



The 2007 Report  
on the Activities and Finances  
of the Energy Regulatory Office

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# The Chairman's Statement



The Report on the Activities and Finances of the Energy Regulatory Office (also "ERO" or "Office") for 2007 provides summary information about the Office's work in the year in which the electricity and gas markets were opened up completely, discusses the heat supply industry, and describes the other activities of the Office as an administrative authority.

In 2007 the energy sector was gradually coping with the impacts caused by the changes in the electricity and gas markets, in particular the unbundling of distribution from other licensed business. In the electricity industry unbundled companies were operating for the second year, while for gas distribution companies 2007 was the first year after unbundling.

A material change took place in the gas industry last year. On 1 January 2007 all customers, including households, became eligible customers, thereby acquiring the right to choose their supplier in the same way as customers in the electricity industry had

acquired this right in the previous year. The Office therefore took steps to make consumers – the general public – aware of the changes resulting from their transition to the eligible customers category.

In the area of thermal energy generation, the Office set the conditions with a view to favouring thermal energy generation from renewable energy resources and combined heat and power generation; the aim was to help reduce the demand for primary resources, while stressing reductions in greenhouse gas emissions. The Office specified certain pricing conditions as well as those applicable to the use of alternative pricing procedures more precisely and modified them.

In licensing, in 2007 the Office focused on licensing electricity generation from renewable energy resources using lower-capacity, in particular photovoltaic installations.

The Office's co-operation with the working bodies of the Council of the European Union was extended significantly. As part of drafting new EU legislation, the Office was put in charge of three regulations in the third legislative package in the energy sector; in co-operation with the Ministry of Industry and Trade, it became an informal co-guarantor of amendments to two directives in this package.

Working with the Ministry of Industry and Trade, the Office prepared *The Czech Republic's National Report on the Electricity and Gas Industries for 2006*, now the third such report.

In 2007 work continued on amendments to, and the drafting of, implementing legal regulations, the need for which was precipitated by the "large amendment" to the Energy Act, and the Office participated in the project for amending energy legislation (NOEL). The Office issued seven statutory instruments (public notices) and in co-operation with the Ministry of Industry and Trade contributed to responses prepared for the European Commission.

The Office is a well-respected arbitrator in disputes, both between licence holders and between licence holders and their customers, and also disputes in other areas of the electricity, gas and heat supply industries, which it adjudicates in administrative proceedings under the Energy Act. Between 1 January and 31 December 2007 the Office received 99 complaints; of these, the Office resolved nine in co-operation with the State's Energy Inspectorate (SEI). None of the complaints that the Office received in 2007 were anonymous.

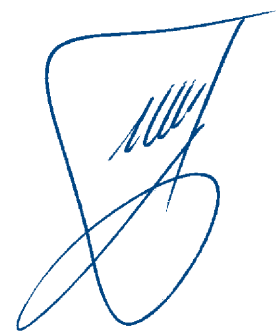
In relation to the Government's anti-corruption strategy in the period from 2006 to 2011 (the Ministry of the Interior being the responsible authority), the Office also drew up and adopted its own Code of Conduct for ERO Employees.

The Office's integrated information system was put into full operation in 2007. The Office has been rated as one of the three best Czech public administration authorities in terms of communication.

In 2007 the Office's staff members attended meetings of the Council of European Energy Regulators (CEER) and the European Regulators Group for Electricity and Gas (ERGEG), whose activities focus on achieving a single and competitive European energy market. The Office's staff members contributed to the debate on the proposals for the third energy package in the working group for energy (H7) of the Council of the European Union. This Annual Report also outlines the Office's co-operation with the EU bodies, regulators of the EU member states and some other countries, and other Czech public administration authorities and the public.

A separate chapter is dedicated to ERO budget management.

I am satisfied that the Energy Regulatory Office carried out all the tasks 2007 brought and extend my sincere thanks to all employees and external co-workers.



**Josef Fiřt**  
Chairman, Energy Regulatory Office

1

Introduction



# 1 Introduction

Under 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”), the Energy Regulatory Office (hereinafter also referred to as “ERO” or “the Office”) has been operating as an administration authority for regulation in the energy sector since 1 January 2001.

The Office’s main responsibilities include market regulation to substitute free market mechanisms and protect consumers’ and licence holders’ interests in the areas of energy industries in which competition is not feasible; support for competition; support for the use of renewable and secondary energy resources; and oversight over licence holders’ adherence to conditions of business, thereby creating the preconditions for reliable electricity, natural and heat supplies.

## 1.1 Highlights of 2007

The third year of the second regulatory period was another period in which the energy sector was gradually coping with the impacts caused by changes in the electricity and gas markets, primarily by the unbundling of distribution from other licensed activities.

In the **electricity industry**, unbundled companies were operating for the second year; they therefore reported their post-unbundling results for the very first time. For gas distribution companies, 2007 was the first post-unbundling year, and they will report their results in the new system only in the following year.

The unbundling and transformation of companies have significantly changed the operation of distribution companies: organisational changes in newly established companies, revaluation of companies and recognition thereof in their books, and outsourcing. Ultimately, they have resulted in a change in cost flows based on contractual relationships.

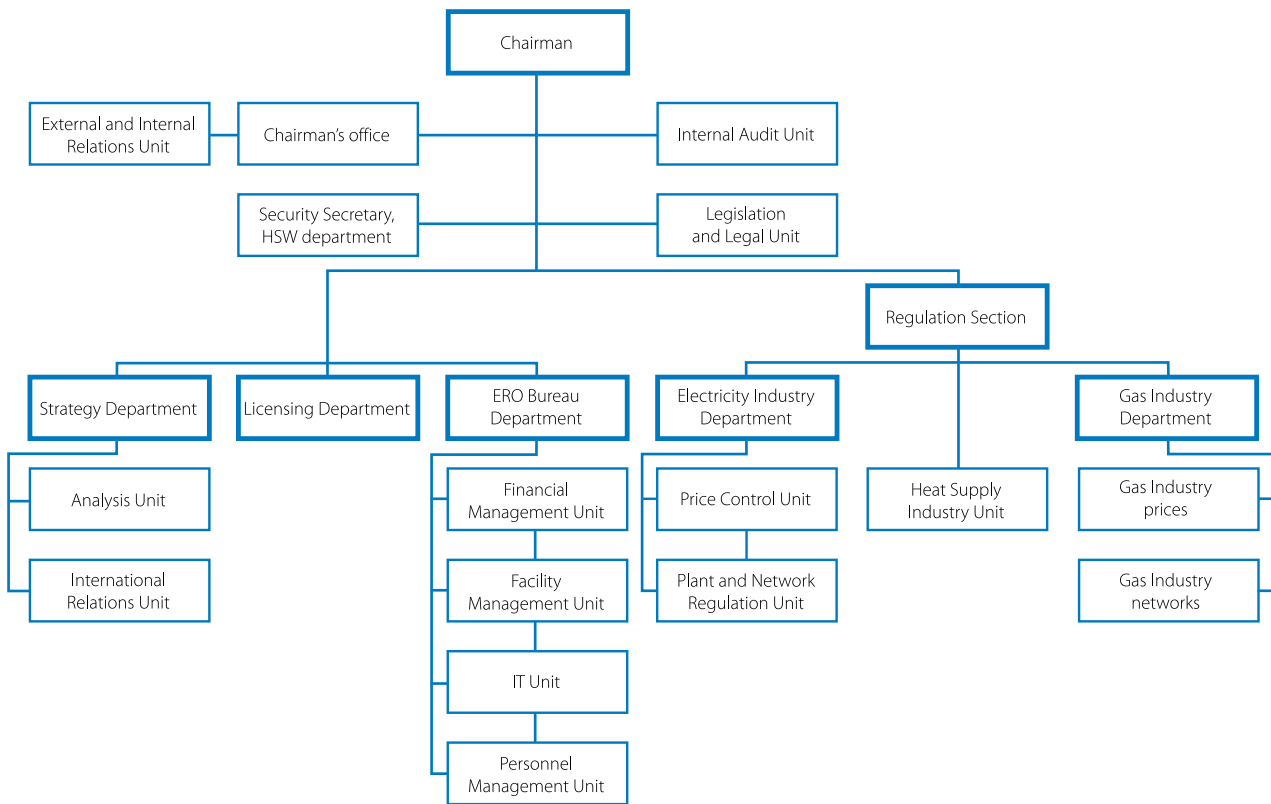
The above circumstances do not only constitute a change of the nature of the data reported for regulatory purposes, i.e., loss of all times series and continuity. They also have an impact on the general approach to regulation. This is being felt in the second regulatory period when due to outsourcing, the key parameters have been reassessed and the eligible minimum costs incurred in unbundling will gradually be recognised before the end of this period; moreover, there is a strong influence on the preparations for the settings of the third regulatory period from 2010, which were started in 2007.

In connection with the complete opening of the electricity and gas markets for all customers and in the light of the fact that customers were not exercising all of their rights in full (supplier switching, supply quality, claiming compensation for failure to keep electricity supply quality standards), the Office took steps, independently of the European Commission’s Year of the Consumer public awareness campaign, to make the general public and all customers aware of the changes brought for them by their turning into eligible customers.

The Office’s co-operation with the working bodies of the Council of the European Union was expanded significantly. As part of the drafting of new EU legislation, the Office was put in charge of three regulations in the third legislative package in the energy sector; in co-operation with the Ministry of Industry and Trade it became an informal co-guarantor of amendments to two directives in this package. The Office is preparing instructions for the working group for energy (H7) whenever the regulations in the third energy package are being discussed, and also cooperates with the Ministry of Industry and Trade in the finalisation of the instructions when the proposed directives are on the working group’s agenda. The Office helps to prepare mandates for meetings of the Transport, Telecommunications and Energy Council and the European Council.



## 1.2 Organisational structure as at 31 December 2007



Chairman  
 Vice-Chairman and Director of the Regulation Section  
 Head, Licensing Department  
 Head, Electricity Industry Department  
 Head, Gas Industry Department  
 Head, Strategy Department  
 Head, ERO Bureau Department

Josef Fiřt  
 Blahoslav Němeček  
 Luděk Pražák  
 Stanislav Trávníček  
 Sylva Škrdlová  
 Martina Veselá  
 Vladimír Kabelka

# 2

Legislative activities



## 2 Legislative activities

### 2.1 Key changes to legal regulations within the ERO's remit

In 2007 work continued on amendments to, and the drafting of, implementing legal regulations, the need for which was precipitated by the so-called large amendment to the Energy Act, i.e. Act No. 670/2004, which amends Act No. 458/2000, the Energy Act, as amended, and, in part, by the knowledge gained from the application of implementing legal regulations issued by the ERO.

The Office followed up on its legislative efforts in 2006 and issued the following implementing regulations [statutory instruments – public notices] related to the Energy Act and Act No. 180/2005 on support for electricity generation from renewable energy resources and changes to certain laws ('law on support for renewable resources'):

- **No. 150/2007 on regulatory methods in the energy industries and price control procedures**

Effective from 1 July, it superseded no. 438/2001 that set out the content of financial information and procedures for price control in the energy sector, as amended in nos. 13/2003 and 575/2004. The main reason for issuing a new instrument was the changes to the respective provisions of the Energy Act on the final dates for the opening of the electricity and gas markets, which had been set out in Act No. 670/2004. On 1 January 2006 and on 1 January 2007 the electricity market and the gas market, respectively, were opened up completely. Another reason was changed provisions of Section 17(7)(f) of the Energy Act, which no longer allows to provide for the content of financial information and procedures for price control in an implementing legal regulation, but enjoins the ERO to set forth the method of regulation in energy industries and procedures for price control. In connection with market opening the structure of controlled prices was changed considerably; one of the changes was, for example, deregulation of electricity and gas supply prices to protected customers and, on the other hand, introduction of electricity and gas supply price control for suppliers of last resort.

- **No. 184/2007 amending no. 524/2006, laying down the rules for the organisation of the gas market and for the development, allocation and use of typical gas supply profiles**

On 18 December 2006 the Czech Republic received the European Commission's reasoned opinion under Article 226 of the EC Treaty, having regard to 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; one of the reasons for the opinion was that the Czech Republic had failed to provide for non-discriminatory third party access to systems as required by Article 18(1) and Article 8(b) of Directive 2003/55/EC. At the same time the Czech Republic was requested to adopt measures conducive to compliance with the reasoned opinion within two months of the notification thereof. The subject of the reasoned opinion was Section 5 of public notice no. 673/2004, laying down the rules for gas market organisation, as amended in no. 542/2005; the system for transmission capacity allocation in the case of congestion had been taken over, with small modifications, into the current provisions of Section 8(1)(a) of no. 524/2006, and so also this provision was in conflict with the requirements of Article 18(1) and Article 8(b) of Directive 2003/55/EC. Due to the discrimination of applicants for transmission capacity, consisting in preference for certain transmission capacity allocation requests according to the reasoned opinion of 18 December 2006, the ERO therefore issued public notice no. 184/2007, amending no. 524/2006 laying down the rules for the organisation of the gas market and for the development, allocation and use of typical gas supply profiles, whereby Section 8, containing discriminatory transmission capacity allocation, was replaced by a non-discriminatory provision under which free transmission capacity would henceforth be allocated on a *pro rata* basis depending on the size of the capacity requested.

Within the meaning of the Commission's reasoned opinion, also the provisions of Section 18 on storage capacity shortage had to be regarded as discriminatory provisions, because they preferred certain types of applications for capacity to others. The provisions of Section 18, containing discriminatory rules for storage capacity allocation, were therefore replaced by a non-discriminatory approach whereby in the case of a shortage of free storage capacity the principle of *pro rata* allocation of the remaining free storage capacity, depending on the size of the capacity requested, would henceforth be used.

This instrument also provides for the way of establishing final customers' gas consumption in the case of a change in the supply price or the charge for commodity distribution outside the meter reading dates. It entered into force on the day of promulgation on 17 July 2007.

- **No. 280/2007 on the execution of the Energy Act's provisions on the Energy Regulation Fund and the obligation over and beyond a licence**

Effective from 1 December 2007 this instrument replaced ERO's public notice no. 377/2001 on the Energy Regulatory Fund, which lays down the method for selecting the designated licence holders, the way of calculating demonstrable loss and the rules for the payment of financial contributions to this fund, as amended in no. 366/2002.

The amendment to the Energy Act, i.e. Act No. 670/2004, has also partly changed the Energy Act's provisions on the obligation over and beyond a licence (Section 12 of the Energy Act) and on the Energy Regulatory Fund (Section 14 of the Energy Act). In accordance with these changes to the Energy Act this instrument provides for the following:

- a) The method for selecting the designated licence holder to perform obligations over and beyond its licence, which include the obligation to supply thermal energy and to distribute electricity and gas outside its licence;

- b) The way of calculating demonstrable loss incurred in performing obligations outside a licence; the calculation of demonstrable loss is based mainly on the accounting documents presented by the licence holder who claims compensation for demonstrable loss, and on evaluating the books of account that are kept separately on the performance of the obligation outside the licence;
- c) The rules for calculating the financial contributions to be paid by licence holders to the Energy Regulation Fund when such licence holders become obliged to make such payments (Section 14(3) of the Energy Act); these provisions no longer apply to all licence holders but only to thermal energy generation and distribution licence holders;
- d) The procedures for drawing on the fund; the provisions on the drawdown on the fund will only be applicable in the event of a claim for compensation for demonstrable loss incurred in performing the obligation of supplying thermal energy outside the licence, because in line with legislative changes, compensation for demonstrable loss incurred in performing the obligation to distribute electricity or gas is paid through adjustments to controlled prices for electricity or gas distribution at the level of the higher distribution system.

- **No. 321/2007, which amends no. 524/2006 laying down the rules for the organisation of the gas market and for the development, allocation and use of typical gas supply profiles, as amended in 184/2007**

The gradual opening of the market was completed and the market was fully liberalised under the Energy Act, and therefore in 2006 no. 524/2006 laying down the rules for the organisation of the gas market and for the development, allocation and use of typical gas supply profiles was issued to put in place the conditions for the fully opened gas market. An assessment of the gas market's functioning precipitated the need to change certain provisions in this instrument, mainly those on the process of gas supplier switching. This process has been simplified and it is smoother now, which has made gas traders' and final customers' position easier on the open gas market. The instrument has redesigned the allocation of transmission capacity in the event of congestion. The TSO is obligated to treat all requests for capacity allocation to good contracts on an equal footing and may not prefer any of them. The change in the provisions on allocation has been balanced by a change in the process of applying for capacity allocation, when under the until then existing provisions applicants first requested capacity allocation for annual and multiannual contracts and only when all requests were granted after an evaluation, also applicants for monthly contracts could start to request capacity.

Due to the full opening of the gas market, certain modifications and more detailed specifications were also made in respect of data transmission by operators and the method for determining a surrogate estimate of expected consumption at offtake [supply] points with type B metering was modified to make the preliminary imbalance evaluation more accurate.

The instrument has also introduced new concepts: gas distribution in trial operation to check the technical parameters of a new or refurbished gas consuming facility, and the sliding gas distribution agreement that permits a flexible beginning of the contract with a shorter time for allocating such capacity.

This instrument came into effect on 1 January 2008, with the exception of its provision on the development of the TSO's information system as a place that would provide gas traders with all information about billing by DSOs, which will come into effect on 1 July 2008.

- **No. 363/2007, which amends no. 426/2005 on details of the licensing of business in the energy industries**

On 1 January 2007 Act No. 183/2006 on Planning and Rules of Construction (the Construction Act) came into effect; it repealed Act No. 50/1976 on Planning and Rules of Construction (the Construction Act), to whose provisions on the use of structures the provisions of no. 426/2005 on details of the licensing of business in the energy industries referred. There was therefore a need to change the licensing instrument's provisions on proving the technical prerequisites for performing licensed activities by way of permissions for use. It also reflects the cases where a time-limited permission for early use of the structure was issued prior to its completion or when the planning office decided that the permission for use could only be issued after trial operation. On the basis of experiences with the application of the instrument in licensing proceedings, a change was made in the way of proving professional competence, in the part concerning the way of proving the requirement of practical experience in the industry. The instrument came into effect on 28 December 2007.

