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

Final Report on DSO Maximum Allowed Revenues

Responses to Comments

Third Regulatory Period (2023 – 2027)

DISCLAIMER

This document is prepared with the purpose of informing stakeholders in the public consultation process. The document shall be read alongside ERO's Consultation Report, published on 16 February 2023. The document does not represent a decision of ERO and shall not be interpreted as such.

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Table of Contents

Table of abbreviations

The abbreviations used in this document have the following meaning:

CPI	Consumer Price Index
EEX	European Energy Exchange
EUROSTAT	European Statistical Office
USS	Universal Service Supplier
MAR	Maximum Allowed Revenues
KEDS	Kosovo Company for Distribution and Supply of Electricity
KEK	Kosovo Energy Corporation
KESCO	Kosovo Electricity Supply Company
KESH	Albanian Power Corporation
KOSTT	Kosovo Transmission System and Market Operator
MFPT	Ministry of Finances, Labour and Transfers
MWh	Megawatt hours
OPEX	Operational Expenditures
DSO	Distribution System Operator
TSO/MO	Transmission System and Market Operator
PRR 3	Third Regulatory Period
OPRK	Office of the President of the Republic of Kosovo
ERO	Energy Regulatory Office

1. Introduction

Energy Regulatory Office (ERO) is in the Periodic Review Process for the Third Regulatory Period (PRR3), which includes the determination of Maximum Allowed Revenues (MAR) for the 2023-2027 period. The Periodic Review shall determine the Maximum Allowed Revenues for Transmission System and Market Operator (TSO/MO – KOSTT JSC) and Distribution System Operator (DSO- KEDS JSC).

Following the initial evaluation of applications regarding the Maximum Allowed Revenues (MAR) for the licensee of the Distribution System Operator (DSO-KEDS JSC), the licensee and other stakeholders were enabled to submit their comments through the public consultation process for a two-weeks period.

This document presents the responses to the comments of the stakeholders and ERO's proposal on DSO Maximum Allowed Revenues.

In relation to the initial evaluation of DSO Maximum Allowed Revenues, ERO has received comments from:

- Kosovo Energy Corporation (KEK),
- Independent Union Elektrokosova KEDS/KESCO,
- Government of Kosovo, and
- DSO – KEDS

The comments received from stakeholders are published in the electronic website of ERO. This part of the document presents a summary of these comments and ERO's responses on them.

2. Comments from Kosovo Energy Corporation (KEK)

2.1 Change of energy price for recovery of transmission losses

2.1.1 KEK comments

The Kosovo Energy Corporation (KEK) states that the current price agreement with the parties KEDS, KESCO and KOSTT expires on 31.03.2023. Due to changes in the costs of coal exploitation, electricity production from thermal power plants as well as the increase in the tariffs of KOSTT, KEK requires from the parties to take into account the prices reviewed by KEK for the period 01.04.2023 - 31.03.2024, as follows:

- Electricity price for recovery of the Universal Service Supplier – 32.40 €/MWh;
- Electricity price for recovery of distribution losses – 39.54 €/MWh;
- Electricity price for recovery of transmission losses – 39.54 €/MWh;

2.1.2 ERO's response

It should be emphasized that with the legal changes that regulate the energy sector, approved by the Assembly of the Republic of Kosovo in 2016, ERO has amended the secondary legislation to be in harmony with the primary legislation, therefore in this regard the production prices for the public generator KEK are not regulated by ERO since 2017, but they are subject to market criteria. The price for which the commercial parties can reach a common agreement must be in accordance with the Energy Trading Procedure, Market Rules and other requirements of the secondary legislation.

So far, ERO has not received any other different request from the parties whose Maximum Allowed Revenues are subject to regulation. Therefore, in the evaluation of wholesale costs for 2023, ERO has taken into consideration the proposals of the parties that are based on current prices. However, the parties must respect the abovementioned principles in future updates of wholesale prices.

