

The 2005 Report  
on the Activities and Finances  
of the Energy Regulatory Office



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At the beginning of 2005 the Energy Regulatory Office faced a number of major tasks. In addition to the day-to-day activities, there was a need to create the preconditions for the last stage of electricity market liberalisation, because on 1 January 2006 the category of protected customers would be abolished and all customers for electricity would become eligible customers. This means that the Office will not longer set the final price of electricity; it will only set its regulated components. Similarly, the conditions for the next stage of liberalisation in the gas industry had to be put in place.

On 1 January 2005 the first stage of gas market opening was started. Under the conditions laid down in the amendment to the Energy Act, the first forty eligible customers emerged on the market. However, this market opening was theoretical only, and certain eligible customers' efforts to switch their gas supplier were futile because there was no other supplier on the market than RWE Transgas, a.s. It was only later in 2005 that WINGAS GmbH entered the market, and won one eligible customer. In addition to the malfunctioning gas market eligible customer also encountered problems with entering into gas supply agreements. Upon their suggestion the Office therefore instigated a number of administrative proceedings, and subsequently reviews of pricing, during 2005. The outputs from these checks, and possible penalisation, will be applied to the gas suppliers in 2006.

In the light of the above negative experience with gas market opening in 2005 the Office decided to impose price controls, and set the maximum gas selling prices for 2006 for RWE Transgas, a.s. and for the regional distribution companies that buy gas for their eligible customers from RWE Transgas, a.s., including the maximum prices for the services associated with gas storage.

Another important line of the Office's activities was focused on improving the legislative framework in connection with the EU legislation, on the amendment to the Energy Act, and on the law on support for electricity generation from renewable energy resources. Public notices on licensing; electricity and gas market rules; conditions for connection to the electricity grid; and reporting and service quality in the electricity industry were amended. In connection with the law on support for electricity generation from renewable energy resources the Office drew up and issued two completely new public notices laying down the conditions, including the timing, for generators to claim the support and defining in detail the conditions of support for electricity generation using co-firing. The Office completed its work in the area of renewable resources by issuing a price decision based on a new optional system of fixed buyout prices or green premiums.

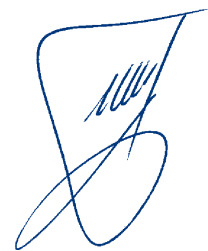
One of the challenges was discussing the model and conditions of the legal unbundling of the gas transmission system operator and electricity distribution system operators with the managements of these companies and the setting of the minimum allowable costs incurred in the unbundling under the Energy Act. This process resulted in the legal separation of transmission and distribution from the other licensed activities.

The year 2005 also saw intensive co-operation between the Office and a number of both national institutions (Ministry of Industry and Trade, Office for the Protection of Competition, Czech Association of Energy Sector Employers, Energy Managers Association) and EU bodies responsible for energy policy. The Office delegated its representatives to participate in CEER and ERGEG working groups, and its direct co-operation with the EU member states' national regulators, in particular those in Central and Eastern European countries, intensified. In 2005 *The Czech Republic's National Report on the Electricity and Gas Industries for 2004* was submitted to the European Commission; it was the country's first national report and had been drawn up in line with EC directives. The Energy Regulatory Office was the main coordinator of the work on this report.

In 2005 the Office further improved its licensing function. This means that the Licensing Department's staff focused both on licensing itself and, primarily, checks of compliance with the terms and conditions under which licences had been awarded.

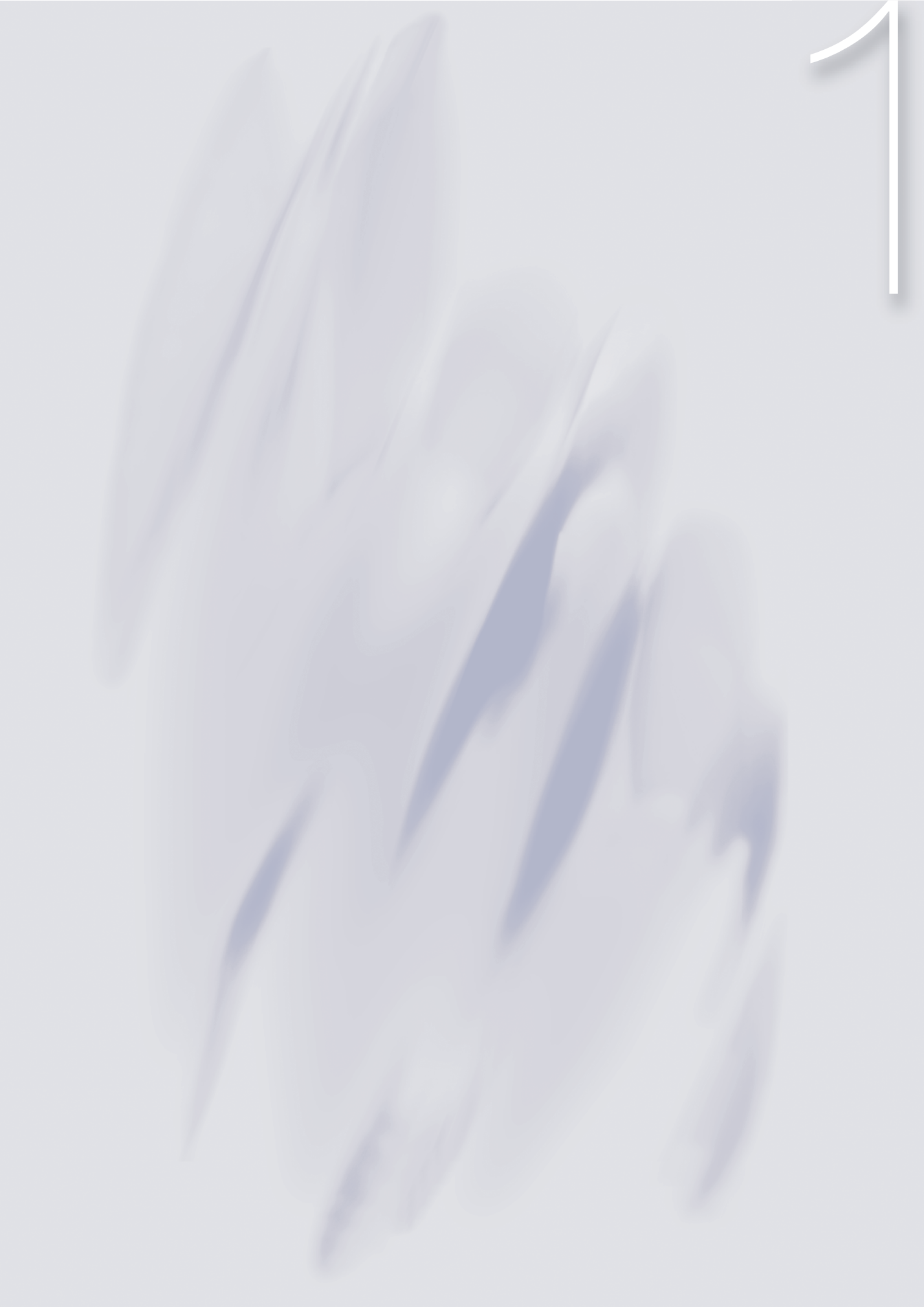
In 2005 the Office also launched a project for its new information system. The project is structured into phases, which are being carried out one by one. The first and the most challenging stage, in many respects following up on the new Administrative Code, was successfully completed before the end of 2005, and the next two phases should be carried out in the autumn of 2006, which will mark the completion of the whole project.

Looking back at the past year I am pleased to say that 2005 was successful and that the Office performed its demanding tasks. I would like to express my sincere thanks to all those who helped to address the Office's everyday and extraordinary assignments, be they ERO staff members or external specialists.



**Josef Fiřt**

Chairman, Energy Regulatory Office





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

In the energy sector, the Office 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 by 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 Energy Regulatory Office is “another central authority of state administration” with its own national budget title, no. 349.

## 1.2 Main developments on the energy market in 2005

### Electricity market liberalisation

In 2005 another major customer category became eligible customers. Businesses in the low demand category acquired the right to select their supplier. The Office had to provide an effective model to ensure the correct functioning of the open electricity market; the model is based on non-discriminatory regulated third-party access to the electricity grid.

### Problematic gas market opening

The year 2005 was marked by the beginning of the Czech gas market's liberalisation, which is to be completed in 2007. Despite the beginning of the Czech gas market opening the Office was, on the basis of the initial experience with liberalisation from 1 January 2005, compelled by the prevailing circumstances to impose a temporary price cap on the natural gas storage services provided by RWE Transgas, a.s., and control the selling prices charged by the distribution companies' traders who buy natural gas from the above company.

### Legislation

In 2005 the Office focused mainly on improving the legislative framework in relation to the amendment to the Energy Act and the law on support for the use of renewable resources<sup>1)</sup>.

In the area of secondary legislation, the Office amended old, and issued new, public notices on licensing, regulatory reporting, service quality, rules of the electricity and gas markets, conditions for connection to the electricity grid, and a public notice that implements the law on support for the use of renewable resources.

### Unbundling

The amendment to the Energy Act<sup>2)</sup> provides, specifically and in detail, for the legal, managerial, information and accounting unbundling of the providers of the regulated activities of electricity transmission, gas transmission, and electricity distribution and gas distribution from the unregulated activities of electricity generation, gas production, and trading.

In 2005 electricity distribution system operators and the gas transmission operator effected their legal unbundling and requested that the costs they incurred in this change be reflected in their prices. Under the Energy Act, the Office has the remit to decide on the inclusion of justifiable and demonstrable minimum costs of unbundling into the prices of regulated activities. In 2005 the Office put forth much effort to determine these unbundling costs and to develop a methodology for reflecting them in prices.

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<sup>1)</sup> Act No. 180/2005 on support for electricity generation from renewable energy sources and on changes to certain laws (law on support for renewable resources).

<sup>2)</sup> Act No. 670/2004, amending Act No. 458/2000 on the conditions for business and state administration in the energy industries and on changes to certain laws (the Energy Act), as amended.

## Mergers of companies and their impact on the tariff system

The year 2005 saw the completion of the process commenced in 2003, when ČEZ, a.s. had acquired majority interests in five of the eight regional distribution companies upon the Government's decision. In that year also the shareholding structure changed in another two regional distribution companies (Jihočeská energetika, a.s. and Jihomoravská energetika, a.s.), the majority owner of which became E.ON Czech Holding AG.

The above developments were the main cause for changes in the average prices of supplies in the various tariffs, which differ from region to region. These differences are due to a transition from the original, different regional prices to the group's common prices.

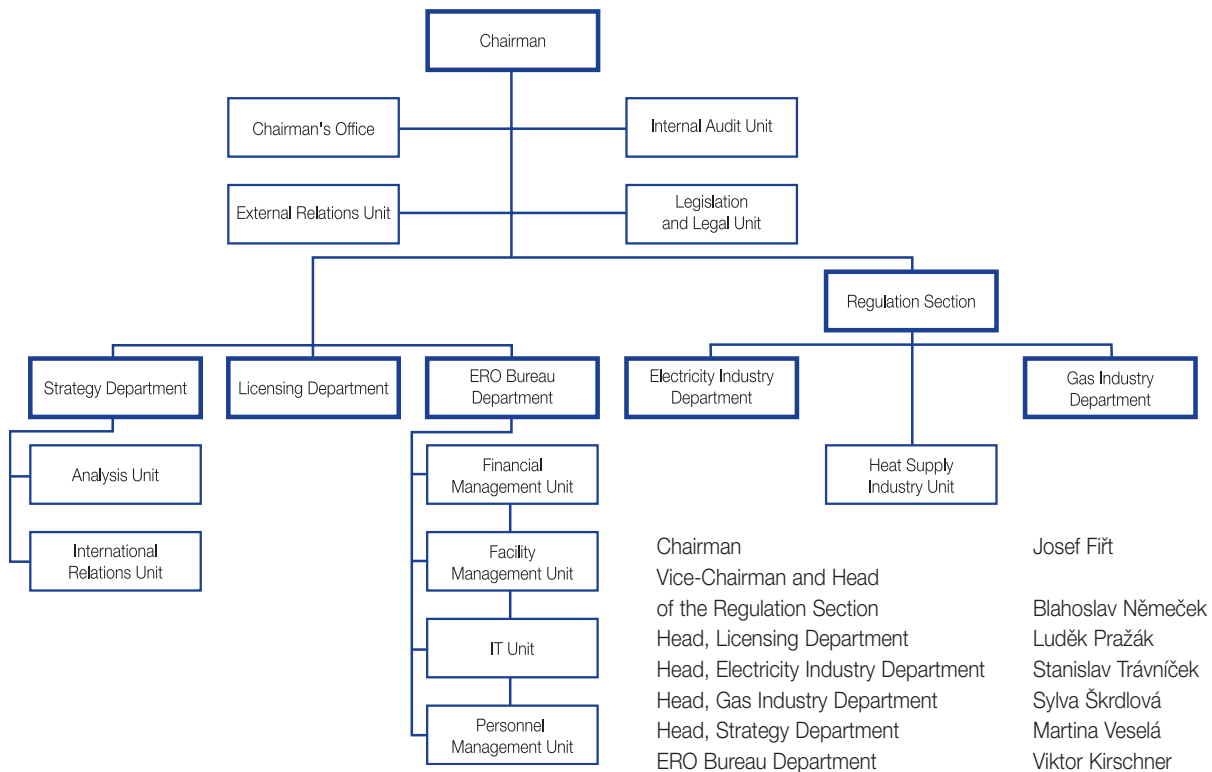
## International relations

The year 2005 was the first year of the reporting and monitoring obligations vis-à-vis the European Commission (EC); they were met by preparing an analysis documenting the state of the play in the implementation of the requirements of the "liberalisation" directives in national law and in the market's functioning from the perspective of competition. The EC requested the Office to accept the role of the coordinator in the Czech Republic and to draw up, in co-operation with the Office for the Protection of Competition (ÚOHS) and the Ministry of Industry and Trade (MPO), *The Czech Republic's National Report on the Electricity and Gas Industries for 2004* ("Czech National Report").

The Office became fully involved in the process of assessing the status of the implementation of Directive 2003/54/ES<sup>3)</sup> concerning common rules for the internal market in electricity and Directive 2003/55/ES<sup>4)</sup> concerning common rules for the internal market in natural gas.

Further, the Office worked mainly with the Council of European Energy Regulators (CEER) and with the EC's advisory body, European Regulators Group for Electricity and Gas (ERGEG).

## 1.3 Organisational structure as at 31 December 2005



<sup>3)</sup> 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.

<sup>4)</sup> 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.

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

The Chairman's Advisory Corps brings together experts delegated by governmental authorities, consumer and business associations, and trade unions. The purpose of their activities is to contribute to the Office's positions by their expert opinions and support the Chairman's objective decision-making in strategic regulatory issues.

In 2005 the Advisory Corps held four meetings.


At its January meeting the group discussed the bill on support for the use of renewable resources; and recapitulated the progress in the drafting and evolution of the various parts of the bill. At its April meeting it focused on the rules for gas market organisation and their impact on prices. The July meeting was mainly devoted to information about the progress in the preparation of the *Czech National Report* and about the unbundling process in electricity companies. At the October meeting the group discussed the proposed price decisions for electricity and gas industries.





# Key changes in the legislative framework for regulation in the energy industries

# 2





## 2 Key changes in the legislative framework for regulation in the energy industries

### 2.1 Implementing regulations issued in relation to the amendment to the Energy Act

On 30 December 2004 Act No. 670/2004, amending Act No. 458/2000 on the conditions for business and state administration in the energy industries and on changes to certain laws (the Energy Act), as amended, entered into force.

Under the amendment to the Energy Act the powers delegated to the Office were extended to include those to issue implementing regulations; also a number of conditions were modified, and they had to be reflected in the secondary legislation then in force. Due to the above changes the following public notices were issued:

**Public Notice No. 404/2005 on the essentials and structure of regulatory reports, including model forms, and the rules for compiling regulatory reports** (in force since 1 January 2006).

The new public notice on regulatory reporting constitutes the basis for obtaining the data that serves as input to the pricing of regulated activities in the energy industries.

The regulatory reports prepared under the new public notice help to increase the information value of the data and promote transparency; simplify reporting for regulated entities; and will improve control over regulated entities by the Office. The details from the reports will also serve as the basis for setting the parameters of regulation for the third regulatory period.

**Public Notice No. 426/2005 on the details of awarding licences for business in the energy industries** (in force since 1 November 2005)

The public notice lays down the details of the financial and technical prerequisites and methods of proving them for the various types of licences; defines the details of the way of demonstrating professional competence and determining the delineated area and operating premises, and of proving the ownership title/usufruct right to energy installations and facilities; stipulates the essentials to be included in the responsible representative's declaration; offers model forms for applications for the award, change and revocation of a licence; and shows licence breakdown for regulatory purposes.

**Public Notice No. 540/2005 on the quality of electricity supplies and related services in the electricity industry** (in force since 1 January 2006, with certain exceptions)

This public notice repeals the original public notice, no. 306/2001, on the quality of electricity supplies and related services in the electricity industry. In addition to the required quality of the supplies and services related to regulated activities in the electricity industry it newly lays down the amount of compensation for failure to keep the quality required; the time limits for raising claims to compensations; and the procedures for reporting compliance with the quality of supplies and services.

The promulgation of this public notice marked the completion of the implementation of Directive 2003/54/EC and the provisions of its Annex A, under which member states must ensure that customers benefit from transparent, simple and inexpensive procedures for dealing with their complaints. Such procedures shall enable disputes to be settled fairly and promptly with provision, where warranted, for a system of reimbursement and/or compensation.

**Public Notice No. 541/2005 on the electricity market rules, principles of pricing the electricity market operator's activities, and the implementation of certain other provisions of the Energy Act** (in force since 1 January 2006, with certain exceptions).

The amended Energy Act, and a further significant enlargement of the eligible customer segment, precipitated the need to issue a new public notice on the electricity market rules. The public notice takes into account the requirements of the Energy Act as well as the further experience gained by electricity market participants with market functioning.

The changes included and concerned, in particular, the following relationships and areas:

- a) Provisions on the fundamental contractual relationships between electricity market participants, including a more precise definition of the obligation to make payments under such contracts, including the essentials to be specified in requests for the entering into certain contracts (particularly electricity transmission and distribution agreements);
- b) Integration of the principles of the spot electricity market, which had originally been defined in public notice no. 19/2002 of the Ministry of Industry and Trade, laying down the way of organising the spot electricity market;
- c) Provisions on the use of the typical supply profiles, which help to evaluate the imbalances caused by eligible customers who are not equipped with continuous metering with remote data transmission, including the application of regional profiles in the so-called regions of typical supply profiles;
- d) Introduction of a simplified system for evaluating imbalances in local distribution systems, based newly on regular monthly readings of consumption by customers with non-continuous metering;
- e) Provisions on the extent and conditions of the provision by transmission and distribution system operators to the market operator of the data required for evaluating and clearing imbalances caused by the entities that are subject to clearing;
- f) More precise provisions on the billing of electricity supplies to eligible customers, including the extent of the items in the invoice, with a view to informing customers about the structure of the resulting payment for electricity;
- g) Provisions on the system of providing data for billing and making payments for system services and for the electricity market operator's clearing activity;
- h) More precise specification of the procedure to be followed by electricity market participants in supplier switching; the whole process is significantly shorter now;
- i) Provisions on the supplier of last resort, including the conditions for electricity supplies in this mode;
- j) Provisions on the procedure to be followed by the affected market participants in the event of electricity supply interruptions caused by unauthorised electricity take or distribution;

- k) Introduction of a system of providing data on electricity generation from renewable resources for the purpose of applying support under the law on support for the use of renewable resources.

