

Prishtina, 21.06.2007

Temporary Instruction I_05_2007 on the Principles of Calculation of Tariffs and Prices in the District Heating Sector in Kosovo for the Heating Season 2007/2008

CHAPTER 1 General Provisions

Article 1 Introduction

In accordance to Article 18 of the Law No. 2004/8 on Energy, Articles 15, 26 and 47 of the Law No.2004/9 On the Energy Regulator, Energy Regulatory Office issues Temporary Instruction on the Principles of Calculation of Tariffs and Prices in the District Heating Sector in Kosovo for the Heating Season 2007/2008 (“the Instruction”).

Article 2 Scope and Purpose

- 2.1 This Instruction determines the principles for calculation and approval of regulated tariffs, and procedures for submission of application, review, modification, and approval of the tariffs and prices of heat in the regulated district heating sector for the heating season 2007/2008.
- 2.2 The purposes of this Instruction are to establish the terms, conditions, and procedures relating to tariffs in order to ensure:
 - a) the transparent and non-discriminatory performance of district heating activities which are subject to public service obligations;
 - b) that prices for district heating activities which are regulated are reasonable and fixed on the basis of a tariff methodology;
 - c) that the interests between customers and district heating enterprises are adequately balanced;
 - d) security of supply of heat through maintenance and construction of necessary generation and distribution capacities;
 - f) protection of customers through promoting transparent and open access to information regarding pricing and tariffs.
- 2.3. The terms used in this Instruction shall have the same meanings as in the Law on Energy and the Law on the Energy Regulator.

CHAPTER 2
Procedures for Submission and Approval of Tariffs and Prices

Article 3
Commencement of the Procedure

By the 13th of August 2007, according to the Implementation Plan & Timetable for district heating price review for the season 2007/2008, the district heating enterprise shall submit to the Energy Regulatory Office a written application for approval of tariffs and prices of heat for the heating season 2007/2008.

Article 4
Verification of the Application

- 4.1 Where an application complies with the provisions of this Instruction, the Energy Regulatory Office shall examine all the data listed in the application and in the attachments and documents thereto.
- 4.2 The Energy Regulatory Office may verify at its own initiative the stated data and circumstances, may contact heat enterprises and ask for additional documents or information. The district heating enterprises shall provide documents and information to the Energy Regulatory Office, within deadlines set forth in Article 5 of this Instruction.

Article 5
Formal Examination

- 5.1 Within fifteen (15) calendar days following the receipt of the application, the Energy Regulatory Office shall examine the submitted application, attachments and required documents.
- 5.2 In case of non-compliance or if the required documents are not attached, the Energy Regulatory Office shall notify the applicant. The written notification shall invite the applicant to rectify his application within seven (7) calendar days from the date of notification.
- 5.3 In case the applicant fails to rectify the non-compliance of his application, attachments or required documents within the period stipulated in Article 5.2, the Energy Regulatory Office shall reject the application and notify the applicant in writing within the seven (7) calendar days from the date set forth in Article 5.2.
- 5.4.1 If Energy Regulatory Office rejects the application as stipulated in Article 5.3, Energy Regulatory Office shall impose fines in accordance to Article 57 of the Law on Energy Regulator until the fulfillment of the requirements stipulated in Article 5.2, and will set the heat tariffs based on the existing information and its best estimations.

Article 6
Proposal of the Tariffs and Prices

- 6.1 In the application the district heating enterprise shall include its proposal for the tariffs and prices for the heating season, which officially starts on 15 October 2007 and ends on 15 April 2008.
- 6.2 The proposal shall include the tariff and price(s) for heat delivered to the final customers.

