

It has become publicly known that the entire energy sector in Albania is in a difficult financial situation and dysfunctional as a result of the accumulation of mutual obligations between the main market actors (CEZ Distribution, Albanian Power Corporation (KESH), OST, independent producers of electricity). Normalization of the difficult financial situation in the sector requires the consistency in contractual relations between the KESH and CEZ Distribution. This consistency creates the opportunities for the regulation of contractual relations between the KESH and hydropower concessionaires and privatized power generating companies (independent power producers).

The current model of market and relevant regulatory framework define the formal aspects of relations among operators, but do not guarantee their functionality because AEC (Albanian Energy Company) KESH bears all hydrologic risk and provides ancillary services. Six years have passed since the market model was introduced and today this model is giving signs of weaknesses, showing that the efficiency and reliability of the energy sector have not increased over these years.

For the aforementioned reasons, it is imperative to restructure the electricity market and commercialize the exchange of energy and services in the market. It is also needed to draft a clear program aimed at the introduction of technologies that exploit renewable energy sources, combined with a proper planning to increase the energy efficiency of the entire energy sector. These changes require an active and constructive participation of all stakeholders of the energy sector, fundamental changes in the primary legislation on the energy sector and beyond, and all regulatory acts. These legal changes associated with tariffs reform, which should be implemented in compliance with the requirements of EU Directives on Energy, will enable the achievement of market liberalization targets envisaged under the Energy Community Treaty.

AEC administration is working on a multifaceted platform (strategic-tactical-operational) to transform the Albanian Power Corporation in a publicly traded corporation that will become economically efficient through the redeployment of domestic energy resources so that, besides fulfilling its public function with responsibility (ensuring continuous supply of tariff customers), it will enter into partnerships with other market operators in order to become an organization which will bring benefits to all participants in the liberalized market, being honest and transparent. For these reasons, in recent months AEC has implemented one of the innovations of institutional, organizational and technical restructuring of companies; i.e. it has established a special division that will be in charge of defining vision and implementing efficient and proactive management of the company in compliance with regulatory framework, as well as adopting a strategic approach in analyzing the different ways and options of resolving the difficult financial situation of the company, arisen mainly as a result of the failure of the current model of the energy market.

Emergence from difficult financial situation and transformation of AEC into an economically

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efficient organization necessarily require a public review of the regulatory framework and the setup of a new market model.

In cooperation and consultation with other stakeholders in the sector, AEC has identified five intervention /priority improvements in the current legal framework/regulations, whereby AEC will address issues which it is currently facing and will be able to begin the process of commercialization of its activity. Priority interventions proposed by the AEC are as follows:

Reduction in the obligations of AEC to deliver electricity to CEZ Distribution to cover the demand of tariff customers.

Under the regulatory framework in force, AEC/Wholesale Public Supplier supplies the Distribution System Operator (CEZ Distribution) with electric power for meeting the demand of tariff customers at medium and low voltage. Since 2012, high voltage customers have had the opportunity to buy electricity on open market. Although this step marked a partial liberalization of the electricity market, AEC was not able to reduce liabilities (14% less) of the RPS (Retail Public Supplier) and to transform it by proportionally increasing its collection, due to privatization of HPPs 4 (Ulez, bats, Bistrica 1-2, with total installed capacity of 78 MWh).

AEC is largely dependent on the financial and technical performance of CEZ Distribution, as the latter is its only client. Only in case of the most favorable hydrologic conditions, usually lasting for short periods of time, AEC can generate extra income by selling electricity at unregulated prices.

The experience of recent years shows that a part of the energy delivered by the AEC to cover tariff customers demand goes to cover distribution losses and that AEC has difficulties in collecting payments for the electricity sold at market prices, except for the energy that is sold at regulated prices. However, under conditions of EPC production probability, there should be the possibility that the latter can directly participate in monthly CEZ Distribution procedures for purchasing electric power, in cases of favorable hydro periods, without the obligation to meet demand of tariff customers.

Further liberalization of the electricity market in Albania is necessary in order to open space for the portfolio diversification of KESH and strengthening of its financial position. Primary energy legislation, which is being prepared, must precede reform of the energy sector gradually releasing KESH from the obligation, as the sole supplier of electricity, to cover demand of tariff customers. This liberalization should be guided by the best European practices and implemented in several stages which can be: i) during 2015 AEC should be freed from the obligation to meet the electricity needs of consumers (industrial) associated with medium voltage, ii) while in 2016, as an obligation of KESH in terms of electricity supply should be considered only the demand of customers connected to low voltage. However, we can discuss different variants of the transitional period in adapting to market

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changes towards liberalization. During the transitional period that will be needed for the opening of the market, it should be established a market participant who will serve as “supplier of last resort”.

Transfer the obligation to purchase electricity produced from PVE-të/PPE-të to AEC / WPS CEZ Distribution.

Current regulatory framework obliges AEC (function Wholesale Public Supplier) for a 15-year period, to purchase all electricity produced by hydropower plants with installed capacity of 15 MW, at preferential prices (averaging about ALL 9 / kWh) based on the type of contract approved by ERE.

SPPs (linked to the network of Distribution System Operator) and IPPs (connected to the network Transmission System Operator) produce electricity through derivation, with no real opportunity for its proper planning. Most of the production of these operators is delivered in the power system, in the period of time that corresponds to large inflows in Drin river cascade. In these circumstances, and based on what has happened in the past, in some cases, AEC was forced (by the current regulatory framework) to purchase all the electricity generated by these operators (due priority in production and trade given according to the regulatory framework PVE-ve/PPE-ve), although at the same time period it was also forced to remove water from hydropower plants under its administration.

