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REGULATORNI URED ZA ENERGIJU
ENERGY REGULATORY OFFICE



Final Report on DSO Maximum Allowed Revenues

Response to comments

(Relevant tariff year 2021)

October 2021



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1 Summary

This document presents the responses to the comments provided by stakeholders and the final proposal of ERO regarding the Maximum Allowed Revenues of the DSO for the relevant tariff year 2021.

Following the initial evaluation of the Applications regarding the Maximum Allowed Revenues for the licensee of the Distribution System Operator (DSO, KEDS), the licensee and other stakeholders had the opportunity to submit their comments through public consultation for a period of two weeks.

The review process for the relevant tariff year 2021, had to be concluded with decisions by the Board of ERO by the end of March 2021, but this did not take place given that the Board was not functional until 2 August 2021, when it was complemented upon the election of two members and the chairman by the Assembly of the Republic of Kosovo. Immediately after the completion of the Board, ERO continued with the tariff review process. ERO had prepared the Consultation Report in March 2021, which was published for consultation on 24 August 2021. The Consultation Report contained ERO's initial assessment of licensee applications regarding their requests for revenues for the relevant tariff year 2021. All calculations were based on available data for 2020 and forecasts for 2021.

During public consultation, ERO received comments and additional important information, which were taken into consideration in the final evaluation of the licensee revenue proposal. The main changes are related to the increase of wholesale energy prices as well as the increase of electricity consumption. This has been mainly influenced by international energy markets/exchanges and the application of carbon taxes in EU countries. Given that these factors have affected the costs of the DSO, and were beyond its control, ERO in the final evaluation has taken into account these circumstances and has re-evaluated the wholesale energy purchase costs, and has also reflected the changes in electricity consumption. All these changes in the wholesale and retail energy markets are reflected in the final DSO MAR for the relevant tariff year 2021.



2 Comments on Energy Balance

KEDS has agreed that ERO for tariff purposes will have to use only the allowed level of losses to calculate the cost of losses. However, KEDS has expressed concern that ERO has not considered exceeding losses during the calculation of energy in distribution. KEDS proposes to use the same approach as used in the Annual Balance Sheet for 2021, which will be restored by applying the interest rate next year.

KEDS states that considering that the data realized during January-July show an increasing trend of consumption, DSO in this application will use the actual data for January-July 2021, which show a more realistic expectation of energy at the entry of distribution level (EED). KEDS further emphasizes that only during the first 7 months of 2021, there is an increase of 11% of consumption compared to the projected one and 14% increase of unbilled energy in the North, which affect the energy that enters the distribution level, therefore the update of data is necessary to ensure stable operation of the distribution system.

Also, the Ministry of Economy (ME) commented on a technical error in the energy balance.

ERO's response

ERO for tariff purposes has used the same approach as in previous years, which means that in its calculations does not take into account the exceeding of losses above those allowed by the Periodic Review 2018-2022. In the initial evaluation, ERO considered the KEDS application regarding the forecast of sales at the DSO level, however, after the provision of actual data by KEDS, ERO considers it reasonable to update the data related to the electricity balance at the DSO level. As for the increase in demand, ERO has taken into account the growth trend, but these calculations do not include the exceeding of losses.

Regarding the comment of the ME, ERO has corrected the energy balance, which in fact had to do with the level of energy entering the DSO, without unbilled energy in the northern part of Kosovo, while energy as Entry at DSO, which is simultaneously used to calculate losses, was correct.

Table 1 – Electricity Balance 2021

Electricity Balance in DSO	Unit	Realization 2020	Initial proposal 2021	Final proposal 2021
Entry at DSO	GWh	5,549	5,452	5,809
Unbilled energy in the North	GWh	335	327	353
Entry at DSO without unbilled energy	GWh	5,215	5,125	5,456
Unbilled energy	%	6.0%	6.0%	6.1%
Technical and commercial losses at DSO	GWh	1,075	894	953
	%	19.4%	16.4%	16.4%
Total losses	GWh	1,409	1,221	1,306
	%	25.4%	22.4%	22.5%
Remaining energy for billing	GWh	4,140	4,231	4,504



3 KEDS comments on DSO costs of losses

The DSO agrees in principle with the method of calculating the cost of losses by ERO, however, given that the actual data show a large difference in the forecast of import prices, DSO requests that this difference shall be reflected when determining the MAR for 2021.

