

The 2004 Report  
on the Activities and Finances  
of the Energy Regulatory Office



<b>Foreword by the Chairman</b>	
<b>Looking back over 2004</b> .....	3
<b>1 Introduction</b> .....	7
1.1 The ERO's position .....	7
1.2 Main tasks in 2004 .....	7
1.3 Organisation and management .....	7
1.3.1 Organisational structure as at 31 December 2004 .....	8
1.3.2 The Chairman's Advisory Corps and its activities .....	8
<b>2 Changes in the legislative framework for regulation in the energy industries</b> .....	11
2.1 Legislation of the European Communities .....	11
2.2 Co-operation in the drafting of the amendment to the Energy Act .....	11
2.3 Co-operation in the drafting of the bill on support for the use of renewable energy sources .....	12
2.4 Secondary legislation .....	12
<b>3 The regulatory framework</b> .....	15
3.1 The results of the first regulatory period and the concept of the second regulatory period .....	15
3.1.1 The first regulatory period .....	15
3.1.2 General approach to the conditions for the second regulatory period .....	15
3.2 The electricity industry .....	16
3.2.1 Electricity market rules .....	16
3.2.2 Pricing .....	17
3.2.3 Price Decisions, an outline .....	21
3.3 The gas industry .....	22
3.3.1 Gas market rules .....	22
3.3.2 Pricing .....	23
3.3.3 Price Decisions, an outline .....	26
3.4 The heat supply industry .....	26
3.4.1 Price control .....	26
3.4.2 Assessment of thermal energy price control in 2004 .....	27
3.4.3 Development of thermal energy prices .....	27
3.4.4 Thermal energy price control prepared in 2004 for the following period .....	30
3.5 Price decisions issued in 2004 .....	30
<b>4 Licences in energy</b> .....	33
4.1 The licensing policy .....	33
4.2 The Energy Regulation Fund .....	33
4.3 Recognition of professional qualifications .....	34
<b>5 Administrative proceedings and dispute settlement in 2004</b> .....	37
5.1 Major administrative proceedings .....	37
5.1.1 The electricity industry .....	37
5.1.2 The gas industry .....	37
5.1.3 The heat supply industry .....	37
5.2 Major disputes over prices and contracts in 2004 .....	38
5.2.1 The electricity industry .....	38
5.2.2 The gas industry .....	38
5.2.3 The heat supply industry .....	38
5.3 Remonstrance proceedings; remonstrance commission's activities .....	39
5.3.1 The electricity industry .....	39
5.3.2 The gas industry .....	39
5.3.3 The heat supply industry .....	39
5.3.4 Licensing .....	39
5.4 Complaints .....	39
<b>6 Co-operation with state administration authorities and Czech Parliament</b> .....	43
6.1 The Government and central state administration authorities .....	43
6.2 Co-operation with Czech Parliament .....	43
6.3 Reform and modernisation of central state administration .....	43

<b>7</b>	<b>International co-operation</b> .....	47
7.1	European Union .....	47
7.2	Council of European Energy Regulators (CEER) .....	47
7.3	European Regulators Group for Electricity and Gas (ERGEG) .....	48
7.4	Energy Regulators Regional Association (ERRA) .....	48
7.5	Organisation for Economic Co-operation and Development (OECD) .....	48
7.6	International Energy Agency (IEA) .....	48
7.7	European Bank for Reconstruction and Development (EBRD) .....	49
7.8	Trips to other countries .....	49
<b>8</b>	<b>Information provision by the ERO</b> .....	53
8.1	Public relations .....	53
8.2	Communication with regulated and other entities .....	53
8.3	Publications .....	54
<b>9</b>	<b>ERO budget management</b> .....	57
9.1	The Chapter's budget .....	57
9.2	Revenues to the Chapter .....	57
9.3	Meeting the mandatory targets .....	57
9.4	Cash Funds .....	58
9.5	The Energy Regulation Fund .....	58
9.6	Phare .....	58
9.7	Budget management results .....	59
9.7.1	Operating expenditure savings .....	59
9.7.2	Programme financing .....	60
9.7.3	Outlays on business trips abroad .....	61
9.8	Improving the internal information system .....	61
<b>10</b>	<b>Internal reviews</b> .....	65
<b>11</b>	<b>Human resource management</b> .....	69
11.1	Personnel management agenda .....	69
11.2	Professional development .....	70
<b>12</b>	<b>Conclusion</b> .....	73
<b>Appendix 1</b>	.....	75
<b>Appendix 2</b>	.....	77



In this annual report, the Energy Regulatory Office is looking back over the fourth year of its activities. I am pleased to be able to note great progress in the quality and quantity of the work the Office has accomplished since its establishment in 2001 for the sake of the reliable functioning of the energy sector, and in providing a level playing field for businesses wishing to enter the market and ensuring the stability of energy supplies to the final customers for reasonable prices.

The evolution of the energy markets in Europe and the requirements for their further liberalisation are generating new demands relating to improvements in the organisation of the internal electricity and gas markets and a better definition of the legislative framework, including the regulatory authorities' position and rights and obligations.

On 1 May 2004, the day of the Czech Republic's accession to the European Union, the European Communities' directives and regulations setting out common rules for the internal electricity and gas markets became directly applicable in the Czech Republic too. It was therefore necessary for the ERO to focus some of its activities, from as early as 2003, on the primary legislation, the Energy Act, which

defines the environment for conducting business in the energy industries and lays down the conditions for regulation in the energy sector, so as to comply with the *acquis communautaire*. This effort, coordinated by the Ministry of Industry and Trade, culminated in 2004.

In connection with the development of the primary legislation for the energy sector there was a need to draft many new, or amend many of the existing, public notices; in terms of their importance and extent, these are indispensable for most of the energy market participants.

In co-operation with the Czech Gas Union and in consultation with the gas market participants, the ERO drafted and issued a public notice which had been missing - on the rules of the gas market organisation, which became one of the key prerequisites for launching the first stage of the gas market opening.

Talking about secondary legislation in the electricity and gas industries, I have to emphasise that the year 2004 brought about a profound change for both the ERO and the regulated entities. The end of 2004 marked the end of the first regulatory period, the rules of which had been formulated simultaneously with the establishment of the ERO. Contrary to the previous method of regulation, based on the cost-plus principle, the regulation model for the first three-year regulatory period relied on incentivising utilities to improve their efficiencies. In 2004 the Energy Regulatory Office therefore analysed the results of the price control of the various companies' deliveries and services in the first regulatory period. This assessment of the working of the regulatory mechanisms in the past period served as the baseline for adjusting the price control parameters for the second regulatory period.

Following consultations with the energy utilities, the regulation rules and procedures for the second regulatory period were incorporated into the amendment to the "regulatory" public notice, and constitute a stable legal framework for all electricity market players until 2009.

At this point, the support for the use of renewable energy sources should be mentioned. The Energy Regulatory Office took part in the drafting of a new bill on support for the use of renewable energy sources for electricity generation, and analysed the impacts of the support granted to these sources on the prices to final customers; it presented this analysis to the committees of Czech Parliament's House of Deputies and Senate.

International co-operation is a major priority for the Energy Regulatory Office. The Czech Republic's accession to the European Union has precipitated a more extensive involvement of the Office in many activities. A marked expansion can be observed in the Office's co-operation with the European Communities' technical bodies, in particular the European Commission's Directorate General for Energy and Transport. The progress achieved in this, formerly neglected co-operation has brought about great benefits for all the stakeholders in the drafting of common positions and policy papers. With the Czech Republic's accession to the European Union the Energy Regulatory Office became a fully-fledged member of the CEER. This makes it possible for us to directly cooperate with the other member states'

regulators and coordinate our procedure in the implementation and application of the EC *acquis*, and share our experience in the regulatory practice. Together with the ERO's membership of the ERGEG, an advisory body of the European Commission, the first-hand participation of the Office's representatives in these institutions is bringing the first concrete results in the Office's everyday work.

In 2004 the Energy Regulatory Office continued to carry out its tasks related to the award, changes and revocation of the licences for conducting business in the energy industries. Unlike the previous years, the Office's work was mainly geared towards modifications to the existing licences, prompted by the process of the electricity and gas market opening, and review of compliance with licence conditions.

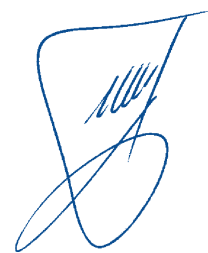
It is to be noted that not all that had been planned was accomplished in 2004. There was a need to change the ERO's information system, and the Office therefore announced a call for tenders for the supply of a new information system. However, the tenders delivered to the ERO differed greatly, and were incomparable for all practical purposes, and therefore this public tendering process had to be cancelled. The ERO is facing this task in 2005. Implementing the concept of the ERO's information system as soon as possible is a prerequisite for improving the regulatory process and intensifying the relationships with the regulated entities.

The year 2004 saw a continued optimisation of the assignment of the ERO staff between its head office in Jihlava and its Prague office. The required organisational changes reflected this. This process has been completed, and I am convinced that the preconditions have been created for the ERO's effective operation under the existing circumstances.

Looking back at the past year I can say that 2004 was successful and that for all practical purposes, the Energy Regulatory Office met its demanding tasks. At the same time, the Office's planned costs were not exceeded.

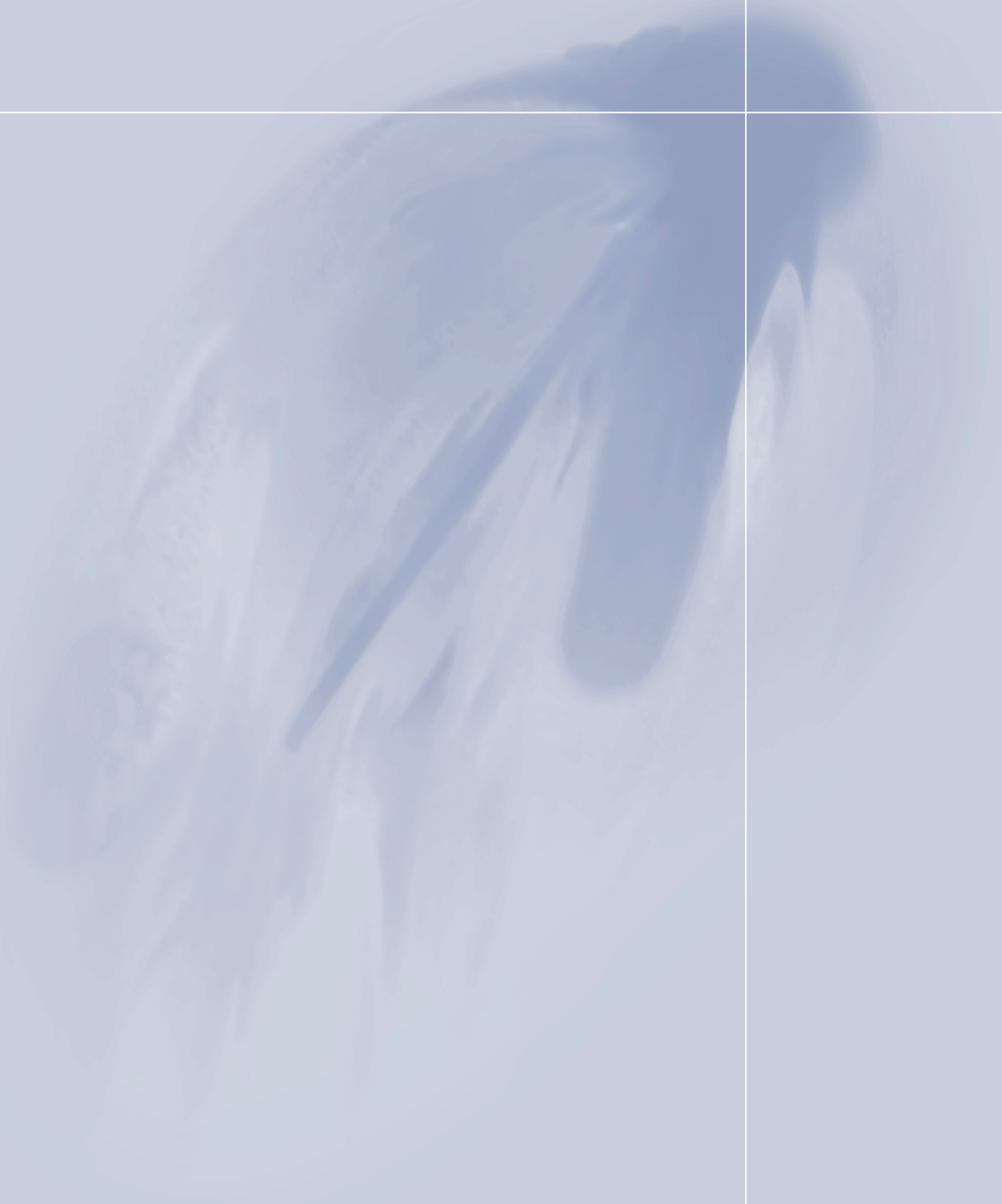
I would like to express my thanks to all who participated in tackling these tasks, be they members of the various task forces, composed mostly of external specialists, or the ERO staff members themselves.

I am convinced that the Office's achievements in the first years of its regulatory practice as well as the strategic objectives set for the second regulatory period express a determination to form a clear regulatory environment accepted by all the energy market players, the ultimate effect of which will be the final customers' satisfaction.



**Josef Firt**

Chairman Energy Regulatory Office



Introduction





The Energy Regulatory Office (hereinafter also referred to as “ERO” or “the Office”) regulates the market to replace market mechanisms in the energy industries, in which competition is not feasible and a monopoly situation may be abused.

In the energy sector, the ERO creates the preconditions for the proper functioning of competition, protects consumer interests and those of licence holders, oversees the licence holders’ adherence to the conditions for business, and creates the preconditions for reliable supplies of electricity, gas and heat.

## 1.1 The ERO’s position

The Energy Regulatory Office was established as of 1 January 2001 in Act No. 458/2000, on the Conditions of Business and State Administration in the Energy Industries and Changes to Certain Laws, as amended (hereinafter referred to as “the Energy Act”), as an administration authority for regulation in the energy sector.

Under Section 2, subsection 1, point 10 of Act No. 2/1969, on the Establishment of Ministries and other Central State Administration Authorities of the Czech Republic, as amended, the ERO is “another central authority of state administration” with its own national budget title, no. 349.

## 1.2 Main tasks in 2004

### Legislation

In 2004 the Office focused mainly on improving the legislative framework from the perspective of the alignment of Czech law with the European Communities’ *acquis* in respect of the liberalisation of the electricity and gas markets on the single internal market and security of energy supplies. It carried out this task in co-operation with the proponent of the legislation, the Ministry of Industry and Trade of the Czech Republic, in respect of the drafting of a bill amending the Energy Act, a bill on support for electricity generation from renewable resources (law on support for the use of renewable energy resources) and the related implementing regulations that help to form the regulatory framework.

In secondary legislation, the Office met the requirements relating to the start of the gas market liberalisation on 1 January 2005 by issuing its public notice no. 673/2004, which lays down the rules for gas market organisation.

### The second regulatory period

In respect of the financial regulation of business, the year 2004 was an important milestone in the ERO’s activities. The Office analysed the meeting of the targets set for the first regulatory period and the efficiency of the regulation in the period from 2002 to 2004, and prepared the strategy, methodology and specific parameters for the second regulatory period (2005 to 2009) for the electricity, gas and heat supply industries.

### International relations

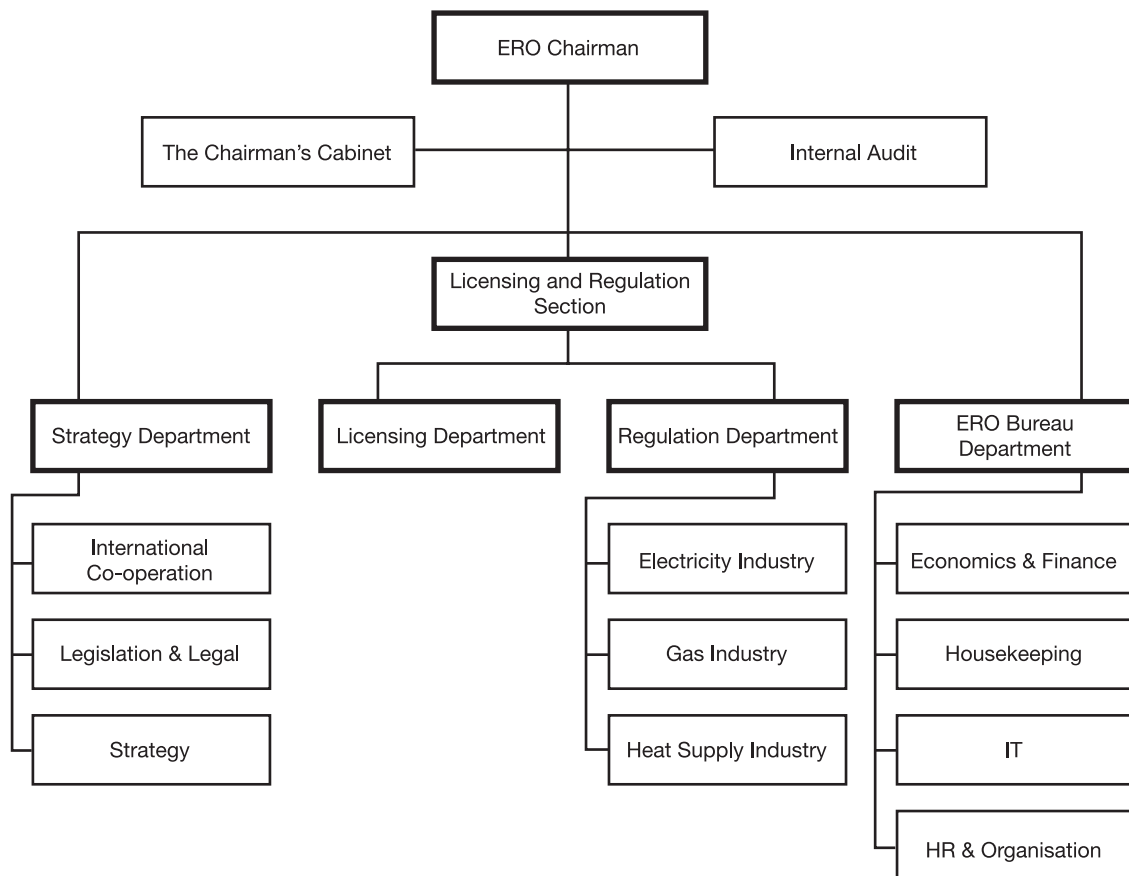
The Czech Republic’s accession to the European Union (EU) brought about the ERO’s more extensive involvement in co-operation with the Union’s technical bodies, primarily the CEER. The Office focused on promoting its international relations and communication with the EU’s bodies. This aim was supported by dispatching an ERO employee on a study visit to the CEER secretariat.

## 1.3 Organisation and management

In its Resolution No. 798 of 25 August 2004, the Government dismissed, with effect from 31 August 2004, Mr Pavel Brychta from the office of the ERO Chairman, and appointed Mr Josef Fiřt to this office with effect from 1 September 2004.

The Office’s activities and the broadening of its competencies resulted in an organisational change in the first half of 2004: by the ERO Chairman’s decision, the operations of the licensing department, up to then carried out in two locations (at the Jihlava head office, and at an office in Prague), were fully concentrated at the Jihlava head office.

### 1.3.1 Organisational structure as at 31 December 2004



Chairman

Vice-Chairman and Head of the Licensing and Regulation Section

Head of the Licensing Department

Head of the Regulation Department

Head of the Strategy Department

The ERO Bureau Department

Josef Fiřt

Blahoslav Němeček

Luděk Pražák

Stanislav Trávníček

Martina Veselá

Viktor Kirschner

### 1.3.2 The Chairman's Advisory Corps and its activities

The ERO Chairman's Advisory Corps, which was set up in April 2003 and is composed of experts delegated by governmental authorities, consumer and business associations, and trade unions, contributes significantly to the Chairman's objective decision-making, in particular as regards the strategic issues of regulation.


In 2004 the Advisory Corps held three meetings.

At its February meeting the Advisory Corps discussed mainly the proposed amendment to the Energy Act and the bill on support for the use of renewable energy sources from the perspective of the ERO's activities. The members of the Advisory Corps presented specific comments to help make the regulatory framework and the ERO's rights and obligations more precise and on the secondary legislation relating to both laws.

Besides discussing the forthcoming energy legislation, at its May meeting the Advisory Corps focused on the timetable and progress of the development of the regulatory conditions for the second regulatory period in the electricity industry, the gas industry, and the heat supply industry. Particularly the proposed transparent timetable of the regulatory process and the regulated companies' involvement in this process met with a positive response.

At the November meeting the Advisory Corps discussed the final version of the preparations for the second regulatory period and a brief for the 50th meeting of the Council for Economic and Social Consensus of the Czech Republic ("the tripartite council", hereinafter "RHSD"), *Causes of the Increase in Electricity, Gas and Heat Prices for 2005 to 2007 and Their Impact on Economic Growth*, which was, following discussion, recommended for submission to the RHSD.

# 2



Changes in the legislative framework  
for regulation in the energy industries



### 2.1 Legislation of the European Communities

The year 2004 saw additions to the legislation of the European Communities on the common rules for the internal electricity and gas markets, conditions for access to networks for cross-border electricity exchanges, support for cogeneration based on a useful heat demand in the single internal market, and measures for the security of natural gas supplies.

The legal regulations that set out the liberalisation of the energy sector in general include the following:

- a) Directive 2003/54/EC of the European Parliament and of the Council of 26 June 2003, concerning common rules for the internal market in electricity and repealing Directive 96/92/EC
- b) Directive 2003/55/EC of the European Parliament and of the Council of 26 June 2003, concerning common rules for the internal market in natural gas and repealing Directive 98/30/EC
- c) Directive 2001/77/EC of the European Parliament and of the Council of 27 September 2001 on the promotion of electricity produced from renewable energy sources in the internal electricity market
- d) Council Directive 2004/67/EC of 26 April 2004 concerning measures to safeguard security of natural gas supply;
- e) Directive 2004/8/EC of the European Parliament and of the Council of 11 February 2004 on the promotion of cogeneration based on a useful heat demand in the internal energy market and amending Directive 92/42/EEC;
- f) Regulation 1228/2003/EC of the European Parliament and of the Council of 26 June 2003 on conditions for access to the network for cross-border exchanges in electricity

The above documents mainly provide for the principles of non-discriminatory and transparent access to the transmission and distribution systems at fair prices; set out the requirements for the legal unbundling of the various activities in the supply chain to form independent businesses; provide for the setting up of regulatory authorities and the implementation of effective regulation, and for the protection of households and small businesses; and set out the new final dates for the electricity and gas market opening phases and the conditions for the use of electricity from renewable sources.

### 2.2 Co-operation in the drafting of the amendment to the Energy Act

The new requirements for the organisation of energy markets were the basis for drafting the amendment to Act No. 458/2000, on the Conditions of Business and State Administration in the Energy Industries and Changes to Certain Laws, as amended (hereinafter referred to as "the Energy Act"), as amended. The ERO contributed to the amendment bill in respect of the sections on the regulatory framework, thus cooperating with the proponents of the amendment bill, the Ministry of Industry and Trade.

A number of amending proposals, with recommendations for the final draft of the amendment bill, were discussed in 2004 during the debates on the amendment bill in the Committee for Public Administration, Regional Development and the Environment and in the Economic Committee of the House of Deputies, in co-operation with MIT and ERO experts.

The amendment to the Energy Act, i.e. Act No. 670/2004, was promulgated in Part 228/2004 of the Collection of Laws and came into effect on 30 December 2004.

