

Water Services Regulatory Authority of Kosovo (ARRU)

Responses to

Consultation on future water supply tariff policy

April 2024

1 The consultation

- 1.1 On 24.01.2024 we published a consultation document setting out our initial proposals for a future review of the tariff determination framework for the water supply and wastewater services sector in Kosovo.
- 1.2 The consultation document can be found on: https://www.arru-rks.org/assets/cms/uploads/files/Publikimet/lajmet/Tariff%20policy%20consultation_eng.pdf
- 1.3 In this consultation we sought opinions from stakeholders in many areas including:
- Overall charging principles and the role of the regulator.
 - Incentives for improved operational efficiency.
 - Current incentive to defer efficiency improvements.
 - Capital investment.
 - Poor quality business plan submissions.
 - Phasing out the current cross-subsidy.
 - Replacing fixed charges with a charge based on connection size.
 - Off-site infrastructure reinforcement charges.
 - Assessed wastewater charges.
 - Wastewater charges based on volume and quality of wastewater discharges.
 - Protection for vulnerable consumers.
- 1.4 We received only six responses to this consultation from: RWCs, Government, investors and consultants working in the water supply sector. We would have preferred a greater level of response but the responses we have received have provided us with guidance for the future.

2 Responses

2.1 Overall charging principles and the role of the regulator.

- 2.1 In our consultation we took the position that the fundamental principles supporting the regulatory framework should remain unchanged. Most respondents supported this position.
- 2.2 One respondent suggested that the principles could be enhanced to include environmental and social sustainability in tariff decision-making where possible. Where the Service Providers include in their business plan submissions activities that are necessary to meet obligatory environmental and other

standards, we, in turn, are obliged to allow the costs of such activities in their business plans provided they are fair and justifiable. Our interpretation of our current duties is that although we support the protection of the environment and social sustainability it cannot be at any price. For example, if an RWC has two project options to choose from and Option A is more environmentally friendly than Option B but Option A is more expensive than Option B, then the selected option must be based on a balance between the needs of the environment against the interests of consumers, service providers and other stakeholders. A methodology that considers the economic (not just financial) costs and benefits of investment decision making may help to determine the best overall investment option, e.g. by attaching economic values to reduced carbon emissions. We shall work with the government to design guidelines for the RWCs to apply in their investment decision making analysis. We shall also take legal opinion as to whether we have the authority to take a pro-active approach to the inclusion of environmental and social sustainability in our decision making and, if necessary, we may seek an amendment to legislation and/or government policy direction.

- 2.3 One respondent commented on the current framework that religious buildings are not charged for their water supply and that this position should be reconsidered in a future tariff review. We shall consider this aspect in the review.

2.2 Cost recovery – incentives for improved operational efficiency

- 2.4 Most of the respondents supported the concept of providing incentives for improved performance and there was no material preference for either of the two options presented. One respondent, however, highlighted a potential legal impediment to these proposals in that bonuses can only be awarded to members of the Boards of Directors of the RWCs and limited to 50% of their basic honorarium (Article 12 of Law 04/L-111). The respondent pointed out that this would need to be implemented through a process of performance supervision by the Ministry of Economy pursuant to the Law on Public Enterprises. We shall consider this issue more detail and consult with the Ministry of Economy to determine the most practicable way forward to incentivise improved performance.

- 2.5 One respondent suggested that performance incentives should be accompanied by penalties for not meeting performance expectations. Although such an approach is sound if the RWCs were owned by the private sector as such penalties would affect shareholder returns, we are concerned that financial penalties applied against publicly owned RWCs could make a bad situation worse by depriving them of much needed financial resources. We shall investigate this option of penalties to be applied to the RWCs but we shall bear in mind the potential unintended consequences of such an approach.

2.3 Cost recovery – current incentive to defer efficiency improvements.

- 2.6 Most respondents agreed that the tariff determination process should be amended to remove the potential incentive to defer efficiency improvement initiatives. We shall develop a module in the model that captures this concept.

2.4 Cost recovery – capital investment

- 2.7 Most respondents agreed that something urgently needs to be done to ensure that investment is delivered as set out in the RWCs' business plans. There was a reasonable consensus that the option of a dedicated account for investment activities may not be practicable, and that the clawback approach is preferred. One respondent suggested that the clawback approach should be modified to one where unspent revenue should rollover into the next review period. This is, in effect what will happen with a clawback, i.e. the revenue attributable to an investment that did not materialise in a particular tariff review period would be rolled over into the next period if that investment was repeated in the business plan.

- 2.8 One respondent did not support the clawback approach as it would place undue financial stress on the RWCs and that the current 'name and shame' approach should continue and where sanctions are to be applied they should be through the powers vested in Government over the Boards and Management of the RWCs.

2.9 On respondent suggested that clawback should be accompanied with financial penalties where appropriate. We consider that this may be over-penalising the RWCs and that the clawback approach is cost-reflective and will benefit consumers.

