

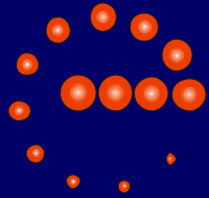
ENERGY REGULATORY AGENCY

regagen@cg.yu

Investor Roundtable Conference in Relation to a Capital
Increase of EPCG

Regulatory Framework and Role of ERA within Montenegrin Energy Sector

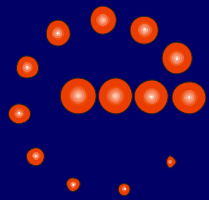
Podgorica, 13 January 2009



DEREGULATION

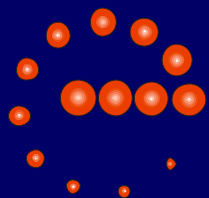
Aims:

- **Unbundling of monopoly:** separation of large, vertically integrated public companies to a number of smaller, customer-oriented companies;
- **Higher efficiency:** better organisation, rationalization, privatization under better terms, generation of competition;
- **Improved quality of services and lower prices:** improved terms for customers, possibility of choosing supplier.



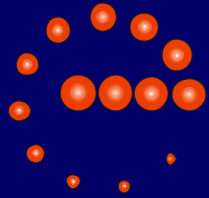
ENERGY LAW

- **Published in the “Official Journal of Montenegro” no. 39/2003 on 30 June 2003.**
- **Regulates the main principles for energy policy and strategy implementation, energy sector regulatory framework, jurisdiction of Government of Montenegro, as well as the establishment, role and responsibilities of the regulatory body for legal implementation.**
- **Energy sector activities are of public interest.**
- **Energy sector regulation is objective, transparent, non-discriminatory and in accordance to applicable international standards, including European energy charter and EU decrees applicable in the energy sector.**

