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

Responses Paper (KOSTT)

Sixth Electricity Tariff Review

ETR6 (2012-2013)

Maximum Allowed Revenues Calculation

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).

This Responses Paper sets out ERO's responses to the comments received on its Consultation Paper, issued with respect to the applications submitted to ERO by the Kosovo Transmission System and Market Operator j.s.c. (KOSTT) for approval of its proposed Maximum Allowed Revenues (MAR) to be recovered by its Transmission System Operator (TSO) and Market Operator (MO) licensed businesses.

The applications received have been published on ERO's website along with the Consultation Paper, the comments received on that paper and this Responses Paper.

The purpose of this Responses Paper is to advise stakeholders of ERO's views on the comments received and ERO's resulting proposals on maximum allowed revenues. These proposals will be considered by the Board of ERO at a public meeting ahead of a decision being issued.

The decision issued by ERO will establish MAR for KOSTT's TSO and MO businesses. The charges applied by these businesses will be determined by the relevant licensees, subject to the requirement that these conform to charging methodologies approved by ERO.

2 Structure of this paper

The only comments received on ERO's review and initial proposals on the MAR for KOSTT's TSO and MO businesses were provided by KOSTT itself. Given this, for ease of reference, this paper is organised according to the headings in KOSTT's comments. For each heading, the arguments presented by KOSTT are summarised followed by ERO's responses on these. Readers are referred to the comments provided by KOSTT for fuller information[1]. The final section of the paper provides ERO's draft proposals.

3 Allocation of costs related to 110kV substations

KOSTT comment that a joint protocol covering the transfer of 110kV assets from KEK to KOSTT[2] to KEK was signed on 29 February 2012. Subsequently, on 12 March 2012, ERO has received a request from KEK for approval for the transfer of these assets. The final agreed values of the assets to be transferred were provided to ERO on 28 May 2012.

[1] Available from ERO's website at www.ero-ks.org under the Pricing and Tariffs menu.

[2] In accordance with Government Decision 10/29 dated 3rd August 2011.

Given this, ERO proposes to adjust the allowed revenues of the TSO business of KOSTT to take account of this asset transfer. The proposed adjustments use information provided by KEK which has been agreed with KOSTT and are as follows:

- The impaired gross value of assets to be transferred is €14.837 million, the accumulated depreciation on these assets is €3,752 million and the net value of deferred grants (on which no return is to be earned) associated and transferred with these assets is €5.092 million. The net RAB of the TSO has been increased accordingly by €5.993 million.
- The gross value of post-2006 assets to be transferred is €9.637 million, the accumulated depreciation on these assets is €2,421 million and the net value of associated deferred grants is €3.855 million. The RABf of the TSO, used to calculate the allowed return, has been increased accordingly by €3.355 million.
- Along with the assets, 130 staff will be transferred from KEK to KOSTT. The annual salary cost for these staff is €875,734. The allowed revenues of KOSTT have been increased by a corresponding amount.
- The annual maintenance costs associated with the transferred assets are estimated at €250,000. The allowed revenues of KOSTT have been increased by a corresponding amount.

Additionally, the losses allowance for KOSTT has been increased by 13 GWh. This represents the estimated losses associated with these 110 kV assets taking into account ERO's expectations of improvements in transmission losses, responsibility for which will now transfer from KEK to KOSTT.

4 Staff costs

KOSTT comments that staff costs in 2011 did not include the costs of additional staff recruited in 2011 despite this recruitment plan being intensively discussed with ERO ahead of ETR5 establishing allowed revenues for 2011. KOSTT comments that the large increase in staff costs proposed for 2012 includes the costs of these additional staff and that, if the full increase is not permitted, staffing costs should be increased at a minimum in line with Kosovo CPI (reported by KOSTT as being 7.3% in 2011).

ERO accepts that KOSTT has recruited additional staff during 2011 but notes that discussion of these plans cannot be assumed to represent ERO approval of them. ERO also notes that KOSTT can be expected to incur additional staffing costs following the transfer of responsibility for 110kV assets to KOSTT. ERO also notes that it expects KOSTT to seek efficiencies in its staffing costs and that KEK, operating in a similar industry, has not felt it necessary to request an increase in staffing costs equivalent to inflation. ERO, therefore, proposes to continue to allow base staffing costs equal to the level in the initial proposals of €2.585 million. To this will be added the additional costs associated with personnel transferred from KEK to KOSTT (see above).

5 Other operating costs

KOSTT comments that it is unreasonable to set the category of 'other operating costs' at their actual value in 2011 and that, at a minimum, these should be increased in line with Kosovo CPI. In addition, KOSTT requests the inclusion of a further €250,000 in costs related to ensuring the physical security of assets.

Omitting staff costs and costs associated with the purchase of transmission losses, ERO's proposed allowance for operating costs in 2012 is €2.7 million compared to the €2.1 million actually incurred in 2011 by KOSTT. This represents a 28% increase on actual costs or far in excess of the increase in Kosovo CPI of 7.3%, as quoted by KOSTT. Given this, ERO sees no need for a further increase to be made in the specific category of 'other operating costs'.

ERO also notes that costs should not be automatically expected to increase in line with CPI and allowance should be made for the potential for efficiency improvements. A review of the appropriate baseline for operating costs and the expected rate of efficiency gains will be conducted ahead of the first multi-year tariff period, to take effect from April 2013.

6 Weighted average cost of capital

KOSTT requests that ERO clarify why the allowed WACC differs between KOSTT and KEK's DSO business, when these are both network business operating in similar financial market conditions.

The real pre-tax WACC applied to KOSTT under ETR6 is 11.5%. This is the base value for WACC for regulated licensees as proposed by ERO in its Consultation Paper on indicative values for WACC issued in December 2011. During the process of determining these indicative values, ERO has emphasised the uncertainties surrounding any WACC calculation, which mean that a range of values around this base value are plausible.