**Public Notice No. 542/2005, which amends Public Notice No. 673/2004 that lays down the gas market organisation rules** (in force since 1 January 2006).

This public notice was promulgated in connection with the next phase of the gas market opening in line with the Energy Act, and also in response to the experience with the application of public notice no. 673/2004 in 2005. The regulation specifies the original provisions more accurately, introduces new terms for gas market organisation, simplifies the procedure for capacity booking in the transmission system, and adjusts the nominations and renominations of the daily gas supplies to the practice on the gas market. It has new provisions on the development, allocation and use of typical gas supply profiles.

The public notice lays down the key principles of the natural gas market:

- a) It divides the Czech Republic into balancing zones, whose size matches that of the areas served by regional distribution systems;
- b) Virtualises underground gas storage facilities for each operator;
- c) Defines gas transmission as gas transport from the gas system's entry points (on the national borders) to the transmission system's exit points, and distribution as gas transport from the distribution system's entry point to the exit point, which is usually the customer's offtake point;
- d) Defines gas transmission, distribution and storage agreements as specific agreements stemming from the contract types provided for in the Energy Act;
- e) Introduces the basic intervals of time for gas market organisation, which are the gas year from 1 October to the end of September of the following year, and the storage year from 1 April to the end of March of the following year;
- f) Provides for the procedure of capacity booking in the transmission and distribution systems and in underground gas storage facilities, including the deadlines for booking; and for congestion management in the transmission and distribution systems;
- g) Defines the basic framework for gas transmission and distribution price controls;
- h) Provides for daily gas supply nominations, with an opportunity to make renominations for a charge;
- i) Provides for the commercial and physical balancing of imbalances;
- j) Provides for the procedures to be followed by the transmission system operator and the eligible customers' new and old gas suppliers in supplier switching;
- k) Provides for the billing of gas supplies to eligible customers, and for the metering and evaluating of imbalances, and for settlement.

**Public notice on the conditions of connection to the electricity grid** (in November 2005 the text of the proposed public notice was distributed for the inter-departmental commenting procedure; the public notice was promulgated in the Collection of Laws, Part 23, of 28 February 2006, No. 51/2006, and shall enter into force on 1 March 2006)

The public notice is based on the following principles, aiming at:

- a) Standardising the general conditions for connecting electricity market participants;
- b) Simplifying the conditions for connection and for providing the required power input/output;
- c) Determining the share of the costs incurred in connection and in providing the power input required by the applicant, by means of a unit price;
- d) Primarily basing the calculation of compensation for damage caused by unauthorised take on identifying the actual situation – the substitute method for calculating the damage is only an auxiliary method, provided that it must reflect the actual damage suffered as best as possible, because the compensation is not a penalty.

## 2.2 Implementing regulations issued under the law on support for the use of renewable resources

On 31 March 2005 Act No. 180/2005 on support for electricity generation from renewable energy sources and on changes to certain laws (the law on support for renewable resources) was passed. Under this law, the Office is authorised to issue the following implementing regulations.

**Public Notice No. 475/2005 implementing certain provisions of the law on support for the use of renewable resources** (in force since 7 December 2005)

The public notice lays down, in particular, the deadlines for and details of selecting the method of support for electricity generated from renewable resources, and the deadlines for notifying of the intention to offer the electricity produced from renewable resources for mandatory buyout.

It further specifies the key technical and financial parameters with the help of which potential investors will be able to be better oriented when deciding on the development of a particular type of a renewable capacity. It provides specific examples of the indicative values of the various technical and financial parameters for selected technologies used for electricity production from renewable resources; this prevents the unnecessary exclusion from the guarantee of the 15-year period of return on investment of those generators who despite exceeding a particular technical or financial parameter nevertheless do meet the prerequisites for achieving the required payback period when all the other parameters combined are taken into account.

**Public Notice No. 502/2005 on methods for reporting electricity quantities in respect of biomass and non-renewable fuel co-firing** (in force since 23 December 2005).

This public notice lays down, in particular, the following:

- a) The method for reporting the quantity of electricity from renewable resources for biomass and non-renewable fuel co-firing;
- b) The method for reporting the actual acquisition of the biomass quantity and its quality;
- c) The method for reporting the actual use of all the acquired biomass for the purpose of electricity generation.

In the case of co-firing the generator is entitled to support related to only that part of its electricity, which originates from renewable resources.

The concept of the return on investment has been designed so as to accommodate not only simple schemes of involvement, but also more complex schemes that may appear in practice.



# Regulation in the electricity industry

3





For the Office, 2005 was a year when it had to pursue extensive activities in respect of not only the updating and amending of the existing legal regulations but also price setting for final customers.

### 3.1 The market in 2005

#### 3.1.1 Market liberalisation

The electricity market was influenced by the culmination of one of the liberalisation phases. On 1 January 2005 another major customer category became eligible customers. Low-demand businesses acquired the right to select their supplier; in 2005 more than 2,000 small businesses exercised this right, i.e. 0.25% of the total number of low-demand businesses in the Czech Republic. In the high-demand business category more than 500 customers switched suppliers in 2005, i.e. approximately 2.3% of their total number. On 1 January 2006 also the remaining customer category, households, will have the same right.

The open market's characteristic feature is that all activities in which competition is feasible have been left to the operation of market mechanisms, and only activities with a monopoly nature are regulated. Subject to regulation by the Office is mainly electricity transport from the generating plant over the transmission and distribution systems to the final customers, and also activities related to securing a stable energy system, in both technical and commercial terms. On the other hand, electricity generation and imports, and electricity trading are left to free competition.

#### 3.1.2 Ownership changes and transformation

In the period under review the reorganisation of the ownership structure of many major entities operating on the electricity market was a profound change in the electricity industry.

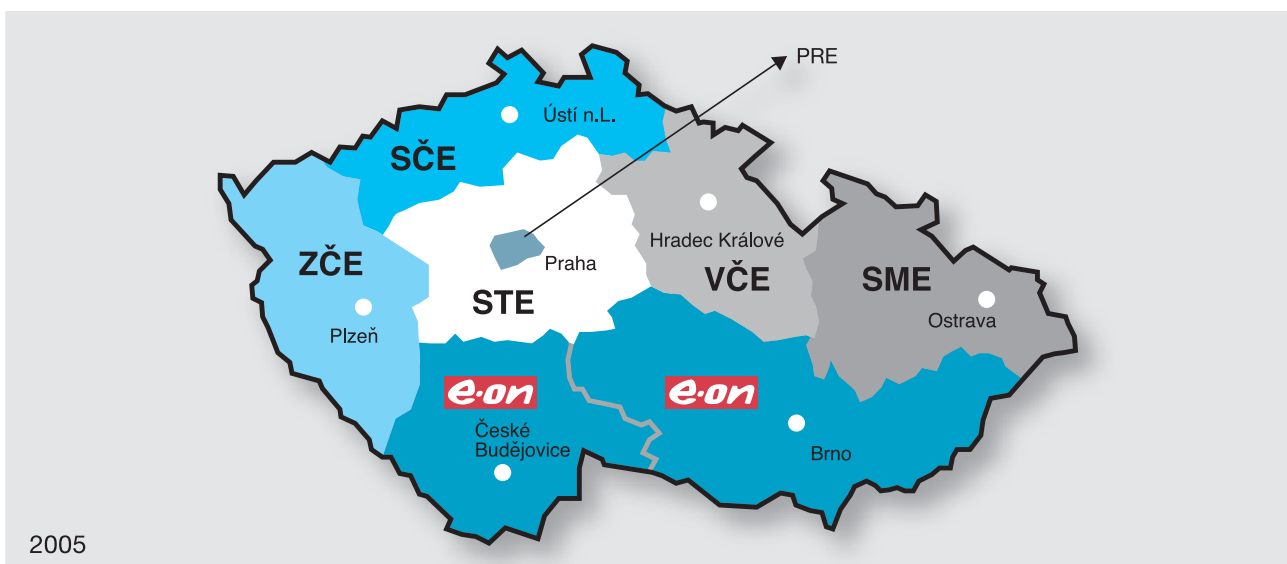
The year 2005 saw the completion of the process commenced in 2003, when ČEZ, a.s. had acquired majority interests in five of the eight regional distribution companies upon the Government's decision. In that year the shareholding structure changed also in another two regional distribution companies (Jihočeská energetika, a.s. and Jihomoravská energetika, a.s.), the majority owner of which became E.ON Czech Holding AG.

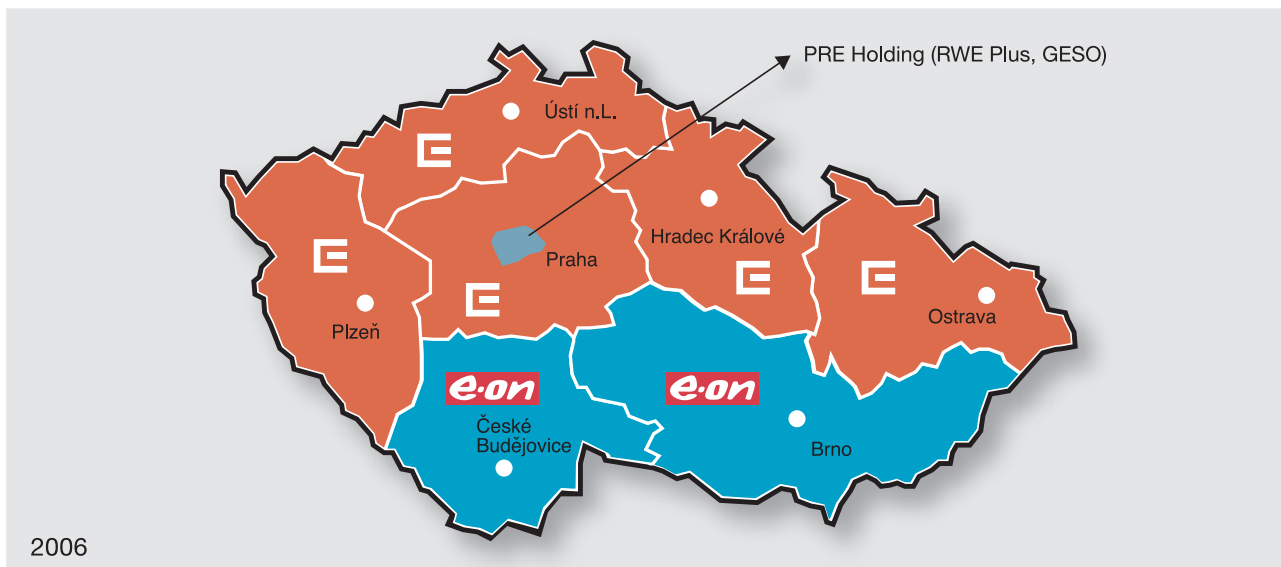
While in 2005 seven regional distribution companies operated in the Czech Republic after the merger of the distribution companies in the E.ON group, from 1 January 2006 three major entities will operate in the country (the ČEZ group, the E.ON group, and the PRE Holding group, which is the majority shareholder in the last of the regional distribution companies – Pražská energetika, a.s.).

Simultaneously with the takeover of the distribution companies by the new owners the investors started to spin off certain services, and assets supporting these services, into separate (sister) companies.

In its price setting for 2006 the Office had to respond to these changes in the ownership and organisational structure of electricity companies. When setting the allowed revenues, the Office therefore partially reconsidered the input parameters that had been set for the second regulatory period and reflected in the prices of 2005.

The above-described outsourcing is causing the original regulated company's assets and depreciation to decrease. The company buys the activities needed to carry on its licensed activities as outside services, which causes its costs to rise.





In line with the above principle the Office therefore regrouped parts of the various components in its calculations of allowed revenues. Specifically, the value of the profit and depreciation related to the spun off assets was transferred, at the same level, to the costs; this move was intended to at least partially maintain the continuity in the development of the various components of the regulatory formula vis-à-vis the actual development of each particular variable.

### 3.1.3 Unbundling

The main changes on the energy markets are carried out in line with the EC *acquis*. One of the key requirements of Directives 2003/54/EC and 2003/55/EC is the legal unbundling of the various activities so that henceforth they can be pursued by legally independent entities, and decision-making independence can be ensured both *de iure* and *de facto*.

Unbundling is a market liberalisation element intended to help create structures enabling competition on the market and to make it possible to do away with monopoly in energy industries. Its objective is the permanent division and independent operation of the levels of vertically integrated undertakings, at which the added value is created. The EU requires unbundling forms that will help to increase competitiveness. These forms are accounting, information, and managerial and legal unbundling.

Under the Energy Act, distribution system operators serving more than 100,000 customers must separate their distribution activity from their other licensed activities by 1 January 2007 at the latest. Electricity distribution companies have met this requirement even sooner, and will carry out their activities separately from as early as 1 January 2006.

Since in the unbundling process regulated companies are compelled to incur a certain amount of extraordinary costs, the Office has, under the Energy Act, the remit to decide to include justifiable and demonstrable minimum costs of unbundling into the prices of regulated activities.

The methodology for calculating and quantifying the minimum costs was developed *ex ante*. During the course of preparing detailed analyses, which helped to eliminate unjustifiable costs and set the minimum level of justifiable costs, the following cost categories were identified:

- a) One-off operating costs of unbundling – these costs will be incurred in the period directly including the legal unbundling exercise as such;
- b) Capital costs of unbundling – one-off expenses related to the acquisition of the assets necessary for carrying out the unbundling are understood to be capital costs;
- c) Ongoing operating costs of unbundling – these costs will be incurred on a regular basis, for the first time in the year of the unbundling itself and then in the following years because of the new nature of the unbundled companies' functioning.

With regard to the resulting level of the unbundling costs the Office has decided to spread the recognition thereof over several years, which means that only a certain part of unbundling costs has been recognised in the electricity distribution prices for 2006.

## 3.2 Setting prices to final customers

In connection with the completion of the electricity market liberalisation process the scope of regulation by the Office has been changed. The transfer of residential customers to the segment of eligible customers enjoying the right to select their energy supplier has necessitated certain changes to the existing principles of setting the supply prices to this category of formerly protected customers.

From 1 January 2006 the resulting price of supply to residential customers will be composed, similarly as for all the other eligible customers, of controlled distribution prices (distribution rates at the low voltage level), the charge for system services, the charge to meet the extra costs incurred in support for electricity generation from renewable resources, combined heat & power generation (CHP) and secondary resources, and the charge for the market operator's clearing activity, plus the price of energy, which will not be subject to control.

At the low voltage level a similar range of tariffs as in 2005 has been preserved for low-demand businesses (category C) and households (category D) for 2006; this will make it possible for the customers to optimise their costs of services related to electricity supply to reflect the nature and level of their consumption.

The regulated items for customers at the low voltage level from 2004 to 2006 can be seen in Table 1.

### 3.2.1 Prices not subject to control

By selecting their supplier, eligible customers can influence the uncontrolled part of the resulting electricity supply price, which is comprised of the commodity itself (energy) and the supplier's margin. On the electricity market, suppliers quote prices that include both of these components and it is therefore very difficult to detect how each of these components of the uncontrolled price develops on its own.

#### Energy prices

The increase in energy prices by the dominant generator, ČEZ, a.s., for 2006 has had an impact on electricity supply prices for all eligible customer categories. Energy prices on the Czech wholesale market went up by more than 15% year on year. This figure is, however, only an average number.

The impact of the energy price hike on the various customer categories differs in relation to the amount and, mainly, nature of a specific customer's consumption. Because of the different amounts by which the prices of the various energy products have gone up, a significant rise in the price can be seen mainly in the category of customers who use electricity for space heating.

The energy price hike has also had unfavourable impacts on the TSO's and DSOs' costs of covering losses in their systems.

### 3.2.2 Controlled components of the electricity supply price

#### Charge for the electricity market operator

The electricity market operator's charge for its clearing activity was set at CZK 4.63/MWh for 2005. The process of electricity market liberalisation, which was completed at the end of 2005, did not cause any significant costs related to the modification of the electricity market operator's information system. The more significant investments were made in the previous years (such as the implementation of a system for data transmission for commercial purposes; introduction of the intra-day and balancing markets; the putting into place of typical supply profiles required for evaluating electricity trades for customers without continuous metering).

#### Charge for system services

System services are necessary for ensuring power balance between electricity generation and electricity demand. The TSO provides these services by purchasing ancillary services from their providers, the costs of which are reflected in the prices to final customers in the form of the charge for system services.

The downward trend in the costs of auxiliary services, attributable to the stabilisation of the system, and increasing demand resulted in a drop in the charges for system services by CZK 15.52/MWh to CZK 156.28/MWh.

#### Charge for network services

The network service charge is composed of a charge for transmission services and a charge for distribution services. The network service charge for 2006 will be influenced by several factors:

##### 1) Transmission service charge

The average price for the use of the transmission system has dropped from CZK 130.14/MWh in 2005 to CZK 110.15/MWh for 2006. This decrease has also been reflected in charges for electricity distribution at lower voltage levels.

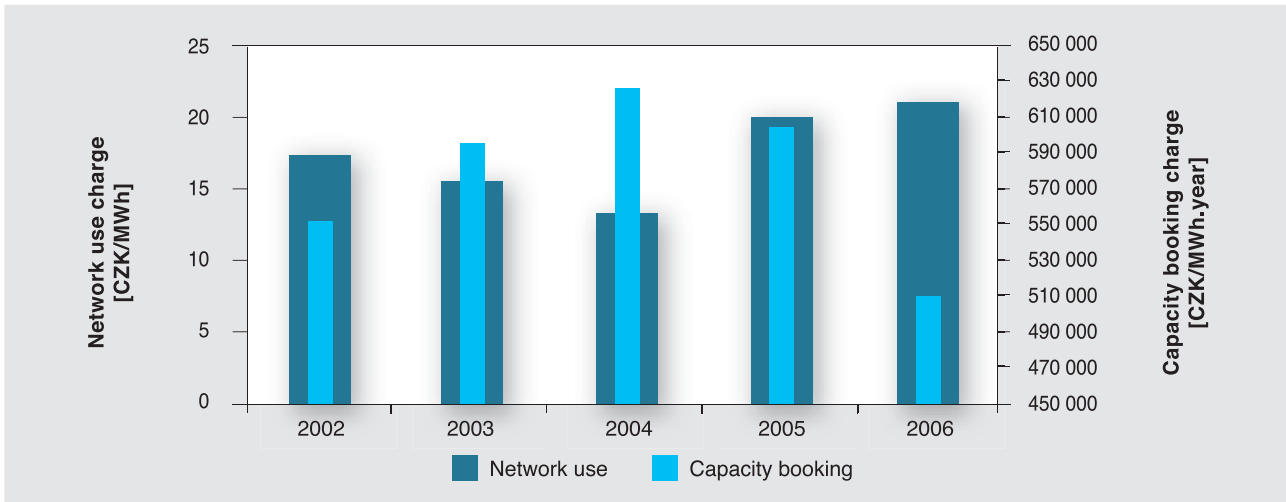
The marked drop in the price for booked capacity at the transmission system level is due to the inclusion of the larger part of the proceeds from auctions at cross-border interconnection sites into price calculations in line with Regulation 1228/2003/EC of the European Parliament and of the Council of 26 June 2003 on conditions for access to the network for cross-border exchanges in electricity. Another part of the proceeds from these auctions is used by the transmission system operator for CBT compensation payments between the national TSOs in the region and also for the development of the transmission networks (mainly in the area of cross-border interconnections). Chart 1 shows the prices for electricity transmission.

