Republika e Kosovës
Republika Kosova - Republic of Kosovo

ZYRA E RREGULLATORIT PËR ENERGJI
REGULATORNI URED ZA ENERGIJU
ENERGY REGULATORY OFFICE

Asset lives – Consultation Paper

TSO/MO and DSO Input Values Periodic Review

(2018-2022)

DISCLAIMER

This Initiation Paper has been prepared by ERO for the purpose of informing energy sector stakeholders. The Paper does not represent a decision by the ERO and should not be interpreted as such.

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1 Introduction

The Energy Regulatory Office (ERO) is conducting the Periodic Review for the Second Multi-Year Tariff (MYT2) to set the Maximum Allowed Revenues (MAR) for the Transmission System Operator (TSO), Market Operator (MO) and the Distribution System Operator (DSO) for the period 1 April 2018 to 31 March 2023. KOSTT J.S.C. is the TSO and MO and KEDS J.S.C. the DSO. The current allowed revenues were established at the first Periodic Review in 2013 (MYT1).

As part of this review, ERO will determine a number of key input variables to the MAR calculation in advance in order to provide adequate time for public consultation on these. This follows the practice applied for MYT1. The input values concerned are:

- The starting level and expected rate of reduction in transmission and distribution system losses, which is subject of this Consultation Paper.
- The expected rate of efficiency improvements in operating costs of the TSO and DSO.
- The Weighted Average Cost of Capital (WACC) of the TSO and DSO.
- Loss Sharing Factor.
- Savings Sharing Factor which is applied for savings which exceed the efficiency factor, and
- Any other input parameter that the Regulator may deem necessary.
- **The appropriate asset lives to be used for the purposes of calculating regulatory depreciation of new investments, which is the subject of this consultation paper**.

This paper is issued for public consultation. Any comments can be submitted in electronic form by email at ero.pricing-tariffs@ero-ks.org or submitted in hard copy to the following address:

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Comments must be submitted by interested parties by 18 July 2017 at the latest.

ERO reserves the right to publish any comments received in full or in part unless identified as confidential.

Related documents

Law on Electricity	http://ero-ks.org/2016/Ligjet/LIGJI_PER_ENERGJINE_ELEKTRIKE_ang.pdf
Law on Energy Regulator	http://ero-ks.org/2016/Ligjet/LIGJI_PER_RREGULLATORIN_E_ENERGJISE_ang.pdf

TSO/MO Pricing Rule	http://ero-ks.org/2017/Rregullat/TSO-MO%20Pricing%20Rule.pdf
DSO Pricing Rule	http://ero-ks.org/2017/Rregullat/DSO_Pricing_Rule.pdf

2 Regulatory Mechanism

The MAR value established for the TSO, MO and DSO at each price review are prepared according to a 'building-block' methodology. Under this, each entity is permitted to earn from the tariffs an amount equal to the sum of its efficient operating costs, the depreciation of its Regulated Asset Base (RAB), a return on the RAB, the cost of losses, a License Fee, and the cost of any public service obligations and other expenses incurred and not otherwise recovered.

In accordance with the Pricing Rule, depreciation of the RAB is calculated on a straight-line basis, using Economic Asset Lives, determined for different asset classes. The economic asset life for each class of asset is considered to represent the technical life of the asset (ie, the period before wear and tear requires its replacement) unless there is good reason to consider the asset will become redundant before this date. An example of where economic and technical lives differ would be a substation dedicated to one customer, where that customer intends to cease operations in five years. In this case. the economic life would be five years (the remaining period over which the customer will use the dedicated substation) even if it would still remain technically functional.

3 MYT1 Decision

Prior to MYT1 ERO did not issue a specific decision regarding asset lives. Instead, those lives previously applied continued to be used. Three different lives were used depending on the type of assets concerned:

- Transmission: 40 years, 10 years and 5 years.
- Distribution: 35 years, 20 years and 5 years.

These lives were based on an assessment of reasonable technical lives for each asset type, given that these form part of a common system and are not user-specific.

4 Options for MYT2

Ahead of MYT2, the relevant licensees for the transmission system (KOSTT) and distribution system (KEDS) have proposed a more detailed breakdown of assets for the purposes of calculating regulatory depreciation and accompanying assumed lives. In each case, these lives are based on expected technical lives as before.

The proposed asset categories and lives are shown below.