During the application for Maximum Allowed Revenues, as a result of low import prices during 2020, the expectation of rising import prices on electricity exchanges was lower for 2021. However, KEDS states that during 2021 a large increase in import prices is noticed. Only in the first 6 months, purchases from imports have increased to 17 million euros from 9 million as were forecasted, or from 8.2 million euros as were realized during 2020. Whereas, total realized purchases of losses during the first 6 months of 2021, including purchases from KEK, have reached € 28.5 million, or about 70% of the costs that ERO has proposed during the review of MAR for 2021.

DSO claims that ERO in its review kept the price of KEK unchanged, without reflecting the request of KEK to adjust inflation, therefore DSO will use the same approach in the final calculation of its demand for costs of losses for 2021.

Regarding the issue of balancing, KEDS states that it has requested earlier from ERO and KOSTT that DSO and USS shall be in a joint balancing group or that a detailed study and methodology shall be initially carried out to ensure a reasonable evaluation and judgment for covering all reporting demands and parameter setting, especially in function of the balancing mechanism.

KEDS claims that the nomination of energy purchases in the initial phase of the application of the balancing mechanism, based on the monthly coefficients from the approved energy balance, has resulted in large differences in the balancing values. ERO after the request submitted by the DSO, through decision V_1276_2020 dated. 27 2020 allowed the DSO to change the coefficients on monthly basis. Furthermore, payments on behalf of imbalances are not included in tariffs of final customers, in accordance with the Rule on DSO Revenues, but the DSO pays them itself.

KEDS, in the comments regarding the imbalances, emphasizes that in order to reflect correctly the costs, the parties USS and DSO apply the required monthly corrections, according to the calculations received from KOSTT.

Technical corrections, based on the request dated 7 July 2021 - KEDS claims that in accordance with the request of ERO and the letter dated on 7 July 2021, DSO has applied the required corrections during the calculation of the final request for allowed revenues for 2021.

ERO's response

Regarding the evaluation of the DSO cost of losses, for tariff purposes, ERO applies the same approach by not including the level of losses exceeded in the energy entering the DSO.

Regarding energy purchases to cover losses, it should be emphasized that ERO in the initial assessment had taken into account the trend of historical import prices, as well as KEDS application. As the tariff process has not been concluded due to the lack of quorum of ERO Board, in this process, we have received new data which present the factual situation of the wholesale energy market. As a result of changing conditions in international energy markets, even the energy sector operators in Kosovo have been affected by high prices. In addition to the change in prices, the energy sector in Kosovo during



the period January-July 2021, has also experienced an increase in electricity consumption compared to the planning according to the electricity balance.

ERO, based on the legal framework in force, after the conducted evaluation, proposes to recognize the additional costs for the purchase of electricity as realized for the period January-July 2021, presented by the DSO. For the remaining part of 2021, ERO, after assessing the price trend in credible energy exchanges and relevant studies related to energy price forecasts, has reviewed the energy purchase costs for the remaining part of 2021. Wholesale energy prices are forecast to be high in 2022 as well. According to S&P Global, energy price forecast in Europe for 2022 is foreseen to be in the range of 80-90 €/MWh¹. For the remaining part of 2021, ERO has applied the price of 90 €/MWh for forecast of energy purchase from imports. This is done in order to reflect the real cost of electricity supply and not to carry forward high costs for the following year, which could cause large fluctuations in electricity tariffs for final customers.

KEDS, in its application for MAR 2021, claims that, during 2020 there were difficulties in making investments due to the situation with the pandemic and as a result did not achieve the goal of reducing losses at the planned level (by 0.3% less), where the financial impact is evaluated to be 0.74 million Euros. ERO has carefully analyzed this request of KEDS, and it noticed that KEDS had deviated significantly from the investment plan, not as a result of the pandemic, but due to changes of investment planning, making replacements of numerous projects, which are under review by Regulator, along with the Development Plan. Therefore, ERO considers that the reason for such a difference is not attributed to the pandemic but to the changes in the investment plan, so it deems unreasonable the request of KEDS that such cost to be transferred to final customers.

ERO clarifies for the DSO and the public that the price of generation from KEK JSC. is not subject to regulation and the price used for calculations of the costs for energy purchase from KEK JSC is the same price as presented in Annex 6 of the agreement between KEK and KEDS.

Regarding the comments of KEDS on the balancing issue, ERO reiterates that the balancing mechanism has not identified a part of energy which was used by the trading parties and as a result the costs of the parties responsible for the caused imbalances are not reflected.

Technical corrections, based on the request dated 7 July 2021- from the analysis of the claims submitted by KEDS, it is noticed that this issue has not been concluded yet, therefore ERO expects from KEDS to inform and consult other trading parties for such corrections and then to identify the implications of this correction on each trading party. In the absence of these technical and financial records, ERO will not consider KEDS 'request in its evaluation of MAR for 2021.

