



ZYRA E RREGULLATORIT PËR ENERGJI
ENERGY REGULATORY OFFICE
REGULATORNI URED ZA ENERGIJU

The Sixth Electricity Tariff Review (ETR6) (2012-2013)

KOSTT Consultation Paper

DISCLAIMER

This Consultation Paper has been prepared by ERO for the purpose of receiving eventual comments from stakeholders. It does not represent a decision by the ERO.

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1 Introduction

The Energy Regulatory Office (ERO) is currently in the process of conducting its Sixth Electricity Tariff Review (ETR6). The tariff review process entails the establishing of the Maximum Allowed Revenues (MAR) that the licensee under review is allowed to recover for the regulated services it provides. The MAR established under this review is expected to be effective from April 1st, 2012.

This Consultation Paper sets out ERO's views on KOSTT's application for the Maximum Allowed Revenues for the Transmission System Operator and Market Operator components. The applications have been published on ERO's website along with this Consultation Paper.

ERO invites stakeholders to provide comments on its views given in this Consultation Paper. Comments on these proposals will be accepted until 12th March 2012 and should be sent either by email to ero.pricing-tariffs@ero-ks.org, with the subject line "ETR6 Comments", or by mail to the address of ERO: Rr. Hamdi Mramori nr.1, 10000 Prishtinë, Kosovë, marked for the attention of "Pricing and Tariffs Department".

At this stage, ERO has taken no decisions on the MAR which will be effective from April 1st. These are preliminary proposals. ERO invites all stakeholders to provide comments on ERO's views presented in this Paper.

2 Allocation of costs related to 110kV substations

On August 3rd 2011, the Government of Kosovo decided to transfer all 400/220/110kV assets including 220/35/10(20) kV and 110 kV/x transformers to KOSTT. The Decision states that all assets and employees currently working on these assets are transferred from KEK to KOSTT.

Both KEK and KOSTT have included the value of these assets and their estimates of the associated operating and maintenance costs in their tariff application.

In a meeting held at ERO premises on 23 January 2012, KOSTT have claimed that the working group for the implementation of the government decision for the transfer of assets has almost completed all tasks and agreements related to the transfer of these assets. According to KOSTT, the implementation is subject to finalization and these assets should be transferred to KOSTT starting from January 31st 2012. KEK, on the other hand, claim¹ that to date no workers and no transformers have been transferred from KEK to KOSTT and that they have no information as to the value of the operating and maintenance costs which are associated with the assets to be transferred. KEK adds that they do not believe this can be done quickly.

¹ Meeting held at KEK premises on January 26th 2012

Structure of this paper

ERO notes that the costs associated with these assets should be allocated either to KOSTT or to KEK but not to both. Taking into consideration the uncertainty over whether the transfer has actually occurred as well as the associated changes in operating and maintenance costs, ERO proposes to allocate these costs to KEK only for the present.

3 Structure of this paper

This Consultation Paper is organized as follows:

- Section 4 reviews the 2012 Energy Balance
- Section 5 reviews KOSTT's proposals on the MAR of the Transmission System Operator.
- Section 6 reviews KOSTT's proposals on the MAR of the Market Operator.
- Section 7 sets out a summary of ERO's proposals on regulated tariffs to apply from 1st April 2011.

4 The Energy Balance

The Energy Balance used for the purpose of calculating the Allowed Revenues is built using a bottom-up approach. First, the value of final energy sales to distribution customers is taken from the Energy Balance that is approved by the MED², adjusted for the increase in sales associated with the decrease of technical and commercial losses. The value of ERO's allowed distribution losses and distribution-embedded generation is then added to that figure to end up with the figure for energy entering distribution. The sum of this value, transmission losses and transmission consumption is then compared to the sum of total transmission-connected domestic generation and exports. The difference is recovered by imports.

ERO has removed the losses associated with 110kV transformers, which were included by KOSTT in its application, consistent with ERO's decision to allocate all costs associated with these transfers to KEK until the next tariff review. The allowed level of losses to KOSTT is therefore 118.0 GWh corresponding to 2.07% of all energy entering the transmission system. The price used for losses purchases was changed as well due to changes between KOSTT's assumptions and those proposed by ERO under this Consultation Paper.

A summary of the Energy Balance considered by ERO in calculating the MAR of KOSTT is given in the following table:

² Ministry of Economic Development

Adjustments

		-- 2012 --	-- 2012 --
		Application	ERO Proposed
Generation			
KEK Generation			
Kosovo A	GWh	1,552.3	1,475.3
Kosovo B	GWh	3,470.2	3,392.5
Other domestic generation			
HPP Ujmani	GWh	82	82
Distribution-connected generation	GWh	52	52
Imports and exports			
Imports	GWh	824.7	800.8
Exports	GWh	-169.8	-183.7
Transmission losses			
Transmission losses	%	2.23%	2.07%
	GWh	132.2	119.0
Transmission-connected demand			
Sales to transmission-connected customers			
220kV (Feronikeli)	GWh	657.0	657.0
110kV (including Trepca)	GWh	87.6	87.5
KEK Consumption	GWh	299.4	131.4
Distribution losses and unbilled energy			
Distribution losses and unbilled energy	%	37.19%	35.04%
	GWh	1,723.8	1,619.9
Distribution-connected demand			
Sales to distribution-connected customers	GWh	2,910.9	3,003.6
Balance	GWh	0.0	0.0

Table 1: The Energy Balance used for calculating Allowed Revenues

5 Adjustments

This section of the Consultation Paper sets out ERO's adjustments made on KOSTT's application. ERO makes no judgment as to the reasonableness of KOSTT's application in this section. The purpose of the adjustments is to set out changes in KOSTT's applications that arise due to the application not being in line with ERO regulatory practice, rules or regulations.

