



UNMIK

MEM

MINISTRIA E ENERGISË DHE MINIERAVE
MINISTARSTVO ENERGIJE I RUDARSTVA
MINISTRY OF ENERGY AND MINING



INSTITUCIONET E PËRKOHSHME VETËQEVERISËSE
PRIVREMENE INSTITUCIJE SAMOUPRAVLJANJA
PROVISIONAL INSTITUTIONS OF SELF-GOVERNMENT

QEVERIA E KOSOVËS

VLADA KOSOVA

GOVERNMENT OF KOSOVO

**MINISTRIA E ENERGISË
DHE MINIERAVE**

**MINISTARSTVO ENERGIJE
I RUDARSTVA**

**MINISTRY OF ENERGY
AND MINING**

TRANSITION PLAN FOR THE ELECTRICITY SECTOR OF KOSOVO

May 2006

TRANSITION PLAN FOR THE ELECTRICITY SECTOR OF KOSOVO

PURPOSE OF DOCUMENT

The European Commission, on behalf of the Energy Community of South East Europe, has prepared an Electricity Transition Strategy¹, which after consultation with members of the Energy Community, was finally approved at the Ministerial Council on 9 December 2005.

Following this approval, parties to the Energy Community Treaty were each requested to prepare their own Electricity Transition Strategies, indicating how their country would bring their own electricity sector into line with the Energy Community Treaty requirements and take into account the issues raised in the overall Transition Strategy.

This document is intended to fulfil this requirement for UNMIK-Kosovo.

I BACKGROUND

Kosovo is administered by the United Nations Interim Administration Mission in Kosovo under United Nations Security Council Resolution 1244.

The assets of the mines and energy sector of Kosovo are administered by the Kosovo Trust Agency, while policy for the energy sector is the responsibility of the Provisional Institutions of Self Government (PISG), in particular of the Ministry of Energy and Mining (MEM). This situation will remain at least until the final status of Kosovo is negotiated, which is anticipated to occur in 2006.

Kosovo Energy Strategy for the electricity sector for the period 2005 to 2015

The Ministry of Energy and Mining adopted a ten-year energy strategy for Kosovo in July 2005. The key points are as follows.

The mission of the Government is to contribute to Kosovo's development by providing energy at competitive prices to Kosovo households and businesses. It also seeks to use energy, including its domestic lignite resources in an environmentally and socially sensible way, consistent with European standards, for the efficient production of energy.

The vision for the energy sector in Kosovo for this period is to become technologically advanced, financially viable and to be fully integrated into the regional and European energy system. In the medium term, the sector's reliance on assistance from the Kosovo Budget should be decreasing. The longer term vision is for the sector to become transformed so it becomes a net contributor to the Budget, by becoming a net energy exporter instead of a net energy importer.

The long term goals of the Kosovo Energy Strategy for the period 2005 to 2015 for the electricity sector are:

- To re-establish, and then to continue to provide, a reliable, safe, affordable and sustainable electricity supply with rational use by all consumers in Kosovo;
- To meet the commitments of the Energy Community Treaty as signed by UNMIK

¹ The document (Energy_Transition-Strategy_122005.doc) can be found in the Energy Community website in the library of core documents: www.energy-community.org.

- To qualify for exploitation of all opportunities arising in the regional energy market of South East Europe, especially opportunities for cross-border trade and investments in new lignite-fired power plants
- To emerge as a regional electricity exporter with private investments in new lignite-fired power plants
- To take advantage of plans to supply the Western Balkans with gas

The initial tasks to achieve these goals include:

1. To improve the billing rate to 100% and payment collection rate to at least 90% of billed electricity by 2009
2. To improve generation capacity by at least 300 MW (from the current maximum of 745 MW) to provide a steady supply for all consumers
3. To expand generation capacity by about 1800-2100MW by 2015 mainly for export
4. To develop the transmission and distribution network and reduce technical losses to the level of international standards by 2010-2012, including integration of the transmission network with the regional and European energy networks
5. To provide an investment climate attractive to international investors who need to participate with substantial investments in lignite mining and power generation
6. To provide district heating for Pristina by cogeneration from Kosovo B and the main towns of Kosovo by cogeneration using gas by 2012
7. To restore the environment round Kosovo A and B by 2010
8. To meet EU standards of environmental protection for new plants
9. To improve awareness of the benefits of rational use of energy and alternative energy resources
10. To increase significantly domestic capacities for research and development and for the implementation of advanced technologies and modern management of energy within institutions and public enterprises.