The amendment to the Energy Act provides for many relationships and institutions that have a bearing on the ERO's activities. These include, in particular, provisions on the following:

- a) Specification of the cases where no licence needs to be awarded for business in the energy sector;
- b) Conditions for licence awarding, including the essentials of licence applications and decisions on licence awarding, in particular with regard to the business of foreign natural and juristic persons;
- c) Obligation to provide facilities for performing obligations over and beyond the licence to include owners who are not licence holders;
- d) The status, and the related rights and obligations, of the universal service provider, i.e. an entity obliged to supply electricity and gas to households and small businesses for controlled prices;
- e) More precise provisions on the Energy Regulation Fund, in particular in relation to the law on the administration of taxes and levies and the procedures for filling the Fund;
- f) More precise provisions on the ERO's competencies, more emphasis on the ERO's review powers as a price controlling authority, etc.;
- g) The provisions on separate accounting were replaced by new provisions on regulatory reporting, with effective tools for making these provisions more specific through the ERO's implementing legal regulations;
- h) Provisions on the regulated access to the transmission and distribution systems and upstream gas pipelines;
- i) Detailed and specific provisions on the legal, managerial and organisational unbundling of electricity and gas transmission and electricity and gas distribution from unregulated activities – electricity and gas production and trading;
- j) New allocation of the rights and obligations between electricity/gas distribution licence holders and electricity/gas trading licence holders; the differentiated approach to the various categories of final customers was eliminated – before the amendment, electricity/gas supply was the obligation of the distribution licence holder while supplies to eligible customers were made under trading licences;
- k) New provisions on the support for electricity generation in CHP units and from secondary sources due to the implementation of certain commitments under Directive 2004/8/EC.

### 2.3 Co-operation in the drafting of the bill on support for the use of renewable energy sources

Since 2003, the ERO has been represented in the working group responsible for drafting a new law on support for renewable energy sources. The ERO's representatives proposed a system that would make it possible to support renewable sources after the complete opening of the electricity market. The proposed system, based on quotas and certificates, served as the basis of the support system that was incorporated in the bill on support for renewable energy sources. In relation to the submission of this governmental bill to the House of Deputies of Czech Parliament, the ERO prepared the theses of two public notices. One public notice sets out the details on the method of recording, reporting and accounting for green certificates and the way of evaluating the meeting of the annual quota, while the other public notice deals with the reporting of the quantities of electricity generated by the common burning of biomass and a fuel from non-renewable sources and on the issue of guarantees of electricity origin from renewable sources.

As the parliamentary committees debated the bill in 2004 the ERO prepared, upon the committees' request, an analysis of the impact of the support for renewable energy sources on the prices to final customers while meeting the indicative target of the share of electricity from renewable sources by 2010.

Since the parliamentary committees found the original governmental bill to be a system burdened by heavy paperwork and associated with certain risks as regards the meeting of the target share of electricity from renewable sources, the ERO participated in the drafting of the proposals to amend the governmental bill, and later prepared a comprehensive amending proposal that changed the system of support for renewable sources from the originally proposed system of quotas and certificates into a system of minimum purchase prices and green premiums.

In February 2005 the House of Deputies passed over the bill, containing support through green premiums, to the Senate of Czech Parliament.

### 2.4 Secondary legislation

The start of the gradual gas market opening, the continued liberalisation of the electricity market and the need to set the conditions for the next regulatory period precipitated the need to issue a new public notice to lay down the rules of the gas market, and to amend the existing public notices on the rules of the electricity market and regulatory conditions and procedures.

**Public Notice No. 673/2004, laying down the rules for gas market organisation, was promulgated on 21 December 2004 with effect from 1 January 2005.**

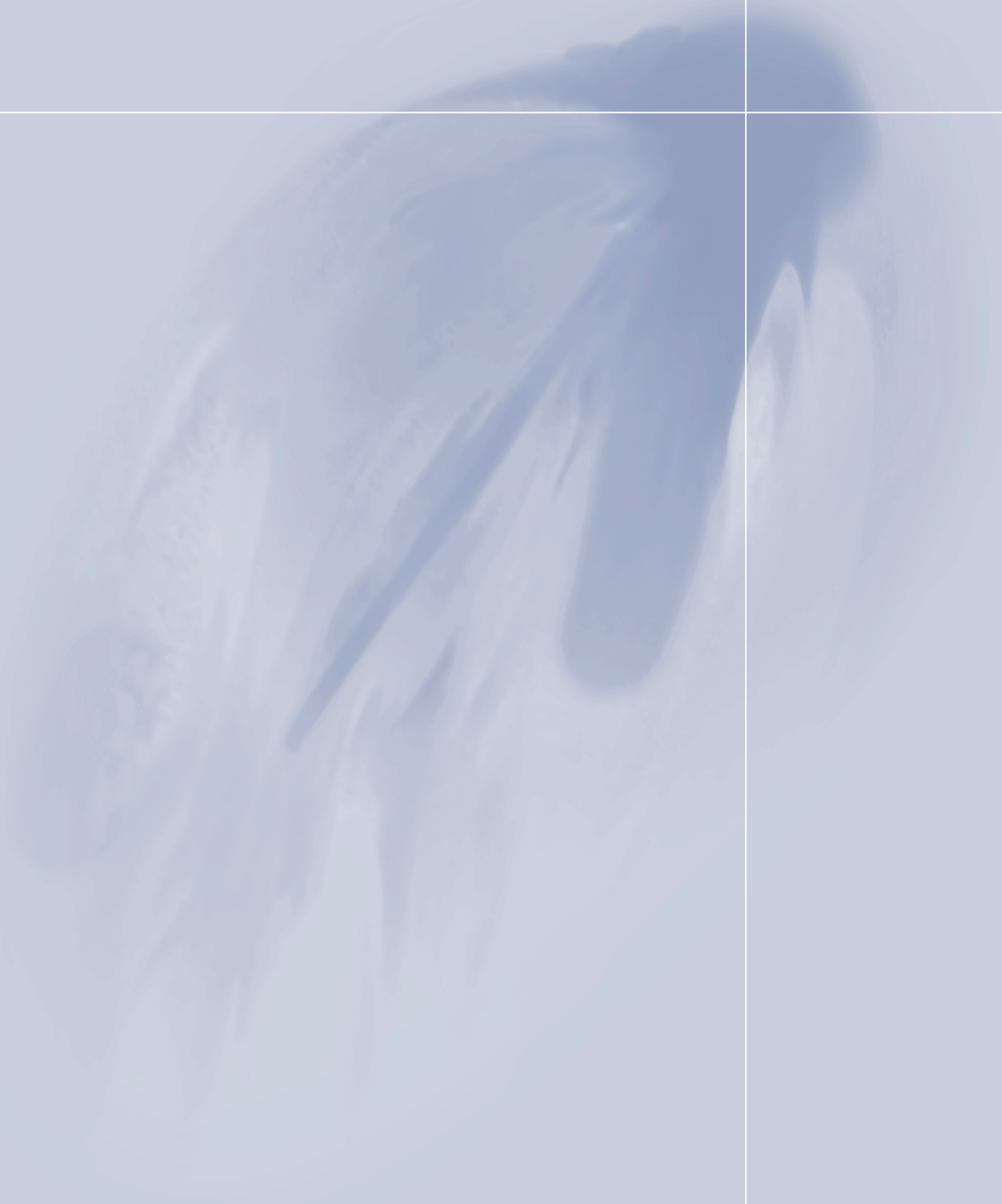
This is a seminal legal regulation, which implements certain institutes of the Energy Act and provides for the required relationships in connection with the gas market opening and with performing trading through access to the gas system. The importance of this public notice is compounded by the fact that in respect of many institutions, the Energy Act refers to the rules for gas market organisation, and the non-existence of this public notice would in fact have prevented the market participants from seeking their statutory entitlement to access to the gas system and the customers from seeking their statutory entitlement to supplier change.

**Public Notice No. 614/2004, which amends Public Notice No. 373/2001, which lays down the rules for electricity market organisation and the principles of pricing the market operator's activities, as amended, was promulgated on 29 November 2004 with effect from 1 January 2005, with the exception of point 44 which became effective on the day of promulgation.**

The need for this amendment was elicited by the next phase of the Czech electricity market's opening: on 1 January 2005 all final customers became eligible customers, with the exception of households, which will become eligible customers on 1 January 2006. The liberalisation of the electricity market has precipitated the need to amend the principles and procedures that have to be applied when opening the electricity market to customers with lower electricity consumption and customers connected to lower voltage levels.

**Public Notice No. 575/2004, which amends Public Notice No. 438/2001, which lays down the content of financial information and the procedures for price control in the energy sector, as amended in Public Notice No. 13/2003, which was promulgated on 10 November 2004 with immediate effect.**

The need to amend this public notice was precipitated mainly by the end of the first regulatory period on 31 December 2004 and the necessity to set new rules and regulatory formulas for the second regulatory period, which will last from 1 January 2005 to 31 December 2009.



The regulatory framework





### 3.1 The results of the first regulatory period and the concept of the second regulatory period

In 2004, the last year of the first regulatory period, the ERO was to develop the regulatory methodology for price setting in the electricity and gas industries for the next regulatory period.

A significant change that occurred in the first regulatory period, and has influenced the energy sector profoundly, is the continued electricity market liberalisation and the beginning of the gas market liberalisation. In this context, a specific way of making the preparations for the second regulatory period had to be followed, applying differentiated approach to each of the industries.

Another important factor in developing the regulatory methodology was the changes in the ownership structures of the regulated entities in both industries and the emergence of new companies and groups.

#### 3.1.1 The first regulatory period

After its establishment in 2001 the Energy Regulatory Office opted for the incentive method of regulation, which is similar to the methodologies used by many European regulators and based on companies' performance. The key principle of the method is a procedure for calculating allowed revenues for each individual company (revenue cap) for a certain predetermined period, known as the regulatory period. Another principle consists in that the regulatory method and the predetermined allowed revenues remain unchanged throughout the regulatory period, with the exception of adjustments using the escalation factor known as RPI, reduced by the efficiency factor X, which gives the method its designation, RPI-X. Allowed revenues are composed of individual parameters – costs, depreciation and amortisation, and profit.

However, in the Czech Republic this was a completely novel approach because until then, cost-based control had been applied, whereby a company's costs had been reviewed and the resulting price had been set on an annual basis.

Throughout the first regulatory period the RPI-X regulatory method ensured stability in the energy industries, both for the final customers and the investors. Nevertheless, it is to be admitted that the actual values of the various parameters achieved by the companies developed differently from the formula parameters adjusted by the escalation index determined by the ERO.

On the basis of the analysis of regulatory results in the first regulatory period it can be noted that the ERO's activities made it possible to create and develop a viable and competitive form of the present-day energy sector while ensuring an acceptable level of prices to the final customers.

#### 3.1.2 General approach to the conditions for the second regulatory period

##### *Objectives of the second regulatory period*

In the light of the positive experience with the existing regulatory models, the ERO has left the regulatory principles in place also for the next regulatory period.

However, as part of developing the methodology for the second regulatory period the ERO has formulated new targets and incentive tools for a further stabilisation of the sector and to ensure that the efficiency of all regulated activities will continue to improve:

- as the regulatory periods roll over, ensure stability of the sector, i.e. stable prices to the final customers while maintaining the quality of the supplies and, at the same time, profitability for investors;
- prepare a method based on generally accepted principles;
- incentivise the regulated entities to improve their efficiency throughout the regulatory period;
- monitor investment activities throughout the regulatory period.

##### *The regulatory period*

A significant change is the fact that the second regulatory period will last for five years, from 1 January 2005 to 31 December 2009. It turned out in the first regulatory period that three years are too short a time to feel the effects of incentive regulation, because, in line with the theory of regulation, the data for the last but one year of the regulatory period serves as the basis for setting the parameters for the subsequent regulatory period.

##### *The regulatory formula*

When putting in place the new rules, the Office made significant changes to the regulatory formula for computing the allowed revenues. The fundamental difference is the separate approach to each of the parameters in the regulatory formula, which are the allowed revenues, depreciation and amortisation, and profit.

In the first regulatory period, the Office set allowed revenues generated by each of the activities for the regulated entities; these were then adjusted by inflation during that regulatory period. This approach provided a degree of freedom to the companies while guaranteeing predictability of regulation to them.

However, a preliminary assessment of this way of regulation has indicated that the actual development of the various parameters of allowed revenues does not reflect the development of the allowed revenues as a whole. The ERO has therefore decided to decompose the single regulatory formula and approach each of its parameters separately.

One of the fundamental changes to the pricing methodology is the shift in the philosophy of the annual indexation of each of the parameters of allowed revenues. Whilst the first regulatory period saw the application of an annual change in the company's total

revenues from regulated activities by applying an index based on the producers price index, reduced by the efficiency factor, in the second regulatory period companies' permissible costs and depreciation and amortisation are subject to escalation, and the index used is a combination of the wage growth factor and a factor based on producers price indexes, and is also reduced by the efficiency factor.

The last parameter of allowed revenues (profit) is calculated on an annual basis in dependence on the development of the companies' regulatory asset base. In this connection a new way of computing the rate of return on operating assets of regulated companies has been introduced, based on the weighted average cost of capital.

The ERO has also decided to design different regulatory formulas for different licensed activities, thereby achieving a better transparency and reflecting the respective specifics inherent in electricity transmission, gas transmission, and electricity and gas distribution.

Another major change is the introduction of the time value of money into the regulatory formula to evaluate the corrections to the actually achieved revenues in relation to the revenues allowed for the companies.

As in the previous years, the rules and procedures of regulation were set out in an amendment to the "regulatory" Public Notice No. 438/2001, which lays down the content of financial information and the procedures for price control in the energy sector, as amended.

## 3.2 The electricity industry

Pricing in the electricity industry in 2004 was influenced by the new requirements placed on the regulatory framework, mainly in respect of the continued liberalisation of the electricity market and the requirements of both the EU Directives and the forthcoming amendment to the Energy Act for a transparent unbundling of electricity generation and trading from regulated activities.

Under the amendment to the Energy Act, distribution companies serving more than 100,000 customers shall have to effect a legal separation of electricity distribution from electricity trading by 31 December 2006. A number of major companies have connected the process of the legal unbundling of the two activities with the process of merging several distribution licence holders owned by a single investor into a single juristic person that will carry on distribution in the delineated areas served by the original regional distribution companies.

All of these key requirements together with the experience acquired with the market mechanism had prompted the need to improve the organisation of the electricity market, which was effected in the amended market rules.

### 3.2.1 Electricity market rules

The electricity market rules define the responsibilities and position of each of the market participants, and enable the eligible customers to participate in the market directly.

The electricity market has been gradually opening up, depending on annual consumption, since 1 January 2002 with a view to making all final customers – consumers – eligible customers from 1 January 2006. This means that the customers will be, in line with the regulated TPA model, able to select their electric energy supplier.

The step-by-step opening continues as follows:

- a) Since 1 January 2004 all final customers whose demand take points are equipped with continuous electricity consumption metering, with the exception of households, have been eligible customers;
- b) Since 1 January 2005 all final customers with the exception of households have been eligible customers;
- c) From 1 January 2006 all final customers will be eligible customers.

The changes in legislation and the significant expansion of the eligible customer segment precipitated the need for an amendment to Public Notice No. 373/2001, as amended, and this amendment also reflected some experience with the operation of the market in the first regulatory period. The modifications concern primarily the following relationships, issues and cases:

- a) Issues related to the execution of agreements on electricity transmission and electricity distribution, including the definition of the components of payments under such contracts;
- b) The amendment repeals the part of the public notice which deals with the conditions for access to networks for cross-border electricity transmission, because of the adoption of overriding legal provisions, namely Regulation 1228/2003/EC of the European Parliament and of the Council of 26 June 2003 on conditions for access to the network for cross-border exchanges in electricity;
- c) The TSO is allowed to obtain a part of ancillary services under multi-annual contracts, with a clear objective of reducing its costs of ancillary services;
- d) A new and more precise definition of the content and extent of the information to be transmitted by the TSO or a DSO to the market operator for the purposes of evaluating the imbalances of the entities subject to clearing;
- e) A new concept of imbalance clearing with the help of typical supply profiles, which help to evaluate the imbalances of eligible customers who are not equipped with continuous metering with remote data transmission;
- f) A new concept of the evaluation and clearing of imbalances in states of emergency, when it is not feasible to proceed under the general provisions on imbalance evaluation;
- g) More precise provisions on the billing of actual electricity supplies to eligible customers;
- h) A new method for collecting the charge for the market operator's clearing activity has been introduced; the charge is paid by all final customers together with the electricity distribution charge, and the DSOs then transfer this charge to the market operator;

- i) A new and more precise description of the electricity supplier change process, with a clear specification of the various parties' responsibilities for a successful supplier change;
- j) More precise provisions on the billing of electricity supplies to eligible customers and new invoice items to help to improve the information to the customers on the structure of the resulting payment for electricity.

Since following a few extensive amendments this public notice has become a rather complicated regulation, the ERO expects to issue a completely new public notice on the rules of the electricity market with effect from 1 January 2006.

### 3.2.2 Pricing

The transfer of another large group of protected customers to the category of eligible customers called for changes in the existing principles of price setting for this category. Following broad-ranging considerations and analyses of the potential developments on the electricity market, the ERO opted for the alternative of differentiating charges for distribution services at the low voltage level depending on the nature of the demand. Thus, at the low voltage level approximately the original range of tariffs has been maintained, which make it possible for the customers to optimise their costs of the services related to electricity supply. A similar range of distribution tariffs is expected to be introduced also for household customers, who will become eligible customers on 1 January 2006.

Other factors that influenced pricing in 2004 also included an amendment to the law on value-added tax, effective from 1 May 2004, which required the issue of new ERO price decisions taking into account the change in the VAT rate.

In addition to the issue of the methodology for pricing electricity distribution for customers connected to the low voltage level, the ERO also addressed the method of demand evaluation, and the potential differences in the demand taken by these customers; it introduced a system of typical profiles and set out the principles for their practical use from 1 January 2005.

For 2005, the resulting average price of electricity supply to protected customers (households) was set at CZK 2,356.17/MWh (w/o VAT). In comparison with 2004, the average price to this customer category has risen by CZK 97.87/MWh, i.e. by 4.33%. This increase in the average price to protected customers is attributable, to varying degrees, to changes in the various components of the price, the development of which in the first regulatory period, and values for 2005, are listed in Table 1.

#### *Price of energy*

The increased price of the energy supplied by the generator, ČEZ, a.s., for 2005 (which is not subject to regulation) has influenced the price of energy in electricity supplies to protected customers and the price of energy intended to cover losses in distribution systems. In comparison with 2004, the increase is CZK 84.50/MWh. Thanks to the reduced charges for imbalances on the electricity market, the increased price of energy is reflected in the prices to protected customers at a slightly lower level of CZK 65.50/MWh.

#### *Charge for the electricity market operator*

The electricity market operator's charge for its clearing activity was set at CZK 4.10/MWh throughout the first regulatory period. The changes in the trading on the electricity market, caused by the progressing liberalisation of the electricity market (particularly the introduction of the system of data transmission for trading purposes and the on-the-day and balancing markets and the system of typical supply profiles, necessary for evaluating electricity trades for customers not equipped with continuous metering), brought about a significant rise in costs for the electricity market operator, incurred in the procurement of the required information system, which in turn caused an increase in the clearing charge for 2005 to CZK 4.63/MWh. In the methodology employed for the second regulatory period, this component of the price to the final customers will evolve only in relation to the PPI in the years to come.

#### *Charge for system services*

System services are necessary for ensuring the balance of power between electricity generation and electricity demand. The TSO provides these services by purchasing ancillary services, the costs of which are reflected in the prices to final customers in the form of the charge for system services. In each year of the first regulatory period, the charge for system services went up, due to the heavier demands on the Czech grid's safe operation. These mainly involved an increase in the volume of reserve output ready to go on stream in the event of failures of the new and the largest units in the grid, the 2x1,000 MW units of the Temelín NPP.

#### *Charge for the network services*

The network service charge is composed of the charge for transmission services and the charge for distribution services. The network service charge for 2005 is influenced by several factors:

##### *a) Transmission service charge*

The average price for the use of the transmission system dropped from CZK 134.56/MWh in 2004 to CZK 130.14/MWh in 2005, and this reduction has been reflected in the cumulative prices for electricity distribution at each voltage level.

The transmission system charges were directly influenced by Regulation 1228/2003/EC of the European Parliament and of the Council of 26 June 2003 on conditions for access to the network for cross-border exchanges in electricity, which has prohibited charging exports of electricity since 1 July 2004. While until mid-2004 exports were charged at the level of the charge for network use, which covered the losses in the transmission system, these costs are now met by the final customers in the Czech Republic. The result is a slight increase in the charge for the use of the transmission network. The increase in the transmission charge is also due to the higher price of the energy purchased by the TSO to cover the losses in the transmission system.

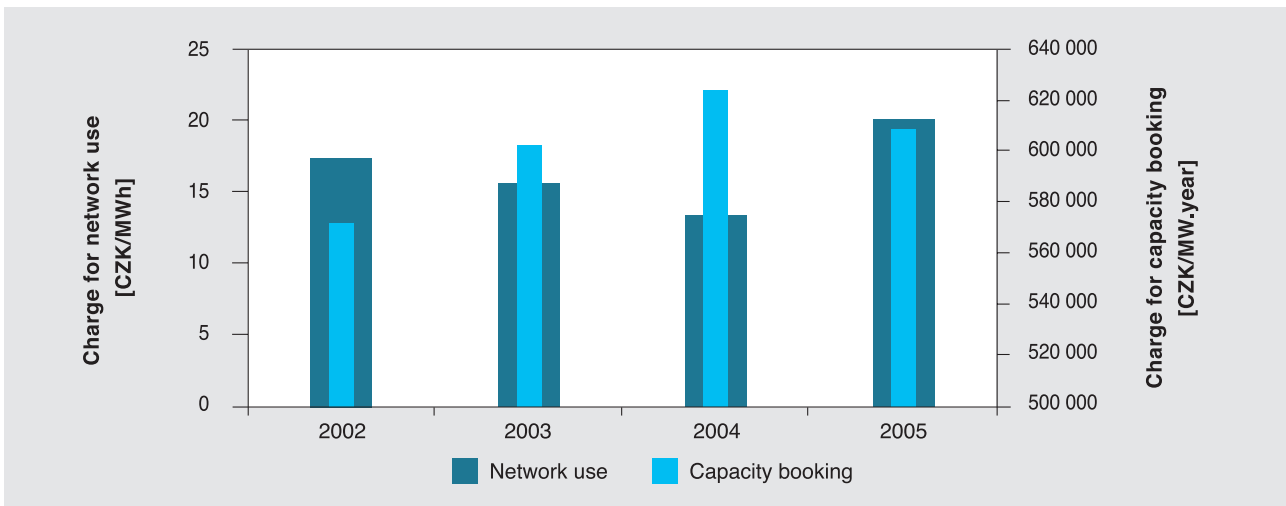
Table 1 Components of the resulting price of electricity supplies to protected customers in the first regulatory period and in 2005

Items constituting the price to protected customers (NN level)	2002 [CZK/MWh]	2003 [CZK/MWh]	2004 [CZK/MWh]	2005 [CZK/MWh]	Share taken by the components of the 2005 price [%]	Decrease/increase in components of the price, 2005-2004 [CZK/MWh]	Decrease/increase in components of the price, 2005-2004 [%]
Energy purchase price	979.70	909.62	966.57	1,032.07	43.80	65.50	6.78
OTE's charge for clearing, related to demand of final customers, including local consumption	4.10	4.10	4.10	4.63	0.20	0.53	12.93
Charge for system services	157.90	159.00	172.00	171.80	7.29	-0.20	-0.12
<b>Network services:</b>							
Charge for U/Q control in the DS		0.08	0.00	0.00	0.00	0.00	0.00
Charge for the DSO for payment mediation	0.00	0.10	0.10	0.10	0.00	0.00	0.00
Charges to cover the extra costs related to electricity purchase from renewable sources and cogeneration	8.72	19.04	41.51	39.45	1.67	-2.06	-4.96
Contribution to decentralised [distributed] generation for plants connected to the DS	7.20	8.66	8.67	7.52	0.32	-1.15	-13.26
Charge to reimburse the losses covered by OTE	0.00	0.63	0.63	0.00	0.00	-0.63	-100.00
Cumulative single-component price for the network service	1,024.93	1,055.44	1,025.42	1,058.66	44.93	33.24	3.24
<b>Total for network services</b>	<b>1,040.85</b>	<b>1,083.95</b>	<b>1,076.33</b>	<b>1,105.73</b>	<b>46.93</b>	<b>29.4</b>	<b>2.73</b>
Charge for electricity trading for protected customers	41.30	40.89	39.30	41.95	1.78	2.65	6.74
Resulting average price of electricity supply to protected customers, without energy	1,244.15	1,287.94	1,291.73	1,324.11	56.20	32.38	2.51
<b>Resulting average regulated price of electricity supply to protected customers</b>	<b>2,223.85</b>	<b>2,197.56</b>	<b>2,258.30</b>	<b>2,356.17</b>	<b>100.00</b>	<b>97.87</b>	<b>4.33</b>

The above negative impacts of the regulation on cross-border exchanges in electricity motivated the ERO to a detailed analysis and a proposal for a new concept of charging transmission services. The result is measures that are not in conflict with this regulation and may have a positive effect, or at least offset the negative impacts on the final customers in the Czech Republic.