2.10 The respondents suggested that the clawback should not commence until the tariff review period 2028-2030 review period and onwards as there will be insufficient time for the RWCS to respond to an earlier clawback process. We shall take this opinion into consideration in our review of the tariff determination framework.

2.5 Cost recovery - poor quality business plan submissions.

2.11 Most respondents supported the concept of an incentive to help deliver high quality business plan submissions. This is very much allied to the issue of investments not being delivered as described above, i.e. a high-quality business plan should provide strong evidence to support the investment plan that gives us a high degree of confidence that the investments in the plan will be delivered. We shall look at this in more detail and if we decide to take it forward we shall set out the criteria as to how the submissions will be assessed.

2.12 One respondent did not support the concept of a higher return but rather to set the quality standards expected and that failure to comply to result in a rejection of the plan. We do not consider this to be a viable approach as we have a duty to undertake tariff reviews and to reject a submission outright without good reason could be contrary to this duty. In some cases, a poor-quality submission may be attributable to staff changes in the RWC with new staff unfamiliar with the requirements. We need to balance the desire to have high quality submissions with what can reasonably be expected under the circumstances within an RWC.

2.6 Cost reflectivity – phasing out the current cross-subsidy

2.13 Most respondents agreed that the current cross-subsidy should be removed but over time, and that we should ensure that the most vulnerable consumers are not unduly penalised as a result. We shall examine this in more detail to determine an appropriate timescale for its removal.

2.7 Cost reflectivity – replacing fixed charges with a charge based on connection size.

2.14 All respondents supported the concept of replacing the current fixed charges with charges based on connection size. We see no reason why this proposal should not be taken forward. We shall, therefore, shortly inform the RWCs of our proposals in time for them to gather then necessary information for their tariff submissions and for them to amend their billing systems to accommodate such a change.

2.8 Cost reflectivity – off-site infrastructure reinforcement charges.

2.15 Most respondents supported the concept that any off-site network reinforcement costs that are triggered by new development should be financed by the developers rather than the existing arrangement where such costs are absorbed in the tariffs for all consumers.

2.16 The proposed charges of EUR 110.00 for water and EUR 90.00 for wastewater were considered reasonable by most respondents.

2.17 There was a consensus that the charge should be reflected in the tariff as a credit against infrastructure enhancement which will provide a small but perpetual benefit to existing consumers. This is consistent with the concept that network reinforcement is, by definition, enhancement and not renewals.

2.18 We shall prepare and issue guidelines to the RWCs as to how the off-site infrastructure reinforcement charges are to be applied. This will include guidance on how to charge for new dwellings that replace existing and how to determine an appropriate charge for new non-domestic consumers.

2.9 Cost reflectivity – assessed wastewater charges

- 2.19 All respondents agreed that assessed wastewater charges are appropriate for consumers that have their own water resources or generate wastewater from products not associated with the RWC water supply.
- 2.20 There was some confusion as to how this would require a different tariff than the current tariff due to return factors. We shall issue explanatory guidance to the RWCs on how to determine assessed flows and charges and how they should be accommodated in the business plan submissions.

2.10 Cost reflectivity – wastewater charges based on volume and quality of wastewater discharges

- 2.21 There were missed responses to our proposals for quality-based wastewater charging for larger industrial consumers. Some respondents supported the concept of trade-waste charging arrangements whereas others stated that these are unnecessary if all non-domestic users pre-treated their wastewater according to the limit values set in legislation and enforced by the Kosovo Agency for Environmental Protection (KEPA).
- 2.22 Our opinion is that the current legislation is open to different interpretations. One interpretation is that the limit values apply everywhere regardless of whether a wastewater treatment plant is in operation and treats the wastewater before discharge into the environment. This interpretation is sound if there is no wastewater treatment plant, as was the case for many years until the last decade or so when there has been extensive investment in wastewater treatment throughout the country.
- 2.23 We now have many wastewater treatment plants that treats the wastewater to environmentally acceptable levels and our interpretation of the legislation is that it should be permissible for a user to discharge wastewater into the sewer network that exceeds the current limit values if it is subsequently treated by the RWC treatment plant and complies with the limit values when discharged into the environment. In this case the enforcement of limit values should apply at the point of entry to the environment, i.e. the wastewater treatment plant discharge point, and not at the point of entry to the sewer system. The RWC, however, should still maintain other limit values to the users at the point of entry to the sewer system to ensure that the wastewater can be satisfactorily treated by the wastewater treatment plant without exceeding environmental limit values when the treated wastewater is discharged into the environment. Such limit values may also be set to ensure that the treatment plant is adequately protected.
- 2.24 Where an industrial user discharges wastewater that is more polluting than average, we consider that the user should pay trade waste charges that reflects the higher treatment cost. The user can then decide if it is economically viable to continue to pay trade waste charges or invest in pre-treatment to bring the charges down. By compelling the user to pre-treat when the RWC can easily meet the discharge standards may result in inefficient investment decision-making to the detriment of the wider economy. In most developed economies the environmental limit values are only applicable at the point of entry into the environment and not at the point of entry into the sewer system. The application of trade waste charges is also a common feature where the decision to pre-treat wastewater is an optimum economic one that considers the cost of pre-treatment versus the cost of trade waste charges. We shall work with the Government to clarify the legislation and, if necessary, seek to amend the legislation to meet the concepts that are applied elsewhere in the world.
- 2.25 If the interpretation of legislation is such that the limit values must apply at the point of entry into a sewer even when there is an RWC wastewater treatment plant we do not consider that it is the intention to insist on the immediate closure of the concern until it invests in pre-treatment to meet the limit values. Rather than immediate closure we consider that the RWCs should apply trade waste charges that reflect the cost of treatment until such time that pre-treatment is installed. This approach would incentivise the industrial users to invest in pre-treatment rather than relying on environmental enforcement measures from KEPA alone.