3. Comments from the Independent Union Elektrokosova KEDS/KESCO

3.1 Increase of salaries for employees of the company KEDS/KESCO

3.1.1 Comments of the Independent Union Electrokosova KEDS/KESCO

The Independent Union Elektrokosova KEDS/KESCO requires from ERO to take into account the increase of salaries for the employees of the company KEDS/KESCO, in the value of OPEX for DSO and USS. The independent union Elektrokosova KEDS/KESCO bases these requirements on:

- Increase of prices of the basic products;
- Increase of inflation;
- Increase of the volume of work;
- High turnover of professional employees.

3.1.2 ERO's response

According to the Rule on Maximum Allowed Revenues, ERO has reviewed the OPEX costs (which also include personnel costs) reflecting the annual rate of inflation. The inflation rate takes into account the Harmonized Index of Consumer Prices published by Eurostat. The value published in January 2023 for 2022 is 8.4%.[1]

It is worth emphasizing that in order for the personnel costs of KEDS and KESCO to be comparable to the personnel costs of other licensees in the energy sector, ERO, within the periodic review for the regulatory period 2018-2022, has adjusted the personnel costs for KESCO in the amount of 251 thousand euros, and for KEDS and KESCO in total in the amount of around 2.3 million euros. These costs are an integral part of OPEX in PRR3.

Furthermore, it should be clarified to the Union that ERO, in accordance with the legal framework, has updated and will update OPEX costs (including personnel costs) to reflect inflation. Therefore, the issues raised by the Union should be addressed to KEDS and KESCO.

[1] https://ec.europa.eu/eurostat/databrowser/view/PRC_HICP_AIND__custom_4860030/default/table?lang=en

4. Comments from the Government of the Republic of Kosovo

4.1 Allocation of subsidies

4.1.1 Comments of the Government of the Republic of Kosovo

The report shows that the allocation in the amount of 24.6 million euros for the tariff subsidy from the Government has been taken into account, however, it is unclear whether there have also been taken into account the Decisions 01/117 and 02/117 of the Government on supporting the electricity sector with the allocation of an additional amount of 20 million euros as well as the extent to which they have been spent and are expected to be spent in the following weeks.

4.1.2 ERO's response

It is addressed in the Report on Determination of Revenues for the Universal Service Supplier. Likewise, the comment about "Covering the gap for MAR for 2023 should be done mainly by businesses" is addressed in the Report on USS too.

4.2 Target of losses for DSO

4.2.1 Comments of the Government of the Republic of Kosovo

For the new tariff year, the target of allowed losses has remained unchanged for 2023, whereas it changes only 0.4 percentage points for 2024, despite the fact that DSO is obliged to reduce losses, and for this is also recognized the allowed investments in the amount of 28.6 million euros for 2023 and 37.7 million euros for 2024. In other words, the customer is forced to pay for new investments in the network, but is not allowed to benefit anything from the reductions of losses resulting from those investments. You, as a Regulator, would have to make sure that such asymmetric relationships are not established between the parties, where the customer pays twice - both the investments and the allowed losses. Also, there was insufficient clarification of what you mean by the 50/50 loss sharing factor for 2023.

Removal of the consumption of the northern part of the country from the calculation of allowed losses for DSO: This issue has also been raised in previous comments by MFLT. This inflates the level of the cost of the allowed losses to about 57 GWh or about 4.9 million euros in monetary value.

4.2.2 ERO's response

On 13 September 2022, ERO has published the Consultation Report with its proposals on Allowed Losses for the Transmission System and Market Operator (TSO/MO-KOSTT) and the Distribution System Operator (DSO/KEDS) for the third regulatory period 2023-2027. In the comments received from the Ministry of Economy, the acceptability of the target and the curve of reducing losses in TSO and DSO is confirmed. The comments of the parties and ERO's responses are published on ERO's website.[2]

[2] https://www.ero-ks.org/zrre/sites/default/files/Publikimet/Pjesemarresit%20ne%20Treg/Furnizim/Raport%20perfundimtar_pergjigje%20ndaj%20komenteve_%20per%20humbje.pdf

The public consultation process resulted in the decision **V_1636_2022** (16 November 2022)[3] on "The loss reduction target and the curve of allowed losses for the Third Regulatory Period (PRR3) 2023-2027 for the Transmission Network (TSO) and the Distribution Network (DSO)".

