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Ymer Fejzullahu
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Alpin Dogan
Chief Executive Officer
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KOMPANIA KOSOVARE PËR DISTRIBUIM DHE FURNIZIM ME ENERGIJË ELEKTRIKE
KOSOVO ELECTRICITY DISTRIBUTION AND SUPPLY COMPANY J.S.C.
KOSOVSKO PREDUZEĆE ZA DISTRIBUCIJU I SNABDEVANJE ELEKTRICNOM ENERGIJOM D.O.O.
KEDS - SH.A.

Nr. 101 Dt. 05.12.2022
HQ 1

Date:05.12.2022

Subject: Extraordinary Review of Maximum Allowed Revenues for the Distribution System Operator

Dear Mr. Fejzullahu,

Through this letter, we are sending the Extraordinary Review of the Maximum Allowed Revenues and the Report on the financial impact of the extraordinary event, which has been prepared according to the DSO Pricing Rule.

Due to the great importance of this process, the Distribution System Operator is willing for cooperation in order to reach a common solution for all parties participating in the energy sector.

Sincerely,


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





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Extraordinary Review of the Maximum Allowed Revenues for the Distribution System Operator

December, 2022



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Introduction

The year 2022 was characterized by the continuation of the energy crisis, which began in 2021, causing unpredictable movements in electricity prices on international exchanges.

The extraordinary review, which began in December 2021 and ended in February 2022, did not provide the necessary results to generate sufficient revenues for the sustainable operation of the Distribution System Operator.

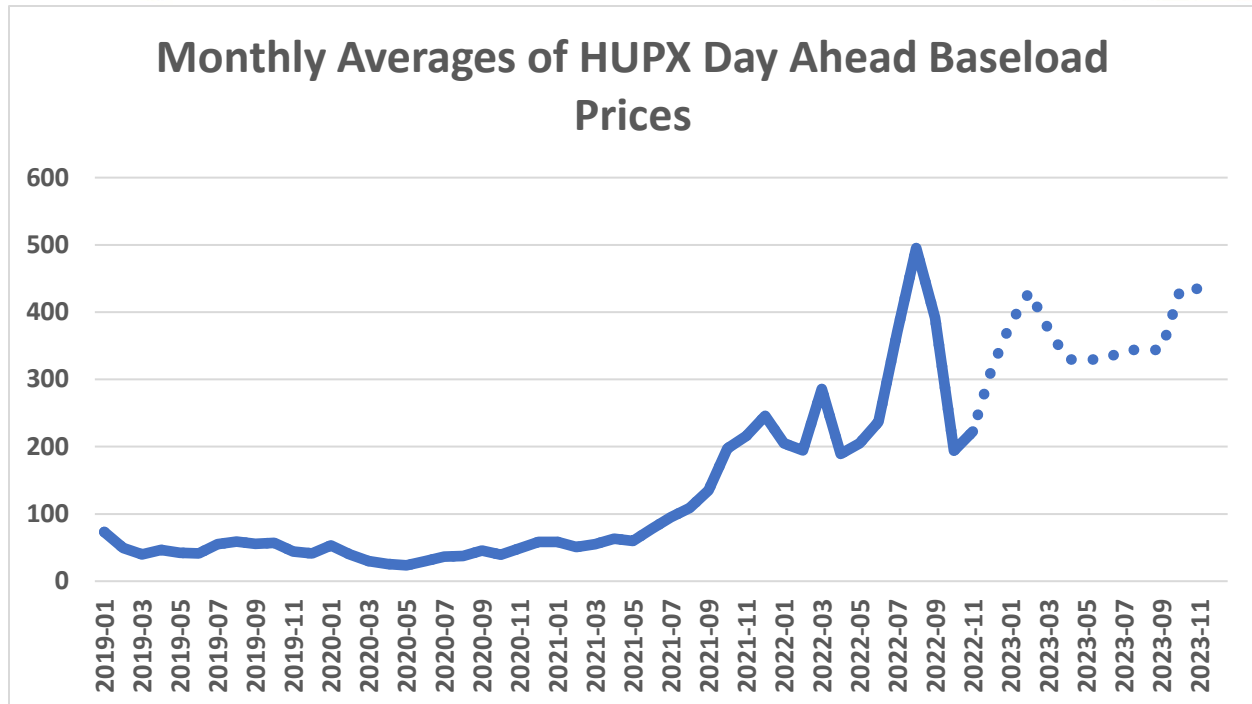
During the 2022 summer season, when the generating units of KEK-generation were undergoing capital overhauls, import prices recorded similar values, and even in certain hours even higher, than the import prices recorded during the month of December 2021, thus exposing DSO to an unprecedented situation. As a result of these events, the Government of the Republic of Kosovo dated 31 July 2022 once again announced emergency measures in the electricity sector, which were also approved by the Assembly of the Republic of Kosovo.

