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



Final Report on Maximum Allowed Revenues of USS

Responses to Comments

Annual Adjustment for USS for 2023

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.

23 March 2023

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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 Company for Electricity Supply |
| KESH | Albanian Power Corporation |
| KOSTT | Transmission System and Market Operator of Kosovo |
| MFLT | Ministry of Finances, Labour and Transfers |
| MWh | Megawatt hours |
| OPEX | Operational Expenditure |
| 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 process of Regular Adjustment of Maximum Allowed Revenues (MAR) for the Universal Service Supplier (USS). During this process, the MAR for USS shall be set in order to cover the supply of regulated customers.

This document presents the responses to the comments provided by stakeholders and the final proposal of ERO regarding the Maximum Allowed Revenues of USS for the calendar year 2023, which sets the tariffs that are applied for the relevant tariff year 1 April -31 March. Following the initial evaluation of applications regarding the Maximum Allowed Revenues for the licensee of the Universal Service Supplier (USS/KESCO), the licensee and other stakeholders were enabled to present their comments for a two-weeks period.

Regarding the initial evaluation of USS Maximum Allowed Revenues, ERO has received comments from:

- Kosovo Energy Corporation (KEK),
- Independent Union Elektrokosova KEDS/KESCO,
- Government of Kosovo,
- Office of the President of the Republic of Kosovo, and
- USS – KESCO

The comments received from stakeholders are published in the electronic website of ERO. This 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 covering 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 KOSTT tariffs, KEK asks the parties to take into account the prices revised 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 an agreement between themselves must be in accordance with the Energy Trading Procedure, Market Rules and other requirements of secondary legislation.

ERO has so far 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 the employees of the company KEDS/KESCO

3.1.1 Comments of the Independent Union Elektrokosova 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 tariff methodology, 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 with 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 USS OPEX.

Further, 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

4.1 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

ERO, on 15 March 2023, has sent a letter to the Ministry of Economy to obtain clarifications regarding the funds allocated for subsidy purposes for the calendar year 2023. On 16 March 2023, ERO has received clarifications from the Ministry of Economy, which highlights the means from the allocation of €24.6 million according to Decision 13/118 have been disbursed to fulfill the obligations of December 2022 and January 2023.

In this regard, ERO has adjusted the subsidy provided for 2023 from €24.6 million to €19.55 million (€19.55 million includes the subsidy disbursed for January 2023 in the amount of €12.8 million without VAT and the remaining funds of €6.7 million from the €90 million fund). The value of €6.7million is calculated as the difference of €90,000,000 - €83,254,572 = €6,745,428.

4.2 The covering of the gap for MAR for 2023 shall be done mainly by businesses

4.2.1 Comments of the Government of the Republic of Kosovo

For 2023, we suggest that tariffs for households shall remain unchanged, while the gap will be covered (largely) by adjusting tariffs for businesses, and especially large businesses. Such an adjustment for large businesses can also be seen in the context of market opening, where the regulated tariffs should gradually converge with the tariffs that are currently in the open market. In the review that took place last year, despite the proposals from MFLT but also from other parties such as the Energy Community Secretariat (ECS), ERO kept the tariffs for businesses unchanged, changing only the tariffs for households with the addition of the new tariff block for consumption over 800 kWh.

4.2.2 ERO's response

The subsidy pledged by the Government of the Republic of Kosovo in 2022 was dedicated to all electricity customers. Therefore, ERO has distributed it to all customers, therefore keeping the same tariffs for industrial, commercial and household customers with consumption below 800kWh, whereas for household customers with consumption above 800kWh it has adjusted the tariffs as follows: the high tariff from €21.00c/kWh is set at €12.52c/kWh, while the lower tariff from €9c/kWh is set at €5.90c/kWh.

As for the comments given on the administrative increase in tariffs, ERO reiterates that the deepening of cross-subsidization through the administrative determination of the price is not the right way to achieve the goal of market liberalization. ERO considers that an additional barrier to market liberalization is the transfer of the cost of cross-subsidization to customers who will continue to remain

regulated. Therefore, this can only be achieved by applying cost-reflective tariffs for all categories of customers.

ERO, during the determination of tariffs for customer categories is based on the tariff methodology, where the basic principles are defined, taking into account the costs allocated to each category of customers, which depend on the cost that each category of customers causes to the system. In this regard, ERO will determine the tariffs for all categories of regulated customers.

4.3 Curve of import prices

4.3.1 Comments of the Government of the Republic of Kosovo

On page 9 of the report, where the import price per MWh is shown and the reference is EEX – PXE Hungarian Power Futures, the price curve should also be clarified as to how it arrived at the appropriated value of 171.5 Euro/MWh (table 3).

