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

Consultation Paper

Ninth Electricity Tariff Review

ETR9 (2015-2016)

Calculation of the Maximum Allowed Revenues For Public Electricity Supplier (PES)

DISCLAIMER

This Consultation Paper has been prepared by ERO for the purpose of receiving potential comments from stakeholders. It does not represent a decision by the ERO and should not be interpreted as such.

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Abstract

Energy Regulatory Office (ERO) is currently conducting the Regular Adjustment and Annual Update process of the Maximum Allowed Revenue (MAR) of the Regulated Companies in the Electricity Sector on behalf of the Ninth Electricity Tariff Review (ETR9). Under this process, ERO will update the MAR of the Public Electricity Supplier (PES) and will adjust the MAR of the Regulated Generator (KEK), Transmission, System and Market Operator (KOSTT), Distribution System Operator (DSO) based on the figures set on the Periodic Review conducted under ETR7. This Consultation Paper presents ERO's assessment of the Maximum Allowed Revenues (MAR) of the Public Electricity Supplier. Alongside this report, ERO will publish their assessment of the Wholesale Power Costs (WHPC) and the MAR's of KOSTT, DSO and PES.

Stakeholder comments

ERO strongly believes that public consultation is at the heart of effective regulatory policy. ERO hereby presents the Regulated Companies and Consumers with the opportunity to examine the evidence and views presented in this Consultation Paper, with which they may disagree, and to comment on them by correcting a factual error, putting forward counterarguments or providing new data which ERO may not have already considered. Parties who wish to express their opinions on ERO's position are invited to submit their comments in writing to ero.pricing-tariffs@ero-ks.org no later than **23 March2015**. Alternatively, comments can be mailed to:

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Related Documents

ERO's final evaluation of PES MAR under ETR7	http://ero-ks.org/Tarifat/2013/Proceset%20e%20Shqyrtimit/eng/Evaluation_DSO_PES_22_March_2013.pdf
ERO's Wholesale Power Cost Consultation Paper under ETR8	http://ero-ks.org/Tarifat/2014/FPEE_Kalkulimet_e_te_Hyrave_te_Lejuara_Maksimale_Raporti_Perfundimtar_SHTE8_final.pdf
ERO's Extraordinary Review Consultation Paper	http://ero-ks.org/Tarifat/2014/Raport_vleresues_shqyrtimi_i_jashtzakonshem_10_8_2014.pdf
KEDS PES application submitted under the third Regular Adjustment process (ETR9)	
Rule on Public Electricity Supplier Pricing (PES Pricing Rule)	http://ero-ks.org/Rregullat/Rregullat_2011/English/PES_Pricing_Rule.pdf

1 Introduction

The Energy Regulatory Office is currently in the process of conducting the Ninth Electricity Tariff Review for the Public Electricity Supplier (PES) and the Regular Adjustment for the Third Relevant Year of the ETR7 Tariff Review for the Regulated Generator (KEK), Transmission, System and Market Operator (KOSTT) and the Distribution System Operator (DSO).

The Maximum Allowed Revenues of the PES are set for a one year period but the Input Values, which are used in calculating the MAR of the PES, are set during Input Values Reviews – such as the Periodic Review process under ETR7 - and are fixed for a prolonged period of time. The MAR of the PES is reset during each Annual Update to correct for differences between forecast and actual costs, under or over-recovery of MAR in the Relevant Year due to differences between forecast and actual billing and under or over-recovery of MAR due to differences between forecast and actual wholesale power costs and forecast and actual pass-through costs, subject to any sharing between the PES and Regulated Customers of imbalance costs and export revenues.

