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USS Comments on the ERO Consultation Report for Extraordinary Review of Electricity Tariffs

January, 2022

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I. Introduction

Energy Regulatory Office dated 07/10/2021 through decision V_1424_2021 approved the Maximum Allowed Revenues (hereinafter, MAR) for the Universal Service Supplier (hereinafter, USS) for the year 2021 in the amount of € 290 million. Although the approved MAR for 2021 reflected actual sales and costs for January-July, as a result of high import prices, the actual data for August-October exceeded the forecasts used during the approval of allowed revenues.

In accordance with the right given in the USS Pricing Rule, on October 28, 2021, USS submitted the request for opening an extraordinary review, which was handled by the Regulator only in December 2021. After submitting the second request for extraordinary review on December 28, 2021, ERO on January 17, 2022 has published the Consultative Report for Extraordinary Review of Electricity Tariffs. In this report ERO has presented the initial assessment for the Maximum Allowed Revenues for the Universal Service Supplier.

According to the USS Pricing Rule, during the extraordinary reviews the impact of the extraordinary event on the regulated revenues for the rest of the regulatory period is calculated. Respectively, if the impact is higher than the materiality threshold of 5%, then the regulated revenues are adjusted. As noted in the ERO Consultation Report, the unprecedented increase in prices in the electricity markets has affected the costs of purchasing electricity, increasing the costs of purchases made from imports. This paved the way for the start of the process for extraordinary review of electricity tariffs in order to cover the significant change in the costs of purchasing electricity and maintaining the electricity system in the country.

In this document, USS will review the proposal of maximum allowed revenues according to the Consultation Report and will present the data that support the proposal of USS for maximum allowed revenues for the period 1 February 2022- 31 March 2023.

II. Adjustment of Allowed Costs

The Universal Service Supplier since July 2021 has observed strong factual global signals of increasing energy prices, which clearly indicated that it would result in an energy crisis. Seeing that the situation will be serious in the following periods, USS during the submission of comments on the Consultation Report on the maximum allowed revenues for 2021, had predicted higher import prices compared to the approvals of ERO. Although as stated in the Consultation Report for Extraordinary Review, the forecast of USS was 142% lower compared to the realizations, the reflection of the request of USS would send clear price signals and respectively would result in more rational use of electricity. It would also help the sector both in terms of costs and in terms of sector liquidity.

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Inaccurate reflection of the costs of purchasing electricity from imports when determining the maximum allowed revenues for 2021 as well as delays to take action regarding the request for extraordinary review put the Universal Service Supplier in a difficult financial position, since the purchase costs of imports were twice as high as the energy sold to the final consumer. As a result, during December, import purchases of energy were impossible to be purchased, considering that import costs marked the highest prices (up to 600 € / MWh), causing imbalances in the electricity system, which could be avoided if adequate regulatory measures were taken.

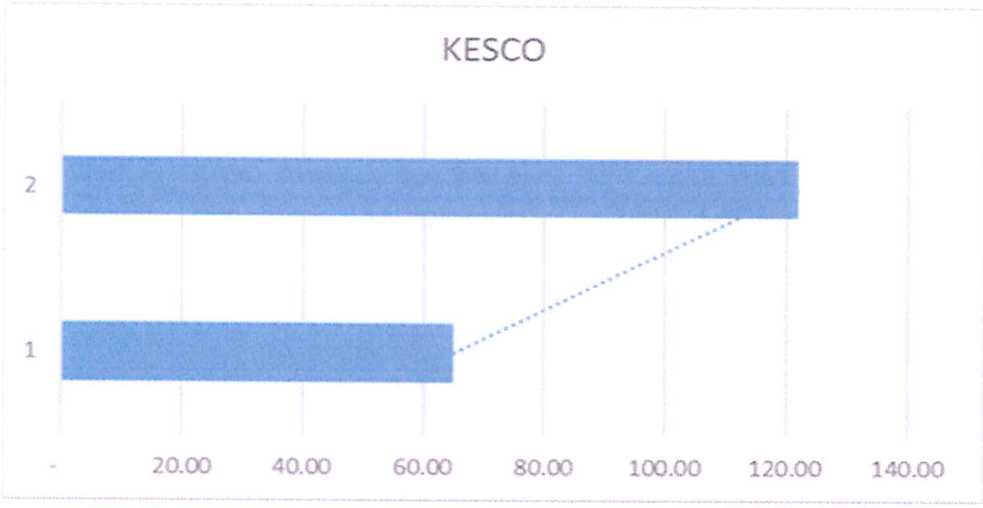

Fig 1. Difference between average price for import purchases and average price sold to end-customers

