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KOMPANIA KOSOVARE PËR FURNIZIM ME ENERGJI ELEKTRIKE SH.A.
KOSOVO ELEKTRICITY SYPPLY COMPANY J.S.C.
KOSOVSKO PREDUZEĆE ZA SNABDEVANJE ELEKTRIČNOM ENERGIJOM D.D.
KESCO SH.A.
Nr. 09 Dt. 08. 3. 2021
HQ 1

Izet Rushiti
Ac. Chairman of ERO Board

Mesut Serhat Dinc
Chief Executive Officer

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 KESCo both in electronic form and hard copy conform requirements set in the Pricing Regulation for Determination of Maximum Allowed Revenues for Universal Service Supplier (USS Pricing Rule).

KESCo 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,

KESCO SH.A.

Mesut Serhat Dinc
Chief Executive Officer, KESCo J.s.c

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# *Application for Maximum Allowed Revenues in 2021 for Universal Service Supplier*

March 2021

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# 1. Introduction

Application for Maximum Allowed Revenues for Universal Service Supplier for the year 2021 is prepared conform Appendix 3 of the Rule on Determination of Revenues for Universal Service Supplier (USS Pricing Rule), and ERO's official letter issued on 11 December 2020.

On 20 January 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, which request was approved by ERO.

In accordance with the approval of ERO and after receiving the updated data from KEK-generation on February 19, KESCO in the role of Universal Service Provider has prepared the request for Maximum Allowed Revenues for year 2021. The request is prepared in accordance with the principles set in the USS Pricing Rule, and the request of supplier, which is evaluated as necessary to perform and ensure sustainable electricity supply throughout the tariff year 2021 (1 April 2021- 31 March 2022).

During the year 2020, the spread of the pandemic Covid-19 in the beginning of March 2020 and its continuation during the entire year, has impacted the daily operation of the supplier, which shall be considered and reflected in this tariff review process. Moreover, on 14$^{th}$ of December 2020, KOSTT-Transmission Operator started operating as independent regulatory area within Albanian zone, which further affected the operations of supply by increasing the costs of securing energy.

On 10 September 2020, Regulator opened the process of determining supply parameters for the next regulatory period, however no decision was taken up to date, and due to termination of the mandate of two ERO Board members, ERO is left without quorum, hence no decision is expected to be taken until the date of submission of this application. In this view, in this application, USS will treat these parameters conform its application submitted to ERO on 8 October 2020.

The following documents consist of seven main parts, respectively:

1. Energy Balance and Purchases
2. Parameters
3. Retail costs
4. Wholesale Energy Costs
5. Pass-through costs
6. Adjustments and revenues correction factor
7. Determination of the Maximum Allowed Revenues for the relevant year t

## 2. Energy Balance and Purchase

Several factors are considered when forecasting consumption for the next year, such as historical data, customer behavior, climate forecasts, inclusion of new customers, power purchase indexes, GDP, etc.

According to the ERO decision on amendment of the Guideline on Market Liberalization on 28 March 2019, customers connected to 35 kV level, that fulfill predetermined conditions defined in Law on Electricity, were expected not to be supplied by Universal Service Supplier from 1st of April 2020, while customers connected to 10 kV level from 1st of April 2021.

In the wake of the crisis due to the pandemic of COVID-19, the Government of the Republic of Kosovo adopted several preventive measures, conform recommendation provided by the Ministry of Health, which directly influenced the customer behavior and operation of entities in the electricity market.

Among restrictions and obligations arising out of the emergency situation, ERO on 23rd of March 2020, requested from KESCO to continue exercising its universal service supply activity also for the customers connected to 35 kV level, although the same were excluded from the end-tariffs. Considering this unprecedented situation, KESCO, being the appointed Universal Service Supplier adopted the ERO's proposal and supplied electricity to all its customers continuously without any interruption.

On 9 December 2020, ERO requested from KESCO supplier to distribute the letter notification for electricity supply with unregulated prices to all its customers connected in 35 kV and 10 kV levels. Conform Law on Electricity, article 37, paragraph 2, customers that have no more than 50 employees or no more than 10 million € have the right of the universal service supply.