Table 1 Regulated items for customers at the low voltage level

Regulated items	2004 [CZK/MWh]	2005 [CZK/MWh]	2006 [CZK/MWh]	Percentage share of price components 2006 [%]	Change in price components 2006-2005 [CZK/MWh]	Change in price components 2006-2005 [%]
Electricity market operator's charge for clearing, related to demand of final customers, including local consumption	4.10	4.63	4.63	0.35	0.00	0.00
Charge for system services	172.00	171.80	156.28	11.98	-15.52	-9.03
Charges to cover the extra costs related to electricity purchase from renewable resources, cogeneration, and secondary resources	41.51	39.45	28.26	2.17	-11.19	-28.37
<b>Network services:</b>						
Charge for the DSO for payment mediation	0.10	0.10	0.10	0.01	0.00	0.00
Contribution to distributed (decentralised) generation for plants connected to the distribution system	8.67	7.52	7.48	0.57	-0.04	-0.53
Charge to cover the losses paid by OTE, a.s.	0.63	0.00	0.00	0.00	0.00	0.00
Cumulative single-component price for the network service	1,025.42	1,026.92 <sup>*)</sup>	1,108.05	84.92	81.13	7.90
<b>Total for regulated items</b>	<b>1,252.43</b>	<b>1,250.42</b>	<b>1,304.80</b>	<b>100.00</b>	<b>54.38</b>	<b>4.35</b>

<sup>\*)</sup> Cumulative single-component price for network services updated in relation to the consumption of residential final customers connected to the low voltage level, for 2005.

Chart 1 Components of the price for electricity transmission



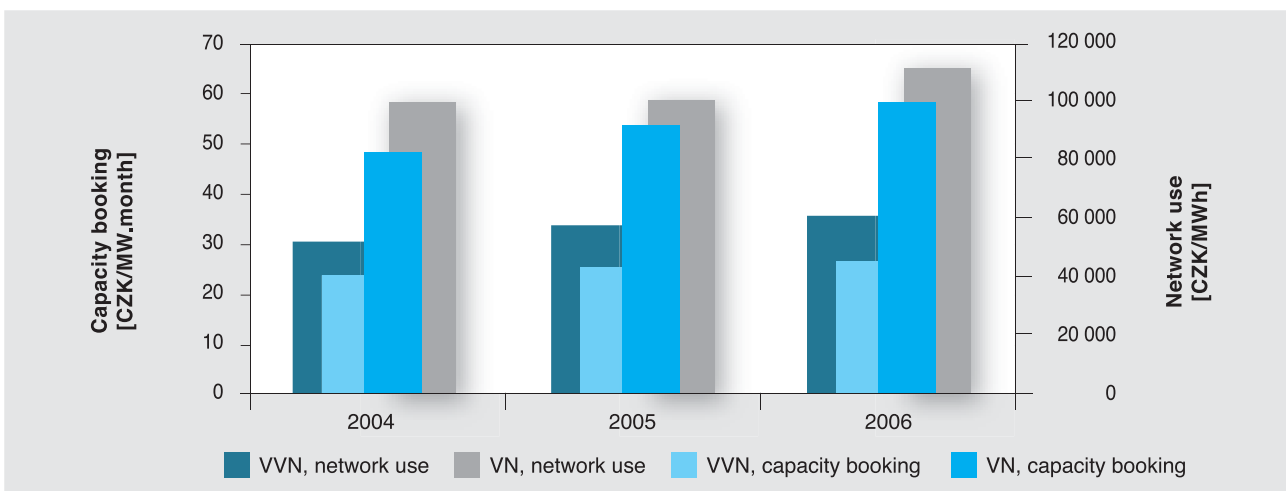
2) Distribution service charge

The charges for distribution at the very high voltage and high voltage levels were negatively affected by the reductions in final customers' booked capacity, and also changes on the electricity market. The statutory requirements for legal unbundling caused additional costs incurred in the spin-off of a part of the distributors' business, which were partially reflected in regional distribution companies' allowed revenues and in booked capacity pricing.

The higher prices for network use, which form a variable part of the distribution rates at both voltage levels, were due to the wholesale market's significantly higher prices of the energy bought by distributors for covering their losses.

The 2006/2005 changes in both of these distribution price components are shown in Chart 2.

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



The 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 charges for distributed generation at the various voltage levels have been kept at the level of 2005.

For the above reason, and due to growing demand, the final customers' resulting contribution to distributed generation has decreased slightly to a national average of CZK 7.48/MWh.

### The charge to meet the extra costs incurred in purchasing electricity from renewable resources and CHP

The charge to meet the extra costs incurred in purchasing electricity from renewable resources, CHP and secondary resources has been reduced from CZK 39.45/MWh in 2005 to CZK 28.26/MWh for 2006.

Two main factors are at play in this significant drop. The growing market price of electricity is compressing the difference between the electricity price on the market and the price for which electricity is purchased from these plants, which helps to reduce the extra costs incurred in support for environmentally friendly technologies. At the same time the Office reconsidered the methodology for calculating the contribution, which had originally been based on expectations of increases in electricity generation in the respective following year for which the contribution was being set. However, the actual developments in 2003 and 2004 showed that the generation expected by the producers and potential investors had been overestimated, and the planned increase in generation in supported plants did not materialise. The new methodology is based on historical data on actual production, and takes into account realistic expectations of the use of these technologies in the following year.

In connection with the new law on support for the use of renewable resources and also in connection with support for secondary resources and CHP under the Energy Act, an increase in the quantity of the supported electricity produced can be expected in the future, and therefore a gradual increase in the contribution.

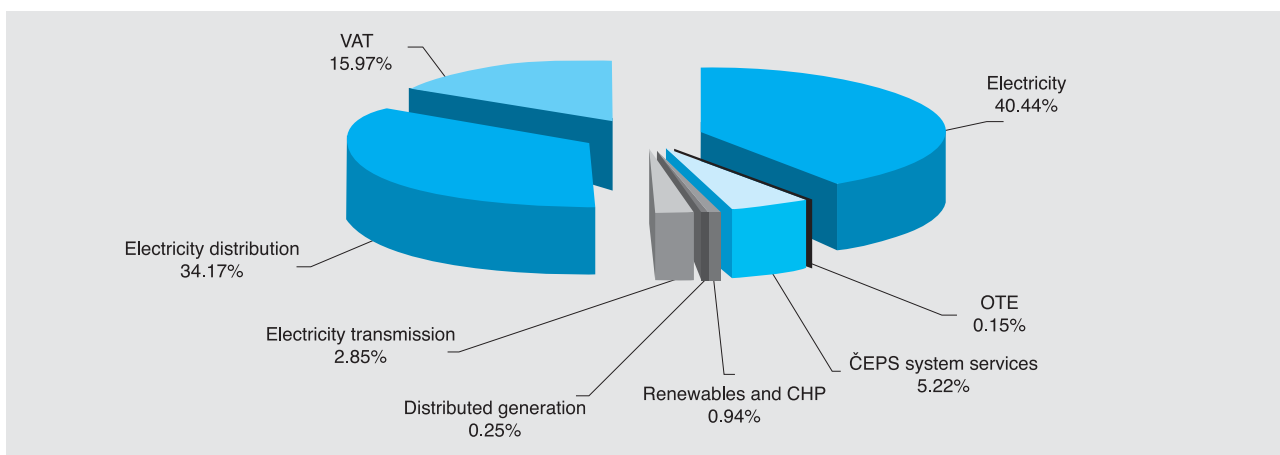
### Electricity prices to households

The resulting price of electricity supply to households is composed of regulated prices for distribution and related services, and the energy price, which is not subject to control and which accounts for about 48% of the final price (without VAT).

The higher prices of residential electricity for 2006 are caused mainly by an increase in the uncontrolled component, i.e. the commodity price, whose level on the wholesale market has gone up by more than 15% in comparison with 2005. The regulated components, which are set by the Office, have risen by 4.3% on average.

The shares, in per cent, taken by each of the components that make up the average price of electricity supply to households in 2006 are shown in Chart 3. Average electricity supply prices and their components since 2002 are shown in Chart 4.

**Chart 3** Percentage shares taken by each of the components that make up the average price of electricity supply to households for 2006



Averaged over the Czech Republic, the prices to households for 2006 have been increased by 9% in comparison with 2005. This year-on-year increase ranges from 4.2% in central Bohemia to 13.3% in northern Moravia. The increase in electricity prices for individual customers differs depending on the tariff selected and the nature and size of their demand.

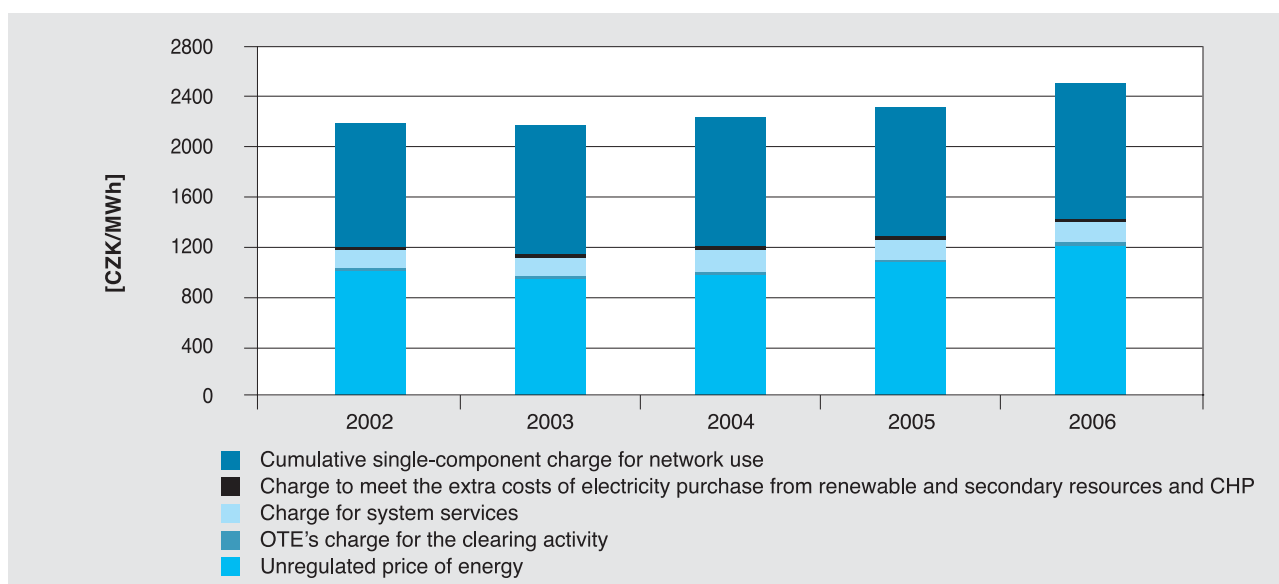
The year-on-year price rises for each of the regions, considering the regional suppliers' (the traders of the respective distribution company) quoted prices are listed in Table 2.

**Table 2** Changes in the average prices to the households category in regions served by each of the distribution companies between 2005 and 2006

Company	Households (low-demand category) [%]
E.ON Energie, a.s.	9.50
Pražská energetika, a.s.	9.90
ČEZ Distribuce, a.s. / formerly SČE, a.s.	9.70
ČEZ Distribuce, a.s. / formerly SME, a.s.	13.30
ČEZ Distribuce, a.s. / formerly STE, a.s.	4.20
ČEZ Distribuce, a.s. / formerly VČE, a.s.	6.30
ČEZ Distribuce, a.s. / formerly ZČE, a.s.	9.40

The varying increase in each of the regions is mainly due to the merger of the distribution companies held by ČEZ, a.s. (SČE, a.s., SME, a.s., STE a.s., VČE, a.s., and ZČE, a.s.) and the transition to the ČEZ group's uniform prices from the original differing regional prices.

**Chart 4** Development of average electricity supply prices to households



### The prices charged by the supplier of last resort

Effective from 1 January 2006 the Office will set new prices of the electricity supplied to customers by the supplier of last resort. Customers will be able to take supplies from the supplier of last resort in cases where their existing supplier has lost its ability to supply electricity. The supplier of last resort should also serve as a safeguard for small customers and households who have the right to select their electricity supplier but have not found their supplier on the electricity market for various reasons. The supply of last resort is subject to price controls.

For 2006 the prices of electricity supplied by the supplier of last resort have been calculated on the basis of energy quotations made by generators and traders and available on the electricity market. Characteristic load profiles (the so-called typical supply profiles), which were valued with the help of these available quotations of energy, were used for calculating the prices to be charged by the supplier of last resort in the various tariffs. The bands of the Rainbow Energy offered by the dominant generator, ČEZ, a.s., served as the basis for the valuation. It is therefore to be kept in mind that the Office could not influence the price of energy on the generating side in calculating the prices for suppliers of last resort; the Office could only use the final energy products offered by generators.

The prices of the supplier of last resort apply only in cases when customers request a supply of last resort or when they are included in such supply for various reasons (for example, the existing supplier is no longer authorised to supply electricity). However, final customers have not yet resorted to this option.



### 3.3 Renewable resources, CHP, and secondary resources

Prior to the passing of the law on support for the use of renewable resources this support was governed by the Energy Act. The Energy Act provided for the support in a general fashion only, and therefore failed to offer sufficient certainty to investors as to whether they should invest in the development of these installations, in particular from the perspective of guarantees of the long-term evolution of price controls in this area.

The passing of the law on support for the use of renewable resources has marked a significant advance. To investors in renewable resources, the law guarantees a 15-year payback period for the funds invested in the various categories of renewable resources. The objective of the law is to increase the share of electricity produced from renewable resources in gross electricity consumption to a level helping the Czech Republic to meet its national indicative target of 8% by 2010. The Office determines the amount of support for renewable resources for each calendar year with a view to creating the preconditions for meeting the above target.

The Office has been supporting electricity generation from renewable resources through its price decisions since as early as 2001. In 2005 the Office set electricity buyout prices for each type of renewable resource, as well as the green premiums, which constitute a new method of support introduced by the law on support for the use of renewable resources. The Office set forth the principles of pricing and other related issues stemming from the law in its implementing regulations to the law, which it issued in 2005.

For 2006 the structure of the renewable categories has been broadened as part of price setting. To calculate the support for electricity generation from renewable resources, in 2005 the Office had to collect and analyse data for more than thirty categories of supported installations. The categories of supported installations are determined on the basis of the primary energy (fuel) and the technology converting this energy into electricity, and also the installation commissioning date. For almost all categories (with the exception of biomass and fossil fuel co-firing) both the minimum buyout prices and green premiums were calculated. Further, for example for biomass firing a new category has been introduced – the parallel firing of biomass and a non-renewable fuel. In the biogas-firing category the prices have been newly differentiated by the technology and fuel used in new installations.

In setting the buyout prices and green premiums for renewable resources, in 2005 the Office cooperated with the relevant governmental institutions, above all the Ministry of the Environment (MŽP), to the legal regulations issued by which the analysis of the prices and premiums was closely related. The Office also obtained the data required for calculating the prices and premiums in co-operation with the relevant umbrella associations of businesses operating in renewable resources.

In preparing the prices for 2006 the Office also focused on electricity generation in CHP installations. Under the amendment to the Energy Act, only premiums to market prices are permitted for CHP as the mode of support. The premiums the Office has set for 2006 reflect not only the markedly higher prices of natural gas, which is largely used as the fuel in small and medium-sized up to 10 MW cogeneration units, but also the higher risk involved in placing the electricity from these capacities on the electricity market. The Office has therefore defined a new supported category, natural gas-fired 5 to 10 MW installations. The premium in the case of large, over 10 MW cogeneration units has also been adjusted accordingly. The Office has introduced a new option, that of multiple modes of support for which generators may apply under certain conditions if they use renewable or secondary resources in a cogeneration unit.

The amendment to the Energy Act has introduced support for electricity generation when secondary energy resources are fired. Similarly as in the case of CHP, the support is provided in the form of premiums to the market electricity price. For 2006 the Office has defined, on the basis of analysing the data available, two categories of secondary resources. The first category includes all secondary resources with the exception of drainage gas (mine gas from open collieries). The premium to the market price helps to meet the electricity generator's extra costs incurred in firing secondary resources. The other category is the drainage gas. In this case, the premium does not only reflect the extra costs of the fuel but also helps to cover a part of the capital expenditure on the erection of the installation firing this type of fuel. As electricity generation by secondary resource firing develops, the years to come will probably see a further diversification of the premiums by the technology and fuel used.



# Regulation in the gas industry

4



The Czech gas market liberalisation was started in 2005, and it should be completed in 2007. In connection with the preparations for a fully liberalised market the Office set forth certain objectives that specified the fundamental tasks under the Energy Act. The Office started to carry them out as early as the beginning of the second regulatory period, i.e. 2005. This mainly involved providing for a more even development of natural gas selling prices in connection with the volatility of the prices at which natural gas is purchased from foreign suppliers, thereby maintaining a price stability for final customers; maintaining the quality of gas supplies; and motivating regulated companies to improve the efficiency of all of their regulated activities, which should be ultimately reflected both in gas prices to final customers and the quality of the services provided.

### 4.1 Market liberalisation in 2005

The first stage of the gas market liberalisation brought about a number of changes in the functioning of this market. From 1 January 2005 the first eligible customers started appearing on the market; their new position is associated with the option of freely choosing their natural gas supplier. Besides eligible customers, protected customers stayed on the market, constituting the majority of the market. In 2005 all final customers whose consumption had exceeded 15 mcm in 2003, and all electricity generation licence holders firing gas in thermal power stations or CHP, to the extent of their consumption of gas for this production, became eligible customers.

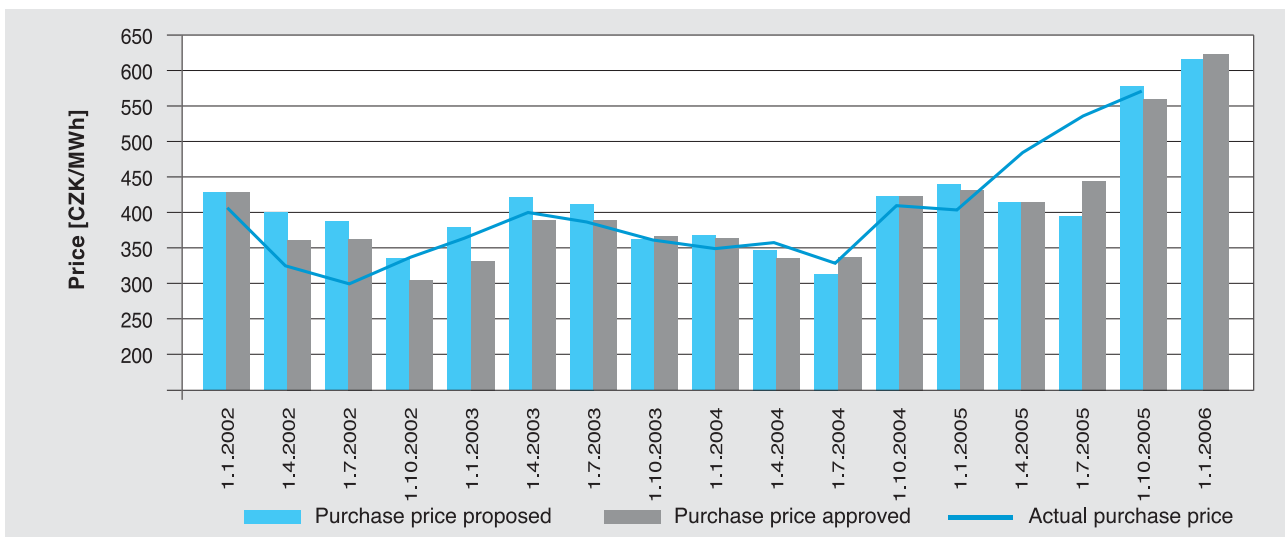
The next stage in market liberalisation is the year 2006, when all final customers for natural gas with the exception of households become eligible customers. The last stage of the Czech gas market liberalisation will be the year 2007: on 1 January 2007 all natural gas final customers will become eligible customers.