The regulation actually permits to regulate the activities of, and revenues from, the process of allocating capacities at cross-border sites. Since a part of the proceeds from the auctions for 2005 was used to cover the TSO's permissible revenues, the result is a reduction in the charge for capacity booking in comparison with each of the first regulatory period's years when the price for capacity booking kept rising due to the allowed revenues of ČEPS, a.s. increasing by the escalation index. Chart 1 shows the prices for electricity transmission.

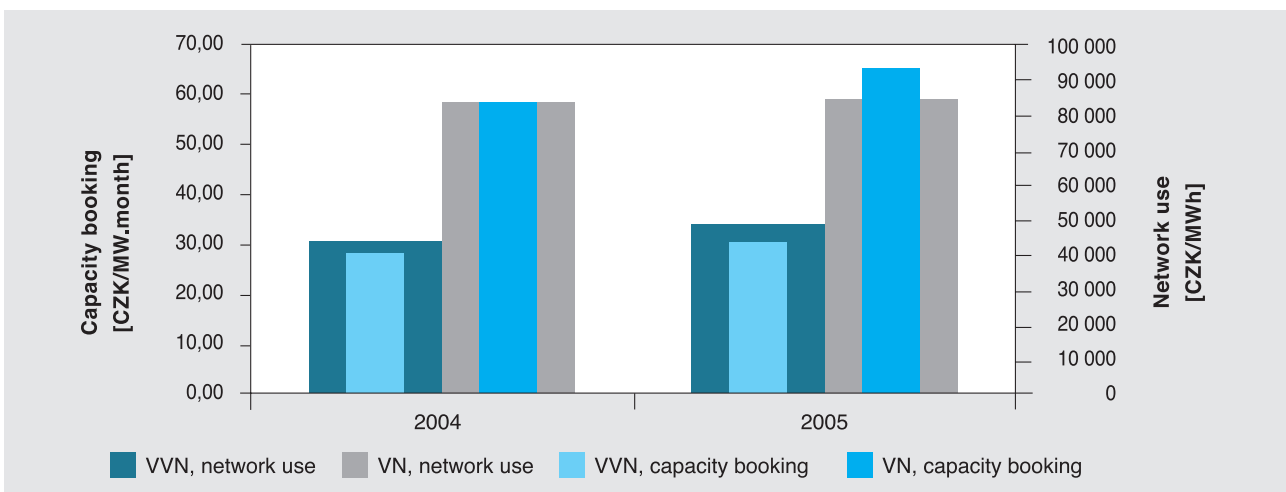
**Chart 1** Components of the price for electricity transmission



*b) Charge for distribution*

The charges for distribution at the very high voltage and high voltage levels were negatively affected by the reductions in final customers' booked capacity, leading to a higher price for booked capacity to help distribution companies to cover their allowed revenues. The rise in the price for network use, which constitutes a variable component of the rates for distribution at both voltage levels, has been caused by the increase in the price of the energy which distribution companies buy to cover their losses. The 2005/2004 change in both of these distribution price components is shown in Chart 2.

**Chart 2** Components of the price for electricity distribution at very high voltage and high voltage levels

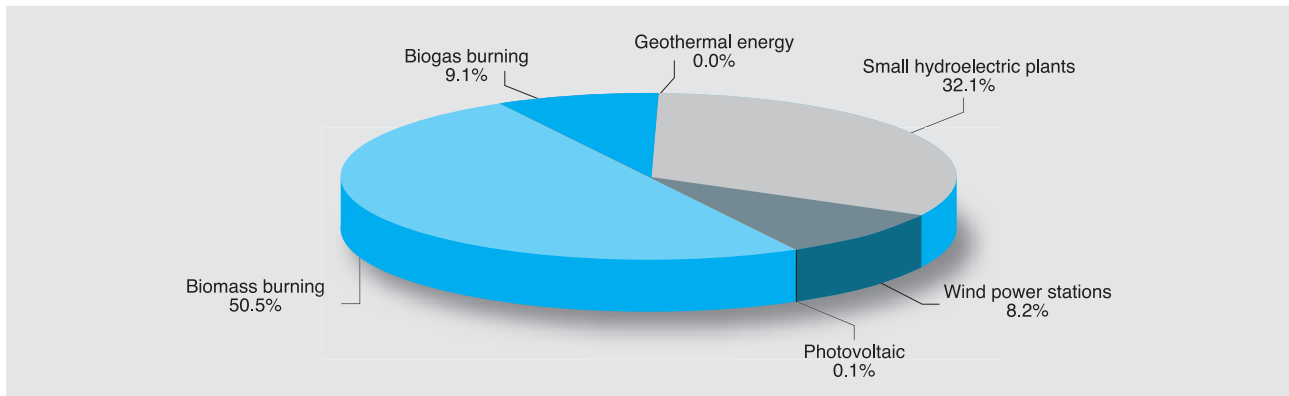


**The charge to meet the extra costs incurred in purchasing electricity from renewable sources and CHP**

The charge to meet the extra costs incurred in purchasing electricity from renewable sources and CHP is going down thanks to the stabilisation of the costs of electricity purchases from these sources; this is due to the fact that the difference between the market price of electricity and the price of purchases from these sources is declining as the electricity market prices go up. However, the quantity of the

supported electricity produced is continuously increasing. The charge to meet the extra costs incurred in purchasing electricity from renewable sources and CHP dropped from CZK 41.51/MWh in 2004 to CZK 39.45/MWh for 2005. In 2005 the total extra costs of support for renewable sources will amount to CZK 1,590 million, while the figure is CZK 424 million for CHP. The shares of the various types of renewable sources in total extra costs of renewable energy sources are shown in Chart 3.

**Chart 3 The shares of the various types of renewable sources in total extra costs of renewable energy sources**



From 2005, this contribution will not be a part of the charge for distribution. It will be paid by eligible customers separately. Protected customers will pay this charge in the electricity supply rates.

#### **Charge for distributed generation**

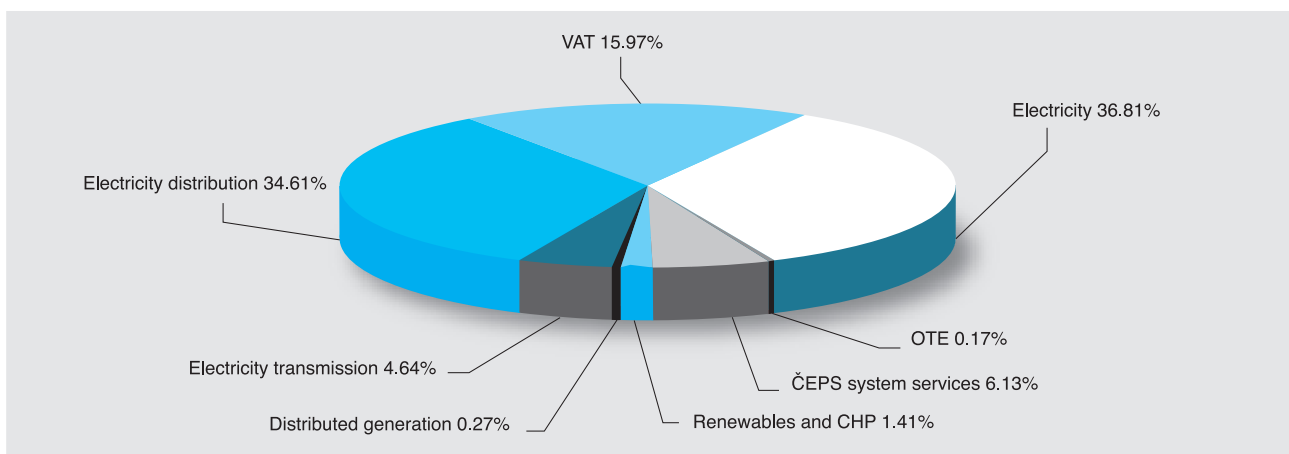
The charge for distributed generation respects the decreasing costs of losses at higher voltage levels, which is attributable to connecting the plants directly to the lower voltage levels of distribution systems. The changes in the price control methodology for the second regulatory period also include a single amount of the contribution to distributed generation at all voltage levels of the distribution system; however, this charge will remain differentiated by the regions.

#### **Price of supplies to protected customers**

The increase in the average price of electricity supply by 6.78% is mainly caused by the increased price of the energy bought by the various suppliers on the wholesale market, which is not subject to price control by the Office. The components of the price that are directly subject to control by the Office have gone up by 2.51% in aggregate year-on-year, while many of these components are now stabilised at the 2004 level or even lower.

Chart 4 shows the shares, in per cent, taken by each of the components that make up the average price of electricity supply to protected customers for 2005.

**Chart 4 The shares, in per cent, taken by each of the components that make up the average price of electricity supply to protected customers connected to the low voltage level for 2005**



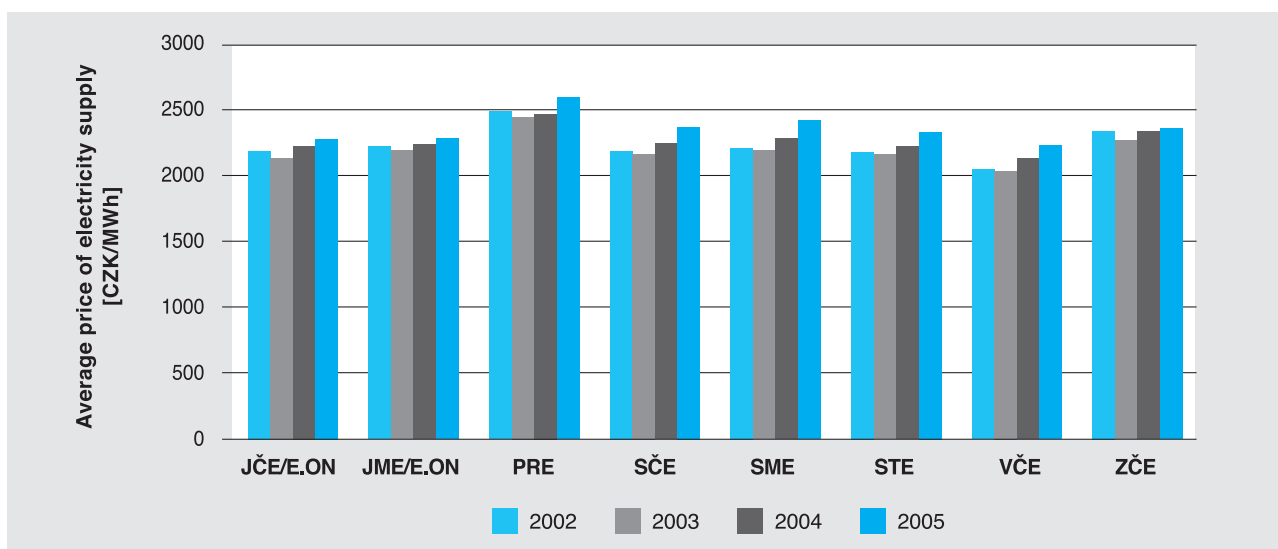
In comparison with 2004, the price to protected customers at the low voltage level has increased by 4.33% on average, with the increase in the average prices in each of the regions ranging from 2.1% for Západočeská energetika, a.s., to 5.0% for Severomoravská energetika, a.s. and Východočeská energetika, a.s., see Table 2.

**Table 2** Changes in the average prices to the households category in each of the distribution companies between 2004 and 2005

Company	Households (low-demand category) [%]
E.ON Energie, a. s.	3.50
Pražská energetika, a. s.	4.30
Severočeská energetika, a. s.	4.90
Severomoravská energetika, a. s.	5.00
Středočeská energetická, a. s.	4.90
Východočeská energetika, a. s.	5.00
Západočeská energetika, a. s.	2.10

Chart 5 illustrates the development of average electricity supply prices to households (low-demand category) in the regions served by the various suppliers. The prices charged by the distribution companies have not increased evenly. The reason is that electricity prices are set for each region and they are based on the permissible costs incurred by the distribution companies in providing electricity supplies to final customers.

**Chart 5** Development of average electricity supply prices to households in the regions served by the various suppliers



### 3.2.3 Price Decisions, an outline

The structure and content of the respective ERO Price Decision prepared during 2004, which lays down the prices of electricity and related services for 2005, have been maintained in a scope similar to the previous year. This Price Decision and its content and changes the can be described as follows:

- The Price Decision has introduced a more detailed categorisation of combined heat and power generation – plants up to 1 MWe, inclusive, and plants from 1 to 5 MWe, inclusive, which have a choice of support in the form of minimum purchase prices or in the form of fixed premiums to the market price; and over 5 MWe plants, which can receive support only in the form of fixed premiums to the market price;
- The minimum purchase prices of electricity from renewable sources have been adjusted in comparison with 2004; at the same time, the decision introduces a further differentiation of the minimum electricity purchase prices for small hydroelectric plants and wind power plants depending on the time of commissioning;
- In line with the forthcoming law on support for the use of renewable sources of energy, the principle of support for burning biomass and fossil fuels together, in the form of minimum purchase prices, has been replaced by support provided through fixed premiums to

the electricity market price agreed between the generator and customer (trader, or the final customer); at the same time the ERO has started differentiating three categories of common biomass and fossil fuel burning, depending on the type of the biomass burned: white biomass, brown biomass, and specifically cultivated biomass, which differ by the amount of the contribution they receive;

- There is a reduction in the average charge for transmission due to a change in the regulation methodology for the second regulatory period;
- The decision has introduced a single-component price for the use of the networks of the regional distribution system operators at the high voltage level, which is suitable for a demand of up to 300 hours/year (seasonal demand); in this case the consumer does not pay the capacity booking charge;
- The charge to meet the extra costs incurred in electricity purchases from renewable sources and CHP is no longer a part of the distribution price; it is now a separate charge paid by eligible customers (for protected customers this charge is included in the electricity supply rate); all final customers, including the generators' local consumption and other consumption by distribution system operators, pay this charge;
- The charge for the clearing activity of Operátor trhu s elektřinou, a.s. has been increased to CZK 4.63/MWh; at the same time there has been a change in the method of collecting the charge and the amount of the charged demand: as from 1 January 2005 all final customers, including the generators' local consumption and other consumption by distribution system operators, have been paying this charge; for protected customers this charge is included in the electricity supply rate.

Since all customers in the 'low-demand business' category became eligible customers on 1 January 2005, the original price decision for protected customers in the above category has become irrelevant. It has therefore been replaced by an ERO price decision laying down fixed prices of electricity distribution for eligible customers from low voltage networks. This price decision has basically the same scope of the original structure of the rates applicable in previous years to customers in the low-demand business category, but defines the prices and terms and conditions for distribution tariffs applicable to this customer category in 2005. Added to these prices are the charge for system services, the charge for meeting the extra costs of electricity purchase from renewable sources and CHP, and the charge for OTE's clearing activity, in accordance with the price decision that lays down the prices of electricity and related services.

The ERO Price Decision that lays down the maximum electricity prices and terms and conditions for electricity supply to protected customers from low voltage networks only contains prices of electricity supplies to the households category. In comparison with 2004, some changes have been made to the scope of the rate structure:

- Because of the low representation of certain tariffs that envisage a high utilisation of the input power, these tariffs have been merged with some other tariffs, which are more widely used for the same nature of consumption;
- A new tariff has been introduced for the demand taken by the heat pumps that will be commissioned from 1 April 2005 and that will no longer receive subsidies within the distribution rates; the rates for the heat pumps commissioned before the above date should continue to be partially subsidised.

### 3.3 The gas industry

For the Office, the year 2004 brought preparations for adjusting the gas market organisation to the launch of the liberalisation process. Despite the problems with the time limits involved in the drafting of the amendment to the Energy Act, the ERO prepared a piece of secondary legislation which adjusts the market organisation to the completely new conditions.

#### 3.3.1 Gas market rules

Under the Energy Act, on 1 January 2005 all final customers with an annual offtake of more than 15 mcm, and all electricity generation licence holders burning gas in thermal power stations or in combined heat and power generation, to the extent of their consumption for this generation, became eligible customers. The next steps in the market liberalisation process are January 2006, when all final customers with the exception of households will become eligible customers, and January 2007, when all final customers will become eligible customer, marking the full liberalisation of the gas market.

The status of the eligible customer is associated with the right to select a natural gas supplier. However, some obligations are also attached, which stem from participation in the liberalised market. The protected customer has no choice of supplier, and therefore the supplier serving the area must provide him with all the services related to natural gas supply down to his offtake point, for controlled prices set by the Office.

In setting the price of gas and related services for 2005 the Office had to respond to the gradual gas market opening. It issued a new public notice, No. 673/2004, which lays down the rules for gas market organisation. The key principles of the gas market are as follows:

- a) The division of the Czech Republic's territory into balancing zones, the managers of which are the current regional distribution system operators;
- b) The real underground gas storage facilities have been replaced by virtual UGS facilities, one per operator;
- c) Gas transmission respecting combinations of pairs of the gas system's entry and exit points;
- d) Definition of gas transmission and distribution agreements, i.e. specification of the types of contract covered by Section 75 of the Energy Act; respecting the essentials of such contracts; the gas market rules specify annual fixed capacity/interruptible capacity agreements and monthly fixed capacity/interruptible capacity agreements;

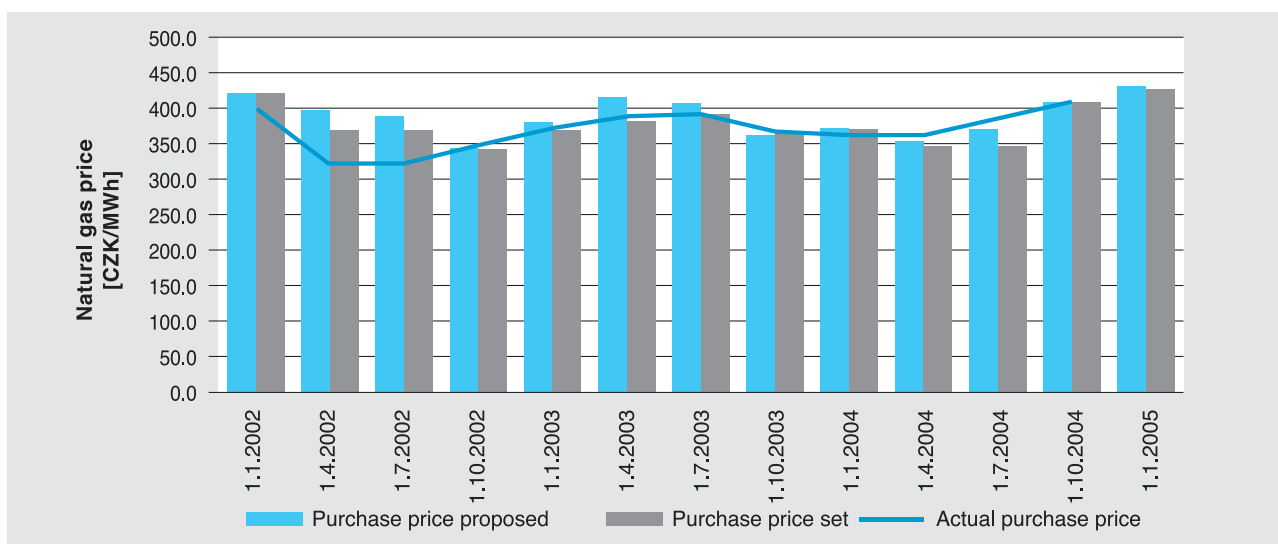


- e) Basic time intervals for gas market organisation: the gas year (from 1 October to 30 September of the following year), the storage year (from 1 April to 31 March of the following year), and the gas day (begins at 6 a.m.);
- f) The procedure for capacity booking in the transmission and distribution systems and in UGS facilities, including the time limits allowed for the booking; procedure for entering into interruptible capacity agreements only after the fixed capacity has been completely exhausted; options to transfer booked capacities between market participants;
- g) Congestion management in the transmission and distribution systems;
- h) The basic framework for gas transmission and distribution price control;
- i) Daily nominations of gas deliveries, and renominations;
- j) Commercial and physical balancing of imbalances;
- k) Time limits for changing the supplier; procedure to be followed by the system operator and the gas supplier to effect supplier change;
- l) Billing of gas supplies to eligible customers, imbalance metering and evaluation, and settlement.

### 3.3.2 Pricing

In the gas industry the ERO sets the gas transmission and distribution prices once a year, with effect from 1 January. However, changes related to those in the price of the energy contained in natural gas may also be made effective from 1 April, 1 July and 1 October of the respective year. In 2004 the prices of natural gas supply were reduced on 1 April, in response to a reduction in the price of the natural gas purchased by Transgas, a.s. Another slight decrease in the price was due to the change in the VAT law effective from 1 May 2004. On the other hand, there was a distinctive increase in the price of natural gas supplies in response to the growing prices of competing fuels, i.e. heavy fuel oil and gas oil, on 1 October 2004. The prices applicable in the fourth quarter of 2004 almost reached the level of the so far highest prices in the first quarter of 2002. The development of the natural gas prices charged by Transgas, a.s. to regional distribution companies can be seen in Chart 6.

**Chart 6 Development of the natural gas prices charged by Transgas to regional distribution companies**



The eligible customers' option to negotiate, after 1 January 2005, the services related to gas supplies brought about another task for the ERO: to set the gas transmission and distribution prices for this group of customers. Based on the analyses made in the first half of 2004 and predictions of the potential developments in the gas companies' behaviour in connection with the unbundling of distribution/transmission from gas trading, the ERO has developed a methodology for pricing these services.

#### **The transmission charge**

Gas transmission involves the costs of transporting the natural gas through the Czech transmission system and the costs incurred in balancing the Czech gas system. Unlike in 2004, when all customers were protected customers and the transmission charge was a part of an integrated rate together with the storage charge, for 2005 there was a need to define a separate transmission charge for the customers who would become eligible customers from 1 January. The separation of the components is also necessitated by the different rights of access to such facilities. For access to the transmission system, regulated TPA is applied, while negotiated TPA applies to gas storage (where the ERO has no control over the storage price).

The above is a fixed single-component price that is uniform for the whole market and independent of distance because of the small area covered by the Czech Republic. The price is related to the required maximum daily capacity, i.e. the gas quantity that has to be transported over one day. For 2005, the fixed price for fixed capacity booking was set at CZK 23,059.30/1,000.m3. This price is an annual price, applicable upon signing an annual gas transmission agreement.

