



Regulated activities and setting of tariffs in Albania

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Introduction

- The process of tariff setting and reviewing is an important process of our Institution.
- In concept of tariff definition
- “Equity/Justice is mother of confusion” Prof. W. Arthur Lewis.
- So our duty is to work hard and to be precise.



What do we must pay attention to?

- In our daily work, we have to base our analyses on the Law “On Power Sector”. The purpose is to ensure compliance with the conditions for an electricity supply to the customers according to the standard parameters. This can be achieved through an efficiently functioning power market and the development of competition, taking into consideration the protection of consumers’ interests, cost minimization in providing electric power service and its compatibility with the environment.

Legal Framework



Law No. 9072, dated 22.05.2003 “On Power Sector”

In article 8, paragraph 2(b), it says that ERE sets, regulates and reviews wholesale and retail tariffs and the terms and conditions of service of electric energy proposed by a licensee or reviews them according to circumstances.

- ✓ Article 26 defines the authority of ERE for tariff setting, upon which:
 - The ERE is the responsible institution for setting tariffs in all activities carried out by the licensees in electric power sector.

What do we must pay attention to during the procedures of setting tariffs

Tariffs for electric power services established by the ERE shall :

- **Protect consumers from monopolistic prices;**
- **Consider needs for improvements of financial and technical indicators of the licencees;**
- **Provide licensees with the opportunity to recover their reasonable costs of providing services;**
- **Encourage efficiency in internal operations and management, by allowing the licensee's financial returns as a result of his minimized cost for providing services;**
- **Reflect cost differences between different categories of consumers;**
- **Consider the National Strategy of Energy and Document of Policies of Power Sector;**
- **Follow the Albanian Government Policy regarding the elimination of cross-subsidies between categories of consumers.**

Methodologies for tariff calculation

- Pursuant to the Albanian Legislation, ERE has established the methodologies and procedures for tariff and price calculation, according to the core regulated activities of the power sector, methodologies and procedures approved by the decision of the Board of Commissioners.
- These methodologies can be classified as follow:
- Methodology for calculating tariffs for electricity generation (PGC tariff)
- Methodology for calculating tariffs for electricity transmission service
- Methodology for calculating tariffs for electricity distribution service
- Methodology for calculating the electricity sales tariff/prices for captive customers.

Methodology for calculating tariffs of electricity generation

Costs that will be included in tariff calculation and that are covered through payments for capacity-related charges and energy-related charges, consist in capital costs, operational costs and taxes.

- Only reasonable economic costs, related to regulated services' insurance, will be included in tariff calculation.
- Requirement revenue level for the base year is equal with:

$$\mathbf{RR = C_{capital} + C_{operating} + C_{tax}}$$

(RR – Revenue Requirement)

- $\mathbf{C_{capital} = R + D - A}$

$\mathbf{C_{capital}}$ – component related to requirement revenues from capital for the base year.

R - Rate of return

D - Depreciation of fixed and other assets.

A – Ancillary services revenue, which is collected from the TSO and represents a payment for ancillary services other than balance power.

Methodology for calculating tariffs of electricity generation (continued)

- **Regulator should think of determining the allowable rate of return on the Regulated Asset Base. This is subject of discussion between interested groups.**

- $r = roe * (1-d) + i * d$

roe – allowable after-tax rate of return on equity; a target set by the regulator

d – debt ratio - i.e. the ratio of long-term debt to fixed assets, which is set by the regulator and applied to the Regulated Asset Base

i – weighted average interest rate on long- term debt

Methodology for calculating tariffs of electricity generation (continued)

- **The generation utility operating costs include:**

$$C_{\text{operating}} = C_{\text{metering}} + C_{\text{maintenance}} + C_{\text{salaries}} + C_{\text{fuel}} + C_{\text{outsource}}$$

- **The C_{tax}** component enables the Regulator to show clearly the portion of the tariff which is attributed to taxes and, therefore, beyond the Regulator's control.
- Thus, the total requirements for the revenue recovery through capacity-related charges and energy-related charges is:

$$RR = C_{\text{capacity}} + C_{\text{energy}}$$

$$RR = C_{\text{capital}} + C_{\text{operating}} + C_{\text{tax}} \quad \text{and}$$

- Average Tariff for generation for 12 months' period results to be:
- $P_{\text{average}} = RR / E$ where E – total energy in kWh flowed in distributed/supplied companies during 12 months' period.

Methodology for calculating tariff of electricity transmission / distribution service.

The principles are the same for transmission and distribution. Both are networks (natural monopolies).

