Republika e Kosovës
Republika Kosova - Republic of Kosovo

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

Consultation Report

Input Values and Operating Expenses of the Universal Service Supplier

Review of Input Values (2025-2027)

STATEMENT

This Consultation Report has been prepared by ERO for the purpose of informing and consulting stakeholders in the energy sector. The report does not represent a decision by ERO and should not be interpreted as such.

16 December 2024

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Contents

1 Introduction

The Energy Regulatory Office (ERO) is in the process of reviewing and setting the input values and operating expenses for the Universal Service Supplier - USS, for the period 1 April 2025 – 31 March 2027. This review is based on the legal mandate and obligations arising from the Rule on Determination of Revenues for the Universal Service Supplier (USS).[1]

Input values are the main parameters that are used for calculation of regulated revenues of Universal Service Supplier.

The Rule on Determination of Revenues for the Universal Service Supplier determines that in the course of reviewing the input values, ERO sets the values of certain parameters that affect the level of the allowed revenues of the USS. The input values that will be determined in the reviewing process are:

- The economic life of the assets related to USS;
- Retail margin;
- Allowed level for bad debts;
- Imbalance Sharing Factor; and
- Any other input parameters that the Regulator may deem necessary (Efficiency Factor).

In accordance with the regulatory framework and ERO practices, the determination of input values is developed through an open public consultation process, where the parties can present their comments and observations regarding the values proposed by ERO. This Consultation Report contains the initial proposals for input values for the USS for the period 1 April 2025 – 31 March 2027, including operational and maintenance costs.

ERO invites all interested parties to review and comment on ERO's views provided in this Consultation Report, with which they may disagree, by providing counter-arguments or providing additional data that ERO may not have considered during the original proposal. The comments on this Consultation Report may be submitted in writing at the e-mail address ero.pricing-tariffs@ero-ks.org or in hard copy at the following address:

Energy Regulatory Office

Tariffs and Pricing Department

St. Bakim Fehmiu (former Fazita building) 2nd floor

Prishtina, 10000, Kosovo

The comments must be submitted by 31 December 2024 at the latest.

[1] http://ero-ks.org/2017/Rules/USS%20Pricing%20Rule.pdf

Upon reviewing the received comments, ERO will publish the Final Report along with the parties' comments and ERO's responses to such comments.

Related documents

Law on the Energy Regulator	https://tinyurl.com/yc3rpdve
Rules on USS Revenues	https://tinyurl.com/zpff9kr3
ERO's proposal for USS Input Values 2022-2024	https://tinyurl.com/5e7cm5dh
Final report on Input Values 2022-2024	https://tinyurl.com/5acmfkzv
Consultation Report on Input Values 2022-2024	https://tinyurl.com/4umpvd54
USS application for input values	https://www.ero-ks.org/zrre/sites/default/files/Publikimet/Modeli%20i%20Tregut/Proposal%20for%20Input%20Values%20and%20Operating%20Expenses%20for%20the%20Universal%20Servi....pdf

2 Input Values

The Rule on Universal Service Supplier (USS) defines the methodology for establishing and updating the Universal Service Supplier's Maximum Allowed Revenues, that cover the costs of providing the regulated service to universal supply costumers (household customers that are entitled the right to universal service). This rule determines the regulated revenues in a way that enables the supplier to cover the costs of retail sales, the costs of purchasing the necessary energy to supply USS costumers and the pass-through costs, including the costs of the Transmission System Operator (TSO) and the Distribution System Operator (DSO). The adjustments are made in accordance with the Rule on USS Revenues, ensuring that the USS has adequate financial liquidity and that the regulated revenues, realized through the application of tariffs, are calculated accurately and fairly.

USS Adjusted Reveneus depends on the Input Values that are determined during their review. In order to promote the predictability of revenues, the input values are determined for a regulatory period of 3 years. Amendments to input values can only be made to the extent that these changes are *'reasonable, justified*

and prudently verified' (section 9.1 of the Rule on Determination of Revenues for the Universal Service Supplier).

The Rule on Determination of Revenues for Universal Service Supplier (Rule on USS Revenues) in Article 12, paragraph 3 defines that the input values consist of:

- The economic life of the assets related to USS;
- Retail margin;
- The allowed level of bad debts;
- The imbalance sharing factor;
- Operating and maintenance costs;
- Efficiency factor; and
- Any other parameter that the Regulator may deem necessary.

USS's proposals on these input values, and ERO 's positions on them, are provided in Chapter 3 of this report.

3 Determination of Input Values

This chapter of the Consultation Report provides USS's proposals and arguments for the level of input values, as well as ERO's positions on each of the proposals presented by USS.

