeting was held and other interaction with DH Companies and other relevant sector stakeholders, in order to explain and clarify the Instructions and the main aspects of the price review process.

In accordance to the procedures stipulated in the above mentioned Instructions price review process started by DH enterprises submitting to ERO regulatory reports and the tariff application package. It must be mentioned that although the regulatory reporting and applications were more complete than previous years, ERO has again faced difficulties such as: delays in submission or even non-submission (as it is a case for Termomit-Mitrovica that didn't submit regulatory reporting nor tariff application and DH Zvecan that didn't submit tariff application), unreliability and incompleteness of requested information, data, and supporting documents.

The price review process has included the following main phases:

- Reconciliation of Revenue performed based on difference between projected and actual revenues of the previous heating season (2005/2006), which resulted from comparison of actual data provided within regulatory reporting versus forecasted data in tariff setting for previous season, and is to be included in allowed revenues for forthcoming season 2006/2007.

- Determination of allowed revenues, based on: i) forecasted information and data provided in tariff application; ii) information provided in regulatory reporting, i.e. financial, technical and customer data that has actually taken place in the heating season 2004/2005; iii) reconciliation of the current tariff and the projected one.

- Calculation of the tariff based on the determined allowed revenues and the tariff proposal, which was subject to final approval by ERO.

Consequently to the phases above ERO issued the following documents:

- Reconciliation for DHC-ies Termokos, Gjakova and Zvecan, accompanied by comprehensive regulatory reports respectively for each DHC as annexes to reconciliation determination. In these reports is presented assessment of regulatory reporting and comparison the comparison of the actual (real) revenues, costs, production, supply and other technical and customer data for the heating season 2005/2006 versus data that are presented to ERO as forecast for the tariff setting for the heating season 2005/2006.
- Decisions on approving allowed revenues for DHC Termokos (D_17_2006), and for DHC Gjakova (D_18_2006), which was accompanied by a comprehensive detailed regulatory report as Annex to determination of allowed revenues. The regulatory report contained the following main parts:
  - Principles and Formulation of the RoR Tariff Methodology, where are specifically presented the basic principles of the methodology, formulation consisting of schematic calculation of allowed revenues, as well as giving the basic regulation formulas.
  - Determination of allowed revenues has mainly included the following:

- evaluation and determination of allowed operational costs which has contained the analytical explanation and justification for determination of allowed value for every cost group and for almost main items constituting particular group of costs.
- evaluation and determination of the depreciation.
- determination of Allowed Return on RAB, which includes: i) establishment of the RAB; and ii) calculation of WACC and Allowed Profit.
- reconciliation of the current tariff, based on the difference between the projected and actual revenues of the previous heating season.

It is to be noted that determination of allowed revenues was the basis for final tariff calculation and the submission of tariff proposal by DH enterprises to ERO for final approval.

Decisions on approving tariff rates and respective annexes for each DH Company, by which is concluded the price review for heating season 2006/2007 by issuing respective:

- Decision D_22_2006 issued on 09/11/'06 on approval of tariff rates for DHC Gjakova;
- Decision D_23_2006 issued on 15/11/'06 on approval of tariff rates for DHC Termokos;
- Decision D_24_2006 issued on 22/11/'06 on approval of tariff rates for PMU Standard / DHU Termomit, Mitrovica; and
- Decision D_25_2005 issued on 05/12/'06 on approval of tariff rates for DHU of PMU Zvečan.