In this view, according to the information known until the submission of this application, forecasted sales for USS for the year 2021 are 4,130 GWh, as presented in the following table:

| Voltage Level | Jan | Feb | Mar | Apr | May | Jun | Jul | Aug | Sep | Oct | Nov | Dec | Total |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| 35 kV | 4 | 4 | 5 | 3 | 2 | 3 | 3 | 3 | 3 | 3 | 3 | 4 | 39 |
| 10 kV | 39 | 36 | 39 | 27 | 23 | 25 | 26 | 27 | 26 | 29 | 33 | 40 | 370 |
| 0.4 kV | 39 | 33 | 37 | 29 | 31 | 31 | 35 | 36 | 31 | 32 | 35 | 42 | 411 |
| 0.4 kV / II | 67 | 60 | 58 | 47 | 47 | 46 | 51 | 56 | 49 | 49 | 57 | 69 | 657 |
| Households | 290 | 241 | 242 | 199 | 200 | 183 | 192 | 197 | 183 | 199 | 223 | 274 | 2,623 |
| Public Lights | 3 | 3 | 3 | 2 | 2 | 2 | 2 | 2 | 2 | 3 | 3 | 3 | 30 |
| **Total** | **443** | **377** | **385** | **306** | **307** | **289** | **308** | **321** | **293** | **314** | **355** | **432** | **4,130** |

Energy purchases to cover the USS needs are forecasted on hourly basis and are composed from KEK generation, Renewable Energy Sources, and import, whenever there is no sufficient local production to cover the consumption needs.

Conform data provided for energy balance (approved by ERO on December 2020), KEK on 30 July 2020, notified 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 initial request of the Supplier was prepared taking into account this information, however on January 20, 2021 KEK submitted an official letter through which notified that the production plan for 2021 has changed, respectively the capital project of unit B1 overhaul which was planned to be implemented during 2021, has been moved to 2022.

Given the fact that KEK-Generation makes up 95% of domestic production and Kosovo has no other alternative to sufficiently meet customers' demand, any change on production plan has a major effect on the wholesale purchase costs and the request for Maximum Allowed Revenues. In this regard, KESCO through a letter addressed to ERO, requested an additional deadline in order to accurately reflect the forecasted costs for 2021, which was approved by ERO, therefore, the request of the supplier for wholesale purchases has been prepared in accordance with the new production plan received by KEK-Generation on 19 February 2021.

Based on the consumption forecasts and available hourly capacities of domestic production forecasted in the energy balance for 2021, USS has estimated the energy purchases according to the source of production, which are presented in the following table:

| Energy Balance 2021 | GWh |
|---|---|
| **Purchases** | **4,130** |
| *KEK Generation* | 3,642 |
| *RES Production in contractual agreement with KOSTT* | 361 |
| *RES Production in contractual agreement with USS* | 44 |
| *Import* | 83 |
| **Consumption** | **4,130** |
| **Surplus/Deficit** | - |

For clarification reasons, it should be emphasized that even if according to the production plan, there is sufficient energy available to cover all customer needs, since the forecast is done hourly, it does not necessarily meet the needs of the supplier on hourly basis, therefore during hourly forecasts based on capacity there's still need for import, especially during peak hours.

## 3. Parameters

Considering that in the late 2016 and beginning of 2017, legislation in the electricity sector has changed to meet the legislative requirements deriving from of EU Third Energy Package, ERO has evaluated as necessary to re-evaluate the conditions of supply with universal service, respectively re-evaluate the incoming values and determination of maximum allowed revenues.

On 10 September 2020, ERO through official letter no. 295/20 opened the process of reviewing the input parameters for Universal Service Supplier. In accordance with the requirement of the letter, USS has prepared the proposal and sent it to the Regulator for approval on 8 October 2020.

Input Values are key parameters that are used in the calculation of the regulated revenues of Universal Service Supplier, which conform Pricing Rule are set for a period of 3 year, and compromised of the following:

- Economic USS Related Assets Lives
- Retail Margin
- Balancing Sharing Factor

- Bad Debt Allowance, and
- Any other input parameters that the regulator may deem necessary.

### 3.1. Economic USS Related Assets Lives

Universal Service Supplier (USS) has limited capital investments, which is mainly limited to office equipment and Information Technology (IT). Prior to first Regulatory period, ERO did not issue a special decision on asset life expectancy. Instead, it applied the same lifespan of 5 years, based on the estimation of technical life expectancy for assets used by the electricity supplier. So up to now the depreciation rates are applied on the historical bases.

