

MANAGEMENT OF THE ELECTRICITY SECTOR

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No VAE-6

SUMMARY

Relevance of the audit

The electricity sector covers the generation, transmission, distribution, supply, consumption and trade of electricity. Electricity costs represent a significant part of industrial costs and household budgets. In order to ensure competition in the energy market, more choice and lower prices for consumers, in 2020, Lithuania joined the ranks of EU countries where household consumers have to choose an independent electricity supplier. In the implementation of the Paris Agreement of the European Union and the United Nations of 12 December 2015, Lithuania has pursued market integration, increased energy efficiency, development of renewable energy production and reduction of the dependence of the energy sector on fossil fuels¹. In order to ensure energy security, the aim is to synchronise with the electricity system of the Continental Europe. The electricity transmission and distribution network ensures access to electricity for consumers. Lithuania's total annual electricity consumption was 13.4 TWh in 2022. The country produces 35.8% (4.8 TWh)² of the electricity demand.

Objective and scope of the audit

The objective of the audit is to assess whether the electricity sector is managed in the public interest.

Key audit questions:

- ✓ whether sufficient renewable sources of electricity generation have been developed;

¹ National Energy Independence Strategy, p. 1.1.

² Data of the National Data Agency. Online access: <https://osp.stat.gov.lt/statistiniu-rodikliu-analize?indicator=S1R109#/> (accessed on 31 August 2023).

- ✓ whether the synchronisation of electricity grids with continental Europe is being properly implemented;
- ✓ whether stable operation of electricity transmission and distribution system infrastructure has been ensured;
- ✓ whether the liberalisation of the Lithuanian electricity market safeguards the public interest.

Audited entities:

- ✓ Ministry of Energy, as it develops state policy in the electricity sector and organises, coordinates and monitors its implementation;
- ✓ National Energy Regulatory Council, as it performs the functions of state regulation of activities in the electricity sector by ensuring supervision and control over the performance of regulated energy activities and the proper implementation of the rights and obligations of electricity companies and consumers;
- ✓ AB Litgrid, as it is the operator of the electricity transmission system, responsible for the safety, stability and reliability of the operation of the electricity system, balancing in the territory of the Republic of Lithuania, and the operation, maintenance, management and development of the interconnectors with the electricity systems of other countries;
- ✓ AB Energijos skirstymo operatorius (hereinafter – AB ESO), as it is the distribution network operator responsible for the distribution networks it owns, from the point of connection of transmission network facilities to the point of connection of consumers, producers or energy storage facilities, and for the safety and reliability of those networks, operation, maintenance, management and development in accordance with the long-term needs of the users of the distribution networks, as well as for the transmission of electricity to consumers through the distribution networks, the quality of the electricity transmitted, the metering of the electricity transmitted and the installation of metering devices.

During the audit, we collected information and cooperated with the Lithuanian Energy Agency and the Ministry of Environment.

The audited period was 2018-2022. In order to assess trends and developments, we used data from previous years and the first half of 2023 in some cases.

The audit was carried out in accordance with international standards for supreme audit institutions. The scope of the audit and the methods applied are described in more detail in Annex 2 "Audit scope and methods" (page 42).

Key audit findings

The public interest would be better served if the development of electricity generation from renewable energy sources was faster, all actions provided for in the synchronisation plan were implemented by 2025 at the latest, and electricity infrastructure development projects were implemented on time.

1. Insufficient development of electricity generation from renewable energy sources

- ✓ The National Energy Independence Strategy foresees an increase in the development of electricity generation from renewable energy sources. In 2020, the plan was for the share of electricity from renewable energy sources in final electricity consumption to reach 30%. The 30% foreseen in the NEIS for 2020-2022 was not reached (it was 20.2%; 20.9% and 25.5%, respectively³). This was due to the untapped potential for onshore and offshore renewable energy development, a low share of the population participating in the electricity market⁴, and the disruption of the supply chain of renewable energy technologies due to COVID19⁵. In 2022, the development of electricity generation from renewable energy sources was accelerated, with the installed capacity of wind and solar power plants increasing by 52% and 124% per year, respectively. However, there were also factors holding back development in 2022: the imposition of a cap on the total gross installed capacity of solar PV power plants, without any provision on the principles of power allocation and further development and delayed granting of permits for the commercial development of solar PV power generation capacity for more than half a year. This prevented the installation of commercial solar PV power plants and delayed their launch. Without sufficient competitive self-generation capacity, we remain dependent on imported electricity (Section 1, page 13).
- ✓ Further expansion of electricity generation from renewable energy sources is planned in the future⁶, but the Law on Renewable Energy Sources and the planning documents for 2030 provide for different targets. The planning documents include measures to reach the target of 45% and 50% renewables in final electricity consumption, while the law provides for an even more ambitious target of 70%. Without a harmonised target and a review of the measures to achieve it, the targeted development of electricity generation from renewable sources will not be ensured (Section 1, page 13).