ERO's approach to determining the input values for the USS is based on establishing efficient values to cover the reasonable costs of the USS based on ERO's past positions. Furthermore, ERO examines whether there is a change in circumstances of supply that could push ERO to change its stance from past decisions. This approach provides regulatory predictability and consistency in decision-making based on past stances and decisions. For each of the input values defined in this Consultation Paper, ERO offers:

- Existing value that is a summary of the past review of input values and their level (2022-2024);
- USS application for input values 2025-2027;
- ERO's proposal for input values 2025-2027.

3.1 Economic Life of USS-related Assets

Asset life is used to calculate the depreciation cost of USS's fixed assets. In accordance with the Pricing Rule, depreciation of assets is calculated on a straight-line basis, using the Economic Life of Assets, determined for different categories of assets. The economic and technical life of an asset are two key concepts on evaluation of assets and projects in the energy sector. The economic life of the asset for each class of assets is considered to represent the technical life of the asset (ie, the period before replacement

is required due to wear and tear), unless there is sufficient reason to consider that the asset should be depreciated before such a date.

3.1.1 Current value

During the review of the 2022-2024 input values, ERO decided that the economic life of USS's assets is divided into two categories, based on the technical and economic analysis of the DSO and TSO periodic review for the period 2018-2022. The weighted average asset life for IT equipment, software, licenses and patents was set at 5 years, while that of furniture and office equipment was set at 7 years [2].

3.1.2 USS Application Summary

According to USS, rapid technological development has caused information technology and related equipment to have a shorter life cycle, requiring more frequent updates and replacements. For example, software and IT equipment often become unusable within a short period due to new improvements and increased security requirements.

The amortization life of activities, especially IT equipment, should reflect current technological advances and usage patterns. Historically, a 5-year depreciation period for computers and office equipment was appropriate, but continuous developments in technology have significantly shortened their useful lives. Many studies and even practices in some other countries suggest reducing this period.

Consequently USS proposes the economic life as follows:

Table 1: USS's proposal for the categorization and useful life of assets

Depreciation Groups	Useful Life of Assets
Office Equipment	5 years
Computer Programs	3 years

3.1.3 ERO Review and Proposal

ERO proposes that asset categories shall remain the same as currently are and that the useful life of the assets does not change.

ERO's proposal is based on the following arguments:

- USS proposes to change the category of assets, but does not provide details on the participation and weighting of assets within the proposed categories. Based on the examples and regulatory precedents, ERO has concluded that softwares can have a shorter or longer deprecitation lifespan and its under the jurisdiction of regulators. However, not all technology equipment depreciates at the same rate as software,

[2] For a detailed analysis of ERO, see chapter 3.3.2 of the relevant ERO Consultation Report (section in the first chapter of this document).

particularly information technology equipment and administrative software, which often have useful lives that exceed the 3-year period.

- Considering that the ERO classification includes "Work equipment, devices and vehicles, computers, IT equipment and software," the useful life of these assets should be weighted according to the participation of each subcategory within this classification. As for office equipment, the economic life usually varies from 7 to 10 years, while for IT equipment and software, it varies from 3 to 8 years[3], according to international practices: Germany (3), Greece (5), Ireland (8), Italy (5), Japan (3-5), Spain (>5), Portugal (3), and USA (3-5).

Considering this, ERO proposes that, as an average, the depreciation rate should continue to be 5 years.

- Regarding the useful life of office furniture and equipment, USS does not provide sufficient arguments to justify why their life cycle should differ from that applied last year, or how this can positively affect the improvement of service quality standards. In the absence of these facts, ERO proposes that the useful life of office furniture and equipment should continue to be 7 years.
- In the last Periodic Review process for the Third Regulatory Period 2023-2027, ERO decided that the useful life of assets related to office equipment and IT infrastructure for the Transmission System Operator - Market Operator (KOSTT) and for Distribution System Operator (KEDS) to be:
  - 5 years for IT equipment, software, licenses and patents and
  - 7 years for furniture and office equipment.

Considering that the electrical system operators in Kosovo - KOSTT, KEDS and USS - operate under similar conditions, ERO proposes that the lifetime of the economic assets of the Universal Service Supplier(USS) be at the same level: 7 years for office equipment and 5 years for IT, software, licenses, patents, etc. Based on the data highlighted above, ERO proposes that the economic life of the assets related to USS remain as before:

Table 2: ERO's proposal for asset classification and useful life

Depreciation Groups	Useful Life of Assets
Furniture, office equipment	7 years
Work equipment, cars, computers, IT equipment and software, computer programs etc.	5 years

[3] Worldwide Capital and Fixed Assets Guide 2024: https://www.ey.com/en_gl/technical/tax-guides/worldwide-capital-and-fixed-assets-guide

3.2 Retail Margin

The retail margin is the percentage return that the USS is allowed to earn on the costs of purchasing wholesale electricity, compensating it for the risk it assumes in trading the volumes for the provision of the regulated service. Therefore, the retail margin/profit in the energy sector represents the difference between the price purchased by the supplier (usually from producers and the market) and the price at which that energy is sold to final customers.

