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



Evaluation of Tariff Application and the Proposal for Tariffs of DH Gjakova JSC for the Season 2021/2022



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1 Introduction

Energy Regulatory Office (ERO) within its duties and responsibilities has started the thermal energy tariffs review for DH Gjakova for the season 2021/2022; in relation to this, on 02 July 2021, DH Gjakova was sent the letter-notice on the commencement of the tariff review for the season 2021/2022 and the "Implementation Plan and Schedule". Following that, DH Gjakova was sent a request for the data and information for tariff review, specifying the data, information and documents that DH Termokos shall submit for tariff review.

DH Gjakova has not submitted the tariff application according to the Implementation Plan and Schedule', but has continuously requested the release from the obligation to submit the tariff application on the grounds that the construction of the new heating plant and change of technology have affected the planning and submission of data and information required for tariff review. In this regard, it should be emphasized that, during the development period of the construction project of the new heating plant, within the project, external consultancy has been engaged in order to assist DH Gjakova, among others, for the preparation of the tariff review application. The provision of assistance for this component has been continuously postponed during the development of the project, both for objective reasons related to the pandemic and due to the unwillingness of DH Gjakova to accept this assistance. However, after the constant insistence of ERO representatives in the Steering Committee of the project, the engaged consultancy started working in this direction and in August 2021 prepared a final version of the tariff application. This final version of the application was submitted to DH Gjakova, in order to be further processed to ERO, following their review and any updates or remarks. Despite continuous requests from ERO, DH Gjakova did not submit the application nor did it confirm compliance with the data and information contained in the version of the application prepared by the consultancy. After the official letter of ERO, DH Gjakova on 24 December 2021 submitted by e-mail the same version of the application prepared and submitted by the consultancy. In order to be in accordance with the regulatory procedures, ERO has requested from DH Gjakova that this application shall be re-submitted in the appropriate format signed by the relevant management staff of DH Gjakova. Consequently, DH Gjakova on 30 December 2021 re-submitted the application in the format required by ERO.

This document contains the evaluations on the content of the tariff application in general as well as the content of each document submitted within the application. The evaluations are related to completion/non-completion of the application, describing the documents that were submitted and the ones that should have been submitted. The evaluations further elaborate in general and provide guidance on the correctness of the documents contained in the tariff application, and also, after the evaluation of each submitted document, the evaluation for the accuracy and correctness of the relevant data and information are specified.



2 Content of Tariff Application

The tariff application submitted by DH Gjakova contains these documents:

- 1) Regulatory Statements with forecast data and information for the heating season 2021-2022:
 - a) Statement A of operational assets – forecast data for fixed assets;
 - b) Statement B of revenues and expenditures – forecast data on revenues and costs (expenses);
 - c) Statement C of billing and collection – data and information on heating area, capacities and amounts of thermal energy, billing and collection of customers;
 - d) Statement D of investments – data and information on planned capital investments;
 - e) Statement E technical - forecast data for thermal energy balance as well as technical and customer data (assumptions for calculation of real heat demand, production and supply of heat and forecast heating area)
- 2) Audit Report and Statutory Financial Statements for 2020;
 - a) Profit/loss statement (Success Balance);
 - b) Balance Sheet;
 - c) Cash flow statement; and
 - d) Statement of changes in equity;
- 3) Additional data and information:
 - a) 'Register of fixed assets' on 31.12.2020 with the annual depreciation of assets for the years 2020 and 2021 as well as calculations of depreciation for the following years 2022-2024;
 - b) Table with the division of assets of the new heating plant allocated for thermal energy (heating), for electricity, and joint;
 - c) Proposed calculation of the depreciation of assets of the new heating plant;
 - d) New investments within the SECO project – Swiss Agency for International Cooperation
 - e) Profit/loss statement – planned for the period 2021-2022;
 - f) Planning the production of electricity and thermal energy, as well as expenditures of fuel and biomass;
 - g) Planning the heating area for the season 2021-2022;

3 Evaluation of the Content of Tariff Application

First of all, it should be noted that the tariff application does not contain data and information as specified in the "Request for Data and Information" of ERO, which describes in detail the data, information and additional documents that must be submitted within the tariff application. The tariff application submitted by DH Gjakova, is especially deficient in the sense of lack of details and additional explanations for the main cost positions but also energy data; in particular, it should be mentioned here the presentation of the assets of the new biomass heating plant regarding which only a basic categorization is presented. There are also shortcomings in the provision of data for customers - their categorization into active/passive - and the respective heating area, as well as for thermal substations.



Another general remark is related to the structuring of data and information where in some cases it is difficult to identify which document they belong to or what they actually represent.