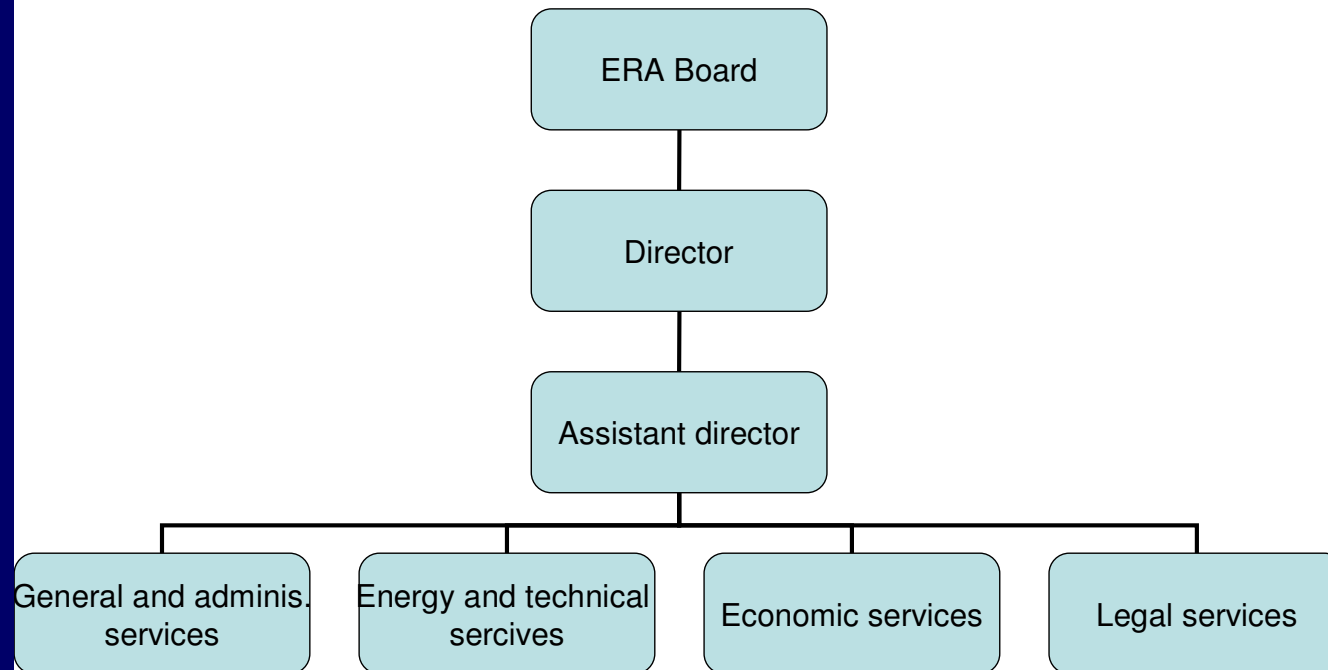


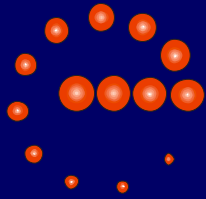
ENERGY REGULATORY AGENCY

- **Autonomous and functionally independent non-profit organisation performing public services in accordance with the Law;**
- **Aims:**
 - **That all principles, policies and programs set and published by the Government are applied following the objectivity, transparency and non-discrimination principles,**
 - **Reliable, safe and ecologically adequate supply of energy to tariff customers in Montenegro at fair prices,**
 - **That energy subjects which provide energy can cover their costs at a certain rate of return on their investments,**
 - **Alignment of customers' and energy subjects' interests,**
- **The Agency supervises the activities and business conducts of energy subjects and has the right to request additional information and reports in order to ensure the fulfilment of obligations from this Law.**



ORGANIZATIONAL STRUCTURE





ERA Bodies: Board and Director

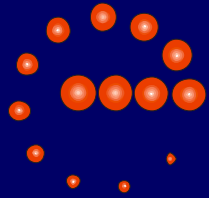
Era Board:

- Three members, elected by the Parliament (open announcement),
- First mandate – 2, 3, 4 years, second 4 years,
- Possibility of two mandates;

Director (and his deputy):

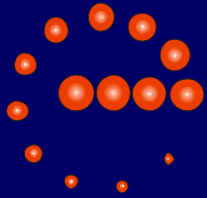
- In their first mandate named by Government,
- In the second mandate and on elected by the ERA Board after Government consent,
- Possibility of two mandates.

Board members, director and deputy director are employed with ERA



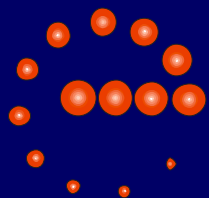
Scope of services:

- **Electricity sector** – until market formation regulates all sector activities, afterwards regulates network activities and performs supervision over market functioning,
- **Oil and gas sector** – determines the rules and regulations referring to transport, storage, distribution, sale and supply of oil products and controls fulfilment of license terms,
- **Coal sector** – determines and applies rules for price determination of coal determined for production of electricity for the period not longer than 5 years following the implementation of the Law. ERA proposed to Government to elongate this authorization for the future period as well.



Responsibilities:

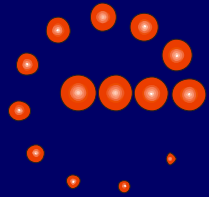
- Adopts and publishes rules and regulations necessary for the fulfilment of obligations arising from the Law and for the implementation and realization of energy policy;
- Awards licences for the performance of energy sector activities and pursues constant control of their application;
- Determines tariffs and prices in accordance with the terms and conditions set out in the Law and other official records;
- Changes, suspends, revokes, supervises, controls and implements the fulfilment of licence obligations,
- Performs audit and authorisation of market rules and network codex, terms and deadlines for network access and connection;
- Supervises the fulfilment of environmental regulations by energy subjects;
- Solves disputes arising between or including tariff customers and energy subjects in accordance with applicable laws, rules and regulations,
- Determines and implements change of rules and regulations: (1) defining the energy sector structure; (2) referring to market conducts; (3) for unbundling of energy subjects; (4) relating to rights and obligations of all energy subjects;



Selected acts implemented by ERA:

Selected acts implemented by ERA:

- Regulation on licences in energy sector in Montenegro,
- Regulation on supervision over activities and business conducts of energy subjects,
- Regulation on electricity tariffs,
- Rules on determination of coal price,
- Rules on third party access to transmission and distribution network,
- Rules on rules for unbundling of energy subject EPCG,
- Regulation on procedures for issuing authorisation for sale or transfer of operational control over assets of licence holders,
- Regulation on transfer of ownership of electricity meters from customers to EPCG.