Although, the situation further seemed to stabilize, the costs recognized in DSO tariffs were exceeded. Now that we are on the eve of the winter season and the consumption of electricity has started to increase, and with it also the costs. This is evidenced by the last decision of the Government of the Republic of Kosovo, which in the electronic meeting dated 30 November 2022, took the decision to extend the emergency measures in the electricity sector, in accordance with Article 25 of Law No. 05/L-081 for Energy.

In order to avoid events when the Distribution System Operator will not have the opportunity to provide electricity to cover its needs, as a result of operating below costs, DSO submits a Request for Extraordinary Review and together with it submits this Application for Extraordinary Review, namely the Financial Impact Report, based on Article 7 and Appendix 8 of the DSO Pricing Rule. The document contains all the necessary data as required by the regulatory and legal framework and the data are presented in tabular form and are argued as follows.

Description of the extraordinary event

Electricity prices in international markets since the second half of 2021 have been very high and unstable. As a result, liquidity problems were caused in the electricity sector in the country. The instability of electricity prices continued during 2022 and they are expected to continue to be unstable during 2023 as well, as seen in the figure below:



Sources: Hupx and hudx markets¹

The Distribution System Operator is responsible for purchasing electricity to cover losses in the distribution network. Considering that the Universal Service Supplier has priority in purchasing from KEK's production, the Distribution System Operator's dependence on imports is high. This is especially evident during the winter season when the demand for electricity increases, but also during the summer season when the generating units of KEK-generation are undergoing capital overhauls.

During the 2022 summer season, when the generating units of KEK-generation were undergoing capital overhauls, import prices reached the highest values, reaching at certain hours even 1000 €/MWh, thus exposing DSO to an unprecedented situation. As a result of these events, the Government of the Republic of Kosovo dated 31 July 2022 once again announced emergency measures in the electricity sector, which were also approved by the Assembly of the Republic of Kosovo. The same were extended for a period of 30 days by the Government of the Republic of Kosovo on 30 November 2022, which proves that the electricity situation in the country continues to be unstable.

The last tariff review, which was an extraordinary review started in December 2021, was concluded in February 2022. ERO assessed and approved the maximum allowed revenues for the Distribution System Operator in the amount of 179.56 million €. However, ERO, during the

¹ Note: Prices shown in the figure are off-peak prices and do not include capacity prices



assessment of the costs of losses for 2022, was not reflected according to the request of DSO, which had taken into account forecasts according to international markets. The lack of accurate reflection of the cost of losses as well as the rapid growth and non-sustainability of electricity prices in international markets has forced DSO to operate below cost, further complicating the financial position, which already in 2021 ended in loss.

While the energy at the entry of the distribution and energy prices in the international markets were higher than those recognized by the ERO for 2022, the revenues collected from the tariffs did not uniformly cover the increase in costs, considering that during the month of January and partly in the month of February 2022 DSO has billed with prices of 2021. In this sense, DSO throughout 2022 has continued to operate below cost and subsidizing the sector until April 2023 is beyond DSO's financial capabilities.

Considering the above, DSO requests an extraordinary review, in accordance with the right given in Article 7 of the DSO Pricing Rule, where the impact of the extraordinary event must exceed the materiality threshold of 5%. Moreover, according to point 4 of article 7 of the DSO Pricing Rule the ERO must also take into account the ongoing impacts of extraordinary events in future periodic reviews.

The reflection of actual costs through extraordinary review, in addition to helping DSO to reflect actual costs, will simultaneously provide price signals to the end consumer, namely signals for load management, which will mitigate the immediate effect of increasing costs in an uncontrolled manner.

In the following, according to Appendix 8 of the DSO Pricing Rule, the analysis of the financial impact and the proposal for the extraordinary adaptation have been prepared.

Financial impact of the extraordinary event

The total cost of losses allowed for DSO for the year 2022 is 106.65 million € or 922.56 GWh, while with the actual data until November 2022 (preliminary data for the month of November) and the forecasts for the months of December (according to the electricity balance 2022) we note that the volumes for the losses allowed for 2022 exceed 2% of the allowed level, while the costs for their purchase exceed the allowed costs by 7%, reaching 114 million € by the end of 2022.

In the calculations used by ERO during the determination of the Maximum Allowed Revenues, the average allowed import price to cover losses in DSO is 205.91€/MWh, while the average import price realized for the period January-November 2022 is 266.35€/MWh, respectively only for the period January-November 2022, the average import price has increased by 29% compared to the average price allowed by ERO for 2022. If we also consider the forecasts for the months of



December, the average import price for the total in 2022 it is 255.73€/MWh or an increase of 24%, compared to the average price allowed by ERO.

