Consultation Paper

Annual Adjustments of Maximum Allowed Revenues for USS

(April 2020-March 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.** |

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Table of Contents

[Introduction 3](#_Toc81818654)

[1 Electricity Balance 2020 4](#_Toc81818655)

[2 Wholesale Costs - Energy Purchase 5](#_Toc81818656)

[2.1 Adjustments of Revenues for 2020 6](#_Toc81818657)

[3 Pass-through Costs 8](#_Toc81818658)

[4 Retail Costs of the Supplier 8](#_Toc81818659)

[5 Maximum Allowed Revenues 9](#_Toc81818660)

# Introduction

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

This Consultation Paper represents ERO’s evaluation on the proposal for Maximum Allowed Revenues (MAR) for Universal Service Supplier (USS) for the relevant tariff year 2021. 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, this process was 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.

The parties who want to submit their eventual comments on ERO's proposals are invited to submit their written comments at ero.pricing-tariffs@ero-ks.org, by 7 September 2021 at the latest. Comments can also be mailed to:

*Zyra e Rregullatorit për Energji*

*Departamenti për Tarifa dhe çmime*

*Rr. Dervish Rozhaja Nr. 12*

*Prishtinë, 10000, Kosovë*

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| USS Tariff Application for 2021 | <https://www.ero-ks.org/zrre/sites/default/files/Konsultimet%20Publike/Application%20USS%202021%20-%208%20March%202021.pdf> |
| KOSTT Tariff Application for 2021 | <https://www.ero-ks.org/zrre/sites/default/files/Konsultimet%20Publike/Aplikacioni_%20p%C3%ABrshtetjet%20vjetore%202021_%20KOSTT.pdf> |
| KEDS Tariff Application for 2021 | <https://www.ero-ks.org/zrre/sites/default/files/Konsultimet%20Publike/Application%20DSO%202021%20-%208%20March%202021.pdf> |

# Electricity Balance 2020

In this tariff review ERO has used the approved balance sheet for 2021. However, the handling of electricity consumption by customers connected to the voltage level of 35kV and 10 kV was carried out in accordance with the position of the Board of ERO to continue the supply of these customers from USS at regulated tariffs. Given that KESCO has applied for the MAR of 2021 based on 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.

Such Balance shall reflect only the costs of electricity supply for customers who are entitled the supply under the criteria of universal service. In this regard, the volumes for wholesale purchase of energy for USS are:

* Energy purchases from KEK JSC;
* Energy purchases from generators connected to transmission level;
* Energy purchases from generators connected to distribution level; and
* Import.

The amount of energy for export during this forecast is not considered as energy of the USS, since USS shall only nominate the amounts required to cover the consumption of Universal Service Customers. This amount of energy shall be managed by the respective producer, in line with dispatching priorities. The consumption of universal service customers does not include the categories of customers connected to the transmission level.

The following table presents the sources of supply for covering the demand of USS customers.

Table 1 - Electricity Balance for USS

|  |  |
| --- | --- |
| **Energy Purchases** | **GWh** |
| Amounts supplied by KEK | 3,732 |
| Other generators at TSO level | 216 |
| Generators at DSO level | 199 |
| Import | 83 |
| **Total supplied amount** | **4,231** |
| **Consumption by categories of USS customers** |  |
| Customers 35 kV | 59 |
| Customers 10 kV | 450 |
| Customers 0.4 kV | 3,722 |
| **Total consumption of USS customers** | **4,231** |

As shown in the table, the amount of energy that is planned to be consumed by customers entitled to universal service is equal to the amounts to be covered by different sources of supply. The allocation of energy to customers with universal service for energy from renewable sources is done proportionally between the consumption of regulated and unregulated customers. While the energy produced by the Hydropower Plants with whom USS has concession agreements, has been allocated to USS customers, in accordance with the agreements between the parties.

Recovery of losses in transmission and distribution system are the responsibility of the respective network operators and as it can be seen, they are not shown in this table. They are handled in Consultation Papers for the MARs of TSO/MO and DSO.

# Wholesale Costs - Energy Purchase

Following the determination of required amount of supply in order to cover the demand of USS customers, a calculation of costs for energy purchase in the wholesale market shall also be carried out. In line with the Rule on USS Revenues, the Universal Service Supplier is obliged to provide electricity in a transparent, competitive and efficient manner. The Universal Service Supplier shall demonstrate that electricity forecast prices that will be procured are justifiable.

From the Regulator’s research on energy purchases, it was found that energy sales from HPP Ujmani which is the largest hydropower plant in the country, are realized through a one-year term contract reached in May 2019 (from 17.05.2019 until 16.05.2020). After the expiration of the contract, contrary to the Procedure for Energy Purchase, the sale and purchase of energy from HPP Ujmani was extended until 31 December 2020. This has prevented KESCO-USS from purchasing energy more efficiently for the supply of regulated customers.

