



KOMPANIA KOSOVARE PER DISTRIBUCION DHE FURNIZIME ENERGJE ELEKTRIKE  
KOSOVO ELECTRICITY DISTRIBUTION AND SUPPLY COMPANY J.S.C  
KOSOVISKO PREDUZECE ZA DISTRIBUCIJU I SNABEIVANJE ELEKTRIKOM ENERGIJOM D.O.O.  
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**Arsim Janova**  
ac. Chairman of ERO Board

**Ermal Koçi**  
Budget Director, KEDS

08 March 2019

**SUBJECT: DSO Comments to ERO Consultative Paper on Maximum Allowed Revenues for the Relevant Tariff Year 2019**

Dear Mr. Janova,

This report summarizes DSO's response to the ERO's Consultation Paper (CP) on Maximum Allowed Revenues for the Relevant Tariff Year 2019, issued on 22 February 2019.

DSO appreciates the opportunity to provide its input on important issues raised by ERO in the Consultation Paper and requires from ERO to consider its stance on issues raised in this report prior to any final decision on MAR for the relevant tariff year 2019.

DSO is available to meet with ERO at any time to discuss the issues raised in ERO's CP and counter-arguments provided in this report.

Sincerely,

**Ermal Koçi**  
Budget Director



## **KEDS Comments to ERO Consultative Paper on Maximum Allowed Revenues for the year 2019**

### **I. Introduction**

This report summarizes KEDS's response to the ERO's Consultation Paper (CP) for the Maximum Allowed Revenues for KEDS (April 2019 – March 2020) issued on 22 February 2019.

KEDS licensed as Distribution System Operator appreciates the opportunity to provide its input on important issues raised by ERO in the Consultation Paper and requires from ERO to seriously consider its stance on issues raised in this report prior to any final decision on MAR for the year 2019. DSO will provide its arguments on all issues for which it doesn't agree with ERO stance, together will supportive tables and proposals for adjustments. Electronic versions of all tables will be provided as well, so ERO can utilize them in its work.

KEDS is available to meet with ERO at any time to discuss the issues raised in ERO's CP and counter-arguments provided in this report.

### **II. Energy Balance**

We noticed that ERO has used the same methodology applied in the previous year for calculating expected Energy Entering into Distribution (EED), which is not in not in line with the methodology used in the approved Energy Balance for the year 2019. Respectively, ERO for tariff purposes doesn't consider the level of excess losses when calculating EED.

We agree that ERO for tariff purposes will and should use the approved allowed level of losses when calculating the allowed cost of losses, however to avoid huge adjustments of losses for volumes (as occurred in the year 2017 and 2018) which will be returned with the interest rate in the next year, it would be more rightful that for purposes of calculating EED to apply the correct calculation of the EED, as applied in the energy balance. Moreover, ERO should take into consideration also the fact that trend of sales shows a 4-5% annual increase in sales, which is reflecting also in an increased EED. We agree that due to decrease level of losses, increase of EED should not be in line with the increased trend of sales, but at least should be close to the one achieved in the end of the year 2018 (5,120 GWh).

DSO has noticed also that sales used from ERO in the CP have changed from its original application, as well as allocation of sales in different voltage levels used for DSO and USS purposes differ. Since customers connected to 35 kV level that fulfill criteria defined in Law on Energy will be deregulated from April 2019



the only difference between DSO and USS sales should be the 35 kV customers. In this view, DSO has allocated properly the revised sales used by ERO in its proposal for the year 2019.

Considering the above mentioned, we suggest ERO to use the real expected value of sales and losses when calculating EED for the relevant year 2019, as presented in the table below:

Energy Balance in the distribution level	Unit	Proposal 2019	KEDS Comments 2019
Expected Sales	GWh	3840	3772
Unbilled energy for North	GWh	259	259
Losses for North Kosovo	%	5.13%	5.0%
Allowed Losses	%	18.80%	18.8%
Allowed Losses	GWh	949	965
Total Losses without North Kosovo	%	18.80%	21.47%
Total Losses without North Kosovo	%	949	1,102
<b>Expected EED</b>	<b>GWh</b>	<b>5,048</b>	<b>5,133</b>

### III. Cost of losses in DSO

DSO in principle agrees with the way of calculating the cost of losses by ERO, however due to the remarks done in the Energy Balance, the correct application of the expected EED and losses shall be applied.

