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KOSOVO ENERGY CORPORATION J.S.C.
ENERGETSKA KORPORACIJA KOSOVA D.D.

KOSOVO ENERGY CORPORATION J.S.C.

Proposal for Maximum Allowed Revenues for the Fourth Relevant Year of ETR7 (for 2016)

04 December 2015

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1 Introduction

Kosovo Energy Corporation is presenting the proposal for Maximum Allowed Revenues (MAR) for the fourth Relevant Year of the seventh Electricity Tariff Review (ETR7). KEK through this document presents the regular adjustments for all the allowed costs by ERO according to the Generation Pricing Rule (Article 5). Part of this document are the reporting forms for annual updates requested by ERO. Forms represent the actual costs according to the set expenditure components. Having in mind this reporting year is not over yet, the actual costs for the remaining months are presented taking into consideration the actual part and a reasonable forecast for the remaining part. Same as until now, KEK will inform ERO for the final actual costs.

In accordance with Schedule 5 of the Generation Pricing Rule where it is specified that "The Regulated Generator shall submit the proposed new Maximum Allowed Revenues, Capacity Charges and Energy Charges for the forthcoming Relevant Year to the Regulator at least 80 Business Days before the start of the forthcoming Relevant Year", as well by referring to the letter dated 13.11.2015 received from ERO, KEK has prepared the proposed Maximum Allowed Revenues for 2016 and has presented them in this document.

After all the necessary data were collected, in accordance with the Generation Pricing Rule, the necessary calculations were done, therefore based on the analysis conducted, KEK considers that the Maximum Allowed Revenues for the fourth relevant year ETR7 should reach the value of 169.4 million euro, in order for KEK to be able to have a good and regular operation and maintenance of generating units (Kosova A and Kosova B) and Mines.

2 Structure of the document

This document is structured as follows:

- Chapter 3 presents the requests of KEK for the accident that occurred and the requests of KEK for accepting the costs of the damages caused.
- Chapter 4 provides the proposal of KEK for the applicable efficiency factor for the Regulated Generator;
- Chapter 5 provides a description of legislation that sets the level of Maximum Allowed Revenues for the Regulated Generator;
- Chapter 5.1 provides the proposal for the component of the Operating and Maintenance expenses;
- Chapter 5.2 of the document provides the proposal for the depreciation component;
- Chapter 5.3 of the document provides the proposal for the component of the allowed returns;
- Chapter 5.4 of the document provides the proposal for assumed costs for supply with coal;
- Chapter 5.5 of the document provides explanation regarding other costs of supply with fuel;
- Chapter 5.6 of the document provides the calculation of the pass-through costs;
- Chapter 6 presents the data on unregulated revenues and others
- Chapter 7 provided a summary of the proposal of the Kosovo Energy Corporation for the Maximum Allowed Revenues for Relevant Year;

The data will be submitted in working sheets in *Excel*, provided calculations for MAR are summarized in the Annex of this Document.

3 The incident that occurred

As a consequence of the accident in 2014 in the generation units (A4 and A5) of PP TC Kosova was not operational according to its plans, due to additional works in these two units. Because of the delays in the beginning of the works in these two generation units, KEK for 2015 cannot fulfill its planned Annual Balance, hence cannot fulfill the Maxim Allowed Revenues set by ERO.

ERO during the review for the third relevant year of ETR7 did not take this issue into account with the justification that "we should first wait for the results of the investigations on the causes of the explosion". KEK wants to reemphasize the importance of taking into account the caused damages for the necessary stability of KEK.

The professional commission of KEK has prepared the final report on the damages caused by the explosion and KEK has also prepared and sent the reviewed balance of electricity on 24.06.2074, as a consequence of explosion/ accident that occurred.

According to the report of the professional commission and the reviewed balance of electricity, the value of the overall damages caused is over 11% of the Maximum Allowed Revenues. Caused damages had an influence in the reduction of production of electricity according to the annual balance of electricity for 488 GWh in a value of 15 464 470 Euro.

Based on the data presented above, also presented in the letter sent for the extraordinary review, letter on caused damages, in the Comments of KEK regarding the Consultative Report on extraordinary review of electricity tariffs within ETR7, presented in the Proposal for Maximum Allowed Revenues for the Third Relevant Year of ETR7, as well as the comments of KEK in the Consultative Report within ETR7.

KEK, once again is asking from ERO to accept all costs caused by the accident (explosion) of the electrolysis of PP Kosova A, in order to be able to perform all its necessary activities as a licensed producer of electricity.

