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**Kosovo Energy Regulatory Office**

**Rule on Distribution System Operator Pricing  
(DSO Pricing Rule)**

D R A F T

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## **CHAPTER 1      GENERAL PROVISIONS**

### **Article 1      Introduction**

- 1      This Rule was adopted by the Board of the Energy Regulatory Office (“the Regulator”) at a public session held on [date], under the authority given to it under Article 8 of the Law on the Energy Regulator.

### **Article 2      Scope and Purposes**

- 1      This Rule sets:
  - 1.1      The basis for the determination of Maximum Allowed Revenues that may be earned by the Distribution System Operator (“DSO”) in any Relevant Year in order to allow it to recover the reasonable costs of making and maintaining the distribution system available to users in accordance with the Law on the Energy Regulator; and
  - 1.2      The process by which such Maximum Allowed Revenues shall be reviewed and periodically re-determined.

### **Article 3      Definitions and Interpretations**

- 1      The following terms are used in this Rule and have the following meanings:
  - 1.1      “Actual Regulated Revenues” means the revenue recovered by the DSO through charges for the provision of Distribution System Services and any other revenue items stipulated by the Regulator measured, measured on an accruals basis;
  - 1.2      “Approved Investment Plan” has the meaning given to it in Schedule 2;
  - 1.3      “Business Days” means all working days of the week as defined in Kosovo law;
  - 1.4      “Connection Charges” means the charges applied by the DSO for connecting customers to the Distribution System;
  - 1.5      “Distribution Losses” means total energy losses occurring in the Distribution System operated by the DSO consisting of (1) technical losses as determined by an engineering estimate and (2) commercial losses defined as energy entering the Distribution System less technical losses less energy billed to customers;
  - 1.6      “Distribution System Operator” or “DSO” means the legal entity owner of the Kosovo Distribution System and holder of the Distribution System Operator Licence;
  - 1.7      “Distribution System Services” means the services which the DSO Licensee is authorised to provide under the terms of the Distribution System Operator Licence granted to it by the Regulator and associated with the making available of a reliable, safe and secure distribution system to persons wishing to use the system for conveyance of electricity for purposes other than transit;
  - 1.8      “Distribution System” has the meaning assigned to it under the Law on Electricity;
  - 1.9      “DUOS Charges” means the set of charges applied by the DSO for the Use of System;

- 1.10 “Economic Asset Lives” means the asset lives used to calculate allowed depreciation on the Regulatory Asset Base;
- 1.11 “EURIBOR” means the European Banking Federation Interbank Offer Rate for Euro deposits for a period equal to 3 months which appears on the appropriate page of the Reuters service at or about 11:00 a.m. Central European Time, or in the event that the Reuter’s service, or any successor thereto, no longer provides such information, such other service as agreed by the DSO and the Regulator. For the avoidance of doubt it shall be an annual rate;
- 1.12 “Excluded Service” means a service provided by the DSO as part of its licensed activities the costs of which are recovered outside Maximum Allowed Revenues and which includes, but is not limited to, the provision of connections to the Distribution System, transit and the provision of services at the request of specific third parties;
- 1.13 “Extraordinary Adjustment” has the meaning given to it in Schedule 7;
- 1.14 “Extraordinary Event” has the meaning given to it in Schedule 8;
- 1.15 “Extraordinary Review” has the meaning given to it in Article 7;
- 1.16 “Force Majeure Event” has the meaning given to it in Schedule 9;
- 1.17 “Licence Fee” means the amount payable under the terms of Article 7 of the Schedule of Fees issued by the Regulator and amended from time to time;
- 1.18 “Loss Target” has the meaning give to it in Article 12 paragraph 3;
- 1.19 “Loss Sharing Factor” has the meaning given to it in Article 12 paragraph 4;
- 1.20 “Market Rules” means the [to be defined when new market rules are in place];
- 1.21 “Materiality Threshold” has the meaning given to it in Schedule 7;
- 1.22 “Maximum Allowed Revenues” or “MAR” means the maximum amount that can be recovered in a Relevant Year by the DSO through the DUOS Charge, the revenues from which are regulated under the formulae in Schedule 1 of this Rule;
- 1.23 “Maximum Distribution System Demand” means the maximum electricity demand in a year (in MW) metered at entry points onto the DSO’s distribution system;
- 1.24 “Metered” means in relation to any electricity metered quantity, as measured by a meter installed for such a purpose under the Metering Code;
- 1.25 “MW” means megawatts;
- 1.26 “MWh” means megawatt hours;
- 1.27 “Net Present Value” means the method of discounting future cash flows;
- 1.28 “Proposal” has the meaning given to it in Schedule 5 paragraph 4;
- 1.29 “Provisional Decision” has the meaning given to it in Schedule 5 paragraph 6;
- 1.30 “Public Electricity Supplier” or “PES” means the holder of the Public Supply Licence;

