Ndërtesa e Elektrokosovës
Bulevardi Bill Klinton nr.3
Prishtinë 10000
Republika e Kosovës
Elektrokosova Building
Bill Clinton Bulevard no.3
Prishtina 10 000
Republic of Kosovo

KOMPANIA KOSOVARE PER DISTRIBUIM DHE FURNIZIM ME ENERGJI
KOSOVO ELECTRICITY DISTRIBUTION AND SUPPLY COMPANY
KOSOVSKO PREDUZECE ZA DISTRIBUCIJU I SNABDEVANJE ELEKTRICNOM ENERGIJOM
KEDS - SH.A.
Nr. 6 Dt. 21.01.2019
HQ 1

Arsim Janova
ac. Chairman of ERO Board

George Karagutoff
KEDS Managing Director

21 January 2019

SUBJECT: PROPOSAL FOR MAXIMUM ALLOWED REVENUES FOR THE TARIFF YEAR 2019

Dear Mr. Janova,

Application for maximum allowed revenues is drafted by KEDS both in electronic form and hard copy, within the time frame set in Appendix 7 of the Distribution System Operator (DSO) Pricing Regulation, and guidelines from ERO provided in the official letter dated 7 December 2018.

KEDS remains committed for cooperation with the aim of reaching appropriate conclusions, which are in the interest of all stakeholders involved in the energy sector.

Sincerely,

George Karagutoff
Managing Director

Ndërtesa e Elektrokosovës
Bulevardi Bill Klinton nr.3
Prishtinë 10000
Republika e Kosovës

Elektrokosova Building
Bill Clinton Bulevard no.3
Prishtina 10 000
Republic of Kosovo

Application for Maximum Allowed Revenues in 2019 for the Distribution System Operator

January, 2019

Ndërtesa e Elektrokosovës
Bulevardi Bill Klinton nr.3
Prishtinë 10000
Republika e Kosovës

Elektrokosova Building
Bill Clinton Bulevard no.3
Prishtina 10 000
Republic of Kosovo

Contents:

1. Introduction

KEDS, as licensed Distribution System Operator has prepared the application for maximum allowed revenues (MAR) for the year 2019, in accordance with Appendix 7 of the Rule on Maximum Allowed Revenues of Distribution System Operator (DSO Pricing Rule), and ERO's official letter received on 7 December 2018.

Conform the DSO Pricing Rule, this application includes all required and needed documents and evidences as per components of the formula on regular adjustment. Moreover it has incorporated all reasonable costs, with the aim of its normal functioning as well as offering better service to all its customer.

Distribution System Operator will update the data approved during the multi-year tariff setting process, and due to the changes that might occur between approved and actual Maximum Allowed Revenues necessary adjustment will be performed.

Given the fact that tariff process is interactive process between ERO and other licensees, as well as changes in legislation, this application might be further adjusted with the aim of reflecting costs that are interlinked with other licensees.

The structure of the document consist of eight main parts, respectively:

1. Energy Balance
2. Cost of Losses
3. Operational Costs
4. Capital Investments Costs
5. Other costs
6. Correction factor –KREV
7. Determination of the Maximum Allowed Revenues for the relevant year t

DSO remains committed for cooperation with the aim of reaching appropriate conclusions, which are in the interest of all stakeholders involved in the energy sector.

2. Energy Balance

Energy Balance forecast for distribution system operator's purposes is done based on the supplier's forecast for consumption and real expected losses. The approach applied by DSO for developing the energy balance is "bottom up" approach.

