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REGULATORNI URED ZA ENERGIJU
ENERGY REGULATORY OFFICE



Final Report on USS 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 ERO's proposal regarding the Maximum Allowed Revenues of USS for relevant tariff year 2021.

Following the initial evaluation of the applications related to the Maximum Allowed Revenues for the licensee of the Universal Service Supplier (USS, KESCO), the licensee and other stakeholders had the opportunity to submit their comments through public consultation for A two-week period.

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 account 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 USS MAR for the relevant tariff year 2021.



Relevant documents:

Application for Maximum Allowed Revenues in 2021 for Universal Service Supplier	https://www.ero-ks.org/zrre/sites/default/files/Konsultimet%20Publike/Aplikimi%20i%20FU%20SH-s%20C3%AB%202021%20-%208%20Mars%202021.pdf
KOSTT's Application on Annual Updates for KOSTT's Tariffs, expected to enter into force on 1 April 2021	https://www.ero-ks.org/zrre/sites/default/files/Konsultimet%20Publike/Aplikacioni%20p%C3%ABrshtetjet%20vjetore%202021%20KOSTT.pdf
KEDS Application for Maximum Allowed Revenues in 2021	https://www.ero-ks.org/zrre/sites/default/files/Konsultimet%20Publike/Aplikimi%20i%20OS%20SH-s%20C3%AB%202021%20-%208%20Mars%202021.pdf
Consultation Report on USS MAR	https://www.ero-ks.org/zrre/sites/default/files/Publikimet/Komunikatat/FSHU_Raport_Konsultativ%20per%20MAR_2021_24.08.2021.docx
Consultation Report on KOSTT MAR	https://www.ero-ks.org/zrre/sites/default/files/Publikimet/Komunikatat/KOSTT_Raport_Konsultativ%20per%20MAR_2021_24.08.2021.docx
Consultation Report on KEDS MAR	https://www.ero-ks.org/zrre/sites/default/files/Publikimet/Komunikatat/OSSH_Raport_Konsultativ%20per%20MAR_2021_24.08.2021.docx
USS Comments	https://www.ero-ks.org/zrre/sites/default/files/Publikimet/Pjesemarresit%20ne%20Treg/OT/Komentet%20e%20FSHU%20-%202021.pdf
KOSTT Comments	https://www.ero-ks.org/zrre/sites/default/files/Publikimet/Pjesemarresit%20ne%20Treg/OT/210908_KOSTT_Komente%20lidhur%20me%20Raportin%20Konsultativ%20p%C3%ABr%20P%C3%ABrshtatjet%20vjet.....pdf
KEDS Comments	https://www.ero-ks.org/zrre/sites/default/files/Publikimet/Pjesemarresit%20ne%20Treg/OT/Komentet%20e%20OSSH-2021.pdf



2 KESCO-s comments on wholesale energy purchase

KESCO, in the comments submitted on the Consultation Report on Maximum Allowed Revenues for the relevant tariff year 2021, has submitted the proposal that ERO, for the period January-July, shall consider the realized electricity consumption, based on the fact that consumption has increased by about 11 % compared to the forecasted consumption in the electricity balance. As a result, the import of electricity during the 7-month period of 2021 has increased, as well as the demand for import is about 100% higher compared to planning. Taking into account that during 2021 the international energy markets are manifested with high electricity prices, this has influenced the increase of USS purchase costs compared to what was planned. Based on the information provided by USS, current data show that for the period January-July, the purchases from import reached € 8 million, with an average price of € 77.23/MWh, whereas in the Consultation Report, the total purchases from import were forecast in the amount of € 5.6 million, according to the projected values during 2020.

KESCO, in relation to the price of energy purchase from KEK JSC., states that during the calculation of wholesale purchases for the Universal Service Supplier, ERO has used the actual price for KEK purchases and has not reflected the adjustment for the inflation rate, as applied by the Supplier after bilateral discussions with KEK generation. The same price was used by USS when calculating purchases from KEK-Generation.