Acts proposed by EPCG and approved by ERA:

- Temporary network codex (Official Gazette RoM No. 13, 09. March 2005.)
- Temporary distribution codex (Official Gazette RoM No. 13, 09. March 2005.)

- Rules on supply (Official Gazette RoM No. 13, 09. March 2005.)

- Rules on award of available transmission capacities
- (web site EPCG www.epcg.cg.yu)

BY-LAW ON LICENCES IN ENERGY SECTOR OF MONTENEGRO

Defines:

- Conditions and procedures for issuing licences,
- Types and content of licences,
- Exemptions from licensing,
- Obligations of licence holders and methods for control of fulfilment of obligations,
- Licence fees,
- Procedures for amendments to and recall of licences.

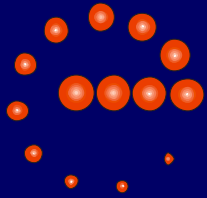
LICENCES

Electricity sector (6 licences issued, all EPCG):

- Licence for generation,
- Licence for transmission,
- Licence for transmission system operator,
- Licence for market operator,
- Licence for distribution and distribution system operator, and
- Licence for supply.

Oil and gas sector (issued so far 122 licences for 55 companies, out of which recalled 7 licences for 4 companies):

- Licence for storage and distribution,
- Licence sale and supply, and
- Licence for commercial transport.



REGULATION ON ELECTRICITY TARIFFS

Protection of tariff customers

- **Protection of tariff customers means:**
 - (1) objective and non-discriminatory relationship by energy subjects towards tariff customers,
 - (2) high quality service of supply by energy subjects, and
 - (3) determination of mechanism that will increase the participation of interested parties in the creation of rules applying to tariff customers.

- **The Agency has the right, in accordance to the rules it sets, to demand from the subject to change tariffs which are inadequate, unfair or unjustified in the Agency's opinion.**

REGULATION ON ELECTRICITY TARIFFS

Governs:

- Methodology for determination of allowed regulatory revenues,
- Structure of fees payed by consumers, separately per activities, including the determination of unit prices for electric energy and services;
- Establishing of tariff elements for each activity;
- Conditions and Procedures for changing of consumption category;
- Procedures for approval and amendments of fees through change in allowed regulatory revenues and tariffs

BY-LAW ON TARIFFS (cont'd)

Aims:

- Defining justifiable costs and methodology of determination of fees and tariffs, the application of which should allow the licence holders to cover their costs while, at the same time, making a reasonable return on investment,
- Determination of system of classification of customers in tariff groups (according to voltage levels, type and purpose of consumption), as well as criteria for change of tariff group,
- Determination of procedures for submission of application for allowed regulatory revenue and application for approval of price tables, as well as procedures for consideration and approval by ERA of the abovementioned, and
- Determination of terms and deadlines for decrease or full elimination of cross-subsidizing between groups of tariff customers.

ESTABLISHING OF THE REGULATORY ALLOWED INCOME

Regulatory allowed income of energy subjects for the year t (ARR_t) is established separately for each activity after cost-plus method. Generic formula for all activities is following:

$$ARR_t = Opext + Oct + Dt + ror * RAV_t - OR_t$$

where:

- Opext-allowed standard costs of operation and maintainance, for all the licencees,
- Oct-other allowed costs of operation and maintainance which are specific for some licensees,
- Dt-depreciation costs,
- ror*RAV_t-allowed return on investment (ror, allowed return on invested capital as percentage%, and RAV_t regulatory basis-value of the assets for the year t), and
- OR_t-any other income made by the licensee within the range of nonregulated services, whereby those services incurred costs included into justified operational costs in the year t.

