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For: **Mr. Ymer Fejzullahu**
Head of the Board
Energy Regulatory Office

KOMPANIA KOSOVARE PËR FURNIZIM ME ENERGJI ELEKTRIKE SH.A.
KOSOVO ELECTRICITY SUPPLY COMPANY J.S.C.
KOSOVSKO PREDUZEĆE ZA SNABDEVANJE ELEKTRIČNOM ENERGIJOM D.D.
KESCO SH.A.
Nr. 74 Dt. 05.12.2022
HQ 1

CC: **Mrs. Artane Rizvanolli**
Minister of Economy

ERO Board

Mr. Petrit Pepaj
Managing Director - ERO

Date: 05.12.2022

Ref: Request for the Opening of the Extraordinary Review of the Maximum Allowed Revenues for the Universal Service Supplier

The year 2021 was characterized by enormous increases in electricity prices, which brought liquidity consequences and increased costs in the energy sector of many European countries, including Kosovo. The increase in import prices during 2021 to unprecedented levels paved the way for the extraordinary review at the end of 2021, which was completed in February 2022. However, the continuation of variation and volatility of import prices during the year 2022, worsened the situation of the electricity sector in the country.

The reduction of energy purchase costs for USS, based on the decision of the Government of the Republic of Kosovo for the allocation of the subsidy in the amount of 100 million euros and the late disbursement of the subsidy, put the supplier in a difficult financial position, letting the same to operate below costs from mid-2021, thus for a whole year.

The planned capital overhauls of KEK-generation during the summer season, when electricity prices reached record values compared to 2021, exposed the supplier with universal service in an unprecedented situation, endangering the supply of electricity. 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 measures were further extended in accordance with Article 25 of Law No. 05/L-081 for Energy.

Although import prices began to stabilize during October 2022 and temperatures proved stable, the final tariffs did not produce the desired effect, resulting for USS to exceed the costs recognized in the tariffs. The allowed cost of purchases for electricity for USS for the year 2022 is 81.12 million €, which also includes the subsidy of 100 million €, while the realized cost of purchases only for the period January-November 2022 reaches the value of 153.9 million €, or a difference of 72.8 million € compared to the total allowed costs in 2022.

Purchases of electricity (in thousand €)	ERO (Jan-Dec)	USS (Jan-Nov)
Purchases from KEK	118.37	109.59
Purchases from Import	21.80	18.84
Purchases from RES	40.94	25.51
Subsidy	(100) ¹	-
Total	81.12	153.94

ERO, during the determination of the Maximum Allowed Revenues, has approved the average price for purchases from imports for USS in the amount of 126.80 €/MWh, while the realized price (preliminary November) together with the forecasts for the December, results in an average import price for the total in 2022 it is 135.08 €/MWh or an increase of 7%, compared to the average price allowed by ERO.

Considering the estimated costs for the month of December 2022, the purchase costs for electricity for the year 2022 will reach the value of 188.03 million €, or a difference of 104.75 million € compared to the costs allowed for the year 2022

Purchases of electricity (in thousand €)	ERO (Jan-Dec)	USS (Jan-Dec)
Purchases from KEK	118.37	123.07
Purchases from Import	21.80	22.09
Purchases from RES	40.94	28.67
Subsidy	(100)	-
Total	81.12	173.84

Since the supplier's revenues cover all the costs of the power system, its costs and revenues are also affected by the pass through costs. Finally, the total costs to the suppliers for the year 2022

¹ The subsidy allocated by the Government of the Republic of Kosovo from USS is treated as revenue

reach the value of 446.37 million € and compared to the revenues, the correction factor has reached 37.99 million € or 8% to the approved MAR, as presented in the following table:

USS MAR 2022	Costs in mil €
Operating expenses	5.52
Wholesale purchases	188.03
Costs for TSO	20.42
Costs for DSO	165.77
BRE fund	4.48
Other costs	62.15
The final MAR	446.37
Expected revenues from Billing	333.83
Revenues from the January-October subsidy	52.86
The expected revenues from the November-December subsidy	21.68
Revenues including the subsidy	408.37
Impact	37.99
Impact in %	10.94%

However, the financial impact and costs borne by USS do not end in December, but the same continue to remain the burden of USS until March of 2022, when the costs are expected to be revised during the determination of the next tariff year.