4. Efficiency Factor

KEK in previous reviews as well, has expressed its concerns that the efficiency factor set by ERO is unachievable, since the units in operation (especially PP Kosova A) are in operation for a long period of time (over 40 years, units in PP Kosova A, while 30 years of PP Kosova B). Efficiency factor is linked to the investments that improve the current situation, as well as with a better control of the components that are subject to the efficiency factor.

Some of these cost are expenses of staff, reduction of maintenance costs or reduction of other expenses that are necessary for the daily functioning of the corporate as other operational expenses, office expenses, transportation, etc.

Staff expenses of KEK are hard to be reduced for the following reasons:

- When the unbundling of KEK that occurred, a part of the qualified staff went to work for KEDS (Kosovo Energy Distribution Services), mainly qualified and experienced staff who were performing duties in generation and supply. Replacement of this staff means hiring and training new staff in a sector that is highly specific and where it is hard to find trained staff;
- Secondly, KEK is in process of creating sectors so that it can perform its duties as a producer of electricity – licensed generator. This is regarding the sectors that enable KEK to act in accordance with the new conditions after the unbundling and opening of the electricity market which would complete the structure of KEK, and
- Thirdly, Kosovo Energy Corporation is a publicly owned enterprise that in itself carries the social concerns. Even is the difficulties regarding the lack of qualifies professional staff would be avoided, the social barrier – rightfully or not – is allocated to KEK, makes it hard to implement rigorous measures of increasing the efficiency of the staff. Cost of maintenance expenses is closely linked with the condition of the generation units (their age), as well as with the lack of capital investments in the maintenance in the past.

Having in mind the justifications presents above, KEK considers that it is unable to achieve the efficiency set by ERO during its review. Its implementation in previous years has resulted in financial losses at the time when KEK is in a hard financial situation as a consequence of reduction of revenues and as a consequence of losses caused by the accident.

KEK reemphasizes the importance of the revision of the efficiency factor by ERO for the fourth relevant year of ETR7. Having in mind the limitations that KEK has in increasing the efficiency due to the arguments provided above, we consider that application of the efficiency factor of 1% annually would be reasonable for KEK.

If the efficiency factor of 1% would be applicable instead of 4%, KEK would generate more revenues, around €2 million more in operation and maintenance.

MAR calculated below has taken into account the efficiency level of 4% in OPMC of Generation and Mines for the fourth relevant year by referring to the Generation Pricing Rule as well as the decision of ERO for the application of the efficiency factor for this Regulatory period.

Regardless of that, KEK encourages ERO to consider our request for changing the efficiency level since that one is unbearable for KEK.

5 Calculation of Maximum Allowed Revenues (MAR)

The calculation of the Maximum Allowed Revenues for the third relevant Tariff year ETR7 of KEK was done based on the principles provided by the Generation Pricing Rule, which determines the level of revenues that KEK may collect by implementing the regulated charges.

Based on the Article 5 of the Rule [1] the differences in the Maximum Allowed Revenues determined in the Periodic Review are calculated in this document. These differences are calculated based on the indexation of the allowed operating and maintenance costs with the efficiency factor determined by ERO, indexation of all allowed costs in order to reflect the inflation and update of allowed costs for supply with coal. MAR was also adapted to reflect the under-covering and, in certain cases, over-covering of allowed coal supply costs and other costs that are outside of control of the Regulated Generator.

The proposed revenues from the Regulator, summarized in part 9 of this Document, have used formulas of Schedule 1 of the Rule for the evaluation of MAR that should be covered by Regulated Charges in the forthcoming relevant year.

$$MAR_t = OPMC_t + DEPC_t + RTNC_t + LGSC_t + OTFC_t + PSTC_t$$

[1] Rule of Regulated Generator Pricing (Generation Pricing Rule)

Where

MAR_t	*is Maximum Allowed Revenues in Relevant Year, summarized in chapter 5;*
$OPMC_t$	*is allowed operating and maintenance Costs in the relevant year, described in section 5.1;*
$DEPC_t$	*is allowed Depreciation in the relevant year, described in annex 5.2;*
$RTNC_t$	*is allowed Return on Capital in the relevant year, described in section 5.3;*
$LGSC_t$	*is allowed coal supply Costs in the relevant year, described in chapter 5.4;*
$OTFC_t$	*is allowed other fuel supply Costs in the relevant year, described in chapter 5.5;*
$PSTC_t$	*is Pass-Through Costs in the relevant year, described in chapter 5.6.*