In coordination with licensed and operational suppliers, DSO has foreseen 3,872 GWh sales in the distribution level for the year 2019, as presented in the following table:

Voltage Level	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Total
35 kV	4	3	4	4	4	4	4	4	4	4	5	5	49
10 kV	32	26	30	26	26	27	28	29	27	31	34	37	353
0.4 kV	32	26	30	26	27	28	31	31	28	30	32	36	358
0.4 kV / II	59	49	50	41	41	41	44	48	43	46	50	61	573
Households	279	223	232	191	183	176	183	188	169	202	217	270	2,514
Public Light.	3	2	2	2	2	2	2	2	2	2	3	3	26
Total	409	330	348	289	283	277	292	302	274	315	341	411	3,872

It should be mentioned that these sales are higher than presented in the energy balance for the year 2019, but if we analyze the actual sales incurred in December 2018 and January trends (both consumption and meteorological trends) of the year 2019 we see higher sales than expected. In this view, DSO in order to more accurately foresee its costs and revenues for this tariff year, has changed slightly its forecast compared to the ones initially forecasted for the energy balance purposes

Meanwhile, DSO has also foreseen losses in distribution for the year 2019 based on reasonable level that can be expected and in line with new prediction of sales for the year 2019 and actual incurred losses in 2018. Similar to the previous year, DSO will presented them in two lines: a) allowed losses – as per the ERO decision V_1019_2018 of the date 20 August 2018, and b) excess losses – which represent losses above the allowed level of losses, which ensures that customers will be charged only by the allowed level of losses, as this represents a direct cost for the company.

3. Cost of Losses

3.1. Determination of the Loss Targets for the second regulatory period

Distribution losses and their allowed costs are regulated through DSO Pricing Rule, respectively Article 12 of the Rule.

On 20 August 2018, ERO through decision V_1019_2018 approved the loss target for the next regulatory period 2018-2022, after over a year from the opening of the consultation process, during which year KEDS has submitted several documents, supporting and justifying its request to set loss target at a reasonable level. Yet, ERO decided to continue with the target set in the first regulatory period and accept only the 1.9% of the inherited losses before the privatization process. However, ERO didn't consider compensating KEDS for the compound effect of these inherited losses during the first Regulatory period.

When setting loss targets in the first Regulatory Period, ERO has performed a detailed analysis and has set the target for decreasing losses based on the actual losses incurred in the year 2011, which was considered as starting point. Without further arguing the reasonability of such aggressive set of the loss target in the PR1, for the second Regulatory Period ERO never performed a similar analysis, but instead grounded its judgment based on ERO Decision No. V_399_2012. It should be emphasized that Decision No. V_399_2012 was appealed in Court, and based on this Court's decision, ERO has already guided licensees to decrease their end-tariffs. Considering this, we believe that it is very worrying and inappropriate grounding calculation for decreasing losses on an appealed decision and without proper analysis.

DSO, on the other hand, has engaged Siemens Company, as respected American consultant company, to perform an independent study in this view, and end-results show both realistic and achievable forecast, which were in line with the DSO's forecast and request. This documents was provided to ERO as a support to KEDS's comments during the consultation phase.

It is important to emphasize that decreasing technical losses requires much higher costs. As shown in the Cost/Benefit analysis provided to ERO during the consolation process for the Second Regulatory period, which is also supported by Siemens Study, decreasing 1% of technical losses requires costly investments. Siemens reports argues that if ERO expects DSO to reach the target of losses at 13.2% by the end of 2022 (as initially proposed by ERO), DSO will need additional 35.2 million euro in additional to the fund committed and proposed by DSO for the second regulatory period, which will means additional cost when determining tariffs for end-customers.

On the other hand, it should be considered that through time commercial losses cannot continue to decrease with the same trend. We admit that commercial losses are still not in the desired level, however as argued several times already, with the current legislation company has difficulties fighting commercial losses, as due to weak rule of law and administrative bureaucracies very few number of customers are being punished for stealing electricity. Moreover, the prolonged judicial procedures enable them to continue stealing, thus making it very problematic for DSO to further react.

The approach proposed by DSO for decreasing losses, will help DSO to overcome the compound effect of excess losses in the first regulatory period, and as argued previously during the consultation process, would be more realistic and similar to the achieved results in Macedonia during the same period and with the same starting point.

