

Prishtina, 15<sup>th</sup> March 2007

## **KEK JSC Retail Tariff Application**

### ***Background to decision***

#### **1 Introduction**

This note has been prepared as background to the decision of the ERO Board on the retail tariffs proposed by KEK JSC in its application to ERO of 19<sup>th</sup> February 2007.

#### **2 Review of application**

In reviewing the application, ERO's has been concerned to ensure that:

- The revenues recovered by KEK JSC's Public Supply business under the proposed tariffs, taking account of their proposed date of effectiveness of 1<sup>st</sup> April 2007 and the continuation of the existing tariffs until that date, do not exceed those approved by the ERO Board in its decision of 21<sup>st</sup> December 2006.
- The tariff increases for individual customer categories are not excessive. Under the Law on the Energy Regulator, ERO is required to ensure that tariffs are cost-reflective and do not involve cross-subsidies between customer categories. However, ERO must also have regard to its other duties, notably that of protection of customers. In this regard, ERO has determined that no customer category should see changes in average tariffs exceeding 10% (or less for household customers) to avoid price shocks and provide for a gradual transition to cost-reflective tariff levels. ERO is also concerned to ensure that electricity remains affordable for those lower-income households who currently benefit from the lower tariffs charged under the <800kWh/month block and who are not eligible for support as defined "social cases".

ERO's review has confirmed that the proposed tariffs comply with the approved allowed revenues, and that the change in average tariffs for each customer category (treating all household customers as a single category) remains within the guidelines established by ERO. These changes are shown in Table 1, below, comparing the actual average unit revenue from each customer category in 2006 with that forecast for 2007 (assuming that the new retail tariffs take effect from 1<sup>st</sup> April 2007 and previous tariffs apply until that date).

**Table 1: Changes in average tariffs under KEK JSC's application**

Tariff Group	Voltage level of supply	Average tariff		
		2006 (actual) €c / kWh	D07 (forecast) €c / kWh	Change
0	110kV	3.62	3.36	-7.2%
1	35kV	4.34	4.71	8.4%
2	10kV	5.16	5.57	8.0%
3	0.4kV Category I (large reactive power consumers)	5.81	6.35	9.2%
4	0.4kV Category II	8.14	8.61	5.8%
5-6	All metered households	<b>4.34</b>	<b>4.58</b>	<b>5.4%</b>
7	Unmetered	5.06	4.76	-5.9%
<b>All households</b>		<b>4.38</b>	<b>4.59</b>	<b>4.7%</b>
8	Public lighting	7.35	7.50	1.9%
<b>Average across all customers</b>		<b>4.92</b>	<b>5.14</b>	<b>4.5%</b>

*a Average for 1 January – 31 December 2007, assuming existing tariffs apply until 31 March 2007 and new tariffs from 1 April 2007*

However, ERO has concerns with respect to two aspects of the proposed tariffs:

- KEK JSC's proposed abolition of the existing two-rate household tariff would lead to a reduction in cost-reflectiveness and may have the results of increasing peak loads, leading to increased costs of supply due to the need to increase electricity imports to meet these loads. It will also have an adverse impact on affordability, by removing the current opportunity for low-income households to reduce their electricity bills by shifting consumption to off-peak periods.
- KEK JSC's proposed abolition of the existing two-band arrangement for household tariffs will lead to very large increases in tariffs for customers with low levels of consumption (who are also likely to be those with the lowest incomes). This raises affordability concerns.
- These are illustrated in
- Table 2, below, by comparing the average tariff in 2006 for typical household customers with those applicable if the new tariffs applied for the whole of 2007<sup>1</sup>.

**Table 2: Comparisons in average household retail tariffs under KEK JSC's application**

<sup>1</sup> A whole year comparison is used as better showing the longer-term distributional impacts of the proposed tariffs, ignoring possible distortions resulting from the proposed new retail tariffs not taking effect until 1<sup>st</sup> April 2007.

0.4kV Household Customer (2-rate tariff)		Monthly consumption kWh	Current tariffs		KEK JSC application (Full year)		
			Annual bill €	Average charge €/kWh	Annual bill €	Average charge €/kWh	Change
0.4 kV domestic	Minimum needs (no heating)	200	93	3.85	132	5.52	43.2%
	Minimum needs (with heating)	600	278	3.85	245	5.10	32.4%
	Medium customer	1,000	509	4.24	582	4.85	14.5%
	Large customer	2,000	1,202	5.01	1,145	4.77	-4.8%

Smaller metered household customers would see increases in average tariffs greatly exceeding the average across all household customers, while the largest household customers would see their average tariffs fall. This is consistent with the planned move to a single household tariff, eliminating the current cross-subsidies from larger to smaller household customers that exist through the use of the differently-priced <800kWh/month and >800kWh/month bands.