4.3.2 ERO's response

The forecast price for the purchase of energy from import is based on the data published by the European Energy Exchange (EEX-PXE Hungarian Power Futures) for the monthly prices that resulted on 9 February 2023.² At the time of publication of these data, the prices were predicted until the month of August, therefore, for the remaining months, ERO made the forecast by making a symmetrical distribution for the remaining months. This exchange was taken as a reference exchange, because it is one of the most liquid exchanges in the region and due to its geographical proximity was taken into consideration in order to optimize the costs of capacity allocation.

However, ERO has continuously monitored the prices that have resulted in these exchanges, and since in recent years they have been affected due to the increase in overall energy demand as global economies recover from the COVID-19 pandemic and the reduction in gas supply as a result of the war in Ukraine, such prices are dynamic. As a result, a fictitious date cannot be recommended for such forecasts, but ERO suggests that the most recent dates for forecasting prices for the future are more representative, therefore in the final proposal it has updated wholesale prices based on the data of 15 March 2023.

4.4 Costs for RES Fund

4.4.1 Comments of the Government of the Republic of Kosovo

In Table 5, Pass-through Costs – RES Fund Costs, the request of USS for 2023 is 3.77 million euros, whereas the proposal of ERO is 12.37 million euros. It should be clearly explained how this proposal was reached.

4.4.2 ERO's response

As it is known, the generation capacities from RES from 2022 have increased due to the entry into operation of new generators. Therefore, as a result of the increase in generating capacities, the adjustment of the price of RES for inflation, the costs of the fund have increased. In this regard, these

² <https://www.eex.com/en/market-data/power/futures#%7B%22snippetpicker%22%3A%2223%22%7D>

costs should be reflected in the tariffs of the Renewable Sources Fund for 2023. USS, in the absence of available data, has applied the current tariff, because the costs of the Renewables Sources Fund are managed by the Market Operator in line with the Rule on Support Scheme and the forecast of RES costs is carried out by TSO/MO.

However, ERO, similar to wholesale costs, has updated the costs of the RES fund to reflect the data realized for the months of January and February, and the updated consumption. In this regard, the costs of the fund have been corrected from €12.4 million in the initial proposal to €11.8 million in the final proposal. However, taking into account that there may be differences between the forecast and realized values, ERO carries out annual adjustments at the end of each year.

4. Comments of the Office of the President of the Republic of Kosovo

5.1 Review of subsidies and avoiding the increase of tariffs

5.1.1 Comments of the OPRK

The OPRK recommends that in this extraordinary tariff review, the possibilities for avoiding the increase of tariffs shall be evaluated by encouraging inter-institutional communication and coordination in order to ensure the subsidization of additional costs which have impacted the increase of difficulties for the regulated operators.

In particular, we emphasize the importance of avoidance of such a decision by ERO, given that, based on previous practices, following the decisions taken in extraordinary tariff review processes, a subsequent re-evaluation has never been conducted, which eventually would affect the restoration of the original tariffs which were valid before the increase in case of rehabilitation of the factors that initially caused the need for extraordinary review.

5.1.2 ERO's response

The Law on Energy Regulator determines that the tariffs for electricity services shall be set at a level that recovers reasonable service costs. The wholesale power purchase costs, especially import costs – which are the main driver of price changes – are largely out of the control of regulated operators. ERO is legally mandated to evaluate the impact of these costs on the Maximum Allowed Revenues and determine tariffs that ensure the recovery of these costs to maintain security of supply in the system.

As for the inter-institutional communication and coordination, ERO strongly believes that public consultation is at the heart of effective regulatory policies. For this purpose, ERO provides to regulated companies, customers and all interested parties the opportunity to review the evidence and views presented in the consultation reports, with which they may disagree, and to comment on them, presenting counter arguments or by providing new data which ERO may not have considered.

With respect to the comment of the OPRK, that there has never been a subsequent revaluation of the tariffs following the extraordinary review, ERO clarifies that the tariffs in 2016 were reduced by 8% for industrial and commercial customers, in 2017 they were reduced by 3.5% in linear manner for all regulated customers to reflect the exclusion of supply costs in the four northern municipalities and in 2018 tariffs were reduced by 5% for industrial and commercial customers.

These regulatory actions have caused the gradual reflection of the costs of electricity service for each group of customers.

Similar to previous practices and in accordance with the legislation, ERO will determine regulated tariffs to reflect the costs of electricity service for each group of regulated customers.

5. Comments from USS - KESCO

6.1 Costs of wholesale energy purchase for 2023

6.1.1 Comments of KESCO

Although ERO in the evaluation of purchases for 2023 is based on the predicted consumption according to the approved Energy Balance with changes for 2023, the forecast of purchases has not been applied uniformly with the forecast of consumption on a monthly basis. Considering the above, USS in this application has used the consumption data of the approved Energy Balance with changes for the year 2023, but has updated the purchase costs according to the monthly consumption forecast.

