Ndërtesa e Elektrokosovës
Bulevardi Bill Klinton nr. 5
Prishtinë 10000
Republika e Kosovës

Elektrokosova Building
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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.
KEDS - SH. A.
Nr. 10 Dt. 22. 1. 2024
HQ I

Ymer Fejzullahu
Chairman of ERO Board

Alpin Dogan
Chief Executive Officer
KEDS j.s.c.

22 January 2024

Subject: Application for Maximum Allowed Revenues for 2024

Dear Mr. Fejzullahu,

Through this letter, we are sending to you the Application for the Maximum Allowed Revenues prepared by the Distribution System Operator (DSO) for the year 2024. This Application has been prepared in accordance with the Rule on Maximum Allowed Revenues of the Distribution System Operator (Rule on DSO Revenues) and the notice of the Energy Regulatory Office (ERO) dated 12.12.2023, for the opening of the process for the annual adjustments of revenues and tariffs for the year 2024.

DSO remains committed to cooperate in order to reach common conclusions, which are in the interest of all participating parties in the energy sector.

With respect,

KEDS SH.A.
HQ

Alpin Dogan
Chief Executive Officer, KEDS j.s.c.

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Application for the Maximum Allowed Revenues for 2024 of the Distribution System Operator

January, 2024

Content:

1. Introduction

KEDS licensed as the Distribution System Operator (DSO) has prepared the application for the maximum allowed revenues (MAR) for the year 2024, in accordance with Appendix 7 of the Rule on Maximum Allowed Revenues of Distribution System Operator (DSO Pricing Rule) and the official letter received on 12 December 2023 from Energy Regulatory Office (ERO).

This application includes all the required and necessary data according to the DSO Pricing Rule, and includes all reasonable expenses with aim of properly functioning and operating the distribution system and better service delivery to all customers.

During 2022, ERO approved the parameters for the third regulatory period (2023-2027), therefore the distribution system operator in this application updated such data in accordance with the DSO Pricing Rule.

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

The following chapters provide the necessary explanations and justification for all the required costs, which are necessary for the proper operation of the distribution system.

2. Operating and maintenance costs (OPEX)

Based on article 9 of the DSO Pricing Rule, operating and maintenance costs of the DSO, attributed to the DSO licensee, can be recovered through Maximum Allowed Revenues for the forthcoming relevant year.

ERO during 2022, through periodic review determined the operating and maintenance costs for the period 2023-2027, which are defined as a continuation of the operating and maintenance costs of the second regulatory period. The DSO, even during the process of determining these costs, has argued that there is an increase in operating expenses over the years, but ERO during the review of multi-year parameters has considered only historical data. ERO did not consider factual data and, respectively, allowed lower levels of operating and maintenance costs, endangering the well-being of the DSO operations for the next five years.

Based on the fact that the number of active customers increases by about 25,000 customers on an annual basis, the need to provide the best quality services increases more and more. The quality of service provided by DSO undoubtedly has a high cost considering that specific and specialized operating system programs are required. From 470,000 active customers in 2013, the number has increased to over 700,000 active customers in 2023, which has also resulted in an increase in expenses for the providing of services to these customers.

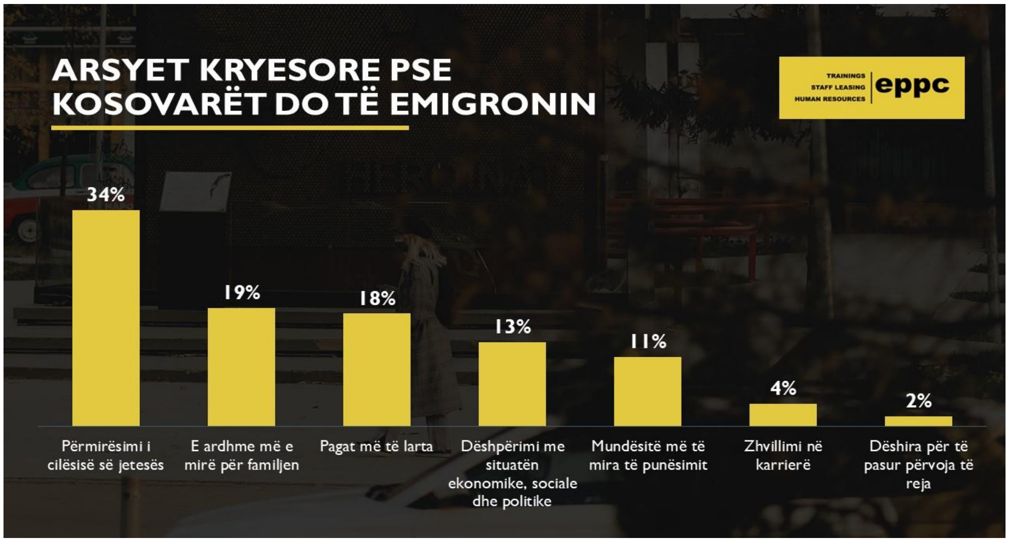
On the other hand, the salaries of the employees are not harmonized with the salaries of other operators in the energy sector in Kosovo, which is resulting with continuous departure of professional employees and lack of interest in employment during the opening of job seeking. The departure and general lack of professional employees is expected to increase even more from January 2024, due to the liberalization of visas for citizens of the Republic of Kosovo.