- **No. 364/2007, which amends no. 475/2005 implementing certain provisions of the law on support for the use of renewable resources**

The technical and financial parameters contained in a schedule to no. 475/2005 include specific cases of indicative values of the various technical and financial parameters for certain technologies used in electricity generation from renewable resources. With regard to the continuous development and improvement of the technologies for using renewable resources and to changes in the price of the inputs, these technical and financial parameters need to be changed from time to time.

In 2007 the Office therefore amended the public notice, in particular its schedule no. 3, which sets forth the indicative technical and financial parameters the keeping of which is, under Section 6(1)(b) of the law on renewable resources, a prerequisite for achieving the 15-year payback period with the support provided through the feed-in tariffs set by the Office. Some definitions have been specified more accurately and certain transitory provisions that have lost their importance have been modified. The public notice entered into force on 1 January 2008.

- **No. 365/2007, which amends no. 541/2005 on the Electricity Market Rules and principles of pricing the electricity market operator's activities and on the execution of certain other provisions of the Energy Act, as amended in no. 552/2006**

After the two years for which no. 541/2005 was in effect the Office evaluated the information received from electricity market participants about its benefits for the Czech electricity market and its application in practice. Having analysed this information, for 2008 the Office issued no. 365/2007 amending no. 541/2005 on the Electricity Market Rules and principles of pricing the electricity market operator's activities and on the execution of certain other provisions of the Energy Act, as amended in no. 552/2006. It responded mainly to electricity market participants' experience. The following changes are incorporated in it:

- a) The short-term electricity market organised by Operátor trhu s elektřinou, a.s. (OTE) has been extended to include the so-called organised block market, on which electricity is traded in certain predefined blocks. The organised block market makes it possible for traders to adjust their trading positions several days to one day before the actual supply;
- b) The so-called re-dispatch has been introduced to control electricity flows in the transmission system in the event of congestion in this system (Section 2(2)(k)); there are related provisions on the transmission of the actual values for the financial settlement of imbalances (Section 18(1)(f)) and provisions on the procurement of electricity by the TSO for controlling the transmissions system (Section 24(7));
- c) In the system of imbalance clearing and settlement, the extra costs of the electricity procured by the TSO for balancing the system imbalance have been excluded from the structure of the payments made by cleared entities for imbalances (Section 25);
- d) A special mode of imbalance clearing and settlement has also been introduced for situations directly preventing the states of emergency declared by the TSO (Section 26), and the related provisions on the publication of information by OTE (Section 29(2) and (7));
- e) There are more precise procedures for supplier switching in the mode of delegated responsibility for imbalance (Section 30) and the related provisions on the first electricity supply to a newly set up supply point (Section 31a);
- f) The way of calculating the clearing price of imbalances and the price for balancing energy supply has been changed (schedule to public notice no. 5); the purpose is to motivate cleared entities to minimise imbalances (i.e., to keep their contracted trading positions).

The public notice entered into force on 1 January 2008, with the exception of points 1, 14, 16, 17, 26 and 42, which entered into force on 1 February 2008, and point 9, which will enter into force on 1 July 2008.

In the project for amending energy legislation (NOEL), the Office participated in the work of all the working groups set up for drafting an amendment to Act No. 458/2000, the Energy Act, and prepared suggestions for amendments, including specific proposals. On the basis of the Legislative Work Plan for 2007 the Office was appointed one of the proponents of the forthcoming amendment to the Energy Act.

## 2.2 Further legislative activities

The Office worked with the Ministry of Industry and Trade on the drafting of the answer to the European Commission's reasoned opinion under Article 226 of the EC Treaty, concerning failure to perform the obligations under 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, which had been forwarded to the Czech Republic, and concerning failure to perform the obligations under 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, which had been forwarded to the Czech Republic.

In response to the Commission's request of 21 July 2007, and a subsequent request of 27 July 2007 by the Agent of the Government who represents the Czech Republic before the Court of Justice of the European Communities and the Court of First Instance, the Office prepared an analysis of the measures adopted by the Czech Republic in accordance with 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, on the performance of the public service obligations and their impact on the competitive environment, consumer protection and environmental protection. A similar analysis was also drawn up in respect of the measures adopted by the Czech Republic in accordance with 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, on the performance of the public service obligations and their impact on the competitive environment, consumer protection and environmental protection. On the basis of these analyses, on 11 December 2007 the European Commission decided **not to continue** the procedure against the Czech Republic and **no action was brought** against the Czech Republic.

The Office contributed to the analysis of the options for using the concept of a Centralised Public Procurement Authority within the various ministries. By preparing and delivering a final analytical report for 2006 to the Ministry for Regional Development, the Office carried out its duty under Czech Government Resolution No. 357 of 11 April 2007, on the Report for 2006 on the Execution of the National Plan for the Introduction of Electronic Public Procurement for 2006 to 2010.

ERO's officers were actively involved in the working groups for the drafting of legal regulations or the meeting of specific strategic goals: the law on free movement of services, law on oversight, and the execution of the Government's Strategy in Fight against Corruption for 2006 to 2011, falling within the remit of the Ministry of the Interior.

The Office prepared and adopted its own Code of Conduct for ERO Employees, which was issued as Chairman's Measure No. 15/2007.

To meet the Office's internal needs, its employees took part in the activities of the Chairman's advisory bodies – the remonstrance commission (which recommends decisions on remedies filed against the ERO's decisions at the level of first instance to the Chairman), the commission for damages (which deals with damage caused in relation to the Office's activities and recommends decisions on compensation for damage under Act No. 262/2006, the Labour Code, to the Chairman), and the commission for asset disposal (which addresses the issue of the disposal of assets falling within the Office's remit and prepares draft decisions on unnecessary assets under Act No. 219/2000, on the property of the Czech Republic and its position in legal relationships, for the Chairman).

# 3

Regulation in the electricity industry





# 3 Regulation in the electricity industry

## 3.1 The market in 2007

During the second year of a fully opened market, primarily small customers were only learning how to use the opportunity to optimise their electricity bills by way of supplier switching. In 2007 more than 46,000 supply points changed their supplier, which is less than one per cent of all eligible customers. Specifically, information received from OTE suggests that the supplier was changed for 38 supply points at the extra high voltage level, 3,475 supply points at the high voltage level and 41,405 supply points at the low voltage level (of which 25,644 were households). For 1,098 supply points the voltage level was not recorded. The electricity market was mainly developing at the level of large and medium-sized customers, at which a sufficient number of traders are operating. However, the situation is very different in the segment of low-demand businesses and households, where only six and five traders, respectively, out of the almost 300 licensed electricity traders are operating in any appreciable way on the national scale.

To provide more information to electricity market participants about issues of not only electricity supply on the liberalised market, the Office set up a Frequently Asked Questions section on its website; the section summarises customers' typical questions and answers them in an understandable way. The Office is watching the evolution of the queries sent by market participants, and in response updates the FAQ section on a regular basis. In this connection an interactive ready reckoner helping to calculate payments for electricity supplies was set up on the Office's website as early as 2006. With the help of this application, low-demand low-voltage customers can, using the data entered (distribution rate, annual consumption), compare their cost of electricity supply from each of the suppliers and find the best supplier with regard to the nature and size of their demand. The ready reckoner is updated on the basis of information received from the suppliers who have provided the Office with their price quotations of energy products for small customers.

However, customers are also not yet fully exercising all of their rights in some other areas provided for in energy legislation, such as the quality of supplies and compensation for network operators' and electrical energy suppliers' failures to keep the standards of electricity supply quality. Prompted by this, the Office is trying to improve customers' awareness of their rights and the procedures for exercising them in practice, through the media and its positions published on the Internet.

In mid-2007 the principle of trading on the electricity market was changed completely. The until then existing principle of wholesale electricity marketing based on annual auctions organised by ČEZ, a.s. and on additional bilateral contracts between electricity generators and traders, was replaced by continuous trading in electricity at the Prague Energy Exchange. This change has had the heaviest influence on electricity suppliers; they now have to adjust their business strategies for buying electricity on the market. However, the introduction of trading on the energy exchange also has a certain impact on final customers, and not only in terms of the electricity price itself but also in those of having an opportunity to agree, with some suppliers, on a flexible price that depends on the price on the exchange.

## 3.2 Price formation and setting

The resulting price of electricity supply to all final customer categories is composed of two main parts. The first component covers regulated activities having a monopoly nature, which include electricity transport from the generating plant over the transmission and distribution systems to final customers and operations involved in providing for the stability of the energy system, in both technical and commercial terms. The other part is the uncontrolled energy price offered by suppliers.

For the first time, a new environmental tax on electricity is included in the electricity supply price as an additional item in 2008. The legal provisions on electricity taxation are contained in Act No. 261/2007, on the stabilisation of public budgets, Part 47 Electricity Tax. The tax rate is CZK 28.30/MWh, with the exception of exempt electricity produced from renewable energy resources and also electricity consumed in energy-intensive processes and public transport.

At the low voltage level, the same scope of tariffs as in 2007 has been maintained for 2008 for small businesses (low demand, category C) and households (low demand, category D), including the conditions for the award of tariffs.

### 3.2.1 Controlled components of the electricity supply price

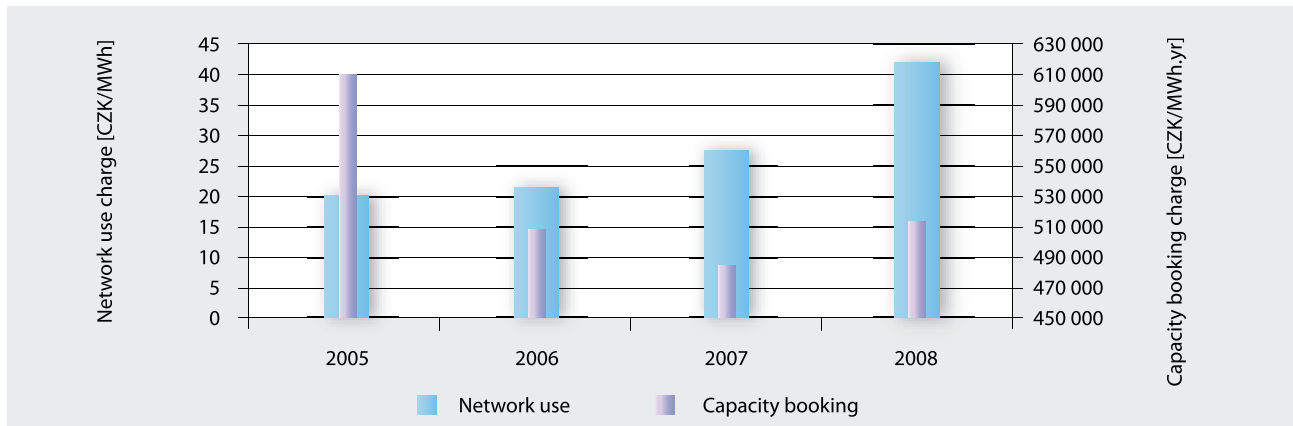
#### Charge for network services

The network service charge is composed of a charge for transmission services and a charge for distribution services. The network service charges for 2008 are mainly influenced by the following factors:

##### Transmission service charge

The charge for using the transmission system's services has risen from CZK 28.08/MWh in 2007 to CZK 41.25/MWh in 2008. This growth (46.9%) is mainly caused by the significantly rising prices of the energy bought by the TSO to cover losses. The much lower increase, in percentage terms, of the unit price for capacity reserved at the transmission system level (ca 6.3%) is due to including a considerable portion of the proceeds from auctions on cross-border interconnections into the calculation of prices 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. Chart 1 shows the prices for electricity transmission.

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



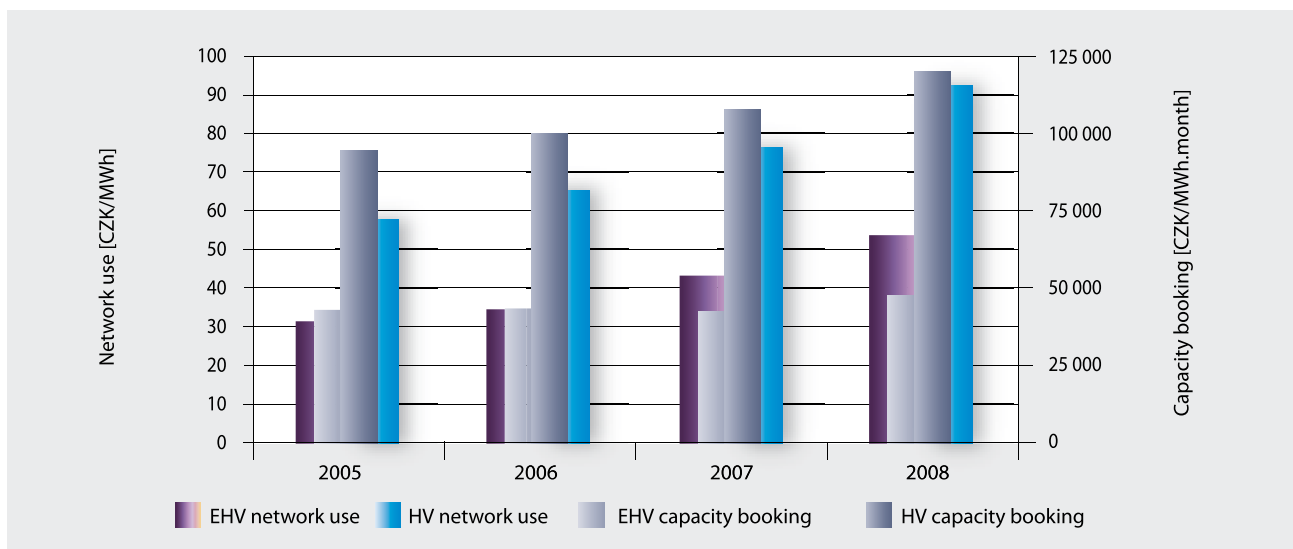
Distribution service charge

The higher prices for network use, which influence the variable part of the distribution rates, are due to the wholesale market's significantly higher prices of the energy bought by distributors for covering their losses. This item has gone up y/y by 26.3 per cent on average at the extra high voltage level and by 19.9 per cent at the low voltage level.

The charges for booked capacity at the various voltage levels are mainly influenced by technical units (the size of the capacity reserved by customers). While at the extra high voltage level a stabilisation of the situation can be observed, in the case of the high voltage level final customers continue to reserve less and less capacity. This, together with other factors such as inflation, has an unfavourable influence on the unit price; for 2008 there has been a y/y increase by 12.6 per cent at the extra high voltage level and by 12.4 per cent at the high voltage level.

Chart 2 shows the development of both components of the distribution charge for extra high voltage and high voltage levels from 2005 to 2008.

**Chart 2 Components of the charge for electricity distribution at EHV and HV levels**



**The charge for distributed generation**

Support for distributed generation is intended for generating plants connected to lower voltage levels rather than directly to the transmission system. Distributed capacities help to reduce the cost of losses in networks and cost of transformation at higher voltage levels. The amounts of support for distributed generation at the various voltage levels have been maintained at the previous levels.

Year-on-year, the final customers' resulting contribution to distributed generation has increased from CZK 9.45/MWh to CZK 9.54/MWh due to rising generation in distributed capacities.

### The charge to meet the extra costs incurred in support for electricity from renewable resources, CHP and secondary resources

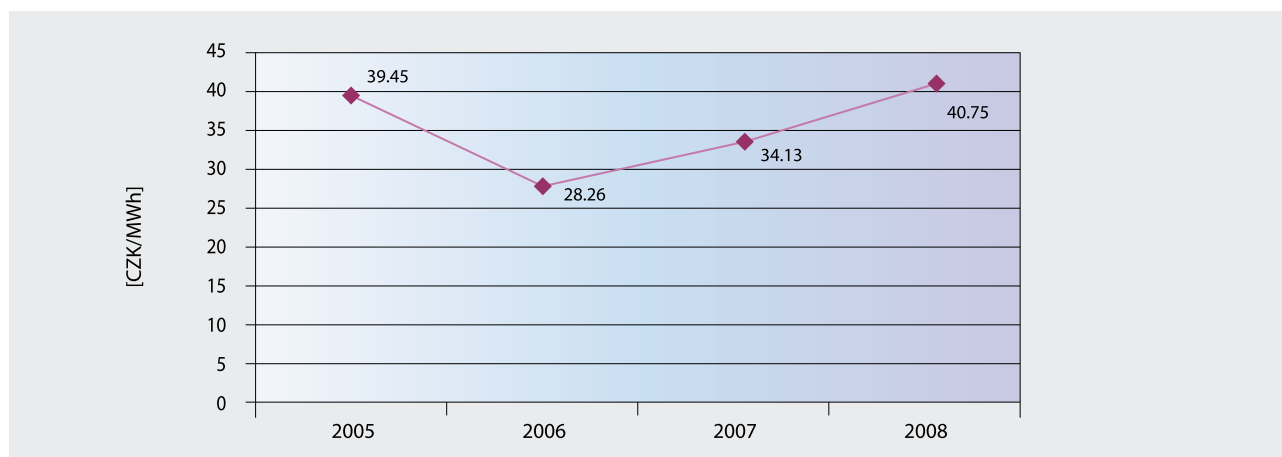
The charge to meet the extra costs incurred in support for electricity from renewable resources, CHP and secondary resources has risen from CZK 34.13/MWh in 2007 to CZK 40.75/MWh in 2008.

The increase in the contribution is mainly caused by the growing amount of electricity generated from renewable resources. This trend is most distinctly apparent in electricity generation from biomass and biogas; to a certain limited extent, also a rising proportion of electricity generation in wind power plants can be registered. The amount of the contribution is also considerably influenced by changed prices of the fuels (biomass and biogas) and increased capital expenditure on new plants in some categories of renewable resources (chiefly small hydroelectric power stations and biogas stations). Not least, also the development of electricity generation in CHP and from secondary energy resources influences the level of the contribution.