ERO's proposed responses to each of these concerns are set out below.

### 3 ERO's proposals

#### 3.1 Two-part household tariff

ERO has indicated to KEK JSC its reluctance to eliminate the two-rate tariff for households, given the importance in Kosovo of providing appropriate price signals to households to shift their demand from peak to off-peak times, in order to improve load management. ERO also considers that the use of a two-rate tariff provides a further means for low-income households to keep electricity bills affordable by shifting consumption to off-peak times.

However, ERO does accept KEK JSC's concerns raised in its application as to the increased risk of meter tampering under the two-rate tariff with existing meters. ***ERO is, therefore proposing to provide for a temporary derogation from application of the two-rate tariff while meters are improved and made more secure.*** The resulting temporary one-rate tariff will be harmonized across household customers with two-rate and one-rate meters so that all metered households pay the same tariff.

This should not be considered as restricting ERO from opting to continue to apply a household two-rate tariff now or in the future, nor as restricting KEK JSC from applying to move to a one-rate tariff on a permanent basis in conjunction with a programme of metering replacement.

#### 3.2 Banded household tariff

While the proposed retail tariffs represent a significant move towards cost-reflective levels, ERO is concerned that the large increases in tariffs for smaller household customers will raise significant affordability concerns—particularly in the short term, as household budgets adjust to the new prices. Although the social cases subsidy scheme provides some mitigation, this does not cover all low-income households who might potentially be affected by these adverse impacts.

***ERO therefore proposes to introduce a three-band household tariff structure for metered household customers.*** The three consumption bands proposed are:

- <200kWh/month – representing ERO’s calculation of the minimum electricity needs of consumers not using electricity for space heating, charged at the lowest tariff of 70% of the average metered household tariff. Average tariffs for these customers should not increase on a whole-year basis.
- 200-600kWh/month – representing ERO’s calculation of the reasonable electricity needs of consumers using electricity for space heating, charged at 90% of the average metered household tariff. Average tariffs for these customers should not increase by more than 5% on a whole-year basis.
- >600/kWh/month – charged at the highest tariff to recover any shortfalls in revenues between those recovered under KEK JSC’s proposed retail tariffs and those recovered under the first two bands as proposed by ERO.
- Under this structure, smaller household customers would continue to benefit from cross-subsidies from larger household customers, as at present. The resulting changes in whole-year average tariffs are shown in Table 3, overleaf. This illustrates the resulting change in average tariffs for households with differing consumption levels, assuming that the new retail tariffs take effect from 1<sup>st</sup> January 2007, for comparison with

Table 2. For example, if the new tariffs had applied for all of 2007 (ie, starting from 1<sup>st</sup> January 2007) a customer with an average consumption of 200kWh/month would see their bill remain unchanged<sup>2</sup>.

Although this proposal better meets ERO’s concerns to avoid excessive price increases for smaller customers, it must be noted that it would also result in a further move of household tariffs away from cost-reflective levels. This will need to be addressed through future adjustment of retail tariffs towards more cost-reflective levels.

**Table 3: Comparisons in average household retail tariffs under ERO's three-band proposal**

*Assumes new tariffs apply for full year, for comparison with*

Table 2

0.4kV Household Customer (2-rate tariff)		Monthly consumption kWh	Current tariffs		KEK JSC application (Full year)		
			Annual bill €	Average charge €/kWh	Annual bill €	Average charge €/kWh	Change
0.4 kV domestic	Minimum needs (no heating)	200	93	3.85	93	3.86	0.0%
	Minimum needs (with heating)	600	278	3.85	292	4.05	5.1%
	Medium customer	1,000	509	4.24	652	5.44	28.2%
	Large customer	2,000	1,202	5.01	1,554	6.47	29.3%

<sup>2</sup> The actual increases will be slightly lower than those shown, as the new tariffs will not take effect until 1<sup>st</sup> April 2007. This is because the new tariffs see a rebalancing between seasons, with winter tariffs for households being increased by more than summer tariffs. As a result of the new tariffs taking effect from 1<sup>st</sup> April 2007, a household pays the lower existing tariffs for the first three months of 2007 and then the lower new tariffs for the next six months.

## 4 ERO's proposed retail tariffs

The resulting retail tariffs, as proposed by ERO, are shown in 4, overleaf.