However, even though ERO has clarified the approach applied in calculating the level of losses allowed for the Ministry of Finances during the extraordinary review process in 2022[4], ERO reiterates that since the Distribution System Operator has no control over the distribution of electricity in the four northern municipalities, also clarified in the decisions PRR2 and PRR3, that the target for the reduction of losses and the curve of allowed losses is applied only to the part of the Republic of Kosovo in which the licensed operators have control. However, whenever DSO will have control in the four northern municipalities of the Republic of Kosovo, then the loss target will be applied according to the method that includes the energy flows in the northern part. However, regardless of the handling of the energy entering the distribution system, following the application of any loss target, the volume of losses is the same.

5. Comments from DSO - KEDS

5.1 Adjustments for capital investments in PRR2

5.1.1 Comments of KEDS

Despite the challenges, DSO emphasizes that it has managed to invest 107.28 million euros for the period 2018-2022, from the 131 million euros that the Regulator had approved for the same period. ERO, in the Consultation Report published on 16 February 2023, has reduced the investments realized in the amount of 29.7 million euros with the justification that they are investments that have not been approved by ERO. Furthermore, for the same ones, ERO has adjusted the allowed depreciation and the allowed return by applying the compound rate of interest and inflation, a concept which cannot be applied to real investments. However, ERO has qualified these projects as necessary investments and they are passed through into the last 4 years of the third regulatory period, although they have been energized and customers are benefiting from these investments. Therefore, knowing their importance and necessity for the distribution system, these investments should be recognized. By postponing recognition to the next regulatory period, the DSO is left to bear the investment costs without corresponding revenues, putting the day-to-day operation of the DSO at risk. Taking into account the above-mentioned arguments and economic and financial principles, DSO requests from ERO that these investments are recognized as they were realized in the period of their realization.

5.1.2 ERO's response

When calculating the adjustments for realized capital investments compared to those approved in PRR2, ERO has applied the provisions of the Rule on DSO Revenues, according to which the Regulator will consider whether or not to approve the replacement of projects in the subsequent periodic review but is not obliged to do so. Based on the justifications of DSO that alternative projects will bring the

[3] https://www.ero-ks.org/zrre/sites/default/files/Publikimet/Vendimet/Vendimet%202022/V_1636_2022.pdf

[4] https://www.ero-ks.org/zrre/sites/default/files/Publikimet/Pjesemarresit%20ne%20Treg/Furnizim/Raporti%20p%C3%ABrfundimtar%20p%C3%ABr%20MAR_P%C3%ABrgjigje%20ndaj%20Komenteve.pdf

same or better benefits to customers than the initial project (taking into account the expected results and costs), ERO has passed through the costs of these projects in the 2023-2027 period.

5.2 Investment Plan for the upcoming regulatory period (PRR3)

5.2.1 KEDS comments

DSO in the five-year investment plan for the regulatory period 2023-2027 has proposed capital projects in the amount of €167 million, which were made based on technical analysis and with the aim of achieving the loss target determined by ERO. ERO, with decision number V_1636_2022, has approved the allowed loss target for the third regulatory period. It is paradoxical that following the decision on the loss target, ERO has reduced investments unilaterally, making it impossible for DSO to achieve the loss targets set for the third regulatory period. ERO in the Consultation Report has evaluated the capital projects for the next regulatory period in the amount of €122.1 million, reducing the projects focused on low voltage and electric meters, directly related to the loss target. In the investments of the third regulatory period, as argued above, ERO has also included the projects realized in the second regulatory period in the amount of €29.7 million. Consequently, the final value of investments for the third regulatory period is €151.7 million.