The importance of the Retail Margin:

Supports the operations of the USS: helps the supplier to cover administrative costs and invest in improving services;

Promotes competition: in liberalized markets, the application of this margin can help suppliers offer lower tariffs to the customer; and

Ensures financial stability: a correctly defined margin ensures that suppliers can withstand unexpected changes in wholesale prices.

The legislation and the regulatory framework in Kosovo determine that the Universal Service Supplier is a regulated activity in the energy sector. As a result, operating costs and other factors related to providing service to customers are predetermined by ERO. In this context, USS must carefully plan the costs and the necessary volumes of energy to cover the demands of its customers.

In accordance with the Rule on USS Revenues, the Universal Service Supplier is obliged to provide electricity in a transparent, competitive and efficient manner. Further, USS must demonstrate that the estimated prices of electricity, which it plans to procure, are reasonable and based on fair and verifiable practices.

The allowed costs of wholesale electricity ($WHPC_t$) has to be calculated according to the formula:

$$WHPC_t = (GENC_t + IMPC_t + IMBC_t * IMBF_t)*(1+RETM_t)$$

The meaning of each variable in the formula is:

$GENC_t$	*Allowed costs of purchasing power from local generators in the relevant year(s).*
$IMPC_t$	*Allowed costs of imported energy in the relevant year(s).*
$IMBC_t$	*Net imbalance costs in the relevant year(s).*
$IMBF_t$	*The dividing factor of the imbalance in the relevant year (t).*
$RETM_t$	*Retail margin in the relevant year(s).*

The Universal Service Supplier (USS) has an obligation to propose its profit on a competitive basis. The Regulator determines the level of the profit margin considering it as a reasonable profit that reflects the risks that the supplier undertakes while providing the service to the regulated customers. To determine this level, the Regulator not only assesses USS's exposure to the risks associated with the provision of the service, but also reviews the comparability with the suppliers' margins in other European countries. In

particular, this evaluation focuses on countries that have markets that are similar to Kosovo, ensuring that the defined margin is competitive and in line with international practices.

3.2.1 Existing values

The retail margin established by ERO in the previous review of input values is 2.54%. This margin was calculated as the average of the actual margin costs during the 2017-2021 period and supported by the decisions of the regulators in the region.

3.2.2 USS application

According to the USS application, the calculation of the retail margin referred to in Article 17 – sub-paragraph 8.1 (comparative method for determining the retail margin), is not appropriate because the adequate comparative samples within Europe are small, considering that most European markets have liberalized the electricity retail markets. Taking that into account, USS submitted the application for retail margin, referring to Article 17 – sub-paragraph 8.2 (reasonable return from net fixed assets used to provide the universal service).

Based on that, USS's retail margin requirement is presented in Table 3 as follows:

Table 3: USS Retail Margin Demand 2025 – 2027

Description		2025	2026	2027
Capital employed	a	106,683	112,704	118,460
Cost of capital	b	8.68%	8.68%	8.68%
Total return	c = axb	9,261	9,784	10,284
Assumed WCLC	d	2,373	2,428	2,501
Net return required	**e = c - d**	**6,888**	**7,356**	**7,783**
WHPC rated	d	217,907	224,187	230,746
Margin	**e/d**	**3.2%**	**3.3%**	**3.4%**

Note: All values are in thousand Euros.

In justifying the proposed retail margin values, USS in their application refers to ACER's *Energy Retail and Consumer Protection Market Monitoring Report* [4], and states that suppliers have had difficulties in managing their margins due to the price increases in the wholesale market. As a result, suppliers have suffered a reduction in profit margins, rendering their financial stability and operations management difficult.

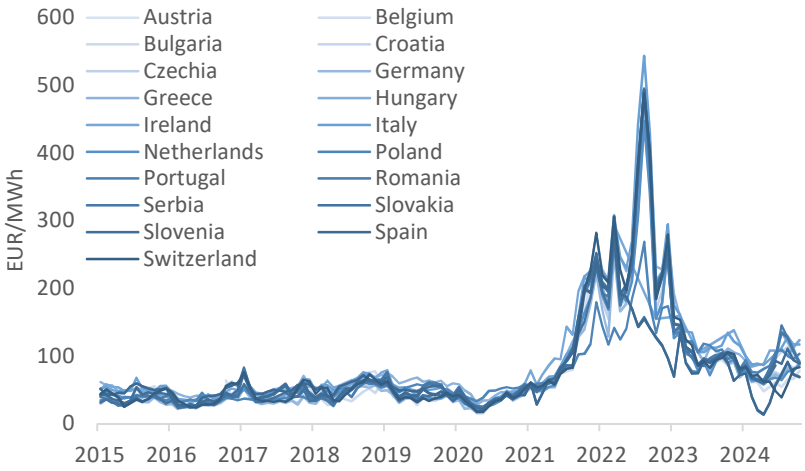
3.2.3 ERO's Review and Proposal regarding USS's Retail Margin