In connection with Act No. 180/2005 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 also a gradual increase in the contribution.

Chart 3 shows the contribution from 2005 to 2008.

**Chart 3 Charge to cover the extra costs incurred in support for electricity generation from renewable resources, CHP and secondary resources**



### Electricity prices to households and low-demand (small) business customers

As in all final customer categories, the resulting price of electricity supply to low-voltage customers is composed of regulated prices for distribution and related services, and the energy price, which is not subject to control, including the supplier's business margin.

The published average increase in the price of electricity supply to households for 2008, by 9.1 per cent (not including the electricity tax), is chiefly attributable to an increase in the uncontrolled price of energy. The percentage shares taken by the various components of the resulting price of electricity supply to an average household customer are depicted in Chart 4 (the shares are including VAT and the new electricity tax).

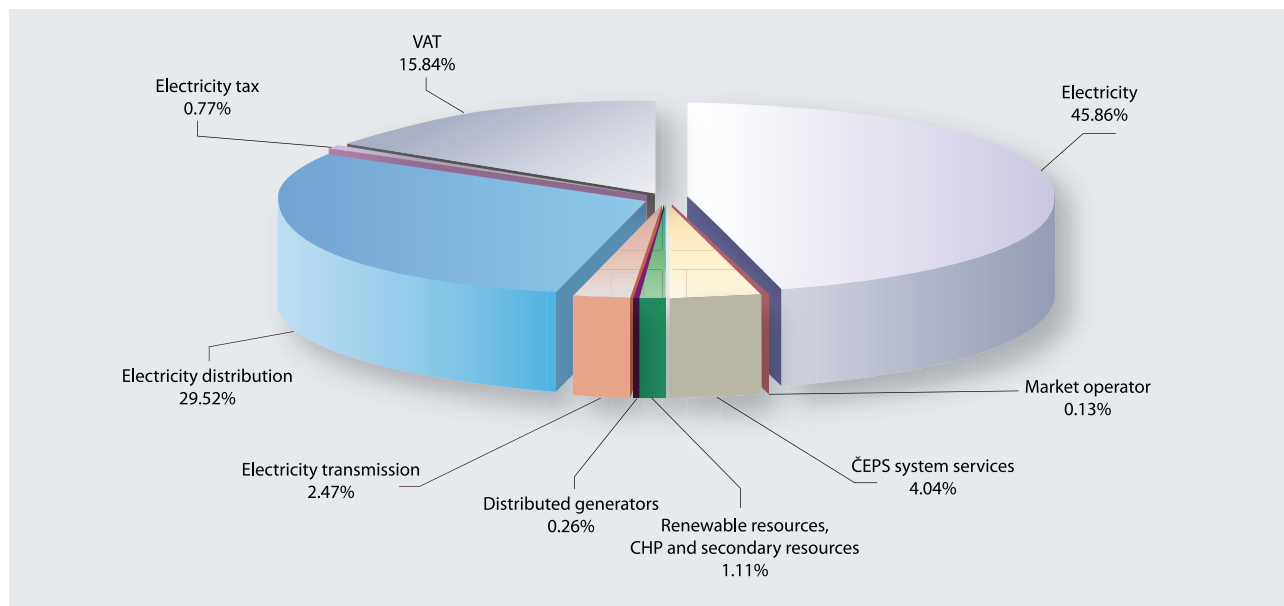
In the case of small business customers the overall average y/y growth is 8.9 per cent (not including the electricity tax).

The increase in the electricity price for each individual customer differs depending on the selected tariff and the nature and size of consumption.

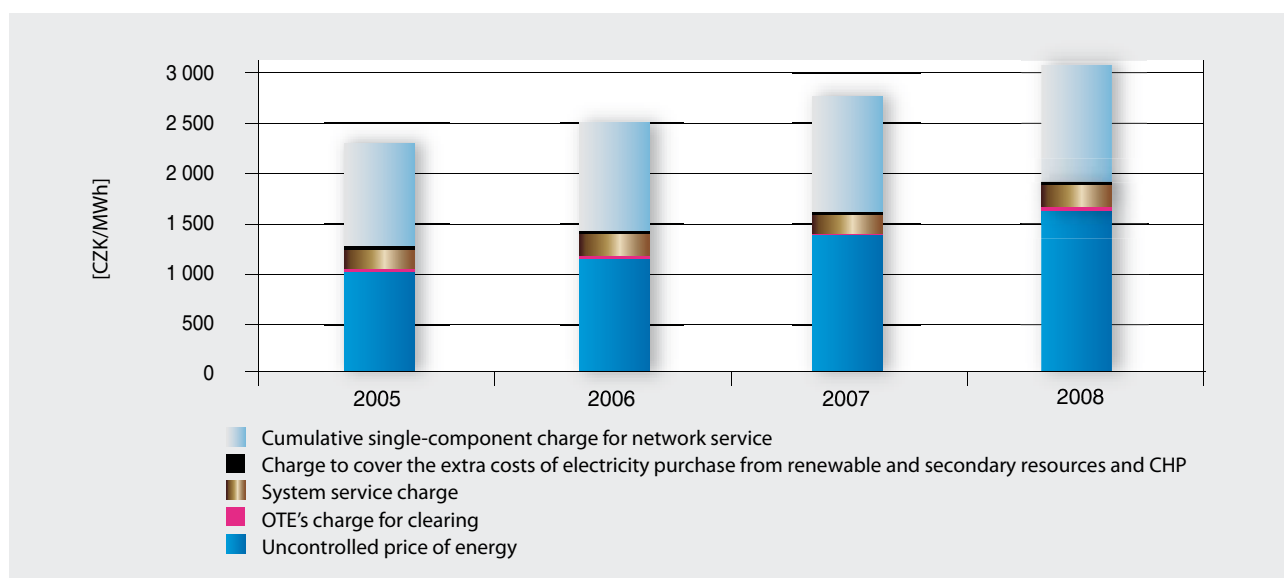
The overall increase in controlled prices for customers at the low voltage level, which the Office is able to influence, is 1.8% on average for the whole Czech Republic, and basically only reflects outside factors having technical and financial impacts on the operation of networks (development of electricity production in supported environmental capacities, line losses, rate of inflation, etc.).

Average prices of electricity supply to households and their components since 2005 are shown in Chart 5.

**Chart 4** Percentage shares taken by each of the components that make up the average price of electricity supply to households for 2008



**Chart 5** Average price of electricity supply to households



The year-on-year price hikes for each of the regions, considering the regional suppliers' (the traders who are part of the same group as the respective distribution company) quoted prices, are listed in Table 1.

**Table 1** Changes in average prices for the household category in regions served by each of the suppliers between 2007 and 2008

Company	Households [%]
E.ON, a.s.	11.1
Pražská energetika, a.s.	10.2
ČEZ, a.s.	8.0

### Prices charged by the supplier of last resort

For 2008 the prices of electricity supplied by suppliers of last resort have been calculated on the basis of the weighted average of electricity prices for which the suppliers have bought electricity at the Prague Energy Exchange and also directly from domestic and foreign suppliers. On the basis of these purchase prices the suppliers calculated, and then submitted to the Office for approval, prices of energy for each of the distribution tariffs at the low voltage level. It is to be kept in mind that the Office could not influence the wholesale price of energy in the calculation of the prices for suppliers of last resort; the Office could only check whether the electricity so procured by suppliers of last resort matched the lowest quotations on the market.

Final customers have not yet used the services of a supplier of last resort.

### Charge for the electricity market operator

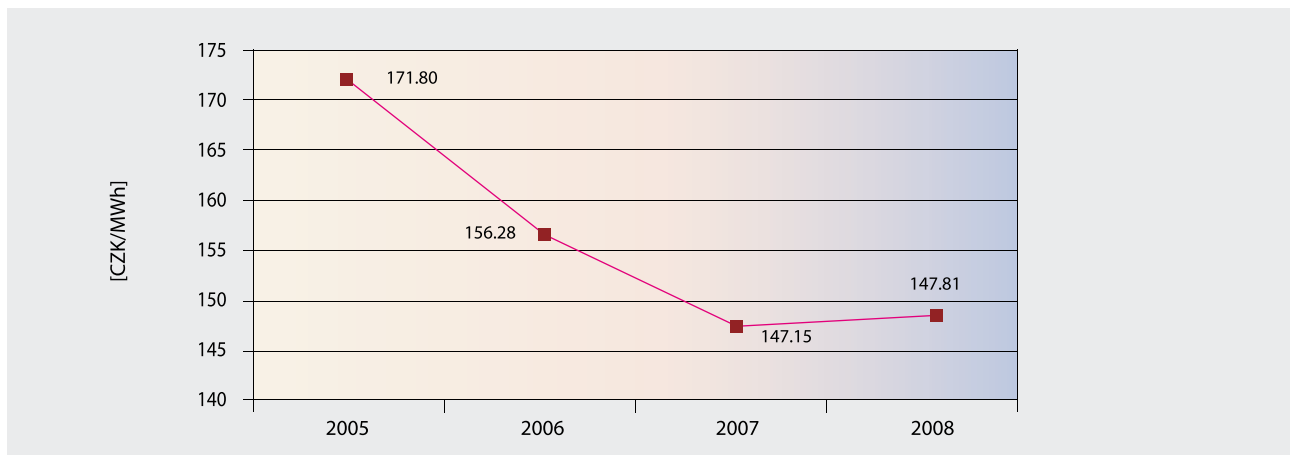
For 2008 the charge for the electricity market operator's activities has been raised to CZK 4.75/MWh. This increase, by about 2.6 per cent, has been made after three years and it mainly reflects inflation in line with the regulatory rules. This charge covers the costs incurred by Operátor trhu s elektrinou, a.s. (OTE) in activities defined in the Energy Act, which include, in particular, the processing of balancing electricity supply offers and of electricity take bids, the clearing of imbalances, organising short-term electricity markets, and some others. For the first time, in 2008 the so-called block market, with the help of which the liquidity of electricity trading is expected to improve, was added to the range of short-term electricity markets organised by OTE.

### Charge for system services

System services are necessary for ensuring that electricity generation and demand are balanced. The transmission system operator, ČEPS, a.s., provides these services by purchasing ancillary services from their providers, primarily electricity generators themselves. The downward trend in the cost of ancillary services, attributable to the stabilisation of the system and increasing demand, which resulted in lower prices of system services between 2005 and 2007, has not been maintained for 2008. The situation on the electricity market, and generators' strong opportunities for marketing their output of energy, have influenced the bid prices of ancillary service. This is the reason for the price of system services rising somewhat for 2008, from CZK 147.15/MWh to CZK 147.81/MWh, i.e. up by 0.4 per cent.

System service charges from 2005 to 2008 are shown in Chart 6.

Chart 6 System service charges



### 3.2.2 Uncontrolled prices

The activities that are subject to price control are set forth in the Energy Act and in the law on renewable resources. They are primarily activities that have the nature of a natural monopoly and as such cannot be competitive, and activities that are supported in order to save primary fuels and use renewable energy resources. The Office is not competent to control the prices of energy offered by generators and traders. Controlling prices of energy supplies would be at variance with the principles of Directive 2003/54/EC, because such control would hinder the development of the EU's internal electricity market.

On the liberalised market customers can, by choosing their supplier, influence the uncontrolled part of their resulting electricity supply price, which is the commodity itself (energy), including the supplier's business margin.

#### Energy price

In 2008 the prices of electricity supply to all customer categories are influenced by the higher wholesale price of energy. As in the last few years, this price hike is the result of the market mechanisms' working not only on the domestic market (the structure of capacities, future consumption, etc.); it is also caused, due to the interconnection of grids, by demand and electricity prices in neighbouring countries. This could also be felt in the results of trading on the Prague Energy Exchange: already in the first months of trading the electricity price was higher by about 17 per cent y/y due to demand exceeding supply. This was later reflected in both the overall prices for final customers and some of the regulated items.

The impact of the above increase in energy prices on the various customer categories differs by the nature and, primarily, size of a specific customer's consumption, i.e. in relation to the ratio between the charges for regulated items, set by the Office, and the uncontrolled price of energy. This can be felt most strongly by customers who use electricity for space heating, where the charge for the commodity (energy) makes up the predominant portion of the total cost of supply.

The higher energy price has also unfavourably affected the TSO's and DSO's costs of covering network losses.

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

In 2007 the Office set the support for renewable energy resources, secondary resources and CHP for 2008. In calculating the prices it maintained the key pricing principles: for renewable resources the 15-year payback period has been kept, and account has been taken of the varying capital expenditure on different categories of renewable energy resources and of the PPI for existing capacities in accordance with Act No. 180/2005 on support for the use of renewable resources.

Feed-in tariffs, green premiums and contributions to the energy price were published in ERO Price Decision No. 7/2007 of 20 November 2007, which lays down support for electricity generation from renewable energy resources, CHP and secondary energy resources.

#### Renewable resources

In view of the technological development in renewable resources and with a view to setting support, in the form of minimum feed-in tariffs and green premiums, for newly installed capacities, in 2007 the Office held a number of meetings with associations that bring together generators of electricity from renewable resources and representatives of the competent governmental institutions. On the basis of updated information the Office amended public notice no. 475/2005, which implements certain provisions of the law on support for the use of renewable resources. The amendment mainly concerned schedule 3, in which the technical and financial parameters were adjusted. For each of the categories of renewable resources, specific capital expenditure and the annual load factor were defined more accurately to reflect real-life data on newly installed capacities. A major change is the extension of the expected service life of photovoltaic capacities from 15 to 20 years, and also the adjustment of technical and financial parameters for small hydroelectric power stations and plants that fire biomass and biogas.

From the perspective of guaranteed support for renewable resources, another major change was the amendment to public notice no. 150/2007, on regulatory methods in the energy industries and procedures for price control. The new provisions set forth that feed-in tariffs and green premiums shall be applied throughout the service life of electricity generating plants and also that feed-in tariffs shall be increased annually to reflect PPI, by at least two per cent but no more than by four per cent, throughout the service life of electricity generating plants, with the exception of those that fire biomass and biogas.

In respect of the feed-in tariffs and green premiums, the principle of differentiation by the year of commissioning has been maintained. In respect of supported renewable resources the feed-in tariffs were increased with regard to the industrial producers price index; the average increase was 2.5 per cent.

Green premiums for the various categories of resources, with the exception of biomass co-firing and parallel firing, have been reduced in comparison with the previous year. The calculation of green premiums included the inflation factor and also reflected the rise in the expected market price of energy. This implies that in absolute terms, green premiums for existing capacities have decreased;

this drop in green premiums is fully set off by the rise in the market prices of energy, while maintaining revenues per unit of electricity generation from renewable resources.

An important change in comparison with 2007 is the introduction of two new categories of biogas stations. They are biogas stations commissioned after 1 January 2008 and firing 'specified biomass', primarily that from farming, and biogas stations commissioned after 1 January 2008 and firing 'other biomass'.

Another change is increased support for biomass firing. The Office expects higher prices of energy crops and green (forest) biomass on the market than in 2007. Fuel price hikes of 14.3 and 10 per cent have been factored into the calculation of the electricity price for energy crops and green (forest) biomass, respectively. New sub-categories have also been introduced for plants that fire biomass, namely plants commissioned after 1 January 2008, for which capital expenditure had increased, which has also been reflected in the support.

New categories have also been introduced for small hydroelectric, wind and photovoltaic power plants: new categories have been introduced for plants commissioned on or after 1 January 2008. For wind and photovoltaic power plants, the feed-in tariffs have been set at the level of the 2007 prices. In the category of small hydroelectric power plants the support has been increased, mainly with regard to the rising capital expenditure required.

Green premiums for electricity produced by fossil fuel and biomass co-firing have been set so as to cover electricity generators' increased costs of biomass firing in comparison with the costs of coal firing. The rising biomass prices is the reason why the green premiums have also been increased for biomass co-firing and parallel firing in comparison with other premiums. In addition to the prices of biomass and coal, the costs incurred by the electricity generators who use these fuels are also influenced by the price of CO<sub>2</sub> emissions allowances, the proceeds from which, generated by the replacement of coal with biomass, have also been reflected in the green premiums.

### Combined heat and power generation

Since 2006 support for combined heat and power generation has been granted to all categories of cogeneration units through a controlled premium on the electricity market price, subject to the amendment to the Energy Act.

The amount of support for small cogeneration plants depends on two key factors – natural gas prices and market prices of electrical energy. In the case of natural gas, an increase of 15% in comparison with 2007 was expected; electrical energy price hikes were included in the calculation at a similar rate. The increase in energy prices on the market will be reflected in generators' higher revenues from the electricity they sell. Having reflected these key factors in the calculation of the premiums for 2007, the resulting premiums are lower for all CHP categories that fire natural gas.

The incentivising amount of premiums has been maintained in the case of large, over 5 MWe cogeneration units and also for all CHP categories that fire renewable resources or drained gas.

In respect of CHP, the alternative option to select the duration of the high rate for a period of eight or twelve hours a day has been maintained. The option to change the duration of the rate once a month is a new element that may contribute to a more effective operation of cogeneration units.

### Secondary resources

A study on the efficacy of support categorisation has been drawn up. The results of the study show that at present, because of the small number of plants firing secondary resources, it is not appropriate to categorise support in more detail. For support of secondary resources two secondary resource categories have been maintained: electricity generation from drained gas and electricity generation from other secondary resources. The Office is not ruling out a more detailed breakdown of the secondary resource category in the years to come.

## 3.4 Quality of electricity supplies and related services in the electricity industry

Under ERO public notice no. 540/2005, on the quality of electricity supplies and related services in the electricity industry, DSOs with more than 90,000 supply points of final customers, or, as applicable, electrical energy suppliers, are obligated to provide the Office with monthly reports on their compliance with the standards of electricity distribution, i.e. standards of supplies and related services. On the basis of the licensed entities' reporting obligation the Office monitored, in accordance with the above public notice, the quality of electricity supplies achieved in the Czech Republic in 2007.