A study conducted by the Riinvest Institute[1] shows that since 2016, about 1% of the population of Kosovo has immigrated to Germany with a work permit, or about 12,000 individuals of working age. According to the Report, businesses have reported that 17.59% of their employees have already informed businesses that they will emigrate during 2024, while the expectation of businesses is that 32.72% of employees are expected to emigrate. This is also supported by the survey carried out in KEDS, where about 30% of employees have expressed interest for emigration, 6% of them at the beginning of the year, while 24% throughout the year 2024.

The report "Impact of visa liberalization on the labor market in Kosovo" prepared by EPPC shows that 60% will be the impact of liberalization on Kosovar companies, while on the labor market liberalization will have this impact of 87%. Accordingly, 22% will have higher staff turnover, while 40% will have a decrease in new job applicants and 64% will increase the demand for salary increases from current employees, as a result of the increased workload.

From the conclusions of the KEDS survey regarding the reasons for migration, the main reason remains the better salary, which also supports the findings of the EPPC reports, in which financial conditions and well-being are listed in the top three main driving reasons for emigration.

[1] Riinvest Institute, November 2023 "A model for sustainable economic growth. Dynamics of the labor market: current and future challenges", link: https://www.riinvestinstitute.org/uploads/files/2023/November/13/19_-_Forumi_Ekonoik_Vjetor_-_ALB021699882724.pdf (Access date 03.01.2024)



Based on the Report of the Riivest Institute, during 2023, businesses have already started to increase the salaries of the employees. About 79% of businesses have increased employees' salaries, with an average increase of over 22% of salaries. Furthermore, the report states that over a third of these businesses report that they will continue to increase salaries even further.

Recently, we have seen that even in the energy sector, steps have been taken to increase employees' salaries, where KEK generation increased salaries again at the end of 2023 for around 15%, raising even more the difference between employees in the same sector. This difference is demotivating professional employees, forcing them to move towards private companies, KEK and KOSTT, average salaries of which are notable higher.

While DSO is a regulated company, whose operating expenses have been reduced over the years, and for more, the efficiency factor determined by the ERO has been applied to the operating expenses, the possibility of the DSO to increase salaries is almost impossible under these circumstances. Therefore, considering the above, with the aim of curbing the migration trend, ensuring operational stability and sustainability, DSO proposes a 15% salary increase for 2024, which will help the operator to be able to maintain a competent and qualified workforce.

It is important to note that during the year 2023, the agreement was signed with the supplier Elektroserver for the supply of 4 municipalities in the North of the Republic of Kosovo. DSO is currently in the phase of collecting data from the field, however from preliminary estimates, we have included an initial cost for operating and maintenance costs for that area.

3. Depreciation and return costs

The Investment Plan of the Distribution System Operator is designed to enable a safe and reliable supply of electricity at a reasonable price, while ensuring the operation of the network in a transparent and commercial manner.

The rapid increase in energy demand is constantly overloading existing outlets as a result of new developments, thus reaching the limit of the line's maximum capacity. Therefore, during the drafting of the investment plan for the year 2023-2027, DSO took as basis criteria such as: network load, voltage drop, losses, interruption indices, total demand in terms of energy, increased consumption, age of the network and the number of customers.

