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Bulevardi Bill Klinton nr.3
Prishtinë 10000
Republika e Kosovës

Elektrokosova Building
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Prishtina 10 000
Republic of Kosovo

KOMPANIA KOSOVARE PËR DISTRIBUIM DHE FURNIZIM ME ENERGJI ELEKTRIKE SH.A.
KOSOVO ELECTRICITY DISTRIBUTION AND SUPPLY COMPANY J.S.C.
KOSOVSKO PREDUZEĆE ZA DISTRIBUCIJU I SNABDEVANJE ELEKTRIČNOM ENERGIJOM D.D.
KESCO- SH. A.
Nr. 03 Dt. 22 1. 2024
HQ I

Ymer Fejzullahu
Chairman of ERO Board

Mesut Serhat Dinc
Chief Executive Director
KESCO j.s.c.

Date: 22.01.2024

SUBJECT: Application for Maximum Allowed Revenues for 2024

Dear Mr. Fejzullahu,

The Universal Service Supplier (USS) has prepared the Application for Maximum Allowed Revenues in accordance with the requirements set forth in the Rule on Determination of Revenues for Universal Service Supplier (USS Pricing Rule).

KESCO remains committed to cooperation in order to reach common conclusions which are in the interest of all participants in the energy sector.

Sincerely,

Mesut Serhat Dinc
Chief Executive Director, KESCO j.s.c

APLICATION FOR MAXIMUM ALLOWED REVENUES IN 2024 FOR UNIVERSAL SERVICE SUPPLIER

January, 2024

Content

1. Introduction

In accordance with Appendix 3 of the Rule on Determination of Revenues for Universal Service Supplier (USS Pricing Rule) and the official letter of the Energy Regulatory Office (ERO) dated 12 December 2023, KESCO burdened with the Public Service Obligation for the provision of Electricity Supply as a Universal Service has prepared the Application for the Maximum Allowed Revenues (MAR) for the year 2024.

In this Application, the energy and financial data for energy purchases from local production and import are presented, namely wholesale purchase costs, retail costs, pass-through costs and adjustments for previous years, while determining the maximum allowed revenues, the parameter values were used according to the ERO decision no. V_1476_2022 of 14 January 2022.

Since the tariff process is interactive between ERO and other licensees, this application can be further adapted to reflect costs that are related to other licensees.

The following chapters provide the necessary explanations and justifications for all required costs, which are necessary for the proper operation of the Universal Service Supplier.

2. Electricity Balance

The Universal Service Supplier annually forecasts sales to its customers for the coming year, using historical information and other components that affect sales, such as weather conditions and economic growth (inclusion of new customers, energy purchase indexes, GDP, etc).

According to the draft electricity balance for 2024, the estimated sales for USS for 2024 are 4,998 GWh, as shown in the table below:

Voltage level	**GWh**
Customers connected at 35 kV voltage level	57
Customers connected at 10 kV voltage level	485
Commercial customers 0.4 kV	461
Commercial customers 0.4 kV / II	773
Household customers	3,183
Public Lighting	39
Total consumption at distribution level	**4,998**

Energy purchases to cover the needs of USS are predicted every hour and consist of KEK-Generation, Renewable Energy Sources (RES) and import, when local production is insufficient to cover consumption needs. The data presented in the Electricity Balance, including the production plan from KEK, play a decisive role in determining the maximum allowed revenues for the Universal Service Supplier.

In the draft electricity balance for 2024, KEK generation has presented an annual electricity production plan of 5,890GWh, which serves as a basis for forecasting purchases from imports for electricity consumption. Taking into account the historical data on the unplanned outages of KEK's generating units, especially during the winter season, the operation according to the forecast in electricity balance is hardly feasible. In this sense, any eventual lack from the local production plan increases the need to replace it with imports. Covering electricity consumption from imports at multiple higher prices creates additional costs for USS.

Although for the purposes of this application we have used data on electricity purchases in accordance with the draft electricity balance, it is important and necessary that the planning be as realistic as possible and that the parties adhere to these plans, since any deviation from the plan causes implications in the financial costs of the company.

