ZYRA E RREGULLATORIT PËR ENERGJI
ENERGY REGULATORY OFFICE
REGULATORNI URED ZA ENERGIJU

ELECTRICITY TARIFF REVIEW 2009 – RESPONSE TO COMMENTS

2 April, 2009

DISCLAIMER

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1 Introduction

The Energy Regulatory Office (ERO) is currently in the process of reviewing retail electricity tariffs to be applied by KEK JSC and transmission charges applied by KOSTT JSC. The review covers received comments on proposed allowed revenues and decision-making on tariffs and charges covering those allowed revenues, once the comments have been reviewed.

In its Consultation Paper published on 3 March 2009, ERO presented its analysis about the application of tariffs received from KEK and KOSTT, and preliminary proposals on allowed revenues and new tariffs to take effect from 1 April 2009. Stakeholders were invited to present their comments in written form on ERO's analyses, preliminary proposals and any other related issue. The following stakeholders have submitted their comments:

- Kosova Energy Corporation (KEK)
- Kosova Transmission and Market System Operator (KOSTT)
- Ministry of Energy and Mining (MEM)
- NGO Fol '08

This Response Paper summarizes the main comments received and ERO's responses to them, before setting out ERO's draft final proposals on allowed revenues and new regulated tariffs. The comments are organized by stakeholder. While all comments have been reviewed by ERO, only those potentially having a significant impact on the proposals set out in the Consultation Paper are provided here for conciseness.

In each case a summary of the comment is initially provided in *italics*, followed by ERO's response.

After reviewing the comments, ERO continues to support the proposal in the Consultation Paper, which represents an increase of 2.5% in allowed revenues. The resulting proposed retail tariffs and transmission charges are shown in the next two pages.

Table 1: Proposed regulated retail tariffs

Tariff Group	Voltage level of supply	Tariff elements	Unit	Time-of-day	Existing High season 1 October - 31 March	Existing Low season 1 April - 30 September	Proposed High season 1 October - 31 March	Proposed Low season 1 April - 30 September
0	110kV	Standing (customer) charge	€/customer/year		981.00		1,006.00	
		Standing (demand) charge	€c/kW		545.00	545.00	559.00	559.00
		Active energy (P), of which:	€c/kWh	High tariff	6.33	1.87	6.49	1.92
			€c/kWh	Low tariff	2.63	1.54	2.70	1.58
		Reactive energy (Q)	€c/kVArh		0.00	0.00	0.00	0.00
1	35kV	Standing (customer) charge	€/customer/year		130.00		133.00	
		Standing (demand) charge	€c/kW		567.00	567.00	581.00	581.00
		Active energy (P), of which:	€c/kWh	High tariff	6.62	2.87	6.79	2.94
			€c/kWh	Low tariff	3.50	2.59	3.59	2.65
		Reactive energy (Q)	€c/kVArh		0.64	0.64	0.66	0.66
2	10kV	Standing (customer) charge	€/customer/year		54.00		55.00	
		Standing (demand) charge	€c/kW		489.00	489.00	501.00	501.00
		Active energy (P), of which:	€c/kWh	High tariff	7.42	3.31	7.61	3.39
			€c/kWh	Low tariff	4.00	3.01	4.10	3.09
		Reactive energy (Q)	€c/kVArh		0.64	0.64	0.66	0.66
3	0.4kV Category I (large reactive power consumers)	Standing (customer) charge	€/customer/year		30.00		31.00	
		Standing (demand) charge	€c/kW		284.00	284.00	291.00	291.00
		Active energy (P), of which:	€c/kWh	High tariff	8.24	4.58	8.45	4.69
			€c/kWh	Low tariff	5.20	4.32	5.33	4.43
		Reactive energy (Q)	€c/kVArh		0.64	0.64	0.66	0.66
4	0.4kV Category II	Standing (customer) charge	€/customer/year		34.00		35.00	
		Active energy (P)	€c/kWh	Single tariff	10.16	6.57	10.41	6.73
		Active energy (P), of which:	€c/kWh	High tariff	12.22	8.01	12.53	8.21
			€c/kWh	Low tariff	6.11	4.00	6.26	4.10
5	0.4kV (domestic 2-rate meter)	Standing (customer) charge	€/customer/year		24.00		25.00	
		Active energy (P), for consumption:						
		<200kWh/month (First Block):	€c/kWh	High tariff	4.53	3.25	4.64	3.33
			€c/kWh	Low tariff	2.27	1.62	2.33	1.66
		200-600 kWh/month (Second Block):	€c/kWh	High tariff	6.27	4.49	6.43	4.60
			€c/kWh	Low tariff	3.14	2.25	3.22	2.31
		>600 kWh/month (Third Block):	€c/kWh	High tariff	9.10	6.52	9.33	6.68
			€c/kWh	Low tariff	4.55	3.27	4.66	3.35
6	0.4kV (domestic, 1-rate meter)	Standing (customer) charge	€/customer/year		24.00		25.00	
		Active energy (P), for consumption:						
		<200kWh/month (First Block):	€c/kWh	Single tariff	4.04	2.89	4.14	2.96
		200-600 kWh/month (Second Block):	€c/kWh	Single tariff	5.59	4.00	5.73	4.10
		>600 kWh/month (Third Block):	€c/kWh	Single tariff	8.11	5.81	8.31	5.96
7	0.4kV (domestic unmetered)	Estimated consumption <200kWh/month	€/customer/month		21.00		21.50	
		Estimated consumption 200-600kWh/month	€/customer/month		38.00		38.92	
		Estimated consumption >600kWh/month	€/customer/month		64.00		65.58	
8	Public lighting	Standing (customer) charge	€/customer/year		34.00		35.00	
		Active energy (P), for consumption:	€c/kWh	Single tariff	8.21	8.21	8.42	8.42