Hence, once again DSO kindly asks ERO before taking the decision for the maximum allowed revenues for the year 2019, to review its decision on loss target for the second regulatory period, by carefully analyzing the whole situation and possible negative outcomes that might hit not only DSO as such but the entire electricity sector in Kosovo, considering that DSO plays an important role in the entire chain of electricity market.

3.2. Cost of losses in the relevant year t

According to article 12 of the DSO Pricing Rule, the allowed cost of losses will be calculated using the Loss Allowance which is set during Periodic Reviews.

According to Appendix 1 of the DSO Pricing Rule, cost of losses are calculated in three parts, respectively the expected cost of losses for the relevant year, considering the reference wholesale market electricity price; adjustments for the actual energy entering into distribution system; and actual wholesale costs using the actual losses incurred, as shown in the formula below:

$$LSSC_t = LSSA_t * REUE_t * RWMP_t + (LSSCa_{t-1} – LSSCf_{t-1}) * (1+ I_t)+ (LSSCa_{t-1} – LSAC_{t-1})*LSSF_t$$

Based on the Article 6 of the Guidance on Market Liberalization, network operators (TSO and DSO) will purchase losses in an open market.

For the year 2019, DSO has foreseen purchase of losses both from KEK and Import, however until the time of the application KEK and KEDS were not able to agree upon a reasonable purchase price, hence no agreement was signed.

Nevertheless, DSO requested from KEK to submit their bidding offer for the price of losses before the application deadline, and based on the offer received on 18 January 2019, the offered price from KEK for 2019 tariff year (1 April 2019-31 March 2020) for losses is 45 €/MWh.

Without prejudging the reasonability of the offer, if we consider the fact that KEK during the year 2018, in the mid-tariff year, requested to increase price by putting DSO in very unfavorable financial position, and in order to avoid similar situation in the future, we request from the Regulator to accept the KEK's offer, or to use its legal right and put public obligation including for allowed level of losses, in order to avoid its impact on tariffs for end-customer.

It should be emphasized that if Regulator doesn't accept KEK's offer as reasonable and putts lower average price for purchasing losses than the market prices, DSO will be put in high risk to remain without financial means in the mid tariff year, and as such resulting with the request for an extraordinary review. DSO already keeps the burden for the excess losses, therefore financing the sector even for 1 years is out of any possible options, especially due to limited access on loans after the approval of input parameters for the second regulatory period.

In this application for the expected purchases from KEK, DSO applies KEK's proposed price on 18 January 2019, which although is higher for 27% compared to the actual price, is still below the modulated price on HUPX market available currently for the year 2019.

For transparency reasons it should be emphasized that with the changes in KEK-Generation prices, the costs for end-customers will be increased for €4.87 million, yet if the same amount of energy will be purchased in an open market, based on the actual predicted prices will be accounted for €15.4 million more.

Taking into consideration the impact of such costs for the end-customers, or for the company itself if such costs are not properly assigned, and in order to avoid any potential financial risk or un-affordability of prices for end-customers, we request one again from the ERO to apply its right and put public obligation for KEK-generation also for the allowed level of losses, since we are providing public obligation.

Last but not least, it should be cleared, that we reserve the right to adjust the application based on the final agreed price with between KEK and DSO, before the final decision on Maximum Allowed Revenues for the year 2019.

3.3. Adjustments of the cost of losses for the relevant year t-1

The first part of the adjustments for costs of losses reflects the difference between allowed and actual incurred flow of energy (EED) in the relevant year t-1 (2018), respectively the difference between the allowed cost of losses and actual cost of losses using the allowed target for losses, as shown in formula below:

$$(LSSCa_{t-1} – LSSCf_{t-1}) * (1+ I_t)$$

During the last year, ERO has accurately used the electricity volumes as requested by the DSO, however the energy entering into the distribution system (EED) was calculated based on forecasted sales and the approved level of losses, which mathematically is correct, however didn’t represent the actual expected EED for the year 2018. DSO during the consultation phase have commented that such approach will result with huge adjustments in the next following year, yet ERO didn’t consider these comments. As a result, the adjustments for this year only for EED are almost 5 million €, which shall be considered by ERO during determination of the costs for the year 2019.