ERO proposes that the retail margin for USS remains the same as the current level (2.54%) for the following reasons:

[4] ACER - CEER Energy Retail and Consumer Protection Market Monitoring Report 2023, September 2022

- The margin determined in the previous review of input values is set as the actual average of USS's financial compensation for the retail margin during the years 2017-2021 which is the same with the level of the regulatory period 2022-2024. As such it reflects adequate long-term average compensation for USS.
- USS is not exposed to energy volumes risks, moreover, energy from KEK is provided by priority to USS at a contracted price;
- In the regulated market, when the margin is not linked to tenders but to the calculations of wholesale energy purchase costs, suppliers are exposed to a lower level of risk;
- Practices have shown that even in cases where wholesale prices have increased, margins have decreased, unless suppliers tend to increase prices for customers;
- Wholesale (import) electricity prices have a steadying/decreasing trend after the energy crisis of 2022[5], as shown in Figure 1, below:

Figure 1 *Wholesale prices in European markets 2015-2024*



- The full costs of USS are recognized and adjusted during regular reviews and annual tariff adjustments.

[5] Wholesale prices of electricity in Central and Eastern Europe (CEE) from January 2017 to June 2024, by country (in euros/MWh): https://www.statista.com/statistics/1094282/cee-wholesale-electricity-prices/

Additional notes and comments on the USS application:

- USS refers to the ACER report " *Energy Retail and Customer Protection Market Monitoring* " emphasizing that suppliers have had difficulties in managing their margins due to price increases in the wholesale market. ERO states that (i) this report refers to suppliers in the open market who are exposed to a higher level of risk in the absence of guarantees provided to regulated suppliers with public service obligations; (ii) the argument could lead to a margin reduction for USS as the retail margin would have to reflect margin movements under unregulated market conditions to avoid market distortions.
- The alternative way of calculating the return, which the USS application refers to, already has a regulatory precedent. According to this precedent, the retail margin production applied to wholesale energy purchase costs cannot be lower than the production between the capital employed in fixed assets and the weighted average of the capital cost. This does not include working capital for which USS is compensated according to the 30-day methodology (30-day approach).

ERO, based on the above-mentioned explanations, proposes the retail margin for the period 2025 – 2027 shall be at the value of 2.54%.

3.3 Bad Debt

Article 16 of the Rule on USS Revenues stipulates that the allowed costs of bad debt are set by the Regulator in determing input values and will be calculated by applying the allowed level of bad debt to the formula for calculating the Regulated Revenues of Universal Service Supplier. Bad debt and accounts receivable are two closely related concepts in finance, related to the management of unpaid revenues from customers. They affect a company's financial results and cash flow.

3.3.1 Existing USS values

The existing level of bad debt allowed in USS's Maximum Allowed Revenues for the years 2022-2023-2024 was allowed at 2.4%, 2.2% and 2.0% to reflect ERO's expectations to improve the level of bad debt in USS. The allowed level of ERO was set based on the actual average value of bad debt (2020-2021).

3.3.2 USS application

USS proposes that the level of bad debt in the Maximum Allowed Revenues shall be increased. USS disputes the way of calculating and determining bad debt by ERO for the period 2022-2024, when the values were: 2.4% in 2022 and 2% in 2024, based on the actual average level for the period 2017-2021, according to Financial Statements and accounting principles (IFRS).

In its argument for the need to increase bad debt, USS presents the collection rate after 12 months of billing, presented in Table 4.

Table 4: USS collection rate after 12 months of billing period

year	2019	2020	2021	2022	2023	2024	Average
Mid-term	91.7%	91.7%	91.8%	93.0%	93.8%	94.8%	92.8%
End-year	93.5%	92.5%	94.0%	95.1%	95.9%	n/a	94.2%

USS clarifies invoices that remain unpaid for more than 12 months have a low probability of being paid in full. The review of collection power shows that USS manages to fully collect all payments up to 12 months, however, after this period collection rate drops to 75%, which means 25% of old debts remain uncollected. USS emphasizes that, through efforts and cooperation with bailiffs, it achieves a certain level of success in collecting old debts.