It is important to note that the evaluations of ERO for the 2023-2027 Investment Plan are not in line with the technical analysis and network demands, with a special emphasis on the last 2 years, so they are not in line with Implementation Agreement, dated on 17 October 2012, signed between the Government of the Republic of Kosovo, Investors, KEK JSC and KEDS JSC.

5.2.2 ERO's response

ERO, in the evaluation of capital projects for PRR3 has had constant consultations and communications with DSO in order to address the needs of customers as accurately as possible. In this regard, the planned capital projects are listed based on their prioritization.

The commissioning plan for capital projects 2023-2027 was made based on the classification and categorization of projects by asset categories based on the costs that have resulted according to the allowance of ERO, so that the value in certain asset categories and through years is accurate. The projects passed through from PRR2 to PRR3, which were commissioned in PRR3 according to the dynamics of PRR 2, were then added to the value of the costs for the corresponding asset category.

Regarding the capital projects for which ERO did not have any information, the evaluation was made based on the data provided by DSO. Such projects are the projects related to the transition of 10-20 kV, where of the €47.9 million requested by DSO, ERO recognized the costs in the amount of €45.9 million. However, ERO has not removed the requested projects, but only in the evaluation of costs per unit it has removed the assets/transformers for which DSO did not have information.

The emphasized differences between the projects requested by DSO and recognized by ERO relate to meter projects, low voltage investments in 2026-2027 and new connections. Regarding the meters, ERO has based its evaluation on the dynamics of investments made in PRR 1 and PRR 2, the number of meters installed in these two periods, the number of current mechanical meters, etc. However, following the consultations with DSO, for 2023, the costs of the meters have been revised from 3 to 4 million €. However, for the following years, ERO has requested from DSO to compile a detailed feasibility study based on the results of 2023 to identify future investment needs related to meters.

For the category of LV projects, ERO based on the large number of projects passed through from PRR2, the administrative processes related to tendering, the realizations in the previous periods, does not suggest that DSO can have the dynamics of implementing projects in PRR3 significantly different from that in PRR 1 and PRR 2.

For the costs of the projects related to new connections, ERO, as it has clarified before, they should not be included in the tariffs, because for this purpose the Principles for Determination of Distribution Use of Tariffs have been reviewed, while the document Distribution Network Connection Charging Methodology must be in line with them. Until then, the costs for new connections which DSO may have caused will be handled by ERO.

Regarding the determination of the target of losses for PRR 3, ERO has analysed several aspects in addition to the level of planned investments, therefore ERO clarifies that in determining the target of losses, in addition to investment plans, it has taken into consideration several other perspectives in determining the target and the curve of reduction of losses in PRR 3. ERO reiterates that the determination of the target of losses is based on previous regulatory policies, investment plans, technical analysis, historical and projected data, as well as regulatory practices.

As ERO has clarified in the consultation meetings, the DSO can apply at any time to the Regulator to replace a capital project in the approved investment plan or to request the inclusion of any new project, respecting the legal obligations provided for in the Rule on DSO Revenues and the Rule on Evaluation of Capital Projects.

It is worth emphasizing that, in addition to the above-mentioned factors, ERO has requested from DSO the information on the funding sources of these projects. From the information received, DSO does not have any loan agreement for the financing of projects planned in PRR3. This fact, as well as DSO's remaining debts, do not recommend that DSO undertakes scaled-up investments in PRR3 compared to those of PRR1 and PRR2.