Public Notice No. 673/2004 also permits to enter into gas transmission agreements for periods shorter than one year, from one to twelve months. Pricing for a period shorter than one year is based on the fact that the transmission system is used to a different extent in different months of the year, and therefore the amount of the effort to provide transmission capacity for a shorter period depends on the specific calendar month and the length of the period. The Office has set factors for each of the calendar months, the values of which make it possible to compute the transmission price under monthly agreements from the annual transmission price.

The charge for exceeding the daily booked capacity under contract, which is applicable from 1 January 2005, was set with a view to preventing threats to the stability of the transmission system and speculation in capacity contracting.

Related to the obligation of the daily transmission system balancing are some other new prices and charges set by the Office for the balancing entities. An analysis of the line pack in the transmission system has resulted in setting the coefficients for calculating the balancing and nomination tolerances. The Office has also developed a procedure for calculating the charges for off-tolerance balancing imbalances and off-tolerance nomination imbalances.

For 2005, a fixed charge of CZK 106.60/MWh has been set for off-tolerance balancing imbalances. The fixed charge for off-tolerance nomination imbalances is CZK 53.30/MWh. For the physical balancing of the transmission system a fixed price for a shortfall in balancing gas was set at CZK 890.24/MWh and for excess balancing gas at CZK 222.56/MWh for the first quarter of 2005.

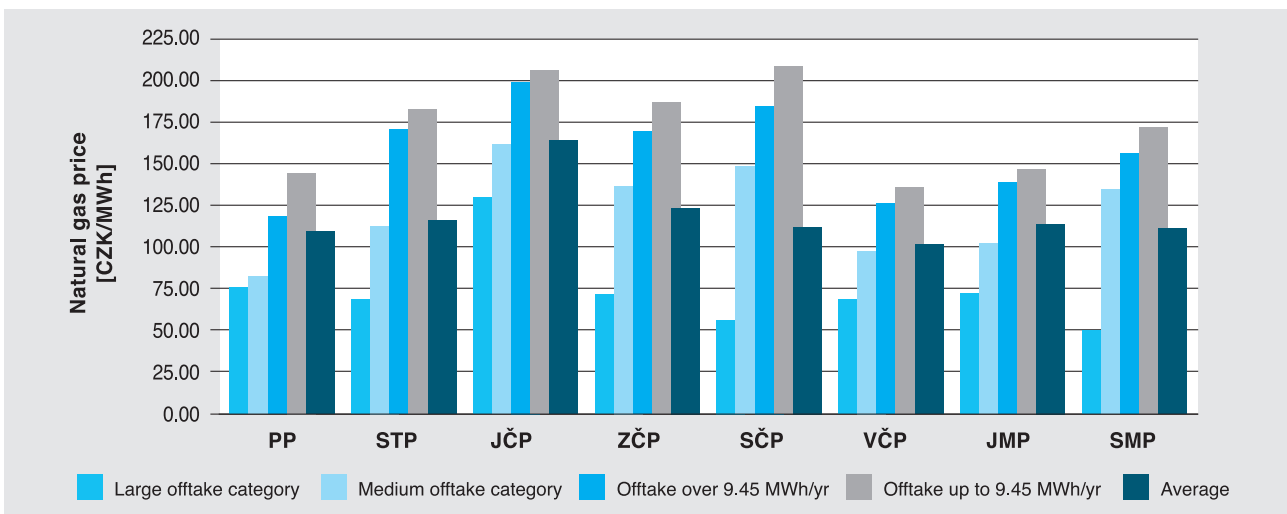
### The distribution charge

As with gas transmission, the defining of the distribution charge and its separation from the other activities and services has primarily been necessitated by the existence of eligible customers and efforts to make it possible for them to exercise their basic right of supplier choice.

The distribution charge covers the respective distribution companies' costs incurred in natural gas transport through the distribution systems, repair and maintenance of the pipeline system, and in metering, reading and billing. Because of the differing cost-intensity of distribution in each of the regions, the resulting prices for each regional distribution companies may differ too.

The distribution charges, which are – unlike the transmission charge – two-component prices, are related to two reference bases. The variable component of the price depends on the gas quantity taken, while the fixed component of the price is, in the case of small consumers, expressed in the form of the standing monthly charge, and in the case of large offtakes in the form of a charge for the maximum daily capacity. Average distribution prices for 2005 are shown in Chart 7.

Chart 7 Average distribution prices for 2005



The end prices for distribution were set for each of the offtake bands in each customer category. This set of prices is identical for the entire area served by one distribution company. The principle on which the distribution pricing methodology has been developed is based on the fact that the costs of using a distribution system are allocated depending on the use of the distribution system by customers in the respective offtake band in the respective customer category, taking into account connections to long-distance gas pipelines and local networks. The degree to which a distribution system is used by the various customer categories depends on the capacity used at the level of the long-distance gas pipelines and at the level of the local networks, and the number of customers in each category connected to the local networks. Based on the distribution cost allocation it is possible to allocate the allowed revenues to each of the categories, and then set the prices for each of the customer categories and offtake bands.

Like gas transmission, also gas distribution can take place under annual distribution agreements for one year and longer, and also under monthly agreements for shorter periods, from one to twelve months. The distribution prices set by the ERO for 2005 apply to annual fixed distribution capacity agreements. For periods shorter than one year, the Office has set factors for each calendar month, with the help of which the distribution price under monthly agreements is calculated. However, only the fixed component of the price is converted in the above way – the variable component does not change. In these cases users with a contracted offtake of over 9.45 MWh/year may choose between two resulting values using the formulas laid down by the ERO in its price decision.

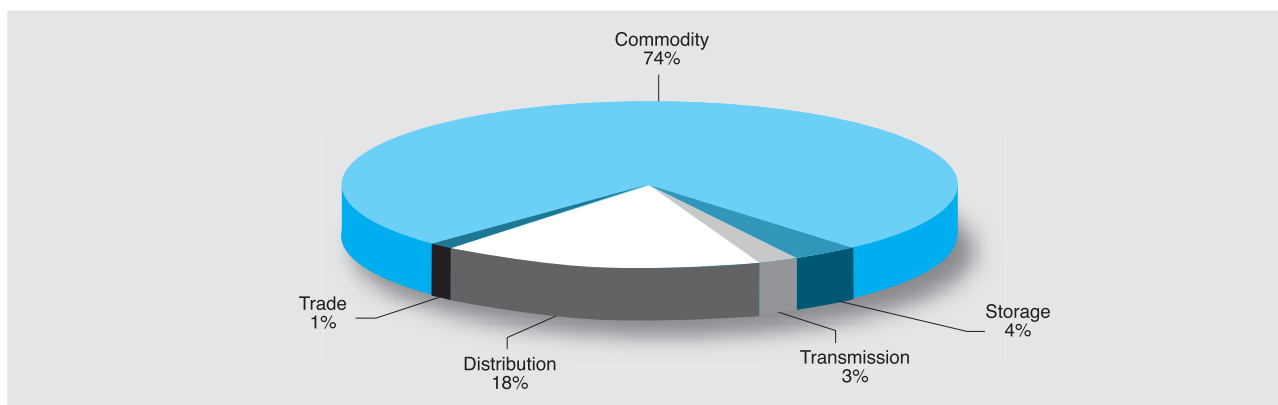
In the case of exceeding the daily booked distribution capacity agreed in the agreement with the distribution system operator, the eligible customer/trader must pay to the distribution system operator a charge intended for such overstepping, calculated using the formulas in the price decision.

### Prices to protected customers

The calculations in 2004 and the pricing of gas supplies to protected customers for the first quarter of 2005 were also based on the new concept of the regulatory formula.

The price charged by trader Transgas, a.s. to the respective licence holders who supply gas to protected customers connected to regional distribution systems, to the extent of their supplies to protected customers, was set as a two-component price like in the first regulatory period. The basis for this price is the forecasts of the development of natural gas import prices, which mainly depend on the prices of gas oil and heavy fuel oil on the world markets, and predictions of the Czech currency's US dollar and euro rates. The price is further adjusted to reflect the difference between the actual costs of gas purchases by Transgas, a.s. and the price in the preceding closed quarter, set by the Office. This price is reflected in the end price of supplies to protected customers. Chart 8 shows the composition, in per cent, of the gas supply price to final customers.

**Chart 8 Structure of the price to final customers**



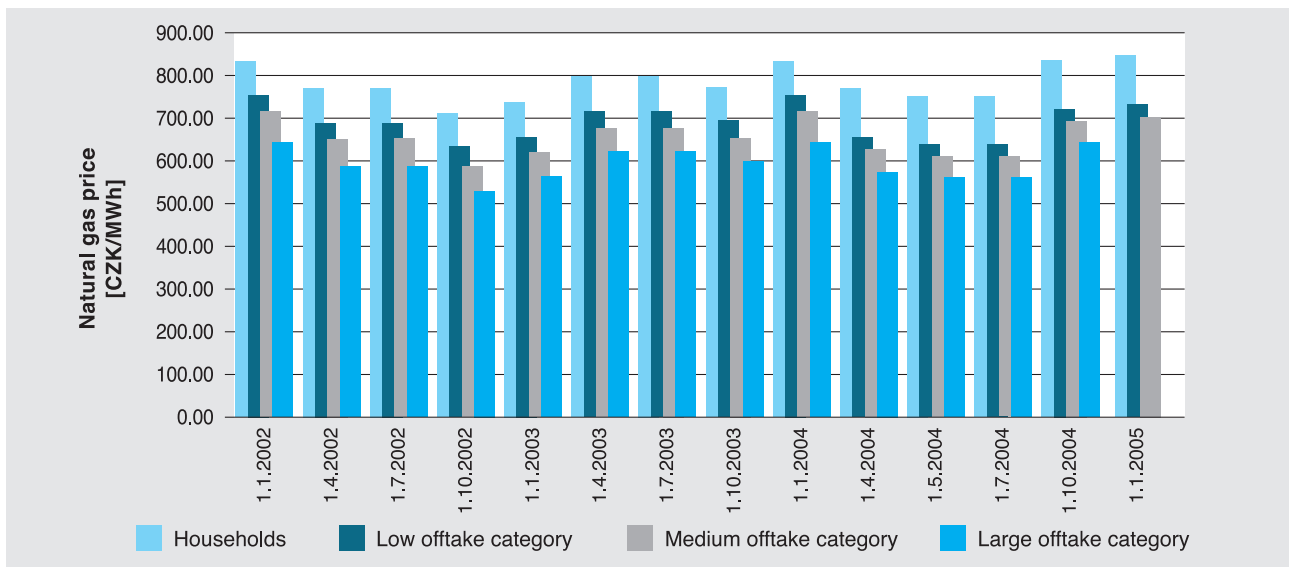
There is a new charge for exceeding the daily booked fixed capacity under the agreement between trader Transgas, a.s. and the respective licence holder who supplies gas to protected customers connected to the regional distribution system.

The price of the gas supplied by the respective licence holders who supply gas to protected customers has been set as a two-component price, and differs for each of the customer categories and offtake bands within these categories. The prices to each of the customer categories and offtake bands are derived from the costs actually incurred by these offtakes.

A part of the price relates to the gas quantity taken, and is regarded as the variable component. The other part is fixed in the case of small consumers, in the form of standing monthly charges, while in the case of larger offtakes it has the form of the charge for the maximum daily capacity.

Although the price of the energy contained in the natural gas from Transgas, a.s. was not changed between the fourth quarter of 2004 and the first quarter of 2005, the price to final customers did change, depending on the distribution company, in the range from -1.4% to +3.7%. For the whole Czech Republic, this means an average increase of 1.4%. The reason for this development is the change in the average price charged by Transgas, a.s., which serves as the input to the calculation of the prices to the final customers of each of the distribution companies. The development of average prices for each customer category can be seen in Chart 9.

Chart 9 The development of average prices for each customer category



### Local distribution systems

The amendment to the Energy Act has brought about some major changes in the rights and obligations of local distribution system operators. Until the end of 2004 local distribution system operators were able to supply natural gas to customers connected to their systems without holding a gas trading licence; the prices for which they supplied gas were cost-based prices. The amendment does not allow natural gas supplies if the supplier does not hold a gas trading licence. The prices for natural gas distribution via local distribution systems and the prices of natural gas supplies to protected customers connected to local distribution systems are now set as fixed and maximum prices, respectively, similarly to the regional distribution system operators.

### 3.3.3 Price Decisions, an outline

ERO Price Decisions, issued in November, differ significantly as from 1 January 2005; the differences can be found in both their structure and content in comparison with the preceding period. The changes are due to the launch of the gas market liberalisation, specifically the transfer of some customers from the protected customer to the eligible customer category.

The principal changes are as follows:

- The newly included part, which lays down the prices for natural gas transmission and distribution, sets the prices for the services related to natural gas supplies to protected customers;
- In addition to the gas prices and prices of services related to gas supplies, the Price Decision also contains prices related to the transmission system balancing and payments for exceeding the agreed capacity;
- The structure of the part of the Price Decision, which lays down the prices for supplies to protected customers, only differs in that it newly includes the payment for exceeding the agreed capacity, which Transgas, a.s. has the right to charge to the respective licence holders who supply gas to protected customers;
- A separate section of the Price Decision sets out the prices (and the way in which they should be applied) to be used for distribution by local distribution systems and for natural gas supplies to protected customers connected to the local distribution systems;
- In comparison with the prices in the first regulatory period, some technical units have been changed. The prices that are based on the maximum daily capacity are related to the volumetric unit of natural gas (cu m), because they reflect the required capacity of the respective facility (pipeline, UGS facility, pressure regulating station, compressor station, metering). The capacities of such facilities are specified in volumetric units, and it is therefore obvious that the price for using such facilities should reflect their technical parameters and relate to cubic metres. Before the end of 2004, also these prices were specified in energy units (kWh, MWh).

## 3.4 The heat supply industry

### 3.4.1 Price control

Typical of the heat supply industry is the large number and variegated nature of the businesses involved. Small, medium-sized and large companies operate in this industry, with considerable differences between their thermal energy supplies, while each of the businesses has its own specific conditions for thermal energy production and distribution.

The heat supply industry businesses can be described as local monopolies, because the choice of alternative heating is constrained in each particular location. These constraints are given by the existing thermal energy and natural gas distributions, and also the energy policies adapted by each town and city. The influence of competition therefore differs from locality to locality, and some consumers have no choice of any alternative heating methods at all, or only at the cost of incurring considerable capital expenditure.

In respect of thermal energy price control, the ERO relies on Section 6 of Act No. 526/1990, on Prices, as amended. The thermal energy price is therefore a regulated cost-plus price, which may only reflect economically justifiable costs, reasonable profit, and value-added tax. Since 2001 the ERO has been gradually specifying the mandatory procedure for thermal energy pricing more precisely for each of the regulated years.

### 3.4.2 Assessment of thermal energy price control in 2004

In its Price Decision No. 21/2003 on thermal energy prices for 2004, the ERO set out the price levels for each of the levels at which thermal energy is transferred. The price levels were set out separately for the prices of the thermal energy produced from coal (hard coal, brown coal and briquettes), and for the prices of the thermal energy produced from other fuels (in particular natural gas, fuel oil, municipal waste, coke, etc.).

The price levels constitute reference values for comparing the prices charged by thermal energy producers and distributors. Only the rules of cost-plus control apply to the thermal energy prices calculated below the respective price level, while a cap on the annual growth in fixed costs also applies to the thermal energy prices calculated above the respective price level, in addition to cost-plus control. Thanks to the price levels the regulation applicable to lower thermal energy prices has been relaxed to a certain degree.

The schedule appended to the Price Decision for 2004 defines economically justifiable costs and specifies more precisely the costs that are not regarded as economically justifiable for inclusion into the thermal energy price. The decision also lays down the structure of the thermal energy price formula and defines the possible price localities in which the price is calculated and applied under the same conditions for all customers. These more precise rules for mandatory thermal energy pricing resulted in a better transparency, and clarity for review purposes, of the price in 2004.

In 2004 the Office published on its website, databases of thermal energy prices for 2001 to 2004, as charged by thermal energy production and distribution licence holders. The databases serve as sources of information on the market environment for thermal energy suppliers (producers and distributors), and also for thermal energy consumers (municipalities, housing associations, and final customers) who can use these overviews for exerting pressure on thermal energy prices in the interest of final customers. This will help to achieve a certain self-regulating effect wherever the competitive environment does not suffice.

The publication of prices may partially replace the laborious review of economically justifiable costs and their structure, conducted by the ERO or the State's Energy Inspectorate upon customers' requests, which are motivated by the insufficient information available to them.

### 3.4.3 Development of thermal energy prices

The method of price control in the heat supply industry results in changes in thermal energy prices varying in different localities. Besides the permissible growth in fixed costs and profit, and changes in the costs of the fuels used for thermal energy generation, the amount of the calculated price is mainly influenced by the improving efficiency of the heating equipment, decreasing heat losses, connection and disconnection of heat supply points, and variable weather conditions.

Using the data from the database of the prices billed by thermal energy production and distribution licence holders, Tables 3 and 4 show the development of the average thermal energy prices (CZK/GJ, including VAT) and the quantities of thermal energy (GJ) delivered at each of the transfer levels from 2002 to 2004. To calculate the average thermal energy prices, the resulting thermal energy prices for 2002 to 2003 have been used, while for 2004 they are prices tentatively calculated as at 1 January 2004. The average prices at each of the transfer levels are also compared with the price levels set out in the ERO Price Decision for 2004.

Table 3 lists average prices of the thermal energy generated from coal, at different transfer levels. At some transfer levels the quantity of the thermal energy delivered dropped significantly, which resulted in a price rise. In some cases, the price went down when the quantity of the thermal energy delivered decreased.

**Table 3 Average prices of thermal energy produced from coal**

Transfer level		2002	2003	2004
Supplies from production, capacity over 10 MWt	Price [CZK/GJ]	165.68	169.79	165.78
	Quantity [GJ]	15,617,024	19,325,355	20,014,998
	Price level [CZK/GJ]			160
Supplies from production, capacity up to 10 MWt	Price [CZK/GJ]	325.54	296.74	344.48
	Quantity [GJ]	394,130	443,007	297,908
	Price level [CZK/GJ]			265
Supplies from the primary distribution	Price [CZK/GJ]	212.46	217.59	223.05
	Quantity [GJ]	55,836,664	59,066,708	63,180,534
	Price level [CZK/GJ]			240
Supplies at the central exchanger station	Price [CZK/GJ]	272.30	278.21	281.45
	Quantity [GJ]	7,304,248	7,998,913	7,846,800
	Price level [CZK/GJ]			265
Supplies from the block boiler house's distribution	Price [CZK/GJ]	327.41	332.25	325.82
	Quantity [GJ]	527,082	485,343	442,228
	Price level [CZK/GJ]			290
Supplies from secondary distribution	Price [CZK/GJ]	308.08	310.97	317.88
	Quantity [GJ]	23,078,978	28,096,699	28,605,069
	Price level [CZK/GJ]			290
Supplies from a house transfer station	Price [CZK/GJ]	317.58	330.56	329.26
	Quantity [GJ]	2,854,396	3,179,820	4,059,830
	Price level [CZK/GJ]			290

Table 4 shows average prices of thermal energy produced from fuels other than coal. It is evident that prices at all transfer levels have risen. The gradual unification of the prices billed by the suppliers who initially applied different prices to households and other customers may also contribute to the increase in the prices of thermal energy intended for final consumption in households in certain price locations.

**Table 4 Average prices of thermal energy produced from other fuels**

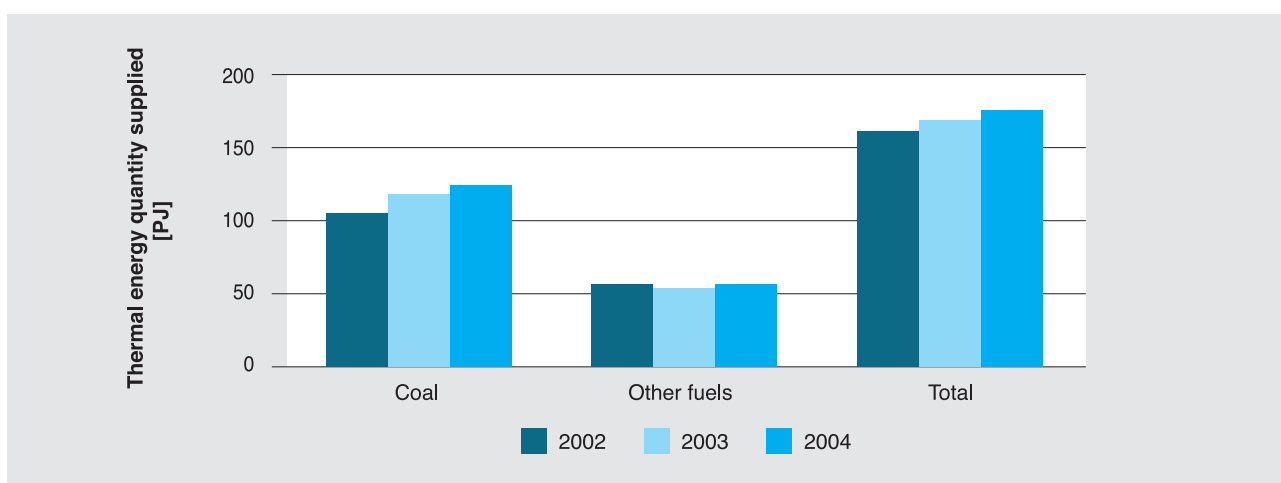
Transfer level		2002	2003	2004
Supplies from production, capacity over 10 MWt	Price [CZK/GJ]	192.96	192.89	198.63
	Quantity [GJ]	7,962,606	7,520,075	7,651,272
	Price level [CZK/GJ]			230
Supplies from production, capacity up to 10 MWt	Price [CZK/GJ]	318.57	319.95	316.35
	Quantity [GJ]	2,520,986	2,871,188	2,598,191
	Price level [CZK/GJ]			335
Supplies from the primary distribution	Price [CZK/GJ]	283.86	281.60	294.78
	Quantity [GJ]	15,743,266	15,294,031	15,183,003
	Price level [CZK/GJ]			310
Supplies at the central exchanger station	Price [CZK/GJ]	338.63	358.81	370.20
	Quantity [GJ]	3,071,835	2,594,411	2,801,870
	Price level [CZK/GJ]			335
Supplies from the block boiler house's distribution	Price [CZK/GJ]	336.66	337.93	354.44
	Quantity [GJ]	10,270,813	10,439,291	11,333,120
	Price level [CZK/GJ]			360
Supplies from secondary distribution	Price [CZK/GJ]	355.78	354.73	367.26
	Quantity [GJ]	11,107,485	9,632,632	10,021,655
	Price level [CZK/GJ]			360
Supplies from a house transfer station	Price [CZK/GJ]	363.26	371.00	375.30
	Quantity [GJ]	6,199,035	6,242,145	6,474,648
	Price level [CZK/GJ]			360

Table 5 compares the quantities and average prices of thermal energy from 2002 to 2004, produced from coal and other fuels. Charts 10 and 11 show the total quantity of thermal energy and average prices from 2002 to 2004.