Taking into account the reasons highlighted above, USS proposes that the average level of bad debt be 4.8%, as shown in Table 5, below:

Table 5: Bad debt estimate assuming a 75% collection rate for old debt (>12 months)

Year	2018	2019	2020	2021	2022	2023
Uncollectible debt (mil. EUR)*	12.73	13.35	15.35	16.02	16.64	17.43
Billed electricity (mil. EUR)	263.60	278.20	289.67	324.06	357.16	419.92
Bad debt (%) =a/b	4.8%	4.9%	5.3%	4.9%	4.7%	4.2%

Source: USS report

Based on what was highlighted above, USS proposes an alternative method for assessing bad debt through expected credit loss (ECL) modeling. This model segments receivables by age and assigns default rates based on historical collection performance. This approach provides a more nuanced assessment, taking into account the different risks of defaulting at different stages. The final estimate of bad debt, applying this methodology, amounts to 4.9% of billed revenues.

Further on, USS, in the justifications to increase bad debt, expresses its concern that these debts may increase in the future due to their assumptions on the increase in electricity prices. This increase, according to USS, may take place as a result of the market opening (ALPEX launch) or the planned renovations of the Kosova B Thermal Power Plant, which would lead to an increase in imports.

USS requests that ERO reassess the bad debt parameter for USS and disputes the way bad debt is calculated, which is based on accounting provisions. According to USS, these provisions do not adequately reflect the real risks and challenges faced by USS.

According to its own analysis and based on historical data, USS believes that the bad debt for the next regulatory period should be in a range between 4.8% and 6.2%.

USS also expresses concern that the market opening, as well as the planned refurbishment of the Kosova B power plant, may cause a price increase and, as a result, a decrease of collection rate.

3.3.3 Review and Proposal of the ERO regarding the Level of Bad Debt

Referring to Article 16 of the Rule on Determination of Revenues for the Universal Service Supplier, ERO determines the level of bad debt based on:

- Evaluation of USS's historical collections and USS's capacity to collect debts from customers;
- Audited financial statements;
- Implementation of legal and regulatory measures related to USS's right to take action against customers who do not fulfill their financial obligations; and
- Protecting the interests of customers who are regular payers.

Based on ERO's assessment, compared to the period 2022 - 2024, the prospect of improving collections from USS is better due to the end of the COVID19 pandemic and the temporary impacts on the reduction of collection rates as well as the adoption of the methodology on establishing disconnection and reconnection charges that is expected to increase the alertness of costumers for the timely payment of bills. The Program for the Protection of Vulnerable Customers with an average income below 150 euros per member for electricity bills, which is supported by the Government of the Republic of Kosovo, also has an effect on improving collections.

Similar to the regulatory practice implemented in the past processes of determining bad debt, ERO again emphasizes that non-collection cannot be considered as bad debt as a whole, because there may be delays in collection, but not all of that non-collection turns out to remain as bad debt.

To assess the Loss/Impairment of Accounts Receivable (LIAR), ERO reviewed financial statements for the years 2020-2023. From the review of historical data submitted by USS and ERO financial statements, they find that the ratio between the total value of Bad Debt and Total Billing for the period 2020 - 2024 is from 3% to 1.1%. Meanwhile, the average level of LIAR Accounts Receivable Impairment for the Period 2020 - 2024 has turned out to be 1.1%.

Table 6: Historical non-collection rates for the period 2020-2024

Billing	Unit	2020	2021	2022	2023	2024*	Total
Energy billing	mil€	289.68	326.08	357.16	419.93	437.31	1,830.17
Billing of services	mil€	1.77	2.08	1.84	1.34	1.31	8.34
Total billing	mil€	291.45	328.16	359.01	421.27	438.63	1,838.51
Collection	**Unit**	**2020**	**2021**	**2022**	**2023**	**2024***	**Total**
Collection for billed energy	mil€	264.11	315.83	344.81	386.33	419.68	1,730.77
Technical errors	mil€			0.00	0.12	0.00	0.12
Advance payment	mil€	8.37	5.63	10.31	7.44	8.53	40.29
Bailiffs	mil€	2.02	2.77	2.74	2.59	2.36	12.47
Services	mil€	1.31	2.17	1.89	1.43	1.32	8.13

Revenues from debt collection - KEK	mil€	0.00	0.04	0.10	0.06	0.06	0.26
KEK Agreement	mil€	0.39	0.40	0.35	0.32	0.24	1.69
total	mil€	276.20	326.84	360.21	398.17	432.19	1,793.61
Non-collection rate (b+c)/a	%	8.1%	2.3%	2.7%	7.4%	3.5%	4.7%
Loss in value of LI/A	mil€	8.59	3.34	2.24	3.36	2.06	19.59
Loss in value of LI/A d/a	%	3.0%	1.0%	0.6%	0.8%	0.5%	1.1%

3.3.2.2 Impact of deregulation

ERO is in the process of opening the electricity market. The work plan for the launch of this process has been prepared and categories of costumers who do not qualify for USS supply have been identified. As the process of deregulation of the market is still in the initial phase, the impact of this process on bad debt rates will be addressed after the data from USS for costumers supplied in the free market have been provided. However, in this regulatory period, as was proceeded in the period 2022-2024, only the impact of the market entry of costumers connected at the 35kV and 10kV level will be assessed.