5.1 Allowed Operating and Maintenance Costs (OPMCt)

Calculations of the allowed Operating and Maintenance costs for the relevant year are done according to the formula in the paragraph 2.1 of the Schedule 1 of the Generation Pricing Rule. The Rule determines that the allowed costs for operation and maintenance of the generation units in one certain relevant year be the costs that are allowed by the Regulator during the periodic review of the tariffs, adjusted to reflect the current value of inflation in the previous year, efficiency factor determined by ERO for the relevant year as well as the profiling factor that in this concrete case is determined to be zero. The formula provided in paragraph 2.1 of the Rule is as follows:

$$OPMC_t = OPMC_{t-1} * (1 + CPI_{t-1}) * (1 – E_t)* (1 – P_t)$$

Where

$OPMC_t$	*is allowed operating and maintenance costs for the relevant year t*
$OPMC_{t-1}$	*is allowed operating and maintenance costs in relevant year –t-1, except for relevant year 1, when the value determined by the regulator at the most recent periodic review shall be used*
CPI_{t-1}	*is the actual Value of inflation in the relevant year t-1, measured using the "Harmonized Indices of Consumer Prices (HICP) – All Items, for Eurozone" published by Eurostat, or any other measure of inflation that the regulator determines is a better measure of the change in operating and maintenance costs over time and is allowed during at a periodic review*

E_t *is the Efficiency Factor in the relevant year t, which is set at the periodic review and which is set by the ERO to be 4%*

P_t *is the Profiling Factor in the relevant year t, which is set at periodic review and which is set to be zero.*

$$OPMC_t = OPMC_{t-1} * (1 + CPI_{t-1}) * (1 - E_t) * (1 - P_t)$$

Since in this case, the profiling factor will not be used, then the following formula will be used:

$$OPMC_t = OPMC_{t-1} * (1 + CPI_{t-1}) + OPMC_t * (1 - E_t) = 18.5 \text{ million euro}$$

5.2 Allowed Depreciation (DEPCt)

According to paragraph 2.2 of the Schedule 1 of the Generation Pricing Rule, the allowed depreciation in every relevant year *t* should be calculated by indexing the inflation in the value of the allowed depreciation in the previous year *t-1*.

$$DEPC_t = DEPC_{t-1} * (1 + CPI_{t-1}) * (1 - P_t)$$

Where:

$DEPC_t$ *is the other allowed depreciation in the relevant year t, which is smoothed such that it is constant over the regulatory period*

$DEPC_{t-1}$ *is allowed depreciation in the relevant year t-1, except the relevant year 1 where the value determined by the regulator at the most recent periodic review shall be used, which is smoothed such that it is constant over the regulatory period*

CPI_{t-1} *is the actual value of inflation in the relevant year t-1, measured using the "Harmonized Indices of Consumer Prices (HICP) – All items, for the Eurozone" published by Eurostat*

P_t *is the profiling factor in relevant year t, which is set at periodic reviews*

Nevertheless, if the allowed depreciation in the relevant year t ($DEPC_t$) is calculated by indexing the allowed depreciation in the relevant year t-1 than the amount of MAR_t would not reach the allowed value by ERO during the periodic review ETR7. This is because the formula of $DEPC_t$ provided in paragraph 2.2 of the Schedule provided by ERO assumes that depreciation will be profiled in that way that it will be constant over the whole regulatory period (see the definition of $DEPC_{t-1}$). Since $DEPC_t$ and

$RTNC_t$ (see Section 5.3) are not profiled during the Periodic Review, the accurate calculation of $DEPC_t$ for the second relevant year should be calculated by indexing for inflation the value of depreciation in $DEPC_{t-1}$, according to the practices of ERO, and by adding to this the allowed value of $DEPC_t$ of the forthcoming relevant year:

$$DEPC_t = DEPC_{t-1} * (CPI_{t-1}) + DEPC_t = 24.2 \text{ million euro}$$

5.3 Allowed Return on Capital (RTNCt)

Allowed return on capital is calculated according to the formula provided in paragraph 2.3 of the Schedule 1 of the Generation Pricing Rule.

$$RTNC_t = RTNC_{t-1} * (1 + CPI_{t-1}) * (1 - P_t)$$

Where

$RTNC_t$	*is allowed return on capital in Relevant Year t, which is smoothed such that it is constant over the Regulatory Period*
$RTNC_{t-1}$	*is allowed return on capital in Relevant Year t-1, except for Relevant Year 1 when a value determined by the Regulator at the most recent Periodic Review shall be used, which is smoothed such that it is constant over the Regulatory Period*
CPI_{t-1}	*is the actual value of inflation in Relevant Year t-1, measured using the "Harmonised Indices of Consumer Prices (HICPs) – All Items, for the Eurozone" published by Eurostat*
Pt	*is the Profiling Factor in Relevant Year t, which is set at Periodic Reviews*

