

Consultation Paper

Annual Adjustments for Maximum Allowed Revenues for KOSTT

(April 2019 - March 2020)

DISCLAIMER

This Consultation Paper has been prepared by ERO for the purpose of informing stakeholders. It 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 currently carrying out the Regular Annual Adjustment for Maximum Allowed Revenues (MAR) to be recovered by the Regulated Companies. In this process, ERO will issue preliminary proposals for the updated MAR for the Transmission System Operator and Market Operator (TSO/MO, KOSTT), Distribution System Operator (DSO, KEDS) and the Universal Service Supplier (USS). This preliminary evaluation is based in the proposals submitted by the regulated companies as well as decisions on Maximum Allowed Revenues for the regulatory period 2018-2022.

The Price Regulation is a tool used by ERO in order to set the Maximum Allowed Revenues- MAR, which the Regulated Companies shall collect for provision of regulated services. MAR is set at the level that enables the regulated licensee to cover the justifiable operational and maintenance costs of their assets and realize a reasonable return of their investments. Also, ERO sets the efficiency targets, which aim the increase of the operational efficiency of companies and provide incentives for fulfilling the targets, or penalties in case the companies fail to fulfill them.

The basic values for MAR components are set at the Periodic Review, carried out in 2018 and remain valid for a five-year period. The current review is related to the evaluations for MAR, presented by the Regulated Companies and their adjustment with basic values for relevant tariff year 2019. Such review evaluates whether the proposals of the licensees are calculated in line with legal requirements.

ERO invites the licensed companies, customers and other stakeholders to provide their contribution in this process by reviewing and commenting on the data and views presented in this Consultation Paper, in order to have an accurate evaluation of Maximum Allowed Revenues for Transmission System Operator and Market Operator (TSO/MO).

The parties who want to present their eventual comments on ERO's proposals are invited to submit their written comments via electronic mail at ero.pricing-tariffs@ero-ks.org, by 8 March 2019 at the latest. The comments can also be submitted via post at:

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Relevant Documents

Final Evaluation of TSO/MO MAR, within the Periodic Review Process-Detailed Evaluation	http://ero-ks.org/2018/Raportet/Pergjigje%20ndaj%20komenteve%20te%20KOSTT_PRR2_final.pdf
Tariff Application of KOSTT for 2019	http://www.ero-ks.org/2019/Tarifat/Aplikacioni_KOSTT.pdf

2 Adjustments of Maximum Allowed Revenues

Based on Rule on TSO/MO Revenues, ERO has carefully analyzed all cost components and requirements of the licensee, submitted in its application for Maximum Allowed Revenues. During the Regular Adjustment Process, ERO used the results taken during the Periodic Review Process 2018-2022 and adjusts the MAR to reflect the difference between the costs that have been forecast during the Periodic Review and actual justifiable costs, incurred by Regulated Companies, due to reasons out of their control. During this process, ERO will:

1. Index the Operational and Maintenance Costs for the Efficiency Factor, which is set during the Periodic Review Process and the Annual Inflation, which is set by using the Harmonized Index of Consumer Prices (HICP) for the countries of the Eurozone;
2. Set the Allowed Costs of Losses (LSSCt) for the TSO, and update them so that they include the difference between the allowed and realized costs of losses for the previous Regulatory Period, which may have occurred due to changes in the wholesale power purchase costs or changes in electricity flows in transmission system;
3. Update TSO/MO MAR in order to reflect the difference between the Allowed and Actual Revenues in the relevant previous year (t-1),
4. Adjust the forecast of allowed costs for ancillary services;
5. Set the TSO/MO MAR for Relevant Year t

3 Energy Balance

ERO has used the balance updated by KEDS to take into account the updated consumption and evaluation for deregulation of customers connected to the voltage level 35kV. The implementation of legal changes within the framework of the market liberalization has an essential impact in handling the losses in electricity system. The updated Balance will be used to calculate the wholesale power purchases for covering the transmission and distribution losses and the retail tariff for Universal Service.

