Consultation Paper

Annual Adjustments of Maximum Allowed Revenues for KEDS

(Relevant Tariff Year 2021)

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| **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.** |

**August 2021**

Table of Contents

[1 Introduction 3](#_Toc81818988)

[2 Adjustment of Maximum Allowed Revenues 4](#_Toc81818989)

[3 Electricity Balance 4](#_Toc81818990)

[3.1 Evaluation of Actual and Forecast Electricity Balance 4](#_Toc81818991)

[4 Regular Adjustments 6](#_Toc81818992)

[4.1 Adjustments for Inflation Rate 6](#_Toc81818993)

[4.2 Additional costs related to COVID-19 7](#_Toc81818994)

[4.3 Adjustment of Pass-Through Costs 8](#_Toc81818995)

[4.4 Adjustments of the Costs of Losses 8](#_Toc81818996)

[4.5 Adjustments of Non-Tariff Revenues 9](#_Toc81818997)

[4.6 Adjustments of Revenues Correction Factor 9](#_Toc81818998)

[5 Proposal for DSO Maximum Allowed Revenues 10](#_Toc81818999)

# Introduction

The Energy Regulatory Office (ERO) is currently carrying out the Regular Adjustment and the Annual Update Process for Maximum Allowed Revenues (MAR) that will be recovered by the Regulated Companies. Under this process, ERO will give a preliminary proposal for the updated MAR for Transmission System Operator and Market Operator (KOSTT, TSO/MO), Distribution System Operator (DSO, KEDS) and Universal Service Supplier (USS). This preliminary evaluation is based on the proposals submitted by the regulated companies as well as the decisions for Maximum Allowed Revenues for the regulatory period 2018-2022 for TSO/MO and DSO.

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 justifiable return of their investments. Also, ERO sets the efficiency targets and the targets for decrease of losses, improvement of performance 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 evaluation of MAR proposals, submitted by the regulated companies, taking into consideration the actual data of 2020, in order to come up with the determination of revenues for the relevant tariff year 2021. This review evaluates whether the proposals of the licensees are calculated in line with legal requirements.

The adjustment process for the relevant tariff year 2021 covers the period 1 April 2021 - 31 March 2022, but due to the lack of the quorum of the Board, such a process has been postponed. The delay in making decisions on the Maximum Allowed Revenues and tariffs for this relevant tariff year will be adjusted in the next relevant tariff year 2022.

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 Distribution System Operator. These papers shall be analysed, referring also to the Final Raports of Periodic Review 2018-2022.

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 7 September 2021 at the latest. The comments can also be submitted via post at:

*Zyra e Rregullatorit për Energji*

*Departamenti për Tarifa dhe çmime*

*Rr. Dervish Rozhaja Nr. 12, Prishtinë, 10000, Kosovë*

**Relevant Documents**

|  |  |
| --- | --- |
| Final Evaluation of DSO MAR, within the Periodic Review Process- Detailed Evaluation | <http://ero-ks.org/2018/Raportet/Pergjigje%20ndaj%20komenteve%20te%20KEDS_PRR2_final.pdf>  |
| KEDS Application for 2019 | <https://www.ero-ks.org/zrre/sites/default/files/Konsultimet%20Publike/Aplikimi%20i%20OSSH-s%C3%AB%202021%20-%208%20Mars%202021.pdf>  |

# Adjustment of Maximum Allowed Revenues

Based on the Rule on DSO Maximum Allowed Revenues, ERO has carefully analysed all cost components and requirements of the licensee, submitted on its application for Maximum Allowed Revenues. During the Regular Adjustment Process, ERO uses the values determined 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 of Regulated Companies. 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 for the Annual Inflation based on the Harmonized Index of Consumer Prices (HICP) for the countries of the Eurozone;
2. Set the Allowed Cost of Losses (LSSCt) for the DSO and update these to include the difference between allowed and actual cost of losses for the previous Regulatory Period, which may have arisen due to changes in wholesale power costs or changes in the flows of electricity in the distribution system;
3. Update DSO MAR in order to reflect the difference between the Allowed Revenues and Actual ones in the relevant previous year (t-1), including the unregulated revenues;
4. Set DSO MAR for Relevant Year t.

