KORPORATA ENERGJETIKE E KOSOVËS Sh.a.
KOSOVO ENERGY CORPORATION J.S.C.
ENERGETSKA KORPORACIJA KOSOVA D.D.

Nr. 129179 23.10.2007

To: **Mr. Ali Hamiti**
Chairman of ERO Board

From : **Mr. Remzi Shahini**
Managing Director KEK

CC: **KEK Board Of Directors**
Michael Farbman - USAID
Mr. Fadil Ismajli – KOSTT
Kevin McCann – KTA

DATE: October 23rd, 2007

RE: **KEK Tariff Filing**

We would like to thank the ERO for its letter of October 10, 2007 pertaining to the next tariff filing by KEK and submit the following responses and recommendations.

1. KEK agrees with the ERO's assessment of the current situation in Kosovo, particularly with the timing of new tariff implementation. We agree that new tariffs should not be implemented prior to April 1, 2008. An effective date of April 1st would correspond with the beginning of the summer tariff season.

2. We would like to bring to the attention of the ERO three major tasks that are currently being done at KEK, all of which affect the tariff filing.

   a. The KEK operating and capital budgets for 2008 are being prepared. The budgeting process has been enhanced to provide training for top-level managers on the new process and forms. However, the final budgets from all of the departments have not yet been completed but it is expected that they will be completed by November 30, 2007. We fully anticipate that the new budgeting process, which is more rigorous than previously used, will provide much improved information (for both operating and capital expenditures) and believe that it should be used in the tariff filing.

   b. The Regulatory Affairs Department at KEK is in the process of being reorganized to better reflect the increased needs. At this time, CV's have been received for the Director and Managers and interviews are scheduled for this week. Our international consultants will be providing a considerable amount of training to the current and new staff on all aspects of electricity economic regulation within the next several months. We expect this will result in a higher quality of compliance with the ERO requirements in all areas of regulation.

   c. KEK is in the process of developing a new long-term load, energy and resource forecast. The new forecasts will provide very important information and data for the energy balance portion of the Tariff filing. Budgeting improvements include more indepth forecasting of customer energy use by tariff class as well as more rigorous determination of generation by unit and import requirements for 2008 and beyond.

3. On Friday, October 19, 2007, KEK received copies of the ERO tariff model, which was revised by the ERO consultants. We have just begun the process of evaluating the model and the impacts that the revisions to the previous model may have on the results. We assume the revised model is not conceptually different from the model used in the last tariff proceeding, however, KEK intends to provide its own assumptions that are used within the model instead of defaulting to the assumptions used by the ERO consultants.

4. KEK is surprised by the ERO time table outline in its letter of October 10, 2007. It appears that the ERO is not in compliance with the Pricing Rule. We would like to point out Article 7.5 which states that KEK should have at least 30 days to prepare its tariff filing and also Article 8.5 that states that the previously approved tariffs must be effective for at least 12 months.

5. Based on an effective date for the new tariffs of April 1, 2008, the following timetable is proposed:
   i. December 15 - Submission of Application for Allowed Revenues for 2008
   ii. December 15 through January 31– Review of allowed revenue application by ERO, including Stakeholder discussions
   iii. February 1, 2008 – Submission of Proposed Tariff Design by KEK
   iv. February 15, 2008 – Submission by KEK of Reconciliation of 2007 Allowed Revenues with 2007 Actual Costs (to be incorporated into 2008 Allowed Revenues)
   v. February 15 through March 10 - Review of Tariffs by ERO and Stakeholders
   vi. March 15, 2008 – ERO Decision on Allowed Revenues and Tariffs
   vii. April 1, 2008 – Effective date for new tariffs

6. KEK has the following comments relating to the Tariff Filing:

   a. Allowed Revenues –

      i. KEK agrees with ERO to update the projection of all allowed revenues
      ii. KEK agrees that the "smoothing" adjustment(s) made in the last tariff review need to be factored into this tariff review
      iii. KEK plans to follow the basic Tariff Methodology as far as calculation of Allowed Revenues is concerned.