Table 7: Impact of deregulation on average collection rate

Effect of deregulation (2022 data)	Collection rate	Difference in points %
Average 35, 10 and 0.4 kV	98.43%	
Average 10 and 0.4 kV	98.40%	0.03%
Average 0.4 kV	98.16%	0.27%

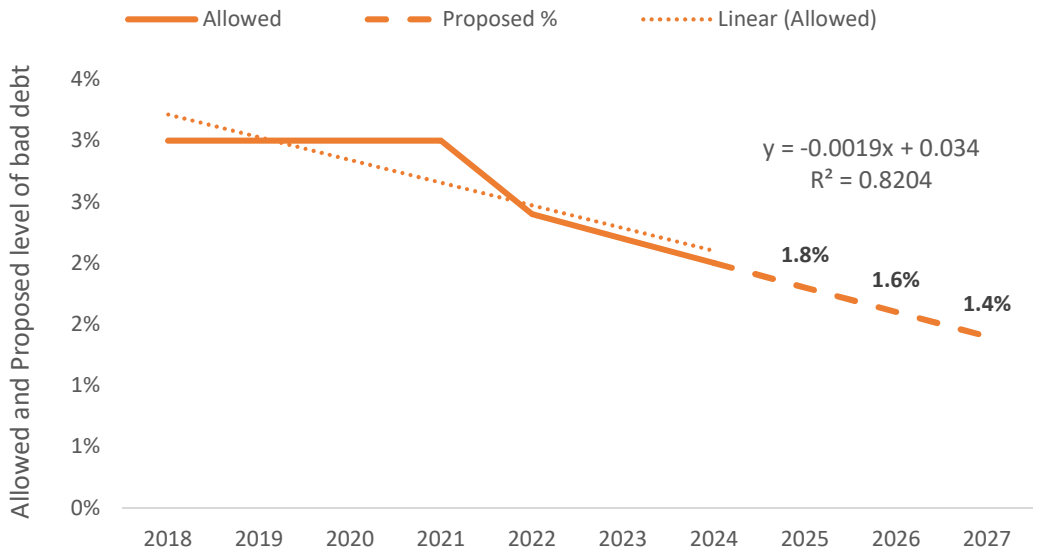
The actual average collection rate, including all universal supply costumers in 2022, was 98.43%. The weighted average collection rate for costumers at the 10kV and 0.4kV levels decreases by 0.03% after the deregulation for 35kV costumers, whereas the collection rate decreases by 0.27% with the deregulation of costumers at the 35kV and 10kV levels.

3.3.2.2 ERO proposal

ERO proposes the level of bad debt covered by the allowed revenues have the same trend to the existing level:

- In continuation of previous practices, ERO will continue to offer financial incentives to the USS to achieve increasingly efficient levels of collection of uncollected revenues.
- The downward trend on the non-collection rate is the same as that of actual setting of Input Values (0.2% percentage points per year) and this is in line with the average historical trend of the decrease in the allowed and actual level of bad debt of USS for the same period.

Figure 2 Allowed level of bad debt 2018-2024 and trend 2025-2027



- Consequently, ERO proposes that the allowed level of bad debt for the period 2025-2027 follow the same linear trend of decrease of the annual percentage of the allowed debt.
- ERO's proposal for bad debt:

Table 8: ERO's proposal for Bad Debt

ERO's proposal for Bad Debt	% allowed
2025	1.8%
2026	1.6%
2027	1.4%

3.4 Imbalance Sharing Factor

The imbalance sharing factor represents the portion of balancing costs that USS is entitled to pass through to regulated costumers. Balancing costs are those that arise due to discrepancies between actual purchases of USS to meet customer demand and forecasts made earlier. In a large and liquid electricity market, suppliers are expected to manage these mismatches through accurate forecasting and buying and selling energy in liquid markets (such as the forward market) so that any remaining imbalances are minimized.

3.4.1 USS Existing Values

The Imbalance Sharing Factor in the last evaluation of USS input values is set at 100% for the period 2022-2024.

3.4.2 USS application

USS points out that limited access to the number and diversity of generation sources, along with dependence on old and inflexible generating units, restricts the system's capacity to remain balanced and operate at minimal cost.

