



Republic of Serbia
**COMMISSION FOR
PROTECTION OF COMPETITION**

25/IV Savska St., Belgrade

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Pursuant to Article 58(3) of the Law on Protection of Competition (Official Gazette of the RS 51/2009 and 95/2013), the Commission for Protection of Competition publishes the following

**NOTICE
of filing commitment proposals which PUC “Gradska toplana” Niš is voluntarily willing to
undertake in order to remove potential infringements of competition, with a call to all
interested parties to submit observations, positions and opinions relevant to the proposed
commitments in written form**

Based on publicly available information published in “Politika” newspaper on February 7, 2018, the Commission for Protection of Competition (hereinafter, the Commission) has gained knowledge of the activities and findings of the State Audit Institution (hereinafter, SAI) concerning the audit of financial statements and regularity of operations of the Public utility company “Gradska toplana” from Niš. At the request of the Commission, in a letter entered under number 5/0-05-190/2018-2 of February 27, 2018, the SAI has submitted the Report on the audit of financial statements and regularity of operations of the Public utility company “Gradska toplana” Niš, no. 400-444/2017-06/10 of December 28, 2017 (hereinafter, the Report), drafted by the SAI in line with the competences stipulated by the Law on State Audit Institution (Official Gazette of the RS 101/2005, 54/2007 and 36/2010).

Having regard to references made in the Report, the Commission found reasonable grounds to believe the existence of competition infringements that as their purpose or effect have or may have a significant restriction, distortion, or prevention of competition. The pricing of thermal energy supply services in a manner which derogates from the methodology prescribed by the Regulation on the establishment of pricing methodology of the cost of supplying end consumers (Official Gazette of the RS 63/2015 - hereinafter, the Regulation), whereas the methodology is based on the “Costs plus” pricing principle, resulting in an increased amount of the service costs relative to the level that would have resulted from the use of the prescribed methodology, and the establishment of the connection costs to the district heating network in a manner not stipulated by the relevant legal framework, in addition to invoicing such costs to end consumers in a manner which could depart from the “cost principle”, may represent acts of infringements of competition from Article 16(2/1) of the Law.

In the Report was underlined that Gradska toplana has been setting the thermal energy supply prices in disregard of the legal framework, by including the following elements in the calculation of the variable operating costs when establishing the maximum revenue level relating to the variable part:

1) fixed costs (system access fee);

- 2) prices based on the July invoices when estimating the market gas prices, although gas prices were known for the entire regulatory period (January-June, based on delivered invoices, July-December, pursuant to the concluded Gas supply agreement with Yugorosgaz a.d. Beograd);
- 3) heating oil prices based on the NIS's wholesale price list for the month of July, rather than on the basis of prices established by the Heating oil supply agreement, while Gradska toplana has not included a rebate subsequently provided by the energy supplier as one of the pricing parameters.

The Report also underlined that Gradska toplana has included the following elements in the calculation of fixed operating costs when establishing the maximum revenue level relating to the fixed part:

- 1) advance payment costs in enforcement procedures;
- 2) the total amount of provisions for costs incurred for fees and other benefits, instead of remunerations paid on this basis under the Regulation;
- 3) wage bill costs, fees for employees and other personal expenses exceeding the amount established by the legal framework.

Furthermore, in the Report is stated that Gradska toplana has failed to include the following elements in the other revenue category which are considered to be deductible, that is, which reduce the maximum revenue level by engaging in the production, distribution and supply of thermal energy – fixed part: revenues from the overhaul and maintenance of heating installations, revenues from the water heating in boilers, revenues from the provision of other services, deferred income based on the implementation of grants, revenues from the remuneration for damages from property risk insurance, the total amount of interest income, and revenues from the provision of thermal energy services to those users whose specific consumption due to the lower energy efficiency level than the average monthly typical thermal energy consumption is increased by 20%.