Considering that KEK was nor working as initially planned, and moreover that ERO didn’t consider the revised version of KEK generation when adopting Energy Balance, the cost of losses allowed for the year 2018 was not reflected properly. DSO was obliged to buy more energy on import than planned. Furthermore the actual price for import was much higher than considered by ERO, which all resulted to higher average price for purchasing losses during the year 2018, respectively almost 3 million higher adjustments only for this price difference.

In this view, and based on the part two of the formula for calculating the allowed cost of losses, both adjustments for EED and price should be considered by regulator when determining allowed cost of losses for the year 2019.

The calculation of the allowed cost of losses has also the third part of the formula which foresees the adjustments of allowed cost of losses and actual cost of losses by applying the loss sharing factor, as it is explained mathematically in the expression below:

$$(LSSCa_{t-1} – LSAC_{t-1})*LSSF_t$$

Since, ERO didn't set the Loss-Sharing factor, and considering that in the previous years applied the loss-sharing factor as 0 for the Distribution System Operator, similarly will be applied also in this application.

4. Operational Costs

Based on article 9 of the DSO Pricing Rule, operating and maintenance costs of the DSO, attributed to the DSO licensee, can be recovered through Maximum Allowed Revenues for the forthcoming relevant year.

Allowed operating and maintenance costs (OPEX) for the relevant year t is composed from forecasted costs for the relevant year t and adjustments of inflation (CPI), efficiency (E) and profiling factor (P) from the costs allowed from the previous year, as per the formula specified in Appendix 1 of the DSO Pricing Rule:

$$OPMC_t = OPMC_{t-1} * (1 + CPI_{t-1}) * (1 – E_t) *(1 - P_t)$$

Whereas second part of OPEX adjustment is calculated as difference of OPEX costs allowed in the relevant year t-1 and actual costs incurred in the relevant year t-1, multiplied with the saving sharing factor, as per the following formula:

$$OPMCAdj=(OPMCft-1 - OPMCat-1) * SHF$$

In October 2018, ERO took a decision for the input parameters and costs allowed for the second regulatory period 2018-2022, yet the only difference between the year 2017 which was set back in 2011 when the cost for the first regulatory period were allowed, and the ones allowed for the year 2018 was reflection of the new changes in the energy sector, legislative requirements, and reflection of the actual costs.

DSO has argued that costs have increased through years, and similarly also the number of services and quality of providing these services has higher costs than allowed through tariffs, such as IT and telecommunication costs. Changes in legislation and market opening require new services, more specific and specialized programs and system – which required more funds available for this line.

It should be emphasized that also the number of customers is constantly increasing. From 470,000 active customers in 2013 the number has increased to over 580000 active customer, which has resulted also with the increase in costs for providing services to these customers.

On the other hand, the maintenance costs allowed represents only the cost for price and materials, as most of the work is done through internal employees, costs of whom are already included in the salary lines. Having in mind the old and damaged inherited network, as well as maintenance costs used in the first regulatory period compared to the network needs, in additional to increased prices of materials, DSO for the second regulatory period will surely need higher costs.

Similarly, if we analyze the fuel costs from 2013 until 2017, the price of fuel has increased on annual basis, which was not considered by the ERO in the first regulatory period, and it is not adjusted to reflect the actual prices when determining costs for the second regulatory period.

Moreover, in the first Regulatory Period ERO has applied with the 5% efficiency factor for two years (cumulative 10%), which forced DSO to reduce its costs in the minimum, effecting also in the release of 80 employees. In the other hand through time and in order to have more effective work and better results, DSO had to hire new employees, costs of which were never included in the recognized OPEX for tariff purposes.