KESCO-USS has not foreseen the purchase of energy from HPP Ujmani even for the tariff year 2021, therefore KESCO-USS must prove that the alternatives used for replacing this energy are more favourable for final customers, as required by the rules on revenues.

During the process of negotiating contracts for the purchase of USS energy from domestic generation, account should be taken of the fact that the forecasted prices are in line with the historical and projected prices of the Kosovo wholesale market.

In estimating the cost of purchasing wholesale energy, ERO has taken into account the direct costs of the Supplier to RES according to the Rule on Support Scheme, the costs for purchasing energy from other generators according to the contractual terms.

The allowed wholesale energy costs (WHPCt) will be calculated according to the following formula:

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

*Where:*

*GENCt allowed costs of energy purchase from domestic generators in relevant year t*

*IMPCt allowed costs of energy import in relevant year t*

*IMBCt net imbalance costs in relevant year t*

*IMBFt  imbalance sharing factor in relevant year t*

*RETMt retail margin in relevant year t*

*The summary of projected wholesale costs for 2021 is given in the following table:*

Table 2 - Energy Purchases

|  |  |  |  |
| --- | --- | --- | --- |
| **Energy Purchase Costs** | **GWh** | **€/MWh** | **€'000** |
| Amounts supplied from KEK | 3,732 | 29.50 | 110,098 |
| Other generators at TSO level | 216 | 41.90 | 9,034 |
| Generators at DSO level | 199 | 41.65 | 8,310 |
| Import | 83 | 67.73 | 5,645 |
| Imbalance costs |  | - | - |
| Imbalance Sharing Factor |  | - | - |
| **Total Supplied Amounts** | **4,231** | **31.5** | **133,086** |
| Retail margin |  | 3.00% | 3,993 |
| **Total Energy Purchase Costs** | **4,231** | **32,4** | **137,079** |

It is important to emphasize that USS is required by the Rule on USS Revenues, respectively Article 17 and Annex 3, to provide electricity in a transparent, competitive and efficient manner. Consequently, USS shall demonstrate that the energy purchase prices are reasonable and comply with the requirements of Article 17 of the Rule on USS Revenues.

In the absence of such evidence, ERO, in its preliminary evaluation has foreseen the costs of purchasing wholesale energy based on current prices realized in 2020, but during the public consultation process, the parties must respect the above-mentioned principles and prove that they have met all legal, regulatory and procedural requirements related to wholesale energy purchases.

## Adjustments of Revenues for 2020

In order to carry out the adjustments for 2020 which shall be applied during the determination of USS MAR for 2021, firstly the evaluation of current electricity supply costs for USS customers shall be conducted. Following the evaluation of these costs and revenues which resulted from billing in 2020, the adjustment of revenues is carried out.

The difference between the revenues evaluated from ERO for 2020 and the revenues realized from USS during the same period, is calculated according to the following formula:

ADJt = (AACat-1 – ARRt-1) \* (1+ It)

Where:

AACat-1  USS Actual Allowed Costs in relevant year t

ARRt-1  Actual Regulated Revenues during 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

The value of adjustments for 2020, following the indexing for inflation, results in the amount of 6.8 million Euros.

Table 3 - Adjustments for 2020

|  |  |  |
| --- | --- | --- |
| **MAR of Universal Service Supplier** | **Unit** | **2020** |
| Indexation Parameters |  |  |
| It Interest rate | % | 5.74.% |
| Retail Costs of the Supplier |  |  |
| OPEX - OPMCt = OPMCt-1 \* (1 + CPIt-1) \* (1 – Et)\* (1 – Pt) | €m | 4.59 |
| Depreciation- DEPCt = DEPCt-1 \* (1 + CPIt-1) \* (1 – Pt) | €m | 0.1 |
| Pass-through Costs |  |  |
| TSO Costs | €m | 23.6 |
| DSO Costs\* | €m | 100.5 |
| RES Fund\*\* | €m | 15.0 |
| Working Capital (WCLCt) |  |  |
| WCLC= (1 / 12) \* It \* (RETRt + WHPCt + PSTCt - NTFRt) | €m | 1.6 |
| Energy Purchase Costs |  |  |
| Wholesale Energy Purchase Costs | €m | 130.3 |
| License Tax |  |  |
| License Tax | €m | 0.01 |
| Bad Debt (BDTA) |  |  |
| BDTA | % | 4% |
| BDTA | €m | 11.0 |
| Adjustments |  |  |
| Adjustments 2019 | €m | -12.2 |
| Adjustments of USS Revenues |  |  |
| MAR of the Supplier AACat-1 | €m | 274.5 |
| Actual Revenues from Billing ARRt-1\*\*\* | €m | 268.7 |
| **Adjustment (AACat-1 - ARRt-1)\*(1+It)** | €m | 6.9 |
| Adjustments for LBT interest for 2020 | €m | 0.4 |
| **Adjustment of Revenues ADJt** | **€m** | **-6.5** |

This value of adjustments of -6.5 mil€ will be carried forward when determining the Maximum Allowed Revenues for 2021.