Article 7
Contents of the Application

- 7.1 An application for approving tariffs and prices of heat shall specify:
 - a) the name of the applicant, the address of the main office, name of the contact person, business registration certificate, and the tax registration number of the applicant;
 - b) a proposal and full justification for the requested tariff and prices (the proposal shall be submitted after Energy Regulatory Office has determined the allowed revenues for the district heating enterprise);
 - c) the application should be signed by the authorized person representing the applicant.
- 7.2. Together with application, the applicant shall submit to the Energy Regulatory Office following documents:
 - a) the annual financial statements (Income Statement, Balance Sheet, and Cash Flow Statement) for the previous year with attachment:
 - i. the auditor report if the annual financial statements of the applicant was subject to independent financial auditing;
 - b) detailed description of available funds and/or sources of funding for performing the energy activity, and evidence of the availability of such funds/sources of funding;
 - c) detailed calculations, evidence and justification for the calculation of each separate element of the tariffs and prices in accordance with the requirements of this instruction (the detailed calculations shall be submitted after Energy Regulatory Office has determined the allowed revenues for the district heating enterprise);
 - d) information regarding the estimated revenue from the sales of heat to final customers, the total forecasted costs of production, distribution and supply of heat, investment plan (if any) and the forecasted cash flow (forecasted Income Statement, Balance Sheet and Cash Flow Statement), the total heat capacity contracted, and the total yearly forecasted heat production in MWh – this information should cover the period from 15 October 2007 until 14 October 2008;
 - e) detailed breakdown of certain main items, and the accompanying explanation and documentation as to justify and clarify stated forecasted information; and
 - f) a list of all submitted documents.
- 7.3. If the applicant intends to implement a long-term investment project, in addition to the documents specified in Article 7.2, it shall submit:
 - a) a financial model for the period of the project;
 - b) a description of important parameters of the financial model;

- c) the signed agreements which govern the implementation of the project and the principles of pricing (if any);
- d) full justification of the reasons for such investment.

Article 8

Determination of Allowed Revenues

- 8.1 Based on the information of the application as stipulated in Article 7 of this Instruction, Energy Regulatory Office shall calculate and determine the allowed revenues for the district heating enterprise.
- 8.2 Energy Regulatory Office will communicate in written form to district heating enterprise the value of its allowed revenues for the heating season 2007/2008, within 15 calendar days after receipt of the application (part of the application containing information as stipulated in Article 7.2, points “a”, “b”, “d”, “e”, and in the Article 7.3 if applicable). Determination of allowed revenues will be accompanied by annex – regulatory report with analytical explanation of the methodology for determination of allowed revenues and full justification of such determination.
- 8.3 In determining the allowed revenues for heating season 2007/2008, Energy Regulatory Office will also consider the reconciliation of the current tariff (heating season 2006/2007) and the new projected one (heating season 2007/2008) on the basis that the equivalent rate of return for each season remains the same (as allowed by Energy Regulatory Office). Reconciliation will be based on the difference between the projected and the actual revenues of the previous heating season.

Article 9

Review and Approval of Tariffs and Prices

- 9.1 Based on the determined allowed revenues as stipulated in Article 8, the district heating enterprise shall submit to Energy Regulatory Office the tariff proposal together with detailed calculations as stipulated in Articles 7.1, point “b” and 7.2, point “c”; tariff proposal and detailed calculations shall be submitted within 15 calendar days after receipt of determined allowed revenues.
- 9.2 After verification and examination of the application for tariffs and prices including tariff proposal, Energy Regulatory Office shall decide as follows:
 - a) either approve the tariffs and prices as proposed by district heating enterprise; or
 - b) refuse to approve the tariffs and prices as proposed by district heating enterprise, and instead set the tariffs and prices for the heating season 2007 / 2008, according to the methodology mentioned in Articles 11 and 12 of this Instruction.
- 9.3. The Energy Regulatory Office shall refuse to approve the proposed tariffs and prices, when they are not in conformity with the principles of tariff calculation as stipulated in Article 16 / Annex 2 of this Instruction.
- 9.4 The refusal shall be justified in written form and shall be objective, non-discriminatory and duly substantiated.

- 9.5 The decision regarding tariffs and prices by Energy Regulatory Office will contain an annex – regulatory report with analytical explanations of the review and approval process, and the justification for such decision.
- 9.6 The Energy Regulatory Office shall make the decision regarding application for approval of tariffs and prices within 45 days from the date of acceptance of the application or from the date of rectifying the application for reasons of non-compliance. The decision in printed form shall be delivered to the applicant or to its authorized representative, and shall be published (without the annex mentioned in 9.5) on Energy Regulatory Office’s official web site.

Article 10
Proposal for Change of Tariffs and Prices

- 10.1 During the heating season 2007/2008, district heating enterprise is entitled to propose to Energy Regulatory Office changes on approved tariffs. This proposal shall be justified, and include all data necessary for ERO to evaluate the proposal.
- 10.2 Proposal for changes may be submitted in case of change in relevant legislation, change within the district heating enterprise effecting expenses, or significant variation of price of fuel or other causes out of control of the district heating enterprise.
- 10.3 The Energy Regulatory Office shall review, modify or refuse the proposal in accordance to the procedures stipulated in this Instruction.

CHAPTER 3
Tariff Methodology

Article 11
Tariff Methodology Applied

- 11.1 For the purpose of formulation of the tariffs and prices for the heating season 2007/2008, the Rate of Return (RoR) methodology (or so called “cost plus”) shall be applied. RoR methodology defines the allowed costs that have to be recovered and the reasonable profit to be earned by the district heating enterprise, which is calculated by an allowed Rate of Return on Regulatory Asset Base (RAB).
- 11.2 In accordance to the principles of RoR Methodology, district heating enterprise is entitled to recover its justified costs and the allowed Rate of Return on its Regulatory Asset Base.

Article 12
Formulation of Rate of Return Tariff Methodology

- 12.1 Formulation of Rate of Return methodology is based on total allowed revenues, which consist of operational costs, which are “justifiable”, depreciation, and the allowed return on its Regulatory Asset Base (RAB), which may include the cost of new assets. It is calculated according to the formula:

$$\mathbf{R = OC + Annual Depreciation + [RoR \times (RAB - Cumulative Depreciation)]}$$

Where:

| | |
|-----|-------------------------------|
| R | Total Allowed Revenues |
| OC | Allowed Operational Costs |
| RoR | Rate of Return allowed by ERO |
| RAB | Regulatory Asset Base |

12.2.1 Allowed operational costs are comprised of fixed part and variable part according to the formula:

$$\mathbf{OC = OC_F + OC_V}$$

Where:

| | |
|-----------------|------------------------------------|
| OC _F | Fix part of Operational Costs |
| OC _V | Variable part of Operational Costs |

12.3 The Depreciation on Investments has a fixed character and shall be calculated in accordance with Kosovo Accounting Standards (KAS) and with UNMIK regulation 2002/3.

12.4 The allowed Rate of Return on the Regulatory Asset Base (RAB) minus Cumulative Depreciation, results in an allowed Profit for the district heating enterprise, and is considered to be a fixed component. The formula is:

$$\mathbf{Allowed\ Profit = RoR \times [RAB - Cumulative\ Depreciation]}$$

12.5 Calculation of the allowed RoR shall be the Weighted Average Cost of Capital (WACC), of which the estimated return required by the equity investors will be calculated in the context of the Capital Asset Pricing Model (CAPM). For information and consistency reasons formula's to determine the WACC calculation are presented in Annex 1 of this Instruction.

12.6 It is at Energy Regulatory Office's discretion to determine the allowed RoR or WACC of the district heating enterprise. It is common practice to determine **one WACC** for the whole District Heating Sector / Utility Sector in Kosovo.

12.7 Regulatory Asset Base (RAB) represents the enterprise assets considered to be used and useful in the public service. New Capital Expenditures (Capex) can be incorporated in the RAB, when it is planned and approved by ERO.

Article 13

Rationale for Tariff Calculation

13.1 Tariffs for the heating season 2007/2008 shall contain two separate types:

- A. Tariff for non-metered customers ("normative tariff"), is based on estimated heat consumption per square meter. This tariff shall apply to those customers who are connected to the supply points (substations) where heat metering is not yet implemented; and
- B. Tariff for metered customers, based on real heat consumption measured at the supply point. This tariff can apply to those customers who are connected to the supply points

(substations) where heat metering is already implemented and proper invoicing will be duly performed.