Considering the request of ERO for updating prices with inflation for RES in contractual relations, USS reflected the changes in its application, however in the consultation report it was noted that ERO did not apply the changes. As a result, USS in this application has again used the inflation adjusted price for RES in the contractual relations with USS.

Also USS in this application has updated the import price based on the latest forecasts in the international stock exchanges.

In its application, USS has also presented the costs per capacity for energy from KESH, which are necessary for the full use of this energy, otherwise, the non-recognition of the 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.

6.1.2 ERO's response

ERO has reviewed the wholesale costs based on current data for the months of January and February 2023, as well as updated import price forecasts based on data of 15 March 2023 according to EEX. ERO has also accepted the costs of capacity allocation for the energy used by USS in the months of January-February 2023, as well as adjusted the costs of subsidies of the Government of the Republic of Kosovo for 2023 based on the clarifications given by the ME described above.

Given that during the tariff process USS has requested the updating of the prices for HPP with concession by applying a different approach from the one foreseen in the contractual agreement, ERO in this tariff process has taken into account the current prices until the defining of the adjustment of costs for the previous period and the determination of prices for these distributive HPPs in the future.

6.2 Allowed retail costs

6.2.1 Comments of KESCO

ERO, by Decision no. V_1476_2022 has approved the input values and operating expenses (OPEX) for the period 2022-2024. According to this decision, the approved OPEX for 2023 is €5.1 million.

Taking into account the requirements for salary increases from the employees, and the needs analyzed in detail, the OPEX proposed by USS is in the amount of €5.71 million. In this report, USS has applied the inflation rate of 8.39% according to the inflation rate used by ERO based on Eurostat data in the adjustments of depreciation costs and OPEX approved for 2022.

6.2.2 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%.³

6.3 Adjustments and Revenues Correction Factor

6.3.1 Comments of KESCO

ERO in the Consultation Report has evaluated the adjustments for 2022 in the amount of 39.5 million. In the adjustments for 2022, ERO did not take into account the updated adjustments for 2021 which included all the final costs incurred during 2021 and which were not reflected in the approved MAR for 2022, considering that it was an extraordinary process and the data of December 2021 were preliminary. In the updated adjustments for 2021, USS has also included the costs for imbalances which ERO did not recognize as realized costs for 2021 during the MAR determination process for 2022.

6.3.2 ERO's response

As it was clarified also in 2022, USS systematically and deliberately in 2021 had deviated from the real demand for electricity consumption, therefore ERO did not recognize such costs. Meanwhile, in relation to revenues correction factor KREV for 2021, ERO clarified that it had been updated to reflect the latest data.

³ https://ec.europa.eu/eurostat/databrowser/view/PRC_HICP_AIND__custom_4860030/default/table?lang=en

6. Summary of USS MAR (KESCO)

Following the evaluation of all available data and the ones presented from the parties involved in the process, as well as after the review of the comments received by the parties during the public consultation process and taking into consideration also the pass-through costs of the TSO/MO and DSO, ERO's final evaluation and proposal for the Maximum Allowed Revenues for USS (KESCO) for the calendar year 2023 is as follows:

| MAR of Universal Service Supplier | Unit | Reviewed proposal USS 2023 | Final proposal ERO 2023 |
|------------------------------------------------------------------------|-----------|----------------------------|-------------------------|
| Indexation parameters | | | |
| Interest rate I_t | % | 6.85% | 6.91% |
| Supplier's retail costs | | | |
| $OPEX - OPMC_t = OPMC_{t-1} * (1 + CPI_{t-1}) * (1 - E_t) * (1 - P_t)$ | €m | 5.71 | 5.62 |
| Depreciation- $DEPC_t = DEPC_{t-1} * (1 + CPI_{t-1}) * (1 - P_t)$ | €m | 0.12 | 0.12 |
| Pass-through costs | | | |
| TSO costs | €m | 22.25 | 23.15 |
| DSO costs | €m | 151.97 | 149.34 |
| RES Fund costs | €m | 12.37 | 11.77 |
| Working Capital (WCLC_t) | | | |
| $WCLC = (1 / 12) * I_t * (RETR_t + WHPC_t + PSTC_t - NTFR_t)$ | €m | 1.99 | 2.00 |
| Power purchase costs | | | |
| Wholesale power purchase costs | €m | 152.74 | 158.15 |
| License tax | | | |
| License tax | €m | 0.04 | 0.04 |
| Bad debt (BDTA) | | | |
| BDTA | % | 2.2% | 2.2% |
| BDTA | €m | 8.80 | 8.77 |
| Adjustment of revenues for USS | | | |
| Adjustment of the year 2022 | €m | 44.10 | 39.49 |
| Maximum Allowed Revenues | €m | 400.09 | 398.44 |