The aim of the gas market liberalisation is to achieve a competitive environment and, in connection with this, a genuine opportunity for supplier selection. In response to suggestions by the final customers who on 1 January 2005 had become eligible customers and felt damaged by their exposure to the effects of an ill-functioning competitive environment, in the second half of 2005 the Office analysed the condition of the Czech gas market and the degree of its liberalisation and the level of competition, and analysed the implications of the next stage of the gas market liberalisation from 1 January 2006. The conclusions of these analyses made it evident that no real competition existed on the Czech gas market and that the entry of an alternative competitive supplier for the about 140,000 low-offtake customers who would become eligible customers in 2006 could not be expected. Having considered all the circumstances the Office decided, with effect from 1 January 2006, to impose temporary caps on the prices of natural gas and storage services provided by RWE Transgas, a.s., and also the selling prices charged by distribution companies' traders who buy gas from RWE Transgas, a.s.

### 4.2 Pricing

In the gas industry, the Office sets the gas 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 relation to the situation prevailing on the market. In 2005 natural gas supply prices were reduced on 1 April, in response to a reduction in the price of the natural gas purchased from abroad. A slight increase in the price was effective from 1 July, and there was a distinctive increase on 1 October. The reason for the gas price hikes in 2005 was the considerable rise in oil prices on the world markets and the related increases in the prices of competing fuels, gas oil and heavy fuel oil, from which natural gas prices are derived. The natural gas prices charged by RWE Transgas, a.s. to regional distribution companies can be seen in Chart 5.

Chart 5 Natural gas prices charged by RWE Transgas, a.s. to regional distribution companies



A liberalised market necessitates the negotiation of prices between the customer and his supplier. However, in network industries, specifically in transmission and distribution, competition on the market cannot be ensured in full, and therefore supervision over the development of the prices of these services must be provided in the form of regulation.

Thus, the transmission charge and the distribution charge are subject to price controls. For eligible customers, with the exception of the regulated transmission and distribution charges, the price of the natural gas supply, including the natural gas itself (the commodity) and the storage charge, are negotiated prices. Prices to protected customers are fully controlled.

Eligible customers' ability to negotiate the services related to gas supplies after 1 January 2005 meant another task for the Office – to set the prices for gas transmission and distribution for this group of customers. The Office developed the methodology for calculating these prices on the basis of its analyses in 2004 and forecasts of the possible development of the gas companies' behaviour, mainly in connection with the separation of transmission and distribution from gas trading.

#### 4.2.1 The transmission charge

Natural gas transmission involves mainly the costs of transporting the natural gas through the Czech transmission system, but also the costs incurred in keeping the gas quality standards, and the costs incurred in balancing the Czech gas system.

The transmission charge is a fixed single-component price, i.e. a price related to only one basis, which is uniform for the whole market and independent of distance because of the small area covered by the Czech Republic. The reference basis is the gas quantity that has to be transported over one day, i.e. the required maximum daily capacity out of all the values over the year. The transmission charge is set for one-year agreements and longer.

It is also allowed 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 use of the transmission system varies 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 has been applicable since 1 January 2005, was set with a view to ensuring the stability of the system and preventing speculation in capacity contracting.

Related to the daily transmission system balancing obligation are some other prices and charges set by the Office for the balancing entities; they are necessary for ensuring a functioning market model. 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.

Under the Energy Act the transmission system operator was obliged to unbundle transmission from its other licensed activities by 1 January 2006. In the unbundling process, the transmission system operator was compelled to incur certain extraordinary costs, and requested that they be reflected in the transmission prices. Under the Energy Act, the Office has the remit to decide to include justifiable and demonstrable minimum costs of unbundling into the prices of regulated activities.

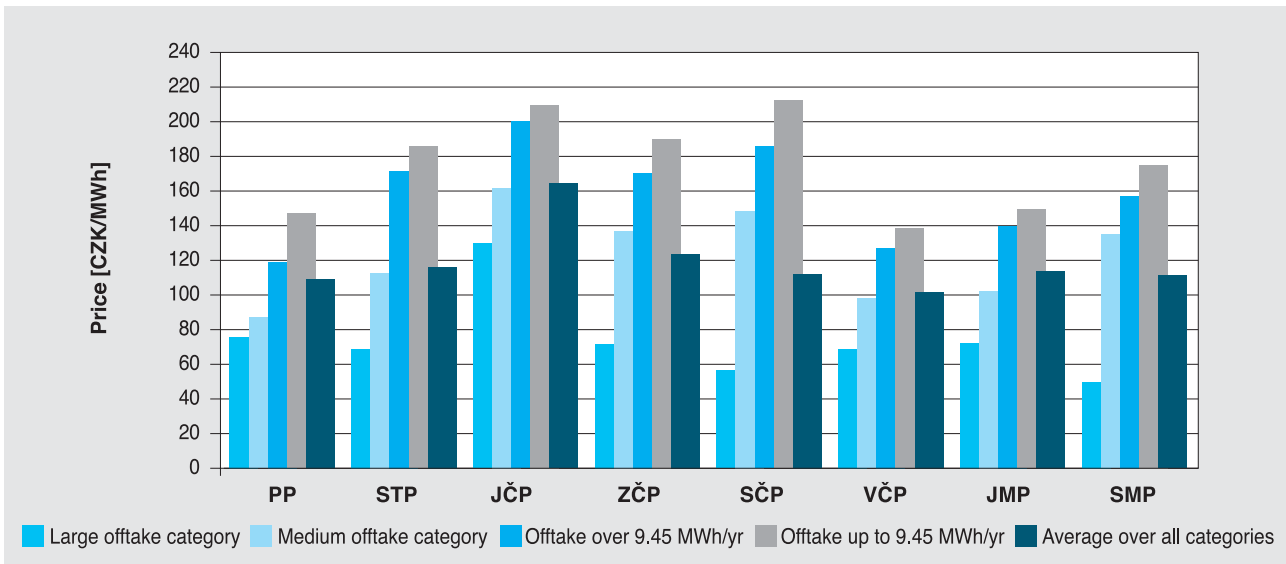
The Office employed the same method for calculating the unbundling cost as in the electricity industry, and determined the justifiable minimum costs of the TSO's unbundling and their inclusion in the transmission charge, spread over time.

#### 4.2.2 The distribution charge

The other regulated component of the price, which together with the other components forms the total price of the supply, is the distribution charge. The distribution charge covers the respective distribution companies' costs incurred in natural gas transport through the distribution systems, in repair and maintenance of the pipeline system, and in metering, reading, and billing. Because of the differences between the distribution systems in each of the regions (length, structure) the prices for each of the regional distribution companies differ too.

The distribution charges are – unlike the transmission charge – two-component prices. This specifically means that a part of the costs is paid in relation to the gas quantity taken, i.e. in the variable component of the price, while the remaining costs are fixed; in the case of small consumers 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. Distribution prices of regional distribution companies for 2005 are shown in Chart 6.

Chart 6 Average distribution prices in 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. 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.

In 2005 detailed analyses were carried out to find how the distribution charges that had been set for that year were working. It was found that the then existing model for calculating the regulated distribution charge had to be made more accurate and that in the following period its application on the market should be standardised. Specifically, the principle of cost-intensity of customer categories has been adjusted, which is reflected in the following changes:

- In the large offtake category, the segmentation of these customers has been integrated;
- The model takes into account the varying extent to which storage services are used by each type of customers;
- The distribution charge has been reduced for the final customers who are connected to a long-distance gas pipeline and take gas via their own regulating station, due to their higher costs of connection;
- The third band in the low offtake and residential customer category has been broken down into ten offtake bands;
- The fourth band of the low-offtake and residential customer category has no standing monthly charge.

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. The distribution prices set by the Office 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.

In the case of exceeding the daily booked distribution capacity contracted in the agreement with the distribution system operator, the eligible customer/trader must pay the distribution system operator a charge calculated using the respective formula. This principle had to be put in place for ensuring the stability of the distribution system.

### 4.2.3 Prices to eligible customers

As mentioned above, eligible customers' basic right is to select their natural gas supplier. The supply price is composed of the above controlled prices, while the remaining components of the price are the result of negotiations between the customer and his supplier.

At the beginning of 2005 the Office received requests from several eligible customers to commence administrative proceedings on failures to reach agreement on the price and contract terms and conditions and on the impossibility to select their gas suppliers.

On the basis of the facts found the Office decided, with effect from 1 January 2006, to temporarily impose caps on the storage prices, on the prices of supplies from RWE Transgas, a.s., and on the prices of supplies from the traders who bought gas from RWE Transgas, a.s., the cap having the form of maximum prices. The Office will set maximum prices until at least 31 March 2007.

The Office analysed the feasible approaches to imposing limitations on prices to eligible customers. The conclusions of these analyses indicated that the best method appeared to be the regulatory approach applied in the preceding regulatory periods, when prices had been set on a quarterly basis and subsequently adjusted to reflect the actual costs of natural gas procurement. According to the Office's

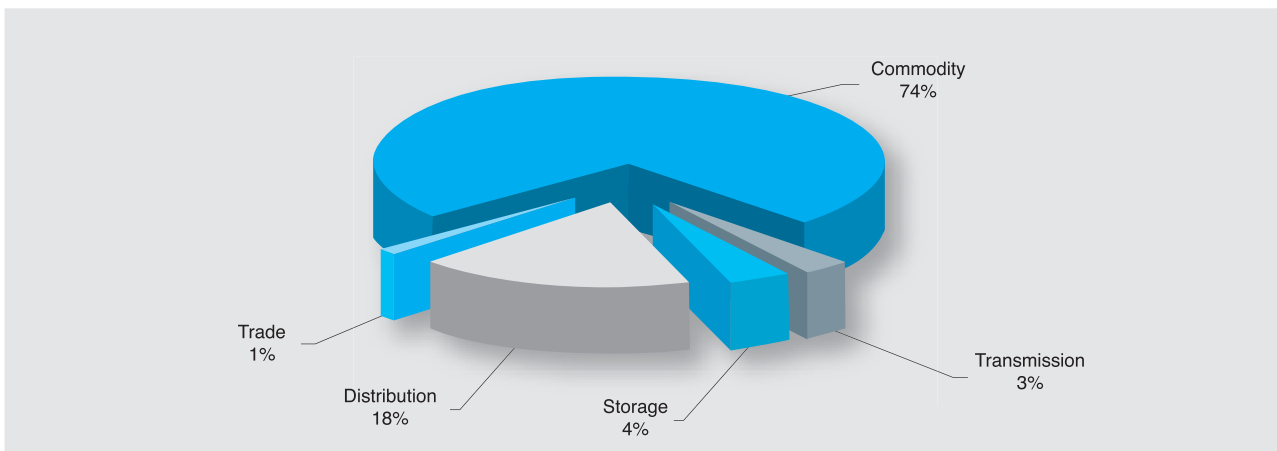
analysis this measure should save eligible customers at total of CZK 1.7 billion in 2006, i.e. approximately 6% of the costs of natural gas purchase. Eligible customers will feel the new price control thanks to the fact that it takes into account the effects of gas storage, whereby cheaper gas injected in summer is withdrawn in winter, and also due to the imposition of regulated margins on traders.

Should the conditions change and ensure that the market functions properly and competition emerges, the above restrictions will be abolished effective from 1 April 2007.

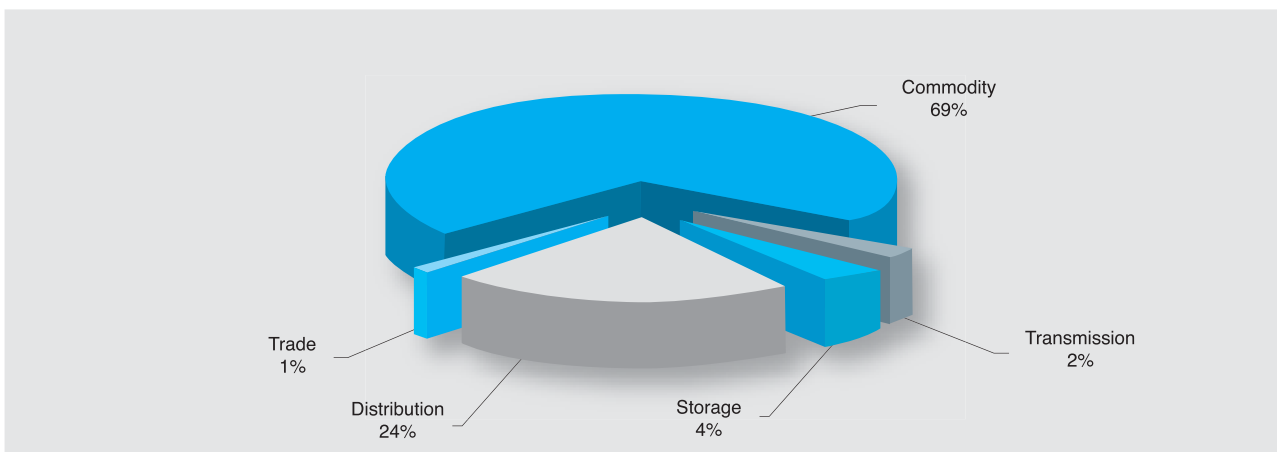
#### 4.2.4 Prices to protected customers

The price charged by RWE Transgas, a.s. traders 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, has been set as a two-component price. This price is controlled in full for protected customers, i.e. including the prices for storage and commodity. The commodity charge is the most important component of the final price of the supply, accounting for 70% to 80% of the final price. The basis for this price includes mainly the forecasts of the development of oil product prices 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 cost of gas purchase by RWE Transgas, a.s. and the price in the preceding closed quarter, set by the Office, as mentioned above. Charts 7 and 8 show the composition, in per cent, of the gas supply price to protected customers.

**Chart 7 Structure of the supply price to protected customers, medium offtake, 1 January 2006**

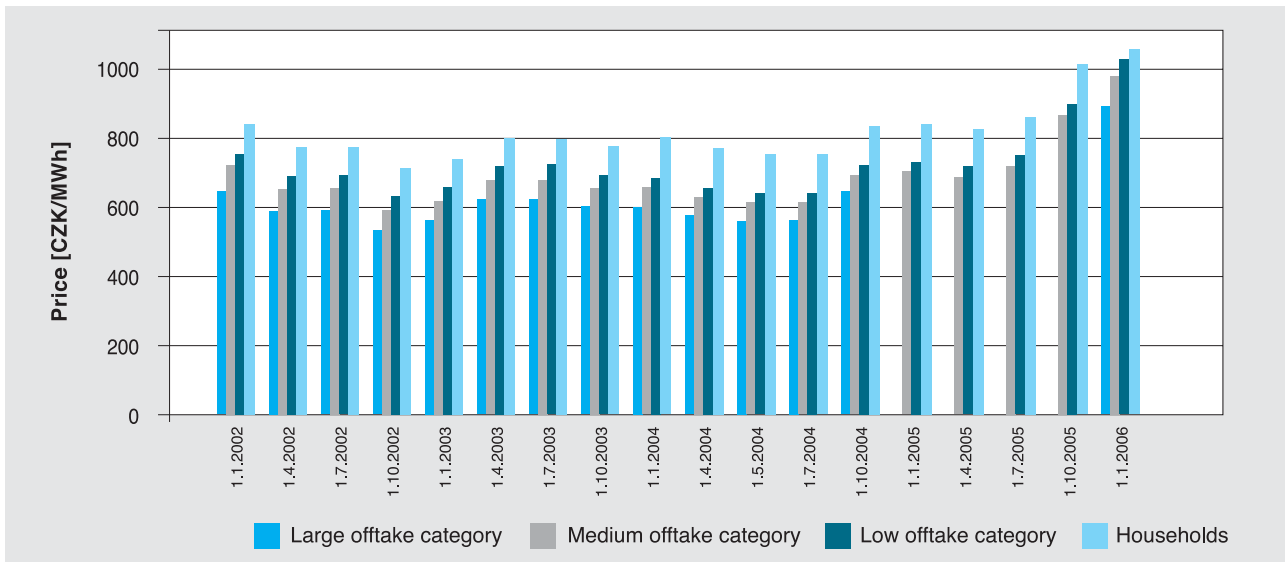


**Chart 8 Structure of the supply price to protected customers, low offtake and households, 1 January 2006**



A part of the two-component 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, and in the case of larger offtakes in the form of the maximum daily capacity charge. The development of average prices for each customer category can be seen in Chart 9.

Chart 9 Development of average prices for each protected customer category



There is a new charge for exceeding the daily booked fixed capacity agreed in the contract between an RWE Transgas, a.s. trader and the respective licence holder who supplies gas to protected customers connected to regional distribution systems. The introduction of this charge was a necessary precondition for the correct setting of booked fixed capacities in contracts, and hence for the correct and non-discriminatory calculation of the supply prices to the each of the customer groups.

In 2005 readings were taken for typical supply profiles, and the load profiles of regional distribution companies were examined by customer type. This data provides a new and more accurate picture of the use of distribution systems, the transmission system, and underground gas storage facilities by customer type. For this reason, in 2005 the procedure for determining the various components of the natural gas supply price had to be made more accurate, thereby ensuring an overall transparency of supply prices effective from 2006.

The following table shows prices, in percentage terms, of natural gas for each category of protected customers in 2005.

Table 3 Prices, in percentage terms, of natural gas for each category of protected customers in 2005

Company	Category	Natural gas price							
		[CZK/ MWh]				[%]			
		IQ	IIQ	IIIQ	IVQ	IQ	IIQ	IIIQ	IVQ
Czech Republic	Medium offtake	697.13	679.67	715.04	864.80	0.92	-2.51	5.2	20.94
	Low offtake	729.25	709.88	745.52	895.32	1.49	-2.66	5.02	20.09
	Households	843.08	823.59	859.25	1 008.96	1.31	-2.31	4.33	17.42
	Total	745.54	727.21	762.93	912.71	1.54	-2.46	4.91	19.63
Pražská plynárenská, a.s.	Households	848.04	827.43	863.15	1 012.93	-0.16	-2.43	4.32	17.35
Středočeská plynárenská, a.s.		848.37	830.04	865.75	1 015.54	3.29	-2.16	4.3	17.30
Jihočeská plynárenská, a.s.		877.12	860.01	896.91	1 045.90	1.34	-1.95	4.29	16.61
Západočeská plynárenská, a.s.		898.12	879.80	915.51	1 065.30	2.24	-2.04	4.06	16.36
Severočeská plynárenská, a.s.		864.36	845.28	880.98	1 030.77	3.23	-2.21	4.22	17.00
Východočeská plynárenská, a.s.		830.22	813.11	848.36	998.22	-1.47	-2.06	4.34	17.66
Jihomoravská plynárenská, a.s.		819.29	797.70	833.21	982.84	0.96	-2.64	4.45	17.96
Severomoravská plynárenská, a.s.		847.04	828.70	864.43	1 014.22	2.10	-2.17	4.31	17.33



#### 4.2.5 Local distribution systems

Under the amendment to the Energy Act, the approach to local distribution system operators is different. 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 were controlled prices in 2005; the distribution charge in the form of fixed prices and the natural gas supply charge in the form of maximum prices.

#### 4.2.6 Structure of the Office's price decisions

In comparison with the preceding period ERO Price Decisions have differed significantly since 1 January 2005; the differences can be found in both their structure and content. 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 changes are as follows:

- a) There are newly included parts, which lay down the prices for natural gas transmission and distribution. The prices have been set for the services related to natural gas supplies to protected customers;
- b) In addition to the gas prices and prices of services related to gas supplies, the price decision also contains prices related to transmission system balancing and charges for exceeding the agreed capacity;
- c) 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 charge for exceeding the agreed capacity, which RWE Transgas, a.s. has the right to bill to the respective licence holders who supply gas to protected customers;
- d) 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.