Based on the forecast of consumption and hourly available capacities of local production provided in the draft energy balance for 2024, USS has foreseen energy purchases according to the source of production as in the following table:

Energy Balance 2024	**GWh**
Purchases	**4,998**
KEK Generation	4,300
Purchases from BRE in contractual relationship with KOSTT	515
Purchases from BRE in contractual relationship with USS	43
Imports	140
Consumption	**4,998**

3. Costs of purchase wholesale energy

According to Article 17 of the USS Pricing Rule, wholesale energy costs related to service to regulated customers consist of the following:

- Costs of energy procured from domestic generation;
- Energy import costs;
- Energy purchase retail margin;
- Net imbalance costs, subject to imbalance sharing factor.

Electricity production in Kosovo is dominated by two large thermal power plants which cover most of the demand in the country, while the remaining part is covered by Renewable Energy Sources and Import.

On 29 December 2023, USS received an official letter from KEK-Generation proposing the purchase price from USS at 31.50€/MWh for the period 04.01.2024-03.31.2025. According to the received letter, this price increase is a result of the increase in KOSTT tariffs during the period 2021-2023 and the increase in inflation, which has affected the increase in the cost of electricity production.

Without prejudging the justification of the offer, with the application of the prices proposed by KEK, the costs for end customers will increase by 6 million €, or an increase of 2% of MAR. Taking into account that there was not enough time to negotiate and respectively to reach an agreement, USS in this application has provided for the purchases from KEK the actual price in accordance with Annex 8 of the BSA Agreement. However, taking into account the trend of price movements in the electricity markets, USS is ready to negotiate with KEK the price according to ERO assessment, which would be acceptable to all parties involved.

As for RES in a contractual relationship with the Market Operator, due to the lack of information about the reference price of RES until the application stage, the actual reference price was used in this application. However, it should be noted that any change in the reference price during this tariff year should be reflected by ERO in the process of calculating the maximum allowed revenues of the USS.

During the year 2023, USS has received from ERO instructions for updating prices by applying the inflation rate in accordance with the agreements in force. KESCO has initiated the process for updating the prices, but since KESCO has not yet reached an agreement by the date of the application, we have used the actual prices in this application.

USS's forecasts for electricity purchases from imports according to the draft electricity balance for 2024 are 140 GWh, with an average import price forecast of 133.40 €/MWh, according to the latest forecasts in international markets, including the costs of the necessary capacities for bringing electricity to the country.

It is worth noting that in this application, USS has also included the adjustments for imbalances for the year 2021. The data for imbalances are in accordance with the invoices issued by the market operator and the same have now been paid by USS. These adjustments have been applied in accordance with the USS Pricing Rule namely appendix 3, point 4.5 determines that any change in revenues that may result from incorrect calculation, incorrect reporting of realized adjusted revenues or disputes related to annual updates will be covered in the relevant subsequent years. Therefore, based on this, USS requests that these costs be recognized as reasonable costs in the maximum allowed revenues for the year 2024.

In accordance with the above and in accordance with the formula for the determination of Wholesale Purchase Costs given in the USS Pricing Rule, the total costs for covering the consumption forecast for the year 2024 are estimated as 184.67 million €.

Description	GWh	mil€
KEK Generation	4,300	126.86
Imports	140	18.68
RES Production in contractual agreement with KOSTT	515	28.81
RES Production in contractual agreement with USS	43	1.93
Adjustments for imbalances		3.81
Retail margin		4.57
Wholesale Energy Purchase Costs	**4,998**	**184.67**