During this Annual Update process, ERO will not review the input values which were set during the last Input Values review. Instead, ERO will:

1. Calculate the Wholesale Power Purchase Costs which include the cost of purchasing power from the Regulated Generators, Imports and the Retail Margin. These are updated to reflect the difference between allowed and actual power purchase costs in the previous Regulatory Period;
2. Calculate the Allowed Retail Costs of the Public Electricity Supplier, which include the costs of operating and maintaining the PES activity, corporate costs, depreciation allowances and other reasonable costs of the PES;
3. Set the new PES MAR by including the difference between allowed and actual billing in the previous Regulatory Period;
4. Set the new Retail Tariffs;

2 Maximum Allowed Revenues of the Public Electricity Supplier (PES)

The Pricing Rules state that the PES MAR is set in a process of three different phases:

- **Phase I**: Determination of import costs. During this phase, the PES submits to the Regulator its own proposal of the import costs necessary to cover energy demand at least 80 days before the start of the forthcoming Relevant Year. At the same time, the Regulated Generator submits to the PES their application for the Regular Adjustment of the Regulated Generator MAR for the second Relevant Year.
- **Phase II**: Determination of retail costs. During this phase, the PES submits to the Regulator their proposal of the Retail Costs to be recovered within the next year. This includes allowed Operating and Maintenance costs, allowed corporate costs, allowed depreciation and any other costs which are reasonably incurred by the PES in providing retail services to Regulated Customers;
- **Phase III**: Determination of Maximum Allowed Revenues and Regulated Tariffs. During this phase, the Public Supplier submits to ERO its proposal for the MAR of PES for the forthcoming Relevant Year.

2.1 S-factor and interest rate for adjustments

According to Schedule 1 Article 2.1 of the PES Pricing Rule, the interest rate applicable to the MAR of PES in any Relevant Year is calculated based on EURIBOR plus S% where S is a value determined by the Regulator at Annual Updates which reflects the premium payable by the licensee for short term loans. This is different from the principle applied in the other Pricing Rules[1] where the S value is set during Periodic Reviews and is kept constant throughout the Regulatory Period.

ERO has reset the S value for adjustments of the Public Electricity Supplier as follows:

The Kosovo Lending Rate has been obtained from the Kosovo Central Bank's Monthly Statistics Bulletin Table 14.2 (ODC Effective Interest Rates – loan interest rates)[2]. The value obtained is the investment business loan rate for loans up to 1 year. This value for January 2014 is 13.08%.

The final interest rate for adjustments is the value for December 2014 (10.8%) less the EURIBOR for December 2014 (0.330%[3] – 1-year EURIBOR for December 2014) + 0.252% (the current EURIBOR rate[4]) = 10.72%.

2.2 The applicable Rate of Inflation

As required by the Pricing Rules, ERO used the Harmonized Index of Consumer Prices (HICP) for all items in the Eurozone to calculate the annual applicable inflation rate for PES. The resulting inflation rate is 0.43%. according to Eurostat.

2.3 PES Adjustments

2.3.1 Adjustments for uncontrolled costs (Insurance)

KEDS have requested an allowance of €0.16 million to recover the costs of insuring their employees with a monthly cost of €13.92 per employee. KEDS claims that the contract was signed before the takeover of KEDS by the private investor (Kosovo Calik – Limak Energy).

ERO has adjusted PES MAR to include the insurance costs.

2.3.2 License fee

KEDS have requested an adjustment to compensate for the difference in license fees payable for the volume of imports purchased under ETR8 (the forecast allowed cost by ERO under ETR8 was €01 million whereas the actual costs incurred by KEDS were €0.094 million. The difference has been compensated with interest).

[1] http://bqk-kos.org/repository/docs/2015/BQK-BMS%20nr%20160.pdf

[2] http://bqk-kos.org/repository/docs/2015/BQK-BMS%20nr%20160.pdf

[3] http://www.euribor-rates.eu/euribor-rate-12-months.asp

[4] Euribor rate for 19 February 2015 (http://www.euribor-rates.eu/euribor-rate-12-months.asp)

2.3.3 Allowed Operating and Maintenance Costs

The allowed Operating and Maintenance costs have been updated to reflect the DSO-PES Personnel Transfer agreement by which a considerable number of customers moved from the supply business to the DSO. This resulted on a deduction of O&M costs of €7.6 million from PES and an addition of the same value to the DSO with a zero net impact on tariffs.

Allowed OPMCt was also updated to reflect the health insurance allowance, as under ETR8 and to compensate for differences between forecast and actual HQ allocation charges. The final OPMCt allowance of PES is, therefore, €6.7 million.