Mining strategy of Kosovo

The electricity strategy of Kosovo cannot be considered independently of its basic fuel: lignite. Hence the following objectives for the mining sector are also mentioned:

- Ensuring sufficient lignite supplies from existing mining for current operational power plant capacities
- Attracting investors for a new lignite mine at Sibovc to supply the full capacity of existing Kosovo A and B power plants as soon as possible
- Maintenance of a stable predictable legal and fiscal system to enable potential investors to assess the risks and rewards of future mining operations, especially those linked to future power plants.

Donors and International Financial Institutions

The following are the main international donors and IFIs active in the electricity sector of Kosovo: EU (through the European Agency for Reconstruction), World Bank, USAID, Kredit fur Wiederaufbau (KfW).

II CURRENT SITUATION

1. Legal Framework

Energy Community Treaty

UNMIK-Kosovo is a signatory of the Energy Community of South East Europe Treaty with the European Community and eight other countries of South East Europe. The aim of the ECSEE Treaty is to apply the same legislation for electricity and gas as applies in the EU, and thus extend the EU internal energy market to South East Europe.

The Treaty was signed in October 2005 and obliges signatory countries to create a national and regional market, open to all non-household customers by 2008 (household customers by 2015). The Treaty also seeks to extend the use of gas into the Western Balkans. *This transition plan is only concerned with electricity however.*

Serbia and Montenegro have also separately signed the Treaty, and so the Treaty will apply to Kosovo whatever the result of final status negotiations.

The Treaty requires ratification by the European Community and six non-EU countries and is expected to enter into force in the summer of 2006. In the meantime, a provisional implementation is expected. As of 8 December, UNMIK completed the process of final approval of the Treaty establishing the Energy Community, which means that UNMIK/ Kosovo is the first party to the Treaty that has completed the approval procedure.

Kosovo National Legislation

Kosovo has adopted and is implementing the following legislation in compliance with previous (non-legally binding) Athens Memoranda of Understanding (2002 and 2003).

- Law on Energy 2004/8;
- Law on Energy Regulator 2004/9;
- Law on Electricity 2004/10;
- Law on Spatial Planning (2003/4)
- UNMIK regulation 2005/15 which amends UNMIK regulation 2001/19, for Executive Branch of Provisional Institutions of Self-Government of Kosovo
- Law on Environmental Protection 2002/8 (under revision)
- Law on Air Protection 2004/30
- Law on Trade of Petrol and Petroleum Products 2004/5
- Law on Scientific Research Activity 2004/42
- Regulation on Establishment of the Independent Commission for Mines and Minerals 2005/3;
- Regulation on the Long-Term Allocation of Socially-owned Immovable Property Managed by the Municipalities in Kosovo 2005/13
- Government Decision on KEK restructuring 2005 (23 June)
- Administrative Instruction on the Energy Inspectorate 2005/1
- Administrative Instruction on the Expansion of existing energy sites 2005/2
- Administrative Instruction No 2005/3 Rules on Rights of Way etc 2005/3
- Administrative Instruction on Administrative Instruction on Rules for Energy Balance 2005/4
- Administrative Instruction on Rules on Restrictive Measure on Energy Supply 2005/6

- Administrative Instruction on Rules on Security Zones 2005/7
- Administrative Instruction On the conditions for determining eligible customers for the year 2006, (001/2006)

Further, the Law on Mines and Minerals and the Law on Energy Efficiency are in line for approval by the Kosovo Assembly. The Law on District Heating Systems is waiting for the signature of the Special Representative of the Secretary General of the UN (SRSG).