Further, taking into account market developments, including prosumers, market opening and the option of switching suppliers, USS believes that the imbalance sharing factor should continue to be applied as 100%, at least up to the next periodic review.

3.4.3 ERO's proposal for the Sharing Factor

Based on the explanation regarding the current circumstances and expectations for integration into the ALPEX coupled market, ERO agrees with USS's proposal that the 100% sharing factor should be maintained for the period 2025 to 2027. However, ERO proposes that in case the intra-day market becomes operational within the period 2025-2027 then the sharing factor should be set at 50% starting from the year the intra-day market is operational. ERO will update the maximum allowed revenues for USS on the regular annual adjustments to reflect the necessary changes in case the intraday market becomes operational.

4 Operating and Maintenance Costs

In Article 14 of the Rule on Determination of Revenues for the Universal Service Supplier it is determined that the allowed retail costs include costs related to the supply of regulated costumers, and they include: (i) Allowed operating and maintenance costs; (ii) Corporate costs; (iii) Depreciation costs; and (iv) Other costs which are beyond the control of USS.

4.1 ERO approach

The common practice of determining the Operating and Maintenance expenses is to allow them at the level ERO considers reasonable on a general level, without analyzing the individual categories of costs that make up the Operating and Maintenance expenses(OPEX). However, during the previous review of the input values for the USS, ERO had determined that it was necessary to analyze all categories of USS costs individually to assess their rationality. In this review of input values and Opex, ERO proposes that operating and maintenance expenses for the period 2025-2027 be evaluated according to ERO's previous practices. According to this practice, ERO sets operating and maintenance costs as a total value that it considers efficient. Over this value, the efficiency factor and inflation are applied in accordance with the USS Price Rule.

Consequently, the Operating and Maintenance Expenses in each year will be determined as follows:

- Initial value: Operating and Maintenance Expenses allowed by ERO for year t-1 (including inflation);
- Adjustments:
    - Adjustments for inflation in year t;
    - Adjustments for efficiency factor (see chapter below) in year t;
    - Any other necessary amendments to Operating and Maintenance Expenses.
- Calculations for each of these values are provided in Chapter 4, below.

4.2 Existing USS values

The allowed values of operating and maintenance expenses, summarized according to the nature of the expenses (controllable or non-controllable), are given in the following table.

Table 9: Existing values of USS 2022-2024

	Unit	2022	2023	2024
Efficacy	%	-	-0.1%	-0.1%
Controllable opex	€'000	3,331	3,328	3,325
Uncontrollable Opex	€'000	1,839	1,839	1,839
Total		**5,169**	**5,166**	**5,163**

It should be clarified that the values provided in Table 9 are presented in real terms of 2021 and do not include the annual inflation reflected on regular adjustments. After indexation inflation, the value of operating and maintenance expenses for the year 2024 is around €5.4 [6]million. This value will be used as the initial value on which the operating and maintenance expenses for the period 2025-2027 will be determined.

4.3 Adjustments

This sub-chapter of the Consultation Report presents the adjustments of Operational and Maintenance expenses over ERO initial value.

- Adjustments for expected efficiency improvements (Chapter 4.3.1);
- Adjustments for inflation (Chapter 4.3.2);
- Adjustments for operating and maintenace (Chapter 4.3.3).

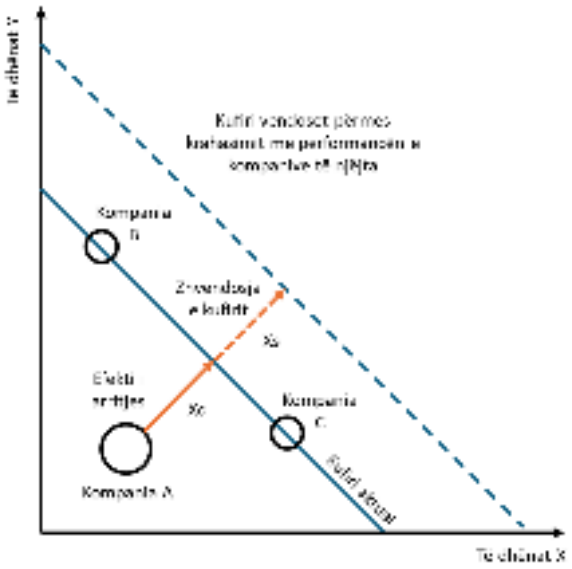
[6] The allowed value of Operating and Maintenance Expenses for the year 2024 of EUR 5,467,389.