ERO for the second regulatory period has again introduced an efficiency factor of 1.5% on annual basis starting from the year 2019. DSO has provided its arguments during the consultation period, yet they were not considered by ERO. DSO continues to believe that any application of the efficiency factor in the second regulatory period will risk the stability of the company and quality of services provided.

Considering the increasing trend in costs, DSO requires from Regulator to remove the efficiency factor set for the second regulatory period. We should emphasize once again that, costs approved by the regulator were considered based on the actual prices of the year 2011 and were never adjusted to reflect the real increase of actual prices, while as argued above such costs have been increased remarkably, while also new services have been added, together with their costs.

Meanwhile, there's a court decision requiring to withdraw the management decision for releasing 80 employees, which will further increase the OPEX costs, especially if the final decision will require to pay retroactively their salaries.

Taking into consideration the abovementioned, DSO proposes a 2% increase in salaries on annual basis, to meet the similar level of the salaries in the sector during the first regulatory period, and meet the increase costs of products and services.

The first regulatory period included salary costs of the employees inherited from the previous licensee and no other costs for new employees were allowed during the first regulatory period. Although, some adjustments were done in the last tariff review, DSO has still big differences on salaries compared to the public sector, while the work load is much higher, as well as working environment is much more stressful.

ERO during when determining cost allowed for the second regulatory period has applied the efficiency factor also on salary line, and as argued several times any efficiency factor applied further in OPEX, especially in salary lines will potentially reflect in decrease of the number of employees, and therefore also in the quality of services provided. It should be emphasized that salaries account for 80% of the total OPEX, and considering that most of other costs within OPEX are out of the DSO's control, application of the efficiency will influence directly employees and quality of services provided. Furthermore, as experiences from the first regulatory period, due to the not so developed economy, any potential decrease in salaries or in the number of employees has big social impact and as a result DSO will be again put in a very unstable financial position, therefore requiring decrease in costs in other lines which are critical for provide quality service, such as maintenance costs. Additionally, considering that ERO during the second regulatory period will approve the new rule on standards of quality of services, DSO will not be able to meet the expected results, hence real reflection of the costs and no efficiency factor shall be considered by the ERO when determining the final MAR for the year 2019.

Considering the abovementioned, DSO for the next regulatory period has foreseen an OPEX of 27.08 million euro, including costs of the shared-services.

As per the second part of the formula, related to adjustments between allowed and actual OPEX, it is very important to emphasize that costs allowed for the year 2018 were approved in October 2018, therefore sharing factor for the year 2018 shall be considered as zero (0) and respectively no adjustments shall be performed, besides inflation factor conform formula defined in the rule.

5. Capital Investments Costs

Investment Plan of the Distribution System Operator is designed to enable the safe and reliable electricity supply at a reasonable price, and ensure the operation of the network in a transparent manner in accordance with commercial principles.

The process for second regulatory period started in May 2017, and DSO with the information known at the time of the application, and conform the 10 year's development plan (Master Plan), DSO has prepared its Investment Plan for the years 2018-2022, which were submitted to ERO for approval, together with the Cost/Benefit Analysis as request by the legislation on power. Investments projects for 5 years period accounted in total for €153 million, out of which €29 million were foreseen to be invested in the first year of the second regulatory period (2018).

The € 153 million investments were planned based on the DSO proposed parameters that would enable sufficient financing to achieve all the targets and respectively the proposed level of investments.

However, due to delays in the review process, DSO was guided to invest no more than €22 million, taken into consideration the ambiguity of the situation, as parameters would be decided at the late 2018. Considering these uncertainties DSO was very careful with the investments in the year 2018.

The approved WACC only in late August 2018 has put DSO in a non-favorable financial situation, both for the fact that investments during the year 2018 were done by considering the WACC approved in the first regulatory period, and for the fast that local financing based on the data provided in December 2017 were already at the level of 8%, and therefore financing these investments is not promising, as financing sources seem difficult to be found. The significant drop in WACC allowance also raise insecurity among lending institution, putting DSO in a very unfavorable position at the time, when tenders for the year 2019 should have been already in place.

