



Minutes of the Meeting Public Hearing on Draft Pricing Rule

Date: Monday, 26 September 2005 from 10.00 a.m. to 12.30

Place: ERO Premises

Attendees: 34

Please refer to the handouts: Draft Rule on Calculation of Tariffs in Electricity Sector (15 pages, 30 slides).

Welcome and Introduction by Nick Frydas: we have received comments until now; we will discuss all the items. Regulated energy activities are Pricing Rule and the other distinct phases will be: Price Review (maximum allowable revenues to be determined by ERO); detailed tariffs, to be submitted by the energy enterprise, which should fit with the allowable revenues.

There are three documents by ERO to issue and to adopt:

Pricing Rule: which will be discussed today and that describes the process and the framework.

Tariff Methodology: this will be discussed in October and it will be defined for each activity. Regulatory Accounting Guidelines: format of data regulated by ERO and to be issued in October.

Merita Kostari explained that the law on the Energy Regulator mentions the obligation to issue secondary regulation. The Board of Directors is now established and this draft Pricing Rule is one of the secondary legislation. It was published on 18 August 2005 on ERO website and we have received comments from the stakeholders. We hope to receive more comments during the presentation and during the coffee break. During the next 3 to 4 months, there will be more of these public sessions and in this way we hope to improve the energy sector. This Pricing Rule is already passed through the Legal Department.

Theranda Beqiri gave presentation about the Draft Rule on Calculation of Tariffs in Electricity Sector in English and Adelina Murtezaj and Alketa Sala did translation in Albanian.

Nick Frydas mentioned during the presentation that the audience could intervene at any stage if something might not be clear.

Question: How long will the consultation process last?

Answer NF₁: Consultation Process will last until today.

NF asked WD₂ to give interpretation regarding 'Performance Based Rates' and 'justified costs'.



WD: Performance based rates are mentioned in the law on Energy Regulator and means the incorporation of an efficiency factor or it is linked to performance standards. The way we interpret this in the Tariff Methodology is the equivalent of using price cap, revenue cap or similar arrangements. When setting the tariffs there is an expectation of efficiency gains. This will be presented later in the Tariff Methodology.

Justified costs: all costs will not be passed through to the customers. Allowed costs included in tariffs must be efficient and ERO needs back up evidence that they are efficient. Those costs will be compared with other countries like Bulgaria, Macedonia, and Albania: if the costs in Kosovo are different, the company has to give a justification why they are different compared to those surrounding countries.

¹ NF: Nick Frydas

² WD: William Derbyshire

Stranded costs are those costs not recovered in a competitive market, previously approved by the Regulator. E.g.: Regulator approved Purchase Agreement, which price is higher than the competitive price, when the competitive market is introduced. This means that the price in the Purchase Agreement is too high and the difference between the market price and the contract price is stranded. In Kosovo there will be separate consultants to estimate those stranded costs before December. It will only refer to Assets and investments before 30 June 2004 when the law on the Energy Regulator was promulgated, and when those cannot be recuperated in the competitive market.

Question: On Rule of Tariffs: could you give more explanation regarding economic and social cohesion?

WD: You do not charge different prices within Kosovo. The price in Mitrovica will be the same as in Pristina. Pricing Rule mentions principles we have to take into account. The tariff has to be cost reflective: the cost in Mitrovica is higher than in Pristina and you should charge the customers more. However the Regulator should consider what is the right balance between cost reflective and social cohesion.

NF: For the same class of customers there will be uniform tariffs in whole Kosovo. For household customers: same tariff, escalated by lifeline tariff.

Question: will the tariff not be adjusted according to demographic changes?

NF: People in the village will have the same tariffs as in Pristina, although cost in Pristina is lower. This extra cost will be socialized. Government can charge extra taxes, but this is outside of electricity. Apart from the issue of poverty, there will be no other deductions on tariffs in geographical areas.

Question: Can Government be included in this process of subsidies?

WD: Government cannot give a direction to ERO to subsidise or charge non-cost reflective tariffs to a certain group of customers. ERO bases tariffs on justified costs. If Government will separately provide money to individual customer groups to help pay electricity bills, it is up to the Government.