4 Evaluations for the categories of costs according to the data submitted to ERO

4.1 Assets

The data on assets are presented in the Regulatory Statements 'A', in the Register of Assets on 31 December 2020 and calculations of the depreciation 2021-2024;

Statement 'A' of operational assets –forecast data for fixed assets;

Statement 'A' shows the assets at initial value (cost of purchase namely re-evaluation), accumulated depreciation and present value (net book value). Assets are presented separately according to licensed activities: production and distribution of supply, as well as joint assets, as follows:

- Production assets: Initial value: 564,698 €; accumulated depreciation: 564,698 €; hence the remaining accounting value: 0 €;
- Distribution and supply assets: Initial value: 2,289,206 €; accumulated depreciation: 1,783,385 €; remaining value: 505,821€;
- Supporting assets: Initial value: 478,460€; accumulated depreciation: 401,390€; and the remaining value: 77,070€;
- Joint assets: Initial value: 655,713€; accumulated depreciation: 655,713€; hence the remaining value 0€;
- Total assets: Initial value: 3,988,077€; accumulated depreciation: 3,405,186€; remaining accounting value: 582,891€.

Evaluation:

Based on the data on the value of assets it is understood that only 'old' assets are presented, i.e. the assets of the new heating plant, which was commissioned in 2021, are not presented. Considering that the new heating plant is currently in operation and is used for the production of thermal energy to enable the provision of heat supply service, for which tariffs are set, Statement 'A' should have contained the assets of the new heating plant. Regarding the presentation of assets of the new biomass heating plant, it should be emphasized that these assets are presented in a separate table, for which a special evaluation will be given.

- Statement 'A' shows that only the value of assets of the distribution network is presented (€ 505,821), while from the comparison with the asset register 2020 and the calculation of depreciation for 2021, it results in approximately the same network value of € 505,704. Also, this statement presents a small value of 'supporting' assets (77,070 €), which, according to the



asset register contains the value of 'buildings' (old) and 'land improvement' (refers to plots where the old heating plant is placed).

-Regarding the distribution network, it should be noted that, as we are aware from other information, the northern part of the distribution network is out of function, therefore it is not operating, due to numerous technical problems and pipeline damage, as well as due to the fact the works for rehabilitation of this part have started, within the SECO project. Thus, presenting the value of assets belonging to network segments that are not operational and non-functional in providing heat supply service is considered erroneous. Also erroneous presentation is the presentation of old buildings and 'land improvements' that are not currently used, at least not for the provision of heat supply service, which is the subject of this tariff review.

-Finally it can be evaluated that the assets in Statement 'A' are not presented correctly because only the 'old' assets are presented, more specifically the assets belonging to the distribution network, while the assets of the new heating plant that is currently operating and functioning in providing heat supply services are not presented.

Register of Assets 2020 and calculation of depreciation for the period 2021-2024

Initially, it should be mentioned that this register presents in detail all the assets of the old heating plant with their book values on 31 December 2020, as well as the calculations for depreciation for the period 2021-2024. Also, the value of assets and related depreciation are given in a summarized manner, in an additional table, according to the following categorization:

- Production ('Land improvements, buildings and equipment/boilers) – remaining accounting value in 2021: 77,071€;
- Network in the remaining accounting value 2021: 505,821 €;
- IT equipment and office inventory depreciated completely – therefore the remaining accounting value 2021: 0€;

Evaluation:

This register presents the accounting value of old assets in 2020 and the calculations of depreciations for 2021-2024, according to depreciation rates of asset, giving the remaining accounting value by years. From the respective comparisons of the data, it is understood that this register, concretely the calculations for 2021 (total accounting value of assets: 582,891€), were used as a basis for presenting the data of Statement "A".

Presentation of assets of the new biomass heating plant – EU project



The establishments of the new biomass heating plant include two units of thermal energy generation only (HoB) with a capacity $2 \times 5.5 \text{ MW}_{\text{TH}} = 11 \text{ MW}_{\text{TH}}$ and the cogeneration unit of thermal energy and electricity (CHP) with a capacity of 4 MW_{TH} and $1.12 \text{ MW}_{\text{EL}}$, are mainly an investment funded-donated by European Union.