After reviewing the Conclusion passed by the City Council of the City of Niš entered under number 1731-46/2015-03, the SAI has established that the City Assembly has issued a recommendation to Gradska toplana to finance the costs of the district heating network from its own resources in a segment of the excess thermal energy provision from the average monthly typical consumption level increased by 20%. It is underlined that Gradska toplana has failed to record revenues in the amount of 5.5 million dinars in 2016 generated from the provision of thermal energy in the volume of 1,212,937 kWh/m³ to users whose specific consumption is above the average monthly consumption level increased by 20%. By failing to record this revenue, and given the manner of thermal energy pricing, Gradska toplana has failed to exclude this revenue from the calculation of the maximum revenue level, and in doing so, has transferred the financing of the above-mentioned costs to other consumers.

Also, the SAI has continued to establish that Gradska toplana has failed to determine the correction element in value as an integral part of the fixed part of a price. Namely, the Report mentions that in relation to the total quantities of delivered thermal energy on an annual basis, one of the elements used for calculation of the thermal energy price has shown a difference between the accumulated thermal energy values and invoiced consumption values. The SAI has established that when calculating the amount of regulated funds (calculation basis for return on capital employed which an energy entity may generate during a regulatory period), for 2015/2016 and 2016/2017 heating season, Gradska toplana has also included the net value of obtained funds free of charge, such as grants, although the Regulation stipulates their exemption.

In the Report was also indicated that Gradska toplana applies prices for connection to the district heating network, where the distance of a targeted building from the backbone district heating pipeline is set as one of the criteria, although this element is not defined by the Rulebook for the establishment of fees for connection and access to the district heating network no. 3855/2010-09 of December 23, 2010.

During the investigation procedure, the Commission has contacted the SAI with a request to submit the case-file used in drafting the Report, and the SAI has submitted a case-file relating to the pricing of the costs of supplying heating energy to end consumers for the 2015/2016 and 2016/2017 heating season.

The provision of Article 58(1) of the Law stipulates that the Commission may enact a conclusion on the suspension of investigation procedure relating to the infringement of competition if the party, based on the content of the conclusion on instituting proceeding, that is, facts established in the proceeding, submits a proposal of commitments that is voluntarily willing to undertake in order to eliminate possible infringements of competition, containing the terms and conditions for taking the measure.

In the letter to the Commission entered under no. 5/0-02-459/2018-10 of December 3, 2018, the party to the proceeding has underlined that it has taken into account all concerns from the Report relating to the calculation of the costs of supplying heating energy to end consumers for the 2018/2019 heating season, including the corrective element for the 2015/16 and 2017/18 heating seasons. To that end, it is underlined that the SAI's official confirmation is expected and that the conditions for the suspension of the proceeding are met.

The Commission has invited Gradska toplana to put the submission in order, no. 5/0-02-459/2018-14 of December 10, 2018, to which Gradska toplana has replied by putting the submission in order. The proposal put in order for the suspension of the proceeding is filed under no. 5/0-02-459/2018-15 of December 20, 2018.

With reference to the manner and procedure relating to the pricing of the costs of supplying heating energy to end consumers, Gradska toplana has clarified that since 2015 establishes the "zero price" baseline at the beginning of a heating season in line with the Regulation. The proposal governing heating prices is enacted by the Supervisory Board of the company, in line with the provisions of the current Statute. The decision with corresponding calculations is submitted to the founder for control and approval by the City Council of the City of Niš. The "zero price" baseline is a two-tariff price and is established as a supply price consisting of the following elements: a) fixed part in the unit of measure din/m² (applied from Aug 1 to July 31 each year, referred to as the 'accounting period'); b) variable part in the unit of measure din/kWh (applied only during the heating season, pursuant to the Decision on the conditions and manner of production, distribution and supply of the thermal energy and an algorithm approved by the founder, providing for the option of paying for the supplied thermal energy in 12 monthly installments). Pursuant to Article 11 of the Regulation, the motion to change the price of thermal energy services due to the increase in the variable part of the price may be submitted when the total price of the energy generating products is increased by more than 3%, while the price reduction is mandatory if the price of the energy generating products is reduced by more than 5%. During the period of implementation of the Regulation, Gradska toplana has adhered strictly to the article mentioned and has modified the variable tariff both upwards and downwards. For all related changes, the founder, i.e., the City Council of the City of Niš, has granted permissions by enacting decisions on approval.