The data reported by the respective companies can be categorised into two groups. One category includes information about the continuity of electricity supplies in networks, i.e. data affected by failures and planned events in operated distribution systems. The other category includes information about the so-called commercial quality, which characterises the distributor's or supplier's ability to respond to final customers' requirements and which is not directly related to the physical operation of the systems. However, the assessment of the level of quality achieved in electricity supplies is considerably affected by the credibility of the data reported and the nature of the area served. The interval over which the level of quality of electricity supplies and related services is analysed



is one year. In 2007 the Office published an evaluation (Report on the Level Achieved in Observing the Standard of the Continuity of Electricity Transmission and Distribution for 2006 (The Quality Report)) of the level achieved in observing the standard of the continuity of electricity transmission and distribution for 2006 on its website. The Quality Report describes the level of achieving continuity in the transmission system, which is operated in the Czech Republic by ČEPS, a.s. The report describes the level of continuity in electricity distribution for the distribution networks of three regional DSOs in the Czech Republic.

In the event of failure to keep the quality parameters of electricity supplies, as set out in no. 540/2005, final customers may claim financial compensation for failure to observe the standards of electricity supply quality. Compensations are not paid to customers automatically; affected customers must apply for them with the respective company within the required time limits. Final customers are not yet making full use of this possibility. The Office is planning to enhance consumers' awareness of the quality of the services provided in the electricity industry.

# 4

Regulation in the gas industry



# 4 Regulation in the gas industry

## 4.1 The market in 2007

The Czech gas market was characterised by several distinct features in 2007:

- Completion of the gas market liberalisation process;
- Entry of new gas traders into the Czech market;
- Application of the amendment to public notice no. 524/2006, laying down the rules for the organisation of the gas market and for the development, allocation and use of typical gas supply profiles, and its amendment;
- Decline in annual gas consumption.

### Completion of the gas market liberalisation process

From the perspective of the natural gas market, 2007 was marked by the completion of the market liberalisation process. The experience from the gradual market opening and the practical application of the relevant legislation, i.e., the Energy Act and public notice no. 673/2004, laying down the rules for the organisation of the gas market, as amended in 542/2005, precipitated the need to change the way of organising the natural gas market from January 2007. The Office therefore amended the above public notice by way of drafting a new instrument, no. 524/2006 of 24 November 2006, which put in place a new gas market model adjusted to the fully opened market's needs. It specifically contains a change of the method for booking capacities in the transmission system, from the point-to-point to the entry-exit approach.

With effect from 1 January 2007 all customers, including households, have become eligible customers. This has provided final customers with the right of supplier choice by way of a free-of-charge change of supplier, and, in turn, the opportunity to influence the uncontrolled part of their overall costs of gas supply, i.e. the commodity itself, and the services related to gas storage.

Table 2 shows the number of final customers who have changed their gas supplier and a comparison between 2006 and 2007. In the Czech Republic, the supplier switching process clearly concerns mainly customers in the large-offtake category. In this connection a ratio is used, the switching rate. It is a coefficient (in per cent) calculated as the ratio of the number of supplier changes per year to the total number of supply points in the respective year. On the Czech market large-offtake customers have so far been the most active; their switching rate for 2007 was 3.8 per cent. On the basis of European experience, a market with a switching rate of over ten per cent is regarded as a fully liberalised gas market.

**Table 2 Final customers' supplier switching**

Customer category	31 December 2006	31 December 2007	2007	
	No. of changed supply points	No. of changed supply points	Total no. of supply points	Switching rate
Large offtake	1	75	1,969	3.8%
Medium offtake	3	2	7,723	0.0%
Small offtake	3	0	192,211	0.0%
Households	0	1	2,643,529	0.0%

Note: The figures in the Table do not include supplier switching for reasons caused by the suppliers themselves.

### New entrants on the Czech market

The new gas market rules applicable from January 2007 motivated new traders to enter the natural gas market. Some new traders, for example, Petr Lamich-LAMA, United Energy Trading, a.s., Česká energie, a.s., and VNG Energie Czech, a.s., started to operate on the market in addition to the RWE Group's traders and Jihočeská plynárenská, a.s. (since mid-2007 E.ON Energie, a.s.), Pražská plynárenská, a.s., Vemex s.r.o. and Moravské naftové doly, a.s. at the beginning of 2007.

### Amendment to public notice no. 524/2006, laying down the rules for the organisation of the gas market and for the development, allocation and use of typical gas supply profiles

The year 2007 saw two amendments to no. 524/2006; one was issued in mid-2007 and was based on the European Commission's objections. The other, in force since 1 January 2008, is based on the conclusions of the Office's discussions with traders and final customers; it turned out that it was possible to modify some of the provisions in the light of practical experience.

On the basis of the reasoned opinion of 18 December 2006 from the European Commission under Article 226 of the EC Treaty and with regard to 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, in 2007 the public notice on the gas market organisation was amended with effect from 17 July 2007; for more details please see Chapter 2.

The other amendment reflected comments that concerned, in particular, the process of supplier switching; it was made shorter and more effective, and adjusted to make it possible to effectively use also short-term gas distribution and transmission agreements after a supplier switch. The other changes, most of them catering to final customers, concerned the introduction of the so-called sliding gas distribution agreement; it is a monthly gas distribution agreement that can be entered into at any time during a month, while the DSO's response is almost immediate. The purpose of introducing this type of agreement is to support natural gas use in cases of short-term needs, which are currently mostly met with the help of other primary energy resources. Another change was new provisions on gas distribution in trial operation to make it possible to check the technical parameters and operating values, and verify the operability, of final customers' newly installed or refurbished gas consuming equipment. The trial operation has been provided both for customers taking gas [mainly] for technological processes and for customers taking gas [mainly] for space heating.

### Decline in annual gas consumption

One of the characteristic features of the market in 2007 was a decline in natural gas consumption in the Czech Republic. According to the Balancing Centre, it decreased by 6.8 per cent to 8.645 bcm. On the one hand, lower consumption is caused by the long-lasting slight increase in ambient temperatures; on the other hand, it is attributable to saving measures adopted by final customers in their consumption.

#### 4.1.1 Assessment of reimposed regulation

On 1 April 2007 the Office discontinued the price control for eligible customers, which it had reimposed from 1 January 2006 as a temporary measure to eliminate the adverse impacts of the malfunctioning gas market, partly liberalised in 2005, on final customers.

The price control was based on limiting the prices of gas supplies from RWE Transgas, a.s., including the storage price, and the sales prices charged by traders of the regional companies that bought natural gas from RWE Transgas.

The main reason for reimposing regulation was the traders' behaviour on the gas market, at that time only partly liberalised (more details are contained in the Office's annual report for 2006). The primary objective of reimposing regulation was to prepare the market for fully liberalised conditions, for which it had not been ready at the time of the first wave of liberalisation. In this respect, the Office held talks with gas companies, primarily RWE Transgas, mainly on the conditions and method of pricing after 1 April 2007, which were to ensure the development of a competitive environment on the market, calculation of adequate prices for final customers, and adjustment of these companies' conduct vis-à-vis final customers in the competitive environment. The adopted measures achieved this objective.

In spite of that, 2007 saw a disagreement between market participants, which resulted in the filing with the Office of requests to commence administrative proceedings. The requests were filed by E.ON Energie, a.s. and Pražská plynárenská, a.s. and concerned access to storage capacity in the underground gas storage facilities operated by RWE Transgas (later RWE Gas Storage, s.r.o., see point 4.1.2). The administrative proceedings were commenced. On 5 October 2007 the Office delivered a first instance decision. All parties to the proceedings filed remonstrance against this decision. By the end of 2007 the administrative proceedings were still pending.

#### 4.1.2 Unbundling

In accordance with the EU *acquis*, on 1 January 2007 regional gas companies were unbundled: the various licensed activities were separated; the aim was for distribution to be henceforth carried out by legally independent entities and to provide for DSOs' legal and actual decision-making independence, which is one of the key prerequisites for ensuring that the companies will behave in a non-discriminatory manner.

On 1 January 2007 eight regional distribution companies were established. They received the assets transferred to them by the original vertically integrated enterprises. Seven of them are limited liability companies (JČP Distribuce, s.r.o., JMP Net, s.r.o., SČP Net, s.r.o., SMP Net, s.r.o., STP Net, s.r.o., VČP Net, s.r.o., and ZČP Net, s.r.o.), and only Pražská plynárenská Distribuce, a.s., part of the Pražská plynárenská, a.s. Group, is a public limited company. The only owner of each of these companies is the company from which the assets have been transferred to the respective distribution company.

The Office has, pursuant to the Energy Act, decided that justifiable and demonstrable minimum costs of unbundling will be passed through to the prices of regulated activities. The accepted resulting costs of unbundling have been spread over several years. The first year in which the unbundling costs were reflected in the distribution charge was 2007, and the last year in which distribution charges will be influenced by this process is 2010.

In addition to the legal separation of the companies that operate regional distribution systems from the regional gas companies that trade in gas, RWE Transgas, a.s. decided to legally unbundle its business of natural gas storage in underground gas storage facilities to make the organisational structure of RWE in the Czech Republic more transparent. On 1 May 2007 a new company, RWE Gas Storage, s.r.o., which operates this licensed activity, came into existence.

## 4.2 Price formation and setting

The price of natural gas supply to final customers is composed of four key elements. One is the charge for the *commodity*, i.e., the natural gas itself; the commodity charge is based on gas import prices, and the suppliers' margin and costs. Then there is the charge for gas *transmission* from the border transfer point to the various distributors' domestic zone over the transmission system, and the charge for the downstream business of gas *distribution* to supply (offtake) points. The fourth element is the charge for gas *storage*.

Until 31 March 2007 all of the above elements of the natural gas supply price were set by the Office. With effect since the end of regulation for eligible customers in the form of maximum prices, i.e. as from 1 April 2007, the Office's price decisions specify the charges for transmission and distribution. Since this date, the Czech gas market has been fully liberalised and the charges for gas trading and storage are now controlled by the various traders operating on the market. On the open market, the Office continues to be responsible for setting the prices to be charged by the supplier of last resort to households and small businesses. The prices of the supplier of last resort are set on the basis of the cost-plus principle. In 2007 no customer ended up in this mode. 31 March 2007 was also the last day of the opportunity, known from the previous periods, to adjust the end prices of energy at quarter-year intervals. On the liberal market, it is up to the suppliers to adjust their end prices; they also decide when a price will be changed.

### 4.2.1 Natural gas supply prices

#### 4.2.1.1 Natural gas import prices; gas traders' costs and margin

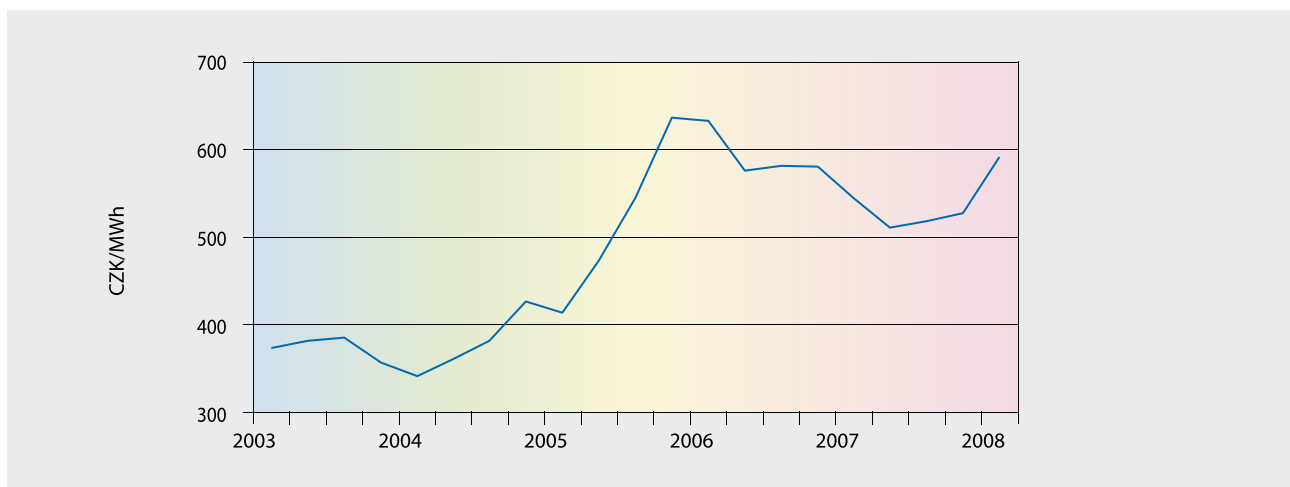
##### Natural gas import prices

The price of gas supply to final customers depends largely on the natural gas import price, which declined gradually in the first half of 2007. The reason was a quieter situation on the world markets after the earlier surge in late 2005 and the tackling of this increase throughout 2006.

When setting the supply price for the first quarter of 2007 the Office expected a normal development of the price during winter, i.e. a rise. It set the price at a higher level than the actual natural gas purchase prices subsequently turned out to be. As a result, RWE Transgas, a.s. generated excessive revenues of CZK 868 million. Since these excessive revenues came from what at that time was a regulated activity, an agreement was reached that this amount would be returned to final customers by way of credit notes or discounts by the end of 2007.

Chart 7 depicts the Office's predictions of the wholesale natural gas price. But for a small decrease, the natural gas price kept increasing in 2006 and the first half of 2007. The chart shows import prices between 2003 and 2008.

Chart 7 ERO predicted wholesale price



## Gas traders' costs and margin

Gas suppliers calculate the final price of supply on the basis of costs and the services that they buy to supply their gas to final customers. These costs include their own costs; mainly those incurred in connection with their IT systems, customer service centres for final customers, and those of natural gas, and also costs of procuring gas transmission and storage services. A gas supplier passes through these costs to the end prices for customers in line with its business strategy; this means the allocation to the variable and fixed elements of the price of supply. The gas distribution service is paid subject to the Office's price decision and must be shown as a separate item on the bill for final customers.

The commodity charge, without the supplier's margin and costs, is the single most important element of the end price; it accounts for 67 to 78 per cent of the price of supply. The actual percentage depends on the current price of the commodity, which mainly depends on the development of the USD/CZK and EUR/CZK rates and oil product and coal prices, from which the natural gas price is derived. Two companies imported natural gas into the Czech Republic in 2007. One was RWE Transgas, a.s., which has a dominant market position as the result of historical development and supplies gas only to gas traders. The other was Vemex s.r.o., a subsidiary of the Russian gas company OAO Gazprom, which supplies gas to both gas traders and final customers.

At the first stage the commodity charge for final customers is based on the gas importers' sales price and the price charged by domestic producers, which account for only one per cent of the total volume of the country's natural gas consumption. The respective gas trader's margin and costs are then added to the above price.

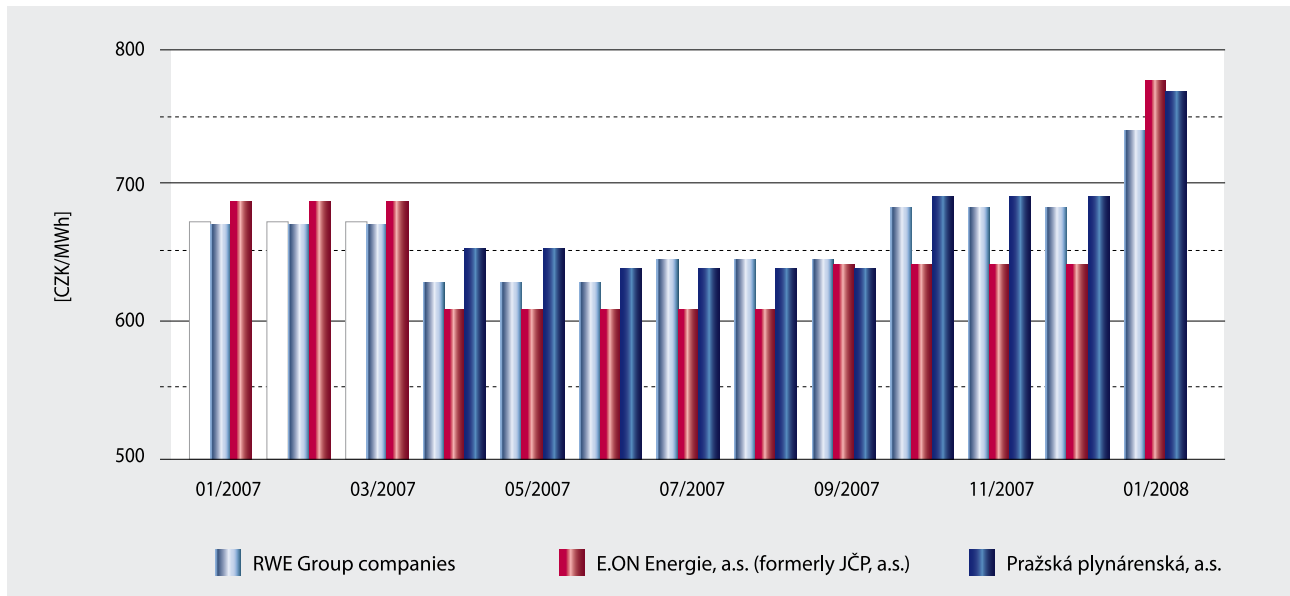
The gas transmission and distribution charges, which are controlled by the Office, are applicable for at least one year, at all times from 1 January of the respective year. The providers of these services are RWE Transgas Net, s.r.o., gas transmission, and the eight distribution companies that were formerly part of the vertically integrated enterprises. Local distribution systems may be connected to the eight distributors. The costs of the gas transmission and distribution services account for approximately 15 to 25 per cent of the end price, depending on customer category.

The charge for gas storage reflects customers' seasonal requirements. The charge is derived from the extent to which the storage facility is used within the overall quantity of annual gas supply. For example, a production process with even gas consumption throughout the year has only minimum requirements for the use of storage; on the other hand, a household that uses gas for space heating, or a heating plant, experience highly seasonal swings in their demand, i.e., there is a significant ratio between consumption in summer and winter months; they therefore have significant requirements for the use of storage.