# Electricity Balance

In this tariff review ERO has used the approved balance sheet for 2021. However, the handling of electricity consumption for customers connected to the voltage level of 35kV and 10kV, has been carried out in accordance with the position of the Board of ERO to continue the supply of these customers from USS, at regulated tariffs. Since KEDS has applied for the MAR of 2021, taking into account the deregulation of customers connected to the voltage level of 35kV and 10kV, there will be differences in the basis of the analysis used by ERO and the application of the DSO.

## Evaluation of Actual and Forecast Electricity Balance

With the purpose of evaluating the costs related to purchase of losses at DSO level, ERO has analysed the data reported by KEDS for 2020 and the data for forecast of Balance for 2021. The analysis of the actual balance for 2020 and the balance forecast for 2021 is presented in the following table:

Table 1 - Electricity Balance

|  |  |  |  |
| --- | --- | --- | --- |
| **Electricity Balance at DSO** | **Unit** | **Realization****2020** | **Proposal****2021** |
| Entry at DSO | GWh | 5,549 | 5,452 |
| Unbilled Energy in the North | GWh | 335 | 327 |
| Entry at DSO without the unbilled energy | GWh | 5,215 | 5,221 |
| Unbilled energy | % | 6.0% | 6.0% |
| Technical and Commercial Losses at DSO | GWh | 1,075 | 894 |  |
| % | 19.4% | 16.4% |  |
|   |  |  |  |
| Total Losses | GWh | 1,409 | 1,221 |
| % | 25.4% | 22.4% |
|   |  |  |  |
| **Energy remained for billing** | **GWh** | **4,140** | **4,231** |
|  |  |  |  |

From the analysis of KEDS application, ERO has noticed that energy purchases to cover losses are 1,026 GWh, while losses realized based on physical energy flows are 1,075 which results in a difference of about 49 GWh. But from the analysis of the balancing mechanism it is noticed that KEDS has been billed 54 GWh (11GWh injection, while 65GWh withdrawal) as energy withdrawal.

Such deviations are covered by the internal network and the interconnection system. After the independence of KOSTT, the balancing of the system should not continue through USS from the Compensation Program for any trading party, because purchases through the Compensation Program have higher costs than the penalties paid by the parties through the balancing mechanism due to deviations they have caused. Therefore, for the costs incurred (by interconnection deviations), the trading parties have paid a lower value as a penalty by the balancing mechanism. Such deviations for the DSO may be caused by inaccuracies in the loss forecast by the DSO itself as well as by changes in the energy demand nominated by suppliers. For such deviations the DSO and USS are charged on the basis of allocation and not on the basis of actual deviations caused. This principle has been applied since the beginning of the implementation of the balancing mechanism. Due to this approach, errors were identified in the real calculation of imbalances for the responsible parties (DSO and USS), as a result, the real costs for the parties that caused them were not reflected. Therefore, we estimate that a reassessment of the deviations for the DSO and USS parties should be made from the commencement of the implementation of the balancing mechanism to identify the real imbalances in MWh and the costs associated with them. Following this reassessment, consideration should be given to reviewing the costs and revenues of the DSO and the USS for such deviations.

KEDS and KESCO, on 7 July 2021, have notified ERO regarding technical errors for electricity sales and energy losses for 2020 reported at ERO and as a result there are changes of about 18GWh as an increase in DSO losses, respectively reduction of billing for the same amount. Given that such difference also implies equations of balancing mechanisms for trading parties, ERO in this consultation report will not consider such a correction, and expects KEDS to inform and consult other trading parties in relation to this and then identify the implications of this correction for each trading party.

The planning of energy flows for 2021 is carried out using the approach from consumption and applying the allowed level of losses in the DSO of 16.4%.

KEDS requested in its application that only 20% of the costs resulting from energy billing for the recovery of losses shall be taken into account, due to the impossibility of their collection, as a result of delays in court proceedings. The return of losses, according to KEDS report and ERO’s verifications, results in an amount of 47 GWh electricity. Such value is used during the calculation of revenues realized from sales.