# The heat supply industry

5





### 5.1 Assessment of thermal energy price control in 2005

To enhance the long-term stability of thermal energy prices, since 1 January 2005 the conditions for thermal energy pricing have remained unchanged; these conditions are laid down in ERO Price Decision No. 9/2004 of 20 October 2004, on thermal energy prices.

The key principles of thermal energy price controls continue to be the following:

- a) Cost-plus prices under Section 6 of Act No. 526/1990, on Prices, as amended; all thermal energy prices may therefore only reflect economically justifiable costs, reasonable profit, and value-added tax;
- b) Levels of thermal energy prices, which are set by the Office as reference values for comparing the thermal energy prices charged;
- c) Determining the maximum year-on-year growth of economically justifiable fixed costs and reasonable profit for the thermal energy prices charged above the respective level of thermal energy price;
- d) Definition of the price localities in which the thermal energy price may be calculated and applied uniformly.

The current conditions for thermal energy pricing have helped to improve the incentive-based regulation method. Thermal energy suppliers are motivated to optimise their costs of thermal energy generation and distribution; investments in thermal installations are encouraged; the efficiency of thermal energy generation and distribution is improving; and the large differences in thermal energy prices between different localities are diminishing. This is favourable for thermal energy prices and stability of its supplies over the long run.

The Office sets separately the prices of the thermal energy produced from coal and the prices of the thermal energy produced from other fuels, i.e. largely natural gas and fuel oils. Setting two price levels depending on the fuel used appears to be substantiated, because the fuel used for its generation has the strongest influence on the thermal energy price. In 2005, which saw surges in natural gas and fuel oil prices, the Office adjusted the levels of the prices of thermal energy produced from other fuels and issued its Price Decision No. 6/2005 of 12 September 2005, on thermal energy prices, whereby it changed the levels of thermal energy prices set out in its Price Decision No. 9/2004.

The Office issued its Price Decision No. 11/2005 of 21 November 2005, which amends its Price Decision No. 9/2004 of 20 October 2004, which specifies more accurately the conditions for potentially reflecting the cost of the required purchase of emissions allowances in thermal energy prices. In connection with the relaxed conditions for trading in emissions allowances there was a need to clarify when the cost of purchasing emissions allowances is regarded as an economically justifiable cost item contained in thermal energy prices, to prevent the potential adverse impacts on thermal energy prices caused by speculative transactions with the allowances.

With a view to improving the controllability of the conditions for thermal energy pricing, unifying the interpretation of energy regulations, and addressing the heat supply industry's issues, the Office continuously works with the State's Energy Inspectorate (SEI) and the Ministry of Industry and Trade (MPO). In 2005 the Office, cooperating with MPO, removed duplicities in the regulatory reports required from thermal energy suppliers.

### 5.2 Development of thermal energy prices

Thanks to the regulatory reports received from thermal energy suppliers the Office has insight into the technical and financial conditions of licensed entities, develops databases and overviews of thermal energy prices and/or the individual items in price calculations, and monitors their development over time.

Thermal energy suppliers provide the Office with, among others, details on the price and quantities of their thermal energy supplies in each price locality and at each transfer level within one price locality. Under the mandatory rules for thermal energy pricing a price locality may include a separate generating plant or heating system and/or disconnected and connected plants and heating systems in one municipality and/or heating systems in different municipalities, connected by pipes.

The Office publishes some information on its website, making it available to the public. An example is the databases of thermal energy prices, which contain, *inter alia*, data on the capacity installed, fuel type, and thermal energy quantities supplied in addition to the prevailing thermal energy prices at each of the transfer levels.

The publication of this data helps to improve information to the public and plays an increasingly important role in the negotiation of thermal energy prices between suppliers and customers, in particular where the competitive environment is inadequate.

### 5.3 Average prices of thermal energy

The data on thermal energy prices and thermal energy quantities supplied is based on the regulatory reports submitted every year by thermal energy generation and distribution licence holders, and also on the overview of thermal energy prices prevailing in the respective regulated year. To calculate the average prices from 2002 to 2004, the actual resulting thermal energy prices are used, while for 2005 the expected resulting prices are used. The average thermal energy prices are shown including the VAT.

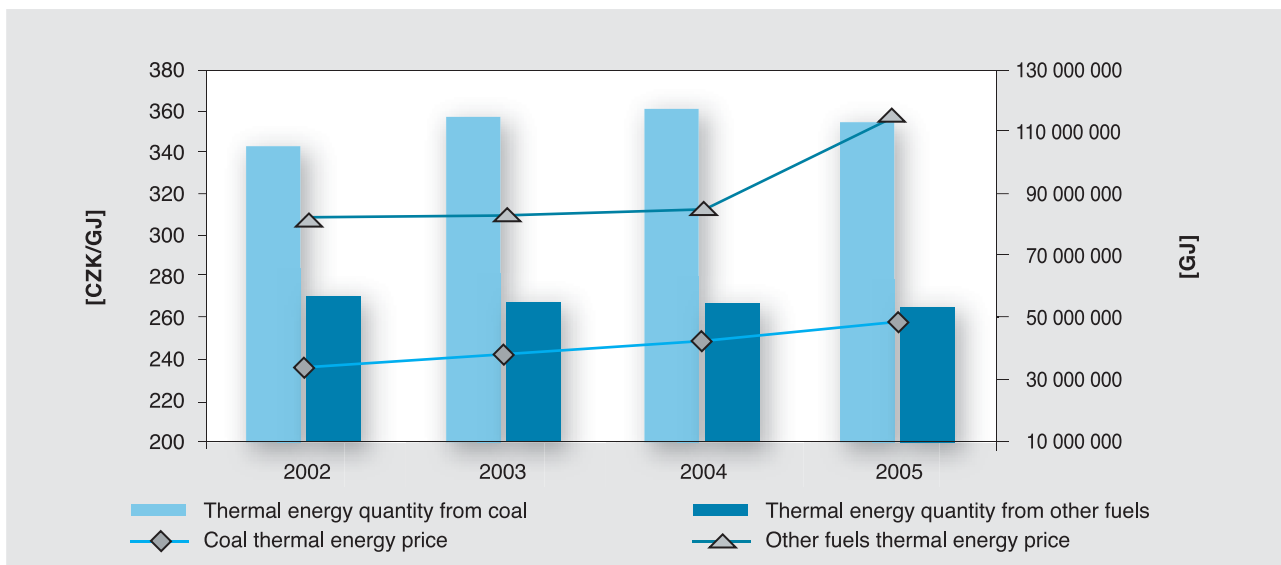
Table 4 compares the quantities and average prices of thermal energy at all transfer levels from 2002 to 2005 in relation to the fuel type. In addition to the changed natural gas price, also the higher rates of excise duty on fuel oils and lower entitlement to the refund of this duty when these fuels are used for thermal energy generation had an impact on the 2005 prices of the thermal energy produced from other fuels. The 2005 price of the thermal energy produced from coal reflects the increase in non-regulated prices of coal, mainly hard

coal, and the coal transport costs. Average prices and overall quantities of thermal energy supplied in 2002 to 2005 can be seen in Chart 10 and Chart 11.

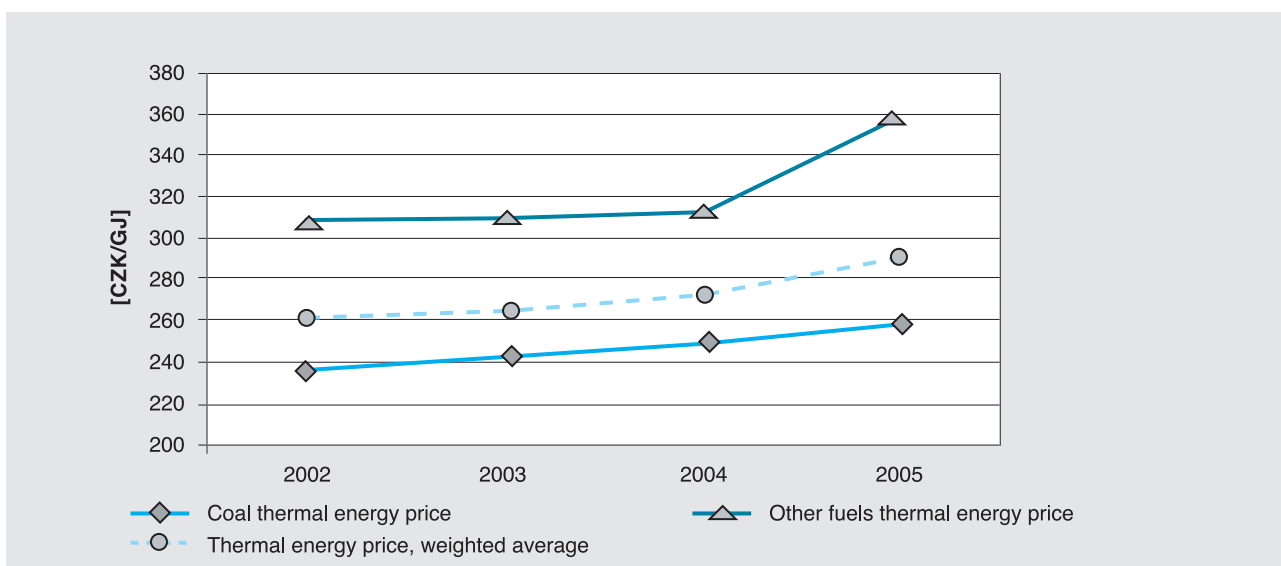
**Table 4 Average prices and quantities of thermal energy delivered at all transfer levels between 2002 and 2005**

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	307.87	56,876,026	260.13	162,488,548
2003	241.91	114,654,045	309.11	54,523,670	263.56	169,177,715
2004	248.08	117,117,241	311.00	54,837,815	268.14	171,955,056
2005	256.72	113,220,097	357.96	53,518,370	289.21	166,738,467

**Chart 10 Average prices and quantities of thermal energy delivered at all transfer levels between 2002 and 2005**



**Chart 11 Average prices of thermal energy delivered at all transfer levels between 2002 and 2005**



## 5.4 Average thermal energy prices at transfer levels

The overviews of thermal energy prices (Table 5) and of the thermal energy quantities supplied between 2002 and 2005 have been compiled in relation to the type of the fuel used (coal, other fuels). The average prices relate to each of the transfer levels and are compared with the price levels set by the Office in 2004.

**Table 5 Average prices of thermal energy produced from coal**

Transfer level		2002	2003	2004	2005
Supplies from production, capacity over 10 MWt	Quantity [GJ]	11,923,490	11,746,463	9,502,755	9,740,709
	Price [CZK/GJ]	165.90	165.46	162.59	168.70
	Price level [CZK/GJ]			160.00	195.30
Supplies from primary distribution	Quantity [GJ]	59,530,198	62,703,800	65,541,842	61,985,439
	Price [CZK/GJ]	209.52	215.06	217.70	227.34
	Price level [CZK/GJ]			240.00	275.10
Supplies from production, capacity less than 10 MWt	Quantity [GJ]	394,130	443,007	197,899	145,891
	Price [CZK/GJ]	325.54	296.74	285.86	342.78
	Price level [CZK/GJ]			265.00	305.55
Supplies from the central exchanger station	Quantity [GJ]	7,304,248	7,998,913	7,268,314	8,789,422
	Price [CZK/GJ]	272.30	278.21	285.86	295.98
	Price level [CZK/GJ]			265.00	305.55
Supplies from the block boiler house's distribution	Quantity [GJ]	527,082	485,343	457,916	379 342
	Price [CZK/GJ]	327.41	332.25	350.68	358.93
	Price level [CZK/GJ]			290.00	330.75
Supplies from secondary distribution	Quantity [GJ]	23,078,978	28,096,699	30,000,058	28,629,603
	Price [CZK/GJ]	308.08	310.97	317.33	324.37
	Price level [CZK/GJ]			290.00	330.75
Supplies from a house transfer station	Quantity [GJ]	2,854,396	3,179,820	4,148,457	3,549,691
	Price [CZK/GJ]	317.58	330.56	343.75	353.97
	Price level [CZK/GJ]			290.00	330.75

Table 6 shows the average prices of thermal energy produced from other fuels between 2002 and 2005. In the years under review, the thermal energy prices were rising at all transfer levels; the most marked change occurred in 2005. Due to higher natural gas and fuel oil prices also thermal energy prices increased. The lower quantity of thermal energy supplied in 2005 can be attributable to the weather, and also heavier austerity measures on the part of customers.

**Table 6** Average prices of thermal energy produced from other fuels

Transfer level		2002	2003	2004	2005
Supplies from production, capacity over 10 MWt	Quantity [GJ]	7,867,900	7,125,716	7,994,324	5,809,798
	Price [CZK/GJ]	193.30	193.17	183.50	200.74
	Price level [CZK/GJ]			230.00	264.60
Supplies from primary distribution	Quantity [GJ]	15,837,972	15,618,287	17,694,983	15,587,070
	Price [CZK/GJ]	283.15	279.62	276.29	329.71
	Price level [CZK/GJ]			310.00	344.40
Supplies from production, capacity less than 10 MWt	Quantity [GJ]	2,520,986	2,871,188	1,180,075	2,125,414
	Price [CZK/GJ]	318.57	319.95	318.28	367.88
	Price level [CZK/GJ]			335.00	371.07
Supplies from central exchanger station	Quantity [GJ]	3,071,835	2,594,411	2,507,497	2,887,809
	Price [CZK/GJ]	338.63	358.81	362.69	407.85
	Price level [CZK/GJ]			335.00	371.07
Supplies from the central exchanger station	Quantity [GJ]	10,270,813	10,439,291	9,705,461	10,233,708
	Price [CZK/GJ]	336.66	337.93	358.78	392.60
	Price level [CZK/GJ]			360.00	394.80
Supplies from secondary distribution	Quantity [GJ]	11,107,485	9,632,632	10,023,897	10,977,136
	Price [CZK/GJ]	355.78	354.73	372.66	403.76
	Price level [CZK/GJ]			360.00	394.80
Supplies from house transfer station	Quantity [GJ]	6,199,035	6,242,145	5,731,578	5,897,435
	Price [CZK/GJ]	363.26	371.00	383.10	414.12
	Price level [CZK/GJ]			360.00	394.80

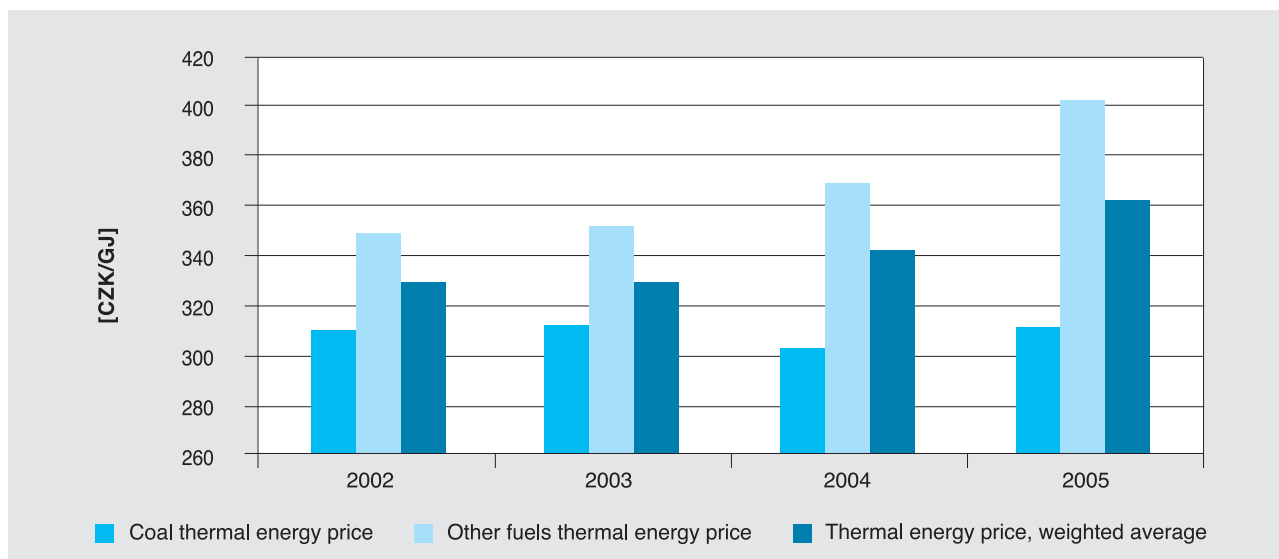
## 5.5 Average thermal energy prices to final customers

The prices of thermal energy intended for final customers are monitored for thermal energy supplies from block boiler houses' distributions, from secondary distributions and from house delivery stations. Table 7 and Chart 12 show average prices of thermal energy supplied to final customers between 2002 and 2005 in relation to the type of the fuel used.

**Table 7** Average thermal energy prices to final customers

Fuel	Average thermal energy prices [CZK/GJ]			
	2002	2003	2004	2005
Coal	309.49	313.26	320.94	328.00
Other fuels	350.34	351.92	369.72	401.80
Weighted average	330.34	330.78	341.62	361.53

Chart 12 Average thermal energy prices to final customers between 2002 and 2005







# Licensing policy and administrative proceedings





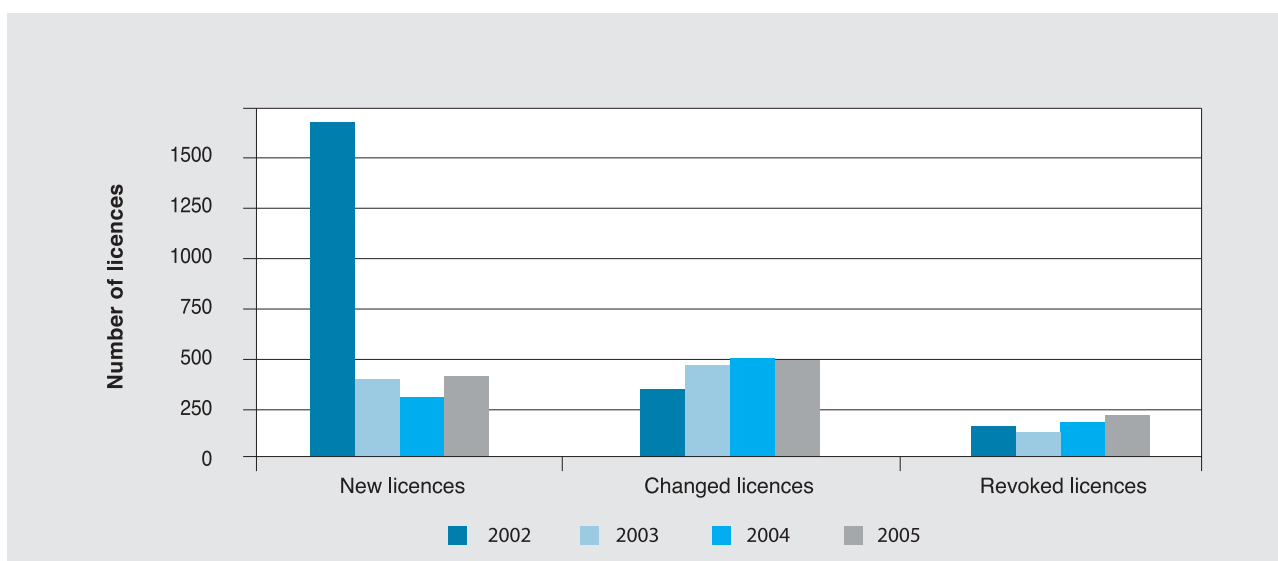
## 6.1 Licensing policy

In 2005 most of the work focused on dealing with businesses' requests for changes to, and revocation of, licences for conducting business in the energy industries. The main reasons for requesting modifications to licences include the transfers of assets 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. The numbers of newly granted licences, and changes to and revocation of licences are shown in Table 8 and Chart 13.