- 1.31 “Periodic Review” means the review by the Regulator to determine Maximum Allowed Revenues of the DSO for the forthcoming Regulatory Period;
  - 1.32 “Regular Adjustment” means the mechanical adjustment to Maximum Allowed Revenues undertaken towards the end of each Relevant Year;
  - 1.33 “Regulated Units Billed” means the aggregate quantity of electricity units billed to Kosovar customers in respect of units supplied to them from the Distribution System;
  - 1.34 “Regulated Units Distributed” means the aggregate quantity of electricity units distributed through the Distribution System for delivery to Kosovar customers in a Relevant Year metered at exit points on leaving the Distribution System (or where no such meter is installed as otherwise reasonably calculated in accordance with recognised engineering practices);
  - 1.35 “Regulator” means the Energy Regulatory Office;
  - 1.36 “Regulatory Asset Base” has the meaning given to it in Schedule 2;
  - 1.37 “Regulatory Period” has the meaning given to it in Article 5 paragraph 3;
  - 1.38 “Relevant Year” means the period of 12 successive calendar months between Regular Adjustments;
  - 1.39 “Statement of Distribution Charging Principles” means a statement issued by the Regulator that the DSO’s methodologies for setting the DUOS Charge and Connection Charges must be in accordance with;
  - 1.40 “Statement of Financial Impact” has the meaning given to it in Schedule 7;
  - 1.41 “Transitional Period” has the meaning given to it in Schedule 10;
  - 1.42 “Unit distributed” means a kilowatt hour;
  - 1.43 “Use of System” means the use of the Distribution System for the conveyance of electrical energy from points of entry into the system to supply points for delivery to Kosovar customers; and
  - 1.44 “Weighted Average Cost of Capital” has the meaning given to it in Schedule 3; and
  - 1.45 “X Factor” means the factor defined at Periodic Reviews and applied at Regular Adjustments to allowed DUOS costs.
- 2 The other terms in this rule shall have the meanings specified in the Law on the Energy Regulator, in the Law on Electricity, or in the Law on Energy.

## **CHAPTER 2 DUOS CHARGES**

### **Article 4 General Principles**

- 1 Annual DUOS Charges shall be set such that:
  - 1.1 Within each Relevant Year the revenues that the DSO expects to earn from the DUOS Charges are equal to Maximum Allowed Revenues (Chapter 3) approved by the Regulator; and
  - 1.2 Annual DUOS Charges are determined in accordance with a methodology developed by the DSO and approved by the Regulator. The methodology shall be in accordance with the Statement of Distribution Charging Principles issued by the Regulator.
- 2 Maximum Allowed Revenues comprise the sum of:
  - 2.1 Allowed DUOS costs, including allowed operating costs, allowed depreciation, and allowed return on capital;
  - 2.2 Allowed cost of losses;
  - 2.3 The Licence Fee; and
  - 2.4 The costs of any public service obligations that are not recovered through another mechanism.
- 3 Maximum Allowed Revenues shall be determined as follows:
  - 3.1 Maximum Allowed Revenues shall be set at Periodic Reviews (Article 5):
  - 3.2 Before the end of each Relevant Year, a Regular Adjustment (Article 6) shall be applied which involves mechanical adjustments to Maximum Allowed Revenues for changes in costs that are considered to be outside of the DSO's control; and
  - 3.3 Extraordinary Reviews (Article 7), which involve an adjustment to Maximum Allowed Revenues for material changes in DUOS costs and/or revenues caused by an Extraordinary Event, shall be made as necessary.
- 4 Transitional provisions given in Schedule 10 shall apply until 31 March 2015.

### **Article 5 Periodic Reviews and Regulatory Periods**

- 1 At Periodic Reviews Maximum Allowed Revenues of the DSO for the following Regulatory Period shall be set.
- 2 A Periodic Review shall be held prior to each Regulatory Period.
- 3 Each Regulatory Period shall equal 5 years, except:
  - 3.1 During the Transitional Period as given in Schedule 10; and
  - 3.2 On the mutual agreement of the DSO and the Regulator, a Periodic Period may be shortened or extended.

4 The process for undertaking Periodic Reviews is given in Schedule 5.

### **Article 6 Regular Adjustments**

1 At Regular Adjustments the permitted change in Maximum Allowed Revenues shall be calculated.

2 A Regular Adjustment shall be held prior to each forthcoming Relevant Year.

3 The change in Maximum Allowed Revenues at each Regular Adjustment shall be based on the following:

3.1 Under or over-recovery of Maximum Allowed Revenues in the current (soon to be competed) Relevant Year, due to differences between forecast and actual electricity delivered on its network;

3.2 Adjustments to Maximum Allowed Revenues for changes in forecast allowed cost of losses (Article 12) and the forecast Licence Fee (Article 13); and

3.3 Under or over-recovery of the allowed cost of losses and the Licence Fee, due to differences between forecast and actual costs, subject to any sharing of such under or over-recoveries between the DSO and users of the Distribution System.

4 The formulae for calculating Maximum Allowed Revenues at Regular Adjustments are given in Schedule 1.

5 The process for making Regular Adjustments is given in Schedule 6.

### **Article 7 Extraordinary Reviews**

1 Extraordinary Reviews shall be triggered by Extraordinary Events, as defined in Schedule 8.

2 At Extraordinary Reviews the impact of the Extraordinary Event on Maximum Allowed Revenues for the remainder of the current Regulatory Period shall be calculated. If the impact is greater than the Materiality Threshold, then an Extraordinary Adjustment to Maximum Allowed Revenues shall be made.

3 The calculation of the impact on Maximum Allowed Revenues and the associated Extraordinary Adjustment shall not account for any factors that are not directly affected by the Extraordinary Event.

4 For the avoidance of doubt, the Regulator shall also take account of the on-going impacts of Extraordinary Events (that pass the Materiality Threshold) at future Periodic Reviews.