4. Retail costs

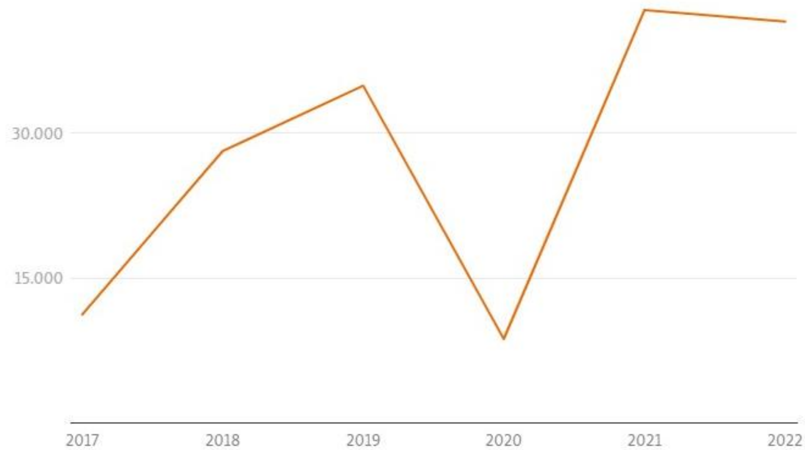
Allowed retail costs include operating and maintenance costs, corporate costs, depreciation costs and costs which are outside the control of the USS. These costs are recognized by the Regulator as reasonable and enable the Supplier to operate properly.

ERO in January 2022, through decision V_1476_2022, determined the operating costs for the 2022-2024 period for the Universal Service Supplier. USS operates within the allowed budget, creating efficiencies whenever possible in certain items in order to be able to cover increased costs in other items.

The number of customers supplied by USS continues to grow by about 25,000 customers on an annual basis, and with this the increase in the costs of providing services becomes more visible. For more, the needs of the time in which we are living are demanding continuous improvement of the provision of services, adding the need to bring into use various technological programs. Consequently, USS is faced with the challenge of balancing operating costs against the need to improve service delivery.

The increase in the number of customers is also affecting the increase in workload and responsibilities within the workplace. With visa liberalization starting in January 2024, the risk of leaving employees is becoming more and more apparent. This potential departure has consequences for the remaining workforce, leading to increased workload and a potential failure to meet deadlines and commitment to providing the services.

The various studies carried out by various institutions, such as the Riinvest Institute, the World Bank and the various analyzes prepared by the Chambers of Commerce in Kosovo, prove how endangered Kosovo is with the departure of employees. According to the Statistics Office in Kosovo, the number of Kosovars who have emigrated to other countries has followed an increasing trend over the last few years - except in 2020, when travel was limited due to the COVID-19 pandemic.



Source: Kosovo Statistics Agency

According to data from the European Commission for the countries of the region, after the liberalization of visas, a trend of decreasing cases of illegal border crossing has been observed, however, at the same time, has increased the number of cases of visitors who exceeded the allowed length of stay in the Schengen zone – up to 90 days within six months.

The analyzes of the Riinvest Institute show that over 30% of employees are expected to departure. The permanent or temporary departure of employees will destabilize the labor market in Kosovo. According to labor force surveys, the main reasons for migration are better salaries and working conditions. According to the Riivnest Institute, over 70% of surveyed businesses have taken steps to curb the trend of employees to departure, increasing on average over 20% of employees' salaries, and that even during 2024, further increases in salaries are expected.

In such a scenario, where USS employees can departure, even temporarily, using the right to stay in the Schengen area for up to 90 days, USS may face stability challenges and operational inefficiencies. In addition, USS has constantly been under pressure from employees who require salary increases and non-reflection of their requests will affect the quality of services provided and not only that.

Considering as above, USS in this application foresees a salary increase for employees of 15%, in order to reflect their value to the company and their leveling with the salaries of other licensees of the sector.

Additionally, in accordance with the USS Pricing Rule, the USS will adjust for inflation the approved 2023 costs for both OPEX and depreciation costs.

5. Pass-through costs

Pursuant to Article 18 of the USS Pricing Rule, during the determination of the MAR, the USS will cover the following costs:

- MO costs that are invoiced by MO and relate to USS Customers;
- SO costs which are invoiced by SO and relate to USS Customers;
- TUOS costs that are invoiced by TSO and relate to USS Customers;
- Distribution Use of System costs that are invoiced by the DSO and relate to USS Customers.

Furthermore, in addition to the above-mentioned costs, the OT invoices USS for the RES fund, which will be included as part of the pass-through costs.