In March 2023, through decision no.V_1711_2023, ERO approved the Investment Plan for the third regulatory period in a total of 122.07 million €, although the DSO proposal for the next five years was 166.87 million € investments, taking into account the above-mentioned criteria and the necessary investments towards the rehabilitation of the network to adapt to the ever-increasing needs of RES.

Despite the fact that ERO approved a smaller number of investments and a very low weighted average cost of capital, DSO has managed to implement the investment plan for 2023 in order to adapt the distribution network to the needs of customers. However, due to the low number of meters recognized in the Investment Plan 2023-2027, during 2023 DSO had difficulties in achieving the targets for the verification and replacement of meters, as defined in the Law of Meteorology, for which DSO received a fine from the inspectorate of the Institute of Meteorology. Considering that DSO is a licensed company, whose revenues are determined by ERO, it is unacceptable not to recognize the reasonable costs for meters, in order to fulfill legal requirements. In this sense, DSO has already submitted for approval to ERO the request for increasing the number of meters in the investment plan and we expect the same to be approved by ERO. Considering that this request has a legal basis, the same have already been included in this application.

The year 2023 was also characterized by an important event in the energy sector, namely the agreement was signed with the supplier Elektroserver for the supply of 4 municipalities in the North of Kosovo. This agreement simultaneously gives DSO access to operate in that area, but at the same time it also means the need for additional investments from DSO, which are not recognized in the approved investment plan for the third regulatory period (2023-2027).

Since the Agreement is in force from 1 January 2024, DSO is in the phase of collecting data from the field on the existing situation, based on which the detailed plan for the necessary investments in the 4 northern municipalities will be prepared. However, in this application DSO has anticipated an initial investment, which is necessary to start operations, such as costs for changing the meters, rehabilitation, expansion of the network, etc. Estimated costs for meter installation include only the meters to be installed in the first phase, while the anticipated costs during the second phase are not included, as from the discussions with the other actors involved in this process, the same are expected to be financed by the European Union. However, if these costs are not covered as discussed, they will be included in the maximum allowed revenues for 2024, since they are necessary towards the normalization of supply and billing in that area.

In this application, DSO has used the approved level of investments during the third regulatory period, including additional investments for the 4 northern municipalities, and electric meters argued as above, and in accordance with the DSO Pricing Rule, depreciation and return costs have been calculated for the year 2024, which also take into account the adjustment of the costs allowed during the year 2023 for the rate of inflation.

4. Costs of losses

According to Article 12 of the DSO Pricing Rule, DSO is responsible for purchasing electricity to cover losses in the distribution network. The allowed cost of losses is the estimated cost of losses that will be covered by DSO to compensate for losses in the distribution system and will be calculated using the allowed level of losses that is determined during periodic reviews. ERO, through decision no. V_1636_2022, has approved the loss reduction target for the third regulatory period 2023-2027, which as such was applied during the calculation of costs for the allowed level of losses for 2024.

The forecast of volumes for the calculation of the cost of losses was made based on the draft energy balance for the year 2024 and the comments of KEDS sent on 15.12.2023, which also takes as a basis the flow of energy and the level of losses for the 4 municipalities in the north. Considering that there's no set target for the losses in the north, the same shall be accounted as actuals. Nonetheless, for the purpose of tariff application the losses ratio in the north is forecasted based on preliminary information gathered from Elektroserver, and conform the data received the same shall be adjusted based on realizations.

In accordance with the ERO instruction issued in March 2017, KEK generation is allocated first to the Universal Service Supplier, and the rest is divided proportionally between KEDS and KOSTT to cover distribution and transmission losses. On 29 December 2023, KEDS received an official letter from KEK-generation proposing the purchase price from DSO at 39.10 €/MWh for the period 01.04.2024-31.03.2025. According to the received letter, this price increase comes as 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 of DSO increase by 1.2 million € or an increase of 1% of MAR. Taking into account that there was not enough time to negotiate and respectively to reach an agreement, DSO in this application has provided for the purchases from KEK the actual price in accordance with Annex 8 of the BSA Agreement. However, considering the price movements in the market, DSO remains open for negotiation if ERO assesses the reasonableness of the request, which should be in the interest and acceptable for all parties involved.

The forecast of the volumes for purchases by KEK is based on the production plan of KEK in the draft electricity balance for 2024, although DSO has expressed skepticism in the production plan, taking into account KEK's historical production realizations, namely the production changes in middle of the year. The latter represents additional operating costs throughout the year for DSO, considering that the lack of KEK production must be covered through import, which has a much higher price, significantly affecting the cost of losses.