- Cost of technical losses is comprised of operating cost, and cost of metering is identified separately and it is comprised of average transmission/distribution tariff.

$$C_{\text{operating}} = C_{\text{maintenance}} + C_{\text{salaries}} + C_{\text{technical losses}} + C_{\text{tech}} + C_{\text{outsource}}$$

- Losses are estimated with the price of electricity import. This is a subject of discussion and may need to be reviewed in the future.
- The revenue requirement for the transmission/distribution utility in the base year includes payments for capacity-related charge, energy-related charge and a fixed charge.

$$RR = C_{\text{capacity}} + C_{\text{energy}} + C_{\text{metering}}$$

- The average tariff for transmission/distribution is equal to:

$$P_{\text{average}} = (C_{\text{capacity}} + C_{\text{energy}} + C_{\text{metering}}) / E$$


Methodology for calculating tariff of electricity transmission/distribution service (continued).

- Methodology used for transmission / distribution tariff is a “Price cap regulation” with tariff review cycle of 3 years - that means Regulator has to determine the revenue/price cap equal to the average transmission /distribution tariff calculated according to costs in the base year.
- The “Price-cap” methodology is a usual method in Europe for network service tariffs.
- For the coming year of the tariff review cycle, the average tariff for the base year is multiplied by the annual adjustment factor:
$$A = (1 + RPI - X)$$

A - annual adjustment factor

RPI - rate of consumer price inflation forecast for the year

X - efficiency improvement factor set by ERE



Methodology for calculating tariff of electricity transmission/distribution service (continued).

The value of **X** should be determined on the basis of a benchmarking study of transmission/distribution system operators, in which the performance of at least 3 transmission/distribution companies is examined over a period of at least 3 years. If the ERE does not have time to conduct such a benchmarking study or review the results of other benchmarking studies, then the value of **X** should be equal to zero. This is the current case in Albania.

Our next step is to determine the appropriate benchmarking for analyzing the efficiency of the transmission/distribution utilities that are operating in our country.



Methodology for calculating tariff of electricity transmission/distribution service (continued).

If a distribution company is a distribution/supplier company, distribution activity and supply activity must be completely unbundled from an accounting standpoint. This is not the case in Albania, since distribution activity is not yet financially separated from supply activity.

The same problem is evident with the transmission activity, which is legally and financially separated, but the loans and debt for projects implementation are not yet separated from the other activities.

Methodology for calculating the electricity sales tariff/prices to captive customers.

The average cost per kWh of electricity for household customers consists of the following components:

$$AC_{\text{household}} = G + I + T + D + S + A$$

- G** - cost of generation, calculated from average tariff of generation.
- I** - the component that must be added to G to cover the cost of imports, purchases from IPPs and purchases from SPPs.
- T** - cost of transmission, calculated from the transmission tariff.
- D** - cost of distribution, calculated from the distribution tariff.
- S** - public supply fee
- A** - adjustment for bad debts, non-technical losses, and experiences related to metering inspection, collections, public information programs, and other activities needed to reduce the level of bad debts and non-technical losses.

Methodology for calculating the electricity sales tariff/prices to captive customers. (continued)

- At each voltage level, the average cost per kWh of electricity sold to non-household customers consists of the following components:

$$AC_{\text{non-household}} = G + I + T + D + S$$

- There is no component A - bad debt and non-technical losses are assumed to occur to household consumers only.
- The value of S will be set by the ERE once a year, on the basis of an application submitted by the distribution/supplier company.

ERE's Procedures for reviewing tariffs to the licensees.

- Tariff review is done based on the rules of related methodologies and on the rules of practices and procedures of ERE.
- Admission of demand for setting or reviewing prices in ERE is accompanied by certifying documentation.
- Board of Commissioners takes decision to accept the demand or not, within 12 days.
- Within 5 days, the company has to inform the public about:
 - the purpose amount for changing tariffs' normative
 - % of change for each category of customers.

ERE's Procedures for reviewing tariffs to the licensees (continued)

- Department of Tariffs and Prices has to review materials of an applicant within 6 months, and has to organize a meeting with the representatives of the applicant in order to fulfill the documentation and other clearances.
- Before final decision, Board of Commissioners has a hearing session with all other interested third parties, such as different institutions, consumer associations, etc.
- After working on the applicant's documentation, Dept. of Tariffs and Prices prepares a detailed analysis for the Board of Commissioners about the proposed price made by company and calculations made by the Department, and also comments taken into consideration by other interested third parties.
- **Board of Commissioners announces an open meeting for the public to make the final decision, based on Law No. 9072, dated 22.05.2003**

Conclusion

- **Tariffs shall be just and reasonable in accordance with the recognized ratemaking principals, non-discriminatory in nature, based on objective criteria, and determined in a transparent manner.**
- **ERE has the responsibility to approve regulated tariffs which reflect costs of services for each activity of the licensees in the Power Sector.**
- **Department of Tariffs and Prices has the responsibility to calculate the tariffs with precision, and has the responsibility regarding the evaluations enforced by the current situation as well as the future.**

THANK YOU !