**Table 8** Number of licences awarded, changed and revoked in 2002 to 2005

Year	New licences	Changed licences	Revoked licences
2002	1,619	334	161
2003	376	485	137
2004	312	493	194
2005	372	495	228

**Chart 13** Number of licences awarded, changed and revoked in 2002 to 2005



In 2005 the trend of slightly rising numbers of holders of licences for electricity generation in small hydroelectric power stations continued. There was also a rather significant rise in the number of applicants for licences for electricity generation in wind power stations.

The unbundling of electricity supplies from distribution services has resulted in a continuously rising number of electricity traders and a declining number of licensed distributors. The amendment to the Energy Act has also led to a higher number of natural gas trading licence holders.

From the perspective of the licences awarded, the situation in the heat supply industry has stabilised; licences are changed only because of ownership and administrative changes.

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 Office'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.

## 6.2 Recognition of professional qualifications

In 2005 the Energy Regulatory Office, which is the body authorised to recognise professional and other competences of the EU member states' citizens for the purpose of conducting business in the energy industries, decided on the recognition of professional qualifications for electricity and gas trading in six administrative proceedings.

## 6.3 Administrative proceedings in 2005

In 2005 three administrative proceedings were concluded in the **electricity industry**. All three cases involved completely novel issues. Specifically, there was a dispute over the granting of an opinion on the connection of a small hydroelectric power station, a dispute over the connection of wind power stations, and a dispute over the electric energy price to an eligible customer. Of these administrative proceedings, two were concluded by a first instance decision and one by the ERO Chairman's decision on a remonstrance.

In this context last year's claim can be reiterated, i.e. that the situation surrounding disputes has stabilised – only a small number of disputes emerge, which is considerably helped by a stable environment, predictable for the electricity market players, that has emerged thanks to the Office's activities in the promulgation of public notices and price decisions, and also its educational activities, etc. These activities 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.

In 2005 two administrative proceedings were concluded in the **gas industry**; one concerned a local distribution system operator's refusal to connect gas facilities and increase natural gas supplies, and the other the price between a regional distribution system operator and a protected customer. Both proceedings were concluded by a first instance decision; in one of the cases the administrative proceeding was discontinued, because talks between the parties on the one hand, and the Office on the other hand, resulted in the execution of the respective contract and the withdrawal of the petition instigating the proceeding.

Further, 16 administrative proceedings were instigated in the gas industry in 2005; they will be concluded in 2006. Most of the disputes concern gas prices between regional distribution system traders and eligible customers. In comparison with the previous years, when a very small number of disputes were adjudicated in the gas industry, we can therefore see a marked increase, caused mainly by the first stage of the gas market liberalisation which, however, was not accompanied by any actual functioning of the market or the entry of new traders, i.e. the emergence of a genuinely competitive environment, or legislative changes. For these reasons the gas industry can be viewed today as the most problematic industry from the perspective of disputes. The Office therefore wants to focus more on this sector in 2006.

In 2005 ten administrative proceedings were concluded in the **heat supply industry**. Two cases involved disputes over the structure of thermal energy prices, and one case concerned a dispute over the execution of an addendum to an agreement on thermal energy supply in relation to the delivery point. Seven cases concerned the execution of agreements on thermal energy supply, where in some of them the reason for the failure to execute the agreement originated in an area other than the energy sector. On the basis of the facts found during the administrative proceedings, in some cases the SEI was requested to start inspection proceedings under Act No. 552/1991 on inspections by the State. Eight of the administrative proceedings were concluded by first instance decisions in 2005; in two cases the proceedings were discontinued, because talks between the parties on the one hand, and the Office on the other hand, resulted in the execution of the respective contract and the end of the dispute. In five cases conciliation was reached and endorsed. In two cases the proceedings were concluded by the ERO Chairman's decision on a remonstrance.

Compared with 2004, when three administrative proceedings were concluded, this means a considerable rise in the number of disputes. However, we can reiterate last year's claim that thanks to the Office's activities, mainly as regards price decisions, the number of newly emerging disputes over thermal energy pricing (both the structure and magnitude of the prices) is decreasing considerably; in 2005 two proceedings related to pricing. A very positive aspect is that in most of the disputes talks with the parties resulted in the reaching and endorsement of conciliation or the parties' agreement, and the petitions were withdrawn.

## 6.4 Dispute settlement in 2005

### 6.4.1 The electricity industry

**WIKÁ, spol. s r.o. and Severočeská energetika, a.s.:** Dispute over the granting of an opinion on the connection of a small hydroelectric power station of WIKÁ, spol. s r.o. in Štětí to the distribution network of Severočeská energetika, a.s. The decision on the remonstrance filed by Severočeská energetika stipulated that Severočeská energetika was obliged to specify, in its opinion for WIKÁ on the connection of the power station in the Štětí 1 cadastre area to the distribution system of Severočeská energetika, the conditions for the connection of the power station to its distribution system under Section 25(11)(c) of the Energy Act, and imposed an obligation on Severočeská energetika to issue, within 15 days of the finality of the decision, WIKÁ with a consenting and binding opinion on the connection under Section 25(11)(c) of the Energy Act and under Section 4(1) and (2) of the Ministry of Industry Trade Public Notice No. 18/2002 on the conditions of connection to and electricity transport in the electricity grid; the opinion was to serve for the purpose of planning proceedings and the connection was to be established at support point no. 61 on the Hošťka 1 and 2 double line, with an option to move the connection point by one kilometre to either side from support point no. 61, with effect for 180 days from the finality of the decision.

**Moravská Energetika, s.r.o. and E.ON Distribuce, a.s.:** Dispute over the connection of 3 x 2 MW wind power stations of Moravská Energetika, s.r.o. to the distribution system of E.ON Distribuce, a.s. near Benešov u Boskovic. An expert opinion was produced on the question on whether the calculation of the maximum connectable capacity in parts 4.2.1.2 and 4.2.2 the Connection Study was correct. It was decided that E.ON Distribuce was not obligated to connect the 3 x 2 MW Vestas V-90 wind power stations, required by Moravská

Energetika, to the 22 kV line no. 127 on the site near Benešov u Boskovic at support point no. 628. Moravská Energetika filed a remonstrance. In his decision on the remonstrance the ERO Chairman rejected the remonstrance and upheld the first instance decision.

**Lahůdky V+V, s.r.o. and ThermoGas TRADING, s.r.o.:** Dispute over the electric energy price to an eligible customer. A decision was taken on regulated prices under ERO Price Decision No. 10/2004 of 29 November 2004, which sets prices of electricity and related services. If despite the option to terminate the contract the eligible customer stayed with its existing supplier – trader, it was solely its own choice with all the potential advantages and risks entailed in it. Having stayed with its existing electricity trader, the customer should pay the prices demanded by the trader.

### 6.4.2 The gas industry

**TEDOM s.r.o. and Rýnovická energetická s.r.o.:** Dispute over the refusal to connect gas facilities and increase natural gas supplies. An agreement was reached on the increase in natural gas supplies due to the installation of gas boilers and a cogeneration unit. TEDOM withdrew its petition for the administrative proceedings, whereupon the Office discontinued the proceedings.

**ŠKODA, KOVÁRNY, Plzeň, s.r.o. (ŠKP) and Západočeská plynárenská, a.s. (ZČP):** Dispute over the gas price for the fourth quarter of 2004 for a protected customer. The parties had executed agreements on natural gas supplies in 2004. In the first three quarters of 2004 the parties agreed on a lower than the maximum price, but the method for calculating this “reduced” price was not covered by the agreement. For the last quarter the customer demanded a higher discount than offered by the supplier. In its decision, the Office determined the maximum gas price for the fourth quarter of 2004 pursuant to Article II of ERO Price Decision No. 8/2004 of 24 August 2004, on gas prices. Had the Office set any other price, it would have been in conflict with the above price decision and it would have denied ZČP the coverage of previously approved justifiable costs and profit, to which ZČP was entitled under the said price decision. If ZČP granted a discount to ŠKP from the maximum price so awarded it granted the discount only at the expense of its own bottom line, but the latter will not be taken into account in any way when setting the maximum price for ZČP in the next price decision.

### 6.4.3 The heat supply industry

**Quick I. v.o.s. and Společenství vlastníků jednotek domu Nová výstavba č.p. 202 [a condominium]:** Dispute over the execution of a purchase agreement on the supply of thermal energy and hot service water. The customer terminated the existing agreement on the supply of thermal energy; despite talks, no new agreement was signed. Thanks to the talks between the parties and the Office, the parties accepted consensus on the controversial provisions of the draft agreement and withdrew the petition for the administration proceedings, whereupon the Office discontinued the administrative proceedings.

**LENOXA a.s. and KVĚTNICE, stavební bytové družstvo [a housing cooperative]:** Dispute over the execution of an agreement on thermal energy supply. The Office revoked, upon the licence holder's request, the licences held by ŽILKA spol. s r.o. for thermal energy generation and distribution. LENOXA became the new operator of the heat supply system for the area in question. This company presented the customer with draft agreements on thermal energy supply, and the customer did not accept the drafts in question. Thanks to the talks between the parties and the Office, the parties signed new agreements on thermal energy supply. The Office endorsed their conciliation.

**Jihostroj a.s. and CENTROPOL CZ, a.s.:** Dispute over failure to execute an agreement on thermal energy supply. On 30 June 2005 expired a steam supply agreement that had been in place between the parties, but no new agreement was executed. Later an agreement on thermal energy supply between CENTROPOL CZ and CARTHAMUS was signed by the new owner as from 1 August 2005 and then also, as from 1 September 2005, under a newly awarded thermal energy generation licence, by the operator of Energoblok in Český Krumlov. The administrative proceedings were discontinued.

**Pražská teplárenská a.s. and České teplo s.r.o.:** Dispute over the execution of an addendum to an agreement on thermal energy supply, concerning the delivery point. The parties had an agreement in place on thermal energy supply, in which a branch-off shaft was defined as the point of thermal energy supply while the inlet to a transfer station was agreed as the delivery point. Over the term of the agreement the technical condition of the heat supply service line deteriorated considerably, and the supplier was compelled to relocate the metering instrument from the original site, i.e. inlet to the transfer station, to the point of thermal energy supply in the branch-off shaft, which led to changes in the details set out on the agreement on thermal energy supply. The talks held between the parties and the Office resulted in consensus: České teplo would accept the requirement by Pražská teplárenská for an amendment to the agreement in respect of the delivery point. The Office endorsed their conciliation.

**TEPLO KRKONOŠE a.s. and five condominiums that had been established by demerger from Stavební bytové družstvo Vrchlabí [a housing cooperative]:** Dispute over the execution of thermal energy supply agreements. On the basis of the privatisation of the flats, under the law on the ownership of flats, i.e. Act No. 72/1994, new entities had come into existence, condominiums, which, however did not enter into thermal energy supply agreements with the thermal energy supplier, TEPLO KRKONOŠE, and continued to take thermal energy through Stavební bytové družstvo Vrchlabí, which had an agreement on thermal energy supply in place with TEPLO KRKONOŠE. After holding talks, the model agreement published on the Office's website was used for signing the purchase agreements on the supply of thermal energy and hot service water with each of the condominiums – parties to the proceedings. The Office endorsed their conciliation.

**Dalkia Ostrava, a.s. and Mr Petr Sukup:** Failure to reach agreement on the execution of a thermal energy supply agreement. The parties executed an agreement on thermal energy supply, which did not comply with the new energy legislation. Thanks to talks, the parties reached consensus and signed a new thermal energy supply agreement. The Office endorsed their conciliation.

**Dalkia Ostrava, a.s. and Společenství vlastníků Karla Pokorného 1553/42 [a condominium], Bytové družstvo DIPLOMAT [a housing cooperative] and Bytové družstvo Lipka [a housing cooperative]:** Dispute over failure to reach consensus on a thermal energy supply agreement. Thanks to talks, the parties reached consensus and signed a thermal energy supply agreement. The Office endorsed their conciliation.

**Chodovské technicko-ekologické služby s.r.o. and MARSERVIS, s.r.o.:** Dispute over the execution of an agreement on emergency heat supplies via the Chodov transfer station. Chodovské technicko-ekologické služby obtained a thermal energy distribution licence for the operation of the Chodov transfer station, while MARSERVIS was the only feasible customer. It was decided that MARSERVIS, as the customer for this thermal energy, was not obligated to enter with Chodovské technicko-ekologické služby into an agreement on emergency heat supplies via the Chodov transfer station. Neither Section 77 of the Energy Act, concerning thermal energy customers, nor any other provisions of the Energy Act stipulate an obligation of the customers to enter into thermal energy supply agreements.

**Chodovské technicko-ekologické služby s.r.o. and MARSERVIS, s.r.o.:** Dispute over the execution of an agreement on heat supplies during outages of the heat generating plant of Sokolovská uhelná, a.s. MARSERVIS requested Chodovské technicko-ekologické služby to ensure thermal energy supplies, and at the same time asked it to present a draft agreement on thermal energy supplies from 5 to 21 August 2005. Chodovské technicko-ekologické služby presented a draft agreement, and MARSERVIS requested that the provisions on the calculation of the thermal energy price be modified. The decision on the remonstrance adjusted the first instance decision so that the thermal energy price would be calculated as a multi-component price under ERO Price Decision No. 9/2004 of 20 October 2004, on thermal energy prices.

**Stavební bytové družstvo občanů Průkopník [a housing cooperative] and TEPLŮ Rumburk, s.r.o.:** Dispute over failure to reach consensus on an amendment to the price provisions in the agreement on heat and hot service water supplies. The decision on the remonstrance adjusted the first instance decision by imposing an obligation on TEPLŮ Rumburk to sign with Stavební bytové družstvo občanů Průkopník new provisions under the agreement on heat and hot water supplies, effective from 2005; it also set forth the method for calculating the components of the multi-component thermal energy price.

## 6.5 Remonstrance proceedings; remonstrance commission's activities

Under the relevant provisions of Act No. 71/1967 on administrative proceedings (Rules of Administrative Procedure) proceedings on remonstrances fall within the competencies of the ERO Chairman, who decides upon proposals submitted to him by the remonstrance commission appointed by him. This commission is composed of ten members, both the Office staff and external lawyers, engineering experts, and economists.

In accordance with the relevant provisions of the Rules of Administrative Procedure the Office's efforts are geared towards preventing disputes and making licensees and their customers resolve their disputes amicably as the preferred option. Where it issues decisions in disputes between these entities, in the substantiation of such decisions and in the dealings related to the issue of first instance decisions the Office makes an effort to motivate the parties to hold talks and respect each other's requirements. ERO received five remonstrances against its first instance decisions in 2005.

In the area of **licensing**, in 2005 one remonstrance was filed against the Office's decision. By TEPLŮ Oskol s.r.o., the Office's first instance decision on the revocation of the licence was reversed in accordance with the Rules of Administrative Procedure, namely by an *error coram nobis* decision that granted the remonstrance in full.

In the **electricity industry**, two remonstrances were filed against the Office's decisions. One was filed by Severočeská energetika, a.s. in the case of the dispute over the conditions for connecting a small hydroelectric power station in the Štětí cadastre area, owned by WIKA, spol. s r.o. The decision on the remonstrance changed the first instance decision so that Severočeská energetika, a.s. would be obligated to issue, for the purpose of planning proceedings, a consenting and binding opinion on the connection of the power station. The other remonstrance concerned the dispute between Moravská Energetika, s.r.o. and E.ON Distribuce, a.s. over the connection of wind power stations to the distribution network. The remonstrance was rejected and the Office's decision upheld.

In the **gas industry** no remonstrance against the Office's decision was filed in 2005.

In the **heat supply industry** two remonstrances were filed against the Office's first instance decisions: by TEPLŮ Rumburk, s.r.o. in the case of its dispute with Varnsdorf-based Stavební bytové družstvo občanů Průkopník over the prices of thermal energy and hot service water; the decision on the remonstrance changed the Office's decision and an obligation was imposed on TEPLŮ Rumburk, s.r.o. to sign new provisions under the agreement on heat and hot service water supplies; the Office also set the formula for pricing. The other remonstrance was filed by Chodov-based MARSERVIS, s.r.o. in the case of its dispute with Chodovské technicko-ekologické služby s.r.o. over the execution of an agreement on thermal energy supplies; the decision on the remonstrance changed the Office's decision and imposed the obligation to enter into a thermal energy supply agreement; the decision also determined the variable and fixed components of the multi-component price.



# The Office's external relations







## 7.1 Co-operation with central state administration authorities

As part of its competencies, in 2005 the Office focused on direct communication with the various central state administration authorities. One of the key lines of this communication was the Office's co-operation with the legal experts and energy-sector staff of the MPO's relevant departments in the assessment of the experience with the application of the Energy Act as the basic framework creating the environment for energy market participants' operations. The drafting of certain amendments to the implementing regulations to the Energy Act, issued by both institutions, was based on their analysis of shared experience.

In 2005 the Office and MPO cooperated on the *Strategy of the Czech Republic's Growth for 2005 to 2013*; in this project the Office provided analyses and opinions concerning the energy sector. The objective of the whole project was to set the priorities for coordinating economic policies until 2013, put in place the best conditions for economic operations, and indicate the direction towards efficient use of public funds in respect of direct interventions. In the second quarter of 2005 the Office also cooperated in the preparation of the *Czech National Report*, see 8.1 below. Other areas of co-operation with MPO included the issue of their joint position on the proposed programme of measures to prevent discriminatory practices and measures for the organisational and information separation of distribution from the other activities in the case of vertically integrated undertakings.

For the Ministry of Finance (MF), the Office prepared briefs on the development of energy prices in 2005 and outlooks for 2006 and 2007.

For the Council for Economic and Social Consensus of the Czech Republic ("the tripartite council", hereinafter "RHSD"), the Office prepared, in the first half of 2005, a detailed analysis that indicated the relationships between the rising electric energy prices and their impacts on the economy. The Office also prepared a paper containing forecasts of energy prices and an analysis of their potential impacts on economic growth and employment. The MF used the Office's outputs in its forecasts of the Czech economy's development.

With the Ministry of Foreign Affairs the Office started closer co-operation in the preparation of the briefs to be used for the Czech Republic's positions on various documents of the European institutions.

Extensive and close co-operation and consultations with the SEI resulted in the signing of a *Programme of Co-operation between SEI and ERO in 2005*. The key points of this programme include co-operation in the legislative area and consultations in licensing and in the performance of regulation; it also 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. In nine cases the Office referred the complaint to the SEI for inspection under Government Ordinance No. 150/1958.

## 7.2 Co-operation with the Czech Parliament

Under the Energy Act the Office has the obligation to inform the Czech Parliament about its activities. In respect of energy legislation the Office maintains continuous contacts with the committees of the House of Deputies, especially the Economic Committee and the Committee for Public Administration, Regional Development and the Environment, and also the Senate's committees, namely the Committee for Economy, Agriculture and Transport and the Committee for Regional Development, Public Administration and the Environment. In the committees of both houses, the Office's representatives regularly attended debates on proposals for support for the use of renewable energy resources, and all technical seminars organised on this law, at which opinions were voiced on its impact on the economy and where the Office was always provided with room for presenting its views and positions. During the course of the legislative process the Office prepared several analyses of this law, which dealt with its impacts on the energy sector.

## 7.3 Public relations

### 7.3.1 Information provision by the ERO

The Office considers the provision of open, complete and true information to the public to be one of its basic tasks. By means of personal consultations, letters, and electronic mail and over the telephone the Office handled thousands of different questions and requests for information in 2005.

In compliance with Act No. 106/1999 on free access to information, as amended, the Office provides information on its activities falling within its terms of reference. The Office provided all the information requested under the above law free of charge, as in previous years. In 2005 the relevant departments handled 261 requests for information (Table 9), which was 70% more than in the preceding year.