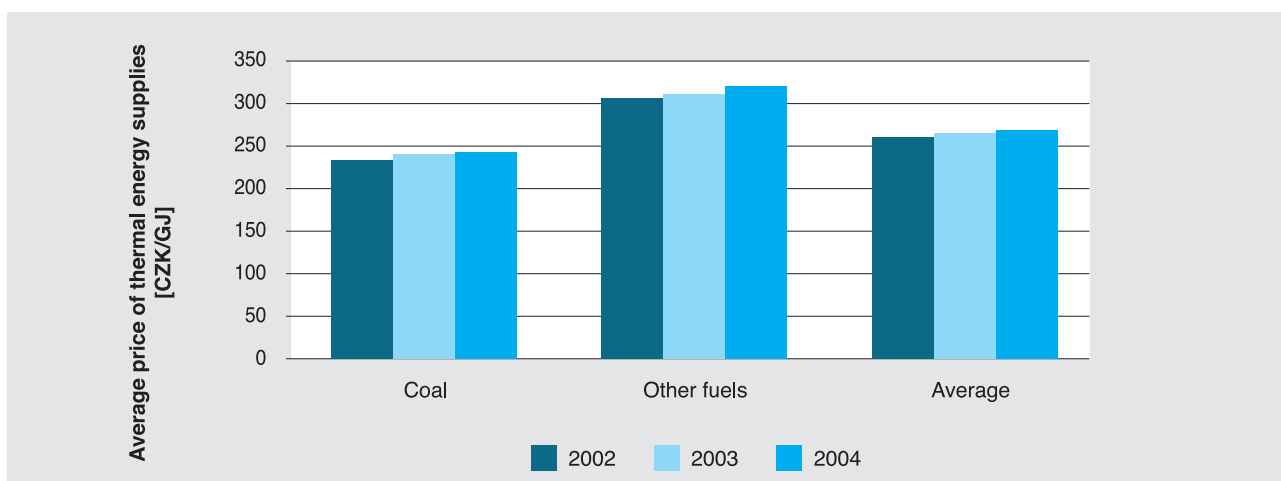
**Table 5 Average prices and quantities of thermal energy delivered**

Year	Coal		Other fuels		Total	
	Price [CZK/GJ]	Quantity [GJ]	Price [CZK/GJ]	Quantity [GJ]	Price [CZK/GJ]	Quantity [GJ]
2002	234.41	105,612,522	307.86	56,876,026	260.12	162,488,548
2003	239.81	118,595,845	308.96	54,593,773	261.61	173,189,618
2004	243.44	124,447,367	320.74	56,063,759	267.45	180,511,126

**Chart 10 Total quantity of thermal energy delivered from 2002 to 2004**



**Chart 11 Average prices of thermal energy delivered from 2002 to 2004**



The following conclusions can be derived from the development of the thermal energy prices billed by thermal energy production and distribution licence holders in the period under review:

- The prices of thermal energy supplies changed only slightly year on year;
- The large differences in thermal energy prices between certain localities are gradually diminishing thanks to the introduction of the incentive-based regulatory approach;
- The gradual unification of prices to households and the other customers in one price locality is helping to eliminate the large differences between thermal energy prices at the same transfer level and having the same nature of supplies;
- Price control can be felt as a price stabilisation factor in the heat supply industry.

### 3.4.4 Thermal energy price control prepared in 2004 for the following period

The ERO laid down the conditions for mandatory thermal energy pricing and price negotiations, applicable as from 1 January 2005, in its Price Decision No. 9/2004 of 20 October 2004. Unlike the previous price decisions, these conditions are expected to remain applicable for several years. In the light of the gradual stabilisation of the situation prevailing on the energy market and of the influence of competitors, who use alternative methods of heating, the rules of thermal energy price control have been partially relaxed for the following years.

Thermal energy prices will continue to be controlled prices based on the cost-plus principle. This means that the supplier may only reflect economically justifiable costs related to thermal energy production and distribution, and reasonable profit based on the relevant price regulations, in its price. Furthermore, the incentive-based regulation has deepened, which should help to minimise the costs of thermal energy production and distribution and operate heat supply facilities at a higher level of efficiency. The last day of 2004 saw the finalisation of the process of the gradual unification of the thermal energy prices for households and the other customers in one price locality, supplied at the same transfer level and having the same nature of demand.

For the sake of comparability of thermal energy prices, a part of the rules of thermal energy price control is the concept of price levels. For 2005, the ERO adjusted these price levels to reflect the rise in the prices of primary fuels. The price levels serve for reducing the large differences in thermal energy prices between different localities in the following way: annual increases in the prices calculated above a price level are constrained (unlike the prices calculated below that price level), usually in relation to the rate of inflation reported for the previous calendar year. The more relaxed control below the price levels should incentivise suppliers to reduce their thermal energy prices to below these levels.

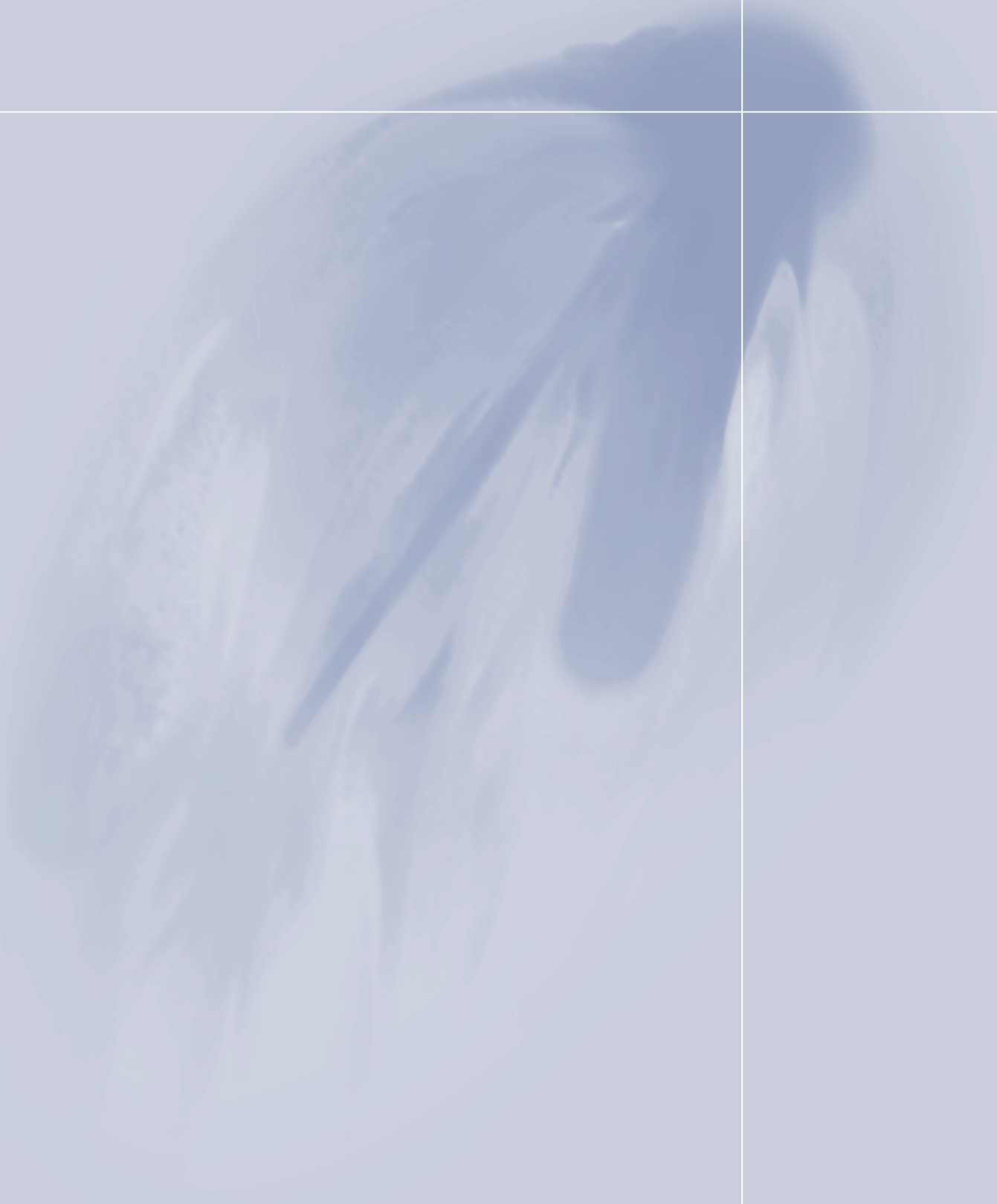
In the years to come, the ERO will update the thermal energy price databases published on its website, with a view to improving the information to the public and utilising a self-regulation effect that can be observed in the negotiation of thermal energy prices between suppliers and customers.

### 3.5 Price decisions issued in 2004

In 2004 the ERO issued the following price decisions, and published them in the *Energy Regulation Gazette*:

- ERO Price Decision No. 1/2004 of 20 February 2004, on gas prices – *Energy Regulation Gazette*, Chapter 2/2004, 27 February 2004
- Correction to ERO Price Decision No. 24/2003 of 1 December 2003 – *Energy Regulation Gazette*, Chapter 2/2004, 27 February 2004
- ERO Price Decision No. 2/2004 of 23 April 2004, which lays down the maximum electricity prices and conditions for electricity supplies to protected customers from high voltage networks - Category B – *Energy Regulation Gazette*, Chapter 4/2004, 29 April 2004
- ERO Price Decision No. 3/2004 of 23 April 2004, which lays down the maximum electricity prices and conditions for electricity supplies to protected customers from low voltage networks – *Energy Regulation Gazette*, Chapter 4/2004, 29 April 2004
- ERO Price Decision No. 4/2004 of 23 April 2004, on gas prices – *Energy Regulation Gazette*, Chapter 4/2004, 29 April 2004
- Correction to ERO Price Decision No. 26/2003 of 26 November 2003 – *Energy Regulation Gazette*, Chapter 4/2004, 29 April 2004
- ERO Price Decision No. 5/2004 of 23 April 2004, on a change to ERO Price Decision No. 26/2003 – *Energy Regulation Gazette*, Chapter 4/2004, 29 April 2004
- ERO Price Decision No. 6/2004 of 2 June 2004, on a change to ERO Price Decision No. 26/2003 – *Energy Regulation Gazette*, Chapter 5/2004, 20 June 2004
- ERO Price Decision No. 7/2004 of 20 July 2004, which sets forth a different method for thermal energy pricing – *Energy Regulation Gazette*, Chapter 6/2004, 2 August 2004
- ERO Price Decision No. 8/2004 of 24 August 2004, on gas prices – *Energy Regulation Gazette*, Chapter 7/2004, 30 August 2004
- ERO Price Decision No. 9/2004 of 20 October 2004, on thermal energy prices – *Energy Regulation Gazette*, Chapter 9/2004, 27 October 2004
- ERO Price Decision No. 10/2004 of 29 November 2004, which lays down the prices of electricity and related services – *Energy Regulation Gazette*, Chapter 10/2004, 1 December 2004
- ERO Price Decision No. 11/2004 of 29 November 2004, which lays down fixed prices of electricity distribution to eligible customers from low voltage networks – *Energy Regulation Gazette*, Chapter 10/2004, 1 December 2004
- ERO Price Decision No. 12/2004 of 29 November 2004, which lays down the maximum electricity prices and conditions for electricity supplies to protected customers from low voltage networks – *Energy Regulation Gazette*, Chapter 10/2004, 1 December 2004
- ERO Price Decision No. 13/2004 of 26 November 2004, on gas prices – *Energy Regulation Gazette*, Chapter 10/2004, 1 December 2004.







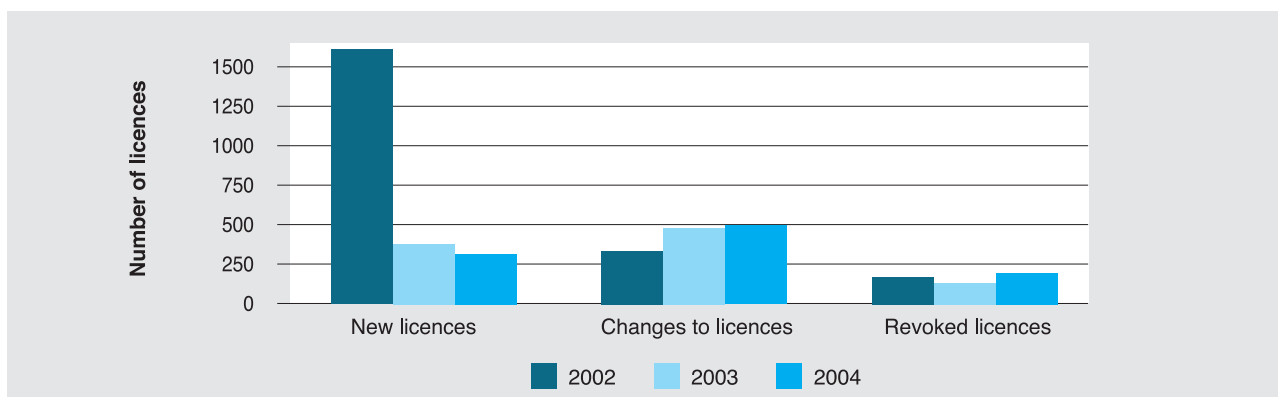
### 4.1 The licensing policy

In 2001 and 2002 the ERO's activities focused on awarding licences to meet the requirements of Section 8 of the Energy Act. Since 2003, the number of requests for changes to, and revocation of, licences for conducting business in the energy industries has been increasing. The main reasons for requesting modifications to licences include the transfers of property between licence holders, which are caused by the ongoing mergers and divisions of utilities as the electricity and gas markets open. This mainly involves the meeting of the requirement for the legal unbundling of transmission and distribution from generation and trading. In the heat supply industry, the changes to licences are prompted by similar transfers of property and changes of the heat supply business lessees.

**Table 6** Number of licences awarded, changed and revoked in 2002 to 2004

Year	New licences	Changed licences	Revoked licences
2002	1,619	334	161
2003	376	485	137
2004	312	493	194

**Chart 12** Number of licences granted, changed and revoked in 2002 to 2004



In 2004 the number of electricity generation licence holders increased, particularly in respect of small hydroelectric power stations. There was also a rise in the number of applicants for licences for electricity generation in wind power stations.

On the one hand, the electricity market opening is resulting in a rising number of electricity traders, while on the other hand the number of licensed distributors on former manufacturing plants' premises is going down – the ones who are no longer interested in promoting their business through participation in the energy market are exiting.

Special attention was devoted to the heat supply industry, continuing the project for obtaining technical and financial data on licence holders in this industry and subsequently evaluating this data using a customised software application. The continuous output from the project, which has been going on for the third year now, is a set of statistically usable data, which becomes more and more accurate. This set can be used for obtaining ratings of licence holders, calculated by the program. The data is collected using electronic forms. The ERO expects to use the data, in co-operation with the State's Energy Inspectorate, for the purpose of preventing sudden interruptions in thermal energy supplies.

Information on the content of the licences awarded, and on changes to and revocation of licences, is published in the *Energy Regulation Gazette*; a list of valid licences is published on the ERO's website, and it is a list of licence holders structured by the licence groups. There is also an application helping to search for data on a particular licence holder.

### 4.2 The Energy Regulation Fund

Under Section 14 of the Energy Act, licence holders (specified in Section 4, subsection 1, items h) and i)), have to contribute to the Energy Regulation Fund ("the Fund").


Since the statutory amount of CZK 50 million was reached and no finances were paid from the Fund in 2004, the respective licence holders will not have to make any contributions to the Fund in 2005.

The amendment to the Energy Act, i.e. Act No. 670/2004, contains more specific and accurate provisions on the Fund, in particular in respect of Act No. 337/1992, on the administration of taxes and levies, as amended. Also the procedure for filling the Fund are specified in more detail.

### 4.3 Recognition of professional qualifications

Under Act No. 18/2004, on the recognition of professional qualifications and other competences of the citizens of the EU member states and on changes to certain laws ('the law on professional qualification recognition'), the ERO is the body authorised to recognise professional and other competences of the EU member states' citizens for the purposes of conducting business in the energy industries. In 2004 the ERO decided on the recognition of professional qualifications in two administrative proceedings.

# 5



Administrative proceedings  
and dispute settlement in 2004



### 5.1 Major administrative proceedings

#### 5.1.1 The electricity industry

In 2004 the electricity industry saw the institution and conclusion of two administrative proceedings. Both cases involved completely novel issues, with which the ERO had not dealt before. One dispute concerned the contract terms and conditions for connecting wind power stations with regard to the approach taken by the distribution system operator to assessing the applications for connection filed by multiple applicants in the area in questions, and the other dispute related to the execution of an agreement on electricity supply to a demand take point at which unauthorised electricity consumption had been identified. Both proceedings were concluded by a decision at the level of first instance; in one case, this decision was to discontinue the proceeding because the parties to the proceeding had entered into an agreement, thereby ending their dispute.

Two administrative proceedings that were to be concluded at the beginning of 2005 were instituted. One concerned a dispute over a connection agreement, specifically the reimbursement of the costs incurred in the adjustment of the substation, and the other concerned a dispute over the connection of wind power plants to the distribution system.

In the electricity industry the trend observed as early as 2003 can be confirmed: the situation surrounding disputes is stabilising, primarily because most of the electricity market participants display a relatively high technical level. The stable environment on the electricity market, predictable for the participants, is significantly underpinned by the Office's activities concerning its public notices and price decisions, and also its educational activities, etc. These result in the introduction of clear-cut and unchallenged rules that ultimately determine such a behaviour of the electricity market participants, which does not lead to disputes that have to be addressed by the Office. The only new area in which disputes arise is the connection of generating plants to distribution networks.

#### 5.1.2 The gas industry

In the gas industry five administrative proceedings were instituted and concluded in 2004. They all concerned a single issue – a dispute conducted by Českomoravská plynárenská, a.s., in its position of a local distribution system operator connected to and buying gas from five regional distribution system operators, which challenged the price for which it was to buy the gas from these regional distribution system operators.

In 2004 the gas industry also saw three administrative proceedings that were to be concluded at the beginning of 2005. They concerned a dispute over a local distribution system operator's prices and contract terms and conditions; a dispute over the price between a regional distribution system operator and a protected customer; and also an issue involving the rejection to connect gas facilities and increase natural gas supplies by a local distribution system operator.

In comparison with the previous period, when no disputes had to be decided in the gas industry, this therefore implies a considerable change, which is largely caused by the gradual liberalisation of the gas market and the related significant legislative changes. In this context, the local distribution system operator's position appears to be the most problematic issue as regards these disputes, also for the future.

#### 5.1.3 The heat supply industry

In the heat supply industry three administrative proceedings were instituted and concluded in 2004. In two cases they concerned disputes over the thermal energy price, and one case involved a dispute over the purchase of thermal energy and its price. Of these administrative proceedings, two were concluded by decisions at the level of first instance; in one case the proceeding was discontinued because the motion for the initiation of the administrative proceeding was withdrawn as an agreement had been signed, and the dispute ended, thanks to talks between the parties to the proceedings and the ERO. In one case the proceeding was concluded by ERO Chairman's decision on a remonstrance.

Furthermore, one administrative proceeding was instituted in 2004, which was to be concluded at the beginning of 2005. It involves a dispute over the entering into an agreement on emergency heat supplies via a transfer station.

Particularly in disputes over thermal energy prices the ERO cooperated in its decision-making with the State's Energy Inspectorate, which conducted reviews at some of the parties to these administrative proceedings (under Act No. 552/1991, on inspections by the State).

In the light of the practical experience accumulated over the past years, when it was noted that due to the considerably variegated nature of the entities operating in this industry, and also the differing technical condition and age of generating and distribution facilities, it was more difficult to define any clear rules that would accommodate the principal commercial relations on the heat supply market than in the electricity and gas industries, the trend can now be confirmed that thanks to the Office's activities, mainly as regards price decisions, the number of newly emerging disputes over thermal energy pricing is decreasing considerably. What can also be seen is the improving technical level of the players in this industry. For these reasons we can note that most of the new administrative proceedings did not arise as new problems, but had "historical roots", such as inept agreements or errors in pricing in the previous years.

## 5.2 Major disputes over prices and contracts in 2004

### 5.2.1 The electricity industry

#### *Moravská Energetika, s.r.o. and Jihomoravská energetika, a.s.:*

- A dispute over the contract terms and conditions for connecting three wind power stations, Vestas V80, within the limits of Benešov u Boskovic, by Moravská Energetika, s.r.o., with regard to the approach taken by the distribution system operator to assessing the applications for connection filed by multiple applicants in the area in question;
- The first instance decision imposed, under Section 17, subsection 8, item g) of the Energy Act, the obligation on Jihomoravská energetika, a.s., as an electricity distribution licence holder, to remedy the shortcomings identified, and, under Section 3, subsection 1 of MIT Public Notice No. 18/2002, on the conditions of connection and electricity transport in the grid, as amended in Public Notice No. 300/2003, and under the Rules for Distribution System Operation, ordered that company to preferentially assess the application for the connection of three Vestas V80 plants within the limits of Benešov u Boskovic, filed by Moravská Energetika, s.r.o.

#### *Severočeská energetika, a.s. and Mrs Lenka Losová:*

- A dispute over the entering into an agreement of electricity supply to a demand take point where unauthorised consumption had been identified;
- The gist of the problem was the claim of identified unauthorised consumption at a demand take point in house no. 391 in Benešov nad Ploučnicí, effected by the connection of a cable upstream from the supplier's meter, through which [i.e. the cable] unauthorised unmetered electricity was taken, and the subsequent refusal by Severočeská energetika, a.s., as an electricity distribution licence holder, to enter into an agreement on electricity supply to that point with Mrs Lenka Losová;
- Once the customer adjusted the demand take point, the agreement on electricity supply was signed.

### 5.2.2 The gas industry

#### *Českomoravská plynárenská, a.s. and Jihočeská plynárenská, a.s.:*

- A dispute over the maximum natural gas price, between gas distribution licence holders;
- The gist of the dispute was that Českomoravská plynárenská, a.s. demanded the execution of an agreement containing a natural gas price calculated under Article I, clause 2 of ERO Price Decision No. 25/2003 of 25 November 2003, on gas prices, whereas the supplier (Jihočeská plynárenská, a.s.) insisted on natural gas supplies to Českomoravská plynárenská, a.s. for prices under Article I, clause 3 of the above price decision;
- The first instance decision rejected the motion for imposing an obligation on Jihočeská plynárenská, a.s. to agree with Českomoravská plynárenská, a.s. on changing the price provisions in the gas supply agreement with effect from 1 January 2004, and held that as regarded the natural gas supplied by Jihočeská plynárenská, a.s. to Českomoravská plynárenská, a.s., the applicable maximum gas price was, effective from 1 January 2004, as per Article I, clause 3 of ERO Price Decision No. 25/2003 of 25 November 2003, on gas prices;
- Českomoravská plynárenská, a.s. then filed a remonstrance. In his decision ERO Chairman affirmed the first instance decision, with some formal modifications, and rejected the remonstrance.

Similar administrative proceedings were conducted by the ERO in disputes over the maximum natural gas price between Českomoravská plynárenská, a.s. and Jihomoravská plynárenská, a.s., Severočeská plynárenská, a.s., Středočeská plynárenská, a.s. and Pražská plynárenská, a.s.

### 5.2.3 The heat supply industry

#### *Jihostroj a.s. and TEZA CK s.r.o.:*

- Dispute over the thermal energy price for 2004;
- According to Jihostroj a.s., as a thermal energy production licence holder, the essence of the dispute was the price of the thermal energy supplied by it, which was contested by TEZA CK s.r.o., as a thermal energy distribution licence holder, although the latter itself observed that the price complied with ERO Price Decision No. 21/2003 of 25 September 2003 on thermal energy prices for 2004; in 2004 and in previous years the price proposed by the latter had been deep below the calculated price level (both cost-based and cost-plus calculations);
- The first instance decision confirmed as justifiable Jihostroj's requirement to execute – between Jihostroj as the thermal energy supplier and TEZA CK as the thermal energy customer – an addendum to purchase agreement no. 1/2001 on steam supply and take, concerning the thermal energy price for 2004.

#### *DESTRA Co., spol. s r.o. and Energetika Chropyně, a.s.:*

- A dispute over the purchase of thermal energy and its price under Section 80, subsection 2, item a) of the Energy Act, generated in a hazardous waste incinerating plant (DESTRA Co., spol. s r.o., as the thermal energy production licence holder), while Energetika Chropyně, a.s. is also a thermal energy producer besides operating thermal energy distribution;



- At a meeting in person a solution was proposed in the form of a price addendum and also an addendum on the method of the thermal energy purchase. The parties to the proceedings reached agreement on the purchase of the thermal energy and its price so as to meet the conditions in Section 80, subsection 2, item a) of the Energy Act, i.e. the case where there is no increase in the total costs of procuring thermal energy for a group of existing customers and at the same time the thermal energy is used as effectively as possible.

