



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

Setting key regulatory parameters

Prishtina, 6 February 2012

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1 Introduction

The Energy Regulatory Office (ERO) is in the process of defining key regulatory parameters to be applied for calculation of Allowed Revenues and Tariffs for Distribution System Operator and Public Electricity Supplier.

On 29 December 2011, ERO approved indicative values for loss reduction in the distribution system and the indicative value of Weighted Average Capital Cost. ERO's Decision and Consultation Paper on these indicative values have been published on ERO's website.

This document aims to determine accurate values, which will be used for calculation of Maximum Allowed Revenues and tariffs for the next Regulatory Period.

2 Indicative values

Following regular public consultation, at its meeting held on 29 December 2011, the Board of ERO approved the indicative values for loss reduction in the distribution network as well as indicative value of Weighted Average Cost of Capital. The purpose of this decision was to reflect the approximate values deemed appropriate for calculation of Maximum Allowed Revenues, in line with conclusions and comments received by stakeholders.

2.1 Indicative value for Weighted Average Cost of Capital

Following public consultation, the Energy Regulatory Office decided that the indicative value of Weighted Average Cost of Capital (nominal with 3% inflation) shall be 14.5%, under an assumption of 50% gearing level.

2.2 Indicative value for loss reduction

Following public consultation, Energy Regulatory Office decided to set the following indicative trajectory for loss reduction in distribution system:

Indicative loss reduction targets	
Years	%
2012	3
2013	3
2014	3
2015	2.5
2016	2.5
2017	2.5
Total	16.5

3 Transaction Advisor's comments

In the meantime, on 24 January 2012, ERO received a note from Government Transaction Advisors on KEDS with respect to ERO indicative values. In their note¹, which according to Transaction Advisors was drafted at the request of the Minister of Economic Development, the Transaction Advisers state that indicative values as set by the Regulator are not sufficient to attract investment in KEDS, in line with the Energy Strategy approved by the Parliament of the Republic of Kosovo. Specifically, the Transaction Advisors ask the following:

1. Nominal pre-tax WACC should not be lower than 16.5%;
2. The loss sharing factor should be 0%. The level of allowed loss should be set at the level realised during the last transitory period. The loss level should not change annually. At the end of regulatory period, the level of allowed losses should be reduced to 15% (6*2.5%) and this level should not be decreased for the next five-year regulatory period. At the end of regulatory period, the loss should be reduced to 10% (5*2.0%).
3. The efficiency factor should be set at 0% for the next 6 years in line with the request of Government of Kosovo to guarantee employment for the first 3 years.
4. The bad debt should be set at 5% for 6 years and 2.5% for the next regulatory period.

In their note, Transaction Advisors have also asked to set some parameters, however, ERO believes that these may be impossible to set without a proper review and notes that such parameters may not be set for such a long period as required by IFC.

4 Setting the final values

Following review of comments from Transaction Advisors, at the meeting held on 6 February 2012, The Board of Energy Regulatory Office decides as follows:

1. The Weighted Average Cost of Capital shall be 15% nominal (3% inflation) for the transitory period and for the subsequent periodic review (1+5 years), under assumption of 50% gearing.
2. The loss reduction trajectory in distribution shall start at values realised during 2011 and shall be reduced by 3% (percentage points) in the first 3 years and by 2.5% (percentage points) in 3 subsequent years. The loss sharing factor shall be 0%.
3. The bad debt level shall be 5% for the first 3 years and 4% for 3 subsequent years.

¹ Note of Transaction Advisors was published on ERO's website.

Setting the final values

4. The efficiency factor shall be 0% for the first 3 years, with a maximum of 5% per year for 3 subsequent years. ERO suggests public consultation before setting final targets for 3 last years.

The Board of ERO finds that values set by the Regulator represent a step towards meeting the requests of Transaction Advisors while, at the same time, complying with indicative values previously set by ERO.