**Table 9 Number of received and handled requests for information in 2005**

Area	Licensing	Regulation	Other	Total
Number	45	190	26	261

Both the lay public and expert circles have recently been showing an increasing interest in market liberalisation issues, and this fact has contributed to the rise in the number of requests for information. Also the amendment to the Energy Act, the new law on support for the use of renewable resources, together with the related public notices, and also the Office's new price decisions elicit a number of queries

and questions, in particular regarding price controls, market opening, licensing, and other topics covering the heat supply, gas and electricity industries.

All requests for information were answered within the statutory time limit. In 2005 the Office did not receive any appeal against a decision in writing refusing to provide the information requested.

The Office also responded to requests from both experts and the lay public for improving the transparency of the process of preparing its decisions, and organised briefings and workshops with a view to providing the stakeholders involved with more detailed information about its regulatory methods, procedures and decisions.

To enhance and facilitate work with the information that has been published the Office further improved its website ([www.ero.cz](http://www.ero.cz)). A precondition for quick and easy search is extended and easy-to-survey links in the Czech and English versions. As in the previous years, the Office published on its website, press releases and communications on the Office's and energy system operators' activities, legal regulations, price decisions and comments thereon, instructions and guidance for licensing procedures, etc. The entire content of the website was redesigned, and also updated on an ongoing basis.

The intranet offers internal regulations and information required for managing and running the Office, a geographical information system linked to the list of licence holders, and authorised access to the database of specialist workplaces. The system makes information sharing more effective and supports better communication within the Office.

In co-operation with the Ministry of Informatics, the Office contributes to the Public Administration Portal project, which also helps to strengthen its position among central state administration authorities.

Regular press conferences and other meetings with the press on specific topics also helped to inform the public about important decisions in the pricing area and in relation to a broad-ranging array of regulatory issues. In 2005 the Office organised four such meetings, at which its senior officials outlined the most important decisions adopted by the Office, and its activities.

The media's constant interest in the Office's work is also reflected in their requests for the ERO Chairman's regular appearances on Czech Television and on both commercial television stations. Together with other senior officials the ERO Chairman also participated in technical discussions on Czech Radio and other radio stations, both national and regional. The Office pursued systematic co-operation with the Czech Press Agency and other news agencies, and trade press titles. To enhance the Office's image the information panels in the lobby of the building in Jihlava were updated; they offer key information about the Office in terms of its main competencies.

### 7.3.2 Publications

The Office produces its publications under the Energy Act. Among others, it publishes the *Energy Regulation Gazette*, which appeared with a circulation of 980 in 2005 (there were 804 subscriptions). Prague-based SEVT, a.s. is in charge of the administration of the *Gazette*. In 2005 fourteen chapters of the *Gazette* were published; four chapters carried a list of licensed persons, including a list of licences that had terminated for some reason; also published were price decisions, notices of the approval of the rules for the operation of energy systems, notices of the approval of energy system operators' Codes, a list of administrative proceedings in 2004, 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* also carried a notice informing about the approval of the Commercial Terms and Conditions of Operátor trhu s elektřinou, a.s.

The Office holds an important position in electricity industry statistics. It is the central point for the processing of operating and technical data on the Czech electricity industry; in relation to the reporting function it has also become the coordinator for the entire state administration, and established close contacts with the Ministry of Industry and Trade and the Czech Statistical Office; the latter takes over the statistical data reported by the Energy Regulatory Office. Mainly energy utilities licensed for business in the electricity industry provide operating and technical data; these include 1,298 electricity generators having an aggregate installed capacity of less than 0.5 MWe, 198 electricity generators having an aggregate installed capacity of 0.5 MWe and more, 321 electricity distributors, 274 electricity traders, and the electricity transmission licence holder and the electricity market operator.

The outputs are published as monthly reports on the operation of the Czech electricity grid; once a year, a summary publication is produced, the *Annual Report on the Operation of the Czech National Grid*.

The monthly reports, which were extended last year to include electricity production broken down by the fuels used and in which adjustments were made to the way of monitoring the development of energy generating plants' installed capacities (in respect of which major changes could be seen in the area of renewable resources for electricity generation), are published on the Office's website; their abridged versions are provided to the energy trade press and other media. As a result, the Office's consulting activities in respect of the electricity industry statistics have increased.

The *Annual Report on the Operation of the Czech National Grid*, which appears in the printed and electronic forms, and which in 2005 moreover contained outputs from a CD-ROM presentation, has been meeting with a favourable response on the part of both experts and the lay public for many years. The report, published in both Czech and English, is extended every year to include new statistical data sets; emphasis is also placed on the quality of maps.

In co-operation with EGÚ Brno, a.s., a unique compilation of maps, schemes of the Czech national grid's 110 kV, 220 kV and 400 kV networks, was produced; it has become a sought-after reference for drafting the country's regional development policy.

The *2004 Report on the Activities and Finances of the Energy Regulatory Office* was published. The Office submits this Annual Report to the Czech Government every year in accordance with the Energy Act.

# International co-operation





In relation to the Czech Republic's membership of the European Union, the Office's representatives actively participated in the meetings of European regulators' organisations, i.e. the non-profit Council of European Energy Regulators (CEER) and the European Regulators Group for Electricity and Gas (ERGEG), the European Commission's advisory group, as well as those of other European groups and advisory committees that had been set up to tackle key issues such as congestion management, energy market integration, etc.

### 8.1 The Czech National Report

Under the rules governing the internal market, liberalisation and regulation, the EU member states have certain reporting and monitoring obligations to the European Commission, specifically to prepare country reports analysing the status of the implementation of the "liberalisation" directives' requirements in national law and the market's functioning from the perspective of competition. In connection with this obligation, the European Commission's Directorate General for Energy and Transport (DG TREN) requested the Governments of the EU member states to prepare these reports. The Energy Regulatory Office took on the role of the coordinator in the Czech Republic, as it had been requested to do so by the European Commission. In co-operation with ÚOHS and MPO it prepared *The Czech Republic's National Report on the Electricity and Gas Industries for 2004* by 31 July 2005.

The key aspects followed and evaluated in the report include regulatory issues (trans-border capacity management and allocation, the electricity and gas TSOs and the respective DSOs, and effective unbundling on the electricity and gas markets), competition issues, security of supplies, and public service issues.

Under these reporting and monitoring obligations a similar national report shall have to be prepared for each year; from 2010 once every two years.

### 8.2 A Mini Forum in central and eastern Europe

As part of the efforts to create a single internal electricity market in the EU, the stepping-stone to which should be liberalised regional markets, the Office was also actively involved in the so-called Central European Mini Forum, which focused on coordinated capacity allocation for trans-border electricity transmission.

To advance the discussions on the introduction of a coordinated market mechanism for regional transmission interconnection sites, on 8 November 2005 the Office organised a meeting of regulatory authorities and transmission system operators of the Czech Republic, Hungary, Poland, Austria, Slovakia, Slovenia and Germany, which was also attended by DG TREN, European Federation of Energy Traders (EFET) and Association of European Power Exchanges (EuroPEX) representatives. At the meeting the delegates expressed their views on the progress achieved in delivering the Mini Forum's mandate. Regulatory authorities' officials touched upon the obligations assumed by transmission system operators at previous meetings, as well as regulatory authorities' requirements concerning the coordinated procedure and the proposed common rules for auctions. However, the regulators also supported the continuation of the project of coordinated explicit auctions between ČEPS, a.s., E.ON Netz GmbH, PSE – Operator S.A., Vattenfall Europe Transmission GbmH (VE-T) and SEPS a.s. ČEPS, a.s. will act as the auction office in 2006. The ultimate objective continues to be the development of a transparent auction mechanism for the entire central and eastern European region, whereby transmission capacities would be sold together with energy.

### 8.3 The Czech Republic's common position on the energy sector

The Office closely cooperated with the MPO's department responsible for international relations in energy, on materials for the Czech Republic's delegates to the meetings of the energy task force and on preparing the mandate of the Minister of Industry and Trade for meetings of the EU Energy Council. These documents dealt primarily with the question of how to make regulation more efficient and the related steps, such as the harmonisation of the regulatory authorities' powers and position and the way of enhancing transparency and customer protection. The Office also provided the MPO with its opinions on DG TREN's Report on Progress in Creating the Internal Gas and Electricity Market and DG Competition's Energy Sector Inquiry: Issues Paper, published on 15 November 2005.

### 8.4 Bilateral co-operation

In 2005 the Office actively cooperated with the regulatory authorities of Estonia, Austria, Slovakia, Rumania, and Hungary. As part of these activities it started closer co-operation in the area of common interests at both the national and international levels. Participants in the meetings exchanged their experience with the regulatory authorities' status and the principles of regulation, consumer protection, quality of supplies, unbundling, licensing, trans-border trading and development of regional markets, and comparative studies, and discussed the potential coordination of common interests at the European level and their promotion through CEER and ERGEG.

### 8.5 Trips to other countries

In 2005 the Office's representatives went on 88 trips abroad; these included international meetings, meetings with partner regulators, and technical seminars and study visits in line with the Office's mission in the area of international co-operation and involvement in the

activities pursued by international groups and associations. Another objective of these meetings was to gain new experience related to issues such as the development of regulation and its models, and new knowledge on issues such as support for renewable energy sources, unbundling, and market functioning from the European and global perspective.

The destination of most of these trips, almost 75%, was Brussels, where the delegates participated in the deliberations held by the respective working groups and task forces in the energy sector.

The Office's representative also attended important international conferences abroad. For example, the EMART Energy conference in Nice can be regarded as highly beneficial; it provided a comprehensive view of the European electricity and gas markets and offered some additional perspectives, emphasising the development of trans-border interconnections within the fully liberalised pan-European market.

Equally interesting was the Athens conference on the current issues of European regulated gas markets' development. The conference made it possible for the Office's delegates to hear about the latest developments on the European natural gas markets. The highlights of the programme included case studies from Belgium and Poland, describing the legal and organisational unbundling of the transmission system operators in those countries' markets.

The Office's new employees had an opportunity to broaden their experience at a technical workshop organised by the Florence School of Regulation (a platform for gauging knowledge of European energy regulation issues). The workshop dealt with the basic theoretical principles of regulation and licensing in the energy sector, and offered case studies and examples from practice.

## **8.6 Council of European Energy Regulators**

The Office cooperated with CEER with a view to participating in the gradual creation of a single European energy market through a coordinated development of regional markets. This co-operation consisted in taking an active part in working groups' meetings, which focused on the questions of open, transparent and competitive markets, consumer protection, security of supplies, and sustainable development. The working groups also discussed the status of the implementation of the "liberalisation" directives.

## **8.7 European Regulators Group for Electricity and Gas**

The Office also participated in the activities of the European Regulators Group for Electricity and Gas (ERGEG). Its representatives were members of the Electricity Focus Group (EFG) and Gas Focus Group (GFG) and contributed to the underlying documents for directives and regulations (for example, Regulation (EC) No. 1775/2005 of the European Parliament and of the Council of 28 September 2005 on conditions for access to the natural gas transmission networks) proposed by the European Commission and approved by the Council and the European Parliament. They also contributed to some other documents, for example, Congestion Management Guidelines (electricity), which address the issue of trans-border trading, and Guidelines for Good Practice Storage System Operation (gas), which should help to enhance the transparency and efficiency of the gas market.



# Human resource management

9





The key priorities of the Office's HR policy include careful recruitment of employees, and their training, as required for the Office's existing and future work, and creating an environment empowering the managerial personnel to support mutual relationships and teamwork within the Office.

In 2005 human resource management therefore focused on personnel management and education. This effort includes the provision of the required numbers of qualified employees for each of the Office's organisational units and systematic promotion and application of educational activities geared towards supporting knowledge, skills and competences and focused on training individuals so as to be able to carry out, now and in the future, a broader and more demanding set of tasks. The basis is employee training in safety and health at work and in legislation.

### 9.1 Personnel management agenda

In 2005 the planned number of the Office's employees was 90, and the actual number was also 90 (FTE); the annual index is 101.12% (i.e. plus one employee). The Office therefore managed to have the planned staffing level. As at 31 December 2005 the Office had 92 employees. The required staffing level was maintained smoothly, and the various organisational units retained the planned numbers of employees having the required qualifications. Related to the optimisation of the staffing levels is the assignment of employees to the two ERO offices, in Jihlava and Prague. As at 31 December 2005 of the total number of 92 employees, 58 worked in Jihlava and 34 in Prague.

The structure of employees is shown in more detail in Tables 10 and 11.

**Table 10 Employee structure by age and sex as at 31 December 2005**

Age	Men	Women	Total	Per cent of total [%]
Up to 20 years	0	0	0	0.0
21 to 30	15	7	22	23.9
31 to 40	8	14	22	23.9
41 to 50	13	11	24	26.1
51 to 60	13	5	18	19.6
61 years and older	6	0	6	6.5
<b>Total</b>	<b>55</b>	<b>37</b>	<b>92</b>	<b>100.0</b>
[%]	60	40	100.0	–

**Table 11 Employee structure by education and sex as at 31 December 2005**

Education	Men	Women	Total	Per cent of total [%]
Elementary	0	0	0	0.0
Vocational	2	0	2	2.2
Secondary vocational	0	1	1	1.1
Complete secondary	0	0	0	0.0
Complete secondary vocational	7	21	28	30.4
College	0	0	0	0.0
University	46	15	61	66.3
<b>Total</b>	<b>55</b>	<b>37</b>	<b>92</b>	<b>100.0</b>

The employee structure by age is favourable, i.e. a prevailing trend can be observed in the recruitment of young graduates. This is also matched by the employee structure by education: most of the staff members are graduates of higher-education institutions.

The personnel management agenda is supported by the Odyssey personnel information system software (PIS) supplied by A.S.E.I. Thus, the Office 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"). The Office applied Government Order No. 637/2004, which changes Government Order No. 330/2003 on wages for employees in public services and administration, and all the employees were reallocated to wage categories with effect from 1 January 2005.

For 2005, average salaries had been planned at CZK 32,631 while the actually achieved average salary was CZK 32,616, index 99.95%. When comparing the actually achieved average salaries between 2005 and 2004, the index is 102.09%. The average tariff salary, including reimbursements, amounted to CZK 20,218 for 2005; the average salary, including personal performance supplements and management allowances, without bonuses, was CZK 27,718. During 2005 six new employees joined the Office while five employees left.

## 9.2 Professional development

New employees took basic information courses to study the Office's internal regulations and the legal regulations relevant for regulatory issues, and also introductory training courses organised by the State Administration Institute attached to the Office of the Government of the Czech Republic. The introductory courses help new employees gain insight into the structure of state administration, structure of government finances, Czech law, the basic regulations of the labour law, the code of ethics for state administration employees, and the administrative code. The Office also organised training courses on EU issues. Employees attended specialist and technical courses, workshops and conferences focused mainly on the energy sector, licensing policy, and business regulation 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. In the training and education system, an important position was held by employee training related to the entry into force of Act No. 500/2004, the Administrative Code, and technical training of employees in the area of the filing service.

The objective of management courses was to prepare managerial personnel for the forthcoming governmental reform of state administration; the participants acquired knowledge of modern management methods and learned communication skills and competences in line with a programme recommended by the Government.

Managers went through a course on objective-based management, complete with an official certificate. Training courses on group communication and teamwork were organised. As part of the training programme recommended by the Czech Government, a specialist EU course was organised on the Structure of the EU Institutions.

Language training takes place and is organised in accordance with the Office's relevant internal regulation and Czech Government Resolution No. 1088 of 6 November 2002 on the system of requirements for language qualifications (prerequisites) in selected positions at administrative authorities and on proving language qualifications.

The ERO Chairman specified a group of official posts for which the command of a selected foreign language is a prerequisite; see Table 12.

**Tables 12 Employees' command of languages**

Language	Number of selected posts subject to the qualification requirement of a standardised language examination, in the order of proficiency				Total number of requirements set for posts
	1st level	2nd level	3rd level	4th level	
English	44	11	–	–	55
German	8	–	–	–	8
<b>Total</b>	<b>52</b>	<b>11</b>			<b>63</b>

In 2005 the qualification requirements were met at a level of 46%. This figure on the number of the qualification requirements met does not include the number of employees holding the above posts, to whom the Chairman has granted an exemption on the grounds of age over 45. There are 14 such exemptions, i.e. 20% of the total number of qualification requirements. After adding the number of exemptions the overall percentage of the qualification requirements met would be 66%. In 2006 the meeting of qualification requirements will continue in accordance with Government Resolution No. 1542 of 30 November 2005.

The structure of the outlays on education, training and professional development can be seen in Table 13.

**Table 13 Structure of training expenses**

Type	Amount [CZK '000]
Language training	1,294.22
Other type of education and training	2,186.53
<b>Total</b>	<b>3,480.75</b>

In 2005 a total of 104 training events, i.e. specialist courses, workshops and conferences, took place; the Office's employees attended 18 foreign and 32 domestic conferences and seminars on regulation and licensing.

# 10





## 10.1 The Chapter's budget

The budget for Chapter 349 – the Energy Regulatory Office, was approved at CZK 118,396,000 in Act No. 675/2004 on the Czech Republic's National Budget for 2005. This budget was later adjusted through a budgetary measure falling within the powers of the Ministry of Finance, in respect of the 'mandatory target' for financing asset replacement programmes, by CZK 5,128,000 to finance the supply of a new information system for the Office. The required funds were found in the approved budget, without any requirements for increasing it, and so the budget for the chapter amounted to the original **CZK 118,396,000**.

## 10.2 Revenues to the Chapter

No targets were planned or set on the income side. The revenues to the Chapter are listed in Table 14.

**Table 14 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>0.00</b>	<b>414.44</b>
	of which:		
2141	interest accrued on accounts – Reserve Fund, FKSP, deposit account		123.19
2322	insurance compensation received		227.23
2324	damages received from employees		11.25
2329	overpayment credit notes (printer's services cancelled)		15.89
4132	transfer of undrawn funds for wages, including insurance for 12/2004, from the deposit account		34.80
4139	transfer of the undrawn allocation to FKSP from the deposit account for 12/2004		2.08

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.

## 10.3 Meeting the mandatory targets

The Office complied with all the mandatory targets. The planned amount of funds was not exceeded under any of the mandatory targets, see Table 15.

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

Table 15 Meeting of the mandatory targets

Mandatory targets	Approved budget [CZK '000]	Budget after changes [CZK '000]	Actual [CZK '000]	Actual/budgeted [3:2] [%]
<b>Aggregate targets</b>				
Total non-tax revenues, capital revenues and subsidies received			414.44	
Total expenditure	118,396.00	118,396.00	105,017.61	88.70
<b>Expenditure targets</b>				
<b>Standard targets</b>				
Wages for employees and other remuneration for work	36,320.00	36,320.00	35,493.00	97.72
of which: wages for employees	35,242.00	35,242.00	35,225.00	99.95
Statutory insurance premiums paid by the employer	12,712.00	12,712.00	12,333.62	97.02
Allocation to the Fund of Cultural and Social Needs (FKSP)	705.00	705.00	705.00	100.00
Expenditure on programme financing	17,000.00	22,128.00	19,525.79	88.24
<b>Specific targets</b>				
Wages for employees and other remuneration for work	36,320.00	36,320.00	35,493.00	97.72
of which: wages for employees in state administration	35,242.00	35,242.00	35,225.00	99.95
Total outlays from the national budget to finance joint EU/CR programmes	2,000.00	2,000.00		
of which, those related to preaccession financial instruments	2,000.00	2,000.00		
of which, Phare	2,000.00	2,000.00		

## 10.4 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 were transferred to the Reserve Fund.

These are funds under the ISPROFIN programme financing scheme, from which a total of CZK 2,602,000 was transferred to the Reserve Fund, see Table 16. These funds will be used for financing programmes in the following years, in line with the budgetary rules.

There were no individual subsidies, or expenditure reviewed on a case-by-case basis, in the budget.