The rule has foreseen that $DEPC_t$ and $RTNC_t$ profiling in order to smoothen the influence of revenues in MAR of high level investments. Same as in the case of the calculation of allowed depreciation, the rule specifies that $RTNC_t$ be calculated by the indexation for inflation the value of RTNC in the period t-1. As mentioned above, this formula assumes that in setting the $RTNC_t$ in the periodic review, ERO has applied the profiling factor so that RTNC be constant for every relevant year t. Since RTNC was not profiled, the calculation should take into account the indexation of inflation allowed in the previous year and to this the allowed return for the forthcoming relevant year should be added:

$$RTNC_t = RTNC_{t-1} * (CPI_{t-1}) + RTNC_t = 9.7 \text{ million euro}$$

Table 1 Calculation of the maximum revenues for generator

		MAR for the Regulated Generator (KSA+KSB)			
		2013	2014	2015	2016
Profiling factor - Pt		0.0%	Euribor	0.49%	
HICP Eurozone (17) All items		0.4%	S-factor	15.00%	
Efficiency factor		4.0%	I	15.49%	
OPMCt		**t-3**	**t-2**	**t-1**	**t**
		2013	**2014**	**2015**	**2016**
OPMCt	€m	33.0	21.9	20.5	27.4
OTFCt	€m	8.3			8.3
OPMCt-OTFCt	€m	24.8			**19.2**
plus Efficiency and inflation ETR7	€m	22.7			
OPMCt corrected	€m	23.8	**20.9**	**19.9**	**18.5**
DEPCt					
		2013	**2014**	**2015**	**2016**
DEPCt	€m	21.0	22.2	23.2	24.1
plus inflation	€m		**22.2**	**23.2**	**24.2**
RTNCt					
		2013	**2014**	**2015**	**2016**
RTNCt	€m	8.0	8.7	9.2	9.6
plus inflation	€m		**8.7**	**9.3**	**9.7**

5.4 Allowed Coal Supply Costs (LGSCt)

The proposal of the Regulated Generator for the Allowed Coal Supply Costs is regulated by the Article 11 of the Generation Pricing Rule. The proposal of KEK for these costs is undertaken only with the purpose of determining the Maximum Allowed Revenues of the Generation Division and presents no prejudice on regulating the coal supply from the Regulator.

The proposal for the assumed costs of coal supply includes the costs of the royalty for electricity and is submitted to the Regulator because at the time when this Document is drafted, the Regulated Generator has no agreement for supply with coal, in accordance with the Article 11 Paragraph 2.2.1 of the Generation Pricing Rule.

During the calculations for the proposal of allowed costs for coal supply, KEK has used the same principles as in determining MAR for the Regulated Generator, in accordance with the Article 11 of the Generation Pricing Rule. This calculation has taken into account the operating and maintenance expenses, depreciation and allowed returns set by ERO during the Periodic Review. Assumed costs of coal supply are adjusted to include inflation in accordance with the Article 11 Paragraph 5 of the Generation Pricing Rule.

Table below presents the calculations of LGSCt by KEK-u. The details of the calculation of the allowed cost forecasted for coal supply are provided in Annex 1 of this Document.

Table 2 Calculation of Allowed Coal Supply Costs (LGSCt)

Coal Supply Costs			2015	2016
Allowed coal supply costs	Euro	LGSCt	**81.246**	**89.232**
Allowed coal supply costs Forecasted	Euro	LGSCft	79.313	87.117
Allowed coal supply costs Actual t-1	Euro	LGSCat	81.144	88.922

$$LGSC_t = LGSCft + (LGSC_{at-1} - LGSC_{ft-1}) * (1+It)$$

$$LGSC_t = 87.12 + (81.14 – 79.31) * (1+0.1549) = 89.2 \text{ million euro}$$

In accordance with the formula above and the results from the above table, the cost for coal supply for 2016 is 89.2 million euro.

5.5 Allowed Other Fuel Supply Costs (OTFCt)

The cost of other fuels of the Regulated Generator are calculated during the Regular adjustments also taking into account the difference between the values of forecasted and actual OTFC for the previous Relevant Year (t-1). According to the Paragraph 2.1 of the Generation Pricing Rule, the Cost of other Fuels for every relevant year should be:

$$OTFC_t = OTFCf_t + (OTFCa_{t-1} - OTFCf_{t-1}) * (1+ I_t)$$

Where

$OTFC_t$	*is allowed other fuel supply costs in Relevant Year t*
$OTFCa_{t-1}$	*is the actual allowed other fuel supply costs in Relevant Year t-1*
OTFCft-1	*is the other allowed fuel supply costs in the Relevant Year t-1*
It	*is the interest rate for the Relevant Year t calculated based on EURIBOR plus S%, where S is a value to be determined by the Regulator at Periodic Reviews and which reflects the premium payable by the licensee for short-term loans above the EURIBOR rate.*

$$OTFC_t = OTFCf_t + (OTFCa_{t-1} - OTFCf_{t-1}) * (1+ I_t)$$

$$OTFC_t = 8.26 + (6.46 - 8.26) * (1+ 0.1549) = 6.2 \text{ million euro}$$

5.6 Pass-Through Costs (PSTCt)

Pass-through Costs of the Regulated Generator present the sum of allowed costs for the services of transmission system and market operator as well as the difference in values between the allowed and actual costs for the relevant year t-1.