In relation to the sale of electricity from HPP Ujmani, KESCO claims that HPP Ujmani has partially and in a limited time used the announcement of the bid and in this regard, the proper prior notice for the tender announcement has not been made. Therefore, USS was unable to submit the bid, respectively to purchase electricity from HPP Ujmani for this tariff year.

Taking into account that USS in its application has used the actual values for the months January-July, it is important to emphasize that during January-March the revenues of USS have been lower, in conformity with the Agreement and the first Amendment to the Agreement on Implementation of the Law on Economic Recovery - COVID-19 on subsidization of the tariff for Renewable Energy Sources. At the same time, USS has been released from its obligations to KOSTT regarding RES, in accordance with the aforementioned agreement.

ERO's response

Regarding the purchases of energy to cover consumption for customers who are entitled the Universal Service from USS, it should be emphasized that ERO in the initial assessment had taken into account the trend of historical import prices, as well as the application of KESCO dated on 8 March 2021. However, given that the tariff process has not been completed due to the lack of the quorum of ERO Board, we now have new data which present the factual situation of the wholesale energy market. As a result of changing conditions in international energy markets, the energy sector operators in Kosovo were affected by high prices as well. In addition to the change in prices, the energy sector in Kosovo during the period January-July 2021 has experienced an increase in electricity consumption in relation to the planning in the electricity balance.

based on the applicable legal framework and following the evaluation of the current situation, recognizes the additional costs for the purchase of electricity as incurred for the period January-July



2021, presented by KESCO. For the remaining part of 2021, ERO, after evaluating the price trend in credible energy exchanges and relevant studies related to energy price forecasts, has reviewed the energy purchase costs also for the remaining part of 2021. Wholesale energy prices are projected to be high in 2022 as well. According to S&P Global, the forecast of energy prices in Europe for 2022 is projected 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 and jeopardize the liquidity of energy sector in general.

ERO wants to explain to USS and the broad public, that the generation price from KEK JSC. is not subject to regulation, and that the price used for calculating the energy purchase costs from KEK JSC. is the same price presented in the Annex to the Energy Purchase Agreement between KEK and KESCO.

In relation to the justifications provided by KESCO on the impossibility of energy purchase from HPP Ujmani, ERO emphasizes that KESCO is obliged to fulfil the electricity demand of USS customers at reasonable, transparent, competitive and efficient prices, therefore it falls under the managerial responsibility of KESCO to supply USS customers at the most favourable conditions that can be found in the market.

KESCO explained in the submitted comments that the Government of the Republic of Kosovo shared a fund for subsidization of customers for the energy purchased from Renewable Sources, as part of the Implementation of the Law on Economic Recovery- COVID 19. This impacted the decrease of electricity bills of final customers, whereas it did not affect the USS costs.

3 KESCO's comments on operational expenses

Expenses for regulated customers-The Universal Service Supplier explains that during the application for Maximum Allowed Revenues has used the operational expenses according to the application for regulatory parameters, submitted to ERO on 8 October 2020, in relation to which it has not received any evaluation yet. This Report presents in a detailed manner the request for operational expenses, as requested by ERO on the letter no.295/20, dated on 19.09.2020 on the Review of Input Parameters and Allowed Revenues for USS. In the same application, USS has emphasized that the request submitted in this document does not include the operational costs for the supply of unregulated customers, who were expected to be supplied at unregulated tariffs starting from 1 April 2021. Furthermore, even in the financial and regulatory statements, the Supplier has presented separately the operational costs for customers supplied at regulated and unregulated tariffs. ERO's request to present the costs related to the provision of services to unregulated customers remains unclear, therefore we kindly ask ERO to explain their request in order for the Supplier to provide the information requested by ERO.

¹ www.spglobal.com; [European power forecast to hold near record levels to 2023: Platts Analytics | S&P Global Platts \(spglobal.com\)](#); visited on 28 September 2021, at 16:03



Additional costs related to COVID-19 pandemic - In the evaluation of operating costs for 2021, we noticed that ERO reflected the increase in costs for health insurance, but did not take into consideration the comments of USS regarding the unilateral reduction of costs for operational expenses during 2020, same as it did not take into account the costs out of the control of USS, related to the spread of the COVID-19 pandemic, the demands for additional costs related to market opening or the demands of employees to level their salaries with other sectors. Further, USS argues that while almost all commercial businesses remained closed and most employees were periodically relieved of their responsibilities at work, supplier employees have continuously worked on fulfilling their duties to provide regular supply of electricity to every citizen in Kosovo, thus endangering their health.