5 The process for undertaking Extraordinary Reviews is given in Schedule 7.

## CHAPTER 3      MAXIMUM ALLOWED REVENUES

### Article 8      General Principles

- 1      Maximum Allowed Revenues shall be set at such a level that enables the DSO to set DUOS Charges at a level that allows recovery of all reasonable costs of providing Distribution System Services to the extent that the costs are justified and prudently asserted.
- 2      The reasonable costs of the DSO shall comprise:
  - 2.1      Allowed DUOS costs, including allowed operating costs (Article 9), allowed depreciation (Article 10), and allowed return on capital (Article 11). At Regular Adjustments allowed DUOS costs shall be adjusted for inflation less the X Factor, and also for changes in Maximum Distribution System Demand, Regulated Units Distributed, and number of customers, to the extent that allowed DUOS costs are determined to vary in this respect;
  - 2.2      Allowed cost of losses (Article 12), which shall be based on a Loss Target and passed-through at Regular Adjustments based on a Loss Sharing Factor;
  - 2.3      The Licence Fee (Article 13), which shall be fully passed-through at Regular Adjustments; and
  - 2.4      The costs of any public service obligations that are not recovered through another mechanism.
- 3      In determining reasonable costs, the Regulator shall refer to, but is not bound by or limited to:
  - 3.1      Past performance;
  - 3.2      Projected performance;
  - 3.3      Comparisons with similar utilities in Kosovo and elsewhere in Europe; and
  - 3.4      Comparisons with the costs of similar activities in Kosovo and elsewhere in Europe.
- 4      Maximum Allowed Revenues shall not recover costs for the provision of any service (including the provision of electric lines or electrical plant) deemed to be an Excluded Service in terms of Schedule 3 and which:
  - 4.1      Is for the specific benefit of any third party who requests it; and
  - 4.2      Is remunerated under any charges other than charges for use of the Distribution System.
- 5      The cost of the provision of Excluded Services shall be recoverable by the DSO in line with Schedule 4.
- 6      At Periodic Reviews the Regulator may adjust the profile of Maximum Allowed Revenues expected to be recovered over each Relevant Year to minimise step changes in Maximum Allowed Revenues.
- 7      At all times, the Net Present Value of the forecast Maximum Allowed Revenues to be recovered in this way shall equal the Net Present Value of the forecast allowed costs of the

DSO to be recovered from DUOS Charges. The calculation of the Net Present Value shall use the Weighted Average Cost of Capital of the DSO, as determined by the Regulator, as the applicable discount rate.

8 The formulae for calculating Maximum Allowed Revenues are given in Schedule 1.

#### **Article 9 Allowed Operating Costs**

1 Allowed operating costs shall not include any proportion or element of corporate costs (of any parent entity or any affiliated entity) that cannot reasonably be attributed to the DSO.

2 In submitting its estimates of fixed and other operating costs required to be recovered through Maximum Allowed Revenues for any forthcoming Regulatory Period, the DSO shall not seek to recover.

#### **Article 10 Allowed Depreciation**

1 Allowed depreciation costs shall be calculated on a straight-line basis as a function of Economic Asset Lives and the Regulatory Asset Base for different classes of assets, as described in Schedule 2.

#### **Article 11 Allowed Return on Capital**

1 Allowed return on capital costs shall be calculated as a function of the Weighted Average Cost of Capital and the Regulatory Asset Base, as described in Schedule 2.

2 Return on capital shall be calculated based on value of the Regulatory Asset Base at the middle of each Relevant Year (as an average of the opening and closing values of the Regulatory Asset Base).

3 The DSO shall not earn a return on assets financed using capital grants.

#### **Article 12 Allowed Cost of Losses**

1 The allowed cost of losses shall be the forecast cost of losses to be recovered by the PES from the DSO to compensate for losses on the Distribution System, calculated using the Loss Target which shall be set at Periodic Reviews.

2 Maximum Allowed Revenues shall be adjusted for changes in allowed cost of losses at each Regular Adjustment, as per the formulae given in Schedule 1. This adjustment shall:

2.1 Return under or over-recovered allowed costs of losses during the Relevant Year, where these occur for reasons other than the non-achievement of the Loss Target;

2.2 Share the difference between the allowed cost of losses and the actual cost of losses incurred by the DSO during the Relevant Year, based on the Loss Sharing Factor which shall be set at Periodic Reviews; and

2.3 Update the forecast allowed cost of losses for the forthcoming Relevant Year, based on the forecast wholesale energy costs of the PES.

3 In setting the Loss Target the Regulator shall take into account:

- 3.1 The outturn level of actual Distribution Losses for the most recent complete period of 12 successive months for which accurate data is available;
  - 3.2 Any expected loss reduction that may reasonably be expected to be obtained based on the Approved Investment Plan during the Regulatory Period; and
  - 3.3 The level of Distribution Losses in comparable distribution systems elsewhere in Europe.
- 4 The Loss Sharing Factor shall be sufficient to encourage the DSO to reduce Distribution Losses.
  - 5 The methodology used for measuring the outturn level of Distribution Losses can be changed by the mutual agreement of the Regulator and the DSO. In such cases, the Loss Target shall be adjusted accordingly to leave the absolute level of loss reductions expected over the Regulatory Period unchanged.

### **Article 13      Pass-Through of Licence Fee**

- 1 The DSO shall pass-through the Licence Fee. Maximum Allowed Revenues shall be adjusted for changes in the Licence Fee at each Regular Adjustment, as per the formulae given in Schedule 1.

## **CHAPTER 4 CONNECTION CHARGES**

### **Article 14 General Principles**

- 1 Connection Charges shall be set from time to time such that:
  - 1.1 The DSO recovers its connection costs that are not recovered from other charges; and
  - 1.2 Connection Charges are in accordance with a methodology developed by the DSO and approved by the Regulator. The methodology shall be in accordance with the Statement of Distribution Charging Principles issued by the Regulator.
- 2 Connection costs shall include the costs of:
  - 2.1 Carrying out of works and provision and installation of electrical plant, lines, meters and other equipment for the purposes of constructing or modifying a connection of an electricity site or customer to the Distribution System in so far as these costs are not otherwise recovered from DUOS Charges;
  - 2.2 The cost of removal of electrical plant, lines, meters and other equipment for the purposes of disconnecting an electricity site or customer from the Distribution System;
  - 2.3 A reasonable rate of return on the capital represented by such costs; and
  - 2.4 The costs of maintenance of electrical plant, lines, meters and other equipment that are not otherwise recovered from DUOS Charges.
- 3 The boundary between those costs to be recovered from Connection Charges, those to be recovered from DUOS Charges and those to be recovered from other charges shall be defined in the methodology on the determination of Connection Charges.