Effective from 1 April 2007 suppliers calculate the end prices for each of their customers by individualised criteria. Particularly in the large-offtake category traders have demonstrated a considerable degree of differentiation between customers. Each company calculates its end prices by customer category, for periods differing in length and with differing periods of applicability, and it is therefore no longer feasible to make a clear-cut comparison of the various traders' prices as at any given date.

For the sake of illustrating the current situation in the household category Chart 8 shows the development of the average prices of natural gas supplies from each of the major suppliers. As indicated, this comparison is illustrative only. The chart differentiates (using a weaker colour) between the period of controlled prices until 31 March 2007 and the subsequent unregulated period. The chart is based on the prices in price lists applicable to each period as published by the trading companies, which they use for their portfolio of household customers. The prices are without VAT, include charges for the commodity and for gas transmission and storage, and do not include gas distribution charges.

**Chart 8** Development of average prices of natural gas supply to households from major suppliers



Source: Trading companies' price lists, ERO

The principle on which gas supply to final customers is priced has remained unchanged in comparison with the previous periods when the Office set and controlled supply prices. They are double-component prices, composed of a fixed part and a variable part. The fixed part covers the specific supply point's costs of gas transmission and distribution and, partly, the gas trader's cost related to this specific supply point. This charge is related to the technical conditions of gas supply and it is therefore irrelevant whether or not any gas is taken at the supply point. The other component covers variable costs, which include the commodity charge and margin and, if applicable, the trader's costs. This component fully depends on the actual gas take and changes in relation to the customer's consumption; it is also related to the price of this commodity on the world market.

Charts 9 and 10 show the structure of the overall supply price for the household category in the first quarter of 2007 and 2008, respectively. The chart for 2008 has been derived from the controlled transmission and distribution charges for 2008 and an analysis of traders' price lists. The only substantive change between these two years is the commodity charge, which has risen year on year, which has also helped to increase its percentage share of the supply price at the expense of the other items, primarily distribution.

In comparison with 2007, in this category the overall share of regulated items has decreased in theory by 4 to 24 per cent. It is only a theoretical comparison because in the first quarter of 2007 all elements of the supply price were subject to regulation; account should also be taken of the strong influence of the commodity charge on the overall proportion between the various items in the supply price.

**Chart 9** Structure of the average gas supply price to household customers, 1Q 2007

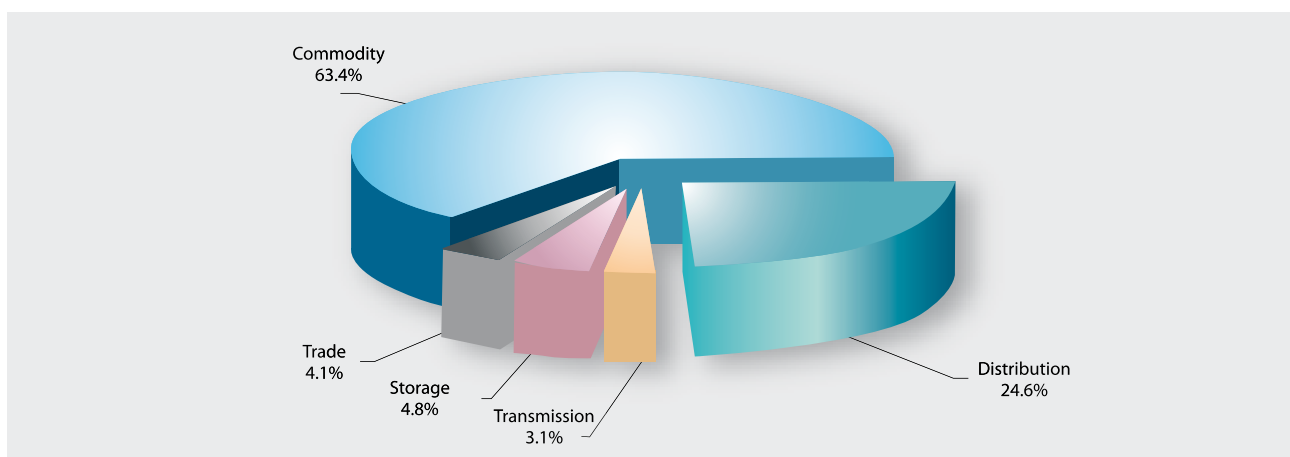
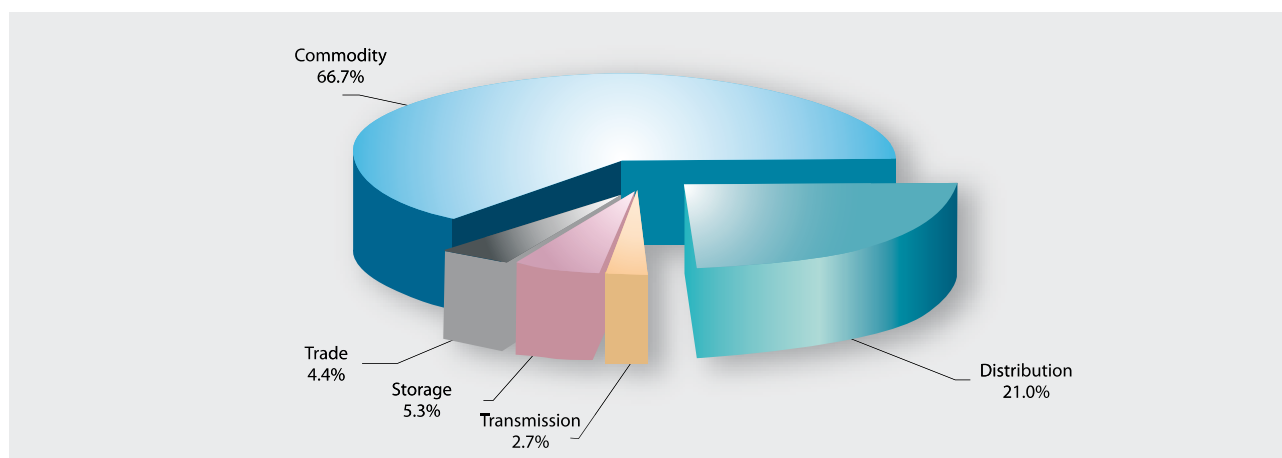




Chart 10 Structure of the average gas supply price to household customers, 1Q 2008



#### 4.2.1.2 Natural gas transmission prices

Natural gas transmission involves multiple types of cost, mainly the cost of transporting natural gas through the Czech transmission system and identifying and keeping the required natural gas quality standards (metering of GCV, pressures, etc.), and the costs incurred in balancing the Czech gas system.

Natural gas transmission charges are uniform for the whole Czech gas market and independent of distance because of the relatively small area covered by the Czech Republic (the postage stamp principle). Their level depends on the gas quantity that has to be transported over one day (maximum daily capacity out of all the values over the year). The transmission charge is set for one-year and longer agreements.

The resulting prices of transmission reflect the type of the respective gas transmission agreement. In addition to the standard one-year term, transmission agreements can be executed on a daily basis and for a term of one to eleven months; the price under agreements shorter than one year takes into account 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 term of the agreement. This is done by means of coefficients, which differ for each month and which put at a disadvantage gas take in winter when, in general, the demand for this service is stronger. Daily contracts are also priced on the basis of these coefficients.

The gas transmission prices for 2008 again include a part of the justifiable minimum costs of the TSO's unbundling (the transmission company has been separate from the trader since 1 January 2006); the Office has set this item in accordance with the Energy Act and using the methodology of 2005. The transmission prices for 2007 reflected, as in 2006, a part of revalued depreciation; the prices for 2008 include revalued depreciation in full. Effective since 1 January 2007, public notice no. 524/2006, laying down the rules for the organisation of the gas market and for the development, allocation and use of typical gas supply profiles, has preserved the TSO's important role of transmission system balancing. In this connection, the TSO must reserve sufficient withdrawal capacities of the storage facilities to carry out this task. The costs incurred in reserving withdrawal capacity for transmission system balancing are also included in the transmission charge. In comparison with 2007, this item increased in 2008; the reason is a higher charge for gas storage.

In 2007 the above no. 524/2006 already was applied, which resulted in a major change in transmission pricing in comparison with the previous year. The new rules defined the entry/exit points on the Czech gas transmission system, which had to be evaluated and for which fixed charges for booked capacity were set. This resulted in six different fixed charges for daily booked firm capacity throughout the term of annual contracts, unlike the previous years when a single transmission charge was set on the point-to-point principle.

The TSO's overall allowed revenues have been increased by five per cent for 2008. This increase is mainly attributable to including complete revalued depreciation and increase in the cost of transmission system balancing. The other factors that helped to increase allowed revenues were inflation-indexed escalation and increased costs related to the TSO's function of the market operator; the TSO has been the market operator since 2006. On the other hand, acting against these factors is a cut in the rate of return on the regulatory asset base from 8.107 per cent to 7.851 per cent, which is due to a reduction in the corporate income tax to 21 per cent.

On the basis of the overall allowed revenues set as above, each of the entry/exit points on the transmission system is evaluated. In this respect, these points are classified as points through which gas flows into the Czech Republic and down to the final customers, and points through which gas can be exported. Final customers in the Czech Republic pay the price of the transmission involved in gas import into the country and of gas transport within the country. Due to the drop in booked capacity in the transmission system, the increase, effective as from 1 January 2008, in these prices was six per cent higher than the increase in overall allowed revenues in comparison with 2006. The increase, in per cent, in the transmission prices for each of the points that represent gas flows from and into the Czech Republic can be seen in Table 3. In 2007 the outward prices were not applied on the market.

**Table 3 Fixed gas transmission charges**

Parameter	Symbol	Unit	2007	2008	Increase [%]
Charge for daily booked capacity at the entry border point	$C_{\text{heni}}$	CZK/1,000 cu m	19,657.10	20,838.56	6
Charge for daily booked capacity at the entry point to the virtual storage facility	$C_{\text{zeni}}$	CZK/1,000 cu m	627.20	664.92	6
Charge for daily booked capacity at the domestic entry point	$C_{\text{deni}}$	CZK/1,000 cu m	10.00	10.00	0
Charge for daily booked capacity at the border exit point	$C_{\text{hexi}}$	CZK/1,000 cu m	78,151.20	85,233.75	9
Charge for daily booked capacity at the exit point from the virtual storage facility	$C_{\text{zexi}}$	CZK/1,000 cu m	0.00	0.00	0
Charge for daily booked capacity at domestic exit points	$C_{\text{dexi}}$	CZK/1,000 cu m	20,430.70	21,660.29	6

#### 4.2.1.3 Natural gas storage prices

In addition to RWE Transgas, a.s. (later RWE Gas Storage, s.r.o.), which owns six of the eight underground gas storage facilities in the Czech Republic, also Moravské naftové doly, a.s., which operates the Uhřice facility, was active on the Czech storage market in 2007. The last, eighth, facility at Dolní Bojanovice, owned and operated by SPP Bohemia a.s., is only used for the Slovak Republic's needs, both under contracts and also for technical reasons concerning connection to the transmissions system.

In 2007 RWE Gas Storage, s.r.o., which was split off the parent company RWE Transgas, a.s. on 1 May 2007, held a share of more than 90 per cent of the market of the service of gas storage in UGS facilities. Since 2006 the facilities have been reinforced and their technical storage capacity is now larger by 66 mcm. The new capacity was offered and allocated as spare capacity among interested market participants from 1 April 2007.

In 2007 more than 98 per cent of the natural gas stored in UGS facilities for supplying the Czech market was owned by RWE Transgas, a.s., the balance was owned by Vemex s.r.o., Pražská plynárenská, a.s. and ENOI S.p.A.

The licensed activity of gas storage in UGS facilities is not subject to regulation. Each SSO charges its own price for gas storage. In comparison with 2007, the natural gas storage price is higher by about 30 per cent in the Czech Republic in 2008.

#### 4.2.1.4 The distribution charge

Following the discontinuation of the temporary restrictions on gas supply prices for eligible customers, since 1 April 2007 the distribution charge has been the only regulated element of the end price of natural gas supply, which is apparent in the billing of supply to final customers. Distribution, as gas transport over the distribution system to supply points, is a typical activity that will always be subject to regulation on a fully liberalised market. The reason is that the ownership of a distribution system establishes a natural monopoly in the respective area. After the commodity charge, the distribution charge is the second most important element of the end price of natural gas supply.

The distribution charge mainly reflects the costs incurred in operating the distribution system, metering, and identifying and processing the data required for balancing the Czech Republic's gas system. It also reflects depreciation of the gas assets that make up a distribution system, which provides for asset replacement. Depending on their geographical conditions, degree of industrialisation of the area they serve, and density of gas penetration in the household category, distribution systems differ considerably. This also necessitates differentiated controlled prices for each of the distribution companies. Table 4 lists average distribution charges in each year of the second regulatory period by customer categories, and distribution charges for households by regional distribution companies. To eliminate the effect of the differences between the quantities distributed in each year, the average prices have been calculated for the quantities planned for distribution in 2008.

The distribution charges are double-component prices; one component is variable and relates to the gas quantity taken at a particular supply (offtake) point. The other component is fixed; in the case of supply points taking annually no more than 63 MWh it has the form of the standing monthly charge for the capacity available, and in the case of higher offtake supply points this fixed component has the form of a fixed annual charge for the maximum daily capacity available. Through this fixed annual charge customers at specific supply points pay the cost of the capacity required to support the maximum daily offtake at the lowest temperatures in the case of space heating, and the maximum output of the process equipment installed in the case of gas offtake for process purposes.

Table 4 Average distribution charges for each customer category between 2005 and 2008

Company	Category	Average gas distribution prices in the second regulatory period							
		Price [CZK/MWh]				Price changes [%]			
		2005	2006	2007	2008	2006/05	2007/06	2008/07	2008/05
Czech Republic	Large offtake	66.58	66.82	67.95	72.86	0.36	1.69	7.23	9.43
	Medium offtake	114.39	125.50	131.36	140.01	9.71	4.67	6.58	22.39
	Low offtake	138.87	154.56	166.05	174.68	11.30	7.44	5.20	25.79
	Households	173.52	187.77	201.92	210.95	8.21	7.54	4.47	21.57
	<b>Total</b>	<b>113.48</b>	<b>121.59</b>	<b>128.58</b>	<b>135.63</b>	<b>7.15</b>	<b>5.74</b>	<b>5.48</b>	<b>19.52</b>
JČP Distribuce, s. r. o.		212.93	263.95	302.65	318.69	23.96	14.66	5.30	49.67
JMP Net, s. r. o.		158.28	168.66	180.13	190.03	6.56	6.80	5.49	20.06
Pražská plynárenská Distribuce, a. s.		159.73	181.96	190.89	192.02	13.92	4.91	0.60	20.22
SČP Net, s. r. o.	Households	231.72	236.07	255.76	251.83	1.88	8.34	-1.54	8.67
SMP Net, s. r. o.		181.96	203.08	220.27	228.95	11.60	8.47	3.94	25.82
STP Net, s. r. o.		177.95	185.36	189.91	206.19	4.16	2.46	8.57	15.87
VČP Net, s. r. o.		142.65	147.56	168.58	178.79	3.44	14.25	6.05	25.33
ZČP Net, s. r. o.		184.97	203.78	212.12	231.82	10.17	4.09	9.28	25.33

The current values of the parameters of the model for calculating distribution charges for 2008 have been obtained from the data reported by distribution licence holders in their regulatory reports for 2006. Regulatory reporting is subject to ERO public notice no. 404/2005, on the essentials and structure of regulatory reports, including model forms, and the rules for compiling regulatory reports, in which the various reports are structured strictly by groups of licensed activities. Technical regulatory reports on gas distribution were submitted using the above model forms. Financial reports were submitted using model forms provided for in an earlier ERO public notice, no. 439/2001 that lays down the rules for keeping separate records of sales, costs and revenues for the purposes of regulation and the rules for the allocation of costs and sales, and revenues from the capital employed in the energy sector; the reason is that in 2006 regional gas companies were not yet unbundled and books were kept and audited for gas distribution and trading together.

As part of testing the reporting module of the IT system that is being implemented at the ERO, in July and August 2007 technical reports were experimentally submitted by all regional gas companies also in the 602XML Filler format.

The fully liberalised gas market and the requirements of no. 524/2006 have necessitated adjustments to regulatory report model forms. The purpose is to enhance their information value, simplify form filling, and improve the Office's options for checking regulated entities and setting the parameters for the third regulatory period commencing in 2010. The objective of the consultations that are under way with all the relevant companies is to draft an amendment to no. 404/2005.

The costs incurred in gas market opening, or the legal unbundling of distribution companies as from 1 January 2007, are being reflected in distribution charges gradually in several phases. They first appeared in distribution charges in 2007. A part of these costs has also been included in distribution charges when calculating the prices for 2008. The amount of the above costs was assessed by independent consultancies; at the same time estimates of demonstrable minimum justifiable costs incurred in gas market opening were made. On the basis of these opinions the amount at the threshold level of minimum costs was determined and applied in distribution pricing.

In comparison with 2007, the average distribution charge set for 2008 has been increased by CZK 7.05/MWh for the whole Czech market, implying a growth of 5.48 per cent, reflected in an increase of approximately 1.15 per cent in the end price of supply averaged over the whole Czech Republic. Looking at the factors reflected in the change in distribution charges for 2008, the most important factor was the inclusion of a part of the difference between regulatory depreciation and accounting depreciation. In the third regulatory period the book value of revalued depreciation (which is the result of the legal unbundling of distribution companies) will be included for distribution pricing purposes, unlike the current approach where the initial value of depreciation, which is set for the respective regulatory period, is escalated for every year of regulation. The transition between the two approaches will be gradual to prevent a surge in distribution charges. The first step was taken when prices were set for 2008. In the Czech Republic, the effect of the included part of revalued depreciation is an increase of 5.04 per cent in the distribution charge, which is about 1.05 per cent of the average end price of supply.