USS bases its request to stimulate employees who were working in pandemic conditions on the fact that in March 2020, the Government of the Republic of Kosovo took a decision to stimulate employees who were working diligently to overcome this extraordinary period with many risks. The supplier submitted a similar request to ERO, that the additional costs caused by the spread of COVID-19 pandemic, but also an additional charge, to be recognized in the next tariff review and requests from ERO to reflect these costs.

Costs for common services- Regarding these costs, USS in the provided comments states that ERO has reduced them unilaterally after the publication of the Consultation Report. Also, USS claims that operating costs for the Universal Service Supplier are approved in total and they do not comply with the annual requirements of the Supplier through years, as the allowed costs are a continuation of the forecasts made during the first regulatory period and do not reflect the change in prices over the years.

Regarding operational expenses, USS requests that during their determination, current and justifiable costs shall be taken into account before making adjustments that affect over 25% of the total operational costs, and that their reduction has placed the Universal Service Supplier in a very unfavourable financial position. Also, USS states that it closed 2019 with losses and at the same time during 2020 it faced collection problems, due to the spread of the COVID-19 global pandemic, which further affected its payment capacity to cover the obligations towards other operators, again resulting in losses. In this regard, USS requests from ERO to take into consideration the operational expenses according to its request adjusted to the expenses incurred during 2020.

Expenses from the rights of use - In its comments on operational expenses, USS states that the data presented in the financial statements regarding operational costs differ from those allowed by ERO, such as lease expenses which from 2019 (including 2020) in accordance with the accounting principles (IFRS 16) require the handling of operational lease expenses as financial lease and the same are presented in the Balance Sheet under the item "Asset usage rights and lease obligations". Respectively, the costs of lease as part of the common services that the supplier pays to the DSO, have not been taken into account by ERO when deducting these costs and in this regard, in accordance with the agreement between the parties, we request that it be adjusted during the review of the request of the supplier.



ERO's response

Expenses for regulated customers - Regarding the allocation of costs for regulated and non-regulated customer service, ERO has requested such information in accordance with its expectations to determine the input parameters for USS and operational expenses for a period of three years according to the Rule on USS Revenues. As ERO lacked the Board quorum since December 2020, the process of setting input parameters and operational costs for USS could not be completed in 2021.

Taking into account the current circumstances in the energy market in Kosovo, as well as the circumstances with the pandemic, ERO decided to postpone the market opening process for customers connected to the voltage level of 35kV and 10kV. Regarding the uncertainties of USS on the request of ERO for division of Operational Expenses (OPEX) between regulated and unregulated customers, the purpose of the request was to have such a division at least for customers who are currently supplied at unregulated prices (customers connected to the voltage level 220kV and 110kV). Due to the lack of such data and the small impact that the sharing of these costs has, ERO will treat the costs as joint, but they will be updated in the next periodic review. However, ERO will take care to monitor the aspect of regulated and unregulated electricity supply activities.

Additional costs related to COVID-19 pandemic- ERO reiterates that it considers it reasonable in principle to recognize the costs related to 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 USS, ERO proposes the recognition of only the direct costs related to maintaining health as a result of COVID-19.

Regarding the claim of USS that other operators in the energy sector have provided allowances for their employees during the pandemic, ERO clarifies for USS and for the public, that USS could consider such a payment to employees, only through the profit of the enterprise, as did other operators, who did not reflect these costs in their prices.

ERO also expresses concern that USS, 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 USS, it results that the additional costs for the pandemic are about 6,398 Euros (expenses for masks, clothes, disinfectants, other hygienic products), while the amount of 36,351 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 6,398 Euros.