Nevertheless, considering the actual lifespan of assets and developments in the IT sector, we proposed to ERO that the lifespan of work equipment shall be depreciated for 5 years, similar to distribution and transmission operators, but IT equipment and software, shall be depreciated for 3 years. We believe that five years period for IT equipment and software is long, and these devices will not have the economic and technical value to respond to the contemporary requirements of continues chancing environment.

As argued in the request submitted to ERO for parameters 2021-2023, since unbundling from distribution system operator, KESCO supplier has faced big changes in the daily operation, including the introduction of market opening, deregulation of customers, start of prosumer's operation, balancing mechanisms, etc. Considering the limited budget allowed for capital investments and increased necessity to update the operational system of the supplier, in the upcoming years it is a necessity to allow higher budget in order to enable necessary investments in the system (billing and CRM).

In this application, USS has used the requested budget for Capital Expenditures for the year 2021, and has calculated the depreciation costs accordingly.

### 3.2. Retail Margin

Universal Service Supplier (USS) is the supplier whom the Public Service Obligation is imposed by the Regulator. In exchange for granting the exclusive right to sell electricity in a given service territory, Regulator determines what are the allowed costs of operation, how much it can charge, and what its retail margin can be.

Universal Service Suppliers worldwide are regulated companies that don't operate in a normal free market system where prices and profits are determined by the willingness of consumers to pay. Instead, they are "regulated companies" in which regulators through determination of a retail margin, guarantee a monetary return for the companies while also determining prices for the customers.

Considering the market conditions before privatization, Regulator has set the retail margin at 3%, which as such was applicable up to date.

A study performed by Energy Community Regulatory Board (ECRB) in December 2013 showed a similar approach applied in all neighboring countries in relation to the application of retail margin[1]. Nevertheless, as market conditions and policy priorities have changed over the years, so have changed the methods for calculation of retail margin. In this view, also retail margins applied for universal service suppliers in the neighboring countries differs, e.g. In Albania retail margin is a fixed percentage applied to the allowed wholesale energy costs, which is allowed by Regulator (determined at 3%), whereas in Macedonia the retail margin is set through an auction (similar to EU countries) which was organized in 2019 and the winning margin was 11.5%[2].

Kosovo is a developing country and although has made some progress in developing a functioning market economy, the business environment still faces many challenges. In this view, considering the developments in the market, and deregulation, USS proposed to continue with retail margin of 3% for the next three years, which will be used as such in this application. This margin will give incentive for the universal service supplier to continue its supply activities although customer with good paying ratios are leaving, while at the same time will provide sufficient gap for other suppliers to compete and increase the interest of customers to switch into the deregulated market.

### 3.3. Balancing Sharing Factor

Article 17 of the USS Pricing Rule, paragraph 5 defines sharing factor as a fixed percentage that is applied to net imbalance costs to determine the sharing of these costs between the USS and regulated customers. Article 17, paragraph 6 highlights that when determining Imbalance Sharing factor, Regulator shall consider the extent to which USS is able to manage imbalances and, especially, the balance between supply from domestic generation and sustainable import, as well as demand fulfilled by USS.

There is always uncertainty in predicting customers' demand, and therefore in buying the correct amount of energy for this. Customer demand varies throughout the year, month and across the day. In order to avoid the exposure of the suppliers towards a higher risk of not being able to recover their operational costs, Regulators support suppliers by introducing the balancing sharing factor. Once there's a historical trend, suppliers can better forecast and manage these costs and Regulator can decide to change the allowance (sharing factor), as it is assumed that allowing a sharing factor between supplier and customer will increase the incentives for supplier to balance more accurately.

Since the functionalization of the balancing mechanisms in Kosovo in June 2017, the imbalance sharing factor was applied as 100% respectively any benefit and/or loss from the imbalances was fully returned to or recovered from customers. Although the data since 2017 show that there is a benefit for the supplier to request a sharing factor, and such request is in line with the international applications, due to the limited number of participants in the market, the issue of balancing still remains complex in Kosovo. Changes from the requirements set by stakeholders in a non-advanced system from the infrastructure

[1] ECRB, December 2013, Status Review of Main Criteria for Allowed Revenue Determination for transmission, distribution and regulated supply of electricity and gas, https://www.energy-community.org/dam/jcr:f0feeb6e-96c9-48fd-b72e-d6cc7d8b0ef1/ECRB_revenue_determination.pdf

[2] Balkan Green Energy News, 2019, Austrian EVN outbids ELEM to become universal supplier https://balkangreenenergynews.com/austrian-evn-outbids-elem-to-become-universal-supplier/

perspective are very hard to be implemented. Access to a limited number and types of resources, dependency on generation units which are old and not flexible, limits the ability for the system to be balanced and to have minimal costs. Moreover, considering also the market developments (prosumers, market opening and switching suppliers), KESCO requested that imbalance sharing factor shall continue be applied as 100% at least until the next periodic review, and as such will be used also in this application.