High Tariff applies 07:00-22:00 Monday-Saturday during the High Season and 08:00-23:00 Monday-Saturday during the Low Season
Customers registered as social cases are charged at a zero rate

Tariffs are rounded to zero decimal places (customer and demand charges) and two decimal places (all other charges).

Table 2: Proposed transmission charges

Tariff group	Voltage level of connection	Tariff elements	Unit	Existing	Proposed
Generator	**400kV / 220kV**	Use of system (capacity) charge	€/kW/year	0.000	0.000
		System operator charge	€/MWh	0.853	1.067
		Market operator charge	€/MWh	0.013	0.020
Generator	**110kV**	Use of system (capacity) charge	€/kW/year	0.000	0.000
		System operator charge	€/MWh	0.853	1.067
		Market operator charge	€/MWh	0.013	0.020
Generator	**Distribution**	Use of system (capacity) charge	€/kW/year	0.000	0.000
		System operator charge	€/MWh	0.289	0.328
		Market operator charge	€/MWh	0.013	0.020
Supplier	**400kV / 220kV**	Use of system (capacity) charge	€/kW/year	3.618	4.636
		System operator charge	€/MWh	0.853	1.067
		Market operator charge	€/MWh	0.013	0.020
Supplier	**110kV**	Use of system (capacity) charge	€/kW/year	7.878	10.094
		System operator charge	€/MWh	0.853	1.067
		Market operator charge	€/MWh	0.013	0.020

2 KEK's comments

KEK's comments were submitted in writing on 13 March 2009 with additional comments being submitted on 24 March 2009. A number of the comments asked for further clarification on adjustments made by ERO to KEK's application. These are not repeated here. More details on these adjustments have been separately sent to KEK and can be made available to other stakeholders on request.

(a) *If ERO corrects in 2009 for differences between actual and allowed capital expenditures in 2008, then the same adjustment should be applied for operating expenditures. It is also KEK's view that the adjustment should not be made as actual revenues collected in 2008 were below those allowed by ERO—therefore, KEK did not over-recover against the allowed revenues.*

ERO's intention is to provide incentives for licensees to carry out capital expenditure for which revenues have been allowed given the urgent need for investment in the Kosovan electricity system. Where these expenditures are not made, then ERO recovers the difference. ERO does not apply the same approach to operating expenditures as it wishes to ensure licensees have sufficient incentives to manage these costs efficiently.

ERO's consistent approach has been that KEK should not recover the costs of collection losses, given that this would mean good payers covering the costs of bad payers. If KEK has failed to collect the full allowed revenue determined by ERO then that is KEK's risk and not that of consumers.

(b) *KEK's forecast of import prices is based on actual contract prices for January to March 2009 arising from a competitive tendering process. These actual prices should be used rather than prices based on previous years.*

ERO considers it appropriate to benchmark import prices against external price indices to assess their reasonableness. ERO also notes that import prices might be expected to fall in 2009 compared to 2008 due to fuel price declines and regional market conditions, and that current import prices based on contracts entered into in late-2008 and early-2009 may not be a good indication of average 2009 prices. ERO does not, therefore, propose to make any change in its assumed import prices.

(c) *Distribution assets include a large proportion of meters which need frequent replacing. Therefore, the average age of distribution assets will be less than that of transmission assets and it is not correct to equalize these at 35 years. KEK's proposed asset life of 30 years is more appropriate.*

ERO agrees with this proposal.

(d) *A life of 15 years should be applied for mining assets. The existing assets are already 20-30 years old. The planned capital expenditures will extend their lives by around 15 years. KEK will be funding these expenditures through a loan from the Government of Kosovo, which is to be repaid over a 15-year term. The life used for depreciation of these assets needs to match this loan term to ensure KEK earns sufficient revenues to meet the debt service obligations associated with this loan.*

ERO continues to consider that existing assets might be expected to remain in service to serve new generating capacity. ERO does not propose to change its assumption in this regard.

(e) *KEK is not requesting an increase in distribution losses but rather a reduction compared to actual 2008 levels. KEK has been making steady progress in reducing losses.*

ERO considers it has set a challenging but achievable target for distribution losses.

(f) *It is not ERO's role to determine the appropriate number and costs of employees, only to review the reasonableness of overall personnel expenses. The requested increase in HQ staff numbers represents the hiring of 54 new staff members for internal audit and revenue protection purposes which will reduce losses, 3 new IT staff and 3 new public relations staff to improve communications with stakeholders.*

ERO agrees that decisions on staffing, salaries and benefits are for the management of KEK. However, in reviewing total personnel expenses, ERO inevitably needs to consider the reasonableness of proposed staffing levels and staff costs.

ERO notes that KEK's application proposes a total increase in staff numbers of 365 on allowed levels in 2008. ERO accepts but not to the full extent of KEK's request, allowing 60 more in the expectation this will lead to further reductions in losses and improvements in collection rates.

(g) *The requested increase in HQ operating expenses is due to the need to improve IT facilities, including participating in the World Bank's CLRP project, the costs of relocation of KEK's offices and the establishment of the new distribution and supply company.*

ERO accepts these costs as reasonable on a one-off basis. From 2010 onwards, ERO expects that HQ operating expenditures will return to closer to 2008 levels.

(h) *All electricity supply companies incur bad debts and so these should be included in allowed revenues to some extent. The short-term financing costs requested are equivalent to the return on the working capital allowance previously included by ERO as part of the regulatory asset base (RAB).*

ERO proposes to incorporate a working capital allowance into RAB, as previously applied. ERO has previously stated that it does not consider collection losses, including bad debts, should be included in allowed revenues recovered from regulated tariffs.

(i) *ERO's proposal to increase all tariffs in line with the proposed increase in allowed revenues is incorrect for two reasons: (1) It assumes that energy sales will not increase in 2009 whereas KEK believes they will. The approved Energy Balance for 2009 should be used as the basis for determining expected sales. (2) Increasing all tariffs by an equal percentage does not move tariffs closer to cost-reflective levels. This would require higher increases for household customers and lower increases for other customers as proposed by KEK.*

ERO understands that KEK considers significant sales growth is possible in 2009 (the 2009 Energy Balance shows distribution-level sales of 2,652 GWh compared to 2,418 GWh assumed in 2008 and actual sales of 2,230 GWh in 2008). ERO continues to believe that these levels of increase are uncertain in current economic conditions and including them in its determining of allowed revenues and tariffs would place significant risks on licensees that actual revenues fall below allowed levels due to shortfalls in actual sales below forecast levels. ERO does not, therefore, propose to make any change to this assumption.

ERO notes that KEK has proposed an alternative methodology to calculating cost allocation to individual customer categories (and, therefore, cost-reflective tariffs) to that applied by ERO. While determining whether this alternative approach is more appropriate, ERO considers it reasonable to apply a common increase to all tariffs.

3 KOSTT's comments

KOSTT's comments were submitted in writing on 13 March 2009. A number of comments were provided on terminology and presentation of ERO's proposals. Comments with an impact on proposed allowed revenues are presented below.

(a) *The proposed increase in transmission losses is a result of the need for disconnections at various stages during 2009 for work on KOSTT's planned investment programme. An increase in allowed losses from 199 to 210.5 GWh as actual.*

ERO accepts this proposal for 2009 only. ERO expects that, following completion of these investments, transmission losses in 2010 and subsequently will fall below the levels seen in earlier years.

(b) *The underspend on maintenance in 2008 relative to allowed levels was due to factors including procurement delays and uncertainty over future revenues. This underspend would be expected to lead to a corresponding overspend in subsequent years.*

ERO allows licensees to retain any underspend of operating expenditures relative to allowed levels. Therefore, KOSTT will be able to use the difference between actual and allowed maintenance expenditures in 2008 to cover any shortfall in 2009.