Costs for joint services - ERO during the determination of MAR allows a reasonable level of costs without compromising the financial liquidity of the company given that these costs are transferred to customers through tariffs. As the costs for joint services are pass-through costs for the USS, and are out of the control of the USS, ERO has evaluated that it is necessary to review the costs for joint services for the USS. The reason for this review of the costs for joint services in 2020 has been the



marked differences between allowances and realizations. ERO would like to emphasize that the level of operational expenses in general, including costs for joint services, was initially based on studies and estimations of the level of operational expenses required to carry out the supply activity. It should be emphasized that this level of OPEX has been updated to take into account the requirements for additional staff costs and health insurance in 2018. These costs are also updated on an annual basis to take into account the inflation rate. Therefore, USS's claim that these costs are static is not grounded, based on the arguments given above.

Regarding the claims related to revenue collection issues from KESCO, ERO through regulatory input parameters allows a reasonable level of bad debt in the real cost of services to regulated tariff customers. Given the circumstances with the pandemic, ERO encourages the operator to make efforts to maintain the level of bad debt within the allowed level.

Expenses from the rights of use – ERO, through allowed investments, determines the Regulatory Asset Base which includes assets that are used and useful for provision of customer services by the regulated entity. In this regard, the economic lifespan of assets must be in accordance with the lifespan of assets set by the Regulator. Therefore, the requirement to recognize depreciation expenses and to recognize in the RAB the cost component claimed by the right of use is not in line with the secondary legislation dealing with tariff aspects. Given that KESCO has changed the policy of handling lease expenses which is related to KEDS, a change which was made without prior notice to the Regulator. Following the receipt of comments from KESCO, ERO held a meeting for additional clarifications with KESCO's staff. From this meeting, ERO was informed that the costs presented by the rights of use (depreciation), are in fact lease costs, only that the way of handling is carried out in accordance with the new rules of IFRS and not according to the regulatory ones. Therefore, ERO, taking into account the additional clarifications, proposes that the issue of lease costs shall be addressed in the next regulatory period.

4 Pass- through costs

USS has noticed that ERO has calculated lower costs for USS for transmission and distribution use of system, but it has not provided detailed information regarding that. Considering that the actual data for the period January-July are higher than the evaluations of ERO, USS in its report presented the actual values realized for 2021. Whereas, for the remaining months, without knowing the exact evaluations of ERO, has used the current prices. USS requests from ERO that upon calculating prices for network operators, the same should be reflected in USS costs.

ERO's response

Regarding the forecast of pass-through costs for 2021 (DSO, TSO, RES fund costs), ERO in the initial Consultation Report is based on the applications of March 2021 and the actual circumstances in the energy market for 2020. As for the claim that ERO did not provide detailed information in the evaluation of these costs, it is not grounded, because the Consultation Reports include all the details with energy and financial data and they were made public. Furthermore, the calculations and models for the Maximum Allowed Revenues are also shared with USS. It is simple for USS to evaluate how DSO costs are transferred to USS, as they are 100% transferred, considering that all customers at DSO level are supplied at regulated tariffs. Regarding the data for the TSO/MO, ERO in conformity with the



initial assessment of the allowed revenues for the TSO/MO has made the forecast of the costs passed-through to USS in accordance with the tariff methodologies for the TSO/MO.

Based on the comments, evidence and circumstances in the wholesale energy market, as described in the chapter of the document related to sale and purchase of electricity, ERO in the final assessment reflected the costs transferred to USS in accordance with reviews of the Maximum Allowed Revenues of the operators.

5 Actual regulated revenues and correction of revenues

Regarding the correction of revenues, USS states that ERO has not taken into account the costs affected by the spread of COVID-19 pandemic, whereas regarding the supplier's obligations to the Transmission System Operator (TSO), USS clarifies that the value of 15.22 € million is in line with payments made by the supplier to the TSO on monthly basis. Taking into account these explanations and the above claims made by USS, it results that the value of adjustments for 2020 is € 5.51 million.

Regarding the differences/imbances between the amount of wholesale energy purchased and the amount of energy billed to final customers during 2020, USS emphasizes that the nominations between the parties USS and DSO are made in accordance with the instructions, decisions and regulatory procedures in force. Furthermore, the revenues generated by USS through the balancing mechanism, the Supplier returns to the final customer through annual adjustments. USS also states that in order to properly reflect the costs, the parties USS and DSO apply the necessary monthly corrections, according to the calculations received from KOSTT.