ERO considers that the cost that results from billing of such energy shall be treated as a total revenue, because this is treated with the accrual principle, where the revenues are recognized at the moment of billing, not when they are collected. Furthermore, it shall be emphasized that this amount of energy of 47 GWh is included in the energy entering the distribution system. From this basis, the costs of energy losses are calculated, therefore the recognition of this energy as a cost, means also the recognition of costs resulting from this energy.

From the table above, it is noticed that the unbilled energy from the four municipalities in the northern part of Kosovo is presented as physical flows and used for the purpose of reconciliation of the electricity balance. However, costs that are derived from the supply of four northern municipalities of Kosovo are not included during the calculation of energy supply costs, in accordance with the decision on the interim measure given by the Basic Court and confirmed by the Court of Appeals.

# Regular Adjustments

This part presents the calculations related to regular annual adjustments for 2020. The calculation of these adjustments will be included during the determination of Maximum Allowed Revenues for relevant tariff year 2021.

## 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 2020 was 0.26%[[1]](#footnote-1). The manner for calculation of such adjustments is set in the Rule on DSO Revenues.

This rate is applied in adjustment of operational costs, depreciation costs and return on capital. Following the application of the inflation rate of 0.26% towards the above-mentioned cost components, the value of adjusted costs in an amount of 0.15 million Euros is derived. The adjustments that have resulted from the application of inflation rate for each of the components of allowed costs in 2020, have been added to the preliminary evaluation of the costs evaluated for 2021. The details on these calculations are presented in the following table:

Table 2 - Adjustments for inflation

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| Line | Unit | a)Allowed2020 | b)Adjustment for HICP | c)Preliminary Evaluation 2021[[2]](#footnote-2) | d=b+c Allowance 2021 |
| OPEX | mil€ | 25.84 | 0.07 | 25.21 | 25.84 |
| Depreciation | mil€ | 15.40 | 0.04 | 16.17 | 16.21 |
| Return | mil€ | 15.12 | 0.04 | 15.90 | 15.94 |
| Total | mil€ | 56.36 | 0.15 | 57.28 | 57.42 |

Despite KEDS's request to increase OPEX costs (increase in salaries, derivatives, maintenance) for 2020 by 2% (€ 0.5mil) compared to OPEX allowances for 2020 evaluated during PRR2, ERO has allowed OPEX increases for KEDS during the periodic review 2018-2022 and considers that further increases are unreasonable, taking into account the efficiency required over the years.

## Additional costs related to COVID-19

Regarding the additional costs of health insurance in the amount of 19 thousand euros/month, ERO considers these costs to be justifiable in principle, however requested from KEDS to prove that it has selected the most favourable contract through a competitive process. Given that KEDS did not provide evidence at the request of ERO, these costs are not recognized at this stage. KEDS will be able to present this evidence during the public consultation, otherwise the additional costs related to health insurance will not be recognized in the MAR of the relevant tariff year 2021. Regarding the costs of vehicle insurance, they have been approved in an amount of 15 thousand euros, because these are out of the control of the licensee.

KEDS in its application has requested the recognition of additional costs of € 0.44 million on behalf of additional payments for the staff, as incentives for their engagement during the COVID-19 pandemic. KEDS also supports his request on the grounds that other operators in the energy sector have applied such incentives. ERO has carefully handled DSO requests regarding additional costs related to COVID-19, and has also analysed the application of incentives set by other operators, including KEK JSC.

Given the difficult financial situation of household and business customers, adding additional costs would further complicate their situation. Therefore, ERO does not consider it reasonable to carry additional costs which are related to direct payments to DSO employees. ERO would like to clarify that the DSO could consider such a payment to workers, only through its profit, as other operators have done, by not reflecting these costs in their prices.

ERO, also in the documents referred to by the DSO in the application for MAR, has clarified that it considers justifiable in principle to recognize the costs associated with maintaining health as a result of COVID-19, according to the Guidelines of the National Institute of Public Health, but not incentives because they would further burden the final consumer.

## Adjustment of Pass-Through Costs

Due to differences between the actual and forecast energy from DSO, related to DSO obligations towards Market Operator (MO) and System Operator (SO), the adjustments to reflect these differences were carried out. The value of these adjustments is 0.16 million Euros (the difference between 0.92 million Euros and 1.07 million Euros).