The tariff application presents a very basic division of these assets, categorized as follows:

- Assets for generation of thermal energy (heat) only– two HoB units– with the value of 1,606,081€;
- Assets for production of electricity (turbines, generator and transformer) with the value of 2,308,000 €;
- Joint assets with the total value of 7,685,762€:
 - 'Joint assets of CHP' – 3,150,684€;
 - Buildings– 1,823,025€; and
 - 'Other assets' – 2,712,053€.
- The total value of the new heating plant assets: 11,599,843 €

In addition, their allocation to assets belonging to the heating service is presented, where the joint assets are allocated between electricity and heating in the ratio 50%: 50%; hence the assets allocated for heating are calculated:

- Assets for production of thermal energy (heat) only: 1,606,081€; and
- Joint assets allocated for heating: $0.5 * 7,685,762 = 3,842,881€$;
- Total value of assets belonging to the heating service: 5,448,962 €

Further, assets belonging to heating are categorized into:

- Buildings – 911,512 €; and
- Equipment and installations – 4,537,450 €

Evaluation:

- As mentioned above, a detailed presentation of assets is not provided, which makes it impossible to categorize assets according to regulatory requirements in separate groups for the purpose of determining depreciation rates; the grouping of assets according to regulatory practices as follows:
 - Buildings;
 - Plants, electro-mechanical equipment and installations;
 - Network –pipelines, fittings and component equipment;
 - Office and IT equipment, as well as equipment of metering and controlling systems;



- A typical example is the non-presentation separately of the new network segment that connects the new heating plant to the existing network, which can be assumed to be categorized as “other assets”. Also, the metering and control systems of the new heating plant are not presented separately. As emphasized above, the respective assets have different depreciation rates and should be presented separately.
- Regarding the allocation of assets in assets belonging to thermal energy, respectively electricity, it should be emphasized that no details and explanations have been given on what methodology has been based on the division of joint assets according to the ratio 50%:50%.

New investments

Regulatory Statement “D” of investments

This statement presents the total new investments in the amount of € 11,248,962 - divided into: The following investments ('current'): € 9,498,962 and the planned investments of € 1.75 million. 'Current' investments are divided into investments in production, distribution and others, while planned investments are only for distribution.

In the absence of additional explanations, it can be assumed that these investments belong to the EU investment project: the construction of the new biomass heating plant and the SECO project. However, the comparison of the respective data with the data for these investment projects shows quite a discrepancy.

New investments within the SECO Project

Regarding new investments, the main components of the SECO project are presented, which is currently starting to be realized with the pre-calculated values as follows:

- Rehabilitation of the substations network and installation of heat meters – 2,400,000 € (replacement of the network 1,6 mil € + substations and meters 0.8 mil €) ;
- Rehabilitation of the internal network and installations in the Regional Hospital in Gjakova; – 1,000,000 €;
- Connection of new buildings- in the amount of 600,000 €

Note: The table also shows the components of technical assistance and consulting services and the respective monetary values.

Evaluation:

- Relevant details and explanations are not provided for the main components, which makes the categorization for determining depreciation rates very difficult. One such example is for the component of connection of new buildings where a total investment amount is presented.



The connection of new buildings usually involves the pipeline segment from the main pipeline to the building and the installation of the substation, which are normally considered separate categories of assets with different depreciation rates.

- In the framework of these new investments, the internal network and heating installations in the Regional Hospital have been presented; these assets do not belong to DH Gjakova and consequently cannot be included in the Regulatory Asset Base.

4.2 Operational costs

Statement “B” of revenues and expenditures – forecast data on revenues and costs

Statement ‘B’ presents the forecast revenues and operating expenses for the period that includes the heating season 2021-2022.

Evaluation:

- Initially it should be emphasized that this Statement is not accompanied by details (disclosures) of key cost positions, as defined in the ERO Request.
- Planned revenues in the amount of € 973,156 are foreseen from the sale of heat and are the same as the billing planned in Statement ‘C’ for the total heating area 100,000 m². We evaluate that this is a very unrealistic forecast, an extremely large over-forecast, because for a heating area of 100,000 m², revenues of approximately 1mil € cannot be even closely realized. For illustration we are mentioning that DH Termokos for the heating area of over 1.4 mil m² realizes revenues from the sale of heat about 7 mil €.
- The subsidy for fuel is not presented under the position “Other Revenues” - In the Kosovo Budget for 2021, through the Ministry of Economy and Environment, € 300,000 have been allocated, and also in the Budget of 2022, € 300,000 are allocated.
- For the cost of fuel, DH Gjakova has presented the value of € 477,134, and no explanation has been given for the amount of fuel - biomass, and the unit price. According to the contract for biomass supply (wood chips), dated 11.06.2021, 3,500 tons of biomass were contracted at a price of € 99.71 / ton, which results in a total value of € 295,750. The difference of about +180,000 € for the cost of fuel remains unclear.
- Another example of incorrect presentation of costs, in this case under-planning is the cost of personnel; DH Gjakova has forecasted the total staff cost of € 125,619, while in the Financial Statements 2020 in the Audit Report this cost is € 191,224.
- Also, relevant details and explanations are not given for other main costs, which make it quite difficult to verify the accuracy and correctness of their presentation.



Regarding operating costs, it should be mentioned that within the application was submitted "Profit/Loss Statement - forecast for the season 2021/2022". As it can be noticed from the comparison with Regulatory Statement 'B', there is considerable discrepancy between the relevant data among these 2 statements. For example, in this statement, in addition to the production of thermal energy, the production of electricity is also forecast, while currently no electricity is produced because the co-generation unit has not been put into operation; consequently, both the amount of fuel and the cost are different. In the same way, there are such changes, for example for the cost of staff, where in this statement the total cost of staff is approximately € 200,000, while in Regulatory Statement 'B' this cost is presented in the amount of about € 125,000. The above-mentioned examples concretely show inconsistency and lack of seriousness in presenting the data for the same positions, which causes confusion and makes it impossible to confirm the data.

4.3 Heating areas and thermal energy balance

Data on heating area and Balance data such as: thermal energy production, losses in the distribution network, supply, etc., are interrelated and affect the costs of the enterprise, and are also, so-called 'billing determinants' that affect the calculation of tariffs. These data are mainly presented in Statement 'C' of Billing and Collection - data provided for heating area, billing and collection and in Statement 'E' - technical data and Balance of thermal energy (heating).

Statement 'C' provides for a total heating area of 100,000 m², all forecast for 'unmetered' customers – i.e. billing based entirely on the heating area per m². In this total area, the area of household customers has a share of 54,600m² while the area of commercial and institutional customers is forecast to be 45,400 m².

An invoicing of € 973,156 is planned for this heating area- for the category of household customers the amount of € 681,209 and for commercial and institutional ones € 291,947; if we refer to the enormous difference between the planned billing amounts of these 2 categories of customers (who have approximately equal heating area), we come to the conclusion of a completely wrong planning by DH Gjakova.

Statement 'E', in addition to heating surfaces, presents the projected data on thermal energy production, losses in the distribution network and heat supply.

DH Gjakova, except for a table with very little data on the planning of the increase of heating areas, did not submit any additional documents or explanations with the details of these positions. In this regard, it should be noted that the updated Customer Database, which was a specific request for tariff review, has not been submitted either; this Database should provide data on the total number of customers, the division into passive and active, the respective heating areas, the number of substations, etc., and would serve to confirm the data in statements 'C' and 'E'.

Evaluation

- For heating areas:



- From previous reports and studies for the above-mentioned projects, in the system of DH Gjakova are connected approximately 200,000 m² of heating area, but due to supply problems over a long period, a significant number of customers have become passive or are disconnected.
 - It is worth mentioning here the northern part of the network, which is in poor technical condition, and as a result most of the customers connected to this part of the network are not supplied with heat. Especially during this season, where due to numerous problems and the commencement of works in the rehabilitation of this part of the network, customers in this part of the network are not supplied with heat at all.
 - From the above, and in the absence of an updated database or explanatory details, it is impossible to confirm the accuracy of the planning of heating areas.
- For thermal energy balance:
- First, it should be emphasized that in the drafting of Thermal Energy Balance as a starting point is 'Energy entered from fuel', which is calculated from the biomass amount planning of 8,460 tons multiplied by the calorific value of 4.2 MWh/ton. Considering that, as mentioned above, the amount specified in the biomass supply contract is 3,500 tons, then this fact from the start devalues this balance sheet as an unrealistic planning and not based on factual data.

4.4 Summary of the evaluation

Referring to the separate evaluations for each of the categories of costs, i.e 'billing determinants', it can be concluded as follows:

- Tariff application of DH Gjakova is incomplete and does not contain all the components as specified in the Thermal Energy Pricing Rule and in the Request of ERO for data and information on tariff review. The accompanying details and explanations of the main cost positions are missing or incomplete and the supporting documents specified in the ERO Request have not been submitted. Also the structuring of the data and accompanying information presented is very chaotic and without a logical order.
- Apart from the fact that a considerable amount of data and information are missing (not presented), it should be noted that the data and information presented within the tariff application are quite inaccurate and inconsistent, in the sense that there are visible discrepancies between the data for the same position, presented in different statements or tables. This generally applies to the presentation of assets, operating costs as well as data of 'billing determinants' - heating area, thermal energy production and supply, grid losses, and other similar



ones. This greatly makes it impossible to confirm the accuracy and veracity of the presented data and information.

