

REGULATORY STATEMENT

1. Purpose and schedules

1.1. General purpose of the Regulatory Statement

The approval of this regulatory statement aims at making possible the calculation of tariffs of publicly owned generation, wholesale supply, distribution and retail supply in accordance with the relevant tariff methodologies approved by the ERE.

1.2. Regulatory periods

The ERE has decided that the period January 1, 2009 to December 31, 2009 be a transitory period during which there will be no change of current tariffs, as defined in the decisions Nr.21, dated on February 14, 2008. This will enable the investor to evaluate the situation within OSSH¹ and prepare the application for review of new electricity tariffs not later than September 30, 2009, which will be effective on January 1, 2010.

The first regulatory period will be 1 January-31 December 2010;

The second regulatory period will be 1 January-31 December 2011;

The third regulatory period will be 1 January 2012-31 December 2014.

The following regulatory periods will be of 3-5 years term.

1.3. Tariff Schedule

According to the above Tariff Schedule, until September 30, 2009 DSO and RPS will submit a tariff application both for the calendar year 2009 ("Tariff Review Application for 2009") and for the first regulatory period, 2010, based on the tariff methodologies described in this approved Regulatory Statement as well as in following decisions:

¹ For the purpose of this regulatory statement the term OSSH means The Joint Stock Company OSSH sh.a. licensed by the ERE for performing two functions: as a distribution system operator for operation, maintenance and development of the network (herewithin referred to as DSO) and the function of Retail Public Supplier for the tariff customers (herewithin referred to as RPS).

Decision Nr. 18, dated on February 14, 2008;
Decision Nr. 75, dated on June 26, 2008;
Decision Nr. 19, dated on February 14, 2008;
Decision Nr. 20, dated on February 14, 2008;
Decision Nr. 21, dated on February 14, 2008.

ERE will review and approve the 2009 tariffs as per the Tariff Review Application for 2009 ("Reviewed Tariffs for 2009") no later than 15 December 2009. The difference between Reviewed Tariffs for 2009 and the tariffs initially approved for 2009 as per the Decision Nr. 21, dated on February 14, 2008 multiplied by the forecast of quantities of energy to be supplied during the whole year 2009 as prepared by OSSH estimated at the date of preparation of the Tariff Review Application for 2009 will be used to calculate the amount of Unrealized Revenues requirements of OSSH in its function of RPS subject to the Compensation Mechanism, as both defined in Article 5.1. and Article 6 below.

In the following years OSSH shall submit its tariff applications for a given regulatory period no later than September 1 of the calendar year preceding such regulatory period and ERE shall approve such tariffs no later than December 7 of the same calendar year; such approved tariffs will come into effect on January 1st of the following year. Independently from the tariff applications, OSSH will submit an investment plan for 2009 and 2010 (the "Investment Plan for 2009 and 2010") no later than [2] months after closing of the OSSH privatization, which ERE will review and approve no later than [2] month after its submission.

1.4. Approval of the subsequent Regulatory Statements

No later than June 30, 2014, the ERE shall approve a Regulatory Statement for the regulatory periods following 2014, which shall not materially differ in approach from this Regulatory Statement. For the avoidance of doubt, the new Regulatory Statement shall continue to include the Compensation Mechanism, as described in Article 6 below.

2. For the tariff of Public Generation Company (PGC):

2.1 Determination of the Regulatory Asset Base (RAB) for the Publicly Owned Generation company for 2009.

According to the PGC tariff calculation methodology, the RAB for publicly owned generation for 2009 will be equal to the book value of fixed assets of the audited IFRS balance sheet of PGC as of December 31, 2007, plus the investments placed in operation during 2008, plus the projected investment by the company for 2009 and accepted by the ERE, less accumulated depreciation for 2009, plus working capital.

2.2 Determination of Rate of Return on Equity (RoE) for the Publicly Owned Generation Company (PGC)

Because the publicly owned generation company will remain in the hands of the Government, it will have a low financial risk profile. Moreover, the Government does not require high equity returns. For that reason, the RoE for the publicly owned generation company is a "non-market" based rate of return set as the percentage yield on short term Treasury Bonds of Central Bank of Albania.

2.3 Targeted Gearing (i.e. debt as a percent of total capital) for the Publicly Owned Generation Company

For the purpose of calculation of the generation electricity tariff the assumed Gearing will be 60% debt, 40% equity.