Secondary legislation still required for fully implementing this primary legislation is in the process of drafting and approval and is noted in the sections below.

2. Regulatory Framework

Energy Regulator

The Energy Regulatory Office was set up in 2004. At present, the Regulator is dependent on funding from EAR and the Kosovo Consolidated Budget, but as soon as licenses are issued, the Regulator will be fully financed from licensing revenue.

The competences of the Energy Regulatory Office are set out in the Law on the Energy Regulator and include the powers to:

- Grant modify, suspend, transfer withdraw and supervise licenses
- Fix and approve tariffs and tariff methodologies for regulated energy services
- Grant permits for the construction and operation of new generation capacities and gas pipelines systems including direct pipelines and direct electricity lines
- Conduct open and transparent tendering procedures for new investments in the energy sector
- Monitor the unbundling of the legal form, organisation, decision-making and accounts of energy enterprises
- Prescribe the general conditions for energy supply and the standards of service to be met by licensees
- Resolve disputes among customers and energy enterprises, system operators and energy enterprises and between two energy enterprises
- Issue general acts, individual acts and secondary legislation in accordance with the law
- Revise, approve and control compliance with all codes and technical rules
- Enforce the provisions of this law and impose fines for its violation

In the 2005 benchmarking by CEER, the Kosovo Regulator was considered to have a full range of competences. Only the appointment of permanent Commissioners remained outstanding.

Independent Commission for Mining and Minerals

The Commission was established in 2005 and has five members including the Chairman.

The Commission has powers to regulate and oversee:

- a) The orderly exploration and exploration of mineral resources in Kosovo in accordance with applicable law;
- b) The optimal utilisation of mineral resources at all mining operations and minimising the environmental impact of mining operations
- c) The implementation of international standards for operations in mines and quarries

- d) The safety of operations in all minerals extraction and processing facilities in accordance with the applicable law and safety standards and
- e) The general compliance of mining operations with the terms of licenses permits agreements and other authorisation instruments.

3. Current issues

Financial situation of KEK

The payment collection rate in the post war period has generally been bad.²

As a result it has not been possible to finance loans using International Financial Institutions to make improvements to the plant, or pay for imports of power. Kosovo A and B are currently working at about half capacity and power demands for households and industry cannot be fully met. The unreliability and insecurity of supply is a severe constraint on the economic recovery of Kosovo, and the ability of industry to operate satisfactorily.

Over the past two years, KTA subcontracted the operational management of the company to the Irish firm ESBI, under a contract till the end of 2006.

The main aim of this management subcontracting is the Financial Recovery Plan (FRP). Under the FRP, a system of irregular power cuts affecting all consumers has been replaced by a planned and published system³ of power cuts according to the payment category of districts, with a monthly review of categorisation of districts to reflect payment improvements. EAR is also financing equipment to improve metering and billing systems in conjunction with the FRP.

A new disconnection policy has been recently approved by ERO. ESBI have been working with the Ministry of Labour and Social Welfare to identify low income and vulnerable customers and to arrange a lifeline tariff for them, though this is not yet in operation.

Incorporation and unbundling of the transmission function to create an Independent Transmission System and Market Operator (ITSMO)

The assets of the electricity sector comprise existing lignite mines, the Kosovo A and B power plants, HV transmission and interconnection lines and distribution networks throughout Kosovo. All assets were assembled into one vertically integrated power company Korporata Energjetike e Kosoves (KEK).

Until recently the company had the status of a publicly owned enterprise (POE) in Kosovo, (ie all shareholdings were held in trust by KTA) with representation on the Board of UNMIK, KTA and MEM.

During 2005, ownership unbundling for the ITSMO was completed with EAR support under a process of incorporation of "old" KEK into four joint stock companies: two asset holding companies and two operating companies, separating the transmission function from all other activities of KEK.

