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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. 1 Dt. 21.01.2019
HQ 1

Arsim Janova
Chairman of ERO Board

Alper Erbas
Chief Supply Officer

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 KESCo both in electronic form and hard copy, within the time frame set in Appendix 3 of the Pricing Regulation for Determination of Maximum Allowed Revenues for Universal Service Supplier (USS Pricing Rule), and guidelines from ERO provided in the official letter dated 7 December 2018.

KESCo 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,

Alper Erbas
Chief Supply Officer

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Application for Maximum Allowed Revenues in 2019 for Universal Service Supplier

January, 2019

Contents

1. Introduction

In accordance with Appendix 3 of the Rule on Determination of Revenues for Universal Service Supplier (USS Pricing Rule), and ERO's official letter issued on 7 December 2018, KESCO as licensed entity by the Regulator to perform the Universal Service Services has prepared the application for maximum allowed revenues (MAR) for the year 2019.

Conform the USS Pricing Rule, this application presents the forecast of both technical and financial data for energy purchases, both from domestic generation and import, respectively wholesale power purchases, operational expenses, pass-through costs and adjustments for previous years.

ERO didn't open and approve input values for the second regulatory period for the Universal Service Supplier, hence USS reserves the right to apply them based on the historical, as well as expected and justified values.

The structure of the documents consist of seven main parts, respectively:

1. Energy Balance and Purchases
2. Retail costs in the relevant year t
3. Wholesale Power Costs for the needs of the USS in the relevant year t
4. Pass-through costs in the relevant year t
5. Working capital costs and bad debt allowance in the relevant year t
6. Adjustments, respectively the revenues correction factor for the relevant year t
7. Determination of the Maximum Allowed Revenues for the relevant year t

USS 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 and Purchase

Each year universal service supplier forecasts sales for its customers for the upcoming year, by using historical information and other relevant components, such as weather conditions and economic growth (inclusion of new customers, power purchase indexes, GDP, etc.).

According to the revised Guidance on Market Liberalization approved by ERO on October 2018, besides customers connected to the transmission level also eligible customers connected to 35 kV level that fulfill defined in Law on Electricity, will be moved to open market from 1st of April 2019. In this view, USS has included the forecast of the eligible customers connected to 35 kV level only until the end of March 2018.

Sales foreseen from USS for the year 2019 are 3,840 GW, as shown in the following table:

Voltage Level	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Total
35 kV	4	3	4	0.46	0.49	0.49	0.46	0.47	0.49	1	1	1	16
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 Lights	3	2	2	2	2	2	2	2	2	2	3	3	26
Total	409	330	348	286	279	274	289	299	270	311	337	407	3,840

Based on the letter submitted by ERO on 3 December 2018, KEK will offer its capacity with priority to USS, hence when drafting energy balance USS initially will forecast hourly purchases from KEK, RES and import, whenever local production is insufficient to cover the consumptions needs of the Universal Service supplier.

Purchases forecasted for the year 2019, are presented in the following table:

Energy Balance 2019	
Purchases	**3,840.0**
KEK Generation	3,480.4
RES Production in contractual agreement with KOSTT	193.4
RES Production in contractual agreement with USS	140.0
Import	26.3
Consumption	**3,840.0**
Surplus/Deficit	-

It should be emphasized that when forecasting energy purchases, USS predicts based on available capacities on hourly basis, and when capacities are converted into energy there might be also some deviation. Moreover, even if, according to the approved energy balance there is sufficient energy available to cover all consumer needs, it does not necessarily meet the needs of the supplier on hourly basis, therefore during hourly forecasts based on capacity need we might see there's still need to import, especially during peak hours.

3. Retail costs for the year 2018

Based on article 14 of the USS Pricing Rule, the allowed retail costs related to supplying Regulated Customers consist of Operating and Maintenance costs, corporate costs, depreciation and other costs that are out of the USS Control.

Since during 2018 Regulator determined costs only for 2018 and didn't open a public consultation on input parameters, USS reserves the right to apply justified values in its application.

OPEX forecast for 2019 foresees a slight increase from the approved OPEX in 2018, to reflect the new changes in the energy sector, governmental requirements, and reflection of the actual costs. USS proposes a 2% increase in salaries on annual basis reflect to meet the similar level of the salaries in the sector during the first regulatory period. A slight increase is also foreseen in other lines of the retail costs in order to reflect the increase in shared service costs –which are a necessity taking into consideration market liberalization, such as PR, consultancy, trainings, telecommunication, and other relevant costs needed.

Considering that retail costs include also depreciation costs, USS will foresee also a slight increase from the approved depreciations costs for the year 2018, considering the market changes and legal enhancements, which require additional investments, especially in telecommunication equipment and software.