### 3.4. Bad Debt Allowance

In the first regulatory period, ERO through decision no. V_399_2012 has determined Bad debt Allowance for 2012-2017 period. Considering that until this year there were no reviews of parameters, Regulator has applied the percentage of 4% up to date, as per the last approved bad-debt allowance in 2017.

USS in each tariff review has requested a higher allowance with the justification that the allowed bad-debt allowance is lower than actual incurred one, as when reviewing bad-debt allowance, all revenues that supplier collects are considered. It is important to emphasize that not all payments that USS collects are related to the energy billed, based on which the bad debt allowance is given.

Conform justifications and support documentation provided to the Regulator when submitting our proposal for input parameters, we have argued that the actual average bad debt since 2017 is 5.58%.

The year 2020 is an extraordinary year due to pandemic spread and quarantine effects. Unfortunately, the spread of pandemic worldwide had an unprecedented effect on the company, resulting immediately negatively in the electricity bill collection rate, which further has effected also the commercial arrangements of the company. Considering that this was a Force Majeure event worldwide and that it has effected also the financial and social stability of the country, USS although being itself an effected company and despite the financially disadvantaged position, it supported its customers through providing reliable and uninterrupted electricity supply and not applying disconnections during quarantine times.

Unfortunately, the entire business sector in Kosovo was effected too, which further influenced the life conditions, as the crises and economic downturn has led also to significant job losses and lower incomes that will increase poverty rate in the country. Furthermore, analysis conducted by different international organizations do not show a promising recovery soon.

In this view, the effect of pandemic spread in the company was enormous and non-recoverable from the allowed bad-debt. Since this is a Force Majeure effect and out of supplier's control, KESCO as Universal Service Supplier has conducted an analysis of the expectation of the collection on receivables. It has revised its collection power for the next three years (2021-2023) in line with the new expectation, considering all relevant available information at the time, such as historical payment power of customers, business closure on yearly basis and the additional number of businesses closed as a result of pandemic effect. Moreover, USS has analyzed also the effect of market opening, since the allowance set in 2017, which continued to be used up to date, has not considered the collection power from all customers (including the ones that already operate in the open market). With the ERO's Guidance for Market Liberalization in the Energy Sector in Kosovo approved in 2017 and amended further in 2018 and 2019,

customer connected to 35 kV and 10 kV level are expected to be supplied with unregulated tariffs from April 2021[3], so the effect will be even higher.

These information were used as base for calculating USS's request for Bad debt in the next regulatory period (2021-2023), detailed of which were provided to the Regulator when submitting the Proposal for Input Parameters.

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Since ERO up to date has neither issued a decision and/or opinion in USS's proposal, in this application USS will use the following parameters:

| Parameter | Value |
|---|---|
| Retail Margin | 3% |
| Bad Debt | 6.22% |
| Balancing Sharing Factor | 100% |

The detailed justification for each parameter is provided in the USS proposal for input parameters 2021-2023.

## 4. Retail costs

Conform USS Pricing Rule, USS is allowed to incur reasonable costs, such as operating and maintenance costs, which are necessary and enable operations of the suppliers. Since the functional and legal unbundling from distribution activities in 2015, the average operation and maintenance costs allowed for the Universal Service Supplier are 6 million €, which are in line with the average actual costs incurred from universal service supplier, as shown in the table below:

| *(in million €)* | 2017 | 2018 | 2019 | Average / Total |
|---|---|---|---|---|
| **Approved** | 5.79 | 5.96 | 6.06 | 5.93 |
| **Actual** | 5.60 | 6.14 | 5.62 | 5.79 |
| **Difference** | 0.18 | (0.19) | 0.44 | 0.15 |

**Please note that actual OPEX excludes costs for unregulated customers*

ERO approves the operational expenses for the Universal Service Supplier in total and they don't match with the yearly requirements of the supplier over the years, as the allowed costs are continuation of the forecasts done during the first regulatory period and do not represent the reflection of price changes over the years. Nevertheless, USS operates within the allowed budget, creating efficiency whenever possible in certain lines in order to be able to cover the increased costs in other lines. Therefore, the decrease of costs for shared-serviced unilaterally by ERO without initially give the right to the USS to provide explanations regarding the shared services, is unacceptable for USS and as such unfairly obstructed the right of the USS to respond and argue on the matter.

[3] ERO letter No. 640/19 of the date 06.11.2019, Notification for the supply of electricity consumers in the market with unregulated prices

It should also be noted that data presented in the financial statements regarding operational costs differ from the ones allowed from ERO, such as rental expenses which from 2019 conform accounting principles (IFRS16) require to treat rental expenses as financial lease and the same ones are presented in the balance sheet as Asset usage right and lease obligation, and if the conditions are met that the same asset will be used for more than a year from the same partner, the same costs in the income statements are presented as depreciation costs - the right to use the asset. Therefore, the deprivation from the argumentation resulted in not taking into account the rental costs as part of shared services, as agreed by the parties through the shared services agreement, signed in accordance with the Regulatory Guideline for Unbundling.

Decreasing operational costs for 25% has put the Universal Service Supplier in a very unfavorable financial position, especially for the fact that USS closed the year 2019 in loss and at the same time it faced collection problems as a result of the spread of global COVID pandemic 19, which further affected its payment powers to cover its liabilities to other operators.

Despite the fact that the number of customers is continuously increasing, which is resulting also with the increase in costs for providing services to these customer, despite the fact that services are improving, and costs per customer increased, ERO did not allow an increased budget for operational costs even though USS has continuously requested and justified its needs . The table below shows a yearly loss USS has created per customer basis, in the last three years.

| | 2017 | 2018 | 2019 | 2020 |
|---|---|---|---|---|
| **Allowed OPEX (in mil €)** | 5,787,503 | 5,957,047 | 6,060,104 | 4,594,113 |
| **Number of active customers (No.)** | 561,827 | 579,963 | 605,694 | 629,359 |
| **Average OPEX cost per customer (€/customer)** | 10.30 | 10.27 | 10.01 | 7.30 |
| **Change in avg. OPEX cost per customer %** | | -0.3% | -2.6% | -27.0% |

As we can conclude from the table above, from 2017 the average loss for USS is around 10% and USS has achieved its full optimization, which has not been compensated through the given OPEX and which will be problematic to be achieved in the future if ERO does not take into account the requirements of the USS.

In this view, considering the abovementioned, ERO by decreasing unilaterally 24% of supplier's operation costs for shared services, without reflecting the actual costs, has put the universal service supplier in an unbearable financial position. The operation costs that were necessary for performing the function of universal service supplier for the year 2020, as shown also in the draft financial statements, were 5.5 million €.

During 2020, the spread of pandemic COVID-19 has affected negatively all socio-economic aspects in our country as well as worldwide. Similar to health personnel, the national police, the personnel of the emergency management agency, etc., also our employees were directly at the forefront and exposed to the risk of infection. Despite the safety measures taken and implemented, our employees had no option but fulfilling their duties by being aware and fully responsible for the vital importance of regular electricity supply even in the times of crises. Considering that governmental institution as well as other companies in the energy sector stimulated their staff with additional payments, we wrote to ERO on 1st of April 2020 requesting to cover additional personnel costs from the tariff mechanisms during COVID-19 emergency. On 28th of May 2020, ERO through letter no 179/20 replied positively to our request, costs payed by KESCO

in the value of 36,351 €, as confirmed through the official letter no 23 of the date 19 June 2020, and the same are included as additional costs in this tariff application.

Considering the abovementioned statements and needs analyzed in detail regarding the requirements for the expected developments in the next three years, the required OPEX proposed by USS which ensures stability and functional operation during 2021 is 7.88 million €, which includes also the additional allowed costs for health insurance during the year 2020. As presented and justified also in the USS request for OPEX, during submission of Parameters for 2021-2023 on 8 October 2020, the increase in OPEX requests results from several factors, summarized as follows:

1. Investing in new billing system requires also additional training for supplier's employees
2. The need of the supplier to be equipped with vehicles, which assets belonged to the distribution operator since the legal unbundling. Car usages mean additional costs for security, maintenance and fuel
3. The spread of the Covid-19 pandemic has fluctuated insurance prices, as well as it has increased the need for additional security
4. In order to benefit from lower import costs, including longer-term import agreements, the need for bank guarantees and their financing costs increases.
5. The constant change of the electricity market and the introduction of new demands in line with European developments, is also increasing the need for internal consulting and better information of citizens about changes in services provided.