² KEK has been paid, on average, for 39% of electricity sold (technical losses are currently running at 21% of electricity generated, only 62% of energy sold, on average, is billed, commercial losses are approximately 38% and only 63%, on average, of the energy billed is paid for by customers. KEK Draft Financial Recovery Plan. V.4 ESB International February 2005. p5. Metering is not however an issue as all legal customers have meters.

³ The so-called A, B and C zoning system, with A zone customers receiving more hours of power than B and C etc.

Two joint stock companies are intended as holding companies for the separated assets, pending the result of final status negotiations. They have no other functions.

The Law on Electricity requires the unbundling of the electricity sector. During 2005, KEK accounting was being unbundled in to the five components: mining, generation, transmission, distribution and supply.

The remaining two joint stock companies formed during incorporation will operate the assets: the Independent Transmission System and Market Operator (ITSMO) will operate the HV transmission system; the remaining assets which have had accounting unbundling being operated by New KEK. New KEK will operate separate divisions dealing with mining, generation, distribution and supply, with unbundled accounts for each division.

For the first six months, New KEK will continue to operate the transmission system under contract, until the ITSMO is fully operational. During this period, World Bank and EAR support is being provided for the ITSMO.

The Board of ITSMO met for the first time in March 2006. It will shortly be applying to the Regulator for the TSO license, when the Government decision on its appointment has been issued as required by the Electricity Law Article 12.

Accounts for the four new companies will be produced using international accounting standards.

Operation of ITSMO

At present the transmission function of KEK consists only of network operation and maintenance. System operation is carried out by the Serbian TSO on a quasi contractual basis.

A new business plan for the next five years for the ITSMO will include the takeover from Serbia of the system management, when the necessary metering and SCADA systems have been installed. Support is being provided by the World Bank on this issue.

Participation in the regional market

Kosovo institutions are full participants in the Energy Community.

MEM is regularly represented at the PHLG and the Athens Forum. The Regulator takes part in the Athens Forum and the CEER Working Groups.

Representatives of KEK Transmission have attended the Athens Forum but have been excluded from the SETSO Working Group on the grounds that they were not a TSO. After complaints to ETSO, it has been temporarily agreed to accept the representative of the Kosovo Regulator.

However, now a ITSMO has been formed, it is expected that the Kosovo ITSMO will be admitted to SETSO, and can play a full part. This will include participating in the SETSO Cross Border Trade (CBT) Mechanism and receiving compensation for electricity flows passing through Kosovo, which are currently not adequately compensated.

III THE WAY FORWARD

The current main policy aims for the sector are:

- To improve the corporate governance of New KEK by the Ministry, to strengthen its strategic management, and to re-establish its financial health for the future; this will also include restructuring and unbundling as required to meet the Energy Community Treaty;
- To create economic and legal conditions to attract investments to rehabilitate two units at the Kosovo A and to upgrade the network systems in general
- To connect the Kosovo HV grid to neighbouring countries especially Albania, to increase stability and reliability both in Kosovo and in the region
- To create economic and legal conditions to attract independent power producers (IPPs), to build a new mine and power plant, the so-called Kosovo C, (but more accurately IPP1).

The last aim is intended in the context of the Treaty establishing the Energy Community where internationally funded studies have established that Kosovo has good potential to be an exporter of power to the regional market.

Further requirements from the Treaty

1. *Energy*

The Treaty requires the Electricity Directive 2003/54/EC and Regulation 1228/2003/EC on conditions of access to the network to be implemented within 12 months of the Treaty coming into force (ie summer of 2007). The current legislation is considered to meet this requirement. Implementation is in progress.

Further actions are anticipated as follows:

Independent Distribution System Operator

The Electricity Law contains provisions for the establishment of an independent Distribution System Operator, within 60 days of promulgation of the Law. However, there is not yet a date for the legal unbundling of distribution from KEK. It is anticipated that that will occur in 2007 before the full opening of the market to non-household consumers.