The spared running costs and the funds allocated to other personnel expenses and the related insurance premiums were not transferred to the Reserve Fund.

Table 16 Funds transferred to the Reserve Fund in 2005

Item	Amount [CZK '000]
<b>Total transfer to the reserve Fund for 2005</b>	<b>2,602.00</b>
of which:	
capital expenditure	1,469.00
current expenditure	1,133.00
of which:	
PHARE funds	0.00
operating expenditure on ISPROFIN programme financing	1,133.00
other current expenditure	0.00

## 10.5 The Energy Regulation Fund

Under Section 14 of the Energy Act, the Energy Regulatory Office shall keep the funds intended as compensation for demonstrable losses suffered by the licence holders who carry out the obligation of supplies over and beyond their licence, in a separate current account kept with the Czech National Bank, account number 3029001/0710.

As at 1 January 2005 the opening balance in the Fund stood at CZK 50,047,540. No significant payments or other financial operations took place from/in the Fund during 2005. After adding the interest (see the Energy Act and the new rules for the Fund put in place in 2005), the closing balance in the Fund was CZK 50,235,040 as at 31 December 2005.

Under Section 14, subsection 10 of the Energy Act, the Energy Regulatory Office 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 were kept in accordance with the legal regulations in force and present fairly the Fund's financial position for the fiscal year 2005 (Appendix 2).

## 10.6 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 2005, because despite many discussions with the foreign partners, there was no success in designing a project that would bring significant benefits to the Office in the area of technical co-operation and regulatory methods.

## 10.7 Budget management results

The total actual draw-down on the budget, including transfers to the Reserve Fund, can be seen in Table 17.

**Table 17 Total actual draw-down on the budget**

Draw-down on budget	Expenditure [CZK '000]	Percentage drawn [%]
<b>Total expenditure</b>	<b>105,017.61</b>	<b>88.70</b>
of which:		
capital expenditure drawn	14,743.98	100.00
current expenditure drawn	90,273.63	87.09

The performance vs. budget for January to December 2005 and the total savings on the expenditure side of CZK 15,980,390 (of which CZK 2,602,000 transferred to the Reserve Fund) are mainly attributable to moving the drawing of the funds for the new information system to 2006, no draw-down on the Phare programme funds, and reducing and saving other current expenditure. The draw-down on the various expenditure items in 2005 is summarised in Appendix 1, Expenditure from the National Budget.

### 10.7.1 Operating expenditure savings

Significant operating expenditure savings were achieved, see Table 18.

**Table 18 Operating expenditure savings**

Item number	Description	Amount [CZK '000]
	<b>Total operating expenditure saving</b>	<b>14,511.39</b>
	of which:	
502	other remuneration for work	810.00
503	statutory premiums paid by the employer	378.38
513	purchase of materials	1,978.83
515	purchase of water, fuels and energy	1,091.89
516	purchase of services	7,556.70
517	other procurement	1,855.98
536	other 'non-investment transfers' to other public budgets	327.39
551	'non-investment transfers' to international organisations and multinational bodies	306.49
	other items of the budget	205.73



## 10.7.2 Programme financing

In 2005 the Office continued financing its projects in keeping with the approved programme financing documentation, which had been prepared in detail for 2003 to 2007. At the beginning of the year the Ministry of Informatics and then the Ministry of Finance approved an addendum to this documentation for the purpose of providing for the financing of a new information system for the Office; under the addendum, the funding for programme financing was increased by CZK 5,128,000 to CZK 22,128,000. Financial management results in 2005, from the perspective of the sub-programmes and current and capital expenditure, are shown in Tables 19 and 20, respectively. During the year minor changes were made to the budget to reflect current developments and the Office's new needs.

**Table 19 Results by the sub-programmes**

	Plan [CZK '000]	Actual [CZK '000]	Percentage [%]
<b>Total, Programme No. 249 010</b>	<b>22,128.00</b>	<b>19,525.79</b>	<b>88.24</b>
of which:			
sub-programme 249 011 – ICT	19,378.00	17,724.12	91.47
sub-programme 249 012	2,750.00	1,801.67	65.52

**Table 20 Results by current and capital expenditure**

	Plan [CZK '000]	Actual [CZK '000]	Percentage [%]
<b>Total, Programme financing</b>	<b>22,128.00</b>	<b>19,525.79</b>	<b>88.24</b>
of which:			
current expenditure	7,384.00	6,250.81	84.65
capital expenditure	14,744.00	13,274.98	90.04

The public tendering process for the supply of the new integrated information system was completed successfully, and on 25 July 2005 the respective agreements on the supply were signed with the winning company. In line with the supply agreement, at the end of 2005 the first stage of the supply was accepted, which had quite a significant impact on the draw-down on the budget, particularly in respect of capital expenditure. The completion of the supply and the putting of the system into full operation are expected in the second half of 2006. The funds required for finalising this major project are fully allocated in the budget for 2006.

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

## 10.7.3 Outlays on business trips abroad

Outlays on business trips abroad, of which there were 88 in 2005, totalled CZK 4,077,520 and are shown in Table 21.

**Table 21 Outlays on business trips abroad**

Item number	Description	Amount [CZK '000]
	<b>Total outlays on business trips abroad</b>	<b>4,077.52</b>
	of which:	
5156	automobile fuels	1.10
5163	financial services (insurance)	2.51
5164	rental (including related services)	75.33
5166	consultancy, advisory and legal services	2.46
5167	education and training services (technical training, language courses)	403.85
5173	travel expenses (subsistence, pocket money, air fare, accommodation)	3,089.85
5176	conference registration fees	495.78
5179	other purchases (visas)	6.64



In comparison with the previous year there was a significant drop in cost item 5173 – travel expenses, and, mainly, in cost item 5176 – conference registration fees. There was a slight increase in item 5167 – education and training services. Compared with 2004, overall outlays on foreign business trips were CZK 926,600 lower.

In the area of 'non-investment transfers to international organisations', item 5511, the actual expenditure reported at CZK 593,510 relates to the annual membership dues to CEER, see Government Resolution No. 781 of 17 August 2004 on the payment of the membership dues to the Council of European Energy Regulators (CEER) from 2004, whereby the amount of the dues for 2005 to 2008 was approved.



# Reviews and inspections





## 11.1 External inspections

In 2005 one external inspection was carried out, specifically by the Jihlava District Social Security Administration. The inspection included checks of premiums, performance under sickness insurance policies, and the meeting of obligations under old-age pension insurance policies.

The Office keeps the employee records required by Act No. 582/1991 on the organisation and performance of social security, as amended.

The meeting of the obligations relating to the payment of the premiums for the respective period, the correctness of the assessment bases, and the calculation of the contributions to social security were reviewed by comparing wage recapitulations and overviews of the premiums and benefits paid, and no discrepancies were found.

The Office keeps the records that serve as underlying documents and the required registration forms in accordance with Act No. 582/1991 on the organisation and performance of social security, as amended. The Office submits the required records of the circumstances relevant for entitlement to pension insurance benefits, and the amount and payment thereof, to the respective social security authorities. The records kept by the Office contain all the details required.

## 11.2 Internal audit

The requirement for the functional independence of the internal audit department was fully provided for in the ERO's Rules of Organisation.

The annual plan of actions was drawn up along the lines of internationally recognised standards and the recommendations for practice issued by the Czech Institute of Internal Auditors. The baseline for drawing up the internal audit action plan was a Risk Map meeting the requirements of Section 30 of the Financial Control Act and approved by the ERO Chairman in January 2005.

In accordance with the internal audit plan, 2005 saw twelve audit actions, one review of a stock-take, and three extraordinary audits. Performance under the respective provisions relating to *ex ante* reviews was also ensured during the year on an ongoing basis. Internal audit staff carried out the following audits 2005:

- Audit of business trips abroad taken in 2004;
- Audit of the process of verifying continuous compliance with the statutory conditions for holding an energy licence;
- Audit of the draw-down on the ERO's 2004 budget and of the documentation that supports contracts for consultancy services;
- Audit of the process of executing contracts; checks of contract documents for completeness; and analysis of the occurrence of risk provisions;
- Audit of the operation of the car fleet and analysis of its alignment with records of business trips;
- Audit of records and disposal of complaints;
- Audit and analysis of the use of the filing facilities of electronic filing centres and the administrative archives;
- Audit of cash desk documents for compliance with bookkeeping regulations;
- Audit of the application of the directive on the circulation of accounting documents;
- Audit of the accounting for the Fund of Cultural and Social Needs under the respective public notice; overview of the use of personal accounts;
- Audit of completeness of the information recorded in the system of the Office's filing service;
- Checks of whether the Office's internal standards were up-to-date and whether the system of internal regulations and statutes of the Office's advisory bodies was complete.

The reports on the audits carried out, and the recommendations following from them, were discussed with the responsible managers. For each of the audits the ERO Chairman approved the final results and the recommendation adopted. The efficacy of the adopted recommendations will be verified during the monitoring carried out as part of the planned audits.

Another component of the internal audit system is the management inspections (*ex ante*, ongoing, *ex post*) carried out by managerial personnel under their powers and responsibilities. The shortcomings identified were remedied on an ongoing basis.

The main purpose of both components of the internal audit system is to prevent potential risks. The Office therefore continues to standardise all work procedures under the relevant standards and regulations, using a precisely defined organisational structure.

The report on the results of financial audits and reviews in 2005 was prepared and sent to the Ministry of Finance in keeping with the relevant legal provisions.



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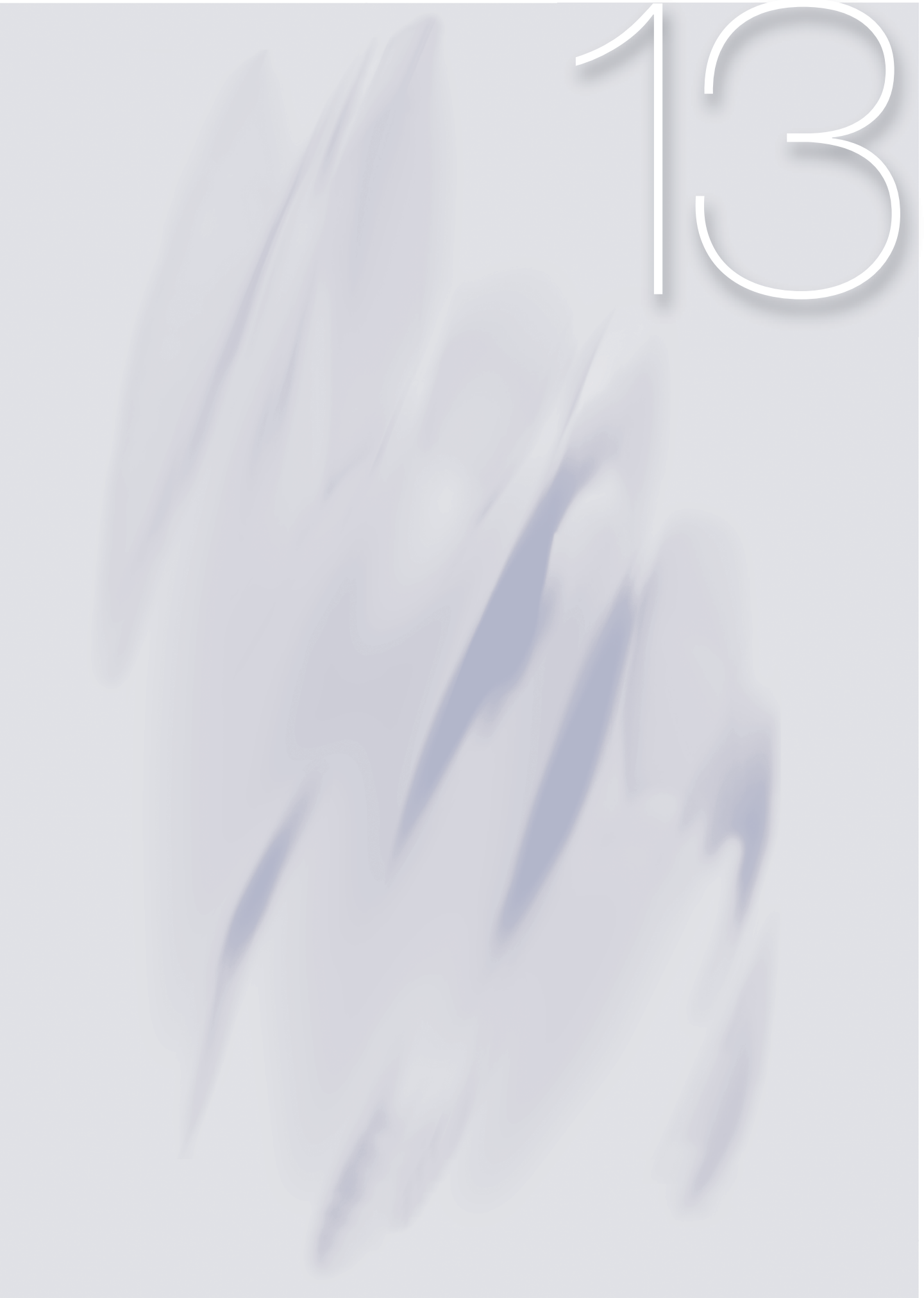
An important internal process that accompanies, and directly influences, the Office's operation is the implementation of an integrated information system. At the beginning of 2005 a call for tenders was duly announced under Act No. 40/2004 on public procurement. The tendering process was entitled Jednotný informační systém ERÚ (JIS) [The ERO Integrated Information System (IIS)], and its object was to create and implement an information system. The implementation was planned for three stages, of which the first, covering the modules of licences, entities, and operations control, was completed in December 2005. After migrating the data from the old systems the IIS modules were put into routine operation on 1 January 2006. The other two stages, covering the Energy Regulation Fund, reporting, and the filing service, will be implemented in the first half of 2006.

Since the new IIS must also support quicker and easier availability of services for the employees of the Prague offices, at the end of 2005 the Office started, in co-operation with the Ministry of Informatics, to build better data transmission lines between the Office's head office in Jihlava and its Prague offices. The purpose is to develop a single local network, thereby also simplifying the management of the Office's ICT infrastructure.

The quality and security of the internal IT network was improved in 2005. The equipment meets the most stringent security requirements, including high-quality stand-by power supply units and fire protection measures. The replacement of backbone switches with more powerful units and the interconnection of these units by fibre optics helped to improve the internal networks' data throughput considerably.



# 13





In the light of the continued liberalisation in the electricity and gas industries, 2005 was an important year for the Energy Regulatory Office.

The right to choose their supplier was acquired by additional customer categories that were transferred from the group of protected customers to the group of eligible customers, which precipitated the need to codify market participants' rights and obligations in legal regulations.

In the gas industry, the Office had to introduce separate transmission and distribution charges for eligible customers.

Towards the end of 2005, following a thorough analysis of the condition of the natural gas market, which was undergoing liberalisation, the Office had to adopt certain regulatory measures and impose temporary pricing limitations.

The Office's intensive legislative activity was also due to the amendment to the Energy Act, which required the promulgation of new secondary legislation.

In the second half of 2005 the Office was preparing an operable system of support for electricity from renewable resources through buyout prices and green premiums in the wake of the passing of the law on support for the use of renewable resources.

The significant changes in prices, caused by mergers in the electricity industry, should also be noted here.

In 2005 another tall order was to calculate the minimum costs of unbundling; the Office developed the methodology and quantification of these costs and their reflection in prices to final customers, spread over a certain period of time.

The Office was successful in improving the incentive-based method of regulation by setting the conditions for thermal energy pricing.

The Office created the conditions for, and promoted, its co-operation with the European Union's bodies, the Council of European Energy Regulators, and the European Commission's advisory body, European Regulators Group for Electricity and Gas. The Office played an important role in the preparation of the Czech Republic's *National Report on the Electricity and Gas Industries in 2004* for the European Commission.

The Office had all the personnel and technical arrangements in place to provide for its operation.

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.

All budgetary funds were spent prudently to ensure the Office's effective operation. In respect of budgeted costs, the key tasks planned were carried out in full, and no mandatory targets were exceeded.





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## Expenditure from the national budget

Period: January to December 2005

Chapter: 349, the Energy Regulatory Office

in CZK '000

Expenditure item	Description	2005 Budget		2005 actual	% drawn (3:2)
		approved	after changes		
		1	2	3	4
501	Wages	35,242	35,242	35,225.00	99.95
502	Other remuneration for work	1,078	1,078	268.00	24.86
503	Statutory insurance premiums paid by the employer	12,712	12,712	12,333.62	97.02
513	Purchase of materials	5,268	4,518	2,539.17	56.20
514	Interest paid and other financial costs	150	150	22.51	15.01
515	Purchase of water, fuels and energy	2,200	3,000	1,908.11	63.60
516	Purchase of services	34,614	34,777	27,220.30	78.27
	of which:				
	5164 rental	3,280	3,280	2,050.73	62.5
	5166 consulting, advisory and legal services	10,850	16,350	14,097.17	86.22
	5167 education and training services	7,500	4,500	3,480.75	77.35
	5169 purchase of other services	9,250	7,648	5,297.55	69.27
517	Purchase of services	14,498	10,151	8,295.02	81.72
	of which:				
	5171 repairs and maintenance	2,550	2,550	2,268.20	88.95
	5172 software	448	1,535	1,534.84	99.99
	5173 travel expenses (domestic and abroad)	7,500	4,466	3,633.07	81.35
518	Advances, sureties, guarantees and government loans provided	50	50		0.00
519	Costs of non-investment purchases, contributions, etc.	10	10	1.81	18.09
534	Transfers to internal funds	705	705	1,838.00	260.71
	of which:				
	5342 non-investment transfers to FKSP	705	705	705.00	100.00
	5346 transfers to funds of the State's agencies			1,133.00	
536	Other non-investment transfers to other public budgets	339	339	11.61	3.42
542	Compensations paid to citizens	20	20	16.97	84.85
551	Non-investment transfers to international organisation and multinational bodies	900	900	593.51	65.95
<b>5</b>	<b>Total current expenditure</b>	<b>107,786</b>	<b>103,652</b>	<b>90,273.63</b>	<b>87.09</b>
611	Intangible fixed assets purchased	6,900	10,685	10,322.14	96.60
612	Tangible fixed assets purchased	3,710	4,059	2,952.84	72.75
636	Investment transfers			1,469.00	
	of which:				
	6361 investment transfers to the Reserve Fund			1,469.00	
<b>6</b>	<b>Capital expenditure</b>	<b>10,610</b>	<b>14,744</b>	<b>14,743.98</b>	<b>100.00</b>
<b>0</b>	<b>Total</b>	<b>118,396</b>	<b>118,396</b>	<b>105,017.61</b>	<b>88.70</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 (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 (hereinafter referred to as "the Energy Act"), as amended, in relation to the annual financial statements. The audit was performed in accordance with the International Accounting Standards and covered the period of 2005.

Recipient of the Report: Management of the Energy Regulatory Office

The statutory body of the accounting unit is responsible for bookkeeping and for complete, true and correct accounting. The auditor's responsibility 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.

Name of the accounting unit: Energy Regulatory Office

Registered office: Masarykovo náměstí 5, 586 01 Jihlava

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 2005.

Reg. No. 70894451

Period under review: 2005

A-CONT, s.r.o., represented by its Managing Director

Ing. Jiří Makaj  
Auditor, Licence No. 1529




Encl.: Balance Sheet,  
breakdowns of the balances in the Fund

A-CONT, s. r. o., se sídlem Pohní 4, 586 01 Jihlava, IČO 49448889, zapsaná v obchodním rejstříku vedeném Krajským soudem v Brně, oddíl C, vložka 12563 a v seznamu auditorských společností u Komory auditorů ČR pod osvědčením číslo 372

Done at Jihlava, on 27 January 2006







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