2.3.4 Allowed Depreciation

The Depreciation allowance set for the second Relevant Year was based on ERO's review of the PES' capital expenditure plan for the next five relevant years. The depreciation allowance for the second Relevant Year was calculated to be €0.3 million. PES allowed depreciation will include an annual inflation allowance of 0.43% to the previously allowed depreciation allowance. The final value of allowed depreciation of the PES will, therefore, be €0.3 million.

2.4 Imbalance costs for PES

During 2015, KOSTT will introduce a balancing mechanism. Under this, generators and suppliers who are in imbalance (actual supply or demand does not match nominated volumes) will be required to pay the costs incurred by KOSTT in compensating for this.

In the PES Pricing Rule, ERO allows for the PES to recover the actual costs in the previous year of resolving any such imbalances subject to an imbalance sharing factor. Where this factor is less than 100%, it means the PES has cannot full recover its imbalance costs to give it an incentive to minimize these (ie, by minimizing imbalances).

During 2015, ERO will monitor the accuracy of the PES's demand forecasts and consequent nominations of demand. Where these are consistently inaccurate by significant amounts, forcing KOSTT to take actions to balance supply and actual demand, ERO will consider setting a sharing factor of less than 100% in 2016 (which will apply to the recovery of the PES's imbalance costs incurred in 2015). This is to provide an incentive for the PES to accurately forecast demand once the balancing mechanism commences operation.

2.5 Allowed Working Capital Costs (WCLCt)

Article 11 of the PES Pricing Rule stipulates that the Public Electricity Supplier should be allowed to recover working capital costs. Working Capital costs will be calculated using the cost of financing this working capital (EURIBOR + S%) plus the sum of allowed retail costs, allowed wholesale energy costs, allowed wholesale capacity costs and pass-through costs. The formula for calculating the WCLC allowance is provided in Paragraph 2.1 of Schedule 1 of the PES Pricing Rule:

$$WCLC= (1 / 12) * I_t * (RETR_t + WHPC_t + PSTC_t - NTFR_t)$$

Where

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 Annual Updates and which reflects the premium payable by the licensee for short-term loans

$RETR_t$	*is allowed retail Costs in Relevant Year t*
$WHPC_t$	*is allowed wholesale power costs in Relevant Year t*
$PSTC_t$	*is Pass-Through Costs in Relevant Year t*
$NTFR_t$	*is non-tariff revenues in Relevant Year t*

The resulting final WCLC to be recovered by PES is €1.9 million.

2.6 Loss adjustment for ETR8

According to the Rule on Public Electricity Supply Pricing (PES Pricing Rule), the Energy Regulatory Office should deduct revenues from sales of losses to the TSO and the DSO from the Maximum Allowed Revenues of PES in order to avoid a situation in which the PES recovers the cost of losses twice.

The Pricing Rules are set up to work in the following manner (The same principle holds for the DSO and the TSO losses):

- The Public Electricity Supplier pays the allowed Wholesale Power Costs through the recovery of revenues retained from charging retail tariffs to regulated customers;
- The DSO MAR is set up in a way so as to allow the DSO to recover sufficient revenues to compensate PES for the level of losses which ERO allows the DSO to recover;
- If the DSO cannot meet the allowed loss target, and PES is therefore obliged to purchase more energy to input into the grid to meet the bottom demand, then the DSO obliged to pay PES for the additional value of energy (because of a higher value of losses than that allowed by the ERO, thereby incurring a loss). This "payment" is done by adjusting the DSO MAR downwards in the next year such that the PES fees payable to the DSO are reduced;
- In calculating the PES MAR, the revenues that PES receives from the "sales" of losses is deducted in order to avoid covering the cost of the losses twice. However the value of the losses deducted should be the total expected loss revenues for the Relevant Year (LSSAt x REUEt x WHEAt) rather than the final loss value which, according the formula on Paragraph 2.4 of Schedule 1 of the DSO Pricing Rule, takes into account adjustments between allowed and actual values of the previous Relevant Year as well. Deducting the total value of allowed DSO losses (LSSCt) from PES MAR, as under ETR8, effectively returns any benefits gained by reducing losses from the DSO to the PES.