\* Costs for DSO are estimated based on preliminary reports and do not include corrections for billing and losses of DSO, according to the letter dated on 7 July 2021.

\*\* The costs of the RES fund in the monthly data turn out to be € 14.98mil, while in the financial statements they are € 15.22mil. Although the differences are minimal, the necessary clarifications should be given in the final calculation.

\*\*\* including other revenues in the amount of € 0.26mil according to the financial statements

In analysing wholesale power purchases and energy billing for universal service customers by KESCO, ERO has noticed a difference in the amount of purchased wholesale energy and the amount of energy billed to universal service customers. Based on the analysis made by ERO regarding wholesale energy purchases and energy billing for customers with Universal Service, it is seen that KESCO-USS has purchased energy in the amount of 4,245GWh (4,044 from the contract and 201GWh from the Compensation Program). As sale (invoicing) KESCO-FSHU has reported the value of 4,140GWh. This difference of 105GWh, means that KESCO-FSHU has purchased more energy than the demand to meet the needs of USS. When forecasting consumption/nominations there may be differences between the nominated values and those realized as energy injections and withdrawals. However, given the current circumstances of the purchase of energy from KESCO-USS and KEDS, it is meaningless for one party during the 12 months of the year to have injections, while for the other party to have energy withdrawals.

Considering that the nominations for both parties are made by KESCO, and the KEDS nominations depend on KESCO-USS, then the eventual deviations should be uniform, and not withdrawal from one party and injection from another.

Based on what was said above, ERO asks KESCO to provide the necessary clarifications.

ERO, seeing this phenomenon and the processes developed in the energy sector in Kosovo, with special emphasis on the independence of KOSTT, emphasizes that it is the responsibility of KOSTT to balance the system and that such balancing should not continue in this form through USS.

# Pass-through Costs

USS Pass-through Costs are the ones that depend on the evaluations for MAR for other regulated companies. These are the pass-through costs for the transmission use of system (TSO/MO- KOSTT), distribution use of system (DSO-KEDS) and any other cost that is out of USS control. The Pass-through costs for KOSTT, also including the renewable sources fund, are foreseen to be 29 mil€ whereas KEDS pass-through costs are foreseen in an amount of 81 mil€.

# Retail Costs of the Supplier

The allowed retail costs are calculated as the amount of allowed operating and maintenance costs (OPMCt), depreciation costs (DEPCt) and license costs (LCICt). The proposed retail costs for USS for 2020 have used as a basis the costs allowed in 2020 and indexed for the inflation rate with a value of 0.26%[[1]](#footnote-1). The value of retail costs for USS for 2021 is foreseen to be 4.7 mil€. Other components of retail costs such as the retail margin, the bad debt and working capital are calculated based on the formula set in the Rule on USS Revenues.

In assessing retail costs, KESCO did not disclose the costs associated with providing services to unregulated customers. ERO requests from KESCO to make an assessment during the public consultation process regarding these costs and to deduct them during the determination of the OPEX of USS.

# Maximum Allowed Revenues

The MAR, proposed for USS for 2021, is €271.2 million, which represents an amount that shall be covered by the regulated tariffs of retail sale. The details on calculations for the proposed MAR, are given in the following table:

Table 4 - Proposed MAR for 2020

|  |  |  |
| --- | --- | --- |
| **MAR of Universal Service Supplier** | **Unit** | **2020** |
| Indexation parameters |  |  |
| Interest Rate It | % | 6.85% |
| Retail costs of the Supplier |  |  |
| OPEX - OPMCt = OPMCt-1 \* (1 + CPIt-1) \* (1 – Et)\* (1 – Pt) | €m | 4.6 |
| Depreciation - DEPCt = DEPCt-1 \* (1 + CPIt-1) \* (1 – Pt) | €m | 0.1 |
| Pass-through costs |  |  |
| TSO Costs | €m | 14.3 |
| DSO costs | €m | 81.4 |
| RES Fund costs | €m | 14.8 |
| Working Capital (WCLCt) |  |  |
| WCLC= (1 / 12) \* It \* (RETRt + WHPCt + PSTCt - NTFRt) | €m | 1.4 |
| Energy Purchase Costs |  |  |
| Wholesale Energy Purchase Costs | €m | 137.1 |
| License Tax |  |  |
| License Tax | €m | 0.02 |
| Bad Debt (BDTA) |  |  |
| BDTA | % | 4% |
| BDTA | €m | 10.8 |
| Adjustment of Revenues for USS |  |  |
| Adjustments of 2020 | €m | 6.5 |
| **Maximum Allowed Revenues** | **€m** | **271.2** |

1. Source: Eurostat, <https://appsso.eurostat.ec.europa.eu/nui/submitViewTableAction.do> (vizituar më 27.01.2020) [↑](#footnote-ref-1)