In the case of regulated firms, investment policies and capital structures policies are absolutely out of entity's control. The regulated entity is unable to lower the capital cost by increasing the debt and also is unable to make alternative investments, except for the regulatory allowance. Moreover, even if generates new incomes, based on the regulation in power, these revenues are return to customers immediately in the next tariff review, thus limiting all alternative possibilities to generate other revenues, and respectively argue to the loan-lending institution for the cash-generation alternatives, and hence lowering the risk-payment for big loans.

The failure to properly set or evaluated correctly the regulatory parameters unfortunately creates unstable financing for the regulated entities. Moreover, only at the end of the year 2017, just before the decision for regulatory parameters was taken, the Government of Kosovo closed the agreement with ContourGlobal Company, for building new power plant (Kosova e Re), after a transparent internationally tender based on market principles, and the proposed/agreed Equity Rate of Return is 18.5% for 20 years, although the business operations are fully secured. Similarly, for RES, equity rate of return approved just in the year 2016 is 13.33% for 10 years, and also their sales are secured based on legislation in power.

Taking into consideration the abovementioned, DSO wrote several time to ERO requesting also re-opening of the MAR application process, however DSO never considered such a request.

After approving the regulatory parameters, respectively, during consultation process for the MAR for 2019, DSO emphasized that based on the approved MAR it has reviewed its investment plan for the second regulatory period, in order to make sure than the company will be able to continue operating as a going concern. Normally, the going concern and financial stability of the company should be ensured by the regulator by allowing sufficient financial resources via the MAR, which is not the case with the current accepted parameters and proposed levels of OPEX and efficiencies. Respectively, DSO is forced to revise its investment plan and propose a new structure of the investments to ensure the sustainability of the operation under the approved input parameters for MY2.

The revised investment plan considers levels of loans that could be obtained in the market, with the unfavorable WACC and losses parameters approved by the Regulator, and concentrates all the investments in loss reduction initiatives, by limiting other investments to the bare minimum needed to sustain the operations. In this view, also the planed Master Plan projects will need to be postponed until the proper level of WACC and loss target are established, allowing generation of cash necessary for their completion.

Company has already suffered financially during the year 2018 and cannot finance them with cash, while banks value as high risk the fact that parameter can change drastically within 5 years, hence no loans are willing to be provided longer than the year 2022.

Based on the current information on loans, only two banks were ready to offer limited amount of loans for investments purposes, but which doesn’t cover the need of DSO to invest as per the plan approved by the Regulator, therefore for the year 2019 DSO foresees to invest 20 million €. DSO revised plan, which will be submitted to ERO, is focused mainly in low voltage, where the need for investments are higher, whereas as emphasized above master plan projects which are focused more on middle voltage should be postponed until DSO financial position is improved, through proper determination of the input parameters.

It should be emphasized that if DSO will be able to find more financing, the investments will increase, however at the time of the application and offers received from banks, DSO will not be able to invest more than 20 million €.

5.1. Allowed Depreciation Costs

Depreciation costs (DEPC) for the relevant year t includes only depreciation costs of the investments to be performed in the relevant year t.

However, DEPC adjustments is composed from two parts: regular adjustments, which adjusts allowed depreciation costs for inflation (CPI), and profiling factor (P), as per the formula specified in Appendix 1 of the DSO Pricing Rule:

$$DEPC_t = DEPC_{t-1} * (1 + CPI_{t-1})*(1 – P_t)$$

Whereas second part of DEPC adjustment is calculated as difference of depreciation costs allowed in the relevant year t-1 and actual depreciation costs incurred in the relevant year t-1, multiplied with the saving sharing factor, as per the following formula:

$$DEPC_{adj} =(DEPCf_{t-1} - DEPC_{at-1})* SHF$$

Since ERO took the decision on DSO’s Investment Plan for the second regulatory period (2018-2022) at the end of the year 2018, when three quarters of the year 2018 were finalized, and considering that DSO during the consultation phase (March 2017-September 2018) was instructed not to invest more than 22 million €, DSO will consider the sharing factor as zero (0).

