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Prishtinë, 10/10/2007

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

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

Mr. Fadil Ismaili
Managing Director of KOSTT JSC

Cc: **Mr. Arben Gjukaj**
Director of Network Division KEK JSC

Mr. Fahredin Maqastena
Director of Supply Division KEK JSC

Ms. Sherife Avdyli
Director for Tariffs and Regulatory issues KEK JSC

Mr. Shefqet Avdiu
Executive Director of Generation KEK JSC

Mr. Muhedin Haxhiu
Director of Mines Division

Ms. Resmije Ahma
Legal and Regulatory Affairs Director KOSTT JSC

Mr. Nagip Krasniqi
Financial Director of KEK JSC

Mr. Nebih Haziri
Financial Director of KOSTT JSC

Subject: **Second electricity tariffs review (ETR2) – Principles and Timetable**

Dear All,

This letter invites KEK JSC and KOSTT JSC to submit applications for revised tariffs to take effect in 2008, for review by ERO. This would be the second electricity tariffs review (ETR2). The letter sets out the principles that ERO considers should govern any such applications and an indicative timetable.

Treatment of network infrastructure businesses

ERO notes that, under the first review of electricity tariffs (ETR1), which concluded in May 2007 for tariffs that came into effect from 1 April 2007, allowed revenues for the

infrastructure operations of KEK JSC's Distribution business and KOSTT JSC were set for a three-year price control period, consistent with the ERO-approved *Tariff Methodology*¹. However, ERO now considers that it would be appropriate to again review the allowed revenues for these businesses alongside the review of allowed revenues for other businesses. This recognizes the uncertainties related to the data available on the costs of and quantities supplied by KEK JSC's and KOSTT JSC's network infrastructure businesses at the time of ETR1² and ERO's expectations that the reliability and availability of data has subsequently improved. In subsequent years, ERO may revert to the use of a multi-year regulatory period for these businesses.

ERO, therefore, expects tariff applications submitted by KEK JSC and KOSTT JSC to include updated projections of the allowed revenues for all regulated activities in 2008. This includes the revenues expected to be recovered from regulated retail tariffs charged to non-eligible customers and regulated transmission and distribution use-of-system (TUOS and DUOS respectively) charges.

ERO recognizes that the allowed revenues approved for KEK JSC's and KOSTT JSC's network infrastructure businesses in 2007 included a 'smoothing' adjustment, which under-recovered allowed revenues in 2007 and compensated by allowing over-recovery in later years of the price control period.

Application principles

ERO's view is that applications for revised tariffs should conform to the same principles established under ETR1. To assist in this, ERO has prepared two guidance notes summarizing the approaches taken to establishing allowed revenues and regulated tariffs under ETR1. These are attached to this letter.

Additionally, ERO proposes that the following further principles should apply to tariff applications submitted under ETR2:

- Existing tariff structures and customer categories should remain unchanged. These were only adopted from 1 April 2007. Further changes will reduce the stability and predictability of tariffs to customers as well as forcing KEK JSC to incur substantial new costs in revising its billing systems.
- There should be a gradual move to cost-reflective tariffs. Revised tariffs should continue the move towards cost-reflective tariffs begun under ETR1, including the rebalancing of relative industrial, commercial and household tariffs, while at the same time ensuring affordability concerns are addressed.
- Separate distribution use-of-system (DUOS) charges should be identified. Although DUOS charges were calculated under ETR1, these were not approved or made effective. With the expected extension of the eligibility threshold above which customers can select their supplier to include customers connected to the distribution network, it will be necessary to establish explicit DUOS charges.

¹ Available from ERO's website.

² KOSTT JSC was only separated from KEK JSC in mid-2006. As a result, full-year information and forward-looking budgetary and other projections were unavailable or unreliable.

Indicative timetable

ERO has previously stated its intention to align the date of effectiveness of new tariffs with the financial year (ie, 1 January to 31 December). In its decisions³ approving the tariffs to take effect from 1 April 2007, ERO noted that the approval is valid until 31 December 2007. ERO, therefore, expects to receive applications for revised tariffs in sufficient time for these to come into effect from 1 January 2008. Taking into account the various deadlines established in ERO's *Rule on Principles of Calculation of Tariffs in the Electricity Sector* (the 'Pricing Rule')⁴, this gives the following timetable for ETR2:

- October 2007 – issuing of guidance and templates by ERO.
- By 25 October 2007 – submission of tariff applications by KEK JSC and KOSTT JSC.
- November 2007 – review of tariff applications by ERO, including stakeholder consultation.
- By 17 December 2007 – decision on tariff applications by ERO.
- 1 January 2008 – date of effectiveness of new tariffs.

ERO recognizes, however, the external circumstances (notably the final status negotiations) may impact on the feasibility of introducing revised tariffs from 1 January 2008. ERO will review the date of effectiveness of revised tariffs in December 2007. If it considers a delay in their introduction is required, then the revised tariffs will be expected to take effect from 1 April 2008 (ie, 12 months after the effective date of the existing tariffs and matching the start of the summer season).

ERO welcomes any comments you may have on the principles and timetable set out in this letter. Please send any such comments by 15 October 2007. Communications regarding this letter should be addressed to ero.pricing-tariffs@eumik.org

In accordance with ERO's principle of maximising 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

Attachments:

- Allowed Revenues Calculation Guidance
- Tariffs Calculation Guidance

³ D_50_2007 and D_51_2007 dated 31 May 2007, amending decisions D_39_2007 and D_41_2007 dated 15 March 2007. Copies of these are available from ERO's website.

⁴ Available from ERO's website.