Import 2022	ERO (January-October)	DSO (January-October)	DSO (January-October)
Volumes (MWh)	432,200	319,870	383,077
Average price (€/MWh)	205.91	266.35	255.73
Costs (mil €)	88.99	85.20	97.96

Although DSO in its comments on MAR's proposal sent to ERO in January 2022 requested higher import costs, ERO did not consider this request. However, the price forecast shows a continuation of peak import prices of 526 €/MWh at least until March 2022, when the new tariff year is expected to begin as shown in the following table:

€/MWh	Baseload	Peak-load
December	321.39	418.29
January	396.05	515.73
February	434.02	573.65
Q1 2022	404.33	526.00

Source: HUDEX import prices on a monthly and quarterly basis ²

It is important to note that the price forecast does not include capacity prices which also play an important role in the final price of imported electricity. The actual data for 2022 show that the ratio of capacity to the average import price is on average 1.5%, but which increases during the winter season, when the demand for imports increases in all the countries of the region.

In order to reflect the real expectation of costs and, respectively, the financial impact of DSO, we have set the preliminary data for the month of November, while the month of December has been set according to the forecasts of the ERO during the determination of the MAR for the year 2022.

Therefore, considering the purchases from KEK, the import and the difference of Energy at the entry of the distribution level, the difference between the actual cost of losses and the cost allowed by ERO for the year 2022 is 7.1 million € or 7% higher than the allowed cost from ERO.

The costs of losses	ERO	DSO
Allowed level of losses (%)	15.10%	15.10%
Energy entry at distribution level (GWh)	6,110	6,214
Average price (€/MWh)	115.60	121.22
Losses cost (mil €)	106.65	113.74

² HUDEX, Electricity Prices <https://hudex.hu/en/market-data/power/daily-data#quarter> Last visited on 02.12.2022



The data presented above do not include costs for excess losses and imbalance costs for which DSO itself bears the financial burden. However, as for the imbalances for the months of July-September, they have flowed as a result of the impossibility of purchasing the electricity needed to cover the losses. The latter resulted due to the state of emergency described above, for which DSO is not responsible.

As described in the DSO Pricing Rule, "Force majeure" - among other things, are other acts or events that are beyond reasonable control and that were not the licensee's fault and the licensee did not have the opportunity to avoid such act or event by the exercise of his will, efforts, skill and reasonable care. Therefore, DSO in this application includes the costs of the imbalance for the months of July-September 2022, and as a result the actual cost of losses for the year 2022 which should be included in DSO's tariffs is 117.39 million euros.

The expected revenues from DSO for 2022 are 165.77 million €, while the total cost, taking into account other costs, amounts to 188.5 million €, so DSO bears the financial burden for about 22.72 million €, which represents 12.65% of the allowed MAR, as shown in the following table:

Description	Costs in mil €
Costs of losses	117.39
Other costs	71.10
MAR	188.50
Expected revenues	165.77
Total impact	22.72
Impact in %	12.65%

However, the financial impact and cost borne by the DSO does not end in December, but continues until March 2023, when costs are expected to be reviewed during the determination of the next tariff year.

DSO forecasts for the purchase of losses allowed according to the revised draft balance sheet for 2023 only for the first 3 months of 2023 are 108.8 million €, with an average import price forecast of 425.3€/MWh, according to the forecasts of the Hungarian market for the first quarter of 2023. According to the change in daily forecasts, electricity import prices are expected to be higher, while the expected revenues for the first quarter of 2023 are 59.6 million €. Respectively, the impact of KREV for 2022 and the expected costs for the first quarter of 2023 show a cost of 133.2 million €, with a non-coverage percentage of 55.2%, as presented in the following table:



Allowed losses	15.10%
Expected EED	2,094
Average price	344
Costs of losses	108,844
KREV 2021 with It	24,338
Costs to DSO	133,182
Expected revenues Jan-Mar 2023	59,556
Non-coverage	73,626
Non-coverage in %	55.28%

If we consider other costs for the first 3 months of 2023, the estimated costs of DSO reach the value of 133.7 million €. Respectively, consider the impact of KREV for 2022, the total costs of DSO for the period January-March reach the value of 158.1 million €, with a non-coverage percentage of 62.3%, as presented in the following table:

DSO MAR January-March 2023	Costs in mil €
Costs of losses	108.84
Other costs	49.3
MAR	158.10
Expected revenues	59.56
Non-coverage	98.55
Non-coverage in %	62.3%

Consider the above analyzes related to the expected costs as a result of the non-reflection of high import costs in the final tariffs (extraordinary event) and exceeding the materiality threshold argued as above, according to the right granted through the legislation in power, the DSO asks the ERO to treat with priority the submitted request for an extraordinary review, otherwise the energy security in the country is expected to worsen since the distribution operator alone cannot bear the burden of this crisis.

Appendix:

Detailed calculations for outstanding review