***SMO, městská akciová společnost Orlová [a municipal plc], and Bytové družstvo v Orlové [a housing co-operative]:***

- An administrative proceeding instituted by the customer, Bytové družstvo v Orlové, in the case of a dispute over the non-execution of addendum no. 17 to agreement on thermal energy supply and take of 1 July 1996; the content of the addendum was the price, quantity, advance payments and an application for thermal energy take, all of that for 2004;
- The first instance decision set out the average preliminarily calculated price of the thermal energy supplied by SMO, městská akciová společnost Orlová, a thermal energy distribution licence holder, for 2004, relating to the Orlová price locality, at CZK 293.78/GJ without VAT;
- SMO, městská akciová společnost Orlová lodged a remonstrance. In his decision ERO Chairman affirmed the first instance decision, with some formal modifications, and rejected the remonstrance.

### **5.3 Remonstrance proceedings; remonstrance commission's activities**

Under the relevant provisions of the still effective Act No. 71/1967, on administrative proceedings (Rules of Administrative Procedure), decisions on remonstrances fall within the competencies of the ERO Chairman upon proposals of the remonstrance commission appointed by him. This commission is composed of ten, mostly external specialists – lawyers, engineering experts and economists.

The ERO's efforts are geared towards preventing disputes and making licensees and their customers resolve their disputes amicably as the preferred option. If it issues a decision in a dispute between these entities, then in the substantiation of these decisions and in the dealings related to the issue of first instance decisions the Office makes an effort to motivate the parties to the dispute to hold talks and respect each other's requirements. Also thanks to this effort the ERO received only 14 remonstrances against its first instance decisions in 2004.

#### **5.3.1 The electricity industry**

One remonstrance was filed, by IMOLA s.r.o., concerning the connection obligation and the obligation to enter into an agreement on electricity supply. The decision on this remonstrance changed the first instance decision so that IMOLA s.r.o. was obliged to ensure the connection of the electricity consuming equipment and enter into the agreement.

#### **5.3.2 The gas industry**

In 2004 the following remonstrances were filed:

- by MIJA-MENMARK, s.r.o., concerning the calculation of the natural gas price – the ERO's decision was reversed, and the case was remanded for new consideration and decision;
- by Českomoravská plynárenská, a.s., which filed five remonstrances concerning the dispute with distributors over natural gas prices – the remonstrances were rejected, and the ERO's decisions were affirmed.

#### **5.3.3 The heat supply industry**

One remonstrance was filed, by SMO, městská akciová společnost Orlová, in the case of the dispute over the thermal energy price – the decision on the remonstrance laid down the average preliminarily calculated thermal energy price, while in other matters it affirmed the ERO's decision.

#### **5.3.4 Licensing**

In 2004 the following remonstrances were filed:

- by IMOLA s.r.o., in the case of the revocation of its licence in group 12; it was rejected, and the ERO's first instance decision was affirmed;
- by MARSERVIS, s.r.o., in the case of the award of a heat distribution licence; it was rejected, and the ERO's first instance decision was affirmed;
- by the city of Chodov in the case of a failure to recognise it as a party to an administrative proceeding; it was rejected, and the ERO's first instance decision was affirmed;
- by DESK-FORM a.s., in the case of the imposition of the supply obligation over and beyond the licence – the ERO's decision was reversed and the case was remanded for new consideration and decision.

### **5.4 Complaints**

In 2004 the ERO received 30 submittals; taking into account their nature and content, these submittals were disposed of as complaints under Government Ordinance No. 150/1958, Official Gazette, on disposing of the working people's complaints, notifications and suggestions.

Eight complaints were directed against the ERO's operations or the procedures followed by its employees, suggesting a breach of the relevant provisions of the Energy Act or the Price Act. These complaints were found unjustified, and four were repeated.

Nine complaints were not reviewed by the ERO; they were referred to other authorities for consideration.

Two complaints on a breach of statutory regulations by licensees were found justified, and the ERO remedied the matter.

The ERO disposed of all the complaints received in 2004 within the time limits under Government Ordinance No. 150/1958, Official Gazette, Chapter 81, with the exception of the complaint against licence holder and operator Teplárna Ústí nad Labem, a.s., in respect of which the time limit was missed because of the late delivery of the documents requested from the licence holder.

In addition to consistently proceeding in line with the above ordinance in disposing of the complaints, the ERO also issued its internal regulation setting out in detail the specific procedures for recording complaints and making annual analyses of finalised complaints having to do with the ERO's terms of reference.



Co-operation with state administration  
authorities and Czech Parliament



### 6.1 The Government and central state administration authorities

In the latter half of 2004 the ERO intensified direct bilateral communication with each of the Ministries. After his appointment, new ERO Chairman Josef Fírt focused on strengthening the ties and co-operation with the other state administration authorities, and held a number of meetings with the Ministers. The outcome of his meeting with Milan Urban, Minister of Industry and Trade, at which they agreed on mutual communication and co-operation, in particular in the formulation of the Czech Republic's positions in the energy sector, can be regarded as a key result. Another important meeting was making contact with Martin Jahn, Deputy Prime Minister for Economy, and his team. They agreed that upon request, the ERO would provide analyses and positions for strategic decisions having a bearing on the energy sector, and potentially participate in the development of these strategies.

For the needs of RHSD's deliberations the ERO prepared, in the autumn of 2004, a detailed report on the expected development of the prices in the electricity, gas and heat supply industries from 2005 to 2007. The ERO's output served as input to analyses drawn up by the Ministry of Labour and Social Affairs and the Ministry of Finance, which focused on the impacts on the economic and social spheres. Although it did not offer any positive developmental trends, the report was regarded favourably in respect of its content, form, and intelligibility, and it fully met its information purpose.

The ERO's co-operation with the State's Energy Inspectorate (SEI) was based on the provisions of the Energy Act and the continuously extending needs for regulation in the energy industries. The two institutions signed a *Programme of Co-operation between SEI and ERO in 2004*. In addition to co-operation in the legislative area, this document also outlines the system of co-operation in licensing and in the performance of regulation. It specifies in detail the inspections to be carried out in relation to the various cases addressed by the ERO, and outlines a system of conclusions of administrative proceedings.

The ERO requested SEI to institute inspection proceedings in almost all disputes, and in six cases referred the complaint to inspection under Government Ordinance No. 150/1958.

### 6.2 Co-operation with Czech Parliament

In addition to its obligation under the Energy Act to inform Czech Parliament about its activities, the ERO maintained intensive communication with several committees of the House of Deputies, especially the Economic Committee and the Committee for Public Administration, Regional Development and the Environment, in respect of energy legislation. The ERO's representatives regularly attended all discussions of the amendment to the Energy Act and the bill on support for the use of renewable energy sources. They also took an active part in all workshops on both laws, where the ERO was always provided with room for presenting its views and positions. Especially for the purposes of the debate on the bill on support for the use of renewable energy sources the ERO drew up several analyses of its impacts, in response to the evolution of the bill and the amending proposals that were raised one by one. It also prepared the requested underlying materials for the meetings of each of the committees.

### 6.3 Reform and modernisation of central state administration

The reform of state administration was launched under Government Resolution No. 237 of 17 March 2004, on the process and main directions of the reform and modernisation of central state administration, containing also some provisions on the responsibilities and on the organisation of the process. Since the start of the reform the ERO has participated in the following projects:

- A.1 Identification of the mission (objectives) of central state administration
- A.2 Description and analysis of the processes in central administration authorities
- B.1 Effective horizontal communication and support for the development of national strategies
- C.2 Reform of regulation in state administration
- C.3 E-government.

Under Point A. Rationalisation of the processes in central state administration, the ERO contributed to project A.1 Identification of the mission (objectives) of central state administration. The ERO prepared a paper on the ERO's mission under Section 17 of the Energy Act.

In addition, it defined its main medium-term objectives, matching the effort to create transparent and non-discriminatory conditions for the second regulatory period for all energy market participants:

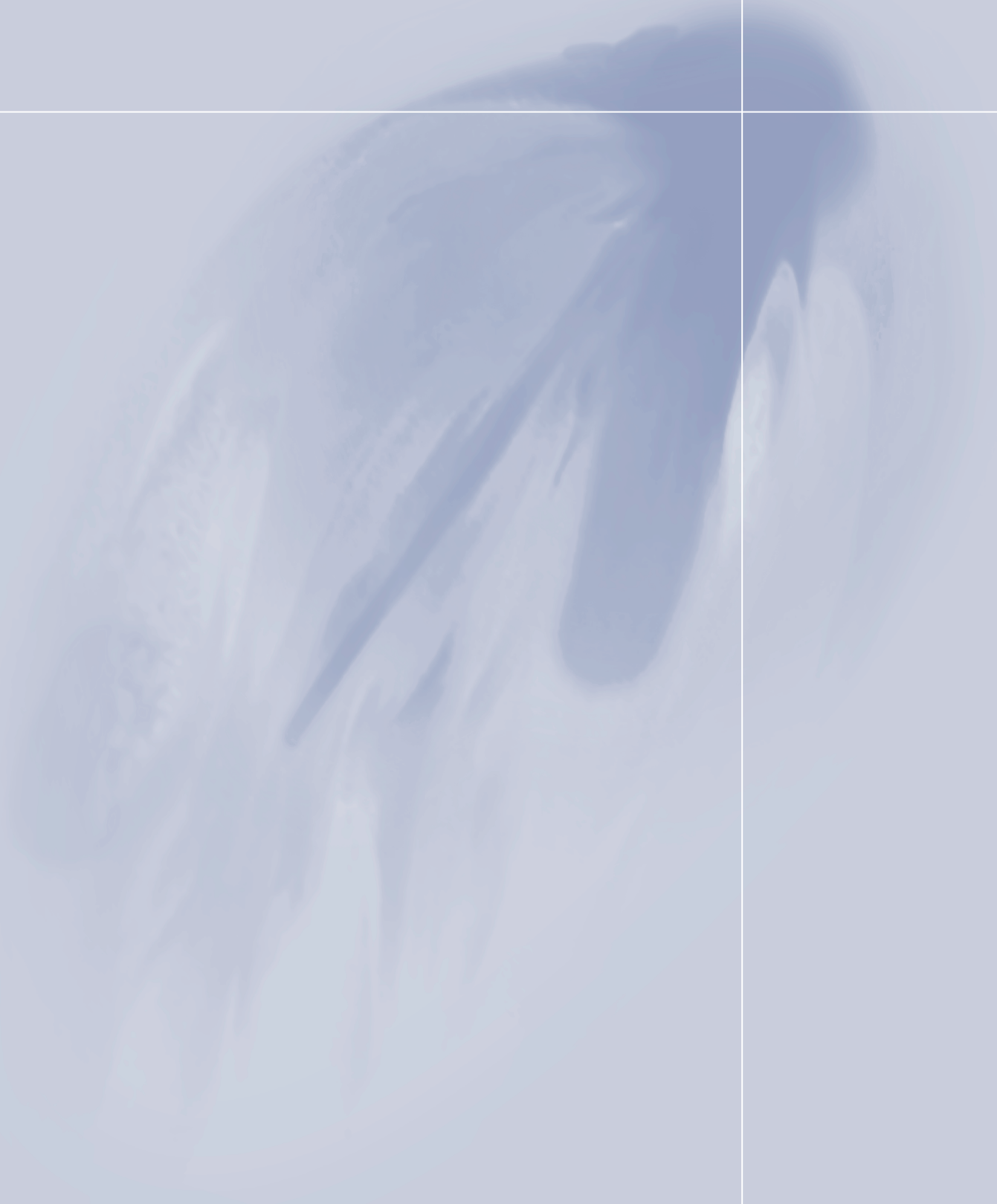
- in line with the liberalisation of energy markets, improve the rules and procedures for economic regulation,
- ensure protection for consumer interests by creating the preconditions for the security, reliability and quality of electricity, gas and heat supplies.

In addition to working on project teams dealing with the other directions (i.e. the Points), in 2004 it was essential for the ERO to take an active part in project C.2 Reform of regulation in state administration. ERO employees contributed to the Draft Rules for the Operation of the National Regulatory Authorities. The output from this project is the General Model of National Regulatory Authorities, which was completed, including the inter-ministerial commenting procedure, on 31 December 2004, and presented to the Government for discussion.

The other outputs of Project Team C.2 in 2004 include:

- An action plan of reducing the administrative burden;
- Proposed methodology for determining the size and origin of administrative burden;
- Proposed procedure for incorporating the regulation impact assessment (RIA) method in the legislative process.

Looking ahead, the progress of the reform and modernisation of central state administration will place greater demands on the ERO's work, primarily in relation to preparing an audit of processes and activities in 2005 and 2006, when the baseline assumptions for the reorganisation of the various central authorities will be drawn up.



International co-operation





## 7.1 European Union

In 2004 the ERO cooperated with the European Communities' technical bodies, particularly the European Commission's Directorate General for Energy and Transport (DG TREN) and Directorate General for Competition (DG COMPETITION). The ERO provided much information on the further development of regulation and licensing, including the secondary legislation promulgated. On the other hand, the ERO received regular information from the Permanent Representation of the Czech Republic to the European Union about the results of the deliberations in the Council's energy working group, especially on the status of debates on European energy legislation.

## 7.2 Council of European Energy Regulators (CEER)

CEER, Council of European Energy Regulators, is a voluntary non-profit association of European energy regulators, governed by Belgian law and based in Brussels. The association was set up on 7 March 2000.

The ERO started attending CEER meetings in 2003, but only in the position of an observer; after the Czech Republic's accession to the EU the Office became a fully-fledged member of this organisation on 4 May 2004.

CEER's main objectives include support for the development of a well functioning and competitive internal market for electricity and gas; facilitation of expedited discussion of problems involved in electricity and gas regulation; support for exchanges of information and experience; provision of assistance between its members; education; promotion of a common approach to transnational energy corporations; co-operation with similar organisations; and furthering the coordination of the co-operation between the individual regulators and DG TREN.

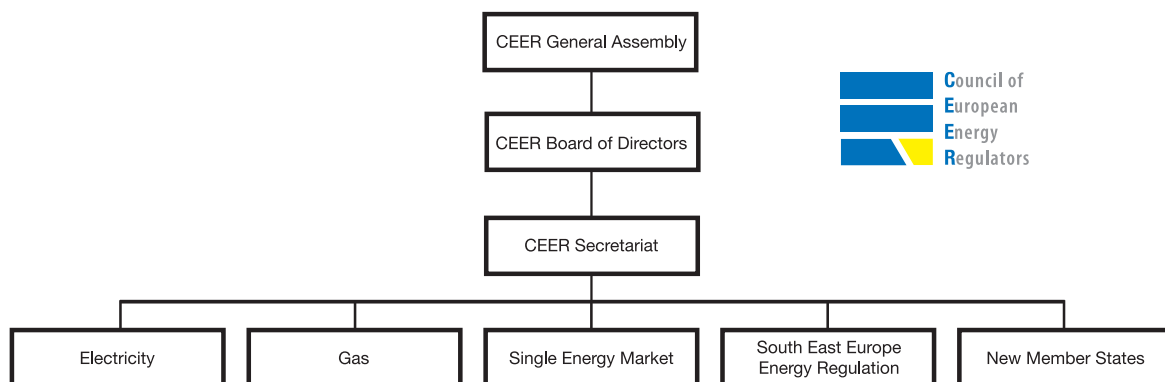
The benefits the ERO derives from its membership of this association include the promotion of co-operation, exchanges of information and experience between regulatory authorities, and mutual assistance in the uniform implementation and application of the EC *acquis*. The findings and information obtained through its membership of CEER are published on the ERO's website.

CEER set up five working groups for 2004:

- Electricity WG
- Gas WG
- Single Energy Market WG
- South East Europe Energy Regulation WG
- New Member States WG

Each Working Group sets up its Task Forces, see Fig. 1, which deal with specific issues assigned to them in the Work Programme for the respective year.

**Fig. 1 Council of European Energy Regulators**



From the perspective of strategic planning the Single Energy Market WG is important for the ERO; its principal efforts are directed towards unifying CEER's attitudes and comments on the EU's legislation and working with DG TREN and DG COMPETITION on the European Communities' proposed directives and regulations on the European energy market. In this working group the ERO also worked with DG TREN on the fourth benchmarking report, which is prepared by the European Commission every year with a view to identifying the level of the implementation of the requirements and/or objectives of these directives in the EU member states. Through its staff members who participated in the working group the ERO was able to directly influence the factors or indicators the study would monitor so that the outputs from the study are suitable for regulators' needs.

Equally beneficial for the ERO was its participation in the Competition & Unbundling Task Force of the Single Energy Market Working Group, which pursues the objective of monitoring and analysing the development of the competitive environment in the EU member states' energy markets and developments in unbundling. The task was to identify the progress in the implementation of the requirements

of Directives 2003/54/EC and 2003/55/EC in the legislation of the individual member states, and point to the shortcomings that may appear in the practical implementation of these requirements.

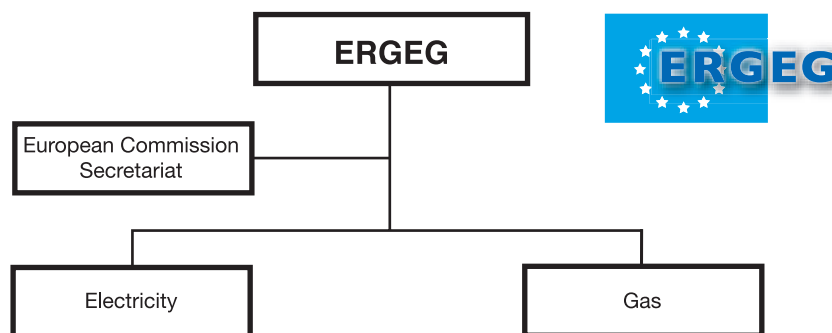
Besides the above groups, ERO representatives attended the meetings of the Electricity WG and Gas WG. The Electricity WG prepares CEER's positions on the technical aspects of proposed legal documents of the EU. The Gas WG's main objective is to prepare the materials and formulate the attitudes for the Madrid Forum. In 2004 this group dealt primarily with methodological guidelines for the needs of a well functioning TPA system, monitoring, benchmarking studies, for example on tariff setting, and the development of new gas pipelines.

### 7.3 European Regulators Group for Electricity and Gas (EREG)

The ERO was also involved in the activities of ERGEG, the European Regulators Group for Electricity and Gas, which was set up by the European Commission's Decision of 11 November 2003 as its advisory group to assist the Commission in the consolidation of the internal market for electricity and gas and to help ensure the application of the recently adopted Directives 2003/54/EC and 2003/55/EC. All national regulators of the EU member states become members automatically.

ERGEG's documents are not binding, but they are frequently the basis for the directives proposed by the European Commission and approved by the European Council and European Parliament.

Fig. 2 European Regulators Group for Electricity and Gas



ERGEG has set up two main working groups on electricity and gas. Each of them has smaller task forces that deal with the specific issues assigned to them in the work programme for each year.

### 7.4 Energy Regulators Regional Association (ERRA)

Since 2001, the ERO has been a member of the international organisation Energy Regulators Regional Association (ERRA). It is a voluntary non-profit organisation that brings together regulatory authorities in Central and Eastern European countries and the Eurasian region. In 2004 ERO representatives attended events organised by this organisation, mainly official and working meetings, and educational and legal workshops and conferences. The main benefits of the ERO's ERRA membership consisted in exchanges of information and experience not only with the ERRA member states, but also with the NARUC association of US regulatory authorities, with which ERRA cooperates closely, and also strengthening the Czech Republic's position among the other Central and Eastern European countries, which was also supported by membership of two standing committee - Tariff/Pricing, and Licensing/Competition.

### 7.5 Organisation for Economic Co-operation and Development (OECD)

On the basis of the OECD questionnaires, the OECD mission prepared another report on the Czech Republic's economic development in 2004, which was received in September 2004 by the Ministry of Finance for comments. In this connection, the ERO was requested to prepare comments on the chapter dealing with the improvements in the business environment and corporate governance in the energy sector.

### 7.6 International Energy Agency (IEA)

In 2004, at a distance of four years, the IEA research team conducted (based on a questionnaire) another in-depth review of the Czech Republic's energy policies. In March 2004 the Ministry of Industry and Trade requested the ERO to cooperate in the filling of the questionnaire. The ERO contributed to the sections on renewable energy sources, natural gas, electricity and heat. On the basis of this questionnaire IEA drew up, in the autumn, a draft *In-depth Review of the Czech Energy Policies*, and at the end of December 2004 the ERO received the report for comments. The official final version of the report is to be printed in the summer of 2005.

## 7.7 European Bank for Reconstruction and Development (EBRD)

In July 2004 the ERO joined the preparation of the materials for the EBRD *Transition Report*, which covers regulation of industry and private sector's participation.

## 7.8 Trips to other countries

In 2004 ERO representatives attended a number of bilateral and multilateral meetings with foreign regulatory authorities (39), international conferences (18), and seminars and training courses (19), with a view to obtaining information on the role to be played by regulatory authorities in the liberalised environment on the single internal market and new experience in issues related to the tasks of its technical departments. The topics of these meetings included in particular, the state of play in the area of regulatory models in the European countries, the condition of the electricity and gas markets in the EU member states, and progress in the implementation of Directives 2003/54/EC and 2003/55/EC in EU member states' legislations. In addition to participation in working groups and task forces, the major events included the following:

- CEER General Assembly (Belgium, Brussels, May 2004)
- A meeting on the issues of the auxiliary services market - SO TF, and international transmission capacities - Inter-TSO TF (CEER) (Belgium, Brussels, May 2004)
- Visit to the Austrian regulator, Energie-Control GmbH (Austria, Vienna, May 2004)
- The Experience the Vision for European Power conference (Spain, Barcelona, May 2004)
- A conference on the EU energy market – development, progress and experience (UK, Cambridge, July 2004)
- European Energy Law workshop (Netherlands, Noordwijk, June 2004)
- European Regulatory TSO Benchmarking workshop (Netherlands, the Hague, May 2004)
- The third Training Course for Energy Regulators (Italy, Florence, October 2004)
- The Gas Liberalisation and Regulation Course (Netherlands, Groningen, November 2004)





Information provision by the ERO



In connection with the ERO's position among central state administration authorities, in 2004 the Office continued expanding its strategy of communication with expert circles and the lay public and the press. In relation to its expanding competencies the ERO regards continuous provision of information as one of its important tasks.

In 2004 the key information provision activities concentrated on presenting the results of the first regulatory period (2001 – 2004) and preparations for the communication strategy for the second regulatory period (2005 – 2009).

### 8.1 Public relations

In compliance with Act No. 106/1999, on free access to information, and under Government Resolution No. 875 of 2000 (a part of which is methodological guidelines for harmonising public administration authorities' procedure in providing for natural and juristic persons' right to information under the above law) the ERO provides information on its activities and the options for resolving problems falling within its terms of reference. In 2004 the ERO received 186 requests for information from citizens and organisations, i.e. about one-third more than in 2003. The ERO also handled 3,367 items of other technical correspondence. The respective technical departments of the ERO dealt with all the requests received.

**Table 7** Number of received and handled requests for information in 2004 in respect of the ERO's activities

Question	Number of requests under Act No. 106/1999	Other technical correspondence
Licences	14	1,806
Regulation	129	1,252
Other	43	309
<b>Total</b>	<b>186</b>	<b>3,367</b>

The requests for information related largely to the ERO's regulatory activities, in particular from the perspective of the price decisions it issued. Many questions concerned issues related to the Energy Act and the relevant public notices. A small number of queries concerned the Office's licensing and other competencies. Some questions touched upon certain general problems of the Czech energy sector. All requests for information were answered within the statutory time limit. In 2004 the ERO did not receive any appeal by an applicant against a written decision not to provide the information requested.