Table 1: Transmission asset categories and lives proposed for KOSTT

	Assets	Asset life (years)
I	Buildings, roads, sewerage networks, water supply, wells, lifts	50
II	HV network	40
III	Low voltage network, substations, transformers, bars, etc.	30
IV	Trucks, cherry pickers and working machinery	10
V	Control and Telecommunication, various equipment, fire protection,	8
VI	Furniture, office equipment	7
VII	IT equipment, software, patents, licenses , cars etc.	5

Table 2: Distribution asset categories and lives proposed for KEDS

	Assets	Asset life (years)
I	Administration buildings	50
II	MV and LV networks, substations, power transformers, and equipment	30
III	Transformer stations, distribution transformers, and equipment	15
IV	Metering devices and equipment, trucks, cherry pickers and working machinery	10
V	Furniture, office equipment	7
VI	Working equipment, metering equipment and devices, cars, computers, IT equipment and software	5

ERO's proposals for categorization and asset lives are based on international standards and regulatory practices as well as proposals of the licensees. ERO considers that distinguishing investment plans, capital expenditures and the regulatory asset base in this way will provide additional information to stakeholders that can be used to assess the reasonableness of the licensees' proposals.

Therefore, through public consultation, ERO is looking forwards to contribution by parties regarding the following issues:

- Are the proposed asset lives for each category reasonable and acceptable?
- Should regulatory depreciation for existing assets be calculated using the new categories and lives or continue to be calculated as before?

5 Proposed Approach for MYT2

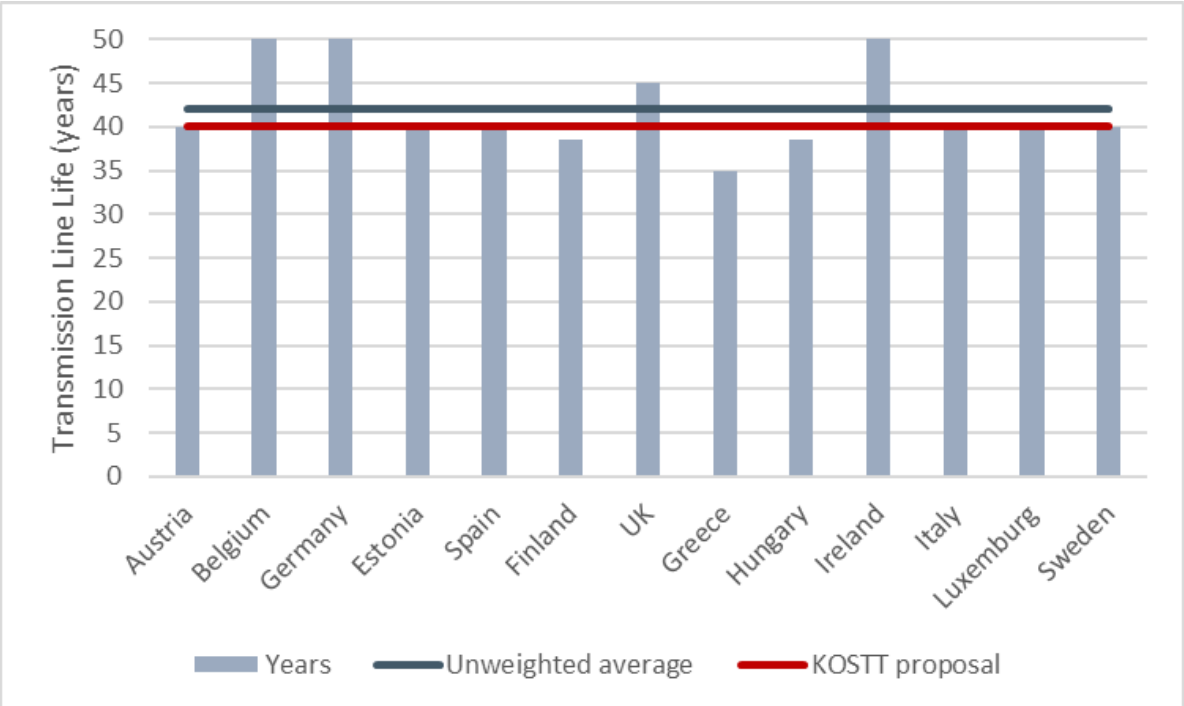
5.1 Reasonableness of asset lives

There is little reliable comparative information on the asset lives applied by regional regulators for the purposes of calculating regulatory depreciation. The main source that ERO has been able to identify is a 2016 review by the Council of European Energy Regulators (CEER)[1]. This provides limited data on the lives used for transmission and distribution assets by EU regulators.

ERO has performed a check for reasonableness of the proposed asset lives for cables and lines against those applied by EU regulators (using either specific lives or the average lives for all network assets where the CEER review does not distinguish between asset types). The comparison for transmission and distribution is shown below. In both cases, the proposed lives from KOSTT and KEDS lie below the EU average but within the range applied by EU regulators.

ERO's proposal is based on the premise that the proposed lives are reasonable when compared to those used by other regulators.