Moreover, conform the previous year, USS will adjust inflation for the approved costs of 2018, both for OPEX and Depreciation costs.

4. Wholesale Energy Costs

According to article 17 of this rule, the wholesale energy costs related to regulated suppliers are comprised of the following:

- Cost of energy procured from domestic generation ($GENC_t$)
- Energy import costs ($IMPC_t$)
- Energy Purchased Retail Margin ($RETM_t$), and

- Net imbalance costs (IMBCt), which are subject to imbalance sharing factor (IMBFt)

The following formula shows the application of these costs, which USS will use further in determination of its revenues for the relevant year t:

$$WHPCt =(GENCt + IMPCt + IMBCt * IMBFt)* (1+RETMt)$$

3.1. Cost of energy procured from domestic generation

The electricity production in Kosovo is dominated by two large power plants which produce 95% of the total electricity production in the country, while the remaining part of about 5% of electricity production is carried by Renewable Energy Sources (mainly hydropower plants).

In the end of the year 2017, due to known problems with expropriation and decrease of lignite reserves, KEK generation had to work with half of its capacities. Similarly during the year 2018 KEK-Generation faced unplanned outages by the end of the year, which left the USS in a very non-preferable situation, as it had to import half of the consumption needs on monthly basis to cover the consumption need, which are higher during winter season.

These unplanned interruptions put both KEK-Generation and USS in a very unfavorable positions, KEK-Generation being unable to cover their costs hence requesting tariff increases, and USS not being able to justify and accept the tariff increase from KEK-Generation, while importing with much higher prices to cover the needs of the customers.

Since until the application time, KEK-generation and USS were not able to reach an agreement, USS requested from KEK to submit a bidding offer for the price for the 2019 tariff year (1 April 2019 – 31 March 2020) and based on official letter received on 18 January 2019, the price proposed by KEK-generation for the USS is 33.3 €/MWh.

Without prejudging the reasonability of the offer, if we consider the fact that KEK during the year 2018 requested to increase its price and in order to avoid repetition of this situation, USS requests from the Regulator to accept the KEK's offer, or to use its legal right and put public obligation and not only guide KEK to offer its sales with priority to USS.

It should be emphasized that if Regulator doesn't accept KEK's offer as reasonable and putts different price than the one offered by KEK, it will put USS in high financial danger in the middle of the tariff year, and as such resulting with the request for an extraordinary review.

In this application, USS has foreseen purchases from KEK-generation with the KEK's proposed price on 18 January 2019, which although is higher for 15% 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, costs for the end-customers will be increased for 11%, yet if the same amount of energy will be purchased in an open market, based on the actual predicted prices, will mean double costs, or an increase of 112%. 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 out public obligation for KEK-generation.

Besides KEK Generation, USS will purchase electricity also from the RES, which will be taken with priority. In accordance with the Rule on Support Scheme, approved by ERO on April 2017, RES Generating Facilities will sell their electricity output to the Market Operator (MO), and MO will allocate all RES production to suppliers proportionally to their individual demand in the Kosovo's total electricity consumption. However, some of the small RES will remain in contractual agreement with USS, due to inherited contractual relations during privatization process and based on the guidance issued by ERO for market liberalization.

In order to calculate the costs of purchasing RES, different prices will be used, respectively for RES which have contractual agreement with the Market Operator, USS will use the price approved by the Regulator in the last tariff review (2018), while for other RES which have contractual agreement directly with USS, a different price will be used (as agreed and approved by the regulator. Any change in the price application for RES during the year 2019 should be reflected by the ERO when calculating the maximum allowed revenues for USS.

3.2. Energy import costs

Generally, the balancing of the energy entering distribution is done based on capacity, on monthly even hourly basis, as local generation is majority of the time sufficient during off peak hours, and respectively, import is done on modulated principle not on base load. For the purposes of Energy balance, USS predicts the loads on bi weekly basis, and based on the predicted work plan of the units (available capacity), it forecast the volumes of import, in order to balance the needs of the market and lack of production.

The winter season of the year 2018 found KEK-Generation with unplanned outages, which reflected to an increased need for emergency import, and as it's known, emergency import has much higher costs that properly planed and purchased import.

In the last half of December 2018, situation improved, and as a result production from KEK-Generation and RES were sufficient to cover USS's needs, by resulting only with a very little need for import, mainly during peak hours.

However, it should be emphasized that any deviation from this production plan results with very high import prices, similar to the situation that occurred both in the ends of 2017 and through 2018 (November–December 2018). Such uncertainty, not only endangers financial stability of the supplier, but also due to the high need of energy in the region sometimes it's hard to find available capacities in the market, thus resulting with undesirable electricity interruptions during the winter seasons, which at the end reflect in the end-user tariffs. Therefore, a better planning from KEK-Generation and allowance of sufficient funds for imports will soften the negative impact both for the company and customers. In this view, we encourage the regulator to allow to the Universal Service Supplier also emergency import until TSO is ready to operate both legally and practically.