### **Article 15 Connection Charges Approval Process**

- 1 The DSO shall submit to the Regulator its methodology for connection charges and any subsequent amendments to this methodology at least [30 Business Days] prior to its proposed date of effectiveness.
- 2 No methodology or amendments to a methodology shall be effective until approved by the Regulator.
- 3 The DSO shall have the right to determine the Connection Charges subject to the requirements of Article 14 above.
- 4 Parties connecting to the Distribution System shall have the rights to refer any dispute over the Connection Charges applicable to them to the Regulator, as provided for in relevant legislation.

## SCHEDULE 1 MAXIMUM ALLOWED REVENUES CALCULATION

1 This schedule sets out the formulae for calculating Maximum Allowed Revenues of the DSO. This schedule is intended to complement the principles set out in the main body of the Rules.

2 Maximum Allowed Revenues ( $MAR_t$ ) shall be calculated using the following formula:

$$MAR_t = UOSR_t + LSSC_t + LICC_t + KREV_t$$

Where

$MAR_t$  is Maximum Allowed Revenues in Relevant Year  $t$

$UOSR_t$  is allowed DUOS revenues in Relevant Year  $t$ , which are set at Periodic Reviews such that, the Net Present Value (over the Regulatory Period and taking account of the X Factor) is expected to equal the Net Present Value of forecast allowed DUOS costs

$LSSC_t$  is allowed cost of losses in Relevant Year  $t$

$LICC_t$  is the Licence Fee in Relevant Year  $t$

$KREV_t$  is the revenue correction factor in Relevant Year  $t$ , which is forecast as zero at Periodic Reviews

2.1 Allowed DUOS revenues ( $UOSR_t$ ) shall be calculated at Regular Adjustments using the following formula:

$$UOSR_t = UOSR_{t-1} * ( a_t + b_t * MDS D_t / MDS D_{t-1} + c_t * REUD_t / REUD_{t-1} + d_t * CSTD_t / CSTD_{t-1} ) * ( 1 + CPI_{t-1} - X_t )$$

Where

$UOSR_t$  is allowed DUOS revenues in Relevant Year  $t$

$UOSR_{t-1}$  is allowed DUOS revenues in Relevant Year  $t-1$  except for Relevant Year 1, when a value determined by ERO at the most recent Periodic Review shall be used

$a_t$  is the proportion of allowed DUOS costs that do not vary with changes in Maximum Distribution System Demand, Regulated Units Distributed, or Customer Numbers in Relevant Year  $t$ , which is set at Periodic Reviews, where  $a_t + b_t + c_t + d_t = 1$

$b_t$  is the proportion of allowed DUOS costs that vary with changes in Maximum Distribution System Demand in Relevant Year  $t$ , which is set at Periodic Reviews, where  $a_t + b_t + c_t + d_t = 1$

$MDS D_t$  is forecast Maximum Distribution System Demand in Relevant Year  $t$

$MDS D_{t-1}$  is actual Maximum Distribution System Demand in Relevant Year  $t-1$

$c_t$	<i>is the proportion of allowed DUOS costs that vary with changes in Regulated Units Distributed in Relevant Year t, which is set at Periodic Reviews, where <math>a_t + b_t + c_t + d_t = 1</math></i>
$REUD_t$	<i>is forecast Regulated Units Distributed in Relevant Year t</i>
$REUD_{t-1}$	<i>is actual Regulated Units Distributed in Relevant Year t-1</i>
$d_t$	<i>is the proportion of allowed DUOS costs that vary with changes in Customer Numbers in Relevant Year t, which is set at Periodic Reviews, where <math>a_t + b_t + c_t + d_t = 1</math></i>
$CUST_t$	<i>is forecast number of customer connections to the Distribution System in Relevant Year t</i>
$CUST_{t-1}$	<i>is actual number of customer connections to the Distribution System in Relevant Year t-1</i>
$CPI_{t-1}$	<i>is the actual value of inflation in Relevant Year t-1, measured using the Harmonised Indices of Consumer Prices (HICPs) – All Items, for the Eurozone, published by Eurostat</i>
$X_t$	<i>is the X Factor in Relevant Year t, which is set at Periodic Reviews</i>

2.2 Allowed cost of losses ( $LSSC_t$ ) shall be calculated at Regular Adjustments using the following formula:

$$LSSC_t = LSSCf_t + (LSSCa_{t-1} - LSSCf_{t-1}) * (1 + I_t) + (LSSCa_{t-1} - LSAC_{t-1}) * LSSF_t$$

Where

$LSSC_t$	<i>is allowed cost of losses in Relevant Year t</i>
$LSSCf_t$	<i>is forecast cost of losses in Relevant Year t, which is calculated as:</i>

$$LSSCf_t = LT_t * REUE_t * WHEC_t / REUT_t$$

Where

$LT_t$	<i>is the Loss Target, which is a percentage, in Relevant Year t</i>
$REUE_t$	<i>is the regulated energy units entering the Distribution System in Relevant Year t</i>
$WHEC_t$	<i>is the wholesale energy cost (€) as determined for the PES in Relevant Year t</i>
$REUT_t$	<i>is the regulated energy units entering the transmission system in Relevant Year t</i>
$LSSCa_{t-1}$	<i>is actual cost of losses in Relevant Year t-1 calculated using the Loss Target</i>
$LSSCf_{t-1}$	<i>is forecast cost of losses in Relevant Year t-1, calculated using the Loss Target</i>

$I_t$	<i>is the interest rate for the Relevant Year t calculated based on EURIBOR plus 1%</i>
$LSSCa_{t-1}$	<i>is actual cost of losses in Relevant Year t-1 calculated using the Loss Target</i>
$LSAC_{t-1}$	<i>is cost of losses actually incurred by the DSO in purchasing energy from the PES as compensation for energy lost on the Distribution System (not calculated using the Loss Target) in Relevant Year t-1</i>
$LSSF_t$	<i>is the Loss Sharing Factor in Relevant Year t, which is set at Periodic Reviews</i>

2.3 Licence Fee ( $LICC_t$ ) shall be calculated at Regular Adjustments using the following formula:

$$LICC_t = LICCF_t + (LICC_{a,t-1} - LICCF_{t-1}) * (1 + I_t)$$

Where

$LICC_t$  *is the Licence Fee in Relevant Year t*

$LICCF_t$  *is the forecast Licence Fee in Relevant Year t*

$LICC_{a,t-1}$  *is the actual Licence Fee in Relevant Year t-1*

$LICCF_{t-1}$  *is the forecast Licence Fee in Relevant Year t-1*

$I_t$  *is the interest rate for the Relevant Year t calculated based on EURIBOR plus 1%*

2.4 The revenue adjustment factor ( $KREV_t$ ) shall be calculated at Regular Adjustments using the following formula:

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

Where

$ARR_{t-1}$  *is the Actual Regulated Revenues in Relevant Year t-1*

$MAR_{t-1}$  *is Maximum Allowed Revenues in Relevant Year t-1*

$I_t$  *is the interest rate for the Relevant Year t calculated based on EURIBOR plus 1%*

## **SCHEDULE 2     REGULATORY ASSET BASE**

- 1     This schedule describes the determination of the Regulatory Asset Base for the purpose of calculating allowed depreciation (Article 10) and allowed return on capital (Article 11).
- 2     The Regulatory Asset Base shall be a regulatory value of the DSO's used and useful fixed assets that are necessary for the provision of Distribution System Services. It shall distinguish between different classes of assets.
- 3     The Regulatory Asset Base shall be updated at each Periodic Review as follows:
  - 3.1     Allowed depreciation costs during the current Regulatory Period shall be subtracted from the Regulatory Asset Base, calculated on a straight-line basis using Economic Asset Lives;
  - 3.2     Asset disposals during the current Regulatory Period shall be subtracted from the Regulatory Asset Base based on their regulatory value. Any difference between the disposal value and regulatory value of an asset, shall be deducted from Maximum Allowed Revenues in the forthcoming Regulatory Period;
  - 3.3     Approved capital expenditure during the current Regulatory Period shall be added to the Regulatory Asset Base as from the date when the asset is brought into service and at the cost approved in the Approved Investment Plan. Interest during construction shall be capitalised. For the avoidance of doubt, the Regulator shall not make any retroactive reduction in future revenues to account for differences between the actual cost of investments and the approved cost. However the Regulator shall consider actual costs at future Periodic Reviews as a means of forecasting the cost of future investments;
  - 3.4     If a capital project in the Approved Investment Plan is not brought into service in the current Regulatory Period, its approved cost shall not be added to the Regulatory Asset Base at the next Periodic Review and any revenues earned from the project in the current Regulatory Period shall be deducted from revenues in the following Regulatory Period;
  - 3.5     Where any maintenance cost is or has previously been included in allowed operating costs it shall not be capitalised, nor shall it be included in the Regulatory Asset Base; and
  - 3.6     The Regulatory Asset Base shall be adjusted to take into account inflation over the previous Regulatory Period, using the Harmonised Indices of Consumer Prices - All Items for the Eurozone area as published by Eurostat as the relevant measure.
- 4     Economic Asset Lives for different asset classes shall be used to calculate depreciation on the Regulatory Asset Base. Economic Asset Lives shall be determined at Periodic Reviews such that they reflect the technical lives of assets, except where there is demonstrable reason why the technical life of an asset shall vary from the useful economic life of an asset.
- 5     Approved capital expenditure shall be determined at Periodic Reviews based on the Approved Investment Plan for the forthcoming Regulatory Period. The Approved Investment Plan shall:

- 5.1 Comprise the capital projects reasonably required to provide Distribution System Services;
  - 5.2 Identify each capital project ranked in priority order;
  - 5.3 Show the benefit to Regulated Customers that each capital project is reasonably expected to deliver, with reference where appropriate to the meeting of any relevant Distribution System Security, Planning or Operating Security Standard as required by the DSO's licence;
  - 5.4 Have regard to any other relevant investment or development plans for the DSO that have been approved by the Regulator (and any differences between these plans shall be identified by the DSO and explained), including the latest 3 Year Investment Plan prepared by the DSO in line with Article 6 of its Licence and as approved by ERO; and
  - 5.5 Be developed using discounted cash flow techniques.
- 6 The Approved Investment Plan shall be implemented as follows:
- 6.1 The DSO shall use all reasonable endeavours to ensure the implementation of the Approved Investment Plan in line with its approved timetable;
  - 6.2 If the DSO shall be or is unable to, for reasons beyond its control, undertake a capital investment in accordance with the timetable given in the Approved Investment Plan, it shall notify the Regulator. The DSO shall also detail the reasons for the delay and the revised timetable;
  - 6.3 The DSO may at any time apply to the Regulator to substitute a capital project in its Approved Investment Plan for an alternative capital project; so long the alternative project can be shown to be expected to result in the same or greater net benefits to customers (taking account of the expected outcomes and lifetime costs). If the Regulator approves the substitution, the alternative project shall be added to the Regulatory Asset Base at the next Periodic Review. For the avoidance of doubt, Maximum Allowed Revenues in the current Regulatory Period shall not be adjusted; and
  - 6.4 If the DSO substitutes a capital project in its Approved Investment Plan for an alternative project without the prior approval of the Regulator, the Regulator shall consider whether to approve the substitution at the next Periodic Review but is not bound to do so.

### SCHEDULE 3 WEIGHTED AVERAGE COST OF CAPITAL

- 1 The Weighted Average Cost of Capital shall be calculated on a pre-tax basis according to the following formulae:

$$WACC = (1 - gi) * (rEi) / (1 - t) + gi * (rDi)$$

Where

WACC is the Weighted Average Cost of Capital

gi gearing (debt:equity ratio) for firm i

rEi real cost of equity (expressed as a %) for firm i

rDi real cost debt (expressed as a %) for firm i

t Kosovo corporate income tax rate

- 2 The gearing (g) shall be a value determined by the Regulator between 0 and 1, and shall represent the share of debt in total financing. The value shall be determined based on a consideration of the actual financing mix of the DSO, the financing mix that might be expected for similar commercial businesses and the financing mix of similar utilities internationally.

- 3 The cost of equity (rEi) shall be a value calculated by the Regulator using the Capital Asset Pricing Model (CAPM) with the following general formula:

$$rEi = rf + \beta i * ERPm$$

rf risk-free rate

ERPm equity risk premium applicable to the market as a whole

$\beta i$  covariance between the returns on the individual equity asset and those of the market as a whole (the equity beta)

- 3.1 The risk-free rate (rf) shall represent the cost of sovereign debt in Kosovo, in real terms, and shall be determined by the Regulator using evidence on the cost of sovereign debt for Kosovo and/or, where this is unavailable or insufficient, the cost of sovereign debt for countries considered to have a similar credit status to Kosovo.
- 3.2 The equity risk premium (ERPm) shall be determined by the Regulator using evidence on the equity risk premium internationally.
- 3.3 The beta ( $\beta i$ ) shall be determined by the Regulator using evidence on the beta applicable to similar utilities internationally.
- 4 The cost of debt (rDi) shall be the average interest rate of existing long-term loans (exceeding one year) to the DSO, expressed in real terms and weighted according to the value in Euros of each loan.

- 4.1 The DSO shall be required to procure loans through a competitive process, or to demonstrate to the satisfaction of the Regulator that the interest rate of those loans not procured through a competitive process is equal to or less than the prevailing market interest rate at the time the loan agreement was signed.
- 4.2 Where the Regulator considers that the interest rate of a loan not procured commercially exceeds the prevailing market interest rate, that loan shall be excluded from the calculation of the cost of debt.
- 4.3 Where the Regulator considers there are insufficient existing loans to provide a reasonable estimate of the actual cost of future debt financing to the DSO, the Regulator may make an adjustment to the actual cost of debt calculated as above. This adjustment shall be made based on:
  - (i) An assessment of the prevailing market interest rate for loans to businesses of similar size, risk and credit status as the DSO.
  - (ii) An assessment of the expected interest rate applied to any future concessional loans to the DSO.
  - (iii) An assessment of the expected mix of commercial (non-concessional) and concessional loans in the debt of the DSO over the coming Regulatory Period.

## **SCHEDULE 4 EXCLUDED SERVICES**

- 1 The DSO may levy a charge in respect of the provision of any Excluded Service, which may include (but not be limited to):
  - 1.1 The carrying out of works the cost of which is required to be reimbursed by a user of the system or a third party (including any necessary reinforcement works or diversionary works) for the purposes of connecting a user to the Distribution System (but only to the extent that the service is not already remunerated under use of system charges described in this Rule);
  - 1.2 The relocating of any electric line or electrical plant (including the carrying out of any associated works) pursuant to any statutory obligation other than one imposed on the DSO under Law on Electricity, the Law on Energy or the Law on the Energy Regulator.
  - 1.3 The moving of any electric line, electrical plant, or metering equipment that forms part of the Distribution System to accommodate the extension, redesign, or redevelopment of any premises on which the asset in question is located or to which it is connected, the cost of which is to be borne by a user of the system or a third party;
  - 1.4 The provision of electric lines and electrical plant to the extent required by any user of the Distribution System to provide a higher degree of security than is required for the purposes of complying with paragraph 2 of Article 11 of the DSO's licence (Distribution System Security and Planning Standards); and
  - 1.5 The provision of any Metering Service that is not already remunerated under any other charge in respect of an Excluded Service.
- 2 Charges for such Excluded Services shall be set at a level that shall allow the DSO to recover:
  - 2.1 Its reasonable costs incurred in providing the service; and
  - 2.2 A reasonable rate of return on the capital outlay represented by any expenditure incurred by the DSO during the period before payment is received of any amounts due by the person requiring the service in question.
- 3 Where applicable, such charges shall be determined in accordance with the approved methodology for Connection Charges.
- 4 In providing a quotation to the person applying for the provision of the Excluded Service, the DSO shall provide such detailed costing as the applicant could reasonably require in order to determine whether the charge is justified.
- 5 The quotation shall make reference to the role of the Regulator as set out in the Law on the Energy Regulator.
- 6 The DSO shall following the end of each Relevant Year provide to the Regulator details of services provided as part of the Distribution Business and treated as excluded services by the DSO during the course of such year and stating the revenue derived in respect of such services.

- 7 Where the Regulator considers that a service claimed by the DSO to be an excluded service is not such a service, then the Regulator shall issue a direction to the effect that the service is no longer considered to be an exclusive service.

## SCHEDULE 5 PERIODIC REVIEW PROCESS

- 1 The Regulator shall, in order to promote transparency, publish all submissions, comments, and other documentation received from the DSO or other interested parties in relation to the Periodic Review on its official website within [5 working days] of its receipt and the Regulator shall disclose all material information submitted to it by the DSO, excluding any information that the Regulator acknowledges as being commercially confidential.
- 2 The Regulator shall initiate the Periodic Review no later than [six months] prior to start of the forthcoming Regulatory Period. Different timing shall apply during the Transitional Period as given in Schedule 10.
- 3 The Regulator shall initiate the Periodic Review by notification to the DSO of:
  - 3.1 The years for which actual, estimated forecast data is required;
  - 3.2 The format in which the data is required to be submitted;
  - 3.3 The timetable for submission of the DSO's Proposal for its Maximum Allowed Revenue for the forthcoming Regulatory Period; and
  - 3.4 The timetable for the overall review process.
- 4 The DSO' Proposal shall contain the following information and address the following matters (without limitation):
  - 4.1 Actual Regulated Revenues earned during the current Regulatory Period (using a reasonable estimate for the remaining months where necessary);
  - 4.2 Actual costs of providing Distribution System Services during the current Regulatory Period, in line with the definition of costs that was used for calculating Maximum Allowed Revenues;
  - 4.3 The annual report and audited financial statements for each financial year that ended in the current Regulatory Period;
  - 4.4 Actual Maximum Distribution System Demand, Regulated Units Distributed, and Customer Numbers during the current Regulatory Period;
  - 4.5 Forecast Maximum Distribution System Demand, Regulated Units Distributed, and Customer Numbers for the forthcoming Regulatory Period;
  - 4.6 Forecast Maximum Allowed Revenues, reporting each of the allowed cost components separately, for the forthcoming Regulatory Period; and
  - 4.7 Any other additional material that the Regulator reasonably considers should be included in the DSO's proposal, so long as the Regulator has notified the DSO a reasonable time prior to the deadline for the DSO's proposal.
- 5 The DSO shall, to the fullest extent possible, apply the methodology set out in this Rule in preparing its Proposal. It shall disclose any areas where it has not applied the methodology, the reason for not applying it, the reasons supporting the alternative approach, and provide an estimate of the impact of using the alternative approach.

- 6 Upon receiving the DSO's Proposal, the Regulator shall determine its accuracy, relevance and reasonableness by applying the methodology set out in this Rule, including determining whether the proposed Maximum Allowed Revenues reflects the reasonable costs of providing Distribution System Services.
- 7 The Regulator shall prepare a Provisional Decision on the DSO's Proposal no later than [50 Business Days] before the start of the forthcoming Regulatory Period, after consulting with the DSO as necessary. The Provisional Decision shall set out the Regulator's proposals on the Maximum Allowed Revenues to be recovered by the DSO during the Regulatory Period and the justification for these. The Regulator, in preparing its Provisional Decision, may amend, remove or replace any part of the DSO's Proposal as it considers appropriate provided that it shall identify such amendments, removals or replacements and provide justification for these.
- 8 At the same time as it notifies the DSO of its Provisional Decision, the Regulator shall launch a public consultation on its Provisional Decision, in accordance with the Law on the Energy Regulator.
- 9 Following completion of the public consultation and no later than [20 Business Days] before the start of the forthcoming Regulatory Period, the Regulator shall make its Final Decision on Maximum Allowed Revenues for the forthcoming Regulatory Period. Its decision shall be consistent with this Rule. Different timing shall apply during the Transitional Period as given in Schedule 10.
- 10 Maximum Allowed Revenues as provided in the Regulator's Final Decision shall apply from the start date of the forthcoming Regulatory Period.
- 11 The DSO may dispute or appeal any decision by the Regulator in accordance with applicable legislation.

## **SCHEDULE 6    REGULAR ADJUSTMENT PROCESS**

- 1     The DSO shall submit the proposed new Maximum Allowed Revenues for the forthcoming Relevant Year to the Regulator at least [20 Business Days] before the start of the forthcoming Relevant Year. The DSO shall also include in its submission all relevant documents and evidence including the values relating to all the components of the Regular Adjustment formulae given in Schedule 1 and any other items notified by the Regulator.
- 2     The Regulator may reasonably require the DSO to further explain its method of calculating the proposed Maximum Allowed Revenues, and if so required, the DSO shall promptly provide to the Regulator any further information or explanations sought.
- 3     The Regulator shall advise the DSO at least [5 Business Days] before the start of the forthcoming Relevant Year whether or not it approves the DSO's calculation of the proposed Maximum Allowed Revenues.
- 4     If the Regulator approves the proposed Maximum Allowed Revenues, they shall become the Maximum Allowed Revenues for the forthcoming Relevant Year.
- 5     If the Regulator does not approve the proposed Maximum Allowed Revenues, it shall provide reasons and evidence why, in accordance with this Rule. The Maximum Allowed Revenue shall not be adjusted until the Regulator approves a proposal or provides its own calculation of Maximum Allowed Revenues.
- 6     Any difference in revenues that arises from incorrect calculations, misreporting of Actual Regulated Revenue, or disputes relating to Regular Adjustment shall be recovered in subsequent Relevant Years.
- 7     If the Regulator does not advise the DSO within the required period, approval is assumed and the proposed Maximum Allowed Revenues shall become effective on the first day of the following Relevant Year.
- 8     The DSO may dispute or appeal any decision by the Regulator in accordance with applicable legislation.