2. The roadmap of actions and measures for the 2025 synchronisation project will not be fully implemented as planned

- ✓ In order to interconnect the Lithuanian electricity system with the continental European grids in 2025, the actions set out in the Synchronisation Action and Measures Plan must be implemented within the deadlines set. By the end of 2022, 10.5% (2 out of 19) of the actions planned to be implemented had not been completed and there is a risk of delays in 16.7% (3 out of 18) of the actions planned for completion by the end of 2025. The *Harmony Link* to Poland will be completed in 2027-2028 at the earliest. Delays in the delivery of equipment and longer than planned procurement procedures have delayed the implementation of the actions (Section 2, page 19).
- ✓ In 2023, a decision was taken to split projects between those enhancing system security and those ensuring system stability and integration with the EU's internal

³ Share of renewable energy in consumption. Online access: [Indicator data database. Official Statistics Portal](#) (accessed on 28 August 2023).

⁴ Energy Development Programme of the Ministry of Energy of the Republic of Lithuania, the manager of the Development Programme 2021-2030, approved by Resolution No 1064 of the Government of 8 December 2021, Problem 6.

⁵ Letter No 3-1477 of the Ministry of Energy of 6 October 2023 "On the Draft Public Audit Report "Governance of the Electricity Sector".

⁶ On 31 December 2022, the installed capacity of wind and solar power plants was 1.5 GW, while Litgrid AB forecasts 3.3 GW by the end of 2024.

electricity market. The security projects are to be implemented by the end of 2024, while the other projects are to be implemented after synchronisation. This removes the obligation to implement all projects by the end of 2025. Failure to implement the actions to ensure system stability and integration with the EU internal electricity market by the end of 2025 will result in lower than planned transmission network capacity (Section 2, page 19).

3. Greater attention should be paid to the state of infrastructure and the quality of the services provided

- ✓ On average, a quarter of the tangible fixed assets used in electricity transmission and distribution activities exceeded their useful life in 2018 – 2022. Since 2018, depreciated electricity transmission infrastructure has decreased by 10 percentage points and electricity distribution infrastructure has increased by 3 percentage points. Assets are renewed depending on the financial capacity of the operators: with limited resources, the investment line is drawn up and decisions to invest in the renewal of assets are taken not only on the basis of the lifetime of the assets but also on the condition of the assets, their importance for the system, the cost-effectiveness of the reconstruction and other criteria. The operation of electricity infrastructure that has reached the end of its useful life increases the likelihood of defects and failures and maintenance costs (Section 3, page 22).
- ✓ 37.5% of the planned projects for the rehabilitation and construction of the electricity transmission system and 61.5% of the distribution network infrastructure were delayed. The average delay in the implementation of electricity transmission projects was 203 calendar days and 149 calendar days for distribution network projects. The main reasons for the delays were delayed supply of materials and equipment, shortage of human and financial resources of contractors, changes in design solutions, natural conditions, and limited possibilities to disconnect the network without compromising network reliability. Failure to implement projects within the deadlines set will result in delayed development or upgrading of the transmission system or distribution network infrastructure (Section 3, page 22).
- ✓ Having conducted an assessment, the National Energy Regulatory Council found that the return on investment of the distribution network operator AB ESO for the 2018–2021 period was EUR 160.2 million higher than the amount set by the NERC due to lower investments in depreciated assets than the expected need. Returning a part of this amount to consumers – EUR 6.4 million – is planned in equal instalments over the 2022–2026 period, while the rest – EUR 153.8 million or 96% of the estimated amount – is planned to be returned in 2032–2036. The repayment has been postponed in order to maintain a sustainable level of the operator's arrears, the necessary investments in the distribution network and the maintenance of a sufficient level of service to consumers. In 2018 – 2021, one consumer overpaid an average of €88.8 for distribution services, but the plan is to fully repay the overpayment to consumers after 15 years only⁷. The NERC can postpone the repayment of overpayments for up to 3 regulatory periods (up to 15 years), but there are no criteria as to when repayment should be made in the first period and when in the subsequent periods. The absence of clear criteria for when consumer overpayments are to be refunded in one or several

⁷ The distribution operator pays annual interest on the amount overpaid by consumers and not refunded.

regulatory periods does not provide legal clarity and certainty and may result in a maximum postponement of the refund of consumer overpayments each time (Section 3, page 22).