The increase in the average distribution charge was also caused by the above-mentioned inclusion of an additional part of the legal unbundling costs and escalation of allowed costs due to rising PPI and the wage index, which are part of the price formula.

Reducing the rate of return on the regulatory asset base from 8.341 per cent to 8.106 per cent in connection with the new corporate income tax, set at a rate of 21 per cent, was another factor, favourable for final customers, that has influenced the distribution charges for 2008.

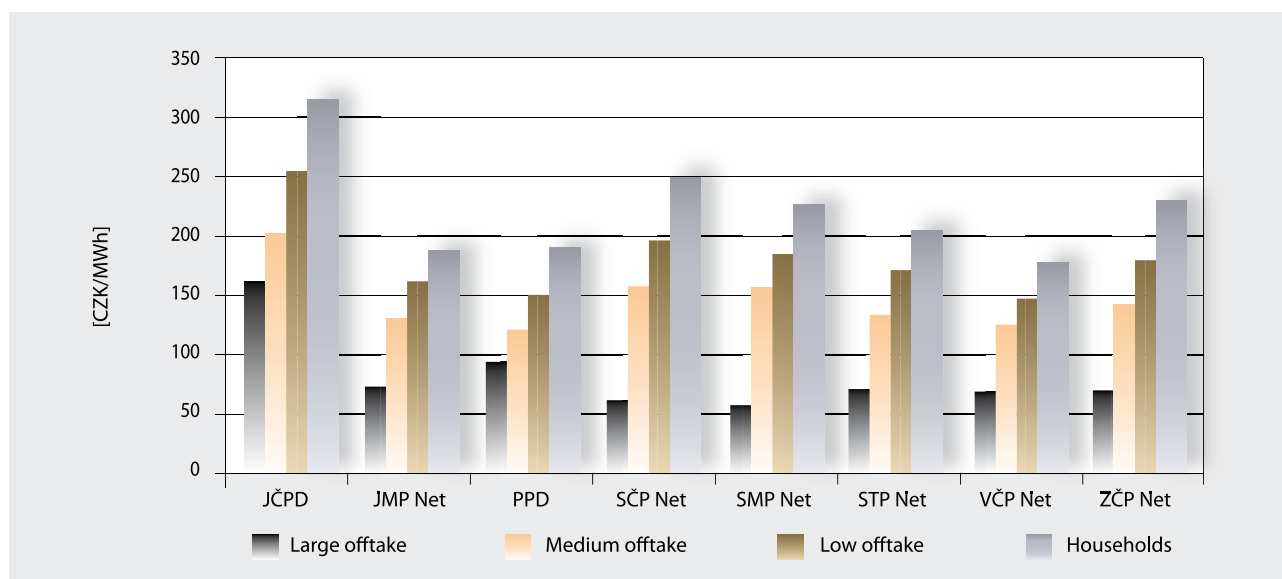
The increase in average distribution charges (Table 4 and Chart 11) differs for each of the distribution companies, which is due to the following factors:

- a) Different value of the correction factor applied to revenues;
- b) Revalued depreciation applied to a varying extent;
- c) Differences between the quantities distributed in each year by each particular company.

A specific cause of the differences between regional distributors in respect of changes in the average distribution charge is the gradual unification of the prices of the three RWE Group distribution companies. RWE Gas International B.V. has acquired 100% equity interests in the regional distribution companies STP Net, s.r.o., SČP Net, s.r.o. and ZČP Net, s.r.o. RWE Transgas, a.s. has expressed its plan to merge these three companies by 2009, and applied for a gradual unification of these companies' distribution charges. The Office has granted the request, and applied an individualised approach to the setting of these companies' prices. The first step was taken in 2008. The basic criterion considered in this step was to minimise sudden 'leaps' in these companies' price lists, which would otherwise occur as a result of unifying them on a one-off basis. This approach has been felt in a very low increase in the prices of SČP Net, s.r.o., by 0.8 per cent, and higher price hikes of about 7.7 per cent for the other two companies.

Chart 11 shows average distribution charges for 2008 by customer categories and by distribution companies.

Chart 11 Average natural gas distribution prices for 2008



#### 4.2.2 Local distribution systems

The amendment of 1 January 2005 to the Energy Act no longer permitted local distribution system operators (LDS), who held only the gas distribution licence, to also supply gas to customers connected to their system.

The approach to the regulation of the prices of distribution provided by LDS operators in the gas industry has changed significantly. In addition to the opportunity to use the prices of the higher-level regional distribution system as the standard practice, delegated legislation, which elaborates on the amended Energy Act, allows LDS operators to request the Office to set individual distribution charges.

In 2007 the overall number of LDS operators dropped slightly, but some of them became also gas trading licence holders.

Since 1 January 2005 a total of 13 LDS operators have asked for individual distribution charges to be set for them. In two cases no individual distribution charge was set after calculating the individual prices and on the basis of consultations with the LDS operators.

In 2006 RWE Gas International B.V. became the only shareholder of Českomoravská plynárenská, a.s. RWE Gas International B.V. sold the gas assets in all delineated areas to the RWE Group's regional distribution companies to whose systems these local systems of Českomoravská plynárenská, a.s. had been connected. Only in the Suchdolsko delineated area, where the LDS was connected to the regional distribution system operated by JČP Distribuce, s.r.o., this company did not buy the gas assets and in 2007 the LDS continued to be operated by Českomoravská plynárenská, a.s. The distribution charges for this LDS were, in keeping with the applicable legislation, identical with the prices set for JČP Distribuce, s.r.o. In late 2007 the LDS assets in the Suchdolsko area were sold to SČP Net, s.r.o., which is operating this system in 2008.

In 2007 MINERAL spol. s r.o. applied for the abolishment of individual distribution charges for its LDS, noting that it was not using its licence and was only re-invoicing the costs of gas procurement to customers connected to its system. The Office granted this request and abolished the individual prices, and at the same time a suggestion was filed with the licensing department for talks on the option of revoking the gas distribution licence held by this LDS operator.

In ERO price decision no. 11/2007 of 26 November 2007 on prices of gases, effective since 1 January 2008, individual distribution prices are set for nine LDS operators.

#### 4.2.3 Traders on the liberalised market

For eligible customers, 2007 was the first year of a fully liberalised market, and new traders started to appear on the market. The most important competitor to the incumbents is Vemex s.r.o., which focuses on the large-offtake category. The other new traders also focus on this customer category. All traders are offering their products in two basic "packages". For sufficiently large customers, i.e. large-offtake companies, payment for supply is offered on the basis of the so-called price formula designed on any time base. The other customers are offered a fixed price, which is quoted in each trader's price list.

In 2008 the Office expects the new suppliers' position to grow stronger at the expense of the traders of vertically integrated companies. The significant increase in the number of supplier switches as from 1 January 2008, tending to favour new traders, especially in the large-offtake category, indicates this development.

# 5

Regulation in the heat supply industry



# 5 Regulation in the heat supply industry

## 5.1 The heat supply market

A range of very different undertakings, typical of which is small to medium-sized business, operate on the market in thermal energy, which is understood to be the energy of heat and cold. They differ by their size and legal personality, and also by the method of thermal energy generation and extent of thermal installations.

In thermal energy generation and distribution, business can be carried on under a licence awarded by the Office. In certain cases, set out in the law, a 'trade licensing certificate' suffices. On the whole, some 800 entities licensed for thermal energy generation and thermal energy distribution were registered in 2007.

Typical of the Czech Republic is the large proportion of district heating systems, which supply thermal energy to approximately one third of households in addition to other customers. In areas where thermal energy is supplied mainly from district heating systems or local boiler installations and heating plants, these businesses are natural local monopolies. For the customers this means a limited opportunity to change their thermal energy supplier or find a substitute for this way of heating. In most towns and villages the customers are limited by location of the existing heat supply installations, and in respect of the development of towns and villages the decision on the way of providing thermal energy is taken as early as the planning stage. Any changes, if feasible at all, then require considerable financial costs and cause an administrative burden.

The objective of regulation is to mitigate the impacts of the market's imperfections and to actively help protect final customers wherever due to the absence of typical market mechanisms competition does not have strong enough influence on thermal energy prices, thereby providing at least the basic protection against potential abuse of thermal energy suppliers' dominant position. Moreover, the pricing conditions have been designed in a way that will motivate thermal energy suppliers to enhance the economy of thermal energy generation and distribution and also to prefer thermal energy generation from renewable energy resources and combined heat and power with a view to reducing the demand for primary resources and greenhouse gas emissions.

## 5.2 Thermal energy price control

Thermal energy prices are subject to regulation under Section 6 of Act No. 526/1990, on prices, as amended, by way of price controls consisting in putting certain requirements for pricing in place. These requirements are contained in the Office's price decisions and stipulate a mandatory procedure for calculating and agreeing on the thermal energy price between a supplier and customer. They also provide support in dispute resolution and for conducting checks of the thermal energy prices charged. Over the long haul they also contribute to the stability of the environment and help to provide for reliable, safe and affordable thermal energy supplies to final customers.

As in previous years, in 2007 the Office assessed the way in which regulated entities observed the basic requirements in creating the preliminarily calculated thermal energy price and verified the data in regulatory reports. Based on this data the Office drew up overviews of thermal energy prices and published the 2006 resulting prices and the 2007 preliminary prices of thermal energy generation and/or distribution licence holders on its website. The purpose of publishing these prices is to enhance awareness of the prices charged in each price location and to make it possible to compare them, thereby potentially exerting indirect pressure for reductions in thermal energy prices in the interest of final consumers.

### 5.2.1 Cost-plus price control

Economically justifiable costs of, and a reasonable profit from, thermal energy generation and distribution may only be reflected in thermal energy prices. All the technical and other specific conditions of thermal energy generation and distribution in a particular locality can therefore be reflected in thermal energy prices.

The mandatory pricing conditions are set out in ERO price decision no. 9/2004 of 20 October 2004 on thermal energy prices, as amended (for 2007). For 2007 this price decision was changed and amended in ERO price decision no. 7/2006 of 27 October 2006 and ERO price decision no. 4/2007 of 10 September 2007, which specified certain economically justifiable costs included in thermal energy prices more accurately and added formulas for calculating the quantity of thermal energy in cases where no licence is required for thermal energy generation or distribution and no thermal energy metering is installed. This more precise specification of economically justifiable costs and the preconditions for charging them has given thermal energy suppliers stronger support in price regulations as regards the possible inclusion of costs into thermal energy prices, while offering inspection authorities a greater legal certainty when they review the justifiability of the costs reflected in thermal energy prices.

In 2007 the Office set a thermal energy pricing procedure differing from the procedure set out in price decision no. 9/2004, as amended, only in two justified cases. It did so in ERO price decision no. 8/2007 of 23 November 2007 and ERO price decision no. 12/2007 of 26 November 2007, laying down different conditions for agreement on thermal energy prices.

In the second half of 2007 the Office issued its price decision no. 5/2007 of 17 September 2007, on thermal energy prices, with effect from 1 January 2008. This new price decision preserves the key regulatory principles of previous years. It contains more accurately specified and somewhat modified requirements for thermal energy pricing and the use of a different procedure, in comparison with the previous procedure, for thermal energy pricing in connection with annual increases of economically justifiable fixed costs and profit.



## 5.2.2 Thermal energy price levels

The 'thermal energy price levels' are reference price levels stipulated by the Office, which serve for comparison with the average thermal energy prices charged by suppliers in keeping with price decisions. These reference levels are set for each level of energy transfer by fuel type; there is only a basic breakdown to coal and other fuels, most of which are natural gas, fuel oils and, recently, also biomass.

In the event that a supplier charges an average thermal energy price under the stipulated price level, this price is only subject to the basic rules of cost-plus control and the regulated entities are granted a certain degree of freedom in their pricing. Suppliers who charge thermal energy prices above these price levels must not exceed the permissible annual increase in fixed costs and profit.

Due to year-on-year changes in fuel prices, each of the thermal energy price levels was adjusted for 2007 in ERO price decision no. 12/2006 of 27 November 2006. In respect of supply of thermal energy intended for final customers and generated from coal, the price level went up by about four per cent. On the other hand, in respect of supply of thermal energy intended for final customers and generated from other fuels the price level was lowered by about three per cent due to lower natural gas prices.

With regard to the expected changes in taxation and fuel prices the price levels were adjusted again for the year to follow, i.e. for 2008, in ERO price decision no. 5/2007 of 17 September 2007. For final consumers, the reference levels of thermal energy produced from coal have increased by 16.4 per cent, while the reference levels of thermal energy produced from other fuels have increased by 9.3 per cent.

Chart 12 shows the quantity of thermal energy supplied to final consumers and produced from coal or other fuels, the price of which is calculated below the stipulated thermal energy price level, for the last four years.

**Chart 12 Thermal energy quantities below the stipulated price level**

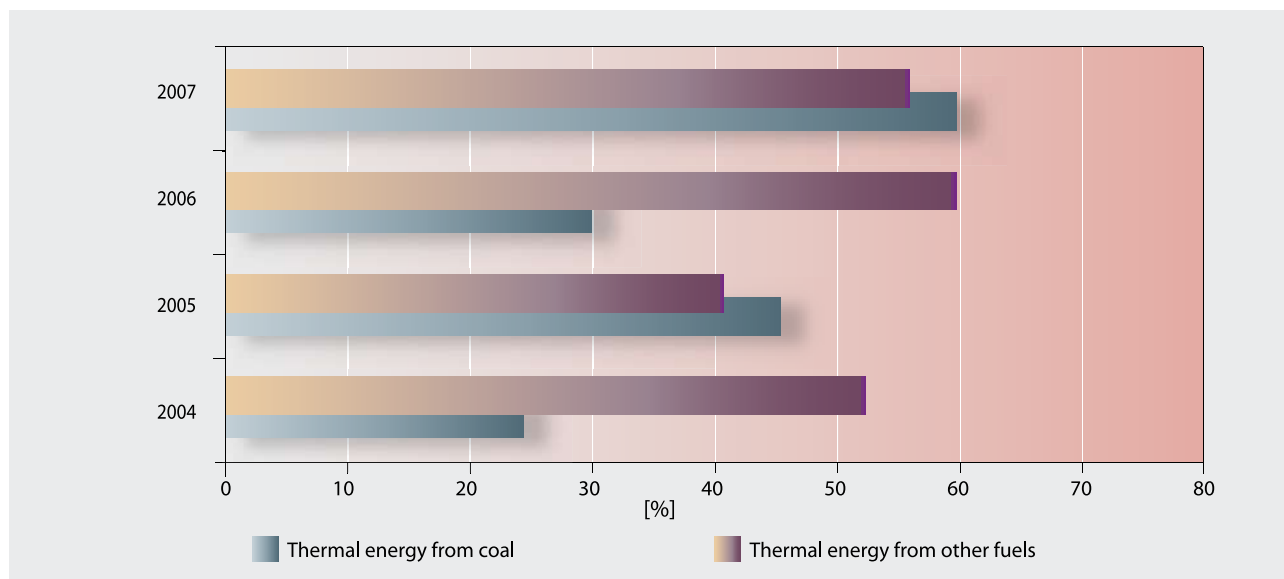


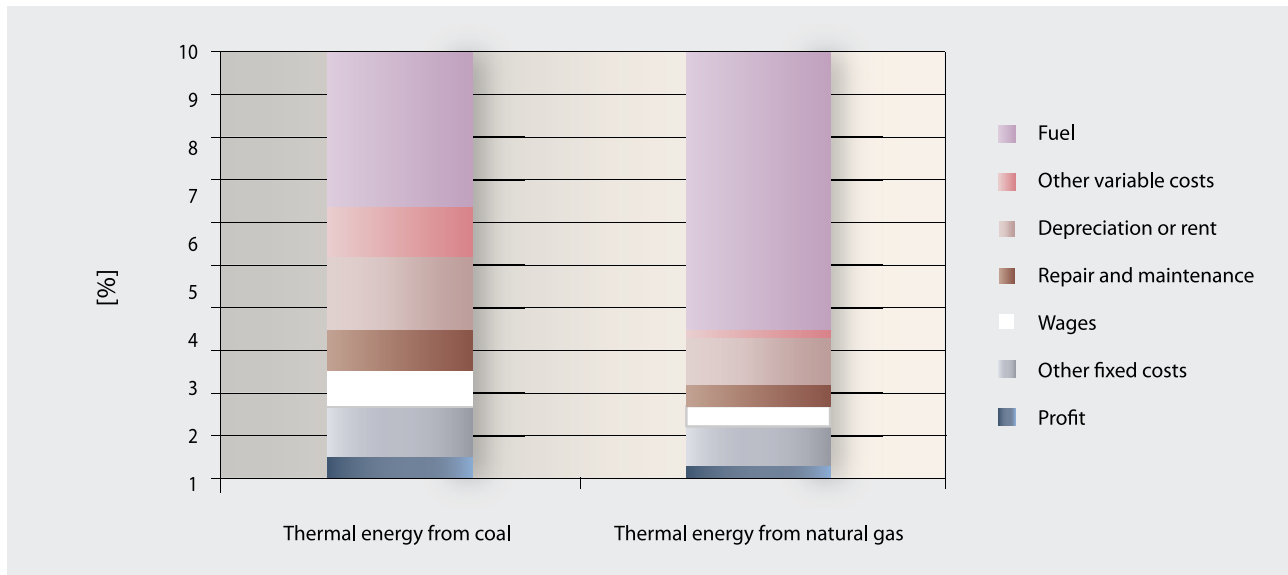
Chart 12 shows, year by year, growing shares of supplies of thermal energy produced from coal below the stipulated price level; according to preliminary prices of 2007 they accounted for almost 60 per cent of the total thermal energy produced from coal. Supplies of thermal energy produced from other fuels also display a rising trend in supplies of thermal energy under the stipulated price level.