## 5. Wholesale Energy Costs

According to article 17 of the USS Pricing Rule, the wholesale energy costs related to regulated suppliers are comprised of the following:

- Cost of energy procured from domestic generation (GENCt)
- Energy import costs (IMPCt)
- Energy Purchased Retail Margin (RETMt), and
- Net imbalance costs (IMBCt), which are subject to imbalance sharing factor (IMBFt)

The following formula shows the application of these costs, which USS will use further in determination of its revenues for the relevant year t:

$$WHPCt = (GENCt + IMPCt + IMBCt * IMBFt) * (1+RETMt)$$

The electricity production in Kosovo is dominated by two large power plants, which produce 95% of the total electricity production in the country, whereas the remaining part (5%) is covered from Renewable Energy Sources.

As stated above, although the energy balance for 2021 approved by ERO shows that in addition to its regular maintenance plan of generation units, the generation unit B1 was out of operation from 14

February – 15th of October 2021, due to the KEK announcement that the production plan has changed and the project on the generating unit B1 has been delayed for 2022, KESCO in this application used the updated production plan.

The actual purchase price from KEK is applicable until the end of March 2021, conform Annex 5 of the BSA Agreement, and new proposed price from KEK for the next tariff year will only reflect the inflation rate. In accordance with the practice used by ERO, as defined in the Pricing Rules, 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.

Based on the official data published in Eurostat, the inflation rate in Europe during 2020 was 0.3%, therefore the price of KEK, in accordance with the request presented in their letter and tariff rules is 29.59 € / MWh for the supplier KESCO , which as such is presented in this application.

Lack of available feasible energy in the market even at certain hours, increase the demand for import. Considering that KESCO's need for import is only at certain hours of the day, which are mainly peak hours, contractual offers are mainly based on service contracts. Starting of the operation of KOSTT as a regulated area as well as border restrictions, nonfunctional commercial border with Serbia and potential network constraints (congestions) during the year are expected to effect the import prices in the upcoming year. In this view, acknowledging higher import prices and allowing financial operations means for the supplier is necessity, especially considering the financial strains supplier faced during 2020 because of pandemic effect, and removal of commercial customers from regulated activity during 2021.

It must be noted that USS will purchase electricity also from the RES, which will be taken with priority. In accordance with the Rule on Support Scheme, approved by ERO on April 2017, RES Generating Facilities will sell their electricity output to the Market Operator (MO), and MO will allocate all RES production to suppliers proportionally to their individual demand in the Kosovo's total electricity consumption. However, some of the small RES will remain in contractual agreement with USS, due to inherited contractual relations during privatization process and based on the guidance issued by ERO for market liberalization.

Due to the lack of information about the RES reference price until the application phase, in this application the actual reference price is used to calculate RES purchases that have a contractual agreement with the Market Operator. It should be noted, however, that any change in the reference price applied to RES during this tariff year must be reflected by ERO in calculating process the maximum allowable revenue for USS.

Regarding RES that are in contractual relations with KESCO, it is important to emphasize that KESCO has received a letter regarding the update of prices, in accordance with the agreements in force, but since until the day of application KESCO has not reached an agreement on prices, in this application we have used the current reference prices.

In line with the abovementioned, and conform the formula for determining the Wholesale Purchase Costs given in the Pricing Rule the total costs for covering the consumption forecast for 2021 are as follow:

| Description | GWh | mil€ |
|---|---|---|
| KEK Generation | 3,642 | 107.67 |
| Import | 83 | 5.64 |
| RES Production in contractual agreement with KOSTT | 361 | 12.79 |
| RES Production in contractual agreement with USS | 44 | 2.01 |
| Retail Margin | | 3.844 |
| **Total Wholesale Power Purchase Costs** | **4,130** | **131.96** |

## 6. Pass through costs

Conform Article 18 of the USS Pricing Rule, during MAR determination, USS shall cover the following costs:

- MO costs that are invoiced by the MO and relate to Universal Service Customers;
- SO charges that are invoiced by the TSO and relate to Universal Service Customers;
- TNUOS costs that are invoiced by the TSO and relate to Universal Service Customers;
- Distribution Use of System costs that are invoiced by the DSO and relate to Universal
- Service Customers; and
- The share of the License Fee that relates to Universal Service Customers.