Market Opening

At present, the Regulator is preparing the necessary secondary legislation for the market, with assistance from EAR and World Bank:

- The Rule on Pricing and the Tariff Methodology were approved on 15 December 2005
- The Code of Conduct and Ethics was approved on 15 December 2005
- The Rule on Dispute Settlement was approved on 17 January 2006
- The Rule on Disconnection was approved on 24 February 2006
- The Rule on Licensing was approved on 24 February 2006
- The Market Model and Rules are currently published on website for public consultation
- The Rule on Authorization Procedure for Construction of New Generation Capacities is currently published on website for public consultation
- The Tariff Application Guidelines and Tariff Application Tables are currently published on website for public consultation

- The Draft Rule on General Condition of Energy Supply is currently published on website for public consultation
- The Grid code (in the absence of a fully operational ITSMO)

These will be completed in 2006.

The electricity market has opened in March 2006 with all consumers (four) connected at 110kV and over being declared eligible for 2006 by a government decision in accordance with the Law on Electricity.

A timetable for further market opening will be produced by MEM during 2006, for implementation in stages in future years. Assistance is provided by EAR on this issue.

It is not possible at present to identify consumers by their electricity consumption, because of inadequate supplies, so an alternative method may be based on the voltage of their supply connection.

It is likely that Kosovo will need to seek some derogation from the Treaty market opening date of 2008 for non-household customers and may seek to use the alternative schedule proposed by the PHLG at the Seventh Athens Forum in June 2005:

<i>Consumer group</i>	<i>Market opening by</i>
Large and medium industrial customers	1 January 2008
Small industries	1 January 2010
Water supply companies	1 January 2010
Service sector (shops, restaurants, schools, etc)	1 January 2012
Household customers	1 January 2015

In any case, opening of the market to smaller consumers will take place only when adequate consumer protection legislation is in force.

Further unbundling of KEK

The Government Decision of 23 June 2005 defines the stages of unbundling of KEK for 2006 and 2007, but an action plan still needs to be prepared for detailed implementation.

Other energy legislation

The following laws are now in draft form and awaiting approval:

- Law on Foreign Investments
- Law on Concessions
- Law on District Heating Systems
- Law on Energy Efficiency

In addition, the Treaty requires the following documents to be submitted:

- Transition Plan for the Electricity Sector (by 15 February 2006)
- A plan to implement Directive 2001/77/EC on promotion of electricity from renewables, and Directive 2003/30/EC on the use of biofuels for transport (within one year of the Treaty entering into force)
- Statement of Security of Supply (within one year of the Treaty entering into force).

This current document is intended to meet the first requirement and the others will be submitted within the deadlines set by the Treaty. Support from EAR is currently assisting the Ministry on developing plans for renewables and energy efficiency, including a review of the draft Law on Energy Efficiency, and implementation of an Energy Efficiency Action Plan. Public information campaigns are in the planning stage.

Demand management

With assistance from EAR, the Ministry is now investigating the scope for demand management. This is now seen as having two advantages: to provide more rational use of current generation capacity as an alternative to power cuts, and as a strategy to manage the growing gap between supply and demand, as older plants' efficiency decreases and demand in a growing economy increases.

Energy Statistics

The Ministry Division for Statistics and Balances is just being staffed and not all positions are yet filled. EAR support is available in 2006 to help establish the Division and prepare the statistical reports for 2003-5.

Investment preparation

In the World Bank Project ESTAP II, a report was provided to identify changes in the legal framework and actions needed to provide an environment attractive to private investment. The Ministry now has a department with responsibility to create a "one-stop service for private investors, and support is provided by EAR to develop this and implement the changes already identified.

2. Environment

Further requirements for primary legislation under the Treaty are the implementation of environmental legislation, with the implementation dates as follows:

Directive	Topic	Date
1. Directive 85/337/EEC as amended by Directives 97/11/EG and Directive 2003/35/EC.	Environmental impact assessment	Summer 2007
2. Directive 1999/32/EC	Reduction in sulphur content for certain liquid fuels	End 2011
3. Directive 2001/80/EC	Large Combustion Plants	End 2017
4. Article 4(2) of Directive 79/409/EEC	Conservation of wild birds	Summer 2007

Consultations with the Ministry of Environment and Spatial Planning have begun to ensure the adoption of the necessary legislation for implementation by 2007. There are, as yet, no operational entities existing to carry out the work envisaged in current environmental legislation, for example environmental impact assessment. Implementation of these tasks therefore requires both institutional building as well in depth technical analysis of the issues and problems to be solved. It is likely that a project for institution building in the area of environment and energy will be required.

