



Pristina, 16 November 2022

ERO Code: V\_1635\_2022

The Board of Energy Regulatory Office,

Based on:

- Provisions of Article 9, paragraph 1, sub-paragraph 1.7, Article 15, paragraph 1, sub-paragraph 1.5, Article 26, paragraph 1, sub-paragraph 1.2, Article 46, paragraph 1, sub-paragraph 1.1
- Provisions of Article 16, paragraph 1, Article 28, paragraph 1 of the Law on Electricity (Law No. 05/L-085);
- Provisions of Article 18, paragraph 1 of the Law on Energy (Law No. 05/L-081);
- Provisions of Article 4, Article 5, Article 8, Article 9, Article 17 and Article 19 of Rule No. 03/2017 on Determination of Maximum Allowed Revenues of Transmission System and Market Operator (TSO/MO);
- Provisions of Article 4, Article 5, Article 8, Article 9 and Article 16 of Rule No. 05/2017 on Determination of Maximum Allowed Revenues of Distribution System Operator (DSO);
- Proposal on Input Values – Efficiency Factor, received by KOSTT JSC, on 27 July 2022; and
- Proposal on Input Values – Efficiency Factor, received by KEDS JSC, on 29 July 2022, within the Third Periodic Review for the Regulatory Period 2023-2027,

in the session held on 16 November 2022 issued the following:

## DECISION

- I. **APPROVAL** – Input Value, Efficiency Factor for the Transmission System Operator, System Operator and Market Operator (TSO/MO) as well as Distribution System Operator (DSO) for the Third Regulatory Period (PRR3) 01 April 2023 – 31 March 2028, as in the following table:

<i>Input Values- Efficiency Factor</i>	<i>Unit</i>	<i>2023</i>	<i>2024</i>	<i>2025</i>	<i>2026</i>	<i>2027</i>
<b>TSO/MO- KOSTT</b>	%	1.5	1.5	1.5	1.5	1.5
<b>DSO- KEDS</b>	%	1.5	1.5	1.5	1.5	1.5

*Input values – efficiency factor determined for TSO/MO and DSO*

- II. The Transmission System Operator, System Operator and Market Operator (TSO/MO) as well as the Distribution System Operator (DSO) are **OBLIGED** to implement this decision for the Third Regulatory Period April 2023- March 2028.

## REASONING

- Energy Regulatory Office (ERO), on 26.05.2022 initiated the Periodic Review Process for the Third Regulatory Period (PRR3) to determine the Maximum Allowed Revenues (hereinafter MAR) of the licensees TSO/MO and DSO, for the period 1 April 2023 until 31 March 2027.



- ERO has announced that in this periodic review process it will review the input values that will be used to determine the MAR.
- ERO, on 27 July 2022, received from the Transmission System Operator the proposal for the Efficiency Factor within the Third Periodic Review for the Regulatory Period 2023-2027.
- ERO, on 29 July 2022, received from the Distribution System Operator the proposal for the Efficiency Factor within the Third Periodic Review for the Regulatory Period 2023-2027.
- ERO, on 13 September 2022, published the Consultation Report - Efficiency Factor for TSO/MO and DSO.
- ERO, through the Consultation Report, has reflected the expected rate of efficiency improvements in the operating costs of TSO/MO and DSO, and the savings sharing factor that is applied to savings that exceed the efficiency factor, whereas it has proposed that the efficiency factor should be of the value of 1.5% - 2% per year for operating expenses (OPEX) controllable for KOSTT (TSO/MO) and KEDS (DSO) for PRR3.
- ERO has proposed in the Consultation Report that the savings sharing factor for savings that exceed the efficiency factor for maintenance and repair costs will be shared between the licensee and the customers according to the 50/50 factor. In case of expenses that exceed the allowed level, they will be covered by the licensees in accordance with the Rules on Revenues.
- ERO, within the public consultation period for the Efficiency Factor for the Transmission System Operator, System Operator and Market Operator as well as the Distribution System Operator, has received comments from stakeholders which were presented in the Final Report.
- ERO, on 07 November 2022 - has published the Final Report - Efficiency Factor and Responses to the comments, submitted by stakeholders, in relation to the Consultation Report.
- The TSO/MO and as well as the DSO have provided detailed responses on the proposal for Efficiency Factor, proposed by ERO.
- The TSO/MO proposed that the efficiency factor should be set to zero, presenting the following justifications: ERO would have to specifically include five of the issues raised by KOSTT in their report of 29 July 2022; The Efficiency Factor level has been arbitrarily set at 1.5% in previous tariff reviews using a methodology designed primarily for highly developed countries; KOSTT points out that as a state-owned company it does not have enough flexibility to manage costs, such as the number and salary of workers, price negotiation with suppliers, etc.; and cash constraints have impacted KOSTT in the past, resulting in the postponement or cancellation of maintenance projects.
- ERO emphasizes that in the absence of compatible standardized calculations, ERO, based on the data reported by the licensees in the previous period, evaluates that companies operate at frontier or near frontier levels.
- ERO evaluates that KOSTT is a state operator, has a level of independence in the organization and employment of staff. In addition, KOSTT is also able to increase procurement efficiency by