**Table 4: ERO proposed KEK JSC retail tariffs**

KEK JSC retail tariff application (with bands)  
Modified by ERO on 8 March 2007

Tariff Group	Voltage level of supply	Tariff elements	Unit	Time-of-day (a)	Current		KEK JSC Application	
					High season	Low season	High season	Low season
					1 October - 31 March	1 April - 30 September	1 October - 31 March	1 April - 30 September
0	110kV	Standing (customer) charge	€/customer/year				34.00	
		Standing (demand) charge	€/kW		1,150.00	895.00	519.00	519.00
		Active energy (P), of which:	€/kWh	High tariff	2.68	2.11	6.03	1.78
			€/kWh	Low tariff	1.34	1.09	2.50	1.47
		Reactive energy (Q)	€/kVArh		1.41	1.15		
1	35kV	Standing (customer) charge	€/customer/year				30.00	
		Standing (demand) charge	€/kW		1,278.00	959.00	540.00	540.00
		Active energy (P), of which:	€/kWh	High tariff	3.20	2.56	6.30	2.73
			€/kWh	Low tariff	1.60	1.28	3.33	2.47
		Reactive energy (Q)	€/kVArh		1.28	0.96	0.04	0.04
2	10kV	Standing (customer) charge	€/customer/year				34.00	
		Standing (demand) charge	€/kW		1,278.00	959.00	466.00	466.00
		Active energy (P), of which:	€/kWh	High tariff	3.52	2.81	7.07	3.15
			€/kWh	Low tariff	1.76	1.41	3.81	2.87
		Reactive energy (Q)	€/kVArh		1.28	0.96	0.32	0.32
3	0.4kV Category I (large reactive power consumers)	Standing (customer) charge	€/customer/year				29.00	
		Standing (demand) charge	€/kW		852.00	631.00		
		Active energy (P), of which:	€/kWh	High tariff	5.11	3.83	9.83	5.40
			€/kWh	Low tariff	2.56	1.92	6.15	5.08
		Reactive energy (Q)	€/kVArh		1.28	0.96	1.53	1.53
4	0.4kV Category II	Standing (customer) charge	€/customer/year				34.00	
		Standing (demand) charge	€/kW		253.00	189.00		
		Active energy (P)	€/kWh	Single tariff	7.57	5.68	9.73	6.23
		Active energy (P), of which:	€/kWh	High tariff	9.47	6.94	11.05	6.35
			€/kWh	Low tariff	5.05	3.79	7.14	6.01
5	0.4kV (domestic 2-rate meter) (c)	Standing (customer) charge	€/customer/year				20.00	
		Standing (demand) charge of which: (b)						
		<800 kWh/month	€/kWh		144.00	115.00		
		>800 kWh/month	€/kWh		192.00	144.00		
		Active energy (P), for consumption:						
		<200kWh/month (First Block) of which:	€/kWh	High tariff	4.80	3.83	3.47	2.49
			€/kWh	Low tariff	2.40	1.92	3.47	2.49
200-600 kWh/month (Second Block) of which:	€/kWh	High tariff	4.80	3.83	4.76	3.42		
	€/kWh	Low tariff	2.40	1.92	4.76	3.42		
>600 kWh/month (Third Block) of which: (d)	€/kWh	High tariff	5.11	3.83	8.43	6.06		
			€/kWh	Low tariff	2.56	1.92	8.43	6.06
6	0.4kV (domestic, 1-rate meter) (c)	Standing (customer) charge	€/customer/year				20.00	
		Standing (demand) charge of which: (b)						
		<800 kWh/month	€/kWh		144.00	115.00		
		>800 kWh/month	€/kWh		192.00	144.00		
		Active energy (P), for consumption:						
		<200kWh/month (First Block) of which:	€/kWh	Single tariff	3.99	3.20	3.47	2.49
200-600 kWh/month (Second Block) of which:	€/kWh	Single tariff	3.99	3.20	4.76	3.42		
>600 kWh/month (Third Block) of which: (d)	€/kWh	Single tariff	6.39	4.80	8.43	6.06		
7	0.4kV (domestic unmetered)	Estimated consumption <400kWh/month	€/customer/month		20.00	20.00	23.00	
		Estimated consumption 400-800kWh/month	€/customer/month		36.00	36.00	42.00	
		Estimated consumption >800kWh/month	€/customer/month		61.00	61.00	71.00	
8	Public lighting	Standing (customer) charge	€/customer/year				34.00	
		>800 kWh/month	€/kWh	Single tariff	8.21	6.31	7.82	7.82

a High Tariff applies 07:00-22:00 Monday-Saturday during the High Season and 08:00-23:00 Monday-Saturday during the Low Season

b Where no maxigraph is installed, the standing (demand) charge is calculated as energy volumes consumed under the High Tariff divided by 100

c Customers registered as social cases are charged at a zero rate

d Under existing tariffs, this tariff applies to consumption >800 kWh/month