According to the paragraph 2.6 of the Schedule 1 of the Generation Pricing Rule, pass-through costs for every Relevant Year t should be:

$$PSTC_t = PSTCf_t + (PSTCa_{t-1} - PSTCf_{t-1}) * (1+ I_t)$$

Where

$PSTC_t$	*is pass-through costs in relevant year t*
$PSTCa_{t-1}$	*is the actual pass-through costs in relevant year t-1*
$PSTCf_{t-1}$	*is the forecasted pass-through in relevant year t-1*
It	*is the interest rate for the Relevant Year t calculated based on EURIBOR plus S%, where S is a value to be determined by the Regulator at Periodic Reviews and which reflects the premium payable by the licensee for short-term loans above the EURIBOR rate*

$$PSTC_t = PSTC_{ft} + (PSTCa_{t-1} - PSTC_{ft-1}) * (1+ I_t)$$

$$PSTC_t = 5.5 + (5.75-4.12) * (1+0.1549) = 7.4 \text{ million euro}$$

$PSTC_{ft}$ was calculated based on the annual draft-balance of electricity for 2016 by applying the existing tariffs of SO and MO and ERO for license.

Depending on the decision of ERO for the tariffs of SO and MO, allowed pass-through costs for 2016 may be changed by ERO by reflecting every change with the costs of $PSTC_t$.

6 Unregulated revenues and other issues

The calculations written above present the calculation of MAR for the forthcoming Relevant Year according to the forms provided in Schedule 1 of the Generation Pricing Rule. According to the first paragraph of the Schedule, the presented forms aim to fulfill the presented principles in the main part of the Rule. For the information of ERO, MAR proposed by KEK does not include the issues listed below. KEK expects that these issues will be reviewed and solved in the coming days, before the determination of the Maximum Allowed Revenues for the forthcoming Relevant Year.

6.1 The unregulated revenues

In practice, in the past, ERO has adjusted MAR of the licensees in order to reflect the additional revenues that the licensees may profit with regards to sales to the third parties. This adjustment was not included in the proposal of KEK but the necessary data were used in the proposal for allowed revenues for 2016.

During 2015 KEK forecasted to have unregulated revenues from selling coal in the amount of around €1.6 million and selling of steam for co-generation of around €1.0 million. These revenues were deducted from the request of KEK for the Maximum Allowed Revenues for 2016 since the same amount will be obtained from the unregulated revenues.

6.2 Government loan debts

Last year as well, KEK has expressed its concern regarding the loans taken from the Government of Kosovo. For this reason, KEK in the forthcoming relevant year risk on operating with loses due to payment of interest for the loans taken from the Government of Kosovo.

During this year, a decision was taken from the Ministry of Finance and at the same the time the agreement was signed between the Minister of Finance and Managing Director of KEK J.S.C. for paying back the loan and interest. Based on this agreement, KEK this year has paid around 2 million euro, while for 2016 it is expected to pay around 7.3 million euro.

This issue was addressed last year by KEK, therefore, we are again asking that this issue be taken into account during the determination of the maximum allowed revenues for the forthcoming Relevant Year (2016).

Referring to the Law for Forgiveness of Debts, uncollected revenues of KEK will be reduced for around €250 million out of which KEK has planned to pay the loan to the Government of the Republic of Kosovo. Based on this, KEK risks the liquidity of the company which is linked to the payment of the loan. Therefore, we request from ERO to take into account our request for covering the payment of the interest as above.

6.3 Support of the Community in the Municipality of Obiliq

According to the conclusion from the meeting held on 18.11.2015 between the Board and the management of ERO, representatives of the Municipal Assembly and those of the Municipality of Obiliq, representatives of the Association of Kosovo Municipalities, representative of Ombudsperson, representatives of KEDS and representatives of KEK, below are the activities specified in details that are linked to the support of the initiative for helping the community in 2016 in the Municipality of Obiliq.