It should be mentioned also that import prices have shown an increasing trend in the last two years. The price prediction in the HUPX market for the year 2019 taken on mid-January shown a modulated average import price of 77 €/MWh, which is similar to the one achieved in the year 2018. Considering these trends we require from the Regulator to properly apply the import price for the year 2019.

3.3. Input Parameters

Input Values are key parameters used in the calculation of regulated revenues of Universal Service Supplier. Based on the Article 12 of the USS Pricing Rule, both Retail Margin and balancing sharing factor (imbalance sharing factor used in the WHPC formula) are considered as input parameters. Paragraph 4 of this article says that among others these two inputs are set for a pried of three year.

In the first Regulatory Period, the retail margin is specified as the input values of 3% for the Public Supplier, so was used also when determining MAR for the year 2018, whereas imbalance sharing factor was discussed during the consultation process for the second regulatory period and was specified as zero when above the allowed costs and as 50-50 if the actual costs are under the allowed costs, yet it should be emphasized that no decision was taken by the regulator related to this one.

USS in this application will use for retail margin the same percentage (3%) as applied in the year 2018, and won't apply any value for the imbalance sharing factor, as determining such input value should be conform processes defined in the USS Pricing Rule.

3.4. Determination of the Wholesale Purchase Costs for the year 2018

Based on the newly adopted Pricing Rule for the Universal Service Supplier, the formula for determining the Wholesale Purchase Cost, as presented below calculates only for the costs predicted for the relevant year t, whereas adjustments for the relevant year t-1 will be included in the calculation of the final retail costs for the USS:

WHPCt =(GENCt + IMPCt + IMBCt * IMBFt)* (1+RETMt)

Table below represents expected purchases from local generation and import, as well as other components of the formula:

Description	GWh	000€
KEK Generation	3,4580.4	111.6
Import	26.3	2.1
RES Production in contractual agreement with KOSTT	193.4	6.8
RES Production in contractual agreement with USS	140.0	4.7
Retail Margin		3.8
Total Wholesale Power Purchase Costs	**3,840.0**	**129.0**

These forecasted capacities and cost are forecasted to cover the need of the customers supplied by the Universal Service Supplier, as per the revised Guidance on Market Liberalization, dated October 2018.

5. Pass through Costs for the relevant year t

Conform Article 18 of the USS Pricing Rule, during MAR determination, USS shall cover the following costs:

- MO costs that are invoiced by the MO and relate to Universal Service Customers;
- SO charges that are invoiced by the TSO and relate to Universal Service Customers;
- TNUOS costs that are invoiced by the TSO and relate to Universal Service Customers;
- Distribution Use of System costs that are invoiced by the DSO and relate to Universal
- Service Customers; and
- The share of the License Fee that relates to Universal Service Customers.

However, it should be emphasized that besides the above-mentioned USS pays to the TSO also for the Renewables Fund, which will be included as part of the pass-through costs.

Meanwhile, since based on the time schedule defined in the USS Pricing Rule, as well as ERO's official letter for MAR Application, has no differences with the times other licensee shall submit their applications, USS will use information which are available at their disposal until the submission of this application, respectively will apply actual prices. Any changes from ERO when determining tariffs for DSO and TSO shall be reflected in the final MAR for the Universal Service Supplier

Licensing Fee is calculated as a pre-determined fee multiplied with the expected import energy in MWh. Since there's no initiation from ERO to change the licensee fee, USS will apply the same fee as applied in the previous regulatory period (0.22 €/MWh).

6. Working Capital Costs and Bad Deb Allowance in the relevant year t

The value of the cost components that will be explained in this section are calculated based on formulas specified in the USS Pricing Rules. However, based on Article 16 of the USS Pricing Rule, Bad Debt Allowance shall be set by the Regulator during the determination of the input values, which as explained above are not determined by the Regulator for this Regulatory Period. Moreover, no consultation paper were initiated hence USS will apply this value as per its realistic and reasonable expectation.

6.1. Working Capital Costs

Conform article 15 and Appendix 1 of the USS Pricing Rule, calculation for allowed working capital costs (WCLC) shall be calculated using the following formula:

$$WCLC= (1 / 12) * I_t * (RETR_t + WHPC_t + PSTC_t - NTFR_t)$$

In this regard, taking into consideration costs components presented in the previous sections of this documents, the expected working capital costs for the year 2019 are € 1.56 million.