5.3 Operating and maintenance expenses (OPEX)

5.3.1 KEDS comments

Since the trend of increasing prices is continuing and the same are out of the control of DSO, the non-recognition of these costs, especially the increase in the costs of materials, as well as the application of the efficiency factor in this line, is unreasonable. Therefore, a review of costs is necessary. Law No. 06/L-005 on Immovable Property Tax, approved in 2018, determines that in the 5th tax year (2023) there will be no general deduction for property tax, in contrast to previous years when the deduction determined according to this law was applied. In this regard, since the costs from property tax are costs outside the control of DSO, we request from ERO to reflect these costs when deciding on OPEX costs for the next regulatory period. Also, the prices for insurance of assets and third parties have increased by 24.45% and considering that they are out of the control of DSO, they should be reflected in the final OPEX. In the proposal for the Maximum Allowed Revenues for the period 2023-2027, DSO has also required from ERO to evaluate the issue of the increase of salaries for the company's employees, which are not harmonized with the salaries of other energy sector operators in Kosovo.

By allowing the Distribution Operator to recognize the increased costs in its allowed OPEX, it will help the operator to be able to retain a competent and skilled workforce, which is essential to its ability to provide reliable and efficient service.

5.3.2 ERO's response

CPI inflation rate - In order to calculate the adjustments related to the inflation rate, the inflation rate published by Eurostat for the Eurozone countries was taken as a reference, which for 2022 was 8.4%. The rate that is applied for adjustments for inflation is the reference rate of the Eurozone as the most reasonable and stable rate, because the general capital costs, imports, are subject to the foreign market. In Appendix 1 of the Rule on DSO Revenues, it is noted: CPIt-1 presents: *"the current value of inflation in the relevant year t-1, measured using the "Harmonized Indices of Consumer Prices (HICPs) - all units, for the Eurozone" published by Eurostat, or any other measure of inflation that the Regulator determines to be the best measure of the change in operating and maintenance costs over time and that is allowed during the periodic review".*

The non-controllable costs, namely the costs of asset insurance, are also adjusted on this principle. Furthermore, since such costs are treated as uncontrollable, ERO does not apply the efficiency factor to them. In this process, ERO did not have any additional evidence from KEDS regarding additional costs for insurance costs, therefore it took as a starting point the costs of the year 2022 updated for the inflation rate (HICP). However, similarly as in the past, ERO will handle such costs based on the evidence/bids received by KEDS for the contracting of such services.

Costs related to property tax will be adjusted in the regular tariff process, based on the information and evidence to be provided by DSO.

5.4 Costs of energy losses

5.4.1 KEDS comments

In ERO's proposal for the costs of losses for 2023, it has predicted the energy at the entry at 6,220 GWh, while the purchase price at €86/MWh. Regarding the energy entering distribution (EED), ERO has used the same methodology as in previous years, considering only the allowed level of losses at the distribution level. In forecasting energy purchases, like ERO, it has taken into account KEK-KESH exchanges and the decision of the Government of the Republic of Kosovo no. 01/117 and 02/117 dated 29.12.2022. However, in its application, DSO also presented the capacity costs for energy from KESH, which are necessary for the full use of this energy, otherwise, the non-recognition of capacity costs jeopardizes the bringing of energy from KESH, risking that this energy is further covered through daily import (intraday) which has a higher and unknown cost in tariffs in the relevant year.

5.4.2 ERO's response

ERO has reviewed the costs for the purchase of losses based on the current data for the months of January and February 2023, as well as updated the import price forecasts, according to the data of 15 March 2023 according to EEX. ERO has also accepted the costs of capacity allocation for the energy used by DSO in the months of January - February 2023. The costs of losses will be adjusted during each regulatory year to reflect: the difference between the forecast and realized volumes of energy, the difference between the forecast and realized price of energy and the difference between the allowed and realized level of losses. Such costs are uncontrollable, as a result, ERO applies mechanical adjustments to these costs.

5.5 Unregulated revenues and excluded costs

5.5.1 KEDS comments

ERO, in the proposed MAR for the third regulatory period has deducted excluded costs in the amount of €0.4 million, without providing arguments regarding such deduction. Considering that ERO has deducted unregulated revenues in the amount of 5 million euros, which include revenues from the services defined in Appendix 5 of the rule, the deduction of excluded costs related to the provision of this service is unreasonable. As a result, the same should not be deducted from the Maximum Allowed Revenues.