## **SCHEDULE 7    EXTRAORDINARY REVIEW PROCESS**

- 1     If an Extraordinary Event has occurred, the DSO may request an Extraordinary Review.
- 2     An Extraordinary Review cannot be launched undertaken within [six months] of a Periodic Review or the completion of a previous Extraordinary Review.
- 3     An Extraordinary Review may relate to more than one Extraordinary Event, in which case this schedule addresses the cumulative financial effect of those events.
- 4     Within [20 Business Days] of the DSO requesting an Extraordinary Review, it shall submit to the Regulator a Statement of Financial Impact that includes the following matters:
  - 4.1     A description of the Extraordinary Event that is the reason for requesting the Extraordinary Review;
  - 4.2     A summary of the impact of the Extraordinary Event on the DSO's business;
  - 4.3     An estimate of the change in the DSO's costs in each year from the date that the Extraordinary Event occurred (or began) to the end of the current Regulatory Period;
  - 4.4     An estimate of the change in forecast revenues resulting from the Extraordinary Event, in each year from the date that the Extraordinary Event occurred (or began) to the end of the current Regulatory Period;
  - 4.5     A calculation of the financial impact on the DSO of the Extraordinary Event in each year, calculated as the sum of the change in the DSO's costs and revenues above. Revenues shall be treated as positive numbers and costs treated as negative numbers; and
  - 4.6     A calculation of whether the financial impact is expected to be greater than the Materiality Threshold multiplied by the revenues received by the DSO (in the year before the Extraordinary Event) multiplied by the number of years between the date of the Extraordinary Event and the end of the Regulatory Period. The Materiality Threshold shall be a fixed percentage determined at Periodic Reviews; and
- 5     If the DSO determines that the financial impact is greater than the Materiality Threshold, it shall include in its Statement of Financial Impact a proposed Extraordinary Adjustment to Maximum Allowed Revenues. The proposed Extraordinary Adjustment shall meet the following conditions:
  - 5.1     The Extraordinary Adjustment shall change Maximum Allowed Revenues in such a manner that the Net Present Value of the forecast change is equal (but opposite sign) to the Net Present Value of the financial impact of the Extraordinary Event, using the Weighted Average Cost of Capital as the discount rate;
  - 5.2     The timing and structure of the Extraordinary Adjustment shall, where possible, reduce the tariff shock to customers (for example by smoothing the effect of the Extraordinary Adjustment over a number of years).
- 6     The Regulator may also launch an Extraordinary Review without the request of the DSO. If so, the Regulator shall notify the DSO and include a description of the Extraordinary Event

and a summary its expected impact. The DSO shall then prepare a Statement of Financial Impact as per the process described above.

- 7 The Regulator may reasonably require the DSO to further explain its method of calculating the Statement of Financial Impact and Extraordinary Adjustment, and if so required, the DSO shall promptly provide to the Regulator any further information or explanations sought.
- 8 The Regulator shall advise the DSO within [20 Business Days] of receiving the Statement of Financial Impact whether or not it approves the DSO's proposed Extraordinary Adjustment. The Regulator shall approve the proposal if it:
  - 8.1 Meets the conditions provided above;
  - 8.2 Is calculated correctly; and
  - 8.3 Takes into account all material information reasonably available at the time.
- 9 If the Regulator approves the proposed Extraordinary Adjustment, the new Maximum Allowed Revenues shall become effective immediately.
- 10 If the Regulator does not approve the proposed Extraordinary Adjustment, it shall provide reasons and evidence why, in accordance with this Rule. Maximum Allowed Revenues shall not be adjusted until the Regulator approves a proposal.
- 11 If the Regulator does not advise the DSO within the required period (above), approval is assumed and the proposed Extraordinary Adjustment shall become effective immediately.
- 12 The DSO may dispute or appeal any decision by the Regulator in accordance with applicable legislation.

## **SCHEDULE 8     EXTRAORDINARY EVENTS**

- 1     An Extraordinary Event shall be the occurrence of any one of the following:
  - 1.1     Any change in the tax rate applicable to the DSO that is greater than 3% and shall not be fully recovered through Regular Adjustments;
  - 1.2     Any force majeure events as defined in Schedule 9;
  - 1.3     Any other event, which meets all of the following conditions:
    - (i)     Was not reasonably foreseeable;
    - (ii)     Was not reasonably under the control of the DSO;
    - (iii)     The DSO was not required or reasonably expected to provide against;
    - (iv)     Shall not be fully recovered through Regular Adjustments; and
    - (v)     Shall significantly change the revenues and/or costs of the DSO over any 12 month period, such that it seems reasonable that the Materiality Threshold (described in Schedule 7) may be breached.
  
- 2     The occurrence of an Extraordinary Event is sufficient to trigger an Extraordinary Review, however as described in Schedule 7, the event must still breach the Materiality Threshold before Maximum Allowed Revenues shall be adjusted.

## **SCHEDULE 9    FORCE MAJEURE EVENTS**

- 1     A force majeure event shall be an exceptional event or circumstance which is all of the following:
  - 1.1     Is beyond the DSO's control;
  - 1.2     The DSO could not reasonably have provided against;
  - 1.3     Having arisen the DSO could not reasonably have avoided or overcome; and
  - 1.4     Is not substantially attributable to the DSO.
  
- 2     A force majeure event may include, but is not limited to, exceptional events or circumstances of the kind listed below, so long as the conditions above are satisfied:
  - 2.1     War, hostilities (whether war be declared or not), invasion, act of foreign enemies;
  - 2.2     Rebellion, terrorism, sabotage by persons other than the DSO's employees, contractors or subcontractors, revolution, insurrection, military or usurped power, or civil war;
  - 2.3     Riot, commotion, disorder, strike or lockout by persons other than the party's employees, contractors or subcontractors;
  - 2.4     Munitions of war, explosive materials, ionising radiation or contamination by radio-activity, except as may be attributable to the party's use of such munitions, explosives, radiation or radio-activity; and
  - 2.5     Natural catastrophes such as earthquake, tsunami, typhoon or volcanic activity.

## **SCHEDULE 10    TRANSITIONAL PROVISIONS**

- 1     The Transitional Period is from 1 April 2012 until 31 March 2013.
- 2     The first Regulatory Period shall be [1 year].
- 3     The Regulator shall define the opening Regulatory Asset Base (as at 1 April 2012) prior to the start of the first Regulatory Period.
- 4     During the Transitional Period the DSO shall submit its Proposal no later than [three months] prior to the end of the current Regulatory Period, and the Regulator shall make its Final Decision no later than [10 Business Days] prior.