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01 November, 2007

**From:** **Mr. Ali Hamiti**  
Chairman of the Board

**To:** **Mr. Remzi Shahini**  
Managing Director of KEK JSC

**CC:** **Mr.Et'hem Çeku**  
Chairman of the Board of Directors of KEK

**Mr.Paul Nelles**  
Member of the Board

**Mr.Kevin McCann**  
Member of the Board

**Mr.Fatmir Rexhepi**  
Member of the Board

**Mr.Haki Shatri**  
Member of the Board

**Mr.Musa Misimi**  
Member of the Board

**Mr. Michael Farbman**  
UASID

**Mr. Fadil Ismaili**  
Managing Director of KOSTT JSC

**Mr. Kevin McCann**  
AKM

**Subject: KEK Tariff Filing (response to KEK letter of 23<sup>rd</sup> October 2007)**

Dear Mr. Shahini,

ERO would like to thank you for your letter of 23<sup>rd</sup> October 2007, with your comments on the proposed timetable for the second electricity tariffs review (ETR2) and suggested

amendments to this. ERO appreciates the helpful and thorough manner in which you have responded.

ERO's own responses to the points raised in your letter are set out below.

1. ERO notes that, in its letter, it identified a target date of 1<sup>st</sup> January 2008 for the introduction of new tariffs but recognized that external circumstances may require a delay. In this case, the revised target date for introduction of the new tariffs would be 1<sup>st</sup> April 2008.
2. ERO has the following comments with respect to the ongoing related tasks being undertaken within KEK:
  - a) ERO agrees that it would be advisable to incorporate up-to-date budgeting information into the tariff application and notes that this information is expected to be available by 30<sup>th</sup> November 2007.
  - b) While ERO appreciates the efforts KEK is making to increase the quality of compliance by its Regulatory Affairs Department, it would not be acceptable to delay the receipt and review of KEK's tariff application to comply with KEK's timetable for recruitment.
  - c) ERO also agrees that incorporating information from KEK's new long-term load, energy and resource forecast into the tariff application would be desirable. However, ERO notes that KEK has not indicated by when this forecast may be available. KEK has also not identified what are the major changes in assumptions that may lead significant differences from the long-term energy balance already approved by the Minister for Energy and Mines.
3. The revised model will follow the same concepts and approaches as that used in the previous tariff review. The revisions being made are solely for the purposes of general 'tidying up' of the model and to make it more 'user friendly'. ERO has no objections to KEK proposing its own assumptions for use in the model, provided these are justified as part of the tariff application.
4. With respect to the questions of compliance with the Pricing Rule, ERO has the following comments:
  - a) Article 7.5 applies where ERO initiates a price review for the purposes of setting a multi-year price control where performance-based rates are to be applied. The current application is for an annual review. In this case the relevant articles are Article 8.3, which requires applications (covering both tariff structures and allowed revenues) to be submitted at least 60 days before the date of effectiveness), and Article 27.4(b), which requires ERO to reach its decision no more than 45 days after the date of submission. Complying with these articles requires the initial application to be submitted by 2<sup>nd</sup> November 2007 and for an ERO Board decision to be issued by 17<sup>th</sup> December 2007 for tariffs to take effect on 1<sup>st</sup> January 2008.
  - b) ERO agrees that Article 8.4 states that the previously approved tariffs must have been effective for at least 12 months. However, ERO notes that the ERO Board decision approving KEK's retail tariffs (D\_39\_2007) stated that the new tariffs would apply until 31<sup>st</sup> December 2007 and that derogation to the Pricing Rule

would apply so that new tariffs would be able to take effect from 1<sup>st</sup> January 2008. The ERO Board decision revising KEK's approved retail tariffs following reconsideration (D\_50\_2007) did not amend this provision. As the Pricing Rule is also issued by a decision of the ERO Board, a subsequent decision is able to approve derogation in this manner.