Based on what was said above, it can be concluded that the tariff application of DH Gjakova is incomplete/deficient, with incorrect presentation of data and with many inaccuracies. Such an application makes it impossible to properly and correctly determine the allowed revenues and consequently the heating tariffs.

Considering that revenues or tariffs have a direct impact on the customer, but also on the financial and operational viability of the enterprise, this tariff application cannot be taken as a basis for determining the revenues and tariffs of DH Gjakova.

5 Proposal for determination of tariffs for the season 2021/2022

5.1 Background and legal basis

Based on the comprehensive evaluation of the tariff application of DH Gjakova (chapter '4') and especially the findings in the evaluation summary (sub-chapter 4.4), it is concluded that the data and information of the tariff application cannot be used to determine the Allowed Revenues and thermal energy tariffs, according to the applicable Tariff Methodology.

Relevant regulatory provisions have also foreseen this possibility and defined the actions related to the determination of tariffs that the Regulator has the right to undertake. Specifically, Article 4 and Annex 5 of Thermal Energy Pricing Rule, which elaborates the tariff review procedure, defines the obligation of the Regulator, in such cases, to determine the tariffs according to its own evaluations and based on existing (historical) data.

In this regard, it should be noted that with the construction of the heating plant that was commissioned in 2021, the production technology has completely changed, from thermal power plants with fuel oil to biomass production plants and a co-generation unit. This shift in technology has a significant impact on changing the enterprise's cost structure - both operating costs and capital costs, making it impossible to compare relevant historical data. Also, the data sent to ERO during the past years (seasons) are few, because during a multi-year period DH Gjakova has operated with limited production capacity and consequently with significantly reduced supply, and also due to the fact that the reports of DH Gjakova have been consistently incomplete. For this, very little historical data can be considered valid and usable to determine thermal energy tariffs for the current season 2021-2022.

It is worth mentioning that the approved tariffs for the previous seasons (including the season 2020-2021) were determined when the old heavy fuel oil production facilities were still in operation; the table 1 below presents the tariffs of the previous season 2020-2021:

Table 1: Thermal energy tariffs of DH Gjakova for the previous season



THERMAL ENERGY TARIFFS OF DH GJAKOVA - Season 2020/2021			
A: THERMAL ENERGY TARIFFS - METERED			
Tariff components	Unit	Value	
Monthly tariff for thermal capacity (fixed comp.)	[€/kW/month]	0,91	
Thermal energy supply/consumption tariff (variable comp.)	[€/MWh]	58,76	
B: THERMAL ENERGY TARIFFS - UNMETERED			
Tariff components	Unit	Household customers	Com&Inst. Customers
Monthly tariff for thermal capacity (fixed comp.)	[€/m ² per month]	0,09	0,12
Thermal energy supply/consumption tariff (variable comp.)	[€/m ² per month]	0,88	1,27
Total tariff for customers - unmetered	[€/m ² per month]	0,97	1,39

5.2 Proposal for thermal energy tariffs for the season 2021-2022

Based on the legal responsibility, as well as the unavailability and invalidity of the historical data described above under 4.1, for the proposal of tariff levels we refer to the comparison of prices of heavy fuel oil and biomass, respectively energy content (calorific values) of these fuels, as well as considering the capital costs associated with investing in the new heating plant.

Consequently, from what was described above, an average tariff reduction of 7% is proposed, as presented in the following table '2':

Table 2: Thermal energy tariffs of DH Gjakova for the current season

THERMAL ENERGY TARIFFS OF DH GJAKOVA - Season 2021/2022			
A: THERMAL ENERGY TARIFFS - METERED			
Tariff components	Unit	Value	
Monthly tariff for thermal capacity (fixed comp.)	[€/kW/month]	0,85	
Thermal energy supply/consumption tariff (variable comp.)	[€/MWh]	54,65	
B: THERMAL ENERGY TARIFFS - UNMETERED			
Tariff components	Unit	Household customers	Com&Inst. Customers
Monthly tariff for thermal capacity (fixed comp.)	[€/m ² per month]	0,08	0,11
Thermal energy supply/consumption tariff (variable comp.)	[€/m ² per month]	0,82	1,18
Total tariff for customers - unmetered	[€/m ² per month]	0,90	1,29

We must emphasize that these tariff levels will be valid exclusively for the period until the end of this season 2021-2022. ERO expects and will insist that the tariff application of DH Gjakova, for the next tariff review for the season 2022-2023, to be in accordance with legal and regulatory requirements, so as to enable a meritorious and grounded determination of allowed revenues and tariffs.