Considering that since the energy crisis, import prices, apart from being higher, are very volatile and difficult to predict, so their fair forecast, including the costs per capacity, are essential. In order to ensure sufficient liquidity, DSO in forecasting the cost of losses for 2024, has used the expected prices in the international stock exchanges, also applying capacity costs, as additional costs applied to the final price.

Based on the above, the estimated cost of losses from DSO for 2024 is 89.53 million €, as shown in the table below:

Inputs for calculation	**Unit**	**2024**
Energy entering distribution	GWh	6,301.39
Loss allowance	%	16.61%
Losses	GWh	1,046.67
Purchases price	€/MWh	85.54
The cost of losses	**mil€**	**89.53**

5. Imbalances of DSO

DSO is responsible for providing electricity to cover losses according to the principles of the electricity market, transparency and non-discrimination. At the same time, DSO is a signatory party to the agreement as the Responsible Party for the Balance (RPB), through which it undertakes to keep deviations/imbalances towards KOSTT and therefore towards the ENTSO-E network within the minimum possible values .

The load on the distribution system, and consequently the losses of electricity, depend on various factors and their forecast, such as: weather, customer's behavior, maintenance plans, eventual breakdowns, investments and other factors. Taking into account the impossibility of forecasting consumption, respectively losses hour by hour, during the drafting of the Market Rules with the amendment of the Energy Laws during the year 2016/2017, the division of losses and supply was determined according to the coefficient of losses predicted for the respective month, which is applicable uniformly throughout all hours and days in the respective month.

Forecasting consumption has been and continues to be a challenge that is impacted by the structure of consumption where the majority is households. This becomes even more difficult when new suppliers are added. Therefore, in such a situation, the imbalances that appear are inevitable and not necessarily are caused by or belonging to DSO. Such a horizon of loss prediction through the coefficient between multiple suppliers means higher degree of inaccuracy, thus creating unnecessary and unrealistic costs in the electricity system.

Events such as the signing of the last agreement between KEDS and Elektroserver (by which it is foreseen that KEDS will take over the coverage of the losses caused in the northern part of the Republic of Kosovo), the entry of new suppliers and the functioning of the ALPEX exchange, are precisely the challenges that will have emphasized implications in the way that how DSO will manage imbalances in the system.

The non-operation of KEDS in the northern part of the Republic of Kosovo for a long time, as well as the fact that the customers of this area have not paid electricity bills for a long time, increase the uncertainty and seriousness of this situation.

On the other hand, the expected functionality of the ALPEX exchange in Kosovo, after its launch in Albania, creates additional risk. This is due to the fact that from the current results of trading on the ALPEX stock exchange, it can be seen that liquidity has not yet been achieved and the fact of coupling with Kosovo is not an indication that it will make it more liquid than it is now. Despite the fact that KEDS as DSO is not yet a member of the ALPEX, there is a fear that even if DSO join ALPEX, the demand may not be adequately met, considering that DSO provides losses mainly from KEK's production and other part on the market from different traders. From the analysis, it can be seen that the remaining quantities from the ALPEX exchange will hardly meet our demand under normal conditions when everything is working according to plan, not including the drop of any unit from KEK generation.

In addition to the lack of production of selling capacity, AL-KS border will be used for day-ahead coupling and this is expected to aggravate the situation even more. During the test sessions of the ALPEX offer area in Kosovo, we noticed that there is no seller even with USS RES amounts the price increases 4000 EUR/MWh. Added to this, the fact that KOSTT will also buy for their needs from ALPEX, but that the capacity is not enough even for them.

Consequently, whenever DSO will not be able to cover its demand in ALPEX, DSO will be obliged to find a way to secure the rest in intraday since the bidding process in other exchanges will be already closed. Knowing that the remaining quantities from the day ahead market are traded Intraday, and there is a high probability that energy will not be secured, all this energy deficit will be reflected in the imbalance.

Taking into account all the above, we propose that the costs of imbalances from 2024 onwards be recognized by ERO as reasonable costs, with the aim of covering them through tariffs. We are open to cooperate with ERO in assessing the current conditions of the energy sector and necessary regulatory changes, since this approach not only sets financial stability for DSO in addressing unforeseen challenges, but also ensures the fulfillment of our responsibilities as the responsible Party for balancing in the electricity market. Moreover, this approach will contribute to fulfilling the obligations of the Republic of Kosovo as a state towards ENTSO-E.