4.3.1 Adjustments for efficiency improvements

Operating and Maintenance Expenses are subject to an efficiency factor which reflects the expected improvements in operating efficiency of regulated companies. This efficiency factor reflects the improvements that a regulated operator must make in order to reach the efficiency level of a comparable efficient company and the potential improvements that that efficient company may achieve during the regulatory period. Consequently, to set an efficiency target for a regulated company, ERO must assess its operating efficiency with a sample of comparable companies, identify the operating levels of the most efficient companies in that sample, and then determine how the company, for which the efficiency factor is being set, compares to the most efficient companies. ERO must then decide how much the overall efficiency improvement is expected to be for the most efficient companies and determine the efficiency factor as the sum of these two factors:

- The equalizing effect with the most efficient companies: How much should a certain company improve its efficiency to be considered an efficient company (x_c); and,
- The effect of changing the productivity frontier: How much improvement in efficiency is expected from the most efficient companies (x_s).

Figure 3 Determination of the efficiency factor (effect Xc + Xs)



In this way, the efficiency factor for a given regulated company may be calculated as:

$$\text{X-efficiency} = x_c + x_s$$

In the past periodical review for the distribution and transmission network, ERO highlighted the difficulties of determining the factor x_c in the context of regulated companies in Kosovo, which are related to the lack of samples of comparable companies over which an efficiency factor would be determined. In the absence of this analysis, ERO determined that the efficiency factor for regulated companies should reflect only the effect of the change in the productivity frontier (x_s)[7].

[7] ERO Consultative Report on setting the efficiency factor https://www.ero-ks.org/zrre/sites/default/files/Publikimet/Pjesemarresit%20ne%20Treg/Furnizim/Efficiency%20Factor%20_%20Consultation%20Report.pdf

4.3.1.1 The Impact of Changing the Productivity Frontier

ERO proposes that the effect of the overall improvement be decided on the basis of regulatory precedents, in line with the determination of the efficiency factor for regulated networks (DSO and TSO) during their periodic review. The difficulty in determining this effect is that regulatory precedents are set in regulated infrastructure sectors such as the distribution network and the transmission network, which may not reflect improvements for regulated suppliers. However, both networks and regulated supply companies benefit from technological improvements and process automation that drive operational improvements. Consequently, the expected improvements in the change of the productivity factor in regulated networks may reflect improvements in regulated suppliers. According to the calculations, ERO proposes that an efficiency factor be applied to the USS that reflects the effect of the change in the productivity frontier of 0.75% that will be applied to the part of the operating and maintenance expenses that are considered controllable by USS.

4.3.2 Adjustments for inflation

The methodology for the application of these adjustments is defined in the USS Revenue Determination Rule. Inflation is adjusted by reflecting the current value of inflation in the relevant year t-1 that reflects the Harmonized Index of Consumer Prices (HICP) for all units for Eurozone countries (*Euro Area 20 countries*) published by *Eurostat* [8]. The average value of inflation for the year 2024, until October, is 2.28%. This inflation rate has been applied to operating and maintenance costs to reflect its impact on the overall cost of operating costs but will be adjusted to reflect the actual level at the end of the year whenever this value is published by *Eurostat*.

4.3.3 Other operating and maintenance expense adjustments

USS in the request for other operating expenses highlighted two costs which have a significant impact on the level of costs for Operation and Maintenance:

- The cost of placing invoices in sealed envelopes, as requested by the Data Protection Agency, the estimated cost of this legal obligation according to the USS estimate is €2m per year; and,
- The cost of insurance services, which is expected to increase with the approval of the minimum wage level in the amount of €350.

In principle, ERO will allow the coverage of all reasonable expenses arising from the obligation to fulfill legally binding requirements. Regarding the request to cover the costs for placing invoices in sealed envelopes, the USS must submit to the ERO satisfactory proof and information regarding the expected level of these costs, providing more detailed information about these costs. The final level of operating and maintenance costs will be determined in the final report after provision of additional information

[8] Eurostat (2024). HICP - monthly data (annual rate of change).

from the USS and comments from stakeholder, and may also be reviewed in the regular adjustment process.

5 Proposal for Input Values and Operating Expenses

The table below shows the summary of the ERO proposal for Input Values and Operating Expenses.

Table 15: ERO Proposal for Input Values and Operating Expenses

ERO Proposal for Input Values and Operating Expenses for USS	Unit	2025	2026	2027
Retail margin	%	2.54	2.54	2.54
Bad debt	%	1.8	1.6	1.4
The imbalance sharing factor	%	100	100	100
Operating expenses[9] without efficiency	€000	5,592		
Efficiency factor	%	0.75	0.75	0.75
Classification of useful life of Assets:	YEARS	7	7	7
I. Furniture, office equipment;				
II. Work equipment, reading devices, cars, computers, IT equipment and software		5	5	5

[9] The permitted level of USS for the year 2024 of 5,467,389 indexed with an inflation rate of 2.28% and which does not include the additional adjustments mentioned in chapter 4.4.3 of this report.