5. ERO's views on an amended timetable for the tariff review are as follows:
  - a) ERO accepts that it would be desirable to wait until data from KEK's budgeting process is available for inclusion in the tariff application and that, if this results in it not being possible to implement new tariffs on 1<sup>st</sup> January 2008, the next suitable date would be 1<sup>st</sup> April 2008.
  - b) Under the Pricing Rule, as described in (4) above, for tariffs taking effect on 1<sup>st</sup> April 2008, the latest date for submission of a tariff application is 1<sup>st</sup> February 2008 with an ERO Board Decision on 17<sup>th</sup> March 2008. However, earlier submission dates are permitted.
  - c) ERO believes that the experience of the first tariff review shows that a longer period for communication with stakeholders to build understanding of the new tariffs is desirable if significant changes to the level or structure of tariffs are proposed. ERO considers that the use of an indicative tariff application would provide a period for such consultation and communication.
  - d) ERO also considers that additional time should be provided for the communication of the new tariffs to stakeholders to increase their acceptability.
  - e) ERO, therefore, considers the following revised timetable more appropriate:
    - (i) 30<sup>th</sup> November 2007 – submission by KEK of indicative requested allowed revenues and changes to tariff structures for 2008.
    - (ii) 30<sup>th</sup> November 2007 until 20<sup>th</sup> December 2007 – review of indicative application by ERO, including informal stakeholder consultation.
    - (iii) 21<sup>st</sup> December 2007 – submission by KEK of tariff application (ERO may accept later submission of the final reconciliation of allowed revenues with actual costs for 2007).
    - (iv) 21<sup>st</sup> December 2007 until 1<sup>st</sup> February 2008 – review by ERO and stakeholder consultation on tariff application.
    - (v) 8<sup>th</sup> February 2008 – ERO Board decision on application.
    - (vi) 1<sup>st</sup> April 2008 – effective date for new tariffs.
6. ERO has the following comments with respect to KEK's views on the tariff application:
  - a) No comments.

- b) ERO appreciates the constraints on the calculation of cost-reflective tariffs based on a LRMC or cost-of-service study. ERO will consider KEK's proposals for the allocation factors to be applied once these are received, and assess how they compare with those developed by ERO's consultants and accepted by KEK in the previous tariff review.
  - c) ERO is willing to consider proposed changes to the tariff structures where justified in the tariff application. However, ERO also reiterates its view that substantial changes to the tariff structure will create further uncertainty among consumers as to future tariffs and may provoke considerable stakeholder opposition. ERO is particularly concerned over the implications of the suggested changes for the affordability of electricity for low-income households.
    - (i) ERO understands that many low-income households take advantage of the potential to reduce their electricity costs by shifting consumption to off-peak hours under the time-of-use charges. Eliminating the time-of-use element will increase costs to these households and remove signals for households to shift their consumption away from peak periods. ERO would need to be convinced that the problems identified with existing meters cannot be solved through less drastic measures.
    - (ii) The three-block structure was adopted to provide a lifeline tariff for households consuming in the lowest block (who will generally be those with the lowest incomes), funded by cross-subsidies from richer households (consuming in the highest block). A shift to a one-block structure would eliminate this protection.
  - d) ERO notes that, under Article 22.2 of the Law on Electricity, it is the responsibility of the Minister for Energy and Mines to prescribe the conditions under which customers may become eligible. KEK's views on the appropriateness of a reduction of the eligibility threshold to include distribution-connected customers should, therefore, be provided to the Minister. ERO understands that such a reduction is being considered for 2008<sup>1</sup> and that, therefore, it will be necessary to establish Distribution Use of System charges. ERO does not consider that the additional work to establish these charges requires any additional delay in the submission of the application.
7. ERO notes that Article 9.3 of the Pricing Rule only applied for multi-year price controls set under a performance-based rates methodology. However, ERO accepts that it is desirable for the tariff application to include better information if this can be expected to be available within a reasonable time period.
8. ERO agrees that it is undesirable for poor quality information to be used in the initial application and then for this to be revised later.
9. ERO appreciates the concerns raised by KEK. In its letter of 10<sup>th</sup> October 2007, ERO also drew attention to the risks that external circumstances pose to the timetable for

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<sup>1</sup> Annex 1 of the Energy Community Treaty requires that all non-household customers become eligible from 1<sup>st</sup> January 2008.

the tariff review. ERO would appreciate KEK providing more information on any constraints on its ability to implement the new tariffs (as identified in (g)).

ERO is happy to meet with KEK to discuss the contents of this letter. In accordance with ERO's principle of maximizing transparency in its work, this letter and any responses will be published on ERO's website.

I look forward to your reply.

Sincerely yours,

**Dr. Ali Hamiti**  
Chairman of ERO Board