

**METHODOLOGY ON CALCULATING THE TARIFFS OF THE
ELECTRICITY PRODUCTION COMPANY WHOSE SHARES ARE
FULLY/PARTIALLY CONTROLLED BY THE STATE AND
CHARGED WITH PUBLIC SERVICE OBLIGATION**

Purpose

This methodology is drafted in conformity with Law no. 43/2015 “On Power Sector”, Council of Minister Decision no.244 dated 30.03.2016 “On approving the conditions for imposing Public Service Obligation”, Council of Minister Decision no. 519 dated 13.07.2016 “On approving the electricity market model” other legal acts in force in Albania as well as other by-legal acts approved by ERE.

The purpose of this methodology is to define the tariffs for the Electricity Production Companies whose shares are fully/partially controlled by the state based on the acknowledged principles of imposing accurate and transparent tariffs based on the detailed data, which transmit the appropriate prices signals.

Object

The object of this methodology is to define the average electricity production tariff. These tariffs shall be applied until when these electricity production units are fully introduced in the competitive electricity market.

I. Definitions

The terms used in this methodology shall have the same meaning as the one defined on article 3 and as follows Law No.43/2015 “On Power Sector”, as well as other by - legal acts approved by ERE. The other terms used in this methodology shall have the following meanings:

1. **Base year** – shall mean the 12 months period during which the tariff of the production company approved by ERE is applied for the invoices of the universal service supplier company.
2. **Existing production units** – three HPP-s of Drin river cascade.
3. **Tariff for energy** – shall mean an average tariff calculated for existing economic production units in conformity with the costs provided for the exercising year that is calculated according to this methodology.

4. **Regulated asset base (RAB)** – The value of long - term assets that are owned by the electricity production unit and are used to ensure energy and capacity for the Universal Service Supplier. Regulated Asset Base is subject of ERE approval.
5. **Regulatory period** – shall mean the period during which the new tariffs become effective and are regulated/reviewed according to the decision taken by ERE

II. General rules and the basic principles

1. The failure to comply with the provisions of this regulation may lead to the refusal by ERE of the tariff application of the electricity production company whose shares are fully/partially controlled by the state
2. ERE shall impose the tariffs according to the following principles.
 - The tariff shall permit the electricity production company to cover the average service costs for each kWh that it delivers according to Public Service Obligation. The average cost shall be subject of verification for each of two following years based on; the foreseen results as well as the accounts according to the audited financial statements. The verification result shall be used to correct the tariff for the following years.
 - The expenses included in the tariff shall be transparent for all the interested parties.
 - Only the services and the products carefully purchased from the electricity production unit shall be accepted in the production tariffs.
3. The payments to the electricity production company for energy shall be according to Public Service Obligation, in conformity with the electricity sale agreement, based on the tariffs for the electricity production companies
4. The electricity production tariff shall not be used to cover the cost of any activity not connected with the energy sale to the Universal Service Supplier.
5. The electricity production tariff shall be based on the costs that shall be incurred by a well-managed production company which performs careful investments and avoids the excessive costs. During the process of defining the tariff of the electricity production company, ERE shall have the right to control the levels of the costs reported by the production company and shall compare the cost for its unit with the one of other production companies in the Country and in the Region.

III. The testing year and the regulatory periods

1. ERE shall decide for the appropriate regulation periods for the public electricity production companies. The process to review the tariffs shall be for annual reviews of the required incomes for the production companies defining the respective tariffs.
2. The first regulatory period of applying this methodology shall be the calendar year 2017.

IV. Net production and the installed production capacity

1. The total electricity quantity that shall be delivered to the transmission system from the electricity production company shall be according to a hourly graph defined on the electricity sale agreement with the Universal Service Supplier. Any shortage or excess on the energy quantity delivered for one hour will be the responsibility of the production company, which shall be subject to the balancing rules administered by the TSO.
2. The electricity quantity delivered for the Universal Service Supplier according to public service obligation, shall be defined on the contract signed with the Universal Service Supplier in conformity with point 2, article 5 of Council of Minister Decision no. 244 dated 30.03.2016 “On approving the conditions for imposing the public service obligation”, based on a rational regime of utilizing the generation capacities and the average annual historic level.

V. Request for the revenues for electricity production

1. The regulated tariffs of the electricity production company shall cover the ownership cost, the construction cost, that of operation and maintenance of the production plants, the cost of the dams used for hydropower production as well as the cost of the land, buildings, roads and equipment/communication instruments.
2. The electricity production company shall accurately report the costs for every regulated service, including not only the assets and the activities connected with the regulated services. The distribution method of the costs shall be accurate and shall be approved by ERE.
3. The costs regarding marketing, electricity sale and the excess capacity are not included at the required revenues for electricity sale to the Universal Service Supplier.

4. Only the economically justified costs which belong to electricity sale activity for the Universal Service Supplier shall be included on tariff calculation.
5. On the application for tariff, the electricity production company, shall accurately submit all the costs up to 100.000 ALL. The regulator shall not control the figures less than 100.000 ALL, except of the case when there are disputes regarding the compensation or the payment to the natural specific persons.

VI. Rate of return over the Regulated Asset Base (RAB)

1. The regulated asset base for the licensed service includes the value tangible and intangible assets, minus the accumulated depreciation plus the working capital component.