All information requested under Act No. 106/1999, on free access to information, was provided by the ERO free of charge, like in 2003.

The ERO devotes great attention to the content of its website ([www.ero.cz](http://www.ero.cz)), on which it tries to offer a clearly laid out menu of links to help the users to find the required information as quickly as possible.

The Internet has become a standard tool for finding information in real time, and both experts' and general public's interest in the ERO's activities is increasing; the ERO therefore extended its website to include new links to statistics, prices and rates and, in connection with the Czech Republic's accession to the EU, also energy information related to the EU's directives and other legislation. The entire content of its website, which is updated almost daily, was simplified and laid out more clearly. It was also possible to accelerate the consultations on the ERO's forthcoming legal regulations via its website.

In compliance with Government Resolution No. 237 of 17 March 2004 on the process and main directions of the reform and modernisation of central state administration, and in co-operation with the Ministry of Informatics, the ERO implemented the Gateway to Public Administration project. Within this project the ERO contributed to the introduction of a system called Situations in Life, where it presented the area of licensing for business in the energy industries. It updated and supplemented the information in that chapter.

Regular press conferences and other meetings with the press, organised as roundtables on technical topics, also helped to promote the ERO's image in the context of a broad-ranging array of the regulatory issues. In 2004 the ERO organised four press conferences, at which its senior officials outlined the most important decisions adopted by the ERO, particularly in the pricing area, and also its activities and forthcoming changes. Very detailed information packs were handed out to the participants at the press conferences.

The Office continuously communicated with all the media. ERO Chairman appeared on a regular basis on Czech Television and both commercial television stations, and participated in technical discussions on Czech Radio and other, both national and regional radio stations. The Office pursued systematic co-operation with the Czech Press Agency and other news agencies, and economic press titles that deal with issues related to its activities.

### 8.2 Communication with regulated and other entities

In line with the principles of a transparent and open approach to the development of the regulatory methodology and specific regulatory instruments, and to prepare a widely accepted method, the ERO drew up and published a detailed timetable of the preparations for the second regulatory period for the electricity, gas and heat supply industries.

Step-by-step, the ERO carried out the timetable and continuously drew up presentations of its views on the way in which the parameters should be defined; it presented its views to the various regulated entities from as early as the beginning of April 2004.

The key theses of, and approaches to, the regulation of each of the activities have been and are subject to public consultations both with the regulated entities and representatives of final customers in industry, business and households. In this context, the ERO used to advantage its experience accumulated in the first regulatory period and the knowledge acquired from its co-operation with foreign regulatory authorities. Not least, the understanding of the strategy and objectives of the regulatory methodology was supported by using the contacts and exchanging information with the communication strategy staff of the electricity and gas distribution companies, ČEZ, a.s., Transgas, a.s., and ČEPS, a.s., especially in connection with price adjustments, also through the participation of these companies' representatives in press conferences and other events, for example specialist meetings. In this respect, the ERO closely worked particularly with the Czech Gas Union, with which it developed a common communication strategy vis-à-vis the media.

### 8.3 Publications

The ERO produces its publications under the Energy Act. It produced the *Energy Regulation Gazette*, which appeared with a circulation of 1,400 every time in 2004 (there were 1,017 subscriptions). SEVT, a.s. is in charge of the administration of the *Gazette*. In 2004, ten chapters of the *Gazette* were published; four chapters carried a list of licensed persons, including a list of licences that had terminated. In addition to price decisions, notices of the approval of the rules for the operation of energy systems, a survey of total annual sales in each energy industry and a report on the management of the Energy Regulation Fund for the previous calendar year, the *Gazette* carried also a list of administrative proceedings conducted by ERO in 2003.

The ERO holds an important position in electricity industry statistics. It currently communicates directly with 2,016 electricity industry entities, which mainly operate in the Czech Republic.

Of the above number, 185 are electricity generators having an aggregate installed capacity of over 0.5 MWe and 1,320 electricity generators having an aggregate installed capacity of less than 0.5 MWe; 367 electricity distributors, 66 electricity traders; 77 major customers with an annual electricity consumption per demand take point of more than 40 GWh; and one is an electricity transmission licence holder.

In 2004 the ERO considerably extended the agenda of electricity industry reporting and improved the structure of the reports. These include, in particular, the monthly reports on the operation of the Czech grid. The offer of supporting outputs serving for analyses was extended. The ERO also intensified its co-operation with the Ministry of Industry and Trade and the Czech Statistical Office with a view to making the data in the electricity generation plant database more accurate, emphasising renewable energy sources.

Regularly, on a monthly basis and for the whole past year, the reports were published on the ERO's website; occasionally, approximately every quarter, they were carried in the trade press. Advisory activities significantly increased as a consequence of the extended content of the statistical information processed.

ERO staff members also attended workshops and other events under a joint Czech-German Phare project, titled Reinforcing the Statistics on Renewable Energy Sources in the Czech Republic.

Like in the previous years, the ERO produced, with utmost emphasis on the quality, a complete annual report on the operation of the Czech national grid for 2004, both printed and on CD-ROM, which can also be found on its website.

Not least, work continued on the schemes of the Czech national grid's networks; they appeared in the printed and electronic forms. The outputs from this work were, in co-operation with the Ministry of Regional Development, linked to the work on the Regional Development Policy, in respect of which the ERO also supplied key information on the electricity industry.

In the form of a brochure and on CD-ROM, in both Czech and English, the ERO produced *The 2003 Report on the Activities and Finances of the Energy Regulatory Office*. The ERO presents these reports to the Czech Government and Czech Parliament's House of Deputies once a year in accordance with Act No. 458/2000, the Energy Act.





ERO budget management



### 9.1 The Chapter's budget

The budget for Chapter 349 – the Energy Regulatory Office, was approved at CZK 116,417,000 in Act No. 457/2003, on the Czech Republic's National Budget for 2004. This budget was later augmented by CZK 490,000 (in co-operation with the Ministry of Finance) through a budgetary measure transferring funds from the State's general treasury (VPS) chapter to help finance additional wages; this step increased the "mandatory target" of funds for wages and other remuneration for work by CZK 358,000.

After the change through the budgetary measure, the budget amounted to **CZK 116,907,000**.

### 9.2 Revenues to the Chapter

No tasks were planned or set on the income side. The revenues to the Chapter are listed in Table 8.

**Table 8 Revenues to the Chapter**

Budget item	Type of revenue	Budget [CZK '000]	Actual [CZK '000]
	<b>Total non-tax revenues, capital revenues, and subsidies</b>	<b>0</b>	<b>749.50</b>
	of which:		
2141	interest accrued on accounts – Reserves Fund, FKSP		38.08
2322	insurance compensation received		170.34
2329	overpayment credit notes (parking fee for Prague-Kampa, etc.)		154.62
3113	proceeds from disposal of assets		3.25
4132	transfer of undrawn funds for wages, including insurance for 12/2003, from the deposit account		382.51
4139	transfer of surplus contribution to FKSP for 12/2003		0.70

These funds on the income side were transferred to the national budget through the Chapter's income account. They are one-off, non-recurring revenues to the Chapter.

### 9.3 Meeting the mandatory targets

The expenditure mandatory target was met at a level of 99.88%; the actual expenditure amounted to CZK 116,770,390. The mandatory target of expenditure to finance programmes, Programme No. 249 010 - programme name 'development and replacement of ERO technical facilities and equipment' was met at a level of 97.26%; actual expenditure amounted to CZK 15,561,150. One of the important mandatory targets, wages and other types of remuneration for work, was met at a level of 97.49%; the actual expenditure amounted to CZK 34,397,460, of which the mandatory target of wages for employees in state administration was met at a level of 99.64%, and the actual expenditure amounted to CZK 34,121,900.

**Table 9 Meeting of mandatory targets**

Mandatory targets	Approved budget [CZK '000]	Budget after changes [CZK '000]	Actual [CZK '000]	Actual/Budgeted after changes [%]
<b>Aggregate targets</b>				
Total non-tax revenues, capital revenues and subsidies received			749.50	
Total expenditure	116,417.00	116,907.00	116,770.39	99.88
<b>Expenditure targets</b>				
<b>Standard targets</b>				
Wages for employees and other remuneration for work	34,924.00	35,282.00	34,397.46	97.49
of which: wages for employees	33,887.00	34,245.00	34,121.90	99.64
Statutory insurance premiums paid by the employer	12,223.00	12,348.00	11,883.07	96.23
Allocation to the Fund of Cultural and Social Needs (FKSP)	678.00	685.00	685.00	100.00
Expenditure on programme financing	16,000.00	16,000.00	15,561.15	97.26
<b>Specific targets</b>				
Wages for employees and other remuneration for work	34,924.00	35,282.00	34,397.46	97.49
of which: wages for employees in state administration	33,887.00	34,245.00	34,121.90	99.64
Total outlays from the national budget to finance joint EU/CR programmes	2,000.00	2,000.00		
in which, those related to pre-accession financial instruments	2,000.00	2,000.00		
in which, Phare	2,000.00	2,000.00		

The mandatory target of expenditure to finance joint EU/Czech Republic projects (the Phare programme) was not drawn at all.

All the mandatory targets were complied with. The planned amount of funds was not exceeded under any of the mandatory targets. The meeting of the mandatory targets is shown in Table 9.

## 9.4 Cash Funds

Under Section 47 of Act No. 218/2000, on budgetary rules and changes to certain related laws ("the budgetary rules"), as amended, undrawn budgetary funds amounting to CZK 27,199,790 were transferred to the Reserve Fund; in accordance with Section 48, they will be used for increasing expenditure in the following years. As at 31 December 2004, ERO held a total of CZK 33,992,550 in its Reserve Fund.

The spared wage funds of CZK 123,100 were not transferred to the Reserve Fund; however, funds allocated to other personnel expenses and the related insurance premiums were transferred to the Reserve Fund. These funds were not drawn because of the delay in the approval of the relevant energy legislation and the drafting of the secondary legislation, and will be used for remuneration to members of the remonstrance commissions, fees to independent experts, specialists in law, economics and engineering, in the legislation development process, and also for payments due under administrative proceedings and other activities of the ERO.

The expenditure on financing the ISPROFIN asset replacement programmes was planned at CZK 16,000,000. There were no individual subsidies, or expenditure reviewed on a case-by-case basis, in the budget. From the capital expenditure on programme financing, recorded in ISPROFIN (the account with the prefix 916) CZK 118,950 was transferred to the Reserve Fund, from the operating expenditure on programme financing, recorded in ISPROFIN (the account with the prefix 5020) CZK 318,090 was transferred. A total of CZK 437,040 was therefore transferred from the funds intended for the ISPROFIN programme financing. These funds will be used to finance programmes in the following years, in line with the budgetary rules.

**Table 10 Funds transferred to the Reserve Fund in 2004**

Item	Amount [CZK '000]
<b>Total transfer to the Reserve Fund for 2004</b>	<b>27,199.79</b>
of which:	
capital expenditure	118.95
current expenditure	27,080.84
of which:	
PHARE funds	2,000.00
operating expenditure on ISPROFIN programme financing	318.09
other current expenditure	23,537.08
funds for wages and other remuneration, including premiums	1,225.67
of which:	
wages for employees (item 5011)	0.00
other personnel costs (item 5021)	761.44
statutory social security insurance premiums (item 5031)	340.11
statutory health insurance premiums (item 5032)	124.12

## 9.5 The Energy Regulation Fund

The Energy Regulation Fund ("the Fund") was set up under Section 14 of Act No. 458/2000, the Energy Act. The funds in the Fund are kept in a separate current account with the Czech National Bank, account number 3029001/0710.

As at 1 January 2004, the opening balance in the Fund was CZK 50,048,450. No significant payments or other financial operations took place from/in the Fund during 2004. Interest income of CZK 249,970 was transferred to the respective account of the national budget. As at 31 December 2004, the closing balance in the Fund was CZK 50,047,540.

Under Section 14, subsection 10 of the Energy Act, the ERO is obliged to present an audit of the Fund for the respective calendar year. In compliance with these provisions an audit was performed in keeping with the guidelines issued by the Chamber of Auditors of the Czech Republic; according to the auditor's report, the Fund's books and accounts were kept in accordance with the legal regulations in force, and present fairly the Fund's financial position for the fiscal year 2004.

## 9.6 Phare

There was no draw down under the mandatory target for expenditure to finance joint EU/CR projects (the Phare programme), planned at CZK 2,000,000, in 2004.

The ERO's initial plan was to follow up, under the Phare programme, on the earlier completed project *CZ-EY-01 Strengthening Regulation and Enforcement of Energy Acquis*. Despite many meetings with the foreign partners, there was no success of the attempt to design a project that would bring significant benefits to the ERO in the area of technical co-operation and regulatory methods.

The spared funds, originally earmarked for expenditure on financing joint EU/CR projects, CZK 2,000,000, will be settled with the national budget in compliance with the respective position of the Ministry of Finance and in accordance with Ministry of Finance Public Notice No. 551/2004, which lays down the principles and time limits for financial settlement of relationships with the national budget, the national financial assets or the National Fund; by the deadlines set, in 2005 they will be transferred to the national budget's settlement account.

## 9.7 Budget management results

The total actual draw down on the budget, including transfers to the Reserve Fund, can be seen in Table 11.

**Table 11 Total actual draw down on the budget**

Draw down on budget	Actual expenditure CZK '000	Actual percentage [%]
<b>Total expenditure</b>	<b>116,770.39</b>	<b>99.88</b>
of which:		
capital expenditure drawn	9,498.19	99.98
current expenditure drawn	107,272.20	99.87

The performance vs. budget for January to December 2004 and the savings on the expenditure side of CZK 27,336,400 (of which CZK 27,199,790 transferred to the Reserve Fund) are mainly attributable to the following key factors:

- the draw down on the funds for a new information system was moved to 2005,
- no Phare funds were drawn.

### 9.7.1 Operating expenditure savings

Significant operating expenditure savings were achieved, CZK 27,215,640. The savings relate mainly to the items listed in Table 12.

**Table 12 Operating expenditure savings**

Item number	Description	Amount [CZK '000]
	<b>Total operating expenditure savings</b>	<b>27,215.64</b>
	of which:	
502	other remuneration for work	761.44
503	statutory premiums paid by the employer	464.93
513	purchase of materials	2,541.54
515	purchase of water, fuels and energy	886.87
516	purchase of services	12,091.60
517	other procurement	9,959.22
	other items of the budget	510.04

Another reason why the ERO did not draw budgetary funds was the delay in the legislative process and the drafting of new implementing regulations and ERO public notices, which was mainly felt in item 516 – purchase of services and item 502 – other remuneration for work. There was a similar effect of the failure to organise a Phare project on item 516 – purchase of services and item 517 – other procurement.

The ERO devotes considerable attention to the economy and efficacy of its spending. In 2004 there were repeated checks of the relationships with suppliers, and new tendering processes were organised with a view to achieving financial savings while obtaining higher quality services for the same money. An example of this effort is the way the ERO succeeded in offsetting the VAT increases caused by the changed VAT rates on telecommunications services. The ERO also reviewed the operation of its vehicle fleet with a view to achieving savings by reducing the number of trips, using vehicles to capacity, cumulating meetings, etc.

## 9.7.2 Programme financing

The ERO's programme financing was based on approved programme number 249 010 – programme name 'development and replacement of ERO technical facilities and equipment', which was prepared in detail for 2003 to 2007. In addition to allocating the respective amounts of funds for each year, the programme also lays down detailed technical and economic parameters and the time limits for ongoing evaluation of each of the projects, and the final evaluation of the whole programme.

The whole programme was divided into the following sub-programmes:

- sub-programme number 249 011 – procurement, upgrade and operation of ICT,
- sub-programme number 249 012 – replacement of the Energy Regulatory Office's assets.

In 2004 the ERO continued financing the various projects in keeping with the approved programme financing documentation. In doing so, it made minor changes to the actual disbursements of funds, depending on the current situation and the Office's new needs.

Financial management results in 2004 from the perspective of the sub-programmes and current and capital expenditure, is shown in Tables 13 and 14 (without the transfers of undrawn funds to the Reserve Fund).

**Table 13 Results by the sub-programmes**

	Plan [CZK '000]	Actual [CZK '000]	Actual percentage [%]
<b>Total programme number 249 010</b>	<b>16,000.00</b>	<b>15,561.15</b>	<b>97.26</b>
of which:			
sub programme 249 011 – ICT	13,280.00	12,860.07	96.84
sub programme 249 012	2,720.00	2,701.08	99.30

**Table 14 Results by current and capital expenditure**

	Plan [CZK '000]	Actual [CZK '000]	Actual percentage [%]
<b>Programme financing, total</b>	<b>16,000.00</b>	<b>15,561.15</b>	<b>97.26</b>
of which:			
current expenditure	6,500.00	6,181.90	95.11
capital expenditure	9,500.00	9,379.25	98.73

In line with the ERO's priorities, the largest amount of funds was allocated to information technologies, primarily to finance the ERO's new integrated information system. However, the ERO cancelled the public tendering process for the selection of the information system supplier (see section 9.8), and therefore new programming documentation shall have to be drawn up, in the form of a supplement, for the ICT sub-programme.

Because of the ERO's decision to update the specifications for announcing a new public tendering process in the fourth quarter of 2004, it did not manage to prepare and present the relevant budgetary measures applicable to programme financing before the end of 2004. Also, in 2005 the relevant budgetary measures shall have to be prepared to ensure an increase in the mandatory target of programme financing for 2005 to 2007, among others using also the funds transferred to the Reserve Fund for 2004.

The mandatory target for programme financing was not exceeded. The basic needs and the running of the ERO were met and provided for, and the preconditions for its further development were created.

### 9.7.3 Outlays on business trips abroad

Outlays on business trips abroad totalled CZK 5,004,120, and are shown in Table 15.

**Table 15 Outlays on business trips abroad**

Item number	Description	Amount [CZK '000]
	<b>Total outlays on business trips abroad</b>	<b>5,004.12</b>
	of which:	
5163	financial services (insurance)	4.87
5167	education and training services (language courses)	284.34
5173	travel expenses (subsistence, pocket money, air fare, accommodation)	3,325.82
5176	conference registration fees	1,380.81
5175	entertainment (entertainment fund)	3.11
5179	other purchases (visas)	5.17

The year 2004 saw a total of 76 business trips abroad. Of these, 36 business trips were to Brussels, which matches the development of the ERO's international co-operation and involvement in the activities of international bodies (CEER, ERGEG).

The ERO did not use all the planned funds originally allocated to business trips abroad. For capacity reasons, the ERO limited the number of participants, and also delegated its representatives only to the most important events. It did not delegate its staff to too expensive international events. Also the fact that no Phare project was launched meant certain savings.

## 9.8 Improving the internal information system

In 2004 the ERO devoted significant attention to an analysis of the data flows so as to be able to specify its new information system (IS). This line of endeavour focused on analysing the existing applications used by the ERO, identifying the users' requirements for the new IS, proposing a new IS solution, and preparing the documentation for a tendering process for IS implementation.

In the first quarter of 2004 the ERO announced, in compliance with Act No. 199/1994, on public procurement, a public call for tenders to select the IS supplier. The deliverable under the public contract was to design, create, implement and put into routine operation a new information system for the ERO, based on the following conditions:

- Create and implement the IS, and deliver the source codes of the technical and user documentation, including training;
- Divide the IS into logical units - modules, in respect of which the amount of labour, price and delivery of the relevant parts would be estimated;
- Transfer all the transferable rights to the developed system to the contracting authority;
- Ensure the integration of the new IS with the contracting authority's existing applications;
- Maintain the operation of the existing applications as the new IS system is put into operation;
- Ensure that the new IS is developed in keeping with the requirements of the standards of the Ministry of Informatics, under which a conformity test is required. The list of standards and certification requirements can be found in the public administration information systems;
- Ensure compliance with the conditions under ISMS (Information Security Management Systems); in terms of data protection and security, the IS must meet the certification conditions under the relevant security standards;
- Provide technical support and maintenance for the new IS for at least three years from putting the IS in routine operation.

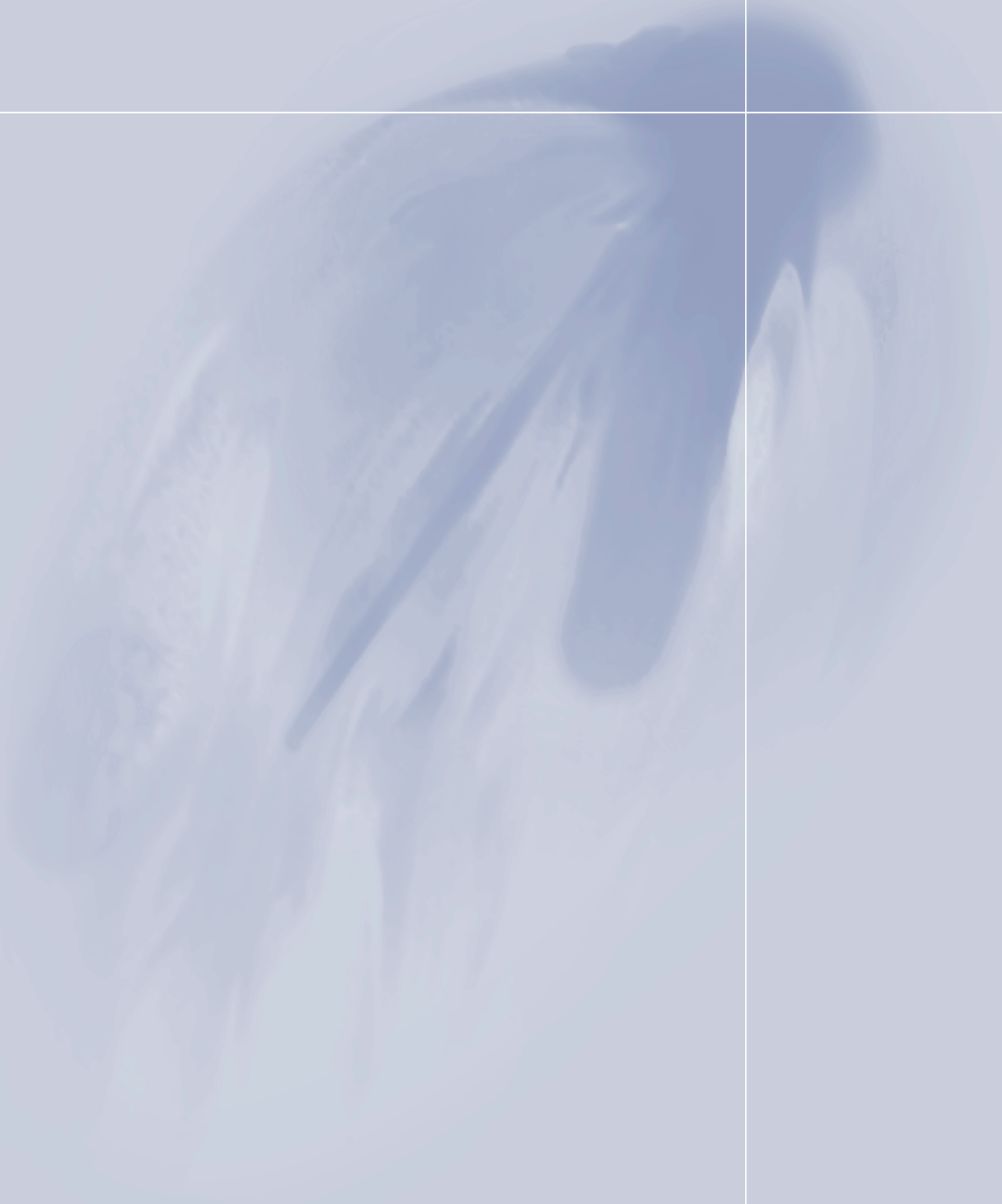
In line with the publicised terms and conditions of the public tendering process and in accordance with Section 66, subsection 2 of Act No. 199/1994, on public procurement, and Section 109 of new Act No. 40/2004, on public contracts, in his decision of 27 August 2004, Ref. No. J/10532/2002/200, ERO Chairman cancelled the public tendering process. The reason was the very different price quotations and the uncertainty whether the companies that had placed high in the ranking actually had enough experience and background for the development, implementation, and long-term support of such an extensive information system.