- 13.2 Tariff mentioned in Article 13.1 point B shall be proposed by the district heating enterprise to every customer where heat metering is implemented, and put into force after written acceptance by the customer.
- 13.3 Every type of tariff shall contain two components:
- a) fixed related to the heat capacity contracted – expressed in [€/ m²] for non-metered customers, and in [€/ kW] for metered customers; and
 - b) variable related to the heat delivered (supplied) to customers - expressed in [€/ m²] for non-metered customers, and in [€/ kWh] for metered customers.
- 13.4 Fixed tariff component shall be calculated based on the fixed component of allowed revenues.
- 13.5 Variable tariff component shall be calculated based on the variable component of allowed revenues.

Article 14

Division of Customers into Tariff Groups

- 14.1 The division of customers into several tariff groups shall only be done if justified by differences in expenses born by the district heating enterprise for delivering (supplying) heat to them, according to the following criteria:
- a) sources of heat generation feeding the district heating network;
 - b) district heating network distributing heat;
 - c) place and type of customers' premises where heat is delivered (supplied) and appropriate scope of supply; and
 - d) customer requirements regarding the reliability and continuity of heat supply.

Article 15

Definition and Allocation of Allowed Revenues

- 15.1 The allowed revenues as stipulated in Article 12.1 shall be the base for calculation of heat tariffs and prices.
- 15.2 Pertinent to the characteristics of its constituents, allowed revenues shall consist of a fixed and variable component, and it is formulated as follows:

$$\mathbf{R = R_F + R_V}$$

- 15.3 Allowed operational costs represent the total yearly forecasted justified operational costs that the enterprise is allowed to recover, and shall include:
- a) cost of the primary energy sources (fuels),
 - b) cost of the energy consumed (electricity),
 - c) cost of make up water consumed

- d) personnel costs - Wages plus pension contribution and other taxes payable by the company,
 - e) cost of system repairs and maintenance,
 - f) other costs which are directly related to the district heating activity, such as purchase of sundry external services from external contractors etc., and
 - g) justified extraordinary costs.
- 15.4 Allowed operational costs shall not include:
- a) subsidies,
 - b) costs rejected by tax authorities,
 - c) costs of setting aside and releasing reserves,
 - d) lease payments for the value of items which are not kept in the bookkeeping record, and
 - e) financial and other extraordinary costs.
- 15.5 In accordance to Article 12.2, allowed operational costs are comprised of a fixed and variable part ($OC = OC_F + OC_V$); division of operational costs into fixed and variable shall be made by the district heating enterprise in accordance to Kosovo Accounting Standards.
- 15.6 For the calculation of the tariffs OC_F and OC_V should be respectively allocated to R_F and R_V
- 15.7 In accordance to Article 12.3, depreciation is calculated on the Regulatory Asset Base, and it is considered as fixed component.
- 15.8 For the calculation of tariffs the annualized depreciation is allocated under fixed part of allowed revenues (R_F).
- 15.9 In accordance to the Article 12.4, the return on asset base minus cumulative depreciation represents the allowed profit, and it is considered as a fixed component.
- 15.10 For the calculation of tariffs the allowed profit is allocated under the fixed part of allowed revenues (R_F).
- 15.11 Consequently the fixed and variable component of the allowed revenues shall be respectively formulated as follows:
- a) Fixed component of allowed revenues (R_F) consist of the fix part of allowed operational cost, annual depreciation and allowed profit as in the following formula:

$$R_F = OC_F + \text{Annual Depreciation} + [RoR \times (RAB - \text{Cumulative Depreciation})]$$

- b) Variable component of allowed revenues (R_V) consist of the variable part of allowed operational costs:

$$R_V = OC_V$$

Article 16

Details for Calculation of Tariffs

Details for calculation of tariffs are presented in the Annex 2 of this Instruction.