Now that we are on the eve of the winter season and the consumption of electricity has started to increase, and along with it the costs of electricity. KEK generation with on 30 November 2022, sent a notice to change its production plan for December 2022 and 2023, which reduced its production, thus increasing the need for imports. According to forecasts, import prices in international markets continue to be at levels above that allowed by the Regulator for the month of December and the coverage of system costs for the months of January-March until the next tariff review is unstable.

Taking into account the above analysis regarding the expected costs as a result of not reflecting the high import costs in the final tariffs, the change in the production plan and the increase in the pass through costs, the supplier cannot afford these costs anymore, therefore, in accordance with article 11 and appendix 4 of the USS Pricing Rule, the Universal Service Supplier submits a Request for an extraordinary review of the Maximum Allowed Revenue and together with it submits Application for Extraordinary Review, namely the Financial Impact Report.

ERO has the authority set by law to set tariffs that will be applied by licensees and that will be charged to end consumers. In these circumstances, ERO must create and maintain an optimal



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balance between the consumer and the licensees. Any lack of proper reflection of costs creates imbalances between consumers and suppliers, thus creating deeper financial problems for USS, which may even jeopardize the security of electricity supply.

With respect,



Mesut Serhat Dinc
Chief Executive Officer, KESCO j.s.c

Extraordinary Review of the Maximum Allowed Revenues for the Universal Service Supplier

December, 2022

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Introduction

The increase in import prices during 2021 to previously unrecorded levels paved the way for an extraordinary review at the end of 2021. However, the continuation of fluctuations and instability of import prices during 2022 also worsened the situation of the electricity sector in the country.

The reduction of energy purchase costs for USS, based on the decision of the Government of the Republic of Kosovo for the allocation of the subsidy in the amount of 100 million euros and the later disbursement of the subsidy, put the Supplier in a difficult financial position, allowing the same to operate below costs from the middle of 2021.

The planned capital overhauls of KEK-generation during the summer season, when electricity prices marked record values compared to 2021, exposed the supplier with universal service in an unfavorable situation, endangering the supply of electricity. 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 measures were further extended in accordance with Article 25 of Law No. 05/L-081 for Energy.

Although, import prices began to stabilize during October 2022 and temperatures proved stable, the final tariffs did not produce the desired effect, resulting in the USS exceeding the costs recognized in the tariffs. Now that we are on the eve of the winter season and the consumption of electricity has started to increase, and with it the costs of electricity. KEK generation on 30 November 2022, sent a notice to change the production plan for December 2022 and 2023, which reduced its production, thus increasing the need for imports. According to forecasts, import prices in international markets continue to be at levels above those allowed by the regulator for the month of December, and the coverage of system costs for the months of January-March until the next tariff review is unstable.

Therefore, the Universal Service Supplier (USS) in accordance with article 11 and appendix 4 of the USS Pricing Rule has submitted Request for extraordinary review of the Maximum Allowed Revenues and together with it submits the Application for Extraordinary Review, namely the Financial Impact Report. This document contains all the necessary data as required by the regulatory and legal framework in force and the data are presented in tabular form and are argued as follows.

Description of the Extraordinary Event

The energy crisis that began during the second half of 2021 as a result of the enormous increase in electricity prices, brought liquidity consequences and increased costs in the energy sector in many European countries, including Kosovo. After continuous requests from electricity licensees in Kosovo, ERO on 13 December 2021 opened the extraordinary review for the maximum allowed revenues for regulated operators. The process was concluded in February 2022 with the decision of the maximum allowed revenues for the USS, Decision no. V_1486_2022 of date 7 February 2022. ERO assessed and approved the Maximum Allowed Revenue for the Universal Service Supplier in the amount of 347.28 million €. Although this value did not cover the maximum allowed revenues, the ERO in the justification of the decision writes that in the evaluation of the costs, it took as a basis the commitment for an additional subsidy of 10 million euros according to the Decision of the Government of the Republic of Kosovo no. 05/55 on dt. 21.01.2022, as well as the Decision of the Government of the Republic of Kosovo for the additional subsidy of 90 million euros according to decision no. 01/60 on 05.02.2022. In other words, the maximum revenues have been reduced in all calculations in the amount of 100 million euros. According to this decision dated 08.02.2022, ERO also approved the final electricity tariffs, which marked an increase only for domestic consumers with consumption over 800 kWh, effective from 9 February 2022.