These activities are not related to the needed costs for the production of electricity or core operations of KEK, or that influence in the increase of the value of assets of KEK. Regardless of that, as concluded in the abovementioned meeting, these projects were identified by the leaders of the Municipality of Obiliq as necessary and urgent to be financed by KEK during 2016, which would help the community at the place where KEK operates and are part of the side obligations of KEK for social responsibility.

During this meeting, ERO declared that it will support every request coming from KEK that refers to this meeting for the support of the community coming from the place where the electricity is produced.

Taking into consideration that projects presented in the table below would not increase the value of assets of the Kosovo Energy Corporation and would not influence the production of electricity, we have requested that ***the cost of these projects be part of the operational expenses*** and not be treated as a cost on capital investments which is mandatory to be registered in the accounting registers and be presented as capital in the balance sheets of KEK.

Table 3. List of the projects for support the community in the Municipality of Obiliq.

No.	Name	Description	Value
1.	Asphalting of the road from Sibovc SW until the Mosque of Hades – Neighborhood of Mirenëve	Repairing the infrastructure around the mine, intervention in the public infrastructure as well as shortening the roads used for transportation of inhabitants of those areas.	200,000 €
2.	Circular road for Sibovc SW Shipitull - Sibovc - Lajthishtë	Repairing the infrastructure around the mine, intervention in the public infrastructure as well as shortening the roads used for transportation of inhabitants of those areas.	500,000 €
3.	General projects for supporting the community and social responsibility	- Support for repairing the river bed of river Sitnica - Support in creating green areas in the Municipality of Obiliq - Support to the community and sport clubs.	300,000 €

		- Support in repairing the public lightning in the main streets of Municipality of Obiliq.	
		Total:	1,000,000 €

6.4 Implementation of the Collective Agreement

KEK until 31.12.2014 for the work experience, for every year has paid 0.3% of the basic wage for every year of work experience. While, as of 01.01.2015 based on the Article 48. Paragraph 1 of the General Collective Agreement in Kosovo "***employees are to be recognized the right to allowance for work experience to, 0.5% of the basic wage, for full working year of the work experience***".

According to this Article and the respective paragraph, KEK as of 01.01.2015 is obliged to implement this norm completely by adding the cost of work for 0.2% for each year of work experience. This cost was not included in the general Cost of staff for 2015 and 2016.

As a result of application of this change, the cost of staff for 2015 which was fulfilled reaches the amount of 833,226€ without the interest as well as calculated cost for 2016 reaches the amount of 958,210€ that were not included in the cost of staff.

6.5 Insurance of Assets

Due to the lifespan of the equipment that KEK operates with, processes and operations with them are very complex and dependent on many factors. In line with this, same as it was proven by the events in the previous years, it is a necessity to analyze and find the possibilities of purchasing insurance policy for strategic assets, vital for the functioning of KEK and which have an influence in planned production.

Taking into account the complexity of this issue and the conditions in the insurance market in Kosovo, this issue requires a study regarding the level of insurance, which assets should have insurance and what would be the cost of purchasing such insurance.

For this purpose, in the beginning of 2016, a feasibility study is planned to be carried out and which will reach a value of around €300 thousand euro.

While, taking into account all the circumstances of a preliminary evaluation regarding the value of assets, their sensitivity in impacting the production and risk assessment, purchase of such policy on annual basis is expected to be around €2 million which should be taken into account by ERO during their annual adjustments.

6.6 Obligations deriving from the decision of Independent Commission for Mines and Minerals (ICMM).

Same as we have notified you on 23.10.2015 regarding the decisions of ICMM that were sent to KEK. These decisions were issued by ICMM based on the Law on Mines and Minerals (Law 03/L-163) as well as the administrative instruction 02/2014 which obliges KEK that on behalf of Bank Guarantee and Insurance " for all the dangers towards the third parties " that for the license for the use of energy minerals, that KEK has, it should deposit 1,500,000,00 € in the bank account, while the Bank Guarantee should be done of 12,000.00€/hectare of mine.

Since the costs requested by ICMM are costs that derive from the legal obligations and according to a simple calculation are around 30 million euro that KEK should deposit in the Bank Account of ICMM. Regardless of the fact that KEK has made a request and appeal to cancel these decisions, we request from you that in case our request and appeal for the cancelation of these decisions are not approved, we should find a solution regarding this during the tariff review.

This is an immediate payment requested by KEK and presents an additional burden besides the payment of royalty which is 3€/ton.

6.7 Adjustments

In the part of adjustments some costs of unregulated revenues were treated which are not included in the maximum allowed revenues for the previous year and that should be included.