## Adjustments of the Costs of Losses

Adjustment of the cost of losses for DSO is carried out through the following formula:

(LSSCat-1 – LSSCft-1) \* (1+ It)

The value of the adjusted cost for losses is -5.3 million euros, results due to differences of the actual energy flows compared to the projected ones, also it occurs due to the differences of the realized prices towards the forecast ones. The details on the calculations are provided in the following table.

Table 3 - Adjustments for the Cost of Losses

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| DSO MAR | Unit | Allowed2020 | Realized2020 | Proposed2021 |
| **Indexation Parameter** |  |  |  |  |
| **It** | % |  | **7.38%** |  |
| **Allowed Losses (LSSCt)** |  |  |  |  |
| **LSSAt** | % | **17.6** | **17.6** | **16.4** |
| **REUEt** | GWh | **5,414** | **5,549** | **5,451.6** |
| **WHEAt** | €/MWh | **49.19** | **42.57** | **46.05** |
| **LSSCat-1** | mil€ |  | **41.58** |  |
| **LSSCft-1** | mil€ | **46.88** |  | **41.17** |
| **Adjusted Costs [[3]](#footnote-3)** | mil€ |  | **-5.3** |  |

Where:

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

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

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

LSSCat-1 is the actual allowed cost of losses in Relevant Year t-1 (calculated using the Loss Allowance)

LSSCft-1 is the forecast cost of losses in Relevant Year t-1 (calculated using the Loss Allowance

It 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

ERO in its preliminary evaluation has foreseen the costs of purchasing energy to cover losses based on current prices realized in 2020, however during the public consultation process, the parties must provide evidence that they have complied with the principles set out in the legal and regulatory framework for the purchase and sale of energy to cover losses.

## Adjustments of Non-Tariff Revenues

Other revenues realized from unregulated activities such as: revenues from distribution services, services for energy consent, other services, revenues from the lease of assets, revenues from various economic operators, sale of assets, etc. are deducted from the Maximum Allowed Revenues. The value of these revenues realized from DSO in 2020 is reported by KEDS in an amount of 7.26 million Euros. ERO in the preliminary assessment has reviewed the data according to the audited statements, which results that unregulated revenues for 2020 are € 6.6mil.

The following table presents the details on unregulated revenues:

Table 4 - Unregulated revenues

|  |  |
| --- | --- |
| **Unregulated revenues 2020** | **€000s** |
| Distribution services | 1,545 |
| Services for energy consent | 1,994 |
| Other services | 2,091 |
| Income from stock without origin | 689 |
| Other revenues | 98 |
| Revenues from the lease of assets | 100 |
| Profit from the sale of fixed assets | 97 |
| **Total** | **6,614** |

## Adjustments of Revenues Correction Factor

The correction of revenues for 2020 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:

KREVt = (AACat-1 – ARRt-1) \* (1+ It)

Where:

AACat-1  Actual Allowed Cost as determined in Relevant Year t-1

ARRt-1  is the Actual Regulated Revenues in Relevant Year t-1

It 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 AACat-1 in an amount of 87.06 mil€ and ARRt-1 in an amount of 100.55 mil€, following the application of interest rate, results in an amount of – 14.5 milion Euros. The difference between actual allowed costs and revenues is passed-through as an adjustment during the determination of MAR for 2021.

# Proposal for DSO Maximum Allowed Revenues

DSO Maximum Allowed Revenues are calculated according to the following formula:

*MARt = OPMCt + DEPCt + RTNCt + LSSCt + LICCt -NTFR t +ADJt +KREVt*

*Where*

MARt Maximum Allowed revenues in relevant year t

OPMCt allowed operational and maintenance costs in relevant year t

DEPCt allowed depreciation in relevant year t

RTNCt allowed return on capital in relevant year t

LSSCt  allowed cost of losses in relevant year t

LICCt license tax in relevant year t

*ADJt adjustment of costs*

KREVt revenue correction factor in relevant year t

The calculation of each of these components is elaborated below.

As a result of calculations of each cost component, the proposed MAR for DSO for 2020 is €81.44 million.