Since the value of the subsidy calculated for consumers according to the prices sent by ERO, for the period 9 February to 30 June 2022, exceeded the value of 31 million euros and considering the lack of reimbursement of this calculated value of the subsidy, USS on 19 July 2022, submitted to the ERO a Request for an extraordinary review of the Maximum Allowed Revenues, according to Article 11 of the USS Pricing Rule. In the submitted request USS emphasized that the lack of reimbursement of subsidy funds from the Government of the Republic of Kosovo of 31 million euros for the period 9 February - 30 June 2022, has exceeded the materiality threshold of 5% as defined by the USS Pricing Rule. ERO had taken into account the request for an extraordinary review and had asked USS to send the report on the financial impact to ERO within 20 days. In accordance with the deadline set by ERO and based on the USS Pricing Rule, on 9 August 2022, the USS submitted the Application for extraordinary review of the Maximum Allowed Revenues, while on 12 August 2022, it also submitted the Proposal for USS tariffs according to the Application for extraordinary review of the Maximum Allowed Revenues.

On 30 August 2022, ERO sent an official letter in response to the Application for extraordinary review of the maximum allowed revenues, in which it was emphasized that the Government's decision no. 23/94 of 24.08.2022 for the budget allocation in the amount of 41 million euros for subsidizing electricity for end consumers has neutralized the impact on exceeding the costs of electricity supply for regulated consumers as determined by ERO Decision V_1486_2022 dated 02.07.2022 and Decision V_1489_2022 dated 02.08.2022 and at the same time, the circumstances

for extraordinary review of the maximum allowed revenues of USS have ceased. Regarding the response of ERO, USS on 7 September 2022 sent an official letter to ERO where it reemphasized that the lack of reimbursement of subsidy funds and not only exceeded the materiality threshold of 5% as provided by USS Pricing Rule. USS has also underlined that the costs of importing electricity, in order to cover the lack of local production, exceed the costs allowed in the final tariffs. However, the request was not considered further.

As a result, the situation of the electricity sector continued to be difficult, especially now that the winter season has started and we have an increase in consumption. Although we have a change in the tariff structure, respectively a change in prices for domestic consumers who consume more than 800 kWh per month, the same have entered in force on 9 February 2022 and their effects have not been seen yet. At the same time, the non-change of prices for commercial consumers has made them continue to use electricity in an uncontrolled manner, marking an average increase of 7% compared to the same period last year. Moreover, the decrease in temperature in the last part of the month of November 2022, shows an increase in consumption values to even higher levels than those of 2021. Finally, as presented in the graph below, the demand of consumers for electricity is elastic to temperatures:



Under these circumstances, taking into account the increase in import prices, the change in KEK-generation production and the high and unstable import prices, USS cannot bear alone the financial burden until the next tariff review, therefore, asks ERO to examine the request for the opening of the extraordinary review for the maximum allowed revenues. Not properly reflecting the costs now endangers its already weakened financial position as a result of the energy crisis that started in the middle of 2021 and simultaneously endangers the security of electricity supply in the country. The reflection of current costs through extraordinary review, in addition to helping USS to reflect current costs, will also provide price signals to the end consumer, which will directly affect load reduction, mitigating the immediate effect of increasing costs in an uncontrolled manner.

Financial impact of the Extraordinary Event

The allowed cost of purchases for electricity for USS for the year 2022 is 81.12 million €, which also includes the subsidy of 100 million €, while the realized cost of purchases only for the period January-November 2022 reaches the value of 153.94 million €, or a difference of 72.82 million € compared to the total allowed costs in 2022.

Purchases of electricity (in thousand €)	ERO (Jan-Dec)	USS (Jan-Nov)
Purchases from KEK	118.37	109.59
Purchases from Import	21.80	18.84
Purchases from RES	40.94	25.51
Subsidy	(100)	-
Total	81.12	153.94

ERO, during the determination of the Maximum Allowed Revenues, has approved the average price for purchases from imports for USS in the amount of 126.80 €/MWh, while the realized price together with the forecasts for the December, results in an average import price for the total in 2022 it is 135.08 €/MWh or an increase of 7%, compared to the average price allowed by ERO.