Reconciliation

5.1 Impairment of assets

KOSTT have raised the value of the RAB used for calculation inflation not only by the value of pre-2006 assets but also by the value of impairment that was done in KOSTT's assets on its latest asset valuation (2005).

ERO has subsequently had a meeting with KOSTT in which ERO explained that the final value of assets, including impairment, should be used for the purpose of calculating the Allowed Revenues under ETR6, and has noted this is consistent with KOSTT's treatment of these assets in its own statutory accounts. ERO has therefore adjusted KOSTT's RAB section of the application.

This adjustment has reduced the depreciation allowance of KOSTT by €1 million.

5.2 RABf adjustment

ERO notes that KOSTT used the same values for RABf as in ETR5. ERO has adjusted this value taking into account audited financial statements of KOSTT.

This adjustment increased KOSTT's allowed revenues by €0.25 million.

6 Reconciliation

This section of the Consultation Paper sets out changes in allowed revenues that arise due to differences between values allowed under the previous tariff review and actual values reported by KOSTT under the current tariff review.

6.1 Operational and Maintenance costs

ERO notes that there are differences between Opex allowed last year and actual reported Opex under ETR6. Due to different accounting practice, a line-per-line comparison of costs cannot be made. Nevertheless, ERO considers it is appropriate to reconcile the sum of maintenance costs and materials and services between allowed and actual values and refund them back to customers.

This reconciliation has reduced KOSTT's allowed revenues by €0.3 million.

6.2 Capital expenses

ERO notes that KOSTT has largely underspent in terms of capital expenses compared to allowed levels under ETR5. Under ETR5 KOSTT recovered an allowed return and depreciation for a projected investment sum of €26.3 million. KOSTT have actually only invested the sum of €11 million during ETR5. As usual, ERO will reconcile the difference between actual and allowed levels under this tariff review.

This reconciliation reduced KOSTT's allowed revenues by €0.3 million.

7 ERO's proposals

This section of the Consultation Paper sets out changes in the MAR that arise due to ERO's judgment on the reasonableness of KOSTT's requested inputs in their tariff application.

7.1 Personnel expenses

KOSTT have requested a total personnel expense allowance of €4.4 million compared to ERO's allowance in ETR5 of €2.2 million. KOSTT have explained that most of the increase in personnel expense is associated with the transfer of 135 workers from KEK to KOSTT, in line with the Government of Kosovo decision on the transfer of 100kV assets.

As ERO assumed that these assets are allocated to KEK for this tariff review, the associated personnel expenses of €1.4 million has been subtracted from the allowance. Moreover, ERO notes that the allowed personnel expenses of KOSTT should equal to those allowed under ETR5, adjusted for the added number of employees at the average salary approved by ERO under ETR5. KOSTT's allowed personnel expenses therefore add up to €2.5 million. ERO encourages KOSTT to improve wage efficiency in line with Kosovo market conditions.

This proposal has reduced KOSTT's allowed revenues by €1.9 million.

7.2 Maintenance costs

KOSTT have requested €1.5 million for Maintenance costs, which is almost a 100% increase from the actual maintenance costs in 2011.

ERO assumes that most of the increase in these costs is associated with the transfer of 110kV assets. As explained before, due to the assumption that these costs are allocated to KEK during this tariff review, ERO has passed through to final customers the value of €1.1 million, corresponding to allowed levels under ETR5.

This proposal has reduced KOSTT's allowed revenues by €0.4 million.

7.3 Ancillary services costs

KOSTT have requested €1.6 million for ancillary services costs supposedly incurred in the form of payments under ancillary services agreements to Kosovo A and Kosovo B.

Consistent with previous decisions, ERO proposes that this value is not passed through to allowed revenues since there are no costs being incurred at the moment as no signed agreements are in place at this time.

This proposal has reduced KOSTT's allowed revenues by €1.6 million.

Summary

7.4 Other costs

KOSTT have requested a value of €1.8 million for other operating expenses. KOSTT have explained to ERO that these costs have gone up as a result of increasing the number of personnel.

As ERO decided to allocate costs associated with the transfer of assets to KEK, ERO proposes that the *Other Costs* category is set equal to the sum of the value allowed under ETR5 and the insurance costs of €0.25 million.

This proposal has reduced KOSTT's allowed revenues by €0.3 million.

7.5 The Weighted Average Cost of Capital

KOSTT have requested a Weighted Average Cost of Capital of 13.8% real pretax which implies a nominal WACC of 16.8% pre tax.

ERO notes that this request is not in line with ERO's Decision on the Indicative Weighted Average Cost of Capital values. For the purpose of calculating Allowed Revenues of KOSETT, ERO has used the WACC valued by ERO Board in that Decision. This level of WACC (11.5% real pre-tax) has been set under the assumption that the actual gearing level of KOSTT is 0.5. The KOSTT gearing level may be different from ERO's supposed value. Therefore, KOSTT has to offer ERO with information regarding the level of actual gearing in KOSTT.

Furthermore, Annex 3 of the Transmission System and Market Operator Pricing Rule states that the actual cost of debt should be used in calculating the WACC. ERO has submitted information about the interest rate of one of their loans however ERO expects that KEK will offer more information in line with the TSO/MO Pricing Rule and provide calculation of actual cost of debt.

This proposal has reduced KOSTT's allowed revenues by 0.4 million.

8 Summary

ERO notes that - subject to the adjustments, reconciliations and proposals made by ERO - tariffs may KOSTT's Allowed Revenues sum up to €14.8 million. The value of allowed revenues under ETR5 were €12.8 million.