Below are presented final approved tariffs for 4 DHC-ies:

Table 6.4 Tariffs for District Heating Companies in Kosovo – Heating Season 2006 / 2007

SUMMARY OF HEAT TARIFF RATES FOR DISTRICT HEATING COMPANIES IN KOSOVO – HEATING SEASON 2006 / 2007

A. HEAT TARIFFS FOR NON-METERET CUSTOMERS

DH COMPANIES	Components of Tariffs	Residential per m^2 per month	Comm. & Inst. per m^2 per month
DH TERMOKOS JSC	Heat Capacity Contracted (fix. comp.)	€ 0.09	€ 0.11
	Heat Delivered (var. comp)	€ 0.70	€ 0.84
DH GJAKOVA JSC	Heat Capacity Contracted (fix. comp.)	€ 0.18	€ 0.23
	Heat Delivered (var. comp)	€ 0.69	€ 1.03
PMU STANDARD / DHU TERMOMIT	Heat Capacity Contracted (fix. comp.)	NA	€ 0.25
	Heat Delivered (var. comp)	NA	€ 1.05
PMU ZVECAN	Heat Capacity Contracted (fix. comp.)	NA	€ 0.10
	Heat Delivered (var. comp)	NA	€ 1.13

B. HEAT TARIFFS FOR METERET CUSTOMERS

DH COMPANIES	Components of Tariffs	Per Metered Unit
DH TERMOKOS JSC	Heat Capacity Contracted (fix. comp.)	€ 0.86 / kW per month
	Heat Delivered (var. comp)	€ 44.70 / MWh
DH GJAKOVA JSC	Heat Capacity Contracted (fix. comp.)	€ 1.86 / kW per month
	Heat Delivered (var. comp)	€ 50.10 / MWh
PMU STANDARD / DHU TERMOMIT	Heat Capacity Contracted (fix. comp.)	NA
	Heat Delivered (var. comp)	NA
PMU ZVECAN	Heat Capacity Contracted (fix. comp.)	NA
	Heat Delivered (var. comp)	NA

NA – Not Applicable

6.3.3 Follow up of Implementation of Tariffs for Heating Season 2006/2007

In follow up ERO closely monitors the implementation of the tariffs, by regularly contacting and meeting with DHC. This interaction with DHC includes request of the feedback on how the billing is performed, collection of customers' payment, impact of the tariffs on collection, and number of customers invoiced with "normative tariff" and with "energy consumption tariff".

ERO continuously encourages DHC to switch from "normative tariff" to "energy consumption tariff" as much as possible emphasizing several facts: "energy consumption tariff" based on the real measured consumption is in favor of incentivising customers to save energy according to their needs; fairness in billing – i.e. the customer is charged for the energy that has been really consumed – which may increase the collection rate; and finally the implementation of the "energy consumption tariff" will be a legal requirement according to the Law on District Heating, which is awaiting to be promulgated.

CHAPTER 7

REGIONAL DEVELOPMENTS AND INSTITUTIONAL RELATIONS

7.1 Energy Community of SEE – ECRB

The Energy Community of SEE is a process that aims to extend the EU internal energy market to the South East Europe region. For this purpose the TREATY ESTABLISHING THE ENERGY COMMUNITY (ECSEE) was signed on the 25th of October in Athens 2005. Kosovo was the first of the signatory parties to ratify the treaty who officially came into force as of 1st July 2006. The main institutions established to oversee the process are the Ministerial Council, the Permanent High Level Group, the Regulatory Board (ECRB), the Fora, and the Secretariat.

ERO is the guardian of the Treaty requirements (implementation of the "acquis communautaire in energy, competition, environment and renewables) for Kosovo. ERO responded to the first visit by EC Secretariat to monitor compliance of national legislation to the requirements of the Treaty and together with MEM drafted the proposed roadmap for its implementation.

During 2006 ERO staff participated and contributed regularly to meetings and fora of the process namely on:

22-23 March	Joint Gas Working Group
27-28 March	Electricity Mini Forum
22-23 June	8th Athens Forum
12-13 October	Gas Forum and Joint Working Group on Gas Infrastructure Investment and Regulation
23 October	ECRB
24-25 October	9th Athens Forum
11 December	Inaugural meeting of ECRB

Regarding ECRB; its competences are described in the Title V of ECSEE Treaty where Chapter III defines the authorizations, duties and responsibilities, the constitution and the procedures of The Regulatory Board. The Regulatory Board shall advise the Ministerial Council or the Permanent High Level Group on the details of statutory, technical and regulatory rules; issue Recommendations on cross-border disputes involving two or more Regulators, upon request of any of them; take Measures, if so empowered by the Ministerial Council; adopt Procedural Acts.