2.4 Working Capital

The allowed Working Capital will be equal to 1/12 of PGC OPEX (allowed operating expenses) as per the publicly owned generation tariff methodology.

2.5 Annual level of publicly-owned hydro generation

The average yearly hydro production for the past 10 years (1999-2008) is 4,400 GWh, and for past 5 years (2004 – 2008) is 4,600 GWh. Considering the fact that KESH uses the level of 4,200 GWh hydro generation for the yearly generation projections, it is probable that the actual production will exceed about 2,500 GWh the projected generation from KESH for the 6 years 2009-2014, thus providing a cushion for future tariff rates and the minimization of hydrology risk. The annual notional level of production of electricity from hydro sources for publicly-owned generation to be assumed for the regulatory periods set forth in this statement in the tariff for the WPS

to the RPS and the OST, for the purpose of tariff application by OSSH and tariff approval by ERE is 4,200 GWh per year- net generation.

3. For Wholesale Public Supplier Tariff

3.1 Profit Margin

- For the Wholesale Public Supplier is equal to 0.5% on annual electricity purchases.
- In order to reduce the risk of the WPS, due to the hydrogenation of the publicly owned company, the following annual adjustments will be made:
 - (i) Wholesale Public Supplier fee will also include any net financing cost caused by the above risk ;
 - (ii) Adjustment to cover the cost of interest for maintaining a line of credit to cover poor hydro years;
 - (iii) An annual adjustment for previous year over or under revenue of Publicly Owned Generation caused by the differences of actual generation with forecasted 4,200 GWh / year net generation.

The WPS will organize an annual tender in accordance with the law no.9643, date 20.11.2006 "On public procurement" for supplemental wholesale energy purchases beyond the forecasted public generation energy production.

4. For Distribution Service Tariff

4.1 Determination of the level of the RAB for the DSO

The value of RAB for 2009, to be used in the Tariff Review Application for 2009 will be calculated as a sum of:

- (i) the book value of fixed assets of the audited IFRS balance sheet of DSO as of December 31, 2007 published;
- (ii) the value of investment for 2008 which will be recognized at the level of at least Lek 1,900 million;
- (iii) the value of investment projected to be made during 2009 according to the "Investment Plan for 2009 and 2010" approved by the ERE based on article 24 of power sector law and article 1.3 Tariff schedule of this Regulatory statement;
- (iv) the value of any assets constructed by KESH (which are financed exclusively by debt and / or equity of METE) on behalf of OSSH and transferred to OSSH in 2009 as confirmed by the Council of Ministers Decision.
- (v) minus the depreciation for 2008 and 2009;

- (vi) the value of working capital equal to 1/12 of allowed OPEX for the period it is applied.

The RAB for 2009 as calculated above will serve as the starting value for the tariff application for the first regulatory period 2010. Such tariff application will include the value of any assets constructed by KESH (which are financed exclusively by debt and / or equity of METE) on behalf of OSSH and transferred to OSSH in 2010 as confirmed by the Council of Ministers Decision.

The ERE has not determined the initial value of RAB, however, as a starting value of fixed assets will be used the book value of fixed assets of the audited IFRS balance sheet of DSO as of December 31, 2007, which is Lek 16,329 million. The fixed tangible and intangible assets financed through grants will be excluded from RAB. The value of fixed assets financed through grants for 2008 (according to 2008 rate application) is Lek 770 million.

For future years, the RAB will be determined according to following formula:

$$RAB=A-CG-D+WC+INV$$

where:

RAB the Regulatory Asset Base;

A the recognized value of used and useful fixed assets;

CG the value of assets acquired through gratuitous transfer or constructed with financial resources of electricity consumers;

D the accumulated depreciation for the past period of assets used to perform the licensed activity;

WC the working capital requirement, which shall be equal to 1/12 of DSO OPEX;

INV the forecast average cumulative nominal amount of investments approved by the ERE, which will be invested during the regulatory period.

4.2 Calculation of Weighted Average Cost of Capital (WACC) for the DSO

For the purpose of calculation of the distribution electricity tariffs, the allowed WACC accepted by ERE will be calculated on yearly basis as described in the Electricity Distribution System Operator Tariff Calculation Methodology Approved by ERE's Board of Commissioners Decision No. 79, Dated 26.06.2008 (Tariff methodology) and this Regulatory Statement.

The Allowed return on equity (ARoE) after tax is and shall be calculated according to the following formula (CAPM model):

$$R_e = r_f + \beta \times (r_m - r_f)$$

Where

β equity beta	covariance of return on stock market and return on individual share of a company in a similar line of business ($\beta=1$ means the stock market and share have the same volatility and therefore non-diversifiable risk)
R_m	return on the stock market as a whole
$R_m - R_{fr}$	equity risk premium
$R_{fr}+CRP$	risk free rate including country risk premium (CRP) defined as 6 months average of yield on sovereign bonds of governments with the comparable rating as Albania

The pre-tax ARoE for the DSO will be equal to 16.44% for the first three regulatory periods (until December 31, 2014). Thereafter, the ERE will review the value of ARoE according to Tariff methodology and this Regulatory statement and then-market conditions. ERE will maintain consistency in its approach and calculation methodology as well as in the data sources it uses.

The table below presents the cost of equity calculation:

Component		
Nominal risk free rate plus country risk premium	$R_{fr} + CRP$	7.43%
ERP (equity risk premium)	$R_m - R_{fr}$	5.60%
Gearing ratio (for Beta)	G	60.00%
Gearing ratio (for D/E)	G	60.00%
Equity Unleveraged Beta	Beta(U)	0.56
Equity Leveraged Beta	Beta(L)	1.32
Allowed return on equity after tax	$ARoE = R_{fr} + CRP + Beta(L) * ERP$	14.80%
Tax rate	T	10%

Allowed return on equity pre tax	Pre tax ARoE = ARoE / (1-T)	16.44%
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In determination of the appropriate after-tax Return on Equity for the distribution system operator, the ERE will rely on the estimates of key parameters to be applied in CAPM methodology provided by reputable publicly available sources including: for estimation of risk free rate + country risk premium and equity beta: *Bloomberg*; for estimation of equity risk premium: *Ibbotson Associates*. In absence of available publications by those providers, the ERE will rely on an independent estimate from a source of comparable reputation.

As for the cost of new debt in WACC model, the ERE will use the most recent estimation of the weighted average cost of new debt obtained via the transparent tender procedure as the interest rate of new debts as defined below.

OSSH shall select banks providing new debt in accordance with tender procedures to be proposed by OSSH no later than the end of February 2009. ERE shall approve such procedures by no later than Closing of privatization of OSSH. Such procedures shall be fair and transparent and in compliance with applicable laws and best practice. Such procedures shall be valid for the term of this Regulatory Statement.

OSSH shall also have the right to raise debt from multinational lenders, including without limitation EBRD and IFC, in which case such tender procedures shall not be applicable. The cost of new debt incurred by OSSH in accordance with such procedures (or as the case may be, obtained from multinational lenders in accordance with the foregoing sentence) shall be fully pass-through into the applicable tariff by way of the WACC calculation contained in this Section.

In case no new debt is possible to be obtained via such tender procedure and/or from international institutions the shareholders of OSSH may provide, as a last resort, additional financing to secure the operations of the OSSH, the cost of such financing will be equal to the ARoE as described above and shall be fully pass-through as the debt component into the applicable tariff by way of the WACC calculation contained in this Section. OSSH will provide reasonable evidence to ERE that it has used its best efforts in obtaining such financing using such procedures.

The new debt incurred by OSSH in accordance with above mentioned procedures (or as the case may be, obtained from multinational lenders in accordance with the foregoing sentence) and/or shareholder financing

according to above paragraph will be considered as the new debt ("New debt").

The assumed interest rate for old debt is the actual interest rates as applicable under the terms of the sub-loan agreement between KESH and OSSH. "Old debt" refers the debt assigned to the DSO in accordance with the Long term debt repayment agreement to be signed between KESH and OSSH ("Long-Term debt repayment Agreement").