Table 6 - Proposal of DSO MAR (KEDS) after the adjustments

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| Maximum Allowed Revenues (mil€) | Unit | Allowed 2019 | Allowed 2020 | Proposed 2021 |
| **Indexation Parameters** |  |  |  |  |
| Efficiency Factor | % | 1.5% | 1.5% | 1.5% |
| Inflation | % | 1.19% | 0.26% |  |
| Euribor | % | -0.2% | -0.3% |  |
| S Factor  | % | 7.6% | 7.6% |  |
| Interest rate - It | % | 7.4% | 7.3% |  |
| **Operational and maintenance costs (OPMCt)** |  |  |  |  |
| Evaluation during PRR2 | €m | 25.85 | 25.53 | 25.21 |
| Allowed - OPMCt = OPMCt-1 \* (1 + CPIt-1) \* (1 – Et)\* (1 – Pt) | €m | **26.30** | **25.84** | **25.28** |
| Additional OPEX costs | €m |  | 0.24 | 0.24 |
| **Depreciation costs (DEPCt)** |  |  |  |  |
| Evaluation during PRR2 | €m | 14.44 | 15.23 | 16.17 |
| Allowed - DEPCt = DEPCt-1 \* (1 + CPIt-1) \* (1 – Pt) | €m | **14.65** | **15.40** | **16.21** |
| **Return costs (RTNCt)** |  |  |  |  |
| Evaluation during MYT | €m | 13.39 | 14.95 | 15.90 |
| Allowed- RTNCt = RTNCt-1 \* (1 + CPIt-1) \* (1 – Pt) | €m | **13.59** | **15.12** | **15.94** |
| **Obligations towards KOSTT** |  |  |  |  |
| Obligations towards KOSTT -forecast | €m | 1.23 | 0.92 | 2.02 |
| Obligations towards KOSTT – actual | €m |  | 1.07 |  |
| **Cost of losses (LSSCt)** |  |  |  |  |
| **Forecast** |  |  |  |  |
| LSSAt | €m | 18.80% | 17.60% | 16.40% |
| REUEt | €m | 4,964.9 | 5,414.3 | 5,451.6 |
| WHEAt | €m | 44.88 | 49.19 | 46.05 |
| Forecast cost of losses | €m | **41.89** | **46.88** | **41.17** |
| **Actual** |  |  |  |  |
| LSSAt | % | 18.80% | 17.60% |  |
| REUEt | GWh | 5,322.0 | 5,549.5 |  |
| WHEAt | €/MWh | 42.89 | 42.57 |  |
| Actual cost of losses | €m | **42.91** | **41.58** |  |
| **Adjustments** |  |  |  |  |
| Unregulated revenues PRR2 | €m | (3.50) | (3.50) | (3.50) |
| Adjustments for PRR1 | €m | (1.50) | (1.50) | (1.50) |
| Adjustment for the price of losses  | €m | ( 2.48) | - |  |
| Correction of imbalances  | €m | 1.74 | - |  |
| Actual non-regulated revenues | €m | (6.84) | (6.61) |  |
| Licensing tax: |  |  |  |  |
| Forecast | €m |  | 0.15 | 0.08 |
| Actual | €m | 0.07 | 0.06 |  |
| **KREV – Revenue Correction Factor** |  |  |  |  |
| Revenue Correction Factor t-1 | €m | 9.58 | (4.14) | (14.49) |
| AACt-1 – actual costs for year t-1  | €m | 99.47 | 87.06 |  |
| ARRt-1 - actual costs for year t-1 | €m | 103.20 | 100.55 |  |
| **KREVt = (AACat-1 – ARRt-1) \* (1+ It)** | €m | **(4.14)** | **(14.49)** |  |
|  |  |  |  |  |
| **MAR – Maximum Allowed Revenues** | €m | **101.50** | **95.40** | **81.44** |
|  |  |  |  |  |

1. <https://www.ecb.europa.eu/stats/ecb_statistics/escb/html/table.en.html?id=JDF_ICP_COICOP_ANR&period=2017-12> [↑](#footnote-ref-1)
2. According to allowances of Periodic Review 2018-2022 link:

 http://ero-ks.org/2018/Raportet/Pergjigje%20ndaj%20komenteve%20te%20KEDS\_PRR2\_final.pdf [↑](#footnote-ref-2)
3. These costs are part of the overall updates and are reflected in the 2021 MAR. [↑](#footnote-ref-3)