staying in line with state guidelines on procurement practices to ensure higher competition from suppliers.

- ERO evaluates that companies operating in a monopolistic market, and especially state-owned companies, are not exposed to the pressures of competitive markets. Therefore, it believes that the effects of competitive markets towards increasing efficiency should be simulated through the Efficiency Factor.
- DSO in its comments emphasized that it does not agree with ERO's proposals on the Efficiency Factor and proposes not to apply the efficiency factor, presenting its arguments as follows: DSO has reduced operative expenses in the first regulatory period by 11% cumulatively, while in the second regulatory period by another 8% reducing to zero the possibility of additional efficiency for the following years. There has been an average annual increase of 4% in active customers, which corresponds with the share of increase of customers per head of workers. DSO has increased efficiency by maximizing work per head of worker and minimizing the cost of service and inflation which in August 2022 in the EU area reached 9.1% compared to July 2022 of 8.9% which gives signals of continued price increases. When determining efficiency factors in operating expenses, the regulator must take into account current costs, economic expectations of prices in order to ensure the financial stability of the company in terms of cash.
- ERO evaluates that due to the lack of compatible standardized calculations, ERO based on the data reported by the licensee in the previous realized period evaluates that the companies operate at frontier or near frontier levels. ERO has already evaluated that DSO operates at levels close to the frontier and has admitted that it has reduced operating expenses by about 1.6% per year for the second regulatory period. Therefore, the efficiency factor of 1.5-2% is based on the displacement of the frontier, the value of which is determined based on the judgment of experts and based on the efficiency factors established by other regulators. The frontier shift assumes that although companies have reached the peak of their efficiency in previous years, due to economies of scale, new innovations and new technologies, companies can further increase their efficiency.
- ERO has made it known that it does not apply "Myopic Behaviour" to licensees when they give results in the short term, but may have a negative impact in the future (e.g.: reduction of staff expenses, reduction of new product & service development, purchase of cheap materials of lower quality so that the company does not exceed its budget) etc.
- ERO evaluates that the increase in the price of goods and services, as well as the effect of inflation, are handled by adjusting the basic OPEX for the annual HICP (Harmonized Indices of Consumer Prices) and do not affect the efficiency factor. Therefore, the comments of KEDS have not resulted in a change from the initial proposal of ERO.
- Based on the provided responses, the final proposal of ERO remains that an Efficiency Factor for OPEX of 1.5% per year should be applied for the Transmission System Operator, the Market Operator (TSO/MO) as well as the Distribution System Operator (DSO) during PRR3. This is in accordance with the scope for efficiency factors based on regulatory decisions in the region and is supported by a comparison with the regional performance of network operators.



- ERO, in the final proposal, following the review of comments has decided that the savings sharing factor for savings that exceed the efficiency factor for repair and maintenance costs will be shared between the licensee and customers according to the 50/50 factor. In case of expenses that exceed the allowed level, they will be covered by the licensees in accordance with the applicable Rules on Revenues.
- ERO Board, following the evaluation and analysis of relevant reports and following the review of comments received by parties, based on the legal provisions mentioned in the introductory section of this Decision, has decided as in the enacting clause to this Decision.

**III.** The decision is issued and published in the official languages of the Republic of Kosovo.

**IV.** The decision shall enter into force on the date of approval by the ERO Board and will be published on the official website of ERO.

**Legal advice:** The party dissatisfied with this decision may initiate an administrative conflict at the competent court within thirty (30) days from the date of the receipt of the decision or the date of its publication on ERO's website, whichever occurs last.

**ERO Board:**

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Ymer Fejzullahu, Chairman

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Selman Hoti, Member

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Izet Rushiti, Member

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Lutfije Dervishi, Member

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Gani Buçaj, Member

**This decision is sent to:**

- (KOSTT JSC.),
- (KEDS JSC.), and
- ERO Archive