Article 17

Prices to Customers and Invoicing

17.1 The invoice from district heating enterprise to the customers connected to the heat distribution network shall be issued on monthly basis during six months of the heating season.

17.2 Each invoice shall detail the total price as follows:

A. For Non-metered Customers:

- a) Monthly payment rate for heat capacity contracted (fixed component), which is calculated as the monthly fixed tariff per square meter expressed in [€/m²] multiplied by the area of the customer's heating space expressed in [m²]; and
- b) Monthly payment rate for heat delivered (variable component), collected in every month when heat was delivered (supplied), is calculated as the monthly variable tariff per square meter expressed in [€/m²] multiplied by the area of the customer's heating space expressed in [m²].

B. For Metered Customers:

- a) Monthly payment rate for heat capacity contracted (fixed component), which is calculated as the contracted capacity measured in [kW], multiplied by the monthly tariff of contracted heat capacity expressed in [€/kW]; and
- b) Monthly payment rate for heat delivered (variable component), collected in every month when heat was really delivered (supplied), is calculated as the metered heat supplied, measured in [kWh], multiplied by the tariff of heat delivered expressed in [€/kWh].

CHAPTER 4

Final Provisions

Article 18

Investigations

18.1 Energy Regulatory Office shall conduct regular investigations, for the purpose of:

- a) evaluation of the reported and estimated financial information submitted by the district heating enterprise;

- b) verification of actual expenses throughout the regulatory period in compliance with the existing legislation on finance and accounting (Kosovo Accounting Standards); and
- c) determining the income of the current district heating season.

Article 19 Appeal

- 19.1 District heating enterprises have the right to appeal to Energy Regulatory Office regarding determination of allowed revenues and / or the final decision of the tariff approval.
- 19.2 Appeal must include full justification of its basis
- 19.3 The appeal referred to in Paragraph 19.1, may be filed to Energy Regulatory Office within ten (10) calendar days from the receipt of the determined allowed revenues with the attached regulatory price review report, and / or final decision on the tariff approval.
- 19.4 Appeal shall not prevent implementation regarding the determination of allowed revenues and decision on tariff approval.
- 19.5 Energy Regulatory Office shall assess and decide on the appeal within ten (10) calendar days upon the receipt of the appeal.
- 19.6 In reference to the Paragraph 19.5, decisions made by Energy Regulatory Office may be appealed to a court of competent jurisdiction.
- 19.7 In reviewing such a decision, the court shall not substitute the technical discretion of the Energy Regulatory Office with its own discretion.

Article 20 Publication

- 20.1 Copies of decisions and approved tariffs shall be published on the official website of the Energy Regulatory Office and in the bulletin of the Energy Regulatory Office.
- 20.2 Submissions and other documentation received in relation to a price review, and regulatory reports as annexes to the decisions issued by ERO may be published on the official website of the Energy Regulatory Office, excluding any material identified as being commercially confidential by the submitting entity and accepted as such by the Energy Regulatory Office.
- 20.3 District heating enterprises shall publish the approved regulated tariffs in at least one local and one national daily newspaper circulated within Kosovo within 5 working after ERO's announcement and publication of the decision on the official website. District heating enterprises shall also publish the approved regulated tariffs on their website (if applicable), and include information on the approved regulated tariffs with the next bill submitted to customers. The information provided in notices issued under this subsection should be sufficient to allow customers to compare the previous and new approved regulated tariffs and their impacts on the customers concerned.

Article 21
Language and Entrance into Force

- 21.1. Application and all documents submitted to the Energy Regulatory Office shall be in one of the languages officially in use in Kosovo.
- 21.2. This Instruction is issued in the Albanian, Serbian and English languages. In case of any discrepancy, the Albanian version shall prevail.
- 21.3. The present Instruction shall entry into force on the date of adoption by the Board of ERO and its publication on the official web-site of Energy Regulatory Office.

Board of ERO

Dr. Ali Hamiti, Chairman,

Mr. Theranda Beqiri, member

Dr. Nysret Avdiu, member

Naim Bejtullahu, member