NF: ERO has no say in subsidies or taxes by the Government.



Question: Tariffs: the practice in other countries is that the tariff is based on GDP; we have in Kosovo the highest tariff compared to surrounding countries. Why not applying the same? Regarding subsidies, the Ministry of Social Welfare is going to deal with this.

NF: It is not true that in other countries the tariff is based on GDP. This would mean that Germany that has a high GDP should have a high tariff, the same for USA: this is not the case! In South East Europe we will have cost reflective tariffs with no cross subsidies. Although we have a high tariff in Kosovo, we have not reviewed it yet. The process will start with the World Bank and based on the Tariff Methodology: after this we will see where we stand. It could be that we have a high tariff: it has to reflect the cost of producing electricity.

Ministry of Social Welfare: for poor families, KEK has to absorb this amount from the budget according to the tariff methodology. What we think will happen is that through the design of lifeline tariff, the customer in the same category will subsidize for poor people, escalated with the level of demand.

Question: How to deal with the situation where the Public Supplier does not receive enough capacity from the Public Producer? Public Supplier cannot purchase enough electricity from Public Producer, so to me there is no need for eligible customers.

NF: Imported electricity is not a regulated tariff, but ERO will approve the justified costs.

Sean McGoldrick from KEK: I am referring to this load shedding schedule every day, by which the utility network will create elevated costs. What are your comments?

NF: Regarding additional distribution and transmission costs related to load curtailment, those will be treated as justified costs.

Clarification: Price control period will be for 3 years. Once allowed revenues are established the tariff will be fixed and reopeners will only be applied when there is an escalating factor.

For Distribution and Transmission: 3 years. According to law, generation costs will be reviewed annually. Law already regulates this.

Question: In the temporary regulation what will be the kind of quality standards because of the technical issues?

NF: Quality depends on Investments and has a reflection on cost. Quality standards will be determined by ERO and, in the case of transmission, by UCTE requirements. ERO will take into account in determining allowed costs, the level of Investment that is needed to achieve quality. Once this level is attained, we can monitor and apply penalties through licensees, e.g. DSO.

Additional comments from Adrian Twomey: Monitoring of quality depends on data on regular basis by licensees to ERO. Regulatory quality of service and supply is based on reliability, voltage quality and information on customer's service. Issue on penalties: if applied, but at this moment there is no final decision yet.

Naim Bejtullahu: Standards of supply will be stipulated in technical code, for Transmission and



Distribution.

Questions from KEK by Sean McGoldrick

First KEK congratulates ERO on this draft Pricing Rule: the principles are clear and it is a good framework. KEK supports this draft rule. Sean has 8 specific questions:

Q1: Article 7.1: Energy enterprises shall submit proposed tariffs to the Energy Regulatory Office annually.

It imposes a regulatory burden on the industry, as KEK did not have any new tariffs since 5 years!

NF: Industry has not submitted for 5 years a new tariff and it is high time we do so. We have heard the comments that we have the highest tariff in South East European Region. I expect that the initial price review, with the benefit of assistance by consultants funded by donors, will be completed in a smooth way and that the annual burden will be less.

WD: There is a legal constraint: The Law on Electricity requires that the prices in PPA's signed by the public supplier and prices for network access are annually approved and reviewed by ERO. We expect that, following the initial price review, this will become a largely automatic process.

Q2: Article 8.1 and 8.3: Notice period to be defined. Provision for 'adequate time' not specified. A specific target: number of days or definition of 'adequate time' would help.

WD: This issue has also been raised by ERO. We will put a time limit.

Q3: Article 16: Provision for Social Tariff: very good. However in present financial conditions and well-documented non-payment, the likelihood of cross subsidy to provide social tariff is unlikely. Our concern is the impact of no payers and no payment of social tariff.

N.F.: In the law is written: all options. There is mentioned: 'may require'. There are two options: (1) subsidies in same class of customers: demand side management incentive for high consumers (2) direct subsidies by government, which is not our preference. But impact on no payment and good customers, can only be assessed when we have defined the tariff.

W.D.: KEK should be compensated for those losses, as long as they are reasonable.