- 2.26 Our position is that for systems where there is no treatment we would expect KEPA to rigorously enforce compliance at the point of entry into the sewer as this is, in effect, the point of entry into the environment. However, this may result in the closure of some industries with an overall net economic loss. Although KEPA is the principal enforcement authority in this regard we consider that any enforcement measures should be reinforced through trade waste charges where the cost of wastewater treatment can be used as a reflection of the cost to the environment. This will encourage investment in pre-treatment regardless of whether there is a wastewater treatment plant serving the user.
- 2.27 We have looked at the customer base of the RWCs and there are very few large industrial users that discharge significant quantities of wastewater where the quality of wastewater is materially worse than average wastewater quality. In some RWCs there are no such non-domestic users. Consequently, we consider that the decision to apply trade waste charges should be left with the RWCs.
- 2.28 We are aware of some smaller concerns, e.g. in dairy production processes, where the wastewater is significantly higher than average. The respective RWCs must determine if their wastewater treatment plants can accommodate the wastewater and, if not, to prohibit the discharge into the sewer network. If it is not prohibited, then the RWC can choose to set trade waste charges.
- 2.29 We shall, in due course, provide guidance to the RWCs on how to determine trade waste charges if they wish to apply them.

2.11 Protection for vulnerable consumers

- 2.30 Half of the responses, including those from the RWCs suggested that some support should be provided to the most vulnerable consumers.
- 2.31 Other responses rejected this proposition and cited the *The Law on Regulation of Water Services (Article 20, subsection 3.2)* which clearly states that it is ‘*the responsibility of the Government Institutions, not Service Providers, to help low-income customers to pay their invoices*’. We presume that support is currently provided through government social assistance and no further intervention from the water companies is provided. These responses suggested that this was the fairest and most practicable approach.
- 2.32 We recognise, however, that some of the most financially stressed households are larger families where water consumption is unavoidably high. Our earlier analysis on the cross subsidy suggests that tariff-based support would be highly inefficient and lead to significant errors of inclusion and exclusion. If some support is necessary, then it needs to be properly targeted, e.g. to households where one or more members receive social assistance. We shall investigate further options for targeted assistance and, if necessary, undertake a separate consultation on this specific issue.

3 Next steps

- 3.1 Following on from the consultation we shall:
- Work with Government to design guidelines the inclusion of environment and social benefits in their investment decision making.
 - Consider the status of religious buildings in the tariff framework.
 - Investigate options for incentivising the RWCs to improve performance but recognising existing legal constraints.
 - Modify the tariff determination model to remove the incentive to defer efficiency improvement initiatives.
 - Investigate further the options and implications of a clawback mechanism to return money to consumers for investment that was not delivered, and to modify the tariff determination model to suit our final proposals.
 - Set out the criteria for what is expected in a high-quality business plan and to consider rewarding qualifying plans with a higher return on capital.

- Issue instructions to the RWCs for the phasing out of the current cross-subsidy, the period of the phase out to be examined in more detail.
- Provide guidance to the RWCs to replace the current fixed charges to charges based on connection size in time for the RWCS to gather the necessary information and to modify their billing systems accordingly.
- Provide guidance to the RWCs to replace the current fixed charges to charges based on connection size in time for the RWCS to gather the necessary information and to modify their billing systems accordingly.
- Provide guidance to the RWCs for the application of off-site infrastructure development charges.
- Provide guidance to the RWCs for the application of assessed wastewater charges where users obtain water from alternative sources and other circumstances where assessed wastewater charges are applicable.
- Provide guidance to the RWCs for the application of wastewater charges to be based on wastewater quality for large industrial users and other users where such charges may be appropriate.
- assessed wastewater charges where users obtain water from alternative sources and other circumstances where assessed wastewater charges are applicable.
- Examine options for targeted support to vulnerable consumers and, if necessary, undertake a further public consultation.