3.1 Evaluation of Actual and Forecast Electricity Balance

With the purpose of evaluating the costs related to purchase of losses at TSO level, ERO has analyzed the data reported by KOSTT in 2018 and the data for forecast of the Balance for 2019. In the forecast of the Balance of 2019, ERO has taken into account the approved Balance, by updating for the expectations

related to electricity generation from entry into operation of renewable energy sources generators and the adjusted forecast of KEDS related to electricity consumption at DSO level.

The forecast of electricity balance for 2019 is presented in the following table:

Table 1: Electricity Balance at TSO

Electricity Balance at TSO	Unit	2019 Proposal
Entry at TSO	GWh	6,479
Unbilled Energy in the North	GWh	259
Export	GWh	663
Import	GWh	849
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Losses at TSO	GWh	115
	%	1.78%
<hr/>		
Exit of energy from Transmission/ Entry to DSO	GWh	5,048

The demand for energy at TSO level in 2019 is expected to have an increase of around 4.4% compared to 2018. Such an increase comes due to the increase of the demand at DSO level.

The import of energy includes the energy required for covering the consumption of costumers connected at the TSO level as well as the energy required for covering the losses at TSO and DSO network as well as the supply of Universal Service customers. The difference is calculated as an export with the purpose of reconciliation of the balance.

4 Regular Adjustments

This part presents the calculations related to regular annual adjustments for 2018. The calculation of these adjustments will be included during the determination of Maximum Allowed Revenues for relevant tariff year 2019.

4.1 Adjustments for Inflation Rate

In order to carry out the calculation of adjustments related to the inflation rate, as a reference was taken the inflation rate published by Eurostat for Eurozone countries, which for 2018 was 1.73%¹. The manner for calculation of such adjustments is set in the Rule on TSO/MO Revenues.

This rate is applied in adjustment of operational costs, depreciation costs and return on capital. Following the application of the inflation rate of 1.73% towards the above-mentioned cost components, the value of adjusted costs in an amount of 0.44 million euros is derived. The adjustments that have resulted from the application of inflation rate for each of the components of allowed costs in 2018, have been added to the preliminary evaluation of the costs for 2019, set during the Periodic Review. The details on these calculations are presented in the following table:

Table 2: Adjustments for Inflation

Line	Unit	a) Allowed 2018	b) Adjustment for HICP	c) Preliminary Evaluation 2019 ²	d=b+c Allowance 2019
OPEX	mil €	7.42	0.13	7.30	7.42
Depreciation	mil €	9.53	0.16	10.31	10.48
Return	mil €	8.52	0.15	9.36	9.51
Total	mil €	25.48	0.44	26.97	27.41

¹https://www.ecb.europa.eu/stats/ecb_statistics/escb/html/table.en.html?id=JDF_ICP_COICOP_ANR&period=2017-12

² According to allowances of Periodic Review 2018-2022 link:
http://ero-ks.org/2018/Raportet/Pergjigje%20ndaj%20komenteve%20te%20KOSTT_PRR2_final.pdf

4.2 Capital Investments

KOSTT, in the submitted documentation, required additional projects along with the ones allowed during the multi-year review process. The documentation submitted by KOSTT contains a general description on the necessity for realization of these projects. In order to assess the technical and financial reasonability of these projects and the related costs, ERO requires KOSTT to evaluate these projects in accordance with the Rule on Capital Investments Assessment, according to which economic parameters such as CBA, NPV, unit costs, alternatives, and job descriptions associated with such projects shall be analyzed.

Due to the lack of the above-mentioned parameters, at this consultation phase, ERO could not assess the reasonability of these projects, therefore they are not included in the evaluation of calculation of KOSTT Maximum Allowed Revenues. ERO expects from KOSTT, within this Consultation Process, to submit the required evidence to ERO Board for further review of these projects.