4 KEDS Comments on Operational Expenses (OPEX)

KEDS claims that ERO should recognize the increase of salaries as required by the DSO, with the justification of leveling salaries with other licensees in the public sector (KEK and KOSTT), increase of salaries in the public sector in general, increased cost of living, inflation, etc., which according to KEDS

¹ www.spglobal.com; [European power forecast to hold near record levels to 2023: Platts Analytics | S&P Global Platts \(spglobal.com\)](https://www.platts.com/industry/electricity/europe); visited on 28 shtator 2021, at 16:03h



also increase the pressure of employees. Whereas, the company, according to KEDS, in addition to pressure from employees, faces rising prices (gas, materials, etc.), the efficiency factor which is applied to operational costs (including salaries), as well as changes from the allowed European inflation to the actual one in Kosovo. Another issue in which KEDS expresses concern is the departure of staff, which according to KEDS happens due to better conditions in the market for them.

Additional costs related to COVID-19 pandemic –KEDS claims that during the evaluation of operational costs, ERO did not take into account the costs caused by the COVID-19 pandemic, although it is known that the spread of COVID-19 pandemic is considered a Force Majeure event, which has negatively affected all socio-economic aspects in our country and worldwide. While almost all commercial businesses remained closed and most employees were relieved of their responsibilities at work, DSO employees have continuously worked, risking their health, in fulfilling their duties to provide regular electricity supply to every citizen in Kosovo.

KEDS refers to the letter of ERO, no. 179/20 of 28 May 2020, which states that all costs that are beyond the control of licensees that can be attributed to the pandemic will be recognized in the next tariff review and requires such costs to be recognized in accordance with the reference letter.

ERO's response

In evaluating the required level of operational expenses during the multi-year review, ERO had taken into account the factors mentioned by KEDS in their comments, including aspects of levelling the salaries with the regulated energy sector. Therefore, OPEX will remain the same as defined in the regulatory period, except for possible legal changes and other indexing parameters.

As stated in previous tariff reviews, ERO wants to re-emphasize that human resources management is the obligation and competence of operators, and ERO does not handle their micro-management, so we ask from operators to be careful in fulfilment of their managerial obligations and competencies without transferring internal managerial challenges to the Regulator.

Inflation Rate CPI - the rate that applies to adjustments of inflation is the Eurozone reference rate, as the most reasonable and stable rate, and not Kosovo's inflation rate as claimed by KEDS, given that total capital costs, imports, are subject to the external market.

Annex 1 of the Rule on DSO Revenues states:

CPI_{t-1} presents: "the actual value of inflation in Relevant Year t-1, measured using the "Harmonized Indices of Consumer Prices (HICPs) – All Items, for the Eurozone" published by Eurostat, or any other measure of inflation that the Regulator determines is a better measure of the change in operating and maintenance costs over time and is allowed at a Periodic Review".

Additional costs related to COVID-19 pandemic - ERO reiterates that it considers it reasonable in principle to recognize the costs associated with maintaining health as a result of COVID-19, according to the Guidelines of the National Institute of Public Health. As presented in the documents referred to by the DSO, ERO proposes the recognition of only the direct costs associated with maintaining health as a result of COVID-19.



Regarding KEDS's claim that other operators in the energy sector have provided allowances to their employees during the pandemic, ERO clarifies to KEDS and the public that the DSO could consider such allowances to its employees, only through the operator's profit, as other operators have done, by not reflecting these costs in their prices.

Also, ERO expresses concern that KEDS even during the phase of public consultation of Consultation Reports, has not presented the direct costs associated with maintaining health as a result of COVID-19, but has assembled it with their request for allowances to employees. Despite this, ERO has once again requested, after the closure of the public consultation, details on direct costs for the pandemic. From the information received from KEDS, it results that the additional costs for the pandemic are 52,864 Euros whereas the remaining part of 437,157 Euros was on behalf of allowances to employees.

ERO proposes to recognize only the direct costs for managing the situation with COVID-19, supported by the Guidelines of the National Institute of Public Health, which are calculated in the amount of 52,864 Euros.

5 Revenues Correction Factor - KREV

Although KEDS has not presented in the comments the changes in the revenues correction factor (KREV), in the final table of MAR calculation, there are differences between KREV applied by ERO (of 14.49 mil Euro) in relation to KREV calculated by KEDS (of 12.77 mil Euro). The main reason for this difference is KEDS claim that in the expected revenues should be applied only 20% of the amount invoiced on behalf of the return of losses.