In the line of adjustments the cost of health insurance of employees was included and that reaches the amount of €1.4 million; costs of implementation of collective agreement according to the point 6.4; forecasted unregulated revenues for 2016 as well as the difference between the actual and forecasts for 2015 according to point 6.1; also, included in this line are the costs according to point 6.2. until 6.5. also the other unregulated revenues of around €0.35 million which were reduced since these revenues were not forecasted in the previous year but are actual.

The total cost for adjustments reaches the value of €14.2 million.

7 Summary of proposals of KEK for MAR

According to the forms of MAR provided by Chapter 5 of this Document, the Maximum Allowed Revenues that are necessary for the normal operation of KEK, after the application of the efficiency factor of 4%, are 169.4 million euro. Calculation is provided in the table below:

Table 4. **Calculation of the Maximum Allowed Revenues of Kosovo Energy Corporation J.S.C..**

		MAR for the Regulated Generator (KSA+KSB)			
		2013	2014	2015	2016
Profiling factor – Pt		0.0%	Euribor	0.49%	
HICP Eurozone (17) All Items		0.4%	S-faktor	15.00%	
Efficiency factor		4.0%	I	15.49%	
OPMCt		**t-3**	**t-2**	**t-1**	**t**
		2013	**2014**	**2015**	**2016**
OPMCt	€m	33.0	21.9	20.5	27.4
OTFCt	€m	8.3			8.3
OPMCt-OTFCt	€m	24.8			**19.2**
plus Efficiency and inflation ETR7	€m	22.7			
OPMCt corrected	€m	23.8	**20.9**	**19.9**	**18.5**
DEPCt					
		2013	**2014**	**2015**	**2016**
DEPCt	€m	21.0	22.2	23.2	24.1
plus inflation	€m		**22.2**	**23.2**	**24.2**
RTNCt					
		2013	**2014**	**2015**	**2016**
RTNCt	€m	8.0	8.7	9.2	9.6
plus inflation	€m		**8.7**	**9.3**	**9.7**
LGSCt					
		2013	**2014**	**2015**	**2016**
LGSCt	€m	87.8	76.8	79.3	87.1
LGSCft-1	€m	87.8	76.8	76.8	81.2
LGSCat-1	€m	71.5	79.9	79.9	
plus interest	€m		**76.8**	**81.2**	**89.2**
OTFCt					
		2013	**2014**	**2015**	**2016**
OTFCt	€m	8.3	6.3	8.3	8.3
OTFCft-1	€m	8.3	6.3		4.4
OTFCat-1	€m	6.4	8.4	6.5	
plus interest	€m		**6.3**	**4.4**	**6.2**
PSTCt		**2013**	**2014**	**2015**	**2016**
PSTCt	€m	3.9	3.5	4.1	5.5
PSTCft-1	€m	3.9	**3.5**		3.6
PSTCat-1	€m	5.1	**5.8**	5.8	
plus interest	€m		**3.5**	**3.6**	**7.4**
MAR corrected		152.8	138.4	141.7	155.2
Adjustment			0.9	-1.4	14.2
MAR Final		152.8	139.3	**140.3**	**169.4**

8 Annex 1 - $LGSC_{ft}$

Calculation of the Allowed Coal Supply Costs LGSCt

This annex provides the details of the calculation of the allowed coal supply costs which according to the chapter 5.4 of this Document were assessed to be 87.2 million euro.

Since there is still no agreement between a company for coal production and the regulated generator, the calculation of LGSCt was done.

During the calculation of LGSCt, KEK assumed that the mining company is a normal commercial company. In the calculation of MAR of LGSCt, KEK assumed the same principles as those of the Regulated Generator, except that application of the costs that may be specific for one body or another.

Different from the Generation Division, the calculation of allowed costs for mines was done using the following equation:

$$MAR_t = OPMC_t + DEPC_t + RTNC_t + PSTC_t$$

Where

MAR_t	*is Maximum Allowed Revenues in Relevant Year t*
$OPMC_t$	*is allowed operating and maintenance Costs in relevant year t*
$DEPC_t$	*is allowed Depreciation in the relevant year t*
$RTNC_t$	*is allowed return on capital in relevant year t*
$PSTC_t$	*is pass-through Costs in relevant year t*

Therefore, the allowed costs (MARt) were assessed as the sum of the operating and maintenance expenses, depreciation, allowed return during the periodic review (without profiling) and pass-through costs in relevant period t.