4.3 Savings Sharing Factor

In addition to the above-mentioned adjustments, ERO has also carried out the adjustments of maintenance costs, by applying the savings sharing factor. These adjustments are applied with the purpose of encouraging the savings from the company's side, where the saved part will be shared between the company and the customers, with a sharing factor of 50%. From the conducted analysis, the resulting amount of savings is 0.58 million Euros, where the adjusted value of savings, following the application of sharing factor, is 0.29 million Euros (the part for which the customers are compensated).

4.1 RES Fund

From the analysis of the application of KOSTT, it is noticed that there is a difference between the costs and revenues from RES Fund for 2018. The value of this difference is -1.54 million Euros. These revenues (as deducted) were taken into account during the calculation of actual costs AAC_{t-1} .

The forecast of costs for RES fund is being carried out based on energy balances as well as latest updates for expectations of entry in operation of RES generators. The value of costs of the fund, taking into account the referent price of 35.6 €/MWh, results in the amount of 12.45 million Euros.

4.2 Adjustments of the Costs of Losses

Adjustment of the cost of losses for TSO is carried out with the following formula:

$$(LSSCat-1 - LSSCft-1) * (1 + It)$$

The value of the adjusted cost for losses is 0.40 million Euros, which results due to higher energy flows, realized towards the forecast ones and the average higher price for purchase of losses for 2018 in transmission network. The details on the calculations are given in the following table:

Table 3 Adjustments for the Costs of Losses

DSO MAR	Unit	Allowed 2018	Actual 2018	Proposed 2019
Indexation Parameters				
I_t	%		7.49%	
Allowed Losses (LSSCt)				
LSSAt	%	1.78	1.78	1.78
REUEt	GWh	5,843.6	6,203.7	6,479
WHEAt	€/MWh	44.00	44.82	42.97
LSSCat-1	mil €		4.95	
LSSCft-1	mil €	4.58		4.96
Adjusted Costs³	mil €		0.40	

Where :

$LSSA_t$ is the Loss Allowance, which is a percentage of energy entering the Distribution System, in Relevant Year t

$REUE_t$ is the energy units (in MWh) or (GWh) entering the Distribution System in Relevant Year t

$WHEA_t$ is the average wholesale energy cost (in €/MWh) as in Relevant Year t

$LSSCa_{t-1}$ is the actual allowed cost of losses in Relevant Year $t-1$ (calculated using the Loss Allowance)

$LSSCf_{t-1}$ is the forecast cost of losses in Relevant Year $t-1$ (calculated using the Loss Allowance)

I_t is the interest rate for the Relevant Year t calculated based on EURIBOR plus 5%, 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

The forecast of the average price for losses in 2019 was carried out through the indexing of the actual generation price from KEK for the harmonized inflation rate of 1.73% and the forecast of import price, based on the actual realized prices as well as referent prices in regional stock markets.

4.3 Adjustments for non-tariff revenues

Other revenues realized from unregulated activities, such as: the revenues from lease of assets, from the compensating mechanism between TSO (ITC), net revenues from the interest, are deducted from

³ These costs are part of the general updates and are reflected in the 2019 MAR

the Maximum Allowed Revenues. The value of these revenues is reported by KOSTT in an amount of 0.52 million Euros, whereas following the request of ERO, KOSTT has submitted draft-Financial Statements, based on which ERO has corrected these revenues, which are in an amount of 1.05 million Euros.

4.4 Adjustments for Revenues Correction Factor

The correction of revenues for 2018 was carried out in line with Rule on Maximum Allowed Revenues. The Principle which is applied is related to the general evaluation of allowed actual costs and actual realized revenues. These calculations were carried out according to the following formula:

$$KREV_t = (AAC_{at-1} - ARR_{t-1}) * (1 + I_t)$$

Where:

AAC_{at-1} Actual Allowed Cost as determined in Relevant Year t-1

ARR_{t-1} is the Actual Regulated Revenues in Relevant Year t-1

I_t 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

The difference between AAC_{at-1} in an amount of € 23.61 mil and ARR_{t-1} in an amount of €14.65 mil, following the application of interest rate, results in an amount of € 9.64 mil. Such difference between actual allowed costs and revenues is passed-through as an adjustment during the determination of MAR for 2019.