The Regulatory Board shall be composed of one representative of the energy regulator of each Contracting Party, pursuant to the relevant parts of the acquis communautaire on energy. The European Community shall be represented by the European Commission, assisted by one regulator of each Participant, and one representative of the European Regulators Group for Electricity and Gas (ERGEG). If a Contracting Party or a Participant has one regulator for gas and one for electricity, the Contracting Party or the Participant shall determine which regulator shall attend a meeting of the Regulatory Board, taking account of its agenda.

The Regulatory Board shall adopt its internal rules of procedure by Procedural Act (Achieved in February 2007)

The Regulatory Board shall elect a President for a term determined by the Regulatory Board. The European Commission shall act as Vice-President. The President and the Vice-President shall prepare the draft Agenda.

7.2 ERRA/WRF/NARUC

ERO is a member of Energy Regulator Regional Association (ERRA) and actively participating in working groups and comities.

During the year 2006 the representative of ERO attended and actively participated in:

- ERRA Licensing Committee meetings in: Riga (on 7 and 8 September), Budapest (on 18 May), and Skopje (on 23 and 24 February 2006);
-
- ERRA Tariff/Pricing Committee meetings in: Warsaw (on 6 and 7 February), Budapest (on 18 May) and Chisinau, Moldova (14 and 15 September, 2006);

- ERRA Legal Working Group held in Budapest on 27and 28 March 2006.

In addition members of the Board of ERO have attended the Annual ERRA meeting and Investment Conference in May 2006.

Staff members of ERO participating in ERRA produced a few comparative studies and discussions papers and made few presentations on role and functions of the Regulator as well as procedure on building of new capacities. Presentations and studies are published on ERRA web site and treated as contribution to the energy sector in SEE counties.

During the year 2006 ERO staff members attending meetings of the working groups and committees of ERRA were mainly sponsored by U.S. National Association of Regulatory Utility Commissioners (NARUC).

On October 9-11, 2006 one member of the Board of ERO was sent to represent the office on the World Forum on Energy Regulation III.

7.3 Conferences &Training of ERO

ERO representatives have participated in several workshops, training and study tours during the year 2006. The purpose of these visits is to offer opportunity to all ERO staff members to benefit from the experience and similar problems of other Regulators.
It is important to emphasize that most of the below mentioned activities and conferences were organized under ECSEE treaty and Energy Regulators Regional Association (ERRA).

- **Working Visit to Albania for CBT Mechanism**, Tirana, Albania, 17-19 January 2006
  Head of Energy Supply and Market Structure (ESMS) department of ERO has participated in working meetings with KESH-TSO Albania where was discussed the CBT mechanism.