CONSUMER CHARGES

- Consumer charges are established for:
- Consumed electricity, depending on daytime,
- Use of transmission system, charges for fixed and variable costs (these costs refer to energy losses on networks),
- Work of transmission system operator (charges for TSO operation, ancillary services and system balancing services),
- Work of market operator(justified operational costs),
- Use of distribution system(charges for fixed and variable costs, work of DOS),
- Electricity supply(justified operational costs).

CONSUMER CATEGORIZATION

Consumer categorization at connection voltage levels was applied for establishment of tariffs that reflect costs which consumers incur to system depending on connection site:

- Consumers on 110 kV (HV consumers),
- Consumers on 35 kV (MV consumers),
- Consumers on 0.4 kV (LV consumers).

The LV consumers are further categorized:

- Households (TTM and OTM),
- Public lighting, and
- Other consumers where belong all the remaining consumers out of the a.m. Groups.

ESTABLISHING OF CALCULATION ELEMENTS

Establishing of tariff elements and tariff rates is done separately for each activity, after:

- Delivery point and metering point of consumed electricity and power, in case where power is metered,
- Category of consumers,
- Weekday and daytime (for consumed electricity and losses in transmission and distribution system).

Calculation of distributed electricity, use of transmission and distribution system, losses in these systems and delivered services to consumers is made on the basis of the elements established this way so charges reflect costs which consumers incur to system.

REGULATED TARIFF APPLICATION OUTCOMES

- Application start: July 2007.
 - First tariff correction: October 2007., prolonged validation to may 2008;
 - Second correction: June 2008., valid untill November 2008.;
 - Third correction: december 2008., valid untill the ened of 2009.
- A: Total growth and average annual growth rate of characteristic indices in period 2004. – 2008.:
1. Electricity consumption: total growth 6.5%, average annual growth rate 1.58%;
 2. Sales: total growth 72.02%, average annual growth rate 14.53%;
 3. Price of electricity sold: total growth 61.51%, average annual growth rate 12.75%;
 - a. Price for HV consumer growth: 76.71%/15.3%
 - b. Price for distribution consumer growth: 52.15%/11.2%
 - Price MV consumer: 42.91%/9.35%
 - Price LV consumer: 52.98%/11.2%

REGULATED TARIFF APPLICATION OUTCOMES

B. Total growth and average annual growth rate of the characteristic indices in the period 2004. to 2008. (estimation):

- Electricity consumption: total growth 6.5%, average annual growth rate 1.58%;
- Import of electricity (quantities): total growth 37.4%, average annual growth rate 8.25%;
- Import of electricity (expenditures): total growth 200.82%, average annual growth rate 31.61%;
- Sales less import costs: total growth 39.96%, average annual growth rate 8.77%;
- Sales less import and fuel costs: total growth 59.55%, average annual growth rate 12.4%

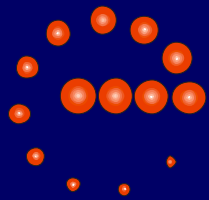
REGULATED TARIFF APPLICATION OUTCOMES

C: In the period 2004. to 2007. it was realized an average price for the electricity from domestic generators 21.93 €/MWh or through years (18.6/21.2/21.9/27.3) €/MWh. In the same period the average annual price growth rate was 13.6%.

In 2008. Agency allowed to EPCG – FU Generation operation costs, depreciation, and return on investment in total amount of 94.2 mil. €, for generation of 2.820 GWh which creates price for the electricity from own sources of 33.4 €/MWh.

We estimate that in period 2004.-2008., average annual growth rate of the price of electricity from domestic sources is about 15%.

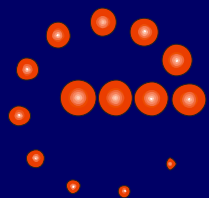
Conclusion: In 18 months of application of the new regulation, price of the electricity from domestic generation has increased from 21.5 €/MWh in the first half of 2007. to 33.4 €/MWh in 2008., or 55%



THE ELECTRICITY MARKET IN MONTENEGRO

Law:

- ERA publishes the rules that enable market creation,
- Energy sector activities are performed as public services,
- Generation and supply services will be conducted for the tariff customers' needs under ERA regulation until ERA determines that a competitive electricity market has been formed,
- If a tariff customer proves that he can secure electricity on the competitive market under the same or better conditions, ERA has the authority to exempt him from the regulated system.