ERO in its paper argued that for calculating the cost of losses has used a compound price, which considers an increased price of KEK for inflation and import price composed from actual incurred priced and the ones available in exchange markets.

DSO wants to emphasize that the actual import price achieved in 2018 was 68.9 €/MWh, which influenced the average price for purchasing losses to be 47.4 €/MWh compared to 44 €/MWh allowed in 2018, a difference of 3 million € that was financed by DSO during the year 2018 (only for price difference). Moreover when considering expected prices the calculation that DSO did in its application was based on available and predicted prices for 2019 on hourly basis, considering also border and service fees which should be paid.

A recalculation of import price on 4<sup>th</sup> of March shows an average price of 72.58 €/MWh. In this view DSO suggest ERO to apply the actual price incurred in the year 2018 to the volumes predicted to be purchased from imports on hourly basis.

In this view, from the calculation done by DSO, the expected costs of losses for the year 2019 shall be € 43.32 million, as shown in the table below:



Description	Unit	ETR11 Proposed	KEDS Comments
Interest Rate	%	7.49%	7.49%
LSSAt	%	18.8%	18.8%
REUEt	GWh	5,048.32	5,133.31
WHEAt	€/MWh	42.97	44.88
LSSCt	€m	40.78	43.32

It is important to emphasize that since the negotiation for the prices are not yet finalized between DSO and possible contracting parties, the price of losses might be different from the one considered from ERO, hence any changes should be subject to correction in the next process of the tariff review.

#### IV. Operational Costs - OPEX

Despite our continues comments that ERO should reflect the proper costs included in OPEX, ERO continues to apply the costs predicted in the year 2011 as well as applies the efficiency factor of 1.5%. Below we will provide our arguments and justifications for ERO's consideration and therefore setting properly the Operational Costs

##### *IV.i Increased cost of services*

With the increased number of customers every year also the costs for providing services to these customers have increased throughout these year, which unfortunately is not being taken into consideration. As we have shown in our application, even if we apply an efficiency factor the costs of service per number of customer still shows an increase, a fact which we request to consider it.

Considering the new parameters set and financial problems that DSO is facing since last year, application of efficiency factor will have a direct impact at employees, especially considering that efficiency factor is applied in salary lines and maintenance. It should be re-emphasized that in order to save costs majority of maintenance work is performed through internal employees (which are included in salary lines), thus application of the efficiency factor in maintenance line will automatically effect maintenance work, as currently the allowed costs cover only cost of price and materials. Since DSO has no control on outside prices, which have increased over the last year we request from ERO to consider this fact when determining the OPEX for the year 2019.



Similarly, the fuel costs are expected to increase again in 2019, as in the last two year the trend is constantly increasing. The table below shows that costs of fuel for 1 km increased 7% on average in the last two years, without considering the contracted price for 2019.

Year	Total Distance of Vehicles	Total Fuel Usage	Per 100 km Fuel Usage	Cost of Fuel Usage	Per Km Fuel Cost	Change in %
<b>2017</b>	9,624,090 km	968,805 Lt	10.07 Lt	€ 831,652	€ 0.09	3%
<b>2018</b>	9,727,650 km	974,915 Lt	10.02 Lt	€ 939,403	€ 0.10	12%

It should be noted also that with the approval of new parameters for the second regulatory period in the late 2018, DSO was is not able to finance its investments as initially requested, focusing only in emergent cases. In this view also the purchase of new vehicles has been postponed, thus influencing further the maintenance cost for the vehicles, especially heavy machineries. It should be noted that also the price of service has increased significantly in the last two years, thus resulting with the increase total cost of regular and irregular services. Table below summarized the increased costs of both regular and irregular services in the last two year, and unfortunately the trend of increasing costs is expected to continue further in 2019.