With reference to the correction element, Gradska toplana has underlined that the issue, pursuant to the Regulation, is set as a value term (monetary amount) that reduces or increases the maximum revenue level for the regulatory period, in the amount of deviations of the revenue generated for the previous regulatory period based on the regulated prices which were approved from the maximum revenue level regulated by the Methodology for the previous regulatory period. When calculating the maximum revenue level for the first regulatory period, the correction element equals zero. When establishing the 2015/16 prices for the first time, Gradska toplana has expressed the correction

element to equal zero. In the following calculation of the “zero price” for the 2016/17 heating season, the position of Gradske toplane and the founder was not to set and calculate the correction element in this calculation, given that the price in force at the time (previous calendar year) was not solely set pursuant to the Regulation (enacted on July 17, 2015). The major shortfall to calculating the correction element, strictly adhering to the definition provided in the Regulation, is that the founder may approve the price which is different to the proposed one in the fixed price segment and that the determination of the variable price segment is based on the supplied thermal energy quantities in kWh for the previous calendar year, while the quantity of supplied thermal energy may considerably vary during the implementation period of the regulated price (due to variations in weather conditions), both upwards and downwards. Also, when calculating the “zero price”, the prices of energy generating products are taken based on the average price during the regulatory period, while significant differences may occur during the implementation of the calculated prices. Gradska toplana has underlined that it has applied a correction element when calculating the “zero price” for the 2018/19 heating season considering such calculation as the only valid one, with an oral agreement obtained from the SAI. The correction element calculated in such manner used in the latest “zero price” calculation has covered the correction element for the 2016/17, 2017/18 and 2018/19 heating seasons, thus fully adhering to the SAI requests.

Gradska toplana has provided a clarification to the payment per m² and per measured quantity of the thermal energy provided. It is underlined that since 2013, that is, since the 2013/14 heating season, Gradska toplana fully applies the tariff system, that is, bills and recovers the costs for the delivery and supply of the thermal energy through a two-part tariff price, namely:

- a) fixed price, calculated in din/m²,
- b) variable price, calculated in din/kWh.

The fixed price is paid throughout a 12-month period, while the variable price is paid during the thermal energy supply period (October-April), envisaging the option for the consumers to opt for the 12-month installment plan in line with the established algorithm. During several heating seasons, a special decision enabled the consumers to pay per m² (lump sum) regardless of the fact that Gradska toplana had the capacity to measure the delivery of thermal energy quantities at all measuring points (100%). This option was canceled starting from the 2018/19 heating season. Also, Gradska toplana has a single price for all users (private users, business users and public users) regardless of the 1:1,25% ratio option provided by the Regulation. For the controlled period referred (implementation of the Regulation), Gradska toplana had an approval of the founder for all established and applied prices for the thermal energy supply services (both for “zero” and changed prices), which was distinctively established during the control. In addition to each decision on prices, the founder is also provided with the Opinion of the advisory body which consists, inter alia, of a representative of registered consumer association “Forum” Niš, pursuant to the Law on Consumer Protection.