Moreover, besides the above-mentioned USS pays to the TSO also for the Renewables Fund, which will be included as part of the pass-through costs.

Licensing Fee is calculated as a pre-determined fee multiplied with the expected import energy in MWh. Since there's no initiation from ERO to change the licensee fee, USS will apply the same fee as applied in the previous regulatory period (0.22 €/MWh).

Meanwhile, since based on the time schedule defined in the USS Pricing Rule, as well as ERO's official letter for MAR Application, has no differences with the times other licensee shall submit their applications, USS will use information which are available at their disposal until the submission of this application, respectively will apply actual prices. Any changes from ERO when determining tariffs for DSO and TSO shall be reflected in the final MAR for the Universal Service Supplier.

## 7. Adjustments and revenues correction factor

During each tariff year supplier forecasts its costs which are approved by the Regulator. However, during the actual year there are differences between costs allowed and actual incurred, hence through a correction factor these costs are adjusted reflecting the difference between the allowed and actual costs.

In accordance with the Pricing Rule, adjustment of 2020 costs and revenues was made, and the correction factor to be adjusted in the MAR of 2021 is 9.23 million €, as shown in the table below:

| Description | mil € |
|---|---|
| **Approved MAR** | 268.99 |
| **Actual MAR** | 273.84 |
| Actual Sales | 265.64 |
| It | 6.85% |
| **Revenue Correction Factor (ADJt)*** | 9.23 |

**Including adjustment for balancing tariff amount*

It should be noted that the biggest changes in MAR determined during 2020 and the actual one is due to higher pass-through costs for 7 million € and the difference of revenues from the sale of electricity to end customers compared to the one forecasted during MAR determination.

Expected sales for 2020 were forecasted in line with customer behavior in the lasts years and expected new connections, however the spread of pandemic COVID-19 since mid-March has affected the customer behavior. Although sales in terms of volumes have increased, the shift of usage between commercial and household customers have resulted with lower revenues compared to expectations.

USS in this application applied only the 20% of billing in the name of the reclaim of losses, because as argued also in the past, not the whole energy billed in the name of 'reclaimed losses' is collected by customers, thus creating financial difficulties for USS. If ERO continues to apply the whole amount billed as revenue from reclaim losses, than USS will need and request a higher allowance for bad debt for receivables related to reclaim losses.

## 8. Determination of MAR for the relevant year t

The Maximum Allowed Revenues (MAR) for the year 2021 will be covered from the regulated retail tariffs, and it includes only the costs of the customers that will be supplied from the Universal Service Supplier.

The table below represents a summary of the requirement for the Maximum Allowed Revenues for USS for the year 2021, after knowing all cost elements as explained in the previous chapters, and conform expression for calculating Maximum Allowed Revenues in the relevant year t:

$$MAR_t = (RETR_t + WCLC_t + WHPC_t + PSTC_t - NTFR_t + KREV_t) / (1-BDTA_t)$$

| USS MAR for 2020 | mil € |
|---|---|
| It | 6.85% |
| **Allowed Retail Costs** | **8.17** |
| *OPMCt* | 7.88 |
| *DEPCt* | 0.29 |
| **Pass-through Costs (PSTCt)** | **132.68** |
| KOSTT fees | 21.08 |
| DSO fees | 95.90 |
| BRE Fund | 15.70 |
| **Working Capital Costs (WCLCt)** | **1.56** |
| **Wholesale Power Costs (WHPC)** | **131.96** |
| WHPC | 128.12 |
| Retail Margin | 3.84 |
| **License fee** | **0.02** |
| **Revenue Adjustments Factor (ADJ)** | **9.23** |
| BDTA | 4.00% |
| **BDTA for the pandemic** | **2.22%** |
| **PES MAR** | **302.42** |

Billing determinants for the year 2021 are based on the volumes of the sales forecasted in the Energy Balance, through which € 274.41 mil revenues are expected to be received. It should be clarified that neither costs, nor revenues are considered for customers that are expected to operate in an open market, conform information known at the time of application.

Last but not least, it should be emphasized that during 2020 there were some discussions in terms of electricity supply in North Kosovo, nevertheless, this tariff application doesn't consider any costs regarding North supplies. Therefore, any development known by the regulator at the time of MAR approval, which might be expected to take please during 2021 shall be reflected accordingly before determining of the final MAR.

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