

Prishtina 27/06/2006
ERO Code: D_11_2006

The Energy Regulatory Office

Taking into account:

1. The legal mandate as per Articles 45 to 48 of the Law no. 2004/9 “On Energy Regulator”;
2. Agreement between Korporata Energjetike e Kosoves (KEK) and Independent Transmission and Market Operator (ITSMO) – “Agreement relating to the transitional commercial and operational relationship between KEK JSC and KOSTT JSC on the transfer of responsibility for operation and maintenance of the Transmission Network to KOSTT JSC – dated 22 June 2006”, hereinafter referred to as “The Agreement”.
3. Minutes of the Meeting between ERO, ITSMO, KEK, dated 17 May 2006
4. Revised applications submitted to ERO by KEK on 22 June 2006 and by ITSMO on 23 June 2006;

Has decided to approve the application for ITSMO Interim Tariff (IIT) and on specific issues regarding:

- a) Linkage between rates of Opex payments by KEK to ITSMO
- b) Split of Inter-TSO compensation mechanism (CBT) which might be received for the period July 2004-July 2006.

Chapter 1: Legal Basis

1. Based on the legal mandate of the Energy Regulatory Office (ERO) regarding Price Regulation as mentioned in Articles 45 to 48 of the Law No. 2004 / 9 on the Energy Regulator, ERO decides on ITSMO Interim Tariff (IIT).
2. As part of the separation of the Kosovo Energy Corporation (KEK) and the Independent Transmission System and Market Operator (ITSMO), the two parties have agreed to establish an IIT to govern payments from KEK to ITSMO from the date of separation, on 1 July 2006, until the end of the current financial year, on 31 December 2006 “The Agreement”.
3. The IIT has been negotiated directly between KEK and ITSMO. However, both parties have also requested that ERO facilitates these negotiations and, in the light of its legal duties and powers with respect to approving regulated tariffs, gives its approval to the final negotiated IIT. The parties have also requested that, where they are unable to reach

mutual agreement on aspects of the IIT, ERO issues a decision which both parties will be bound by.

- 4 For the avoidance of doubt, the IIT is not a tariff application and the resulting approved IIT does not represent a 'regulated tariff' approved by ERO. ERO has restricted its review and decision to those areas where the two parties are unable to reach mutual agreement.
- 5 Separately, ERO is currently conducting a full review of allowed revenues of electricity enterprises, following which the enterprises will be expected to submit proposed regulated tariffs for review and approval by ERO. The new regulated tariffs are expected to take effect from 1 January 2007. It should be noted that ERO has not reviewed or approved the operating costs and capital expenditures included in the IIT and that the regulated tariffs will be determined based on a separate review of allowed revenues without reference to the costs included in the IIT.
6. Based on the revised IIT proposal, submitted to ERO by KEK on 22 June 2006 and by ITSMO on 23 June 2006, and the minutes of the meeting held between KEK and ITSMO and facilitated by ERO on 17 May 2006, ERO understands there are two issues to be addressed:
 - Linkage between collection rates and Opex payments by KEK to ITSMO; and
 - Split of inter-TSO compensation mechanism (CBT)- potential revenue

On both of which ERO gives below its final decision.

Chapter 2: Linkage between rates of Opex payments by KEK to ITSMO

Although KEK and ITSMO mention in their proposals respectively €1.52m and €1.7m, it was clearly agreed in the meeting of 17 May 2006 between the two parties that ITSMO will have a minimum budget for the second half of 2006 of €1.61m in line with the below mentioned incentive-based linkage with KEK's collection rate.

Based on ITSMO's allocated budget of €3.57m for 2006 and a performance collection rate by KEK of €92m in 2006 (to be considered as 100% target), ERO decides that the realized budget for ITSMO will be directly related to the percentage of collection rate by KEK. If the collection performance is higher/lower than 100%, then ITSMO will receive a higher/lower budget in same proportion of the allocated budget to the percentage above/below the 100% collection rate achieved by KEK. However ITSMO's realized budget will be capped at 90% minimum of the allocated budget, even if KEK's collection rate might fall below 90%. The calculation will be adjusted on a quarterly basis. In other words the following incentive based linkage between KEK's collection rate and ITSM's allocated budget has to be implemented:

Allocated budget for 2006: €3.57m

- > 100% collection rate → ITSMO budget pro-rata increased
- 95-100% collection rate → ITSMO budget stays at 100% of allocated budget
- 90-95% collection rate → ITSMO budget pro-rata decreased
- < 90% collection rate → ITSMO budget fixed at 90% of allocated budget

Based on the above incentive based linkage, ITSMO will have a minimum budget during the second half year of 2006 (transitional phase) of **€1.61m** (= €3.57m * 90% * 6/12).

Chapter 3: Split of Inter- TSO Compensation Mechanism (CBT)- Potential Revenue

In the event that payments might be received by ITSMO from the inter-TSO compensation mechanism (CBT) of SETSO, relating to transit flows prior to 1st July 2006, then in compliance with EU Regulation 1228 /2003/EC “on access to the network for cross border exchanges in electricity”, and inter-TSO (CBT) guidelines issued by EC on 1st September 2004, it would be necessary to take those payments into consideration to reduce (reconciliate) Transmission Network tariff charges accordingly. Alternatively, the payments could be used to reduce future regulated network charges from 1 January 2007 onwards.

On the other hand “**start-up costs**” of an unbundled utility are expected to be recovered through the regulated network tariff charges. Those “start-up costs” should be subject to regulatory approval. Therefore should payment be received by CBT prior to 1st of July 2006, an amount up to the start- up cost of ITSMO, as allowed by ERO, will be allocated to ITSMO. If a surplus exists (above allowed start up costs), then the allocated split between KEK and ITSMO will respectively be 85% and 15% according to KEK’s T&D budget of 2006.

ERO will receive an application from ITSMO to justify and approve “start-up costs” by 15 July 2006 and release appropriately a decision while it will take in consideration and reconcile in the allowed amount any other source of finance for “start-up costs”, from KCB and/or donors.

Chapter 4: Applicability

This Decision shall enter into force on the date of the approval by the board of ERO.

Approved by the Board of ERO: Prishtina, 28 June 2006

Chairman of the Board of ERO:

Dr. Nick Frydas

Members of the Board:

Mrs. Merita Kostari

Mr. Naim Bejtullahu

Mrs. Theranda Beqiri

Dr. Nysret Avdiu