6.2. Bad Debt

Bad debt is an estimate and reasonable level of bad debts incurred to USS during a relevant year t. Although no formula are provided for calculation of the Bad Debt Costs, in the first Regulatory period, the process of calculating Bad Debt was by firstly calculating initial MAR, after which the Bad Debt allowance was applied, and the difference between two MARs presented the bad debt costs, and similarly will be used also in this application.

However, for this Regulatory Period, ERO did not determine the Bad Debt Allowance, nor has initiated any consultation paper, yet when determining USS costs for the year 2018 has used the same debt allowance as applied in the year 2017.

Although in the last 3 years of the Regulatory period the Bad Debt Allowance was 4%, it should be emphasized that such ratio considered collection from all customers operating in the electricity market. USS requires for the year 2019 to be applied as 6% due to the market changes, decreased number of industrial and commercial customers – who are the regular payers. From April 2018, USS will be left mainly with customers who tend to delay and/or reject their payments of the bills received, and since based on the new law is not allowed to disconnect customers who complain until there's a decision from court, and considering the bureaucratic and slow-work of courts in Kosovo, operations will become impossible to be handled within the relevant tariff year.

A bad debt allowance at least for 6% will provide some security for the daily operation of the universal service supplier and moreover will help eliminating the existing cross subsidies. Any lower application than 6% will expose directly the USS into financial risk.

7. Adjustments and revenues correction factor for the relevant year t

During each tariff year supplier forecasts its costs which are approved by the Regulator. Yet, during the actual year there are differences between costs allowed and actual incurred, hence through a correction factor these costs are either give back to the company or customer. The revenue adjustment factor shall be calculated using the following formula:

$$ADJt = (AACt\text{-}1 - ARRt\text{-}1) * (1 + It)$$

As such, the Revenues Adjustment factor presents the difference between Allowed Actual USS costs in the relevant year t and actual regulated revenues in relevant year t-1. For the year 2018 a negative adjustments of €20.54 million shall be applied, which is a result of higher sells than initially forecasted by the supplier, as well as due the fact that new tariffs started from November 2018 and therefore the supplier billed more revenues for commercial and industrial customers, while had lower expenses towards DSO and TSO, as shown in the table below:

Description	**mil €**
Initial MAR	214.32
Balancing Tariff Amount	9.48
Final MAR	**223.81**
Actual MAR	**222.06**
Actual Sales	241.28
Revenue Correction Factor (ADJ_t)	**(20.54)**
Sales Difference	(18.68)
Wholesale Adjustment	9.25
Other Adjustments	**(11.11)**

In the previous regulatory period, ERO increased revenues for the total amount of reclaim of losses. USS is using the same approach this year, although it 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:

1. 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.
2. 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 USS in this application applied only the 20% of billing in the name of the reclaim of losses, and requires from the regulator to also recognize and apply only 20% of the billing in the name of reclaim losses. DSO pays to the USS only for the amount received by the end-customers, and if ERO continues to apply the whole amount billed as revenue from reclaim losses, than USS will need a higher allowance for bad debt for receivables related to reclaim losses.

8. Determination of the MAR for relevant year t

The Maximum Allowed Revenues (MAR) for the year 2019 will be covered from the regulated retail tariffs, and it includes only the costs of the customers that will be supplied from the Universal Service Supplier.

USS has considered that customers connected to 110 kV levels, as well as eligible customers connected to 35 kV will operate in the open market from April 2019 as per ERO guidance, therefore no costs were calculated for these customers from April onwards. Similarly no revenues will be calculated when determining revenues for the year 2019.

The table below represents a summary of the requirement for the Maximum Allowed Revenues for USS for the year 2018, after knowing all cost elements as explained in the previous chapters, and conform expression for calculating Maximum Allowed Revenues in the relevant year t:

$$MAR_t = (RETR_t + WCLC_t + WHPC_t + PSTC_t - NTFR_t + KREV_t) / (1\text{-}BDTA_t)$$

USS MAR for 2018	**mil €**
It	6.90%
Allowed Retail Costs	**6.37**
OPMCt	6.26
DEPCt	0.11
Pass-through Costs (PSTCt)	**141.72**
KOSTT fees	25.00
DSO fees	111.72
BRE Fund	5.00
Working Capital Costs (WCLCt)	**1.56**
Wholesale Power Costs (WHPC)	**129.02**
WHPC	125.26
Retail Margin	3.76
Licence fee	**0.01**
Revenue Adjustments Factor (ADJ)	**(20.54)**
BDTA	6.0%
PES MAR	**274.62**

Billing determinants for the year 2019 are based on the volumes of the sales forecasted in the Energy Balance, whereas their allocation was done based on the actual allocation and other billing determinants components in the year 2018. With the application of actual tariffs on billing determinants forecasted for the year 2019, it is expected to receive €251.96 mil expected revenues.

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