Calculation of OPMC

The way of calculating the operating and maintenance expenses of the Mine division was done same as for the regulated generator. Calculation of OPMCt for the Mine division is provided in the following table:

Table 5. Allowed coal supply costs of the Regulated Generator (OPMCt)

		Allowed Coal Supply Costs (LGSC)			
		2013	2014	2015	2016
Profiling factor - Pt		0.0%	Euribor	0.49%	
HICP Eurozone (17) All Items		0.43%	S-factor	15.00%	
Efficiency factor		4.0%	I	15.49%	
OPMCt		**t-3**	**t-2**	**t-1**	**t**
		2013	**2014**	**2015**	**2016**
OPMCt	€m	42.2	42.0	41.5	41.0
plus Efficiency and inflation	€m	40.5	**39.2**	**36.9**	**34.8**
Adjustments Opex HQ			-1.86		
			37.3	**35.7**	**33.5**

Calculation of 33.5 million euro was done as follows:

1. The value of allowed OPMCt for the fourth Relevant year (34.8 million euro), the efficiency factor (4%) was applied;
2. Resulting value in $OPMC_{t-1}$ of 35.7 million euro, the norm of inflation used was 0.43%;
3. The amount of the resulting value from point 2 and the resulting amount from point 1 present the amount of $OPMCt_{2016}$.

$$OPMCt = (35.7*0.0043) + 34.8 * (1-0.04) = 33.5 \text{ million euro.}$$

Calculation of DEPCt

Allowed depreciation in calculated same as in the Generation Division. Allowed cost of depreciation, as in the previous case, is not profiled as requested by the Generation Pricing Rule, therefore this made it impossible to apply the Depreciation formula strictly:

$$DEPC_t = DEPC_{t-1} * (1 + CPI_{t-1}) * (1 – P_t)$$

Application of this formula in the way requested by the Rule would result in the LGSCt not being equal with MARt as assumed by ERO during the periodic review. Therefore, same as in the case of Generation, KEK proposes that the calculation be made by applying HICP in DEPCt-1 and adding to this the value of DEPCt that is allowed for the third Relevant Year during the Periodic Review. The result of this calculation is 16.9 million euro:

$$DEPC_t = DEPC_{t-1} * (CPI_{t-1}) + DEPC_t$$

$$DEPC_t = 15.9 * 0.0043 + 16.9 = 16.9 \text{ million euro}$$

Calculation of RTNCt

Allowed cost on the return on capital investments is calculated under the same principle as the one of the Regulated Generation. Since RTNCt was not profiled as requested in Schedule 1 of the Rule, the calculation of RTNCt has used the same methodology as the one of DEPCt. RTNCt that is added to LGSCt- of the Regulated Generator results to be 11.3 million euro.

$$RTNC_t = RTNC_{t-1} * (CPI_{t-1}) + RTNC_t$$

$$RTNCt = 10.7 * (0.0043) + 11.3 = 11.3 \text{ million euro.}$$

Calculation of PSTCt

Pass-through costs of the Mine Division include the costs of royalty on coal and licensing taxes. According to paragraph 2.6 of the Schedule 1 of the Rule, pass-through cost for every Relevant Year should take into account the forecasted value for that Relevant year during the Periodic Review, but to this value, the difference between the actual pass-through costs in the relevant year t-1 and those allowed for that relevant year should be added:

$$PSTC_t = PSTCf_t + (PSTCa_{t-1} – PSTCf_{t-1}) * (1+ I_t)$$

PSTCt= 24.4 million euro.

Summary of $LGSC_{ft}$

Table 6. Forecasted coal supply costs (LGSCft)

		Forecasted Coal Supply Costs (LGSCft)			
		2013	2014	2015	2016
Profiling factor - Pt		0.0%	Euribor	0.49%	
HICP Eurozone (17) All Items		0.43%	S-factor	15.00%	
Efficiency factor		4.0%	I	15.49%	
OPMCt		t-3	t-2	t-1	t
		2013	2014	2015	2016
OPMCt	€m	42.2	42.0	41.5	41.0
plus Efficiency and Inflation	€m	40.5	**39.2**	36.9	34.8
Adjustments Opex HQ			-1.86		
			37.3	35.7	33.5
DEPCt					
		2013	2014	2015	2016
DEPCt	€m	13.1	14.2	15.8	16.9
plus inflation	€m		**14.3**	15.9	16.9
RTNCt					
		2013	2014	2015	2016
RTNCt	€m	8.5	9.3	10.665	11.3
plus inflation	€m		**9.3**	10.705	11.3
PSTCt					
		2013	2014	2015	2016
PSTCt	€m	25.7	24.5	25.9	24.6
PSTCat-1	€m	24.5	22.2	24.7	24.9
PSTCat-1 – PSTCft-1	€m	-1.2	-2.3		
plus interest	€m		23.1	23.12	24.4
adjustment			**-6.1**	-6.1	0.9
LGSCt	**€m**	**87.821**	**79.326**	**79.310**	**87.117**