The WACC is calculated as follows:

$$\text{CoOD\%} * \text{OldL-T}/(\text{OldL-T} + \text{NewL-T}) = \text{Y1\%}$$

$$\text{CoND\%} * \text{NewL-T}/(\text{OldL-T} + \text{NewL-T}) = \text{Y2\%}$$

$$\text{WACC} = 40\% * \text{Pre tax ARoE\%} + 60\% (\text{Y1\%} + \text{Y2\%})$$

Where:

Pre tax ARoE%	= Allowed Return on Equity pre tax
CoOD%	= Weighted average actual interest of Old debt
CoND%	= Weighted average interest rate of New debt
OldL-T/(OldL-T + NewL-T)	= Old debt share of total debt
NewL-T/(OldL-T + NewL-T)	= New debt share of total debt
OldL-T	= outstanding debt payable by the OSSH as specified in the Long-Term debt repayment Agreement, with actual value as per the audited IFRS balance sheet of OSSH for year preceding tariff application
NewL-T	= outstanding, other than OldL-T, interest bearing debt drawn by the OSSH, with actual value as per the audited IFRS balance sheet of OSSH for year preceding tariff application

4.3 Targeted Gearing for the DSO

For the purpose of calculation of the distribution electricity tariffs the assumed Gearing will be 60% as indicated in the above formula.

4.4 Working Capital

The allowed Working Capital will be equal to 1/12 of DSO OPEX (allowed operating expenses) as per the distribution tariff methodology. Only for the purpose of calculation of the Working Capital, the OPEX represent the allowed annual operational costs incurred for carrying out the licensed activity excluding depreciation and financial expenses. Expenses related to purchases of electricity to cover distribution losses including all applicable transmission costs are also part of allowed OPEX.

The level of OPEX approved in 2008 tariffs was Lek 21,000 million for DSO and Lek 1,800 million for RPS.

The most recent forecast of OPEX for 2009 available as of the date of tariff application (however not lower than the level of OPEX for 2008 defined above) will serve as the basis for calculation of Reviewed Tariffs for 2009 and 2010 tariffs. The forecast for the cost of electricity to cover the cost of losses for DSO for the part of 2009 after Closing and 2010 will not take into account the effects of any adjustments to the estimated DSO and /or RPS costs, related to the Government Decision No. [143] dated [11.02.2009] (On an Amendment on the Council of Ministers' Decision No. 338, dated 19.03.2008, of the Council of Ministers, "On the Approval of the Power Market Model:", as amended). For avoidance of doubt the cost of Loss Audit and Loss Study, Bad Debt Study and the costs of Partial Risk Guarantee to be obtained from the World Bank ("PRG") will be accepted and recognised for inclusion in the OPEX by ERE.

4.5 Targets for losses reduction

For establishing the targets of distribution losses reduction throughout the regulatory periods, an expected level of losses of 32% of energy injected to the distribution network will be assumed for 2008. The percentage distribution losses of energy shall be understood as difference between the energy received by the distribution system and the energy billed to final customers, shown as a percentage of energy received by the distribution system.

No specific study on distribution losses has been carried out so far, but for tariff purposes, based on KESH estimations, the ERE assumes the total losses (technical and non-technical) reach the level of 15 % at the end of the third

regulatory period (2014), assuming that the starting value in 2008, to be confirmed in the Loss Audit described below, is at the level of 32%.

The ERE expects a rapid improvement of the level of non-technical losses, and a slower but continuous reduction of technical losses. ERE forecasts the reduction of the total losses in distribution according to the following scenario:

4% (percentage points) reduction for the first regulatory period;

4% (percentage points) reduction for the second regulatory period;

9% (percentage points) reduction for the third regulatory period (3*3).

No later than 31 July, 2009 the DSO shall carry out a detailed loss audit ("Loss Audit") to determine the methodology of calculation of total losses and verify the Actual 2008 losses ("Actual 2008 Losses").

No later than 31 July, 2010 the DSO shall carry out a detailed loss study ("Loss Study") to determine the technical and non-technical losses incurred in 2009.

Loss Audit and Loss Study will be prepared by an independent technical expert selected from the following list:

- Arthur D.Little
- Deloitte
- Ernst & Young
- KPMG
- PricewaterhouseCoopers

The Loss Study and Loss Audit shall be approved by the ERE within 2 months and 1 month, respectively, from the date of submission.

The Actual 2008 losses as verified in the Loss Audit shall serve as the basis for calculation of Reviewed Tariffs for 2009 and 2010 tariffs. At the same time Actual 2009 Losses shall be equal to the Actual 2008 losses ("Actual 2009 Losses") and shall be fully pass-through for the DSO tariff according to the Compensation Mechanism described in Article 6, and shall serve as a starting level for the subsequent loss reduction schedule presented above.²

On the basis of the Loss Study, DSO shall propose to ERE a schedule for the reduction of total losses for the three regulatory periods mentioned above, broken down in years, associated with the investment plan for reduction of losses according to such a schedule, if the scenario proposed by ERE is not

² (e.g. if the Actual 2009 Losses are 33%, the end level of losses at 31.12.2014 will be 16%.)

considered appropriate. For avoidance of any doubt the level of total losses shall not be lower than 15% at the end of the third regulatory period (2014).