The equivalent WACC applied to the DSO is 12.0%. This was established by a decision of the Board of ERO on 6 February 2012[3]. In reaching that decision, the Board of ERO took account of additional evidence provided by the advisors on the Kosovo Electricity Distribution and Supply (KEDS) transaction that a higher WACC is necessary for the success of that transaction. Clearly, this justification applies only to the DSO and not to KOSTT, which will remain wholly Government-owned.

[3] Decision V_399_2012. Available from ERO's website at www.ero-ks.org under the Acts / Decisions 2012 sub-menu.

7 Costs in relation to KEK-KOSTT dispute

KOSTT is currently in dispute with Kosovo Energy Corporation j.s.c. (KEK) over the payment of transmission fees for 2010. This dispute has been referred to ERO who, at a Board meeting held on 29 December 2011, issued its decision[4] that an outstanding amount of €3.88 million was owed from KEK to KOSTT and that this amount should be deducted from the allowed revenues recovered by the PES through regulated retail tariffs for 2012-13 (ie, those established under ETR6). KEK has stated that it is appealing this decision to the Supreme Court.

KOSTT comments that ERO's decision is not in line with its decision on tariffs and fees for 2010 and that the treatment of the disputed amount in the decision is incorrect. This Responses Paper is not the place to enter into a discussion of ERO's decision, the reasons for which are fully explained in the published decision. Instead, the relevant matter for this Responses Paper is whether the appeal to the Supreme Court by KEK means that the decision, as issued by ERO, should be suspended until a decision on the case is issued by the court.

ERO's understanding is that an appeal to the relevant court against a decision of the Board of ERO does not invalidate that decision or require its suspension. The decision remains in effect as issued unless and until the court rules it to be invalid or to require amendment at which time the court may also require damages to be paid to parties adversely affected by the decison. Given this, ERO will continue, under the current review, to apply the decision as issued by the Board of ERO.

8 KOSTT financial situation in 2011

In relation to this dispute, KOSTT also comments that it would have faced severe financial difficulties in 2011 if it had not been able to access other sources of revenue. ERO again notes that this Responses Paper is not the appropriate place to consider the decision issued by ERO. The justification for that decision has been published on ERO's website. If KOSTT wishes to dispute the decision, it should do so in accordance with the procedures for his laid down in the Law on the Energy Regulator.

9 Compensation for losses in transmission

KOSTT comments that ERO has failed to include an adjustment for differences between actual and allowed transmission losses in previous year resulting from differences between expected and actual volumes flowing through the transmission network in the previous year (which is considered to be outside the control of the TSO). KOSTT states that this adjustment is required under the pricing rules issued by ERO.

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[4] Decision V_400_2012. Available from ERO's website at www.ero-ks.org under the Acts / Decisions 2012 sub-menu.

ERO agrees that this adjustment will be applied under the new Pricing Rule in future. However, ERO notes that the allowed 2011 losses were determined under the preceding Pricing Rule and that no adjustment was expected at that time. The adjustment will apply to actual and allowed losses in 2012 onwards, which will be the first year in which losses and allowed revenues in general are set under the new Pricing Rule. ERO's does not, therefore, intend to make any adjustment.

10 General comments

KOSTT comments that it has not received any response by ERO to its request for a revaluation of its assets to be made ahead of the implementation of the multi-year price control period from April 2013. ERO notes that this matter has been discussed in a number of bilateral meetings and that ERO has made clear its position that this request should not be considered as part of ETR6 and instead should be addressed as part of the multi-year price review.

11 Technical comments

KOSTT comments that there are apparent discrepancies between the Consultation Paper published by ERO and the spreadsheets provided by ERO showing the detailed calculations made. ERO is unable to respond to this comment without KOSTT identifying to which discrepancies it is referring.

12 ERO's Proposals

ERO's assessment of the comments provided by KOSTT is that these justify the following modifications to the initial proposals set out in ERO's Consultation Paper:

- An increase in staff costs of €0.876 million, RAB by €6.0 million and RABf by €3.4 million and of transmission losses by 13 GWh following the transfer of 110kV assets from KEK to KOSTT.

A summary of the initial application received from KEK, the initial proposals contained in ERO's Consultation Paper and the draft proposals determined in accordance with this Responses Paper is provided below. These spreadsheets also provide the breakdown between proposed allowed revenues for KOSTT's two separately licensed businesses.

ERO's Proposals

Table 1: Summary of applications and proposals on allowed revenues

€ millions unless noted	2011 Allowed	Application	ERO Initial Proposals	KOSTT Comments	ERO Proposals
KOSTT TSO + MO					
O&M costs excluding depreciation		9.5	5.3	6.6 (a)	6.4 (a)
Depreciation		5.3	4.3	4.6 (b)	4.7 (b)
Allowed return		1.9	2.2	2.8 (b)	2.6 (b)
Purchase of transmission losses		4.1	3.9	4.5 (b)	4.4 (c)
Unregulated revenues		0.0	0.0	0.0	0.0
Other adjustments		-0.3	-0.7	-0.5	-0.7
KOSTT MAR	**12.8**	**20.5**	**14.9**	**17.9**	**17.3**

Notes

a Includes the costs of staff transferred from KEK to KOSTT

b This change results from the incorporation of the transfer of 110kV assets from KEK to KOSTT

c This change results from the incorporation of the transfer of 110kV assets from KEK to KOSTT and in increase in the estimated average wholesale power cost resulting from adjustments to the costs of KEK's mining and generation divisions to allow for the increase in lignite royalties from January 2013 (see the KEK Responses Paper for more details).