New developments during 2024, such as the start of operation of the Albanian Electricity Exchange (ALPEX) and the start of operation of DSO in the northern part of Kosovo will affect the operating costs of TSO and DSO, and therefore in the pass-through cost of USS.

Considering the above and the trend of increasing costs among other licensees and since there are no differences in deadlines when other licensees submit their applications, USS will apply an increase in the request for the maximum allowed revenues for 2024 of 5% for pass-through costs. However, any changes by ERO during the determination of tariffs for DSO and TSO should be reflected in the final MAR for the Universal Service Supplier.

The start of operation of the Albanian Electricity Exchange (ALPEX) will result in additional costs for USS as well. ERO, through decision no. V_1766_2023, has approved the tariffs for the transitional period of the Albanian Electricity Exchange ALPEX for the bidding area of the Republic of Kosovo, therefore in this application USS has presented the costs foreseen according to this decision.

In accordance with the USS Pricing Rule in this application the pass-through costs for 2023 have also been adjusted. In addition to them, USS has also applied the adjustments for pass-through cost for 2021, considering that the maximum allowed revenues for 2021 were approved as a result of extraordinary reviews and the data for the month of December 2021 were preliminary.

6. Adjustments and revenues correction factor

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

In accordance with the USS Pricing Rule, the 2023 revenues correction was made and the correction factor was 25.66 million €, as shown in the table below:

Description	mil €
Approved MAR	**398.44**
Actual MAR	**413.28**
Actual Sales	389.28
It	6.91%
Revenue Correction Factor (ADJt)	**25.66**

It should be noted that the biggest changes in the actual MAR of 2023 from the approved one is due to the higher value for 17 million € in the import cost as well as the change in revenues from electricity sales to the end customers with that foreseen during the determination of the MAR for 2023.

Accurate reflection of costs enables stable and efficient operation. For the third year in a row, starting from 2020, USS operates with a lack of coverage of costs as a result of the COVID-19 pandemic and the energy crisis, which has reflected with a positive KREV, a financial burden borne by the licensee. Therefore, the correct application of costs enables the supplier to operate stably but at the same time with lower costs for the end customers, who pays additional interest for any costs exceeded during the current year.

7. Maximum Allowed Revenues for 2024

The Maximum Allowed Revenues (MAR) for the year 2024 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 request for the Maximum Allowed Revenues for USS for the year 2024, after knowing all cost elements as explained in the previous chapters, and conform expression for calculating Maximum Allowed Revenues in the relevant year t:

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

The Maximum Allowed Revenues for 2024	**mil€**
It	6.91%
Allowed Retail Costs	5.89
OPMCt	*5.76*
DEPCt	*0.13*
Pass-through Costs (PSTCt)	183.55
OST costs	*24.47*
DSO costs	*142.57*
BRE Fund	*16.51*
Working Capital Costs (WCLCt)	2.15
Wholesale Power Costs (WHPC)	184.67
WHPC	*180.10*
Retail Margin	*4.57*
Revenue Adjustments Factor (ADJ)	25.66
BDTA	8.20
MAR	**410.15**

Billing determinants for the year 2024 are based on the sales volumes foreseen in the Draft Electricity Balance for 2024. With the application of actual tariffs on billing determinants foreseen for the year 2024, it is expected to receive billed revenues in the amount of 397.47 million €, while the necessary costs for the proper operation of the USS for the year 2024 are 410 million €.

Over the years it has been proven that the tendency to provide affordable electricity tariffs is reasonable, keeping the costs of operations below the expected level. However, developments in recent years have proven that it is essential to strike a balance between short-term affordability and long-term stability. The continues reduction of anticipated costs has detrimental effects on infrastructure investment, innovation, financial stability and the overall resilience of the energy sector. Therefore, a more holistic and comprehensive approach is needed to ensure a reliable, efficient and environmentally conscious energy future for all customers.

USS remains committed to cooperation in order to reach appropriate conclusions, which are in the interest of all parties involved in the energy sector.