The level of investments for reduction of losses according to the submitted schedule by DSO shall be approved by ERE according to article 24 of power sector law.

ERE understands that DSO should bear no risk arising out of power procurement on the open market. The cost of recognized losses for the purpose of establishing the distribution tariff for the following year shall be determined as weighed average cost of DSO year-ahead power purchases multiplied by the expected amount of power to cover losses.

For the avoidance of doubt, each calendar year OSSH will launch tenders in accordance with tender procedures to be proposed by DSO by no later than the end of February 2009 ERE shall approve such procedures by no later than closing of the privatization of OSSH. Such procedures shall be fair and transparent and in compliance with applicable laws and best practice. Such procedures shall be valid for the term of this Regulatory Statement. The cost of losses determined in accordance with such procedures shall be fully pass-through into the applicable tariff for the next year.

4.6. *X – Factor*

4.6.1.1 X factor for first three regulatory periods will be zero,

4.6.2 The ERE will recognize any profit stemming from the reduction of operational expenses (excluding losses) and it will be left to the investor for a regulatory period. The adjustment of OPEX for the subsequent regulatory period will be subject of review of the ERE

5. For Retail Public Supplier Tariff

5.1. Retail Public Supplier Tariff

The Revenue Requirements associated with End User tariff shall be calculated in line with the following methodology, also recognizing amount due from the compensation mechanism as defined in article 6:

$$RR_{act\ n} = (WPS_{tariff\ n} + OST_{tariff\ n}) \times V_n + DSO_{tariff\ n} \times V_{dn} + PSO_{costsn} + RPS_{costs} - \Delta COMPB_n$$

where:

$$\Delta \text{COMPB}_n = \text{RR}_{\text{cal } n} - \text{RR}_{\text{max } n}$$

$$\text{RR}_{\text{max } n} = T_{\text{act } n-1} \times (1+g) \times (1+\text{CPI}_{n-1}) \times V_n$$

$$\text{COMPB}_n = \text{COMPB}_{n-1} + \text{RoC}_n + \Delta \text{COMPB}_n$$

$$\text{RoC}_n = [\text{COMPB}_{n-1} + \max(\text{RR}_{\text{cal } n} - \text{RR}_{\text{max } n}; 0)] \times \text{WACC_Comp}_n$$

$$\begin{aligned} \text{if} \quad & \text{COMPB}_{n-1} + \text{RoC}_n + \Delta \text{COMPB}_n \leq 0, \\ \text{then} \quad & \Delta \text{COMPB}_n = -(\text{COMPB}_{n-1} + \text{RoC}_n) \end{aligned}$$

with above mentioned variables defined as follows:

$\text{RR}_{\text{act } n}$	– actual applied revenues requirement of OSSH in its function of RPS recognised by ERE in year n
$\text{RR}_{\text{max } n}$	– maximum revenues of OSSH in its function of RPS allowed by ERE in year n , as implied by the max real growth rate of total RPS tariff
$\text{RR}_{\text{cal } n}$	– recognized revenue requirement of OSSH in its function of RPS based on the tariff application (without impact of compensation balance)
COMPB_n	– compensation account balance as of n year end. For 2008 COMPB equals 0.
ΔCOMPB_n	– change in the accrued compensation balance during year n
g	– the annual weighted average end-user tariff increase in real terms recognized by ERE, g shall be equal to or higher than 15%, as long as there are remaining positive amounts in the compensation account
$ \Delta \text{COMPB}_n $	– absolute value of ΔCOMPB_n in year n
WACC_Comp_n	– allowed regulated return on the compensation balance for year n ; according to art.6 WACC_Comp_n shall be equal to the DSO WACC from year n as defined in 4.2
RoC_n	– return earned on the compensation balance in year n
$T_{\text{act } n}$	– total weighted average RPS tariff approved by ERE in year n
V_n	– total sales volume of electricity to tariff customers in year n agreed by ERE and OSSH for year n
V_{dn}	– total sales volume of electricity to tariff customers connected to the distribution system in year n agreed by ERE and OSSH for year n

