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Republic of Kosovo

KOMPANIA KOSOVARE PËR DISTRIBUIM DHE FURNIZIM ME ENERGJI ELEKTRIKE
KOSOVO ELECTRICITY DISTRIBUTION AND SUPPLY COMPANY J.S.C.
KOSOVSKO PREDUZEĆE ZA DISTRIBUCIJU I SNABDEVANJE ELEKTRICNOM ENERGIJOM
KEDS - SH.A.
Nr. 20 Dt. 08. 3. 2021
HQ 1

Izet Rushiti
Act. Chairman of ERO Board

Alper Erbas
Managing Director, KEDS

08 March, 2021

SUBJECT: PROPOSAL FOR MAXIMUM ALLOWED REVENUES FOR THE TARIFF YEAR 2021

Dear Mr. Rushiti,

Application for Maximum Allowed Revenues is drafted by KEDS both in electronic form and hard copy, within the time frame set in Appendix 7 of the Distribution System Operator (DSO) Pricing Regulation, and guidelines from ERO provided in the official letter dated 9 December 2019 and 20 January 2021.

KEDS remains committed for cooperation with the aim of reaching appropriate conclusions, which are in the interest of all stakeholders involved in the energy sector.

Sincerely,

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KEDS SH.A 1

Alper Erbas
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Republika e Kosovës Republic of Kosovo

Application for Maximum Allowed Revenues in 2021

Distribution System Operator

March 2021

Content:

1. Introduction

KEDS, as licensed Distribution System Operator has prepared this application for maximum allowed revenues (MAR) for the year 2021, in accordance with Appendix 7 of the Rule on Maximum Allowed Revenues of Distribution System Operator (DSO Pricing Rule), and ERO's official letter received on 11 December 2020.

On January 20, 2021 KEK - Generation informed the parties in the energy sector that the capital project of unit B1 overhaul which was planned to be implemented during 2021, has been moved to 2022 and as a result the production plan for 2021 has changed. Considering that this change has an effect on the purchase costs of allowed losses at the distribution level, respectively on the request for Maximum Allowed Revenues, KEDS politely requested from ERO an additional deadline in order to accurately reflect the forecasted costs for 2021, of which ERO approved.

As soon as KEDS received the updated production plan from KEK on February 19, 2021, the same has been reflected in the request for the maximum allowed revenues for 2021.

The basis for determination of Maximum Allowed Revenues is to allow DSO to recover the reasonable costs of developing, operating, and maintaining the distribution system in order to make it available to system users. Maximum Allowed Revenues include the following costs:

1. Operational Costs
2. Depreciation and Return costs calculated conform the allowed Investments
3. Costs of Losses
4. Unregulated Revenues, if any
5. Correction factor for any under or over-recovery of the allowed costs between forecasted and actual volumes of electricity distributed, electricity purchased, and referent prices of electricity market.

During the year 2018, ERO has approved the major components for the second regulatory period (2018-2022), hence Distribution System Operator in this application updates these data conform the DSO pricing Rule. Following chapters provide explanation and justification for all reasonable costs requested, which are necessary to enable normal functioning of the distribution services.

New developments during the year 2020, such as spread of pandemic COVID-19 since March and KOSTT becoming an independent regulatory body in mid of December resulted with unexpected costs, which are part of this application together with detailed explanations.

Given the fact that tariff process is interactive process between ERO and other licensees, as well as changes in legislation, this application might be further adjusted with the aim of reflecting costs that are interlinked with other licensees.

2. Operational Costs

Based on article 9 of the DSO Pricing Rule, operating and maintenance costs of the DSO, attributed to the DSO licensee, can be recovered through Maximum Allowed Revenues for the forthcoming relevant year.

During the determination of the input parameters for second regulatory period, ERO in September 2018 through decision V_1027_2018 approved the expected Maximum Allowed Revenues for the period 2018-2022 and respectively also the operating expenses for the same period. The OPEX allowed for the year 2021 is 25.66 mil €.

These costs are determined as a continuation of operating expenses determined during the first regulatory period, although DSO has argued several times that costs have increased throughout the years. Number of customers has increased in distribution level have increased from 470,000 active customers in 2013 to 630,000 active customers at the end of 2020, which has resulted with increased costs for providing services to these customers. Similarly, legislative changes and market opening constantly requires new services, more specific and specialized system programs, costs of which were not considered during the first regulatory period, respectively are not included also in the second regulatory period.

Moreover, DSO workers are continuously seeking annual salary increases to reflect the increased volume of their jobs, the pressure and risk they face on a daily basis. The DSO' costs on employee salaries reflect basic legal obligations, including work experience pay and government health insurance, but which still remain far less than those from public sector. This is also one of the reasons why the dismissal of the employees is continuing, especially with the employment opportunities available in various European countries. To reward the effort of its employees as well as to provide motivation and efficiency enhancement, DSO requires from ERO to accept a small increase in the payroll category, which will be distributed to employees as end-of-year allowances. This will reflect their value to the company and at the same time keep them competitive in the electricity market.

During 2020, the spread of pandemic COVID-19 has affected negatively all business in Kosovo including the distribution company. Our employees were directly exposed to the risk of infection, especially field employees, who were visiting customer's houses for reading activities, including quarantined zones. Due to the importance of the services we offer, although safety measures are taken and implemented, our employees had often contacts with customers and contractors, in order to ensure that electricity is distributed continuously and without interruption to all customers. Governmental institution supported frontal workers with 300 € support payment for their vital services offered in this emergency, which was further implemented also by other companies in the energy sector. Considering this, a letter request was submitted to ERO on 1st of April 2020 where DSO asked for additional personnel costs for support payment for COVID-19 emergency, which should be recognized by ERO in the next tariff mechanisms. On 28th of May 2020, ERO through letter no 179/20 replied positively to

our request. DSO through the official letter no 23 of the date 19 June 2020, informed ERO that the additional payments for employees that were exposed in the danger of pandemic COVID-19 were implemented on 18 of June 2020 in the values of 437,157 €, which are included as additional costs in this application.

Considering the abovementioned, OPEX request for the year 2021 is 25.9 mil €, which includes also the additional costs for health insurance that were rightfully approved by ERO in the last tariff review process.

3. Depreciation and Return Costs

Investment Plan of the Distribution System Operator is designed to enable the safe and reliable electricity supply at a reasonable price, and ensure the operation of the network in a transparent manner in accordance with commercial principles.

The process for second regulatory period started in May 2017, and DSO with the information known at the time of the application, prepared its Investment Plan for the years 2018-202. ERO, approved the 5 years Investments Plan on September 24, 2018. Changes in regulatory parameters, approved only at the end of August 2018, put DSO in an unfavorable situation financially in terms of the investments plan initially forecast, which considered different input parameter. The considerable decrease of allowed WACC increased confusion among accreditation institutions, which combined with external considerations, such as bureaucratic procedures, operational challenges, difficulties in accessing property, social implications, economic crises, etc., affected both the costs and the timing of planned investments.

Moreover, in 2020 due the outbreak of pandemic COVID-19 and measures taken by the Government, DSO had to organize the work conform legal requirement and by taken all necessary preventive measures. During the period of March-June, majority of planned maintenance and investments in 10 kV and 35 kV feeders have been postponed. Contractors were not working due to the Government's decision to close all business activities, and many areas were quarantined. This all affected the timing of planned investments and limited the number of routing controls for unauthorized use of electricity. In this view, DSO was unable to achieve a the target for reduction of losses in accordance with the Loss Reduction Plan for 2020. This will also affect the inability of DSO to accomplish targets set by ERO. Planned maintenance and non-realization of capital investments will also have an impact on non-realization of the level of losses and at the same time will deviate the achievement of investments allowed by ERO for the 5 years period.

Considering the above-mentioned and possible delays and/or deviations in the implementation of the investment projects, in application the DSO has used the approved level of investment during the

second regulatory period, in accordance with the methodology applied by ERO over the years. In accordance with ERO's approvals and complying with the DSO Pricing Rule, depreciation and return costs have been calculated for the respective year, which take into account also the adjustment of the allowed costs during 2020 for the inflation rate.

4. Cost of Losses

In energy systems the losses refer to the difference between the electricity that has entered the system and the energy that has been distributed to the final consumers. Distribution System Operator, conform Article 12 of the DSO pricing Rule, is responsible for purchasing of electricity for recovering the losses in the distribution network. Moreover, during MAR determination any under or over-recovered allowed losses during the actual year shall be adjusted.

On 20 August 2018, ERO through decision V_1019_2018 approved the loss target for the next regulatory period 2018-2022. In spite of disagreements between ERO and DSO regarding the target for losses' reduction at the distribution level, in this application DSO has used the allowed level of losses.

The expected losses within a given year are done based on expected sales and investment plan for that specific year. Conform losses plan, the energy need to cover the losses is purchased from KEK generation and import. Conform ERO guidance issued on March 2017, KEK generation is allocated initially to the Universal Service Supplier, and remaining is divided proportionally between KEDS and KOSTT for covering distribution and transmission losses. Considering that allocation of energy is done on hourly basis, and that KEK generation is not sufficient to cover the needs of energy in Kosovo, KEDS as DSO has to purchase losses from import, which affects the costs of losses.

KEK Generation notified on 30 July 2020 that generation unit B1 will be out of operation from 14th of February until 15th of October 2021, in addition to the regular annual maintenance of the generating units. The same is acknowledged and presented also in the approved Energy Balance approved for the year 2021. However, on January 20, 2021 KEK announced the change of the production plan and respectively the delay of the project on the B1 generation unit for year 2022. In this regard, according to DSO's request and ERO's approval for the accurate reflection of costs on purchase of allowed losses, KEDS in this application has used the updated production plan of KEK.

The current KEK-generation price on distribution losses is applicable only until March 31, 2021, while in accordance with KEK letter no. 383 dated 18 January 2021, KEK requested that the current price be reflected in the inflation rate above the base price. Considering that ERO applies the inflation adjustment in accordance with the Rule on Maximum Allowed Revenues, where the actual value of inflation is measured using the "Harmonized Index of Consumer Prices (HICP) of all units for the Euro area" published by Eurostat. In this sense, KEDS in this application has used the updated price for inflation known in Eurostat, which for 2020 was 0.3%

As known, KOSTT on 14th of December 2020 became an independent regulatory body, which resulted with increased import costs during this period due to border constraints in the region. Non-functional commercial border with Serbia will keep the import prices high, especially during peak season due to potential network constraints (congestions) considering the dependency of all neighboring countries on import during peak seasons. Therefore, acknowledging higher import prices, and allowing financial operations means for the DSO is necessity, especially considering the financial strains faced during 2020 because of pandemic effect.

As stated in the previous chapter, pandemic effect has negatively affected the daily operations of the Distribution System Operator. Besides affecting investments, it has directly affected also the routine control for unauthorized use of electricity, by affecting the expected decrease of losses. Although due to the closure of businesses worldwide, there was sufficient energy in the energy markets, by resulting with low import prices, pandemic affected the network conditions in our country and respectively the losses.

According to the Loss Pan for 2020, the reduction of technical and commercial losses in the distribution network was expected to decrease by at least 0.3%more, the financial effect of which is 739.26 thousand euros. As known, the current situation caused by the spread of the COVID-19 pandemic is an extraordinary event. This extraordinary event was recognized and declared as an Public Health Emergency in international level[1] and the spread of the pandemic[2] by the World Health Organization (WHO) in early 2020, as similarly on March 15 it was declared as a Public Health Emergency[3] by the Government of the Republic of Kosovo ('GoK') through Decision no. Nr. 01/11. Considering these, DSO has reflected these unexpected costs, and requires from the regulator to reflect this effect when setting the Maximum Allowed Revenues.

[1] WHO, The 2019-nCOV pandemic was recognized and declared as an Public Health Emergency in international level
https://www.who.int/news/item/30-01-2020-statement-on-the-second-meeting-of-the-international-health-regulations-(2005)-emergency-committee-regarding-the-outbreak-of-novel-coronavirus-(2019-ncov)
[2] WHO, WHO states that the spread of Covid-19 is a pandemic
https://www.euro.who.int/en/health-topics/health-emergencies/coronavirus-covid-19/news/news/2020/3/who-announces-covid-19-outbreak-a-pandemic
[3] Decision no. 01/11 dt. 15.03.2020 https://kryeministri-ks.net/wp-content/uploads/2020/03/Vendimi-nr.01-11.pdf

5. Unregulated Revenues

ERO for the second regulatory period has foreseen € 3.5 million of unregulated revenues included in the MAR forecast for year 2020, while the DSO has realized € 7.26 million in total, which will be adjusted when determining allowed revenues for the year 2021, in accordance with the Pricing Rule.

Moreover, in accordance with ERO Decision no. V_1205_2019 dated 27 November 2019, DSO has decreased the compensation for the payment of customers who were charged through Energy consent for payment of metering group, given that these costs have been deducted in the past as unregulated revenues through regular adjustments.

At the same time, the DSO wants to emphasize that in order to provide an incentive to further extend similar services, a sharing factor should be applied, as in contrary, DSO does not have any benefit for providing these services. Application of a sharing factor, would be an additional incentive for DSO to apply even further non-tariff services, which could be beneficiary also for end-customers.

6. Financial Obligations for transmission network and license

With the newly adopted laws, and changes in the electricity market DSO shall pay for the usage of the transmission system and market operator, as well as it has to pay the licensee fee to ERO.

In process of determining the maximum allowed revenues for 2020, the DSO's allowed financial liabilities for the Transmission System Operator were € 0.92 million, but the actual liabilities amounted to € 1.07 million, hence conform regulation in power an adjustment is reflected in the final MAR for year 2021. DSO has also calculated the foreseen costs for 2021, however, any change in transmission tariffs should be reflected by ERO before determining final MAR for DSO.

Conform Article 6 of the DSO pricing Rules, regular adjustments include also the payment for license fee, which is an obligation that each licensee has to pay to the Regulator based on the import volumes. During 2020, the DSO has paid € 0.06 million for license, while for 2021 this amount is expected to reach € 0.08 million. Given that this is a recognized cost, we recommend the Regulator to consider these costs when determining costs for 2021.

7. Correction Factor

The year 2020 was an extraordinary year, due to the outburst of pandemic COVID-19, which started on March 2020 and continues throughout the year. Decision no. 01/09 dated 13 March 2020, following many more measures and decision taken by Government throughout the year has impacted entire socio-economic environment in the country.

Closure of businesses and/or limited operations of the businesses during entire 2020, has switched consumption from industrial and commercial customers to household customers. Considering that pandemic COVID-19 was a worldwide spread pandemic, this has also influenced the economy and energy sectors elsewhere. Quarantine applied worldwide has resulted with more production of electricity than its consumption, thus influencing the price offers in exchange markets. From March-June the average import price for DSO was 32.62 €/MWh, lower than price purchased from KEK Generation from 36.00 €/MWh. As a result the correction factor to be adjusted in the MAR of 2021 is € 12.92 million. Yet, it is important to emphasize that 2020 was an extraordinary year and as such shall not be considered as base for determination of 2021 costs.

8. MAR Request

After knowing all cost components justified in the previous sections, DSO has calculated the Maximum Allowed Revenues for the year 2021 conform formula expression explained in Annex 1 of the DSO Pricing Rule:

$$Mar_t = OPMC_t + DEPC_t + RTNC_t + LSSC_t + LICC_t - NTFR_t + ADJ_t + KREV_t$$

Maximum Allowed Revenues – MAR	
DSO	**2020 (mil €)**
Operational Costs	25.91
Depreciation	16.43
Return	16.16
Cost of Losses	41.94
Obligations to the TSO	0.87
Unregulated Revenues (3/5)	(3.50)
Adjustments for PR1 (3/5)	(1.50)
License fee	0.08
Correction factor	(12.92)
Request for Maximum Allowed Revenues	**83.47**

In order to ensure sustainable operation of the distribution system operator and provide better services for its customers, DSO needs MAR of € 83.47 million. After ERO approves the Maximum Allowed Revenues for the year 2021, DSO will use the approved MAR to prepare charges for distribution use of system based on the forecasted revenues and methodology approved by ERO.