5.2. Allowed Return Costs

Similar to calculation of depreciation costs and OPEX, return is calculated as return costs for the relevant year 1 and adjustments from the previous year, which are further composed from two parts: regular adjustments (inflation and profiling factor), and adjustments for correction between allowed and actual incurred costs.

Since ERO took the decision on WACC parameters in late August, and for Investment Plan in late September, DSO will consider the sharing factor as zero (0).

6. Other costs

This chapter summarized costs that DSO shall pay to the Transmission System Operator (TSO), licensee fee, as well as unregulated and excluded costs.

6.1. Obligation to Transmission System Operator

With the newly adopted laws, and changes in the electricity market, operational costs of the DSO have increased, respectively DSO shall pay for the usage of the transmission system and market operator, as well as shall pay licensee to ERO.

Obligations of the DSO allowed for Transmission System Operator for the year 2018 were 0.79 million €, however since the new TSO tariffs were approved only in October 2018, the actual obligations were 0.54 million €, hence when determining costs for the year 2019, this adjustments shall be reflected. As per the costs forecasted for the year 2019, based on the actual approved tariffs and loss level forecasted for the year 2019, the obligation of DSO for TSO account for 1.21 million €. Any difference on transmission tariffs, shall be reflected in the final calculation when calculating DSO obligations for TSO.

6.2. License Fee

Licensee Fee is an obligation of the licensee paid to the Regulator, based on determined percentage and import volumes.

Despite the fact that DSO in its application has forecasted a license fee, this was not considered by ERO when determining costs for the year 2018, a cost of 0.09 million € which shall be adjusted by the Regulator.

Considering that this is a known cost, we recommend Regulator when determining cost for the year 2019 to consider also these costs. DSO has forecasted these costs for the year 2019 as 0.07 million €, which was calculated using the same principles as applied in previous years, respectively a 0.22 €/MWh multiplied with the expected level of imports for the year 2019.

6.3. Unregulated revenues and excluded revenues for the year 2019

In the first regulatory period ERO has not forecasted any non-tariff revenues when determining MAR, however adjustments were done on annual basis with an interest rate. DSO for the second regulatory period has forecasted non-tariff revenues to be included in the MAR forecast, although continuously required to keep these revenues, by excluding the costs incurred by DSO through tariffs. Such a request was never considered by ERO during the first regulatory period, and neither was considered when determining cost for the second regulatory period.

When determining cost for the year 2018 ERO forecasted 3.5 million € as unregulated revenues, while DSO in total account for 6 million € for the year 2018.

DSO continues to believe that such revenues shall remain with DSO, and it has justified several times that for some of the services, such as telecom services, DSO doesn’t have any incentives, but is obliged to keep providing these services due to the inherited agreements from the previous license holder. It should be emphasized that these services not only do not provide any benefits for the DSO but they even create often problems in the network, especially when distribution cables are cut accidentally from the telecom’s contractors while performing their work.

Furthermore, as indicated each year during the first regulatory period, in order to provide an incentive for DSO to further expand the services, then at least a sharing factor should be applied, otherwise as such DSO doesn't have any benefits for offering particular services, and if not considered by ERO for the second regulatory period, DSO seriously will consider cancelling these contracts as soon as their contracts expire.

In this view, DSO believes that no revenues shall be deducted from DSO's MAR for the year 2019, therefore ERO shall remove the 3.5 million € as proposed for the second regulatory period.