Import 2022	ERO (Jan-Dec)	USS (Jan-Dec)
Volumes (MWH)	171,960	163,539
Average price (€/MWh)	126.80	135.08
Cost (mil €)	21.80	22.09

Although USS in its comments on the MAR proposal sent to ERO in January 2022 requested higher import costs, ERO did not take this request into account. However, the price forecast shows a continuation of the increase in import prices at the peak time 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 basis¹

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

¹ HUDEX, Electricity Prices <https://hudex.hu/en/market-data/power/daily-data#quarter> Last visited on 29.11.2022

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 USS, we have updated the forecasts for the month of November with the actual data until 21 November while the month of December was set according to the forecasts of the ERO during the determination of the MAR for the year 2022.

Taking into account forecast costs for December 2022, the purchase costs for electricity for the year 2022 will reach the value of 188.03 million €, or a difference of 104.75 million € compared to the costs allowed for the year 2022. For purposes of transparency, the subsidy allocated by the Government of the Republic of Kosovo in this document has been treated as revenues until February 2023.

It should also be noted that USS, during the assessment of wholesale purchase costs, also included disputed invoices for imbalance for the months of July-September 2022. USS, as it has announced through official letters, as a result of the extraordinary event described above, has been obliged to nominate only the energy produced in the country and has asked the Transmission System Operator to take all the necessary steps to not allow deviations in the system and, moreover, will not be held responsible for the same.

Purchases of electricity (in thousand €)	ERO (Jan-Dec)	USS (Jan-Dec)
Purchases from KEK	118.37	123.07
Purchases from Import	21.80	22.09
Purchases from RES	40.94	28.67
Subsidy	(100)	-
Total	81.12	173.84

Since the supplier's revenues cover all the costs of the power system, its costs and revenues are also affected by the pass through costs. Finally, the total costs of the supplier for the year 2022 reach the value of 446.37 million € and compared to the revenues, the correction factor has reached 37.99 million € or 10.94% to the approved MAR, as presented in the following table:

USS MAR 2022	Costs in mil €
Operating expenses	5.52
Wholesale purchases	188.03
Costs for TSO	20.42
Costs for DSO	165.77
BRE fund	4.48
Other costs	62.15
The final MAR	446.37
Expected revenues from Billing	333.83
Revenues from the January-October subsidy	52.86
The expected revenues from the November-December subsidy	21.68
Revenues including the subsidy	408.37
Impact	37.99
Impact in %	10.94%

However, the financial impact and costs borne by USS do not end in December, but the same continue to remain the burden of USS until March of 2022, when the costs are expected to be revised during the determination of the next tariff year.

USS's forecasts for wholesale electricity purchases according to the draft balance sheet for 2023 only for the first 3 months of 2023 are 118.54 million €, with an estimated average import price of 426.38€/MWh, according to market forecasts Hungarian for the first quarter of 2023, while the expected revenues for the first quarter of 2023 are 131.75 million € including the remaining subsidy. Respectively, the impact of KREV for 2022 and the expected costs for the first quarter of 2023 show a cost of 232.69 million euros, with a non-coverage percentage of 43.38%, as presented in the following table:

USS MAR January-March 2023	Costs in mil €
Wholesale purchases	118.54
KREV 2022	40.17
Other costs	73.98
The final MAR	232.69
Expected revenues from Billing	113.70
The expected revenues from the Subsidy	18.05
Revenues including Subsidy	131.75
Impact	101.41
Impact in %	43.38%

Taking into account the above analysis regarding the expected costs as a result of the non-reflection of the high import costs in the final tariffs and the increase in the pass through cost (extraordinary event) and exceeding the materiality threshold argued as above, the Supplier with Universal Service asks ERO to consider with seriousness and priority the request of USS for extraordinary review in accordance with the legal right.

ERO has the authority set by law to set tariffs that will be applied by licensees and that will be charged to end consumers. In these circumstances, ERO must create and maintain an optimal balance between the consumer and the licensees. Any lack of proper reflection of costs creates imbalances between consumers and suppliers, thus creating deeper financial problems for USS, which may even jeopardize the security of electricity supply.

Appendix:

Detailed calculations for outstanding review