5.5.2 ERO's response

The evaluation of unregulated revenues is based on the data of the previous periodic review, while the excluded costs as a reference value were based on the allowance from PRR 2, when it was expected that the DSO would collect revenues from the provision of services foreseen in the Connection Charging Methodology. However, whenever the realization of these unregulated revenues and excluded costs may be different from ERO's evaluation, they will be adjusted on annual basis as until now.

5.5.3 Regular Annual Adjustments 2023

5.5.4 KEDS comments

It has been noticed that ERO, in the adjustments for inflation of operating expenses, did not take into account the total OPEX approved for 2022. DSO in its application requested the recognition of the imbalance costs for the months of July-September, which are caused due to the impossibility of purchasing the electricity necessary to cover the losses, due to the extraordinary event and after taking all actions to prevent them. Taking into account the above, the correction factor of DSO for the year 2022 is 28.5 million euros from 24.94 as proposed by ERO in the Consultation Report. ERO, in the Consultation Report, divided the Correction Factor (KREV) for 5 years and distributed the same throughout the third regulatory period equally, treating it similarly as the corrections made for the regulatory period.

5.5.5 ERO's response

ERO agrees with the comment of KEDS regarding the inclusion of additional costs of €0.24 million (allowed in 2020 related to the costs of health insurance and vehicle insurance), given that these costs are beyond the licensee's control. Following the indexation for HICP, the adjustment value for OPEX from €2.20mil as it was in the initial proposal is corrected to €2.22mil.

The costs related to non-controllable OPEX have also been updated for PRR3 to reflect the costs of health insurance and vehicle insurance as costs that are outside the control of the licensee.

Regarding the imbalance costs, ERO understands the concern of KEDS, however, as is known, balancing the system is the responsibility of KOSTT, and for this purpose ERO has allowed balancing costs to KOSTT. Therefore, in line with the preliminary reviews, the revenues and costs of DSO for such services have not been addressed in the determination of MAR, so ERO will continue with the same treatment.

In line with the Rule on DSO Revenues, regulatory precedents, ERO has applied the annual adjustments (including the extraordinary event) and those of the previous period by adjusting the impact in several years. Such situations are described in the rules on revenues as follows:

"The Regulator will also take into account the ongoing impacts of extraordinary events (that cross the materiality threshold) in future periodic reviews";

"The timing and structure of the extraordinary adjustment will avoid, where possible, immediate increases in tariffs to customers (for example by mitigating the impact of the extraordinary adjustment over a number of years)".

6. Summary of DSO MAR (KEDS)

Following the evaluation of the available data and the ones presented by the parties involved in the process, as well as taking into account the comments received by the parties during the public consultation process and the decisions of the ERO Board on the input values for PRR3, ERO's final evaluation and proposal for the Maximum Allowed Revenues for the Distribution System Operator (KEDS) for the third regulatory period 2023-2027 is as follows:

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	2023	2024	2025	2026	2027
	Proposed	Proposed	Proposed	Proposed	Proposed
Opex Base	28,241	27,848	27,461	27,079	26,704
Costs of losses	76,721	76,516	69,697	64,001	59,407
Depreciation	17,303	19,414	21,541	22,306	23,608
Allowed return	14,886	16,338	17,720	18,546	18,974
Excluded costs	-408	-408	-408	-408	-408
Non-tariff revenues	-5,000	-5,000	-5,000	-5,000	-5,000
Obligations towards SO and MO	1,884	1,884	1,884	1,884	1,884
License tax	90	90	90	90	90
Starting MAR	**133,718**	**136,683**	**132,985**	**128,500**	**125,259**
Adjustments 2022 and PRR2	89	89	89	89	89
Total proposed MAR	**133,807**	**136,772**	**133,075**	**128,589**	**125,349**

As it has been continuously emphasized, the components of the costs of the Maximum Allowed Revenues are adjusted on annual basis according to the provisions provided in the rules on revenues in order to reflect the reasonable costs of electricity supply and service for the respective year.