5 TSO/ MO Maximum Allowed Revenues

The Maximum Allowed Revenues for TSO/MO are calculated according to the following formula:

$$MAR_t = OPMC_t + DEPC_t + RTNC_t + ASVC_t + LSSC_t + LICC_t - ITCR - NTFR_t + ADJ_t + KREV_t$$

Where:

MAR_t - Maximum Allowed Revenues in relevant year *t*

OPMC_t - Operational and Maintenance Costs in relevant year *t*

DEPC_t - Allowed Depreciation in relevant year *t*

RTNC_t - Return of capital cost, allowed in relevant year *t*

ASVC_t - Allowed Costs of Ancillary Services, in relevant year *t*

LSSC_t - Allowed cost of losses in relevant year *t*

LICC_t - Cost of License Tax in relevant year *t*

ITCR_t - TSO/MO Net Revenues from the Inter/TSO Compensation Mechanism in relevant year *t*

NTFR_t - Non-tariff revenues in relevant year *t*

ADJ_t - Adjustments of costs

KREV_t - Revenues Correction Factor in relevant year *t*

The calculation of each of these components is elaborated below.

Table 1 - Proposal of TSO/MO MAR

Proposal of TSO/MO MAR		2018 Allowed	2018 Actual	2019 Evaluated (PRR2)	2019 Proposed
Indexation parameters					
Efficiency Factor	%			1.5%	
HICP	%		1.73%		
Euribor	%		-0.11%		
S-factor	%		7.6%		
It	%		7.49%		
Operational and Maintenance Costs (OPMCt)					
$OPMC_t = OPMC_{t-1} * (1 + CPI_{t-1}) * (1 - E_t) * (1 - P_t)$	€m	7.42	7.42	7.30	7.42
License cost					
Adjustment of maintenance costs			-0.29		
Allowed Depreciation (DEPCt)					

$DEPC_t = DEPC_{t-1} * (1 + CPI_{t-1}) * (1 - P_t)$	€m	9.53	9.53	10.31	10.48
Allowed Return (RTNCt)					
$RTNC_t = RTNC_{t-1} * (1 + CPI_{t-1}) * (1 - P_t)$	€m	8.52	8.52	9.36	9.51
Allowed Losses (LSSCt)					
LSSAt	%	1.78	1.78	1.78	1.78
REUEt	GWh	5,843.6	6,203.7	5,833.9	6,478.9
WHEAt	€/MWh	44.00	44.82	40.00	42.97
LSSCat-1			4.95		
LSSCft-1	€m	4.58		4.15	4.96
LSACT-1					
LSSCt					
Costs of RES Fund					
Costs		2.87	-1.54		12.45
Ancillary Services					
ASVCt		2.59	-	2.66	2.66
Non-tariff Revenues					
Unregulated revenues	€m	-0.06	-0.41	-0.06	-0.06
Revenues from ITC		-0.40	-0.64	-0.40	-0.40
Adjustments of PRR1 and 2017					
Adjustments	€m	-1.26	-1.26	-1.26	-1.26
Revenues remained from KEK		-3.33	-2.67	-3.33	-3.33
DSO MAR					
Preliminary MAR	€m	30.47	23.61	28.75	
KREV					
AAC _{t-1}	€m		23.61		
ARR _{t-1}			17.32		
$KREV_t = (AAC_{t-1} - ARR_{t-1}) * (1 + It)$			9.64		
KREV _{t-1}					9.64
Final MAR					52.08

As a result of calculations of each cost component, the proposed MAR for TSO/MO for 2019 is €52.08 million.