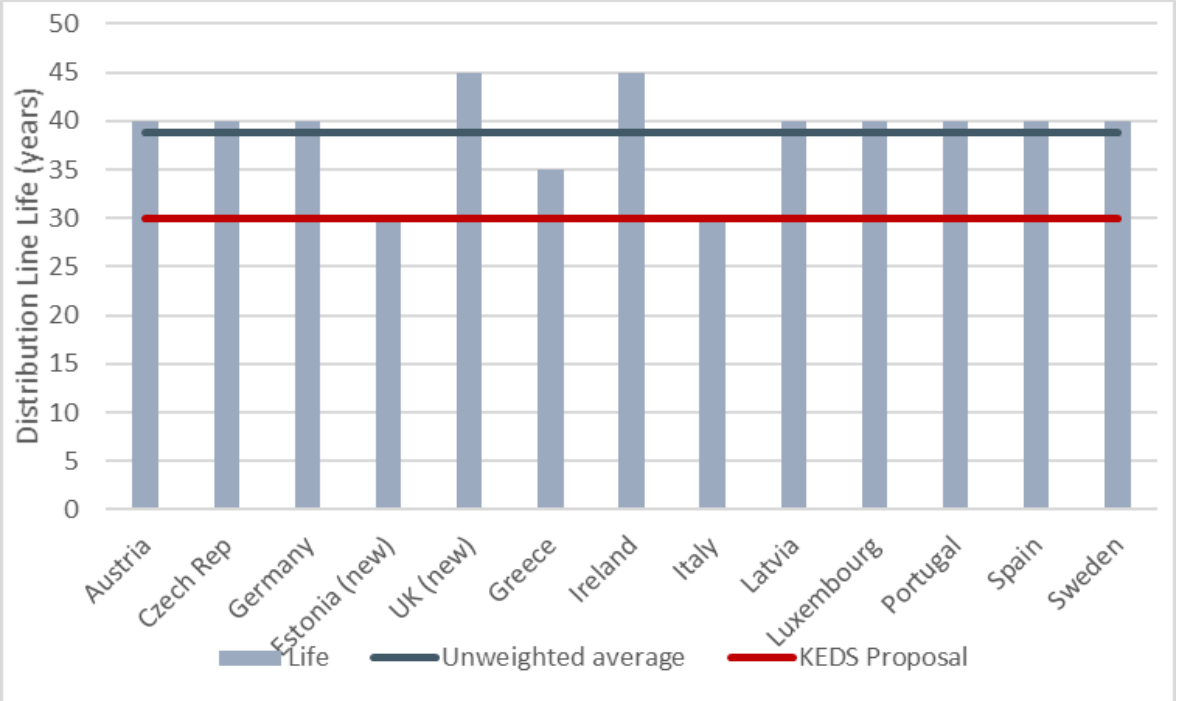
Figure 1: EU energy regulators decisions on transmission cables / lines asset lives



Source: *Investment Conditions in European Countries* (Ref: C15-IRB-28-03), March 2016, CEER, analysed by ERO.

[1] *Investment Conditions in European Countries* (Ref: C15-IRB-28-03), March 2016, CEER

Figure 2: EU energy regulators decisions on distribution cables / lines asset lives



Source: Ibid

5.2 Application to existing assets

Applying the same asset lives to existing assets (pre-MYT2) as used for new assets for the purposes of calculating regulatory depreciation has the advantage of consistency. It avoids the need to have two separate RAB calculations, one for existing and one for new assets. It also means that the expected timing of replacement of existing and new assets is the same.

The reasons for non-separation of Regulatory Asset Base are as follows:

- Licensees would need to separate their existing regulated asset base into the various new individual asset categories and recalculate depreciation for each based on the revised lives. This would be a significant amount of work and one that it may not be possible to complete ahead of MYT2 commencing.
- The new asset lives are generally shorter than those applied to existing assets under MYT1, therefore, such a change would result in an increase in allowed revenues. While ERO accepts that revenues should reflect efficient costs, it does not consider that such a change is justified given the inherent uncertainties over what is the 'true' life of existing network assets.

Therefore, ERO proposes to retain the MYT1 asset lives for existing assets, defined as those commissioned prior to the start of MYT2 (before 1 April 2018). Consequently, the calculations for depreciation and allowed return for MYT1 shall be adjusted based on the assets commissioned in MYT1, whereas return and depreciation costs for MYT2 shall be calculated in accordance with the new proposed categories for asset lives.

It should be noted that distinguishing between assets in this way is not unique to Kosovo. To take one example, in Great Britain the energy regulator, Ofgem, applies separate lives to pre- and post-privatisation assets. The former are depreciated over a period intended to ensure sufficient cash flows for their owners to fund replacements while the latter are depreciated over their economic lives.