CPI_n	– annual end year consumer price index in year n as published in the CPI bulletin of the Statistical Institute of Albania (INSTAT) ³
$WPS_{tariff\ n}$	– recognised tariff of the Wholesale Public Supplier approved by the ERE on year n
$OST_{tariff\ n}$	– recognised tariff of the Transmission System operator approved by the ERE on year n
$DSO_{tariff\ n}$	– recognised tariff of the distribution system operator of electricity approved by the ERE on year n
PSO_{costsn}	– recognised public service obligation costs by ERE in year n.
RPS_{costsn}	– recognised retail public supplier costs by ERE in year n. This shall include the RPS profit margin as specified in Article 5.3 below

Shall for any reason the RPS tariff cease to be regulated (as the case may be, following unbundling of retail from distribution) and the compensation account has not been fully released into the OSSH revenues, such outstanding compensation balance shall be transferred to the DSO and reimbursed in line with the methodology specified above via DSO tariff.

5.2 Bad Debt

ERE recognizes that certain level of bad debt is an inherent part of the retail business and as such needs to be reflected in the tariffs. The Bad Debt Allowance will be applied as a percentage of the total revenues of OSSH acting in its function of RPS, including all tariff charges of WPS (including PGC), OST, DSO, PSO, RPS and other charges as the case may be excluding Value Added Tax ("RPS Revenues"). For establishing the targets of Bad Debt reduction throughout the regulatory periods, an expected level of Bad Debts of 14% of RPS Revenues will be assumed for 2008.

For 2009, a level of Bad Debts (as % of RPS Revenues) is assumed at the same level as for 2008. In 2010, a level of Bad Debts (as % of RPS Revenues) shall be reduced by 1 percentage point compared to the 2009 level.

Until 31 July 2011, the OSSH in its function of RPS shall carry out a detailed Bad Debt study ("Bad Debt Study") to determine (i) the methodology of calculation of Bad debts and (ii) the Actual 2008, 2009, and 2010 Bad Debt Levels ("Actual 2008,

³ For avoidance of doubt, in 2007 the CPI was 3.1 % and in 2008 was 2.2 % as published by INSTAT in December 2008

2009, and 2010 Bad Debt Level"). Bad Debt Study will be prepared by an independent financial expert selected from the following list:

- Deloitte
- Ernst & Young
- KPMG
- PricewaterhouseCoopers

The Bad Debt Study shall be approved by the ERE within 2 months from its submission.

For the purposes of calculation of the Bad Debt Levels, the actually received proceeds from the Compensation Mechanism will form part of the RPS Revenues.

At the same time Actual 2010 Bad Debt Level shall serve as a starting level for the subsequent Bad Debt reduction schedule presented below, provided that it is not higher than the Actual 2009 Bad Debt Level, otherwise Actual 2009 Bad Debt Level shall apply.

- 1% (percentage point) reduction for 2011;
- 1% (percentage point) reduction for 2012;
- 1% (percentage point) reduction for 2013;
- 1% (percentage point) reduction for 2014.

In case Actual 2009 and/or Actual 2010 and/or Actual 2011 Bad Debt Level⁴ is higher than the 14% and/or 13% and/or 12% respectively, the difference shall increase the compensation amount according to Article 6.

In case Actual 2009 and/or Actual 2010 and/or Actual 2011 Bad Debt Level is lower than the 14% and/or 13% and/or 12% respectively, the difference shall reduce the compensation amount according to Article 6.

5.3. Other

- The wholesale public supply tariff shall be a pass through cost for RPS.
- Profit Margin for the Retail Public Supplier is equal to 2.2 % on annual expenses for electricity purchases from WPS with regulated price. RPS profit margin is based only on energy purchases from WPS and it is not calculated based on transmission cost, distribution cost or any ancillary services cost, nor the cost of purchases of electricity by DSO for covering losses.
- As to the tariff structure of household customers, the ERE has initiated a study to determine the monthly electricity consumption lifeline. ERE will make

⁴ Actual 2011 Bad Debt Level is defined as Actual 2010 Bad Debt Level minus 1% point.

the results of the study available to DSO before OSSH prepares its tariff application, i.e. no later than June 30, 2009. The results of this study will be used for reviewing the level of first block for household customers for the tariffs that will be effective from January 1, 2010.