Q4: Chapter 5: Transmission Tariffs: how to recover the cost of ancillary services?

WD: Rule pertaining to that is mentioned in the market rules, rather than in tariff methodology. Those costs should be recovered.

Q5: Article 22.3 and 22.4: both imply changes to our Billing System. This will result in significant costs, procurement issues and associated delays: we will request that ERO will give sufficient time to implement those changes.

NF: Of course, Billing System in restructured industries changes: there are several variations. In Slovenia: all unbundled accounts, what customer pays as component for the Regulatory office, although very small, have to be mentioned. We will take this into



account, but KEK has to change the Billing System in accordance with unbundled accounts.

WD: We recognize that it will take time to introduce new billing systems and we will include it in the Transitional Provisions, powers for ERO to delay the requirement to separately identify these charges on customer bills.

Naim Bejtullahu: Technical assistance from the World Bank starts in November and it will last 8 months, so there is enough time available to adjust the Billing System of KEK.

Q6: Article 25.4 b): ERO shall issue its decision within 45 days. I am curious to know whether there will be a public hearing?

WB: It is intended to be 'the' decision. Any public hearings will be held before this date and therefore within the 45-day period. We expect that public hearings will only be held where a significant change to existing tariffs takes place.

Q7: Article 28: Expert reviews: acceptance by all parties: fair and reasonable response if ERO does not find something inappropriate. In particular we feel that any subsequent legal issue will be solved through analysis and this will shorten the process.

Q8: Removal of cross subsidies: KEK supports and agrees with this principle. KEK likes to inform that there are cross subsidies in existing tariffs and the removal of cross subsidies will create a 'rate shock' and many customers will see a change in their rates. KEK would request ERO whether there are mechanisms to alleviate this shock?

NF: There is a restriction of EU directives that forbids cross subsidisation of different customers. There is a window of opportunity: price review: first two years you have not to adhere.

I hesitate to propose any other mechanism before starting the tariff review in November 2005. What is the size of the shock? At this moment more than 70% of the customers are residential.

WD: Strictly speaking it is up to KEK to manage this rate shock, as the actual tariffs will be proposed by KEK.

Sean Mc Goldrick: If overall tariff were fully collected, it would cover the costs at a fair rate of return. Indeed there are different elements of cross subsidies among customers and various businesses. The result of non-payment: 76% is indeed domestic and 8% industrial. Payment and commercial losses between the different categories vary.

Question: After Price Review what will be the price: will it be based on marginal costs or average costs?

WD: Price will be based on allowed average costs: this level will change over time given expected efficiency improvements. If enterprises sell below average cost, it will be acceptable for customers, but not viable for the company.

Reply: Government will have to reduce the taxes.

WD: If the company makes a profit then this might help but if company makes losses then this won't help much, it will be a problem. However, in electricity the marginal cost



is very low: the cost of supplying an additional unit is very small, and so much more than tax reduction is needed.

William Derbyshire presented the questions and answers received from the stakeholders and others.

Conclusion of the meeting by Nick Frydas:

- The draft pricing rule including all the comments will be published again tomorrow evening on ERO website.
- There will be two weeks more for comments and in case of no major comments, ERO will adopt the Pricing Rule.
- This is our first public hearing: it is a process and a learning curve for ERO and for the stakeholders.
- This is the last stage before adopting the Pricing Rule.

William Derbyshire introduced the Draft Tariff Methodology.

The draft is done by consultants and still to be reviewed by ERO and will be published on the ERO website in the next few weeks. A presentation will be given at a public workshop. In advance of this, the consultants have prepared a handout in English (distributed to participants) to introduce the proposed methodology and allow additional time for stakeholders to review it. It will give the opportunity to people to look at the tariff methodology. The draft methodology published on ERO's website for comments will be in all three languages: English, Albanian and Serbian.

Remark from one participant: Some specific terms are badly translated: 'Eligible customers' are translated in Albanian as 'Suitable customers'. New terms have to be well translated!

Last words from Nick Frydas: no other comments? Public hearing Pricing Rule is closed. Take handout from William Derbyshire regarding Tariff Methodology and look at ERO website for final text of Pricing Rule and draft text on Tariff Methodology.