4. Liberalisation of the electricity market could have better helped to ensure consumers' interests

- ✓ The State has extended the deadline for Phase II of electricity market liberalisation by half a year (from 31 December 2021 to 30 June 2022). The extension was granted on the grounds that household consumers have not been sufficiently active in choosing independent suppliers to avoid price increases and to give consumers more time to make up their minds and to assess suppliers' offers. This did not encourage consumers to choose independent electricity suppliers. In the first half of 2022, electricity prices on the power exchange increased by 71%. Around 44% (326.1 out of 739.4 thousand) of consumers who took advantage of the State's opportunity to take their time in choosing independent electricity suppliers concluded electricity sales and purchase contracts on the power exchange at a higher electricity price than they could have done if they had made their decision before 31 December 2021 (Section 4, page 30).
- ✓ In the second half of 2022 and the first half of 2023, consumers were partially compensated for electricity costs. Under the compensation scheme, independent suppliers had to reduce bills to consumers by a set compensation amount, and the State had to reimburse this amount to suppliers. From 2023 onwards, the principles for the calculation of a compensation were detailed: the decision on the payment of compensation and the amount of the compensation is taken on the basis of the supplier's actual cost of purchasing electricity in the reporting month⁸, the cost of the regulated electricity price components, the operating costs of supplying to household consumers and the profit margin that meets the criterion of reasonableness. The concept of a reasonable profit margin is not defined in legislation. Without a definition of how the reasonable profit margin is determined, the procedure for calculating compensation is not clear and transparent and it is difficult for the supervisory authority to assess the reasonableness of the funds paid out (Section 4, page 30).
- ✓ During the period from 2018 to 2023, there were no requirements to ascertain the ability of an electricity supplier to meet its obligations to customers. Supervision of independent electricity suppliers did not include an assessment of financial capacity. When Perlas Energija UAB ceased its operations on 1 September 2022, 17.6% of its customers who did not choose another supplier were placed on a guaranteed supply at a price 3 times higher than the price of public supply. The State decided to partially compensate these customers for their costs. The compensation amounted to EUR 4.2 million. The National Energy Regulatory Council has appealed to the court to order UAB Perlas Energija to repay the funds allocated for compensation to the State budget. The absence of requirements to assess the financial capacity of suppliers, as well as the absence of an obligation to have a guarantor to secure obligations, does not ensure that suppliers are able to fulfil the obligations assumed. Changes made during the audit: Amendments to legislation - since 1 March 2023 additional requirements for

⁸ Including electricity exchange fees, the cost of imbalances in the electricity market, the reasonable result of using electricity market derivatives, and the interest required to use these measures.

persons seeking to get a permit to engage in the activity of independent electricity supply were introduced (Section 4, page 30).

Recommendations

To the Ministry of Energy

1. In order to ensure the development of renewable energy sources, the objectives for the development of renewable energy set in different documents need to be coordinated, and the measures to achieve these objectives must be selected and adopted (Key Audit Finding 1).
2. In order to ensure full integration of the Lithuanian electricity system with the continental European grids by implementing all the actions foreseen in the Synchronisation Action and Measures Plan to enhance energy security (Key audit Finding 2).

To AB Litgrid

3. In order to speed up the implementation of electricity transmission infrastructure projects, to improve the process of risk management of project implementation so that these projects are implemented within the planned timeframes (Key Audit Finding 3).

To AB ESO

For more reliable electricity distribution:

4. To upgrade key elements of the electricity distribution infrastructure network faster (Key Audit Finding 3).
5. To reduce the average duration and frequency of long electricity distribution outages (Key Audit Finding 3).
6. To improve the risk management process for the implementation of infrastructure projects to ensure that they are implemented within the planned timeframe (Key Audit Finding 3).

To the National Energy Regulatory Council

7. In order to ensure consumer interests, to establish criteria for assessing the timeframe within which consumer overpayments would be repaid (Key Audit Finding 3).
8. In order to ensure efficient use of the State budget, to make sure that the amount designated for a partial compensation of the consumed electricity is justified (Key Audit Finding 4).

The measures and timeframes for implementing the recommendations, the expected impact of the audit and the indicators for assessing change are set out in the Section “Plan for the implementation of recommendations” of the report (p. 36). Up-to-date

information on the status of the implementation of the recommendations, results and developments is published in open data on the website of the National Audit Office at <https://www.valstybeskontrole.lt/LT/AtviriDuomenys>.