Year	Cost Of Regular & Irregular Services	Change in %
<b>2017</b>	€ 422,856	10%
<b>2018</b>	€ 474,660	12%

From draft financial statements provided to ERO as well, it can be clearly seen that daily operational expenses of the DSO in 2018 are higher than the ones in 2017 for 6%, for the reasons justified above. Therefore, any further decrease in OPEX with the application of the efficiency factor is threatening the financial position of DSO even further, in the time when DSO is facing financial difficulties due to not proper set of parameters.

#### *IV.ii Salaries*

During the second period review, ERO approved the level of salaries in the same level as approved for the year 2017 with a small increase reflecting changes in the energy sector and governmental requirements, however still the gap between employees working in the public sector (KEK, KOSTT) and the ones working at the distribution operator (KEDS) are high, therefore there is no reflection of the actual costs. Moreover, ERO applies the efficiency factor also in the salary lines, thus directly effecting employees.

Increased volume of work, modernization of technology and overall changes in the organization of the staff is reflecting with the increased number of engineers, respectively higher cost per employee



(salaries), and no matter that the number of physical workers is decreasing, this is not proportional neither in the number of employees, nor in costs.

Higher salaries in the public sector expose DSO in continues threat to lose its professional employees, hence influencing also the workflow and quality of work.

Taking into consideration the abovementioned, this request should be treated also separately and with the involvement of all interested parties.

#### *IV.iii Final remarks*

Considering the above mentioned justification, DSO requests from the regulator to apply a 3% increase from the approved OPEX in 2018, and respectively not apply the efficiency factor.

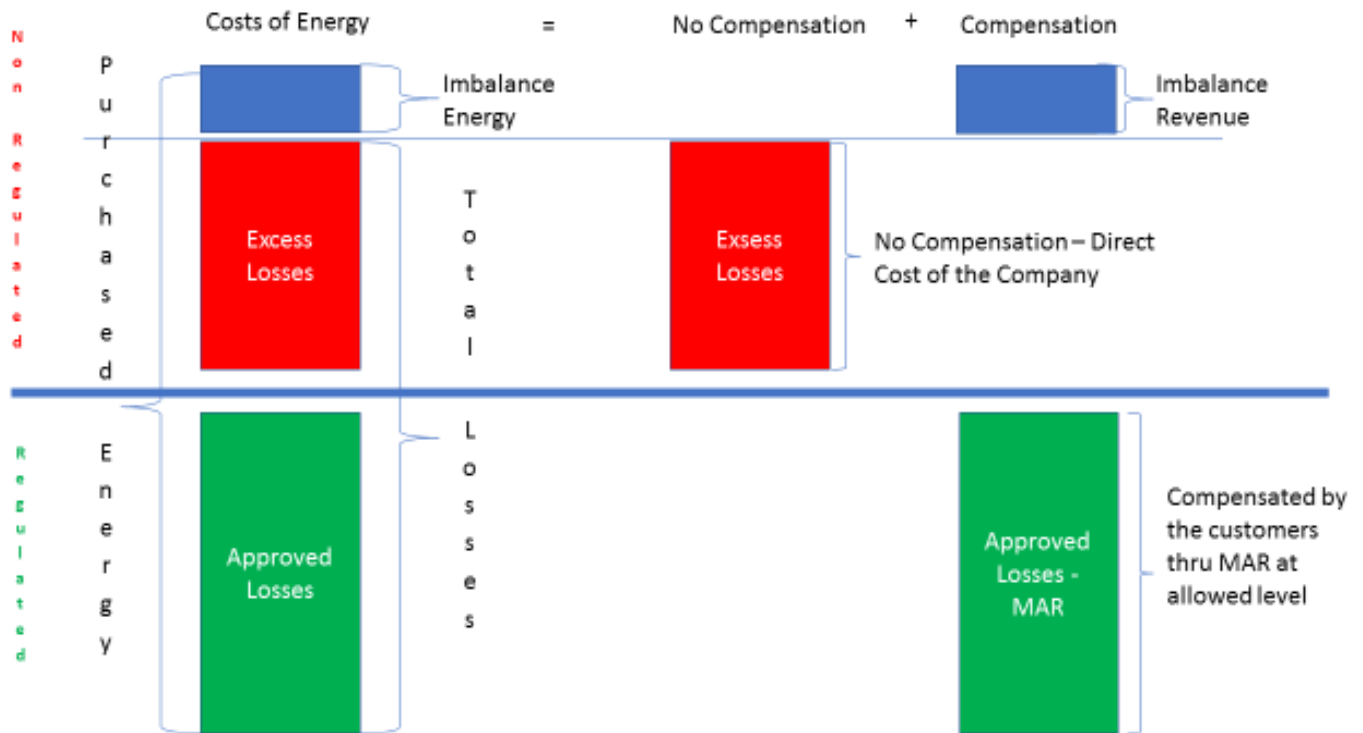
This would enable DSO to recover the financial losses and continue its sustainable operations.