ERO in its report stated that it has reduced the costs of imbalances in reflecting the allowed costs, with justification that USS has deviated systematically and intentionally, however it is important to clarify that USS has consistently raised its concerns about increased costs and problems with financial liquidity, also announcing that it is impossible to insurance imports. The stance of ERO that USS has systematically and continuously deviated does not stand because this phenomenon is a consequence of inaction by policy makers, leaving the sector to face the risks warned in advance to all relevant stakeholders. Such evaluations from the Regulator should be treated conform legislation in power, but decreasing imbalance costs in this way is in contradiction with the Pricing Rule for USS.

At the time of the application for extraordinary review, the December data were incomplete. USS has submitted this data to the Regulator after the end of the month, however ERO has partially updated the same during the adjustment of pass-through costs. USS in this document has updated the full data for 2021.

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Universal Service Supplier MAR of 2021	Unit	Allowed	Actual
Indexation parameters			
Interest Rate It	%	5.74.%	
Retail Costs of the Supplier			
OPEX - $OPMC_t = OPMC_{t-1} * (1 + CPI_{t-1}) * (1 - E_t) * (1 - P_t)$	€m	4.61	4.61
Deprecation - DEPCt = DEPCt-1 * (1 + CPIt-1) * (1 – Pt)	€m	0.11	0.11
Pass-through costs			
TSO costs	€m	20.96	21.01
DSO costs*	€m	105.86	105.86
RES fund**	€m	10.45	10.49
Working capital (WCLCt)			
WCLC= (1 / 12) * It * (RETRt + WHPCt + PSTCt - NTFRt)	€m	1.47	1.49
Energy purchase costs			
Wholesale energy purchase costs	€m	176.98	180.40
Licensing Tax			
Licensing Tax	€m	0.04	0.04
Bad dept (BDTA)			
BDTA	%	4%	4%
BDTA	€m	13.64	13.78
Adjustments			
Adjustments 2019	€m	6.79	6.79
Adjustments of revenues for USS			
USS MAR AAC_{at-1}	€m	340.89	344.57
Actual revenues from billing ARR_{t-1}***	€m	299.97	299.97
Adjustments for interest of LBT for year 2020	€m	0.28	0.28
Adjustments of revenues ADJ_t	**€m**	**43.56**	**47.44**

III. Adjustment of Allowed Costs

ERO in the Consultation Report for Extraordinary Review has used the sales according to the forecasts used in the first draft of the Energy Balance. Although USS seeing the trend of increasing consumption during 2021 submitted the updated sales report, considering the tariff increase proposed by ERO in the Consultative Report of the Tariff Structure, USS believes that the increase will not be in line with the trend of recent years, therefore in principle agrees with the proposal of ERO. Yet, USS updated the January data in order to reflect as accurately as possible the expected costs and revenues.

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Regarding Operating Expenses, regulator during the adjustment of costs used the inflation of 2.12% as predicted by USS before the official publication of inflation for 2021, which turned out to be 5%, therefore USS in this report has applied the correct inflation rate applicable in the euro area, as defined in the Pricing Rule for USS.

Regarding the necessary purchases to cover the demand for electricity supply, the ERO has used the most optimistic production scenario from KEK-Generation which is expected to operate throughout March with 3 units of Kosovo A and 2 units of Kosovo B. Considering the unplanned one after the other of the generating unit during 2021, the operation for a longer time with 3 units of Kosovo A, we believe that the production scenario is optimistic. In this sense, any eventual absence from the domestic production plan increases the need for its replacement with import which has a price 10 times higher than the actual prices forecast in the international market for March. Above all, considering the changes in import prices and their unpredictability, the forecast of the import price with an average price of 171 €/MWh is low and does not represent the real expected costs. Moreover, the ERO in its forecasts has not considered cross-border prices, which have increased significantly compared to previous years and the same increased during the winter season, given that all countries in the region are importers of electricity and demand grows beyond free cross-border capacities.

International market forecasts show an increase in import prices, which have started to increase steadily from January 20, as shown in the figure below.