During the period 2012-2014, small producers generated over 1.2 billion kWh more electricity than it was projected and reflected in the wholesale tariff of ALL 2.2/kWh approved by ERE for AEC/Wholesale Public Supplier for the period from 2012 to 2014. A legal obligation to purchase this amount of electricity caused to AEC an additional cost of approximately ALL 10 billion (or approximately EUR 70 million) in particular wholesale charge.

The obligation imposed by the current regulatory framework for AEC to buy electric power from these producers, besides being a financial burden that exacerbates the liquidity of the company (under conditions of non-payment of bills by CEZ Distribution), also drastically limits the possibility of optimizing production in the river cascade and improving its economic portfolio.

Despite the effort and work made by Distribution System Operator to reduce losses in the distribution network, current losses are high (averaging over 200,000 MWh per month) and will continue to be relatively high in the following 2-3 years. Meanwhile, SPPs and IPPs currently produce approximately 90,000 MWh per month on average and it is forecasted that in the next 2-3 years production will reach 150,000 MWh per month. Since the Distribution System Operator must purchase energy needed to cover network losses as long as the amount of energy produced by SPPs and IPPs is less than the amount necessary to System Operator Distribution to cover network losses, it is logical that the energy produced by SPPs and IPPs can be bought by the Distribution System Operator and EPC/Wholesale

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Public Supplier that today are absolved of this right, which is inconsistent with any commercial and economic logic, and is in contrast with European practices.

Through this change (which precedes the substantive changes that the energy sector as a whole should undergo as of 2015 onwards), AEC will be freed from financial pressure to pay bills for electricity generated by SPPs and IPPs that is injected directly into electricity distribution network.

Determination of incentive mechanisms for producing excess electricity from AEC.

In the section 4.2 of the current model of the Albanian electricity market it is noted that “All the revenues from the hydro resources of the country will be saved for the Tariff Customers of Albania”. Based on this provision, alternatively with the approval by ERE’s incentive mechanisms in this respect, fees of AEC/WPS turn out to be significantly reduced over the years as a result of significantly reducing tariffs of AEC-Gen.

In view of the commercialization of the AEC’s activity and in accordance with the mission and mandate of AEC provided for in the Charter of KESH corporation, it is necessary that any additional revenue that AEC realizes as a result of the sale of electricity produced on planning/Tariff Customers’ needs, is not transferred to subsequent years fees but placed / kept in a special fund to buy electric power in the market during unfavorable hydro energy (electricity production is below average perennial), and/or to build new generating capacity. In this way it becomes possible for the customers to benefit from additional revenue through the stabilization of tariff rates over time and/or to increase the generation capacity. In these conditions, building new energy capacities is deemed vital enough and will allow to increase energy security, reduce dependence on imports, etc.

To implement this measure, it is necessary that the electricity bill, which is being prepared, includes provisions that create the opportunity for AEC to derive all additional net profit from its own production capacity, to use it for building new generating capacity and /or the creation of a dedicated fund to buy electric power in the market over the years with electricity production under multiyear average. Following this definition and calculation under Gen. AEC fee, ERE should account for the full value of the investment in building new generating capacity of AEC.

Provision of ancillary services based on a competitive process.

Although the current model of the Albanian electricity market (items 4.1 and 4.2) posits that the Transmission System Operator (OST) must purchase ancillary services (through competitive and transparent procedures) from all market participants, currently AEC is the only operator of the electricity market that offers all ancillary services to OST (while being financially compensated by fee-for-service only adjusted balance).

AEC and DSO are already preparing the relevant study on calculation of the costs of ancillary services, which must then be approved by ERE. Providing ancillary services versus respective tariffs enables AEC to generate additional income that it can invest

in increasing its production capacity. In the future, the liberalization of the market for ancillary services will enable the delivery of these services through competitive procedures, not only in the country but also in the region.

Selling the electricity to cover transmission losses on the free market.

Currently, OST covers losses in the transmission system exclusively based on AEC relevant fee Gen (ALL 1/kWh). Meanwhile, the current model of the Albanian electricity market (items 4.1 and 4.2) provides that "DSO buys electricity to cover losses in the transmission system from KESH Gen and other members of the electricity market."

In full compliance with the provisions of the third legislative package on the EU gas and electricity markets, our electricity market should be an open market, free and competitive and reflect the real costs to operators in this system/market.

For this reason, the OST should be allowed to purchase the energy required to cover losses in the transmission network through competitive and transparent procedures approved by ERE. In this way, AEC will have the opportunity to benefit from the amount of energy delivered to cover losses in the transmission network at one currency price/kWh, or to sell it in the market (i.e. higher price) by generating additional income.

Implementation of the foregoing measures to improve the legal/regulatory framework not only will be considered as a more fair and compliant with the best European practices, but it will also enable further development of the energy sector by developing competitiveness, enhancing performance and providing better services to customers. The implementation of these measures with significant impact on improving the financial situation of KESH will enable full rehabilitation of hydropower plants on the Drin river cascade (administered by AEC), further optimization of the economic/energy portfolio of KESH and investment in new generating capacity, to make the company become reliable, competitive and active participant in the regional market.