#### **V. Other components**

From March 2017, DSO as part of the balancing system is responsible for any deviation on forecasted losses, which costs were not forecasted by ERO.

It should be considered that the losses mainly occur at any time when the sales occur, also the planning of distribution consumption is done together for customers' consumption and energy for the respective losses, and for the energy procured on hourly basis. All of these factors are taken into account when planning the distribution consumption in hourly basis. Unfortunately, since there's no proper forecast of load, application of coefficient when predicting losses will generally result with incorrect forecast of losses.

Costs of these revenues are not recognized by the regulator, and a part of these revenues is also due to excess losses, thus considering all revenues but not recognizing in full the costs represents a non-fair treatments, as shown in the figure below:



It should be also emphasized that imbalances represent an amount of energy put in the system, which has a costs (part of it not recognized and accepted in tariffs), while nobody in the local market consumed it, respectively customers didn't have a cost of purchased energy which was transferred to them therefore it should be returned to them. Furthermore, treating imbalances as unregulated revenues shows that ERO is willing to take only positive balances, but if such imbalances are negative no recognition will be considered.

The argument provided by the Regulator that these revenues are non-tariff revenues doesn't stand as based on the methodology used for the Universal Service Supplies, the calculation of MAR includes both non-tariff revenues, while treating separately the imbalances in the calculation of wholesale costs. In this view, **there's no legal ground for taking away revenues from imbalances**, especially because based on the Pricing principle no revenues shall be considered if no costs are allowed and charged to the end customers/portion of revenues for the cost of losses are regulated only to the allowed level of losses. Imbalance represents only costs for trading activities and are not part of the DSO, as such no costs were allowed and therefore no revenues shall be taken away.

Energy for which DSO received compensation for imbalance services is a cost that is not regulated, not transferred to the end-customers, and the compensation in the form of an imbalance is not derived from the Regulatory Asset Base.



### V.i. Imbalance treatment for 2017

The year 2017 represented the first year of the treatment of imbalances, and since there was no formula in the DSO Pricing Rule, when such costs were requested to be presented DSO put them in the calculation of energy costs, similar to the application done in the USS.

This treatment has decreased the average price of losses from 46 €/MWh to 44 €/MWh, for the fact that imbalances were positive, thus included as decrease in the final calculation of the costs, as shown in the table below:

Description	Used by Regulator		With no imbalance included	
	MWh	Euro	MWh	Euro
Purchases from KEK	381,665	13,510,927	381,665	13,510,927
Purchases from Import	315,260	18,532,083	315,260	18,532,083
Imbalances		- 1,424,265		
Total	696,925	30,618,746	696,925	32,043,011
Average Price		<b>43.93</b>		<b>45.98</b>

Besides using the decreased average price for the imbalance values (as initially forecasted at the time of the application), ERO when calculating final MAR decreased the total revenues presented in the Financial Statements, including the revenues for imbalance sots, **thus decreasing the end MAR of the DSO twice for the same revenues.**

Revenues considered from ERO are presented in the table below:

Description	Amount
Power Permission	1924
Other Services	1668
Other Income	924
Rent	100
Imbalance	1519
Interest Rate	14.87%
Total with interest rate	7,047

Without presuming and arguing once again if such imbalances should be treated as revenues, in 2018 ERO has decreased twice the revenues from imbalances: once in the calculation of the average price of losses and second time in the unregulated revenues, thus, in this application DSO requires a correction to be applied.