ERO in its proposal forecasts a deduction of the excluded costs of 408 thousand €, which shall remain with DSO if unregulated revenues will be decreased for DSO's MAR. The initial proposal of the DSO during the multi-year tariff process was excluding these costs by considering the approval of the new Connection Charging Methodology, which would allow DSO to keep the revenues for providing such services. Since, ERO didn't approve the Connection Charging Methodology, and if it will continue to remove the unregulated revenues also in the year 2019, DSO shall keep these costs within OPEX, as in contrary will be hit twice. In this view, until unregulated revenues are deducted from the MAR, DSO will keep these expenses in the OPEX.

Last but not least, last year ERO unfairly decreased our unregulated revenues for 'Imbalance of energy'. As argued and discussed with the regulator, this line represents DSO's effort to help the system stay in balance. Imbalance costs compensate cost of energy purchased for meeting the losses needs and respectively should be treated together with the energy for losses, rather than as separated revenue. If such revenues will be decreased, than ERO shall recognize also the purchase costs for excess of losses. Considering this and close discussions with ERO, in this application DSO has foreseen the compensation for these revenues.

7. The Revenues Adjustment factor - KREV

In the previous approved DSO Pricing Rule, correction factor KREV was calculated as difference between approved MAR and ARR (Actual Regulated Revenues). With the newly adopted DSO Pricing Rules, the calculation of correction factor has changed. The revenue adjustment factor (KREV) shall be calculated using the following formula:

$$KREV_t = (AACa_{t-1} - ARR_{t-1}) * (1+ I_t)$$

As such, KREV presents the difference between Allowed Actual costs in the relevant year t-1 and actual regulated revenues in relevant year t-1, and for the year 2019 a positive adjustments of 9.9 million € shall be reflected, including losses, or net positive adjustments of 1.25 million €, as shown in the table below:

Description	mil €
Approved MAR	**83.46**
Actual MAR	88.51
Actual Sales	79.27
KREV Adjustment **($(AACa_{t-1} - ARR_{t-1}) * (1+ I_t)$)**	**9.90**
Adjustments for Losses	8.08
Net KREV	**1.25**
Sales Difference	4.50
Other Adjustments	(3.25)

In the previous regulatory period, ERO increased revenues for the total amount of reclaim of losses. DSO continuously objected this approach by showing that not all the billed energy as ‘reclaim of losses’ is collected from the customers, for the fact that:

- Customer can claim in the first instance at ERO, and later on also in Court, and as such not all the energy billed might be allowed to be billed after their decisions, respectively collection of this value is of a lengthy and questionable procedure.
- Practice is showing that only a part of this value is collected in practice, around 20% of the energy billed in the name of reclaim of losses.

Therefore DSO applied only the 20% of reclaim of losses, and requires from ERO to recognize only 20% of the billed amount for reclaim of losses. If ERO continues to apply the whole amount billed as revenue from reclaim losses, than DSO will need an allowance for bad debt for receivables related to the collection from reclaim of losses.

8. Determination of the Maximum Allowed Revenues for the relevant year t

The table below represents the summary request for Maximum Allowed Revenues for the year 2019, after knowing all cost components justified in the previous sections, as well as conform formula expression explained in Annex 1 of the DSO Pricing Rule:

MARt = OPMCt + DEPCt + RTNCt + LSSCt + LICCt -NTFR t +ADJt +KREVt

Maximum Allowed Revenues – MAR	
KEDS DSO	**2019 (mil€)**
OPEX	27.08
Depreciation	14.08
Return	13.02
Cost of Losses	53.31
OS and OM obligation to KOSTT	1.21
Other-Non tariff Revenues approved	(3.50)
Other-Non tariff Revenues Difference	(3.07)
PR 1 Adjustments	(1.50)
Adjustment from previous year (Imbalances)	1.63
License Fee	0.07
Initial MAR	102.33
KREV	9.90
Final MAR	**112.23**

The DSO request for revenues in the amount of €112.23 million is with the aim to operate and provide better services for its customers. After ERO approves the Maximum Allowed Revenues for the year 2018, DSO will use the approved MAR to prepare charges for distribution use of system based on methodology approved by ERO and rules in power.