On the basis of all the information submitted, Gradska toplana has presented a proposal of commitments which the public utility company is voluntarily willing to undertake in order to remove potential infringements of competition, namely:

- In the following calculation of prices, Gradska toplana shall fully and consistently adhere to the Regulation and clarifications concerning the implementation of specific articles of the Regulation, foremost the correction element;
- As in the previous period, Gradska toplana shall submit each proposal of the newly established price to the founder with the Opinion of the advisory body, where a representative of a local consumer association is the full member, which represents a form of the public debate. An additional form of public debate is the “empty-chair” principle ensured in the Supervisory board – reserved for the representative of the district heating system’s users, holding the right of discussion and no right to vote, which is the principle that has already been in place for some time and which Gradska toplana will continue to implement in the future;

- In the case of any doubt regarding the calculation of any element from the Table with reference to the Regulation, Gradska toplana shall contact the Ministry of Mining and Energy in written form, as an institution who drafted the Regulation and thus is considered to be authorized to provide the interpretation of said regulation.
- The instructions/guidelines/explanations received shall be published on Gradska toplana website, thus providing for public access to information and enabling a control function to the general public;
- In terms of the connection price to the district heating network, the criteria set by the founder's act – City of Niš, shall be exclusively applied, while on the day of drafting this proposal this obligation refers to the Rulebook on the fixing of connection fee to the district heating network (Official Gazette of the City of Niš 17/2018), Decision on the establishment of connection fee to the district heating network no. 3178/2 of June 12, 2018, and the Decision no. 4068/1 of July 18, 2018, and Gradska toplana shall publish the prices on its website.

In the letter no. 5/0-02-65/2019-4 of February 12, 2019, Gradska toplana has proposed an additional commitment that is voluntarily willing to undertake in order to remove potential infringements of competition, namely:

- In the future, Gradska toplana shall regularly, namely after the end of a heating season inform the Commission in written form on the implementation of proposed commitments and activities taken in the proceeding concerned, with evidence provided in support of the implementation.

In order to attest the veracity of the statements provided in the proposal for the suspension of the proceeding, the Commission has contacted the SAI with a request to express a view on the acknowledgment of observations from the Report, including the correction element for the 2015/2016 and 2017/18 heating seasons. In the reply entered under number 5/0-02-65/2019-03 of February 6, 2019, the SAI has underlined that a written report on the elimination of detected irregularities or inappropriateness (response to the audit report) drafted by Gradska toplana, pursuant to the Law on State Audit Institution, needs to be submitted no later than 90 days, starting from the next day from the delivery of the report. Gradska toplana has submitted a response to the audit report to the SAI within the provided timeframe, providing an insight into the correction measures with respect to the detected irregularities. Upon reviewing the response to the audit report, the SAI has assessed the correction measures described in the response to the audit report and carried out a valuation of the unsatisfactory removed irregularities, and established that irregularities which have not been removed in a satisfactory manner, by value, nature and context, represent considerable irregularities, pursuant to which the SAI has enacted a conclusion on the serious violation of good business practice. Following the submission of the response to the audit report and publication of a post audit report, Gradska toplana has subsequently submitted the 2017 financial statements and the 2018 Program of operations and other documents that were not the subject of the SAI audit, and which were used for the pricing of the thermal energy supply services for the 2018/19 heating season, evaluated by the SAI.

On the basis of the above, the SAI has established that Gradska toplana has acted in full and complete compliance with the recommendations, thus removing the irregularities established in the Report. It is particularly noted that the pricing was aligned with the rules laid down the Regulation, as well as that the correction element was calculated in accordance with the Regulation.

Pursuant to Article 58(3) of the Law, the Commission publishes on its webpage the notice of filing commitment proposals by the party to the proceeding and calls all interested parties to submit observations, positions and opinions relevant to the proposed commitments by PUC Gradska toplana in written form, no later than within 20 days from the date of publication of the notification to the

following address: Commission for Protection of Competition, 25 Savska St., 4th floor, 11000 Belgrade.

The submission containing observations, positions and opinions relevant to the proposed commitments should contain an annotation referring to the proposed commitments submitted by PUC Gradska toplana.

Within the same deadline, observations, positions and opinions relevant to the proposed commitments can also be submitted electronically, to the following email address: miki.vidakovic@kzk.gov.rs.

COUNCIL OF THE COMMISSION FOR
PROTECTION OF COMPETITION