3. Competition

A review needs to be undertaken during 2006 of current Kosovo legislation on Restriction of Competition, Abuse of Dominant Position and State Aid to ensure that the Articles 81, 82 and 87 of the Treaty establishing the European Community are upheld.

It is probable that there will be additional requirements for institution building in order to implement this legislation.

4. Compliance with EU standards

The business plan for the new ITSMO will include all necessary measures for Kosovo to join UCTE in its own right.

In practice, at present the system operation is carried out from Serbia, and as Serbia is a member of UCTE, the system already operates in general compliance with UCTE, as inherited from former Yugoslavia.

5. Financial requirements of the Treaty

Kosovo is ready in principle to contribute its share (0.1%) of the budget. However since no indicative budget has yet been set, no allocations have been planned for 2006/2007.

6. Memorandum of Understanding (MoU) on Social Issues

Kosovo is interested in general to sign the MoU on Social Issues and has already begun actions to create a Social Plan. EAR has provided some initial support on this issue. However, implementation of the Social Plan would be dependent on adequate funding being available. Since Kosovo is still some way from becoming an EU candidate country, the usual pre-accession funding available to candidate countries would not be applicable, or not available at the time the funds are needed. Kosovo would like to stress the need for further sources of funding to carry out the Social Plan. Furthermore Kosovo would like to stress that social consequences can not be contained within the competences of the Ministry of Energy and Mining, so consultations with other ministries will be required.

Vulnerable customers

A lifeline tariff has already been agreed, but work is needed before it can be introduced. Kosovo did not take part in the original EBRD managed Affordability Study in 2002, and the UNDP Affordability Study for Serbia and Montenegro "Stuck in the Past" in 2004 did not take Kosovo's circumstances into account. The World Bank has provided assistance to ERO for work on vulnerable customers. In Kosovo's post-war economy, vulnerable customers may include some sick and disabled consumers, as well as those with low incomes. Arrangements are now being made for funding of an affordability study for Kosovo in the very near future.

Employment Issues

MEM has already begun a dialogue with the electricity trade unions and is ready to hold consultations with them as suggested by the Energy Community Secretariat. A meeting is planned for the second half of April, and MEM is currently awaiting confirmation of a representative of the European Commission.

Social consequences of new mining activities

Kosovo would like to propose the inclusion of these issues into the content of the MoU. The consequences may include relocation and resettlement of villages outside the mining area, and so

public awareness and public consultation will be required, as well as compensation. Kosovo is not in a position to fund all these social costs with the current state of its economy.

Since the mining will support a regional power plant, it is reasonable to expect that the social costs are either included in the cost of the power plant (especially if privately funded, though this may make it less attractive) or funded at regional level by the Energy Community.

With World Bank assistance, terms of reference for the Strategic Environmental and Social Assessment will be prepared, covering Environmental Impact Assessment, Social Assessment and the Resettlement Action Plan, including establishing the necessary investments for mitigating measure for the social consequences. The assessments and mitigating investments will be the responsibility of the private investor according to the World Bank documentation.

IV CONCLUSIONS

Obviously, the main factor influencing a future Electricity Transition Strategy for Kosovo will be the result of the final status negotiations. Since this is not known at the time of writing, it is assumed that current developments in Kosovo will continue on its current path. Whatever the result, a period of adjustment will be needed, which may influence the speed of changes to be expected.

Kosovo intends to comply fully with the provisions of the Treaty but may have some difficulty meeting some of the deadlines envisaged, in particular, those for achieving full payment targets and full opening of the non-household market.