- The RPS tariff to final consumers shall include an adjustment to compensate the RPS for differences between forecast and actual revenue as a result of deviations in forecasting demand in individual consumer categories when these are newly created or when there are tariff changes that are not the same proportion for all customer categories.

6. Compensation Mechanism for Distribution and Retail Service Tariff

In case ERE does not allow in the tariff a portion of the recognized Revenue Requirements of the DSO and RPS calculated according to the electricity distribution system operator and retail tariff calculation methodology approved in ERE's Board of Commissioners Decision No. 79 and No. 80, both dated June 26, 2008 then such portion of revenues shall become subject to the compensation mechanism as defined below and article 5.1.

In case the calculated revenue requirements of OSSH in its function of RPS for a given year result in an increase of the weighted average end-user tariff (the total required revenues of OSSH in its function of RPS in given year divided by total estimated volume in a given year) higher than 15% in real terms (above CPI)⁵, the minimum average tariff increase recognized by ERE will be 15% in real terms. For avoidance of doubt such tariff shall lead to minimum increase of revenue requirements of OSSH in its function of RPS of 15% in real terms.

Should the required increase of the weighted average end-user tariff (prior to application of any amounts due from the compensation mechanism) for the following year be lower than 15% in real terms, ERE shall approve such increase and not to increase the balance of the compensation account. In addition, if there are remaining amounts in the compensation account, ERE shall raise the weighted average end-user tariff to the level needed to reduce the compensation account to zero, provided that such tariff increase is no greater than 15% in real terms, as defined by the formula in Article 5.1 above. Any remaining amount in the compensation account shall be carried forward to the next year.

Such portion of the revenues which was not taken into account in tariff calculation shall form compensation account from the year when the

⁵ The real terms increase shall be calculated using the formula $(1+g) \times (1+CPI_{n-1})$

entitlement arises and ending in the year (inclusive of) in which the amount becomes fully compensated according to formula described in article 5.1. above. During the compensation period the OSSH is entitled to regulated return on this amount. Regulated return shall be equal to the DSO WACC as defined in 4.2. prevailing in year preceding its application.

The compensation mechanism shall be applied throughout the period covered by this regulatory statement and shall be also preserved in future regulatory periods.

The entire revenue requirement difference stemming from the difference of the tariffs approved for 2009 as per the decision of No. 21, dated February 14, 2008 and the "Reviewed Tariffs for 2009" shall be subject to the Compensation Mechanism.

In case Actual 2008 Losses are higher than the assumed level of 32% and as result Actual 2009 Losses are also higher than 32%, then the difference between the revenue requirements applicable to the new loss reduction and those to the former loss reduction schedule (based on the assumed level of 32%) as described in this document, shall also be subject of the compensation mechanism.

In case Actual 2009, 2010 Bad Debt Levels, and/or Actual 2011 Bad Debt Level, is higher than the 14%, 13% and/or 12% respectively, then the difference between the revenue requirements applicable to the new bad debt reduction and those to the former bad debt reduction schedule (based on the 14%, 13% and 12% level respectively), as described in this document, shall also be subject of the compensation mechanism.

7. Quality of electricity supply service

Until some standards for the quality of service will be in place, the ERE has established only two indicators of quality of service:

- electricity outages (frequency and duration) in case of repairs to be carried out by the DSO. The DSO shall submit to the ERE the repairs schedule on yearly basis;
- billing accuracy of 99% - billing accuracy is critical to reducing losses and fairness to customers. Furthermore, the ERE and the DSO/RPS should work together to establish rules concerning how often meters are read, and how to allocate usage among months if a meter reading is less frequent than once per month.

The investor, in collaboration with other licensees, will propose to the ERE the standards of the quality of service. The standards shall address the quality and the security of supply of electricity. The ERE anticipates that this process may last about

1 year for DSO and RPS, until they know the system, develop benchmark levels for the quality and security of supply, and establish objectives and programs for achieving these objectives.

8. Final provision

As in all official documents approved by the ERE, the Albanian version of this document shall be the official one.

In the event of any discrepancy between this Regulatory Statement and any other ERE decision , this Regulatory Statement shall prevail.

10. Approval

This Regulatory Statement was approved by the decision no [12], dated [03.03.2009] of the Board of Commissioners.