   b. Allocation of Allowed Revenues –

      i. As discussed above, KEK is in the process of properly staffing its Tariff Department and building in-house expertise. We do not expect to have the resources or time to perform a comprehensive Long Run Marginal Cost (LRMC) study and a cost of service by tariff class.
      ii. We propose utilizing the allocation factors that will be developed after the new budget and technical studies are completed to allocate the new level of Allowed Revenues to tariff classes

   c. Tariff Design - Although your letter states that the ERO intends to maintain the same tariff structures, KEK believes that some changes are needed. KEK was forced to accept a tariff design that we felt was not in the best interest of the company and many of its customers. Issues we plan to raise in the upcoming tariff review include:

i. Elimination of time-of-use tariffs for households. The reasons for this elimination were communicated to ERO in KEK's original tariff filing in February 2007. ERO initially agreed with KEK's position, however, the subsequent interference from the Government in the tariff process meant that TOU tariffs remained. Although a detailed study has not been performed, it is obvious to KEK that the TOU tariffs are not working, mostly due to the fact that the time clocks driving the meters do not have batteries.
ii. Reduction of the 3 block tariff structure to one or two blocks
iii. Less emphasis on recovering fixed costs in the on-peak winter energy charge. KEK will provide its own cost allocation that will demonstrate the economic justification for this proposal.

d. Distribution Use of System (DUOS) Tariff –

i. As stated by ERO, if the eligibility threshold above which customers can select their supplier (i.e. become "Eligible" Customers) is changed, then it would be necessary to develop DUOS charges by voltage level (35 KV, 10 KV, 0.4 KV).
ii. KEK does not believe that market conditions in the next few years will be such that it is feasible to designate any more customers as "Eligible". It is inconceivable that any generator or energy trader outside of Kosovo would be willing to provide power to a consumer in Kosovo at a price less than the KEK price in the near term. Correspondingly, it is inconceivable that the ERO would allow the internal Kosovo tariff to rise to the average price of the region.
iii. Therefore, KEK believes that a DUOS Tariff is not necessary at this time. As the new Tariff Department develops expertise, a DUOS tariff can be developed in the future that will satisfy the requirements, primarily suggested by the EU in its Directives, and allow eligible customers to participate in an energy market.

7. Should the ERO proceed with its proposed filing schedule, KEK will respond with the information that we now have; however, we fully expect that the ERO will allow adjustments prior to its final decision and when the new budget and better information becomes available. This is consistent with Pricing Rule (Article 9.3 states: "The Energy Regulatory Office may include provisions as part of the within-period adjustment calculation methodology for a review of all or part of the price control in the event that actual values for identified parameters move outside a defined range."

8. As stated earlier, KEK is in the process of making changes that will improve the quality of information and data as well as the training and reorganization changes that will improve the knowledge and increase the performance of our employees. We believe that by making the tariff filing in October, including the collection, analyses and provision of all of the data and information, then updating it later is not an efficient process for both KEK and the ERO. It may also cause unnecessary confusion and anxiety for our customers and government officials, particularly when the data is updated and the resulting proposed tariffs are changed from the original tariff filing.

9. Both the ERO and KEK realize the importance of electric service to Kosovo's economy and its citizens. Given KEK's experience in the previous 2007 filing, we have concerns about:

a. The timing of the filing of new tariffs and the effective date,
b. Sensitivity to the timing of the elections in November;
c. potential status issues in December;
d. The potential delay in forming a new government.
e. The previous May 2007 tariffs planned on, and expected, the collection of a significant portion of the allowed revenues during the winter season; this may change if the new tariff becomes effective on January 1, 2008

f. Furthermore, it would not be appropriate to change the tariff on January 1st since it is during the high (winter) tariff period.
g. Lastly, it is unlikely that KEK have the ability to be able to implement the new tariff on January 1st.

We propose that the ERO and KEK meet to discuss the details of the tariff filing and reach agreement on the schedule.

Sincerely yours,

Remzi Shahini
Managing director of KEK JSC

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