6. Other costs

An integral part of the maximum allowed revenues (MAR) are also unregulated revenues, obligations to the market operator and the transmission system operator, as well as any other reasonable costs related to the providing of distribution system services.

6.1 Unregulated revenues

When determining the maximum allowed revenues, ERO deducts the revenues realized from the exempted services, which are known as unregulated revenues. The unregulated revenues anticipated in the MAR of the third regulatory period are 5.41 million € for the year 2024, which are also included in the DSO proposal for this year's MAR.

In this application, in addition to the adjustment of unregulated revenues for the year 2023, the adjustments of unregulated revenues for the years 2020-2022 have also been applied, in accordance with the final data presented in the financial statements. Considering that the maximum allowed revenues for 2021 and 2022 have been approved as a result of extraordinary reviews, and during these processes the financial statements have not been audited, the data on unregulated revenues are presented as preliminary data. The adjustments applied for these years are in accordance with the invoices issued for these services and the presentations in the audited financial statements, which have already been submitted to ERO.

It is important to note that during the past years, ERO has deducted all unadjusted revenues from DSO's MAR. However, as previously argued, DSO continues to believe that the deduction of all unadjusted revenues is not fair and provides no incentive to DSO for the potential increase in these revenues. Moreover, it is important to note that the actual revenues do not cover the damages caused to the network by the operators, such as the physical damage to the DSO lines and poles during the works by the operators, as well as the impact on the lifetime of the DSO assets from the additional load of the operators' lines, but because of the legacy contracts DSO is obliged to offer these services.

DSO is committed to maintain the highest standards of service and compliance within the regulatory framework. In line with this commitment, we have also identified opportunities to diversify our non-tariff service offerings by offering additional services beyond those already deducted from MAR. However, the total deduction of these revenues from MAR is also affecting the effective reduction of the incentive for DSO to explore and invest in these roads.

To address this challenge and foster innovation in the sector, we propose to apply a sharing factor of 50% on the revenue generated by these additional services. We believe that a sharing factor of 50%, strikes a fair balance between encouraging innovation and benefiting the end customers, within regulatory compliance. This approach would enable us to benefit from the additional revenues generated, while contributing to the overall growth and sustainability of the energy ecosystem.

6.2 Obligation to Market Operator and Transmission System Operator

The anticipated costs for DSO's obligations to the Market and System Operator for 2024 are 2.15 million €. These costs are foreseen based on existing tariffs and anticipated losses for the year 2024. Any changes in OST tariffs must be reflected by ERO before determining the final MAR for DSO.

6.3 Obligation to ALPEX

New developments during 2023, such as the start of operation of the Albanian Electricity Exchange (ALPEX) result in additional costs for DSO. 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, DSO has presented the anticipated costs according to this decision.

7. The revenues adjustment factor – KREV

In accordance with the DSO Pricing Rule, DSO has made the correction of the 2023 revenues, which is applied by calculating the difference between the values predicted for the 2023 tariff year and those realized.

In this sense, DSO has calculated the actual MAR and the realized revenues during the year 2023 and the correction factor has resulted to be 13.81 million €, which should be reflected in the MAR of 2024.

8. Maximum allowed revenues for 2024

Considering all the costs presented in the previous sections and in accordance with the formula given in appendix 1 of the DSO Pricing Rule, the request for the maximum allowed revenues for the year 2024 is as follows:

Maximum allowed revenues-MAR	2024 (mil€)
Operating Costs	33.80
Depreciation	20.78
Return	17.60
Costs of losses	89.53
Obligations for TSO	2.15
Unregulated revenues	(5.41)
Adjustments for Unregulated Revenues	3.78
Adjustments for PR2	0.09
Costs for ALPEX	0.02
Correction factor_KREV	(13.81)
MAR	**148.53**

DSO's request for the maximum allowed revenues for 2024 in the amount of 148.53 million € ensures sustainable operation of the distribution system operator, offers better services to customers and also maintains the financial stability of DSO. Any tendency to reduce DSO's demand will jeopardize DSO's financial liquidity and the sustainability of electricity supply.