ERO's proposal for correction of revenues (KREV) –ERO considers that the cost resulting from energy billing, including the energy for recovery of losses is handled as a total revenue, given that this is handled with the accrual principle, where revenues are recognized at the time of billing and not when collected. Furthermore, it should be emphasized that the energy value of 47 GWh, which is related to the recovery of losses, is included in the energy entering the distribution network, based on which the costs of energy losses are calculated, therefore the recognition as cost of this energy also means recognizing the revenues that result from this energy. This position is consistent by ERO throughout the regulatory period.

In order to evaluate the revenues correction factor for 2020 that is applied during the determination of revenues for 2021, the actual allowed costs for 2020 (AACT-1) must first be verified. Details of actual costs under the initial proposal, KEDS comments and final proposal are described in the table below:

Table 2 –Evaluation of actual allowed costs for 2020

Actual costs components	Unit	Initial proposal	KEDS Comments	Final proposal
OPEX	mil€	26.09	26.09	26.09
Additional costs for COVID 19	mil€	-	0.44	0.05
Depreciation costs	mil€	15.40	15.40	15.40
Return costs	mil€	15.12	15.12	15.12
Pass-through costs	mil€	1.07	1.07	1.07



Costs of losses	mil€	41.58	42.32	41.58
Unregulated revenues	mil€	(8.06)	(8.06)	(8.06)
Correction of revenues t-1 (2019)	mil€	(4.14)	(4.14)	(4.14)
Total AAC	mil€	87.06	88.23	87.11

As shown in the table above, the difference between the initial and final proposal for the actual allowed costs relates to the direct costs for Covid-19, also described in section 4 (ERO's responses to KEDS comments for OPEX).

difference between the actual allowed costs (AAC_{t-1}) of 87.11 million Euros and the realized regulated revenues in the relevant year (ARR_{t-1}) of 100.55 million Euros, turns out to be negative KREV of -14.44 million Euros, which are carried forward to the following year and are reflected in the calculation of DSO revenues for the following year 2021.

The table below presents the Revenues Correction Factor – KREV.

Table 3 – Revenues Correction Factor (KREV)

KREV Components	Unit	Initial proposal	KEDS Comments	Final proposal
AAC – actual allowed costs	mil€	87.06	88.23	87.11
ARR – realized regulated revenues	mil€	100.55	100.12	100.55
It – interest rate	%	7.38%	7.38%	7.38%
$KREV=(AAC_{t-1} - ARR_{t-1}) * (1+ It)$		-14.49	-12.77	-14.44



6 Maximum Allowed Revenues for DSO for relevant tariff year 2021

In the final evaluation of Maximum Allowed Revenues for the DSO, ERO has analyzed each of the cost components, and made their adjustments compared to the initial evaluation to take into consideration the current circumstances of the electricity market. As noted above, one of the main factors that has caused the differences compared to the planning for 2021 is the changes in the costs for purchase of losses and the increase in consumption. The other cost components have remained the same, as set out in the multi-year review adjusted for indexing parameters.

In order to have a clearer view of the comparison between the initial and final proposal, the following figure shows the comparison of MAR cost components:

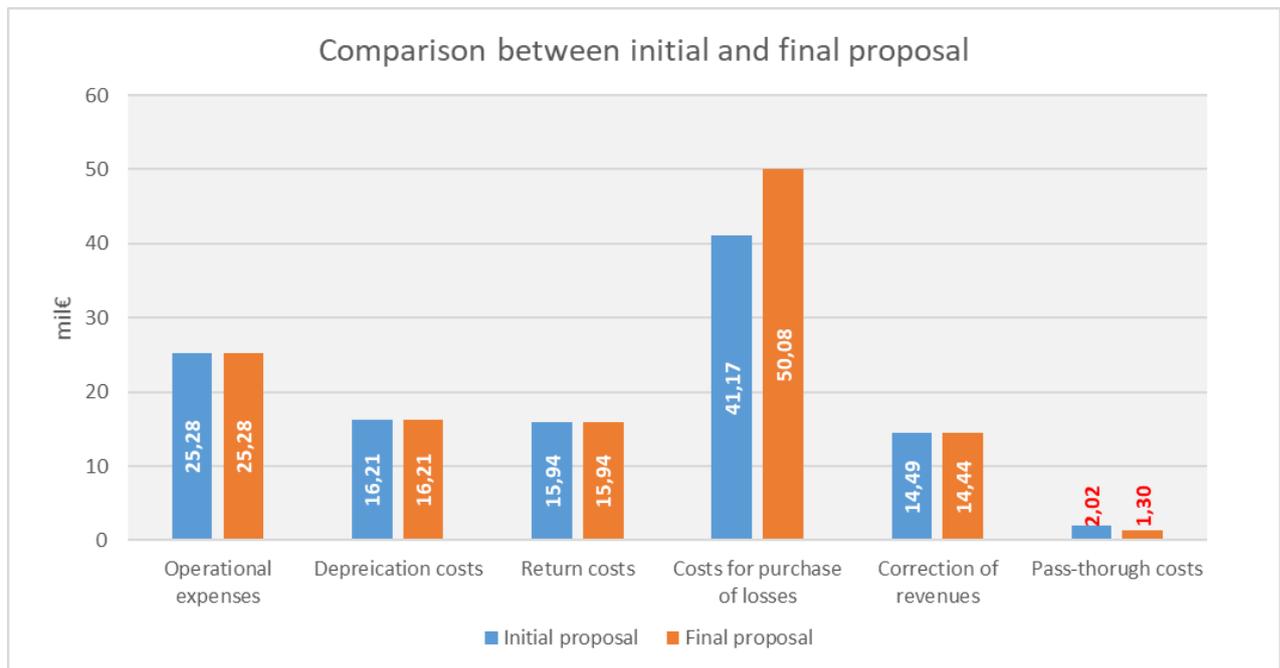


Figure 1 – Comparison of costs between initial and final evaluation

As shown in the figure above, the difference between the initial and final valuation is mainly attributed to the costs for purchase of losses.

Following the analysis of all data and comments submitted by stakeholders, ERO's final proposal for Maximum Allowed Revenues for the Distribution System Operator for 2021 is as follows:



Table 4 – Proposal of DSO MAR (KEDS) for relevant tariff year 2021

Maximum Allowed Revenues (mil€)	Unit	Allowed 2020	Initial proposal 2021	KEDS proposal 2021	Final proposal 2021
Indexation parameters					
Efficiency factor	%	1.5%	1.5%	1.5%	1.5%
Inflation	%	0.26%			
Euribor	%	-0.3%			
S - Factor	%	7.6%			
Interest rate - It	%	7.3%			
Operational and maintenance costs (OPMct)					
Evaluation during PRR2	€m	25.53	25.21	25.21	25.21
Allowed-OPMct=OPMct-1*(1 + CPit-1)*(1-Et)*(1-Pt)	€m	25.84	25.28	25.28	25.28
Additional costs for health insurance	€m	0.24	0.24	0.24	0.24
Depreciation costs (DEPct)					
Evaluation during PRR2	€m	15.23	16.17	16.17	16.17
Allowed - DEPct = DEPct-1 * (1 + CPit-1) * (1 - Pt)	€m	15.40	16.21	16.21	16.21
Return costs (RTNct)					
Evaluation during MYT	€m	14.95	15.90	15.90	15.90
Allowed - RTNct = RTNct-1 * (1 + CPit-1) * (1 - Pt)	€m	15.12	15.94	15.94	15.94
Obligations to KOSTT					
Obligations to KOSTT -forecast	€m	0.92	2.02	2.02	1.30
Obligations to KOSTT – actual	€m	1.07			
Costs of losses (LSSct)					
Forecast					
LSSAt	€m	17.60%	16.40%	16.40%	16.40%
REUEt	€m	5,414.3	5,451.6	5,931.7	5,809
WHEAt	€/MWh	49.19	46.05	61.39	53.41
Forecast cost of losses	€m	46.88	41.17	59.72	50.88
Actual					
LSSAt	%	17.60%			
REUEt	GWh	5,549.5			
WHEAt	€/MWh	42.57			
Actual cost of losses	€m	41.58			
Adjustments					
Unregulated revenues PRR2	€m	(3.50)	(3.50)	(3.50)	(3.50)
Adjustments for PRR1	€m	(1.50)	(1.50)	(1.50)	(1.50)
Actual unregulated revenues	€m	(6.61)			
Licensing tax:					
Forecast	€m	0.15	0.08	0.1	0.1
Actual	€m	0.06			
KREV – Revenues correction factor					
Revenues correction factor t-1	€m	(4.14)	(14.49)	(12.77)	(14.44)
AAct-1 – actual costs for year t-1	€m	87.06		88.23	
ARRt-1 - actual costs for year t-1	€m	100.55		100.12	
KREvt = (AAct-1 – ARRt-1) * (1+ It)	€m	(14.49)			
MAR – Maximum Allowed Revenues					
	€m	95.40	81.44	101.74	90.51

Following the approval of Maximum Allowed Revenues, the DSO makes the proposal for distribution use of system tariffs for 2021 which should reflect the proposed MAR.