ERO's response

Regarding the costs related to the COVID-19 pandemic, as explained above, 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.

Regarding the pass-through costs for the renewables sources fund realized in 2020, ERO in the initial assessment had recognized the costs in the amount of 14.9 million Euros. Following the finalization of the financial statements for USS, this value turns out to be 15.2 million Euros. ERO in the final evaluation has accepted this correction, based on the audited data. Whereas, regarding the pass-through costs of the distribution system operator for 2020, ERO estimates that the obligations of USS to the DSO shall remain the same (100.55 million Euros), which means that the costs related to the imbalances caused by USS (in the amount of 3.49 million Euros) remain the same as in the initial assessment.

ERO reiterates that the balancing mechanism has not identified parts of the energy which is required to be corrected by USS, as presented in its calculations, therefore the costs of the parties responsible for the caused imbalances have remained the same based on the invoices and corrections made by KOSTT. Taking into account the explanations given, the costs of imbalances for USS remain 3.49 million Euros and not 4.2 million Euros as requested by USS.



Based on the explanations given above, the revenue correction factor for 2020 results in an amount of 6.79 million Euros. This correction is carried forward in the calculation of revenues for the relevant tariff year 2021.

6 Bad debt

USS emphasizes that during the calculation of the level of actual bad debts, all the revenues of the Supplier should not be taken into account. It also claims that the current ratio of bad debts is higher, also expressing concern that the same level will increase further when we consider the exit of customers connected at the level of 35 kV and 10 kV to the unregulated market, since USS will remain mainly with irregular payers, who tend to delay and/or refuse the payments of received invoices. USS also claims that the spread of the pandemic during 2020 had a negative effect on the collection rate from electricity bills. In its calculation, USS has applied the level of bad debt of 5%.

ERO's response

ERO, in determining the Revenues for KESCO, allows a reasonable level of bad debt through the establishment of key regulatory parameters during the periodic review. The level of bad debt is determined based on historical data and the expectation of improved performance. Also, an important factor in determining the level of bad debt is the comparison with other operators in the countries of the region and other countries with similar regulatory and economic characteristics. Therefore, ERO encourages the operator to make efforts to maintain the level of bad debt within the allowed level.

Despite KESCO's concerns about price deregulation and its impact on bad debt growth, ERO considers that KESCO's claims are not reasonable at this time. In future reviews of parameters, ERO will, among other things, review the new circumstances created after the deregulation. ERO considers that the allowed level of bad debt of 4% is reasonable for this relevant tariff year as well, and the same will be applied until the input parameters for USS are set.



7 Maximum Allowed Revenues for USS for relevant tariff year 2021

Following the evaluation of all available data and those submitted by stakeholders during the public consultation, ERO's final proposal for Maximum Allowed Revenues for the Universal Service Supplier (USS) for the relevant tariff year 2021 is presented in the table below. ERO will handle the difference between its evaluations of the Allowed Revenues required for the USS and the Revenues that the USS is expected to collect from current tariffs as a balancing measure that can be used in electricity tariff reviews in the future.

ERO evaluates that the difference between the Allowed Revenues estimated by ERO and the Revenues that are expected to be covered by the regulated tariffs in force is about 5.0 million euros. This change will be allocated to the Tariff Balancing Account (LBT). The balance of this account will be adjusted in future tariff processes.