- **SETSO TF meeting in Zagreb-Croatia**, 20 January 2006. Head of ERO has participated on this meeting.
- **Regulatory Information and Public Participation Training (Budapest, Hungary)** 22-25 January 2006**;** Head of CPD of ERO has participated as ERO representative on Training co hosted by ERRA and NARUC.
- **Workshop on Regulatory Monitoring of Electricity Sector (Kazakhstan**)*:* Workshop on Regulatory Monitoring of the Electricity Sector, **co-hosted by** NARUC, ERRA **and** Agency of the Republic of Kazakhstan for Regulation of Natural Monopolies (ANMR), **sponsored by** USAID**.**
- **CEER Working Group South East European Energy Regulators (SEEER) Meeting and Gas Regulatory Group meeting, held in Italian Regulatory Authority (AEEG) premises in Milan (Italy**): Head of ERO and District Heating Expert participated in above mentioned meetings.
- **ERRA Licensing/Competition Committee Meeting (Skopje)**; Head of LLD (Board Member) has participated as ERO member on this committee meeting.
- **2nd South East Europe Customer (SEC) TF Meeting (Vienna, Austria,** *9 March***;** Head of CPD of ERO as the member of the SEC TF has participated on 2nd meeting of this TF.
- **Joint Work Group on Gas Industry and Infrastructure, Financing and Regulation (**Belgrade 22-23 March 2006.**);** District Heating and Gas Expert of ERO have participated on the meeting of Working Group chaired by European Commission.
- **Athens Mini Forum and 15th SEE WG Meeting (Dubrovnik, Croatia, 27-28 March 2006);** Head, Power System Expert and Market Monitoring Analyst of ERO participated on this event.
- **Workshop "Addressing Key Challenges of Network Utilities Reform & Regulation" (London, UK, 27-31 March 2006);** Senior Regulatory Economics and Tariffs Advisor participated on this Workshop as ERO representative.
- **Study Tour in Romania, 10-15 March 2006;** TA project in ERO (EAR project) organized a study tour in Romania, nine (9) staff members of ERO visited: ANRE, OPCOM, TRANSELECTRIKA, and ELECTRIKA of Romania were visited. It was a good opportunity to exchange experience with the colleagues at similar regulatory experience and practices, and better understanding of the functions of the Regulator.
- **SETSO Meeting (Budapest, Hungary, 12 May 2006);** Head of ERO participated on this meeting.
- **ERRA Investment and Annual Conference (Budapest, Hungary, 14-19 May 2006);** Board Members of ERO participated on this event.
- **Study Tour by SEETEC (Paris, Stockholm, 17-19 May 2006)**; Market Monitoring Analyst of ERO has participated as ERO representative on this study tour.
- **Participation in SETSO SG (Zagreb, Croatia, 8 June 2006)**: Workshop with the topic "Balancing Management".
- **Greater Mekong Sub-region, Energy Sector Meeting organized by WB. Siem Reap, Cambodia, 13-16 June 2006,** Participation and Presentation of Chairman of ERO**;**
- Attendance of ERO Board Members to **Athens Forum, Athens, Greece, 19-24 June 2006**;
- **Tariff/Pricing Committee Meeting** held on September 14-15, 2006 in Chisinau, Moldova;
- **Working visit to ERE**, 21-22 September 2006, Tirana, Albania;
- **World Forum on Energy Regulation**, Washington DC, 09-11 Oct.2006;
- Mini **Gas Forum, 12-13 October, Vienna, Austria**;

- **Workshop on National Electricity Markets two years after UCTE Reconnection**, 17 October, Zagreb, Croatia;
- **SEE Market Monitoring Design Workshop**, Brussels, Nov.16 2006;
- **Power-Gen International 2006 US**, Florida, Orlando November 24, 2006 to December 01, 2006;
- **Trilateral meeting between three regulators: ERE-ERC-ERO**, Tirana, 01 December 2006;
- **Inaugural ECRB meeting in Athens**, Greece, 11th December 2006*;*
- **Structuring Regulatory Frameworks for Dynamic and Competitive South Eastern European Markets**, Conference organized by WB - Athens, December 18 -19, 2006

CHAPTER 8

2006 FINANCIAL STATEMENTS – BUSINES PLAN AND PROJECT DOCUMENT

8.1 ERO Annual Financial Report – Year 2006

In 2006 the Energy Regulatory Office has been finance by the Kosovo Consolidated Budget, UNMIK Pillar IV, and donor organizations. As of 1st of August 2006, and pursuant to its legal mandate as per Articles 19 to 24 inclusive of Law 2004/09 on Energy Regulator and according to the provisions of secondary legislation adopted "Schedules of Fees" ERO has started with its fee collection from the licensees, thus becoming self-financed independent institutions**.**

Explanatory notes:

In 2006, the Consolidated Budget of Kosovo has allocated an amount of € 247,446.00 for ERO activities
The approved budget was allocated in to three main categories:

1. Salaries and Wages,
2. Goods and services,
3. Municipal Expenditure,

The EU Pillar has assisted ERO in some categories such as:

1. Staff salaries (a number of staff were paid by EU Pillar),
2. Official trips,
3. Expenses for mobile phones,
4. Public and Utility expenses (until 30.06.2006),

In the below tables are shown in details financial data:

Table 8.1 Review of financial resources and expenses in €

ENERGY REGULATORY OFFICE	YEAR 2006	
	Budget	**Actual**
SOURCES OF FUNDS		
Kosovo Consolidated Budget	**247,446**	**201,557**
UNMIK (EU Pillar)	**N/A**	**200,468**
Donor Organizations		
EAR	**809,524**	**809,524**
WB	**441,369**	**441,369**
Total Donor Organizations	1,250,893	1,250,893
TOTAL SOURCES OF FUNDS	1,498,339	1,652,918
APPLICATION OF FUNDS		
Staff costs		
UNMIK (EU Pillar)	**N/A**	**159,258**
Kosovo Consolidated Budget	**71,196**	**65,430**
Total Staff Costs	71,196	224,688
Goods and Services		
UNMIK (EU Pillar)	**NA**	**41,210**
Kosovo Consolidated Budget	**176,250**	**136,127**
Total Goods and Services	176,250	177,337
Technical Assistance from Donors	NA	**NA**
UNMIK (EU Pillar)	**-**	**-**
EAR	**809,524**	**809,524**
WB	**441,369***	**441,369**
Total Technical Assistance	1,250,893	1,250,893
TOTAL APPLICATION OF FUNDS	1,498,339	1,652,918

**600,000.00 $ converted on 18.04.2006*

Table 8.2 Total ERO expenses for the year 2006 in percentage

Designation of budget allocations	**Amount**	**Percentage in total expenses**
Staff expenses	**224,688**	**13.6 %**
Goods and Services	**177,337**	**10.7 %**
Technical Assistance	**1,250,893**	**75.7 %**
Total	1,652,918	100 %

8.2 ERO Staff

In the end of 2006 ERO had 25 staff members: 15 financed by KCB, 10 financed by EU pillar budget of which 2 Internationals and 8 nationals. During 2006 and especially in the last months of 2006 the turnover of staff because of low KCB salaries was evident. During this period 4 ERO employees paid by KCB resigned from their positions in ERO.
Referring to its staff functioning and efficiency, ERO in 2006 was fully functional. As far as financial procedures of KCB are concerned, all leading participants were local, apart from authorizing officer who was of international staff (Chairman of ERO).

8.3 Revenues from fees of licensees

The Energy Regulatory Office has started with issuing of licenses from August 2006, whilst the first licenses were issued on October 2006. Pursuant to the Law 2004/09 and the ERO Board decision, an initial and annual fee has been decided for the licensees. From the decided initial fees, ERO has collected an amount of 67,170.00 €. While from the annual fees of the licensees for the period of October-December 2006 are collected 67,446.54 €. Total amount collected from fees for the period October -December 2006 is 134,546.54 €
The other part of obligations of licensees for the year 2006 will be collected in the year 2007. If the Energy Regulatory Office collects all projected License fees, then ERO can function and deliver its salary levels based on Business Plan and retain good expert staff.

8.4 Business Plan

On 16th of January 2006 the Board of ERO has approved the five years (2005-2009) Business Plan, which expresses its goals, strategy and initiatives of ERO during this financial period. In a special way the plan shows the frame of the mission of ERO, its mandate, objectives and organization; it gives a view of structure and developing prospect in the energy sector in Kosovo; identifies the challenges which the ERO is facing in terms of strategic goals and factors which could have an effect in their achievements; it specifies projects, results and duration during 2006 and determines strategies and planned initiatives for four upcoming financial years; defines the required resources for implementation of projects and planned initiatives; and contains detailed financial projections for the five year planned period. The Business Plan is published on ERO website.