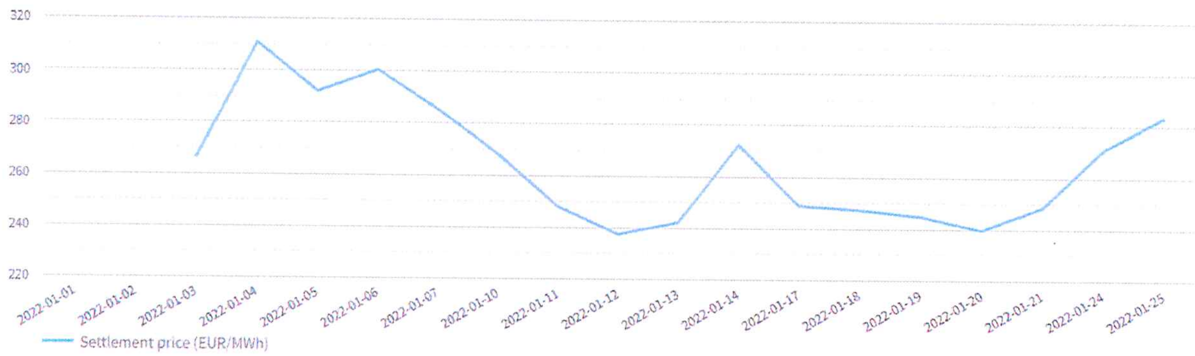

Fig 2. Trend of import price for the period of 1-25 January 2022

Peak load prices according to HUPX are projected to reach 302.47 €/MWh during February and respectively 283.84 €/MWh during March[1], not to decline less than 269.61 in the 4th quarter of 2022. In this sense, take into account above said, in the following document, FSHU has considered the average price of 250 €/MWh for import purchases, according to the optimistic scenario of KEK-Generation.

Since the moment of submission of this report there is no decision on electricity subsidy and the modalities of providing this subsidy are not known, USS cannot prejudge the same.

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[1] HUDEX, Forecast of Import Prices date January 26, 2022https://hudex.hu/en/market-data/power/daily-data#month

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Regarding the pass-through costs for USS, (DSO and TSO costs) are presented according to ERO forecasts as the same are unknown by USS at the time of application. ERO's comment regarding the DSO cost forecast in the consultation report has been unclear. For clarification, USS in the Consultation Report has forecast the increase of DSO and TSO costs in line with the increase of USS. Whereas, in this document USS presents them as forecast by the ERO in the Consultative Report for extraordinary review.

IV. Proposal for Maximum Allowed Revenues for the USS for 2022

The following table summarizes the MAR required by USS for 2022, after considering all the necessary adjustments, as argued above.

MAR of Universal Service Supplier for 2022	Unit	Proposal ERO	Proposal USS
Indexation parameters			
Interests rate It	%	5.53.%	5.53%
Retail costs of the Supplier			
OPEX - $OPMC_t = OPMC_{t-1} * (1 + CPI_{t-1}) * (1 - E_t) * (1 - P_t)$	€m	5.29	5.42
Deprecation - DEPCt = DEPCt-1 * (1 + CPIt-1) * (1 – Pt)	€m	0.11	0.11
Pass-through costs			
TSO costs	€m	18.34	18.34
DSO costs *	€m	174.50	174.50
RES Fund**	€m	3.54	3.54
Working capital (WCLCt)			
WCLC= (1 / 12) * It * (RETRt + WHPCt + PSTCt - NTFRt)	€m	2.22	2.31
Energy purchase costs			
Wholesale energy purchase costs	€m	186.10	203.30
Licensing tax			
Licensing tax	€m	0.07	0.07
Bad dept (BDTA)			
BDTA	%	2.4%	2.4%
BDTA	€m	12.52	13.13
Adjustments			
Adjustments 2021	€m	43.56	47.44
Adjustments for OPEX	€m	0.42	0.42
Adjustments of revenues for USS			
USS MAR AAC_{at-1}	€m	446.67	468.46
Actual revenues from billing ARR_{t-1}***	€m	314.33	319.82
Adjustments of revenues ADJ_t	**€m**	**446.67**	**468.60**

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In order to reflect the expected costs necessary for the safe operation of USS, € 468.59 million are needed. Expected revenues from sales with actual tariffs are € 319.82 million, so the system needs a tariff increase of 47% on average.

Any reflection lower than the required costs will jeopardize the sustainable operation of USS, which during 2021 has already faced liquidity problems.