(c) *KOSTT expects to employ 24 additional staff members in 2009, comprising 17 substation operators, an internal auditor and six members of the Board of Directors. Actual staff numbers in 2008 were 210, so this would give a total staff of 234 in 2009.*

ERO accepts the proposed staffing level of 234, which represents an increase of 4 personnel on the level assumed in determining 2008 allowed revenues.

(d) *KOSTT has conducted analysis on the revenue risk it faces if actual generation output and demand is below the levels expected by ERO. This risk is substantial and should be taken into account in setting allowed revenues.*

ERO notes that it has been conservative in its assumption of energy sales and, therefore, the risk that sales will fall below this level is very low.

4 Ministry of Energy and Mining's comments

Comments from MEM were received in writing on 13 March 2008.

(a) *It does not seem appropriate to compare import costs in a chaotic market such as Kosova with those on an organized market such as EEX. Import prices can be expected to fall as more transmission capacity becomes available and access charges decrease.*

ERO recognizes the difficulties in comparing import costs in Kosova with prices on organized European power exchanges. However, these can provide a useful guide as to current price levels and price trends to verify the reasonableness of import costs requested by licensees. ERO's assumption on import prices is that the average across 2009 will be lower than the price in contracts entered into by KEK for the first three months of the year.

(b) *Kosova A is expected to retire in 2017 and Kosova B not until 2027 at the earliest.*

At present, ERO assumes a 16 year remaining life for all assets of KEK's generation business. ERO will review whether it would be appropriate to separate these assets into those related to Kosova A and Kosova B and apply separate asset lives consistent with planned retirement dates ahead of the next tariff review.

(c) *Allowed distribution technical losses should be 17.1%, consistent with actual 2008 losses, rather than 17.4% as shown in the Consultation Paper. This level of losses is already too high and doesn't give incentives for KEK to reduce losses.*

ERO agrees that it would be inappropriate to allow an increase in allowed technical losses relative to actual levels achieved, and proposes to reduce allowed technical losses to 17.1% accordingly.

(d) *The allowed maintenance expenditures for KOSTT appear too high, especially given the actual level in 2008.*

Refer to KOSTT comment (b) and ERO's response. ERO has already applied a significant reduction to the maintenance expenditures requested by KOSTT.

(e) *Any savings achieved in allowed revenues should be allocated to maintenance of Kosova A and B given their importance to the system.*

ERO considers this is a matter for KEK. It is KEK's responsibility to request appropriate maintenance allowances and to allocate any savings from underspends of actual against allowed expenditures in other businesses and areas.

(f) *Tariffs for the first household block (<200 kWh/month) should not be increased given affordability concerns.*

ERO recognizes these affordability concerns but also considers it necessary to increase tariffs for this block to avoid their further deviating from cost-reflective levels. The first block group of electricity consumption under 200 kWh already pays a tariff that is lower than the cost of production and service of that electricity. Last year, the increase was higher for block 2 and 3 compared to block 1. Since this block tariffs are already low, increase of 2.5% will reflect lower growth in nominal value compared to the two other blocks. For this reason, and for the purpose of approaching a tariff that reflects cost of production, ERO continues to support the proposal provided in the Consultation Paper.

5 FOL '08's comments

(a) *No increase in tariffs should be allowed, given the economic difficulties faced by Kosovan citizens.*

ERO welcomes the initiative of civil association to obtain the views of citizens regarding the eventual increase of the electricity tariff. In the meeting with civil association representatives, held on February 13 2009, ERO explained that it is well-acquainted with the economic difficulties 365,000 customers connected to KEK are facing, and that the increase of 2.5% is the lowest value with which KEK can function normally. ERO does not consider that affordability is put into risk when taking into account the fact that the increase of 2.5% reflects an increase of about 0.60 euro for the average consumer.

6 Conclusions

Following review of comments received, ERO proposes to make a number of adjustments to the allowed revenue proposals contained in its Consultation Paper. In total, these adjustments would raise allowed revenues by approximately €1.83 million for KEK and €40,000 for KOSTT.

However, these increases are offset by the proposed reduction in allowed distribution technical losses from 17.4% to 17.1%. This will reduce energy imports by around 18 GWh in 2009. At ERO's assumed import cost of €112.5/MWh, this reduction in imports represents a cost saving of €2 million.

The net change in total allowed revenues to be recovered from regulated tariffs is, therefore, approximately zero.

Consequently, ERO continues to support the proposed increase in retail tariffs of 2.5% contained in the Consultation Paper.