Proposed MAR for relevant tariff year 2021

MAR of Universal Service Supplier	Unit	Initial proposal 2021	USS proposal 2021	Final proposal 2021
Indexation parameters				
Interest rate I_t	%	6.85%	6.85%	6.85%
Retail costs of the Supplier				
$OPEX - OPMC_t = OPMC_{t-1} * (1 + CPI_{t-1}) * (1 - E_t) * (1 - P_t)$	€m	4.6	6.0	4.6
$Depreciation - DEPC_t = DEPC_{t-1} * (1 + CPI_{t-1}) * (1 - P_t)$	€m	0.1	0.1	0.1
Pass-through costs				
TSO costs	€m	14.3	21.5	17.8
DSO costs	€m	81.4	104.2	90.5
RES fund costs	€m	14.8	11.9	9.9
Working Capital (WCLC_t)				
$WCLC = (1 / 12) * I_t * (RETR_t + WHPC_t + PSTC_t - NTFRT_t)$	€m	1.4	1.7	1.5
Energy purchase costs				
Wholesale energy purchase costs	€m	137.1	149.4	147.2
Licensing tax				
Licensing tax	€m	0.02	0.0	0.03
Bad debt (BDTA)				
BDTA	%	4%	5%	4%
BDTA	€m	10.8	15.8	11.6
Adjustments of revenues for USS				
Adjustments of 2020	€m	6.5	5.5	6.8
Maximum Allowed Revenues	€m	271.2	316.2	290.1

It should be taken into account that the increase in costs does not necessarily mean an increase in tariffs, given that in 2021 there is also an increase in consumption, namely higher revenues are expected from billing.



Below is graphically presented the share of costs by activities in the total costs for electricity supply to regulated customers.

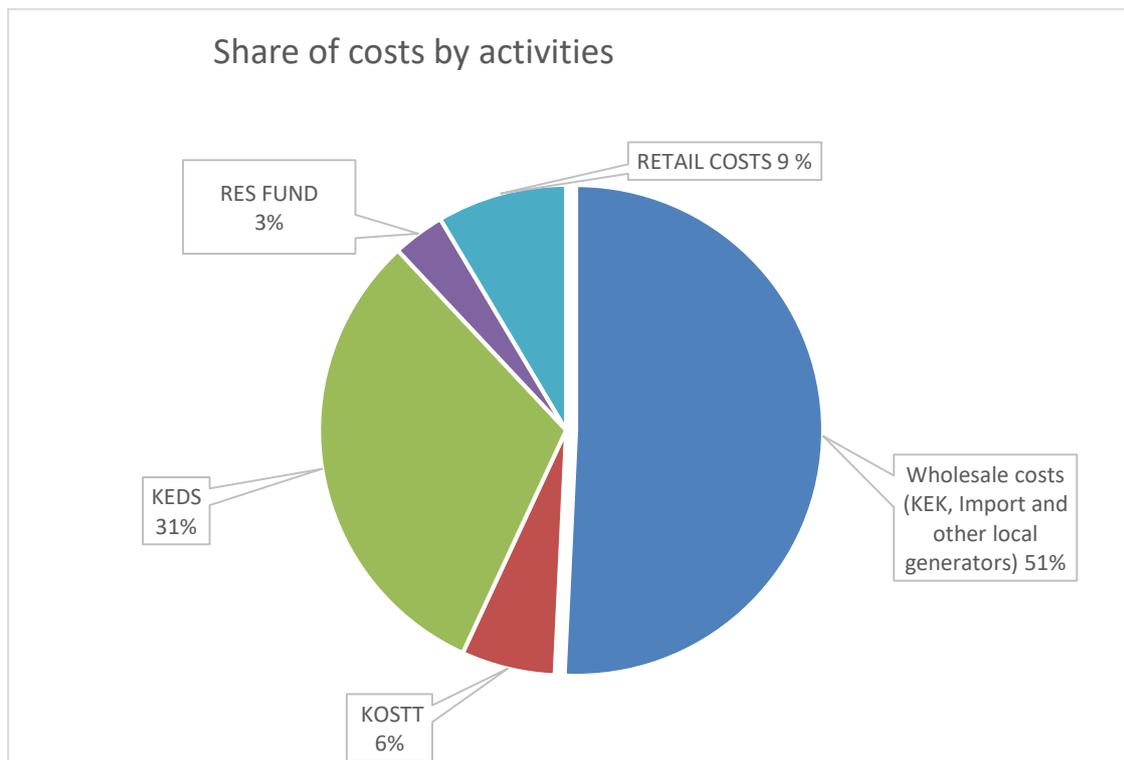


Figure 1 – Share of costs by activities

Note: The Renewable Energy Sources (RES) Fund is the fund created and managed by the market operator in accordance with the Rule on Support Scheme.