DECISION ON MARKET MODEL (July 2007)

Identifies the structure:

- The Montenegrin electric energy market consists of a wholesale and a retail market,
- The wholesale electric energy market model includes :
 - Long-term – Market based on bilateral contracts,
 - Medium-term – One day ahead market (can be established when a certain level of market development is achieved),
 - Short-term – Balancing market, and
 - Activities post real time – settlement of accounts and smoothening of deviations.
- The retail electric energy market will be formed on the principles of:
 - Enabling competition in supply sector by issuing licences for supply of electricity according to the legal procedures,
 - Enabling the necessary commercial contracts for public supplier, which will be responsible for the electricity supply to tariff customers.

MARKET OPENING IN MONTENEGRO

Within the framework of activities on market opening, the ERA Board has adopted the:

- Decision on Qualified electricity customers
 - Decision on Approval of rules for electricity market establishment,
 - Decision on Approval of market rules,
 - Decision on Electricity market opening, and
 - Decision on Appointment of public supplier.
-
- All Decisions are presented on ERA web site www.regagen.cg.yu

RULES FOR ELECTRICITY MARKET ESTABLISHMENT (December 2008)

Define:

- Principles of market organization (free network access, healthy competition),
- Terms for market opening,
- Division (by type) of activities following market opening (competitive and regulated),
- Division (by type) of electricity customers following market opening (qualified and unqualified),
- Basic work principles in supply of qualified customers and the ways to change their supplier,
- Basic work principles of the public supplier,
- Basic doctrines and principles for the development of competition and the repression of malpractice of dominant (monopoly) position on the market.

DECISION ON ELECTRICITY MARKET OPENING (December 2008)

Basic provisions:

- Montenegrin electric energy market is open as of 1 January 2009,
- The market is separated into wholesale and retail,
- Wholesale market participants include producers, traders, suppliers and qualified self-supplying customers,
- Retail market participants include suppliers and qualified customers,
- The development and liberalization of the market will occur gradually, in accordance with the development of competition and overall market relations, and
- During the initial period of market opening, i.e. until the appearance of competition in the supply sector, all end customers have a right of supply from the public supplier, under valid regulated tariffs, except for customers that are supplied under special contracts

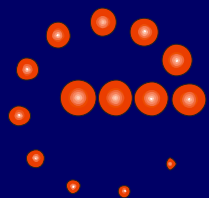
DECISION ON APPOINTMENT OF PUBLIC SUPPLIER (December 2008)

Basic provisions:

- Elektroprivreda Crne Gore AD Nikšić – Functional unit Supply, as a public supplier, will perform the supply of electricity of tariff customers in Montenegro as of 1 January 2009,
- The public supplier is obliged to perform supply of qualified customers, which until 31 December 2008 were supplied as tariff customers, until the abovementioned find another supplier, and
- The public supplier is obliged to perform the duty of so called “supplier of last resort”, responsible for supplying electricity to tariff customers that, for some reason, remained without their supplier, until they find another supplier.

ERA'S ROLE IN THE PRIVATIZATION PROCESS

1. ERA and the state apparatus – Privatization Council are to cooperate in the preparation of privatizations of energy sector subjects;
2. ERA cannot engage in the examination and evaluation of bids (for the share purchase) nor in the sales process;
3. Independently, or in association with other relevant bodies (subjects), ERA's role is to:
 - Ensure the Company performs the same activity after privatization,
 - Continue keeping stable prices after privatization,
 - Ensure the privatized companies are participants of the energy sector,
 - Ensure and promote the conditions for healthy competition in the sector.
4. Applies the by-law on procedures for issuing authorisation for sale, alienation or transfer of operational control over assets of licence holders

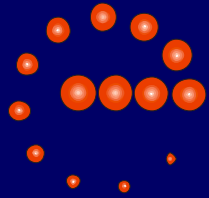


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Thank you!