In the light of its experience acquired in the cancelled public tendering process, in November 2004 the ERO decided to update the comprehensive analyses of its existing software and hardware, and, at the same time, specify more precisely the end users' requirements for IT. These steps were taken in order to develop updated detailed documentation for a new call for tenders for the integrated information system and to put in place an overall IT concept for the ERO in the future.

In 2004, the IT unit further improved the protection of the internal network against viruses, spam and other attacks from the Internet. At both the Jihlava and Prague offices, access points for wireless access to the internal computer network were installed in the meeting rooms. A virtual private network was set up to allow remote access for selected staff members to their mailboxes and files via the Internet. All of these measures have helped to enhance the security of IT operations at the ERO, and improvements in the ERO's activities as a whole.







Internal reviews



In 2004 the internal audit department's activity was based on Act No. 320/2001, on financial control in public administration and changes to certain laws ('the Financial Control Act') and the relevant regulation No. 64/2002, which executes Act No. 320/2001, on financial control in public administration and changes to certain laws ('the Financial Control Act').

The internal audit department carries out internal audits in accordance with half-yearly plans of internal audit actions. These plans were drawn up along the lines of internationally recognised standards and the recommendations for practice issued by the Czech Institute of Internal Auditors. The starting line for drawing up the internal audit action plans was a Risk Map meeting the requirements of Section 30 of the Financial Control Act and approved by ERO Chairman in January 2004.

The requirement for the functional independence of the internal audit department is fully provided for in the provisions of the ERO's Rules of Organisation. In accordance with the internal audit plan, 2004 saw twelve audit actions, one review of a stock-take, and two extraordinary audits. In 2004 internal audit staff carried out the following audits of selected working processes and their results, and proposed the relevant recommendations:

- I/1. Audit of electronic information protection against leakage, audit of software licensed to the ERO;
- I/2. Audit of the draw down on the ERO's 2003 budget and of the documentation that supports vouchers (a document called 'tentative approval of the proposed task' (PONÚ), three offers, a decision, one purchase order);
- I/3. Audit of the process of disposing of submittals (licence applications) in the Licensing Department;
- I/4. Description and review of the Regulation Department's system of issuing price decisions;
- I/5. Audit of the reliability of the system of keeping business trip records and issuing meal vouchers;
- I/6. Audit of the reliability of the personnel management system – inclusion of employees in wage categories and classes;
- II/7. Audit of the reliability of the system of keeping ERO asset records on personal cards;
- II/8. Audit of the disposal of tangible and intangible fixed assets;
- II/9. Audit of documents supporting information security at the ERO (ERO ID cards, PT and ERO magnetic cards; installation reports, specification sheets).
- II/10. Audit of budget management and of the way of recognising advisory services in books and accounts;
- II/11. Audit of account vouchers from the perspective of compliance with Act No. 320/2001, on Financial Control. Audit of the use of the ERO vehicles for business trips ordered;
- II/12. Audit of the documentation stored with licence applications (awarded, rejected, shredding signs and time limits).

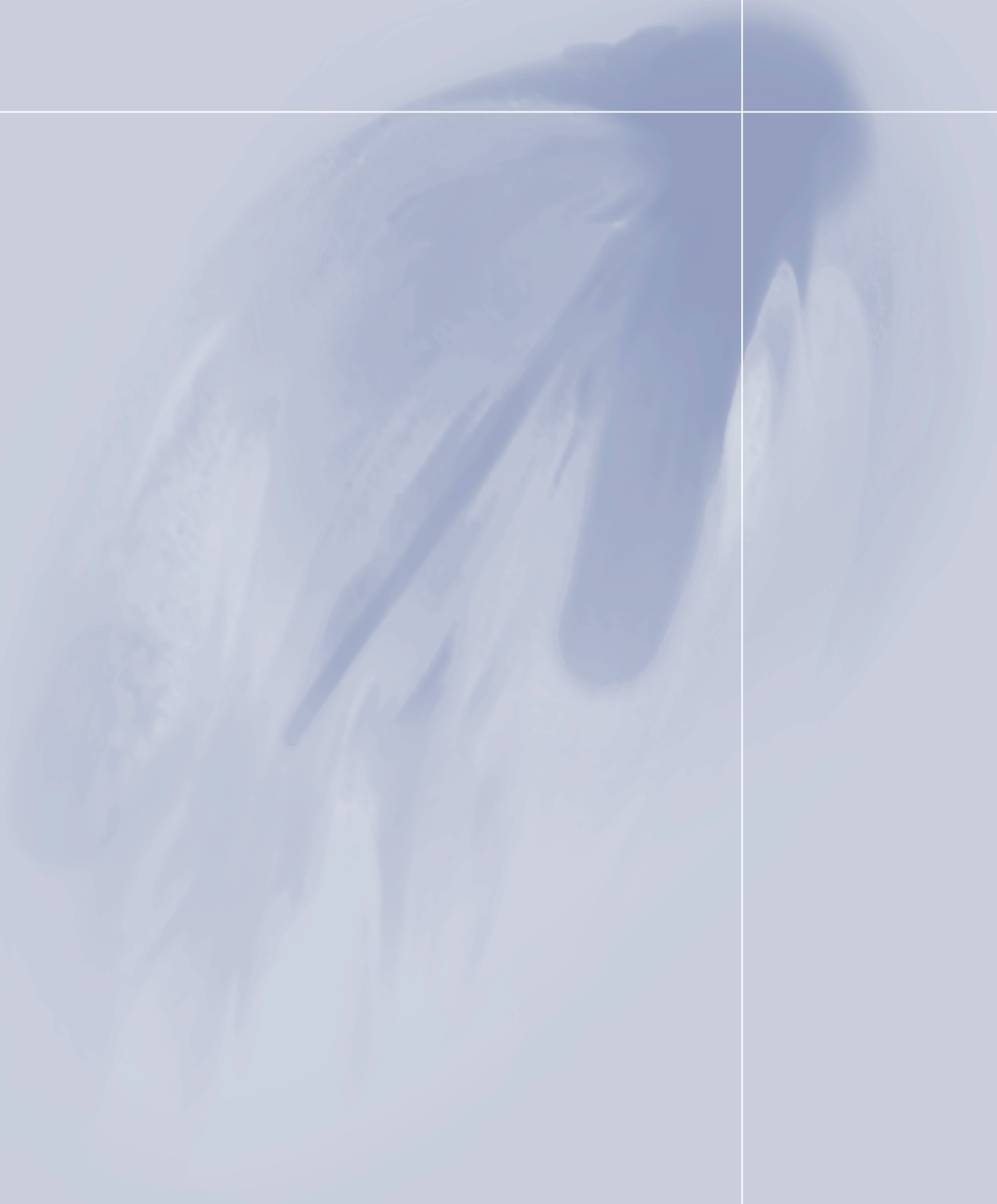
A subsequent verification action was taken to review again internal audit's recommendations that were not accepted when discussing the results of internal audit actions in December 2004. The ERO management assessed the unused recommendations from the perspective of their expediency, and assigned new tasks.

Another component of the internal review system is the inspections carried out by managerial personnel under their powers and responsibilities. This means that in the work processes, compliance with the provisions of the Financial Control Act must be continuously ensured. The main purpose of both components of the internal review system (internal audit and management inspection) is to prevent potential risks. The ERO therefore continues to standardise all work procedures under the relevant standards and regulations, using a precisely defined organisational structure.

ERO management assessed the overall internal review activities at the end of 2004, and concluded that the system met all the needs and requirements. In 2004 there were no serious findings within the meaning of Section 22, subsection 6 of Act No. 320/2001, on Financial Control.

The report on the results of financial audits and reviews in 2004 was prepared and sent to the Ministry of Finance in keeping with Public Notice No. 416/2004, which executes Act No. 320/2001, on Financial Control, as amended in Act No. 309/2002, Act No. 320/2002 and Act No. 123/2003.







The key prerequisites for carrying out the tasks on job are the employees' knowledge and motivation, their personal initiative, and continued interest in their personal development together with further education, both technical and linguistic. The ERO therefore places a great emphasis on careful selection of the employees, which constitutes one of the principal priorities of the ERO's personnel policy.

In 2004 human resource management focused on personnel management and education. This activity includes the provision of the required number of employees for each of the ERO's organisational units, a further development of the necessary basic administration (PIS – a personnel information system), professional development of the employees and their training in safety and health at work and in law and legislation, and, in the social sphere, the keeping of the Fund of Cultural and Social Needs (FKSP), provisions for meals at work, and the creation of an adequate working environment.

In the first and second quarters of 2004 a personnel audit was carried out at the ERO, based on the methodology of the Directorate General of the Civil Service of the Office of the Czech Republic Government.

## 11.1 Personnel management agenda

In 2004 the planned number of ERO employees was 90, and the actual number was 89 (FTE).

The planned and required staffing level was maintained smoothly, and during the year the various organisational units managed to maintain the planned numbers of employees having the required qualifications. During the year, the Office also adopted some measures intended for rationalising work and streamlining support service professions.

Related to the optimisation of the staffing level is the assignment of employees to the two ERO offices, in Jihlava and Prague. As at 31 December 2004, of the total number of 91 employees 57 worked in Jihlava and 34 in Prague.

The structure of employees is shown in more detail in Tables 17 and 18.

**Table 17 Employee structure by age**

Age	Number of employees	Per cent of total
Up to 25 years	1	1
26 – 35	30	33
36 – 45	23	25
46 – 55	22	24
56 – 65	15	17
<b>Total</b>	<b>91</b>	<b>100</b>

**Table 18 Employee structure by education**

Level of education	Number of employees	Per cent of total
University	57	63
University (BA).	5	5
College	1	1
Complete secondary	26	29
Primary and vocational school	2	2
<b>Total</b>	<b>91</b>	<b>100</b>

The employee structure by age is evolving favourably. A prevailing trend can be observed in the recruitment of young and professionally able employees for position requiring expertise, mainly university graduates: 68.13 per cent of employees are university graduates. The ERO management's plan is therefore gradually carried out.

The personnel management agenda is supported by the Odyssey personnel information system software (PIS) supplied by A.S.E.I. Thus, the ERO provided for the electronic processing of the required personnel data under Act No. 218/2002, on the service of civil servants in administrative authorities and the remuneration of these and other employees of administrative authorities (the "Civil Service Act"). In the first half of 2004 the social funds and the education subsystem modules were installed and put into operation, while in the second half of 2004 the controlling subsystem was implemented. The ERO implemented Government Order No. 469/2002, which lays down the catalogue of work and qualifications and changes a government order on wages for employees in public services and administration, as amended in Government Order No. 331/2003, which changes Government Order No. 469/2002 and Government Order No. 330/2003 on wages for employees in public services and administration, in the Office's personnel management regulations, and all the employees were newly included in wage categories with effect from 1 January 2004.

## 11.2 Professional development

For the Office's senior personnel training courses on the civil service law, time management and project management were organised. Further specialised education was directed towards promoting computer literacy, communication skills in teamwork, and economic issues (economics of business ventures, accounting and pricing issues). Improving the employees' language skills was one of the key priorities.

The Office's employees also attended specialist courses, workshops and conferences focused mainly on the energy sector, regulation of business and licensing policies both in and outside the Czech Republic.

There were many specialist courses and workshops dealing with new regulations and legislation, the knowledge of which is required for the employees to carry out their technical assignments. New employees took basic information courses to learn the Office's internal regulations and the legal regulations relevant for regulatory issues. Courses were organised for official drivers (i.e. employees having the right to drive the organisation's automobiles) and in the area of safety and health at work.

Total outlays on education, training and professional development of the employees amounted to CZK 1,528,700. This amount accounts for 4.48 per cent of the actual payroll costs.

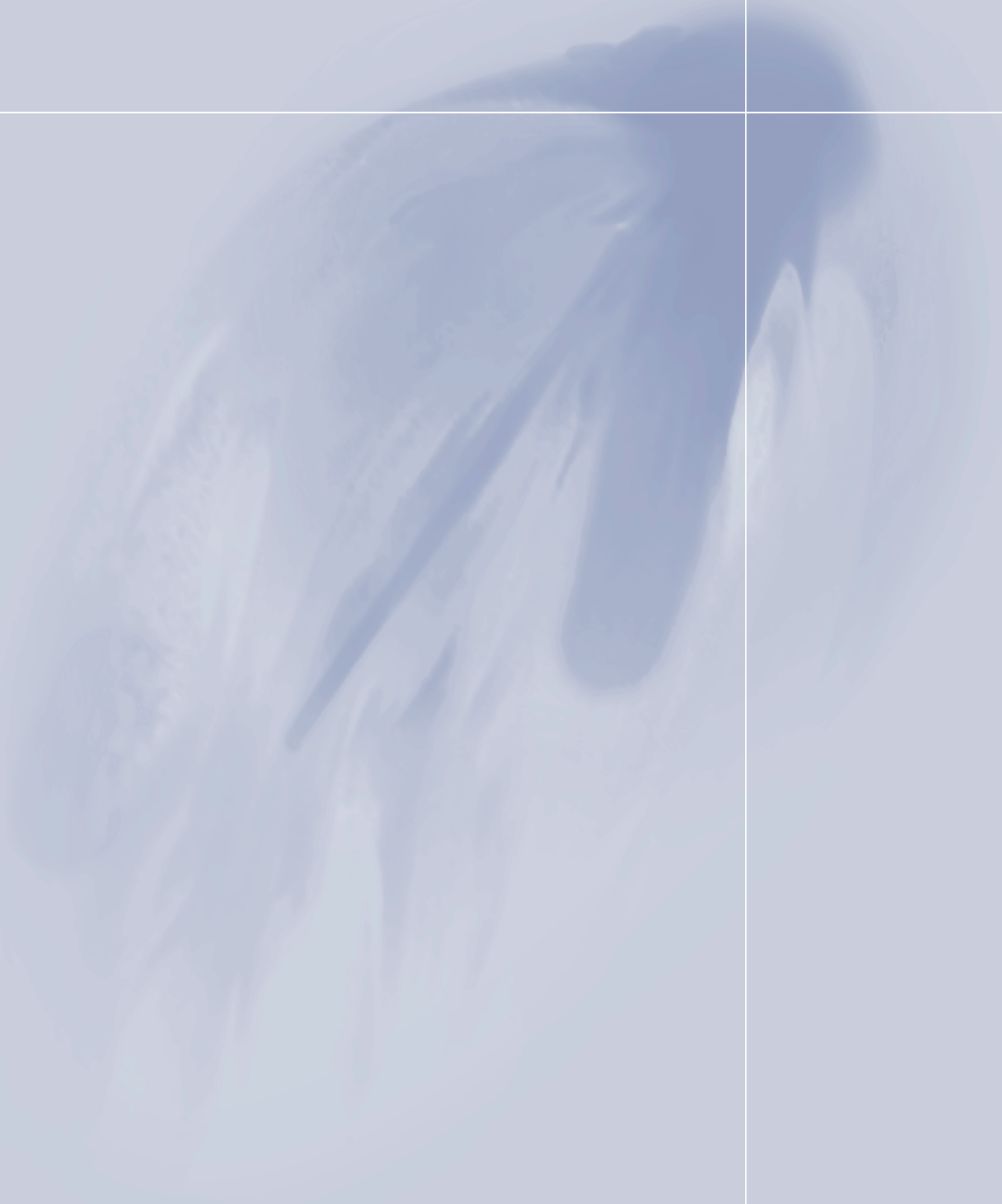
The structure of the outlays on education, training and professional development can be seen in Table 19.

**Table 19 Structure of training expenses**

Type	Amount [CZK '000]
Language training	954.00
Other types of education and training	574.70
<b>Total</b>	<b>1,528.70</b>

In 2004 a total of 147 employees took part in 73 educational events. Thirty-three employees attended 28 conferences, seminars, and training courses outside the Czech Republic.







In 2004 the ERO carried out all the tasks and requirements stemming from the legislative framework defining its rights and obligations.

First of all, it carried out the tasks relating to the application of the EU directives that set out the new requirements for the liberalisation of the internal electricity and gas markets, including the regulatory authorities' position and extended obligations. The ERO took an active part in the drafting of the amendment to the Energy Act and the bill on support for the use of renewable energy sources.

It fulfilled its obligations in the preparations for the second regulatory period from 2005 to 2009. Most importantly, despite the technical problems in the legislative area, it succeeded in drawing up the rules for the gas market and amending the rules for the electricity market, which prepared these markets for a gradual liberalisation.

The ERO created the preconditions and carried out the requirements for a deeper co-operation with the EU bodies in Brussels. Its representatives mainly cooperated with CEER.

The ERO had all the personnel and technical arrangements in place to provide for its operation. All budgetary funds were spent prudently and to ensure the Office's effective operation. In respect of budgeted costs, the main planned tasks were carried out and no mandatory targets were exceeded. The ERO was successful both in providing for its operation under very taxing conditions and in creating the preconditions for its further development.

Many of the initially envisaged activities, for example in education and training, international relations, etc., were reconsidered and then reduced significantly.

Despite intensive and repeated talks, the attempts to follow up on the earlier completed Phare project – thereby carrying out an initially prepared plan of co-operation in this area – were not successful, due to lack of interest on the part of foreign partners.

One of the main objectives was to continue in the development of a new, all-round information system for the Office, and much effort was therefore geared towards this aim. In spite of that, the public tendering process for the supply of new software was not concluded successfully, and this work will therefore continue in 2005 on the basis of restated specifications.

In preparing the strategic objectives for the second regulatory period, the ERO drew up, as part of the project 'identification of the mission (objectives) of central state administration' a survey of the ERO's objectives, which outlines the strategic medium-term goals:

1. For the sake of the stability of the energy sector, the ERO will set transparent and non-discriminatory conditions for the energy market players for the second regulatory period (up to the end of 2009); in this context, it will
  - improve the rules for the entry of businesses into the electricity and gas markets;
  - improve the rules for the entry of businesses into the heat supply market, including the provisions for the obligation of supplies over and above the licence;
  - put in place transparent rules for the electricity and gas markets;
  - set the conditions for connecting electricity generating plants and final customers' demand take points to the grid; and the conditions for connecting gas production plants, underground gas storage facilities and final customers' offtake points to the gas system.
2. In line with the continued liberalisation of the energy markets within the single European market, the ERO will continue to improve the rules and procedures for economic regulation, including the introduction of a transparent regulatory framework; it will
  - draw up transparent implementing regulations, including the procedures for electricity, gas and heat price controls applicable in the second regulatory period;
  - set the rules to incentivise utilities to reduce the costs of energy supplies and regulated services, with a view to achieving a medium-term stability of prices to each of the customer categories;
  - set the rules for keeping separate records of the costs and revenues for regulatory purposes;
  - lay down the procedures for controlling the prices of the supplier of last resort;
  - ensure compliance with the conditions applicable to support for purchase of electricity from renewable sources, secondary sources and combined heat and power generation.
3. To protect consumer interests, which include the creation of the preconditions for secure, reliable and, above all, high-quality electricity, gas and heat supplies, the ERO will
  - specify the required quality of the supplies and services related to regulated activities in the electricity and gas industries, including the compensations for non-compliance;
  - set the conditions for electricity and gas supplies to final customers and conditions for supplies by the supplier of last resort.



## Expenditure from the national budget

Period: January to December 2004

Chapter: 349, the Energy Regulatory Office

in CZK '000

Expenditure item	Description	2004 Budget		Actual 2004	% drawn (3:2)
		approved	after changes		
		1	2		
501	Wages	33,887	34,245	34,121.90	99.64
502	Other remuneration for work	1,037	1,037	275.56	26.57
503	Statutory insurance premiums paid by the employer	12,223	12,348	11,883.07	96.23
513	Purchase of materials	5,350	5,460	2,918.46	53.45
514	Interest paid and other financial costs	120	120	49.09	40.91
515	Purchase of water, fuels and energy	1,875	1,875	988.13	52.70
516	Purchase of services	35,407	32,587	20,495.40	62.89
	of which:				
	5164 rental	2,480	2,480	1,580.17	63.72
	5166 consulting, advisory and legal services	12,337	13,137	10,391.40	79.10
	5167 training and education services	6,400	6,400	1,528.70	23.89
	5169 other services	8,900	7,730	4,823.53	62.40
517	Other purchases	16,860	18,275	8,315.78	45.50
	of which:				
	5171 repairs and maintenance	1,850	3,900	2,188.68	56.12
	5173 travel expenses (domestic and abroad)	7,490	7,490	3,718.53	49.65
518	Advances, sureties, guarantees and government loans provided	50	50		0.00
519	Costs of non-investment purchases, contributions, etc.	10	10	8.00	80.00
534	Transfers to internal funds	678	685	27,765.84	4,053.41
	of which:				
	5342 non-investment transfers to FKSP	678	685	685.00	100.00
	5346 transfers to funds of the State's agencies			27,080.84	
536	Other non-investment transfers to other public budgets	260	260	11.28	4.34
542	Compensations paid to citizens	20	20	4.80	24.00
551	Non-investment transfers to international organisation and transnational bodies	150	435	434.89	99.97
<b>5</b>	<b>Total current expenditure</b>	<b>107,927</b>	<b>107,407</b>	<b>107,272.20</b>	<b>99.87</b>
611	Intangible fixed assets	4,340	3,000	2,920.91	97.36
612	Tangible fixed assets	4,150	6,500	6,458.33	99.36
636	Investment transfers			118.95	
	of which:				
	6361 investment transfers to the Reserve Fund			118.95	
<b>6</b>	<b>Capital expenditure</b>	<b>8,490</b>	<b>9,500</b>	<b>9,498.19</b>	<b>99.98</b>
<b>0</b>	<b>Total</b>	<b>116,417</b>	<b>116,907</b>	<b>116,770.39</b>	<b>99.88</b>



## Auditor's Report

on the audit of a fund established under Section 14 of Act No. 458/2000, on the Conditions of Business and State Administration in the Energy Industries and Changes to Certain Laws, as amended (hereinafter referred to as "the Energy Act"), as amended.

The auditor's opinion intended for the institutor of the Energy Regulatory Office I have audited the fund set up pursuant to Section 14 of Act No. 458/2000, on the Conditions of Business and State Administration in the Energy Industries and Changes to Certain Laws, as amended (hereinafter referred to as "the Energy Act"), as amended, for the accounting period of 2004, and its alignment with the annual financial statements, in accordance with the audit guidelines issued by the Chamber of Auditors of the Czech Republic.

The statutory body of the accounting unit is responsible for bookkeeping and for complete, conclusive and correct accounting. My responsibility as the auditor is to obtain all information required for examining the way in which the fund is maintained and relates to the annual financial statements. The audit has been carried out with regard to the extent of the accounting, by examining all evidence supporting the amounts and disclosures while respecting the significance of all disclosures.

In my opinion, the fund was maintained in accordance with the legal regulations in force, and is truly and fairly reflected in the annual financial statements of the Energy Regulatory Office for the accounting period of 2004.

Done at Jihlava, on 22 January 2005



Ing. Miroslav Klíma, m.p.



Object and purpose of audit: The purpose is to audit a fund established under Section 14 of Act No. 458/2000, on the Conditions of Business and State Administration in the Energy Industries and Changes to Certain Laws, as amended (hereinafter referred to as "the Energy Act"), as amended, for the accounting period of the year 2004.

Auditor: Ing. Miroslav Klíma, Birth Reg. No. 580304/1189

Business name and Licence No. Ing. Miroslav Klíma, Licence No. 1310

Date of the Report: 23 January 2005

Appendices: Balance Sheet  
Breakdown of the balances in the fund