RAB is calculated according to this formula: $RAB = A - CG - D + WC + INV$

Where:

RAB	Regulated Asset Base
A	Acknowledged value of the useful assets in usage/operation from the beginning of the regulatory period
CG	Value of the assets acquired through donations
D	The accumulated value of depreciation for the previous periods of the used assets to perform the licensed activity. Depreciation for the new investments during the current regulatory period shall be equal with the cumulative annual average of depreciation for the middle year (6 months).
WC	Permitted value for the working capital
INV	Average cumulative nominal value of the investments foreseen for the middle year, approved by ERE, which shall be invested during the year.

2. Not all the assets of an electricity production company whose shares are fully/partially controlled by the state may be included on the regulated asset base to calculate the regulated tariff of electricity production. The assets that do not serve to the purpose for which it is licensed shall be exempted from the regulatory asset base. Examples of the exempted assets from the Regulated Asset Base, shall include but will not be limited only at the assets uses for the not licensed activities, the assets used for entertaining, or the assets purchased from the electricity production company on the market value. ERE based on the assessment of the consultant or ERE staff, defines the asset value in the market only in cases when the investment value is questionable.

3. The land and the easement rights used from the electricity production company whose shares are fully / partially controlled by the state may be accessed with the original purchase cost, corrected with the inflation level. It is not necessary to access the market value of the land.
4. Long-term finances of the electricity production company whose shares are fully partially controlled by the state shall be used to finance the capital expenses to repair or renew the existing plants, but shall not be used to cover the operational expenses or the construction of new generation capacities and that do not serve to comply the request of the customers that benefit from the universal service.
5. ERE shall apply the fiscal system for calculating the depreciation for regulation. ERE may decide to use other depreciation rates for specific cases when the electricity production company may submit engineering studies regarding the life of the assets.
6. The basis on defining the permitting value of the working capital shall be 1/12 of the permitted elements sum.
7. The return rate of the electricity production company shall not reflect the acquired through donations. The electricity production company shall be allowed to cover the depreciation expenses for these assets.
8. The Regulated Asset Base (RAB) shall be calculated as the sum of:
 - RAB value approved with Decision no. 139 dated 26.12.2014;
 - Investment value for 2015-2016 period;
 - Investment value foreseen to be realized for the regulatory period that is reviewed according to the investment plan approved by ERE;
 - minus the accumulated depreciation;
 - Value of the permitted working capital equal with 1/12 of the permitted Operational Expenses for the applied period.
9. The permitted return rate over the RAB is calculated according to a permitted return rate over the capital on the base year, an assessment of the average interest rate for the long-term debts during the base year as well as a debt/capital ratio. Three of these values shall be notified at the decision for the approved tariff from the regulator, in such a way that the assumptions used to calculate the permitted rate of return over RAB shall be submitted clearly. The permitted return rate before tax over RAB is:

$$WACC = [ES * ARoE / (1-T) + DS * CoD]$$

$$ES + DS = 1$$

Where:

ES	Object for its capital ratio at RAB
T	Tax rate
ARoE	Permitted rate of return over the capital after the tax
DS	Object for the debt ratio of RAB
CoD	Cost of the debt

10. ERE shall define the appropriate value of return over the capital (after the capital) for the electricity production company which shall be the risk free rate of short term treasury issued from the Central Bank of Albania.
11. The interest rate of the debt component shall be based on the interest rate for the unpaid debt of the production company. The used interest rates to define the required incomes may / may not be the same rate with the current interest rate of the debt. The production company shall show that the interest rates for the debt are on the same line with the interest rates for the presumed debt from the company with similar credit risk. The debts included for the calculation of the average rate of the interest for the debts and with an interest rate higher than the current level of the market, shall be regulated decreasing to the market level.
 - 11.1. The weighted average interest rate on long - term debt shall be defined as the sum of interest payments for the long – term debt of the base year, dividing it with the total principal of the long-term debt (total amount of the debt) at the beginning of the base year.
 - 11.2. ERE shall base its decision according to a capital structure of 30% of its capital and 70% debt for the electricity production company.

VII. Annual review of the electricity production company to finance the capital expenses

1. The electricity production company shall submit at ERE an annual financial statement for the nearest year that terminates on 31 December as well as the foresee of these statements for the base year. The financial statements shall include the report of the money flow indicating the resources of using the funds.
2. The electricity production company shall submit at ERE the foresee of the financial expenses for the base year which identify the resource of the funds used to cover the annual capital expenses.

- 2.1. ERE, by the end of each month may review the current investments to the planned ones and may change the tariffs if the electricity production company fails to realize the investments plan.

VIII. Calculation of the electricity production tariff

Electricity production tariff from the electricity production company, whose shares are fully/partially controlled by the state, for the sale at the Universal Service Supplier, is calculated as the report of the annual required revenues with the electricity quantity contracted according to Council of Minister Decision no. 244 dated 30.03.2016 “On approving the conditions to impose public service obligation”

IX. Terms

Based on this methodology, the electricity production company shall submit at ERE the application for new tariffs, at least 4 months before the day the proposed tariffs enter into force, in conformity with the “Regulation on ERE organization, operation and procedures”.

X. Last provision

The methodology of calculation the electricity production company tariffs is approved by ERE Board with decision no. 17, dated 19.01.2017. This methodology substitutes the one approved with Decision no. 77 dated. 26/06/2008.