The PES MAR has therefore been adjusted to reflect the fact that the revenues PES receives from sales of losses are deducted before adjustments, as explained above, rather than after adjustments. The argument is valid for both DSO and TSO loss calculations.

2.7 KREV

One of the key elements affecting the MAR of the Public Electricity Supplier (but also that of the DSO and TSMO) is the difference between the Maximum Allowed Revenues (MAR) and the Actual

Regulated Revenues (ARR). This difference is recovered by applying the *KREV* formula, as defined in Article 5 paragraph 3.2 and Annex 1 paragraph 2.4 of the PES Pricing Rule.

The resulting KREV calculation under ETR8, after interest, is €33.78 million.

3 Summary

The final MAR value for the sector for the Second Relevant Year is €256.7 million.

Allowed Retail Costs (Article 10 of the PES Pricing Rule) have been estimated to be €6.7 million. This allowance has included an adjustment for health insurance, HQ reallocation and license fee costs. Allowed Pass-through costs (PSTCt) for payments to the DSO and the TSO are €93.6 million. Allowed Revenues from sales of losses to the TSO and the DSO are €30.8 million. Working Capital costs are €1.9 million. Total Wholesale Power Costs are €149.6 million. Allowed Bad Debts are €13.2 million. The allowances are summarized in Table 6.

Table 1 Allowed Retail Costs, Pass-through Costs and Sales Revenues of the PES

PES MAR		ETR8 Allowed	ETR8 Reviewed	ETR9 Proposed
Indexation parameters				
Efficiency Factor	%	0.00%	0.00%	0.00%
Profiling Factor		0.00	0.00	0.00
HICP	%	0.70%	0.70%	0.97%
Euribor	%	0.60%	0.60%	0.25%
S-factor	%	12.54%	12.54%	10.47%
It	%	13.14%	13.14%	10.72%
Allowed Retail Costs (RETRt)				
$OPMC_t = OPMC_{t-1} * (1 + CPI_{t-1}) * (1 – E_t) * (1 – P_t)$	€m	12.4	12.4	6.7
Adjusted OPEX without HQ	€m			10.7
DEPCt = DEPCt-1 * (1 + CPIt-1) * (1 – Pt)	€m	0.20	0.2	0.3
Health Insurance Allowance	€m	0.2	0.2	0.0
HQ Reallocation Allowance	€m	1.3	1.3	2.9
Licence allowance	€m	0.1	0.1	0.11
PES-DSO Personnel Transfer	€m	0.0	0.0	-7.6
Inter-company charge	€m			0.3
Pass-through Costs (PSTCt)				
KOSTT fees	€m	17.8	18.0	22.8
DSO fees	€m	63.9	66.4	70.7
			81.7	93.6
Revenues from Sales of Losses to TSO and DSO				

TSO Revenues	€m	3.3	3.5	3.1
DSO Revenues	€m	23.8	26.3	27.6
			27.1	

Working Capital Costs (WCLCt)

WCLC= (1 / 12) * It * (RETRt + WHPCt + PSTCt - NTFRt)	€m	2.2	2.3	1.9

Wholesale Power Costs (WHPC)

WHPC	€m	142.3	154.0	149.6
Retail Margin	€m			
Retail Margin Adjustment	€m	0.0	0.0	

Licence fee

Licence fee	€m	0.0	0.0	0.0

Non-Tariff Revenues (NTFR)

Non-tariff Revenues (NTFRt)	€m			

Bad Debt Allowance (BDTA)

BDTA	%	5%	5%	5%
BDTA	€m	12.0	12.6	13.2
BDTA Adjustment	€m	0.3	0.3	

KREVt

PES KREVt	€m	15.4	15.4	33.7
DSO KREVt	€m	3.0	3.0	3.1
TSMO KREVt	€m	-0.2	-0.2	1.5

Other Adjustments

Uncontrolled costs adjustment (Insurance)	€m	0.2	0.2	
Uncontrolled costs adjustments (HQ reallocation)	€m	1.3	1.3	
Licence fee (Imports)	€m	0.0	0.0	
ETR8 DSO losses adjustment	€m			-6.1
ETR8 TSO losses adjustment	€m			0.3

PES MAR

PES MAR	€m	240.0	252.4	256.7