Considering the approach used by ERO in their proposal we apply this correction in the losses price. In this view the adjustments for cost of losses allowed for the year 2018 should have been 39.44 million € instead of 37.78 million €, as showed in the table below:

Description	2017 Proposed	Adjustments Applied	Correct Application
It	14.87%	14.87%	14.87%
LSSAt	18.13%	18.13%	18.13%
REUEt	3,962.1	4,731.3	4,731.3
WHEAt	35.43	44.04	45.98
LSSCat-1		37.78	39.44
LSSCft-1	25.5		
LSSCt	29.72		
		9.26	11.17
<b>Correction</b>			<b>1.91</b>

For clarification purposes, these calculations include period April-December, as applied by the ERO during the MAR determination process in 2018, because for the first three months (Jan-March) purchases for covering the need of the system (TSO and DSO losses) were being purchased by the Public Service Supplier therefore are included in the USS MAR. In this view in this application, DSO applies the correction of 1.91 million € with an interest rate.

Nevertheless, taking into consideration the arguments provided in the section above and that ERO doesn't have legal basis to take away these revenues, also the difference of 1.5 million€ taken from the unregulated revenues should be given back with an interest rate.

Both of these adjustments are considered in this report, when calculating final MAR.

### *V.ii. Unregulated Revenues*

ERO similar to last year application has decreased in total the unregulated revenues as presented in the financial statements. As argued previously, in the Financial Reports are presented revenues used for accounting purposes, however not all of these revenues represent cash items. It should be emphasized that the line 'Impairment lines' presented in the Financial Report as revenues for accounting purposes, shall not be considered by the regulator as unregulated revenue, as this line doesn't represent actual revenues, respectively no bills were issued or money circulated. DSO has presented these values in details in the excel format.

Moreover as argued above, DSO in its final calculations has also removed the revenues from imbalances from the unregulated revenues presented in the financial statements.



### V.iii. KREV Adjustments

Generally we agree with ERO methodology of calculating KREV, however due to above-mentioned corrections, a final adjustments of KREV should be reflected.

## VI. Maximum Allowed Revenues for DSO

The table below represent final MAR for DSO for the year 2019, after taking into consideration all necessary adjustments as explained in the sections above.

DSO MAR		ERO proposal	KEDS Comments
It	%	7.49%	7.49%
<b>Operating and Maintenance Costs (OPMCt)</b>			
$OPMC_t = OPMC_{t-1} * (1 + CPI_{t-1}) * (1 - E_t) * (1 - P_t)$	€m	26.30	27.42
<b>Allowed Depreciation (DEPct)</b>			
$DEPct = DEPct_{t-1} * (1 + CPI_{t-1}) * (1 - P_t)$	€m	14.65	14.65
<b>Allowed Return (RTNct)</b>			
$RTNct = RTNct_{t-1} * (1 + CPI_{t-1}) * (1 - P_t)$	€m	13.59	13.59
<b>OS and OM Obligation to KOSTT</b>			
		1.13	1.13
<b>Allowed Losses (LSSct)</b>			
LSSAt	%	18.80%	18.80%
REUet	GWh	5,048.32	5,133.31
WHEAt	€/MWh	42.97	44.88
LSACT-1			
LSSct		40.78	43.32
<b>Adjustments</b>			
Unregulated Revenues	€m	-3.50	-3.50
Adjustments (2017 & PR1)		-1.50	-1.50
<b>KREV</b>			
KREV	€m	4.98	13.26
<b>MAR</b>			
$MAR_t = OPMC_t + DEPct + RTNct + LSSct + LICct + KREV_t$	€m	96.44	108.37

DSO believes that the MAR of 108.37 million € represents the real costs of the distribution network, and is available to meet with ERO at any time to discuss in further details the issues raised in this report.