## 5.2.3 Annual growth of economically justifiable fixed costs

Restrictions on the annual increase in fixed costs and profit also apply to the thermal energy prices charged above the respective thermal energy price level set by the Office, in addition to the basic rules of cost-plus control. What is therefore important for regulated entities is the amount of the costs that are reflected in the thermal energy price, both the variable costs, which include primarily fuel costs, and the fixed costs and profit, which reflect the technology of generation, age of the installations, the way of their financing and other factors relating to thermal energy generation and distribution. In thermal energy generation and distribution suppliers are therefore incentivised to optimise their cost items and make the operation of their installations more effective, for example, by increasing their efficiency and reducing thermal losses.

Although natural gas is used for thermal energy generation in most price locations, the predominant part of thermal energy is produced from coal. The average share of costs in the price of thermal energy produced from coal and from natural gas is shown in Chart 13.

**Chart 13 Average share of costs in the price of thermal energy from coal and natural gas**



The above suggests that fuel costs predominate significantly in thermal energy from natural gas, while fixed costs have a high share in thermal energy from coal.

### 5.3 Development of thermal energy prices

To analyse the development of thermal energy prices the Office uses the reports it receives from thermal energy generation and distribution licence holders for each year subject to regulation under no. 404/2005 on the essentials and structure of regulatory reports, including model forms, and the rules for compiling regulatory reports. The reports contain the key financial and technical information that helps the Office to make a picture of the condition and development of the heat supply industry and to assess the regulated entities' financial stability.

Data on resulting prices for 2003 to 2006 and preliminary prices as at 1 January 2007 and 2008 has been used for evaluating the development of average thermal energy prices. Average thermal energy prices for final consumers include prices for thermal energy supply from distributions of block boiler installations, outdoor secondary distributions and house delivery stations. In the following all average thermal energy prices are inclusive of VAT.

#### 5.3.1 Average prices of thermal energy from coal for final consumers

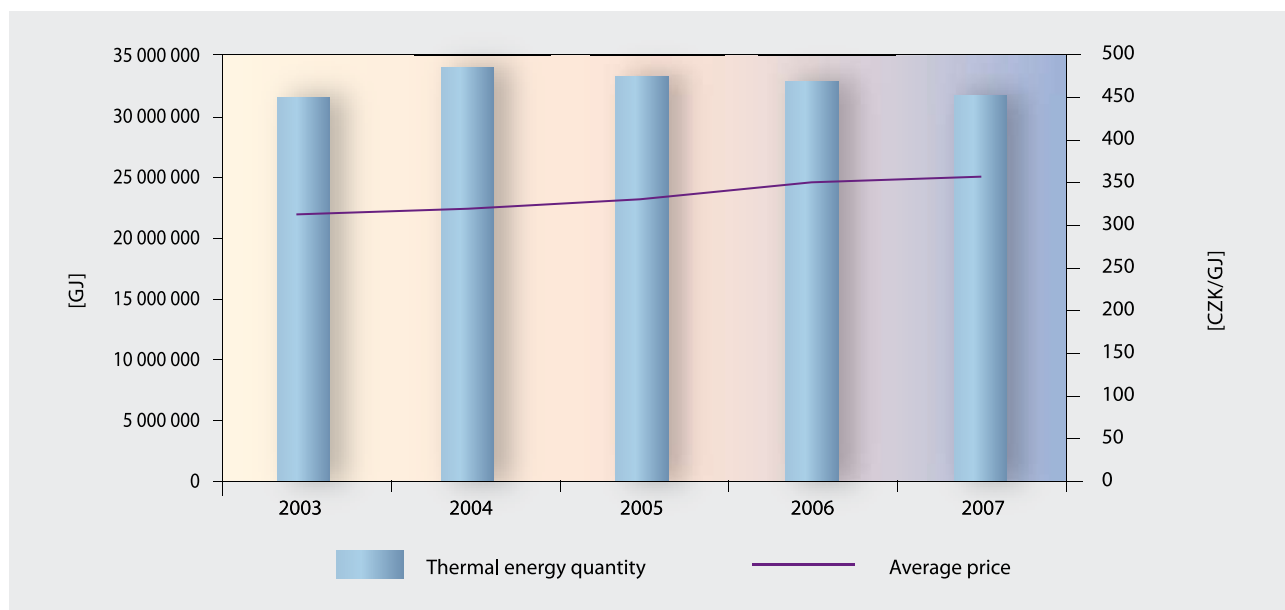
Coal is mostly used for thermal energy generation in large district heating systems. Average coal-generated thermal energy prices for final consumers have been rising moderately; the annual increase has been two to five per cent. Since 2003 the price has risen by about CZK 44/GJ in absolute terms. One of the factors contributing to this trend may be the rising price of coal, but also the declining quantity of thermal energy supplied to consumers.

The drop in the quantity of thermal energy supplies, apparent since 2005, may be attributable to the fluctuations of ambient temperatures in the heating season and thermal insulation of buildings, and also the use of devices that control thermal energy supply.

**Table 5 Average prices and quantities of thermal energy from coal**

Year	Average price [CZK/GJ]	Thermal energy quantity [GJ]
2003	313.26	31,761,862
2004	320.94	34,606,431
2005	332.30	33,428,382
2006	350.21	32,818,844
2007	357.59	31,620,590

**Chart 14 Average prices and quantities of thermal energy from coal**



### 5.3.2 Average prices of thermal energy from other fuels for final consumers

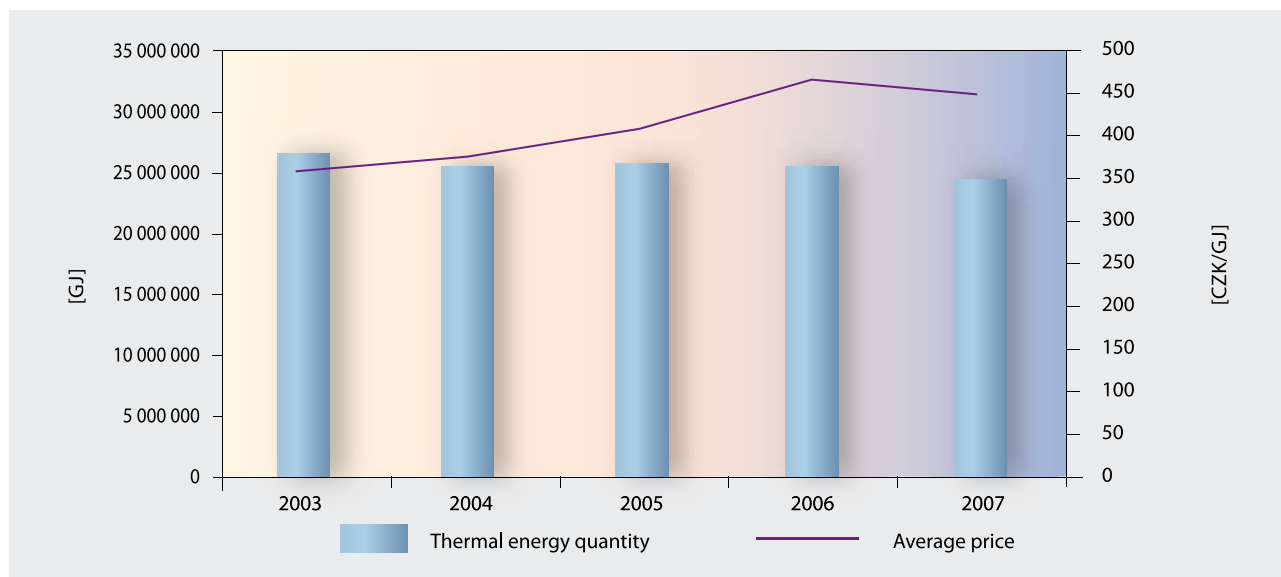
Natural gas and fuel oils predominate among the other fuels used for thermal energy generation; they are mostly used in small and medium-sized district heating systems. Average prices of thermal energy produced from other fuels display a more distinctive increase; between 2003 and 2006 the rise was about CZK 110/GJ in absolute terms. One of the factors contributing significantly to this trend was the rising natural gas price, which is the single most important item in thermal energy prices. However, 2007 saw a slight decrease in natural gas prices, which had a favourable effect for final consumers – the average expected thermal energy price decreased.

Despite the current trends of declining thermal energy consumption, the quantity of supply of thermal energy produced from other fuels is approximately constant in comparison with the quantity of thermal energy produced from coal in the years under review.

**Table 6 Average prices and quantities of thermal energy from other fuels**

Year	Average price [CZK/GJ]	Thermal energy quantity [GJ]
2003	351.92	26,314,068
2004	369.72	25,460,936
2005	402.36	25,367,674
2006	462.66	25,745,563
2007	454.47	24,639,424

**Chart 15 Average prices and quantities of thermal energy from other fuels**



### 5.3.3 Average thermal energy prices by regions

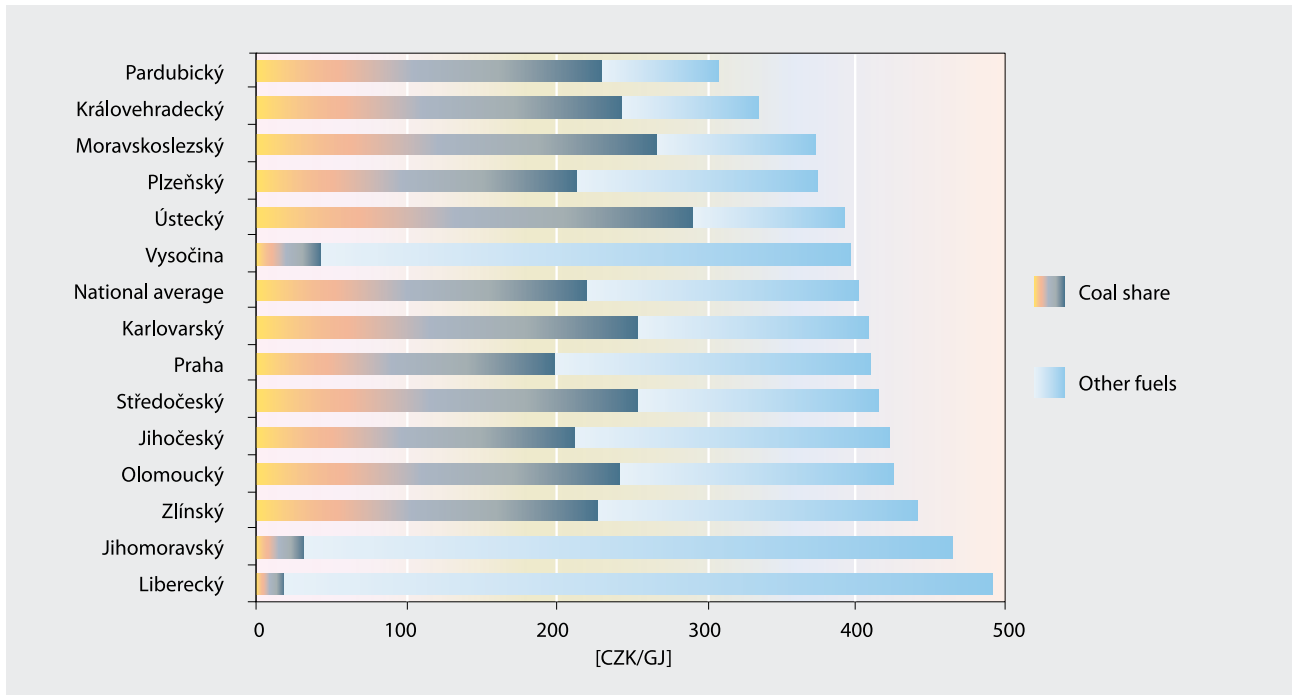
The survey of average thermal energy prices for final consumers is complete with a breakdown by regions, showing the shares of the fuels used in thermal energy production. The calculations are based in resulting prices of 2006 and preliminary prices on 1 January 2007.

Regions with extensive district heating systems and large combined heat and power generation capacities in which coal predominates as the fuel, have the lowest average thermal energy prices. On the other hand, regions with the largest proportion of district heating systems fired mostly by natural gas and fuel oils have the highest average thermal energy prices for final consumers. An exception is the Vysočina Region, where the other fuels predominate but owing to the large share of biomass it has a lower average price than the national average.

Table 7 Average thermal energy prices for final consumers by regions

Region	Average resulting thermal energy price	Share of coal	Share of other fuels	Average preliminary thermal energy price	Share of coal	Share of other fuels	Difference
	2006			1 January 2007			2007/2006
	CZK/GJ	%	%	CZK/GJ	%	%	CZK/GJ
Pardubický	309.32	74.74	25.26	307.95	74.84	25.16	-1.36
Královehradecský	335.10	75.10	24.90	335.50	73.00	27.00	0.40
Plzeňský	361.47	60.30	39.70	374.63	57.27	42.73	13.15
Moravskoslezský	365.62	70.91	29.09	373.11	71.90	28.10	7.49
Ústecký	389.51	76.52	23.48	392.49	74.50	25.50	2.98
Karlovarský	392.55	60.38	39.62	408.80	62.42	37.58	16.26
Praha	406.43	49.75	50.25	410.79	48.64	51.36	4.36
Jihočeský	409.45	52.85	47.15	422.66	50.37	49.63	13.21
Vysočina	411.94	11.44	88.56	397.29	10.98	89.02	-14.65
Středočeský	414.05	66.88	33.12	416.26	61.51	38.49	2.21
Olomoucký	419.78	53.26	46.74	424.69	57.31	42.69	4.91
Zlínský	436.66	50.64	49.36	442.13	51.58	48.42	5.47
Liberecký	494.25	4.34	95.66	491.87	3.90	96.10	-2.38
Jihomoravský	497.69	6.35	93.65	464.40	7.12	92.88	-33.29
<b>National average</b>	<b>399.61</b>	<b>56.04</b>	<b>43.96</b>	<b>401.88</b>	<b>55.19</b>	<b>44.81</b>	<b>2.27</b>

Chart 16 Average thermal energy prices for final consumers by regions, 1 January 2007



# 6

Licensing policy



## 6 Licensing policy

### 6.1 Awarding, changing and revoking licences

In 2007 the licensing department's work focused on awarding licences for electricity generation from renewable energy resources in lower-capacity installations, particularly photovoltaic, in response to the requirements of the operators of newly developed generating capacities, and also on businesses' requests for changes to their licences, motivated by organisational changes and transfers of assets. The number of electricity and gas trading licence holders continues to rise slightly.

The numbers of licences for distribution in the electricity and gas industries have stabilised. In the heat supply industry, transition to thermal energy supply from companies' own capacities can be seen.

**Table 8 Numbers of valid licences from 2001 to 2007 by object of business**

Licence	2001	2002	2003	2004	2005	2006	2007
Electricity generation	572	1,258	1,302	1,353	1,407	1,467	1,702
Electricity distribution	147	395	380	348	321	282	281
Electricity trade	55	87	106	146	274	285	293
Gas production	3	8	12	12	14	13	13
Gas distribution	73	134	136	135	124	103	99
Gas trade	12	15	17	31	69	83	85
Gas storage	3	4	4	4	4	4	4
Thermal energy generation	204	678	688	693	689	674	672
Thermal energy distribution	215	725	753	747	737	721	719
<b>Total</b>	<b>1,284</b>	<b>3,304</b>	<b>3,398</b>	<b>3,469</b>	<b>3,639</b>	<b>3,632</b>	<b>3,868</b>

**Table 9 Number of licensing proceedings from 2002 to 2007**

Licence proceedings	2002	2003	2004	2005	2006	2007
New licences	1,619	376	312	372	413	540
Licence changes	334	485	493	495	542	504
Revoked licences	161	137	194	228	229	174

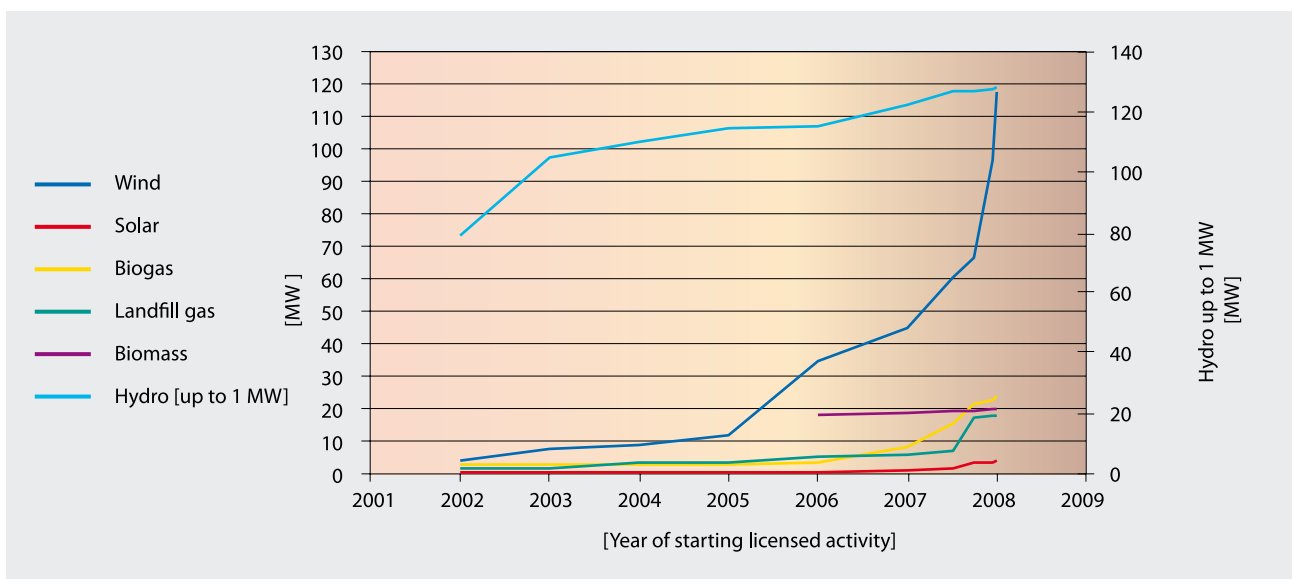
In respect of licensing, 2007 saw an increase in the number of licences for electricity generation, in particular from solar energy. These were almost exclusively licences for 2 to 5 kW installations. There was a moderate increase in the number of licences for electricity generation in wind power plants and from biogas used in combined heat and power generation, as illustrated in Charts 17 and 18 and Table 10. This rise was mainly attributable to the subsidy policy of the Ministry of the Environment (the national programme for support of energy savings and use of renewable energy resources for 2007), support for generation from renewable resources, where the scheme guarantees a stable level of support for a relatively long time, and also the low administrative burden on setting up these plants and obtaining licences for lower-capacity installations (photovoltaic). Biogas plants are developing; they feature good economics of the use of biological waste from animal production, particularly from new farming (animal keeping) operations.



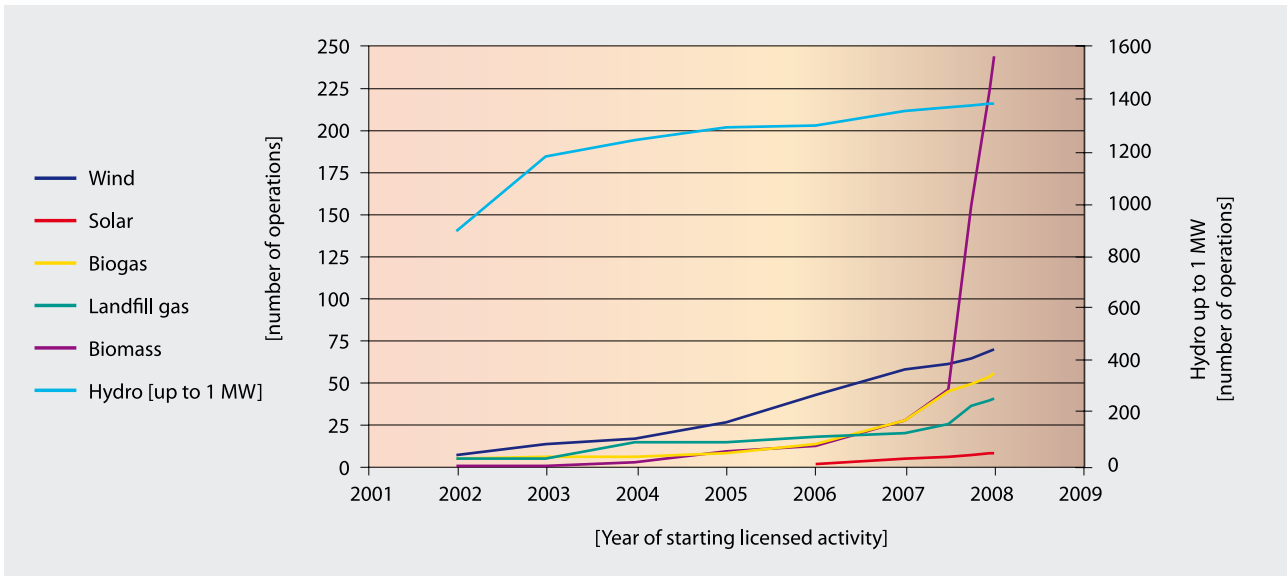
**Table 10** Number of electricity generating operations and installed capacities, 2001 to 2007, by type of renewable energy resource

Operations		2001	2002	2003	2004	2005	2006	2007
Hydro	Number [up to 1 MW]	878	1154	1214	1262	1271	1320	1351
	Capacity [up to 1 MW]	79.03	105.17	110.49	114.80	115.21	122.44	128.18
Wind	Number	7	14	17	26	42	57	69
	Capacity [MW]	3.39	6.97	8.19	11.49	34.41	44.50	117.52
Solar	Number	1	1	3	10	13	27	238
	Capacity [MW]	0.01	0.01	0.02	0.12	0.15	0.35	3.40
Biogas	Number	5	6	6	8	14	27	55
	Capacity [MW]	2.12	2.27	2.27	2.34	2.74	7.90	23.72
Landfill gas	Number	5	5	15	15	18	20	40
	Capacity [MW]	1.27	1.27	3.30	3.30	4.87	5.45	17.49
Biomass	Number					2	5	8
	Capacity [MW]					18.09	18.58	19.68

**Chart 17** Installed capacity based on renewable resources



**Chart 18** Number of operations based on renewable resources



Information about 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 posted on the Office's website; it is a list of licence holders structured by the licence groups. There is also a web application that helps to search for details about a particular licence holder. Subject to the electricity and gas traders' consent, their contact details are published to facilitate the search for potential electricity and gas suppliers.

### 6.1.1 Proceedings on administrative fees

In connection with licence award, change or revocation, 28 proceedings were conducted in respect of the refund of the administrative fee; in three administrative proceedings the applicant was requested to pay the administrative fee.

## 6.2 Recognition of professional qualifications

In 2007 the Office decided in 15 administrative proceedings on the recognition of professional qualifications, with favourable results. No compensation measures within the meaning of Act No. 18/2004, on the recognition of professional qualifications, were required. More complicated cases were consulted with the national coordinator, Ministry of Education, Youth and Sports of the Czech Republic. The Office is involved in the project for an information system of the internal market for effective administrative co-operation and mutual communication between the EU member states' recognition authorities.





Administrative proceedings



# 7 Administrative proceedings

## 7.1 Administrative proceedings completed in 2007

### Electricity industry

**Energetika Vítkovice, a.s. and VÍTKOVICE, a.s.:** A dispute over the execution of an electricity distribution agreement, caused by VÍTKOVICE's requirement for the integration of different customers' supply points (the customers are part of the VÍTKOVICE holding) into a single point with reference to a connection agreement executed between the parties in early 2004. The parties subsequently executed the electricity distribution agreement, and Energetika Vítkovice retracted its petition for the administrative proceedings and requested the discontinuation of this proceeding, with the other party agreeing to this, and the Office therefore discontinued the proceeding.

**C.B.C. – Czech Build Company, a.s. and ČEZ Distribuce, a.s.:** A dispute over a change to a connection agreement, in the part on the payment of a share of justifiable connection costs. In 2004 the parties executed an agreement on the payment of a share of the justifiable costs incurred in connecting a new supply point and in providing reserved capacity under ERO public notice no. 297/2001, which lays down the conditions for connecting protected customers and supplying them with electricity. Due to delays and postponement of the date of approval for commissioning, C.B.C. – Czech Build Company requested ČEZ Distribuce to return a part of the share paid, referring to Section 17, second sentence, of public notice no. 51/2006 on conditions of connection to the electricity grid, which repealed no. 297/2001. The Office discontinued the proceeding, noting that the respective transitory provision of no. 51/2006 clearly sets forth that the DSO must reconsider the opinion in question prior to executing the connection agreement. Since the agreement was already in place and in accordance with the legislation applicable at the time of executing the agreement, the Office was not in the position to determine a different share for the applicant of the costs incurred in connection and in supplying the power required. In the ERO Chairman's decision on remonstrance, the decision delivered in the first instance was upheld and the remonstrance rejected.

**ČEPS, a.s. and PROVENTI a.s.:** A dispute over the execution of an agreement on the connection of wind power plants. According to ČEPS, on account of the disputes between Czech Venti a.s. and PROVENTI a.s., which were the object of lawsuits, the court's potential ruling that the general meetings were invalid (and that therefore the legal acts carried out by the new Board of Directors of Czech Venti were invalid) might result in a situation where the connection agreement would already be executed with a different entity, and in turn a risk to the foreign investor's investment and also a risk that ČEPS would not recoup its costs. The Office decided as follows: it rejected ČEPS's petition for the imposition on ČEPS to refrain from executing the agreement on the connection of the wind power plants in the Větrný park Chomutov project on the basis of PROVENTI's application for connection, pending the final decision to be delivered by the Regional Court in Ústí nad Labem.

In 2007 three administrative proceedings were completed in the **electricity industry section**. These included a dispute over the execution of an electricity distribution agreement due to the integration of several different customers' supply points into a single point, a dispute over a change to a connection agreement in the part on the payment of a share of justifiable connection costs, and a dispute over the execution of an agreement on the connection of wind power plants. Two of the above administrative proceedings were closed by a decision at first instance – one endorsed reconciliation and the other rejected the petition. In the third case the administrative proceeding was closed by the ERO Chairman's decision on remonstrance, upholding the first instance decision, whereby the proceeding was discontinued.

Similarly as in previous years it can be noted that the situation surrounding disputes in the electricity industry has stabilised – only a small number of disputes have emerged over a long time, and they do not share any characteristic feature. This 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 are conducted towards the introduction of clear-cut and unchallenged rules, which ultimately predetermine these market players' behaviour that does not result in disputes adjudicated by the Office.

### Gas industry

**Moravské naftové doly, a.s. and JMP Net, s.r.o.:** A dispute over the execution of a natural gas distribution agreement due to disagreement with the requirement of demonstrating good financial standing. According to its own statement, Moravské naftové doly refused to accept the condition demanded by JMP Net, on the basis of which it would have had to prove its good financial standing to JMP Net in a way that would have incurred additional expenses to Moravské naftové doly. On the basis of further talks, the parties signed the gas distribution agreement and the proceeding was discontinued.

**Jihočeská plynárenská, a.s. and RWE Transgas, a.s.:** Disagreement on a substantive provision of a natural gas purchase and sale agreement – on the pricing of gas supply from 1 April 2007. Subsequently, an agreement was concluded on the price of the gas taken by Jihočeská plynárenská under the gas purchase and sale agreement. Jihočeská plynárenská retracted its petition for the administrative proceeding, and the other party agreed. The Office discontinued the proceeding.

**Pražská plynárenská, a.s. and RWE Transgas, a.s.:** Disagreement on a substantive provision of a natural gas purchase and sale agreement – on the pricing of gas supply from 1 April 2007. Subsequently, an agreement was concluded on the price of the gas taken by Pražská plynárenská under the gas purchase and sale agreement. Pražská plynárenská retracted its petition for the administrative proceeding, and the other party agreed. The Office discontinued the proceeding.

In 2007 three administrative proceedings were completed in **the gas industry**. This implies a considerable drop in the number of disputes in comparison with previous years. On the other hand, unlike in the past these were disputes between the largest gas market players (also with regard to the still pending administrative proceeding commenced in 2007 on access to underground gas storage facilities). For this reason, we can reiterate the assessment from the previous year, i.e., that the gas industry can now be viewed as the most problematic in terms of disputes, and risky for the proper functioning of the market.

The completed administrative proceedings concerned, in two cases, failure to sign an addendum to an agreement on bundled gas supply services, concerning the gas price, and in one case a dispute over the execution of a natural gas distribution agreement due to disagreement with the requirement of demonstrating good financial standing. In all three cases the agreements were signed on the basis of talks between the parties. In two cases the petition for the administrative proceeding was retracted and the proceeding was discontinued. In one case conciliation was endorsed.

### Heat supply industry

**Pražská teplárenská a.s. and U Labutě, Černého 511-516, bytové družstvo [a housing co-operative]:** A dispute over failure to sign addenda to thermal energy supply agreements. Between the parties thermal energy supply agreements are in place, which do not fully meet the current requirements of the Energy Act or the actual supply parameters. Since the customer has no obligation to contract, such an obligation cannot be imposed on it by the Office's decision and the Office therefore rejected Pražská teplárenská's petition for obliging the U Labutě housing co-operative to sign an addendum to a thermal energy supply agreement.

**OLTERM & TD Olomouc, a.s. and Společenství vlastníků jednotek domu č.p. 479 ulice Na Orátě, Hlubočky [a condominium]:** A dispute over failure to execute a thermal energy supply agreement. A decision was taken on the wording of the contentious points of the agreement. The ERO Chairman's decision on remonstrance upheld the first instance decision and rejected the remonstrance.

**DEZA, a.s. and CZT Valašské Meziříčí s.r.o.:** A dispute over the price of thermal energy supplies from 1 January 2007. The parties had executed an agreement on heat purchase until 31 December 2015. The agreement contains a provision on deriving the price of the heat, under which the heat price is to be agreed every year in a price agreement. The purchase agreement also sets forth a formula for deriving the heat price, which, together with the other terms and conditions, limits annual increases in heat price. Due to the other costs increasing, the thermal energy price has become considerably loss-making for the supplier. The Office noted that the current level of the thermal energy price was not contrary to the Office's price decisions. The parties executed a thermal energy supply agreement that was not at variance with legal regulations, and therefore the dispute was not such on which the Office was competent to decide, and it therefore discontinued the proceeding. The ERO Chairman's decision on remonstrance upheld the first instance decision and rejected the remonstrance.

**Talorm a.s. and Spoluvlastníci podílů v domě ČSA 652/8 Zábřeh [co-owners of a house]:** A dispute over the execution of a thermal energy supply agreement. On the basis of talks at the Office, the parties agreed on the wording of the agreement, retracted the petition, and the proceeding was discontinued.

In 2007 four administrative proceedings were completed in the **heat supply** section. Two cases mainly concerned the wording of several contentious provisions of agreements. One dispute was over changes to thermal energy supply agreements executed earlier, and one case involved a dispute over a change of the then existing formula for deriving the price of heat. In 2007, of these administrative proceedings two were closed by a decision at first instance, with one case involving retraction of the petition and discontinuation of the proceeding and the other rejection of the petition (this first instance decision was issued under the ERO Chairman's decision on remonstrance, whereby the case was remanded to the authority of first instance for new consideration and decision). In two cases the proceedings were closed by the ERO Chairman's decision on remonstrance, which upheld the first instance decision and rejected the remonstrance.

It can therefore be noted that in comparison with 2006, when five administrative proceedings were completed, in 2007 the agenda was approximately as extensive. It is to be highlighted that clearly, thanks to the Office's activities, in particular its price decisions (the unchanging nature of the principles of its price decisions), disputes over the structure of thermal energy prices, which predominated a few years ago, have disappeared completely; the same applies to the level of thermal energy prices – there were two such proceedings on pricing in 2005 and only one in 2006. All disputes stemmed from disagreement on the wording of contracts (and/or addenda) for thermal energy supply.

### Licences

In 2007 decisions were taken to revoke the electricity distribution licence of ThermoGas TRADING, s.r.o. in connection with the imposition of the obligation to provide energy installations and to impose the obligation to provide distribution on the premises of the former sugar mill in Břeclav over and beyond its licence on E.ON Distribuce, a.s. There was no interruption in distribution and electricity supply.

## 7.2 Administrative proceedings in which the ERO Chairman delivered decisions on remonstrances in 2007

Under Act No. 500/2004, Rules of Administrative Procedure as amended, remonstrances, as a remedy against the ERO's first instance decisions, fall within the competencies of the ERO Chairman, who decides on them upon proposals submitted to him by the remonstrance commission appointed by him.

In 2007 the ERO Chairman decided on remonstrances filed by parties to the proceedings in five cases. It is also to be noted that another seven remonstrance proceedings were commenced in 2007, which were still pending at the end of 2007.

### Electricity industry

#### **C.B.C. - Czech Build Company, a.s. v. ČEZ Distribuce, a.s.**

In its resolution the Office discontinued an administrative proceeding for a change to an agreement on connection to the distribution system, commenced upon a petition filed by C.B.C. – Czech Build Company on the grounds of a change in the amount of the share of the justifiable connection costs. The petitioner filed a remonstrance against the Office's resolution. Following deliberations in the remonstrance commission and upon its proposal, the ERO Chairman rejected the remonstrance and upheld the impugned resolution that had discontinued the proceeding.

### Heat supply industry

#### **OLTERM & TD Olomouc, a.s. and Společenství vlastníků jednotek v domě č.p. 479, Na Orátě 479, Hlubočky [a condominium]**

In the case of the dispute over failure to execute a thermal energy supply agreement between the petitioner, OLTERM & TD Olomouc, and respondent, the Společenství vlastníků jednotek v domě č.p. 479, Na Orátě 479, Hlubočky condominium, the Office decided that the petitioner had the right to present the respondent with a thermal energy supply agreement in the wording as presented. Following deliberations in the remonstrance commission and upon its proposal, the ERO Chairman rejected the remonstrance and upheld the impugned decision.

#### **Pražská teplárenská, a.s. and U labutě, Černého 511-516, bytové družstvo [housing co-operative]**

In the case of the dispute over the execution of a thermal energy supply agreement, or rather the execution of a new thermal energy supply agreement, between the petitioner, Pražská teplárenská, and the respondent, the Bytové družstvo U labutě housing co-operative, the Office decided that the petitioner had the right to request the respondent to execute a thermal energy supply agreement with content as set out. The petitioner filed a remonstrance against the Office's decision. In his decision on the remonstrance the ERO Chairman, following deliberations in the remonstrance commission and upon its proposal, quashed the impugned decision and remanded the case to the first instance for new consideration and decision.

#### **DEZA, a.s. and CZT Valašské Meziříčí s.r.o.**

The Office decided to discontinue the administrative proceeding on the dispute over a change to a thermal energy supply agreement between the petitioner, DEZA, and the respondent, CZT Valašské Meziříčí, on the grounds on the manifest legal inadmissibility of the petition for proceedings to be initiated. The petitioner filed a remonstrance against the decision that discontinued the proceeding. Following deliberations in the remonstrance commission and upon its proposal, the ERO Chairman rejected the remonstrance and upheld the impugned decision.

### Licensing procedure

#### **IMOLA s.r.o.**

The Brno Regional Court's decision quashed the ERO Chairman's decision of 20 October 2007, which had rejected the party's remonstrance against a first instance decision in the case of the revocation of a licence, and the matter was remanded to the ERO Chairman for further proceedings. Because of the grounds on which the decision was quashed the ERO Chairman decided to reverse the first instance decision and to remand the case for new consideration and decision.

#### **Mr Petr Ptáček**

In proceedings for a change of the decision on the award of a gas distribution licence to OKD, DPB, a.s., commenced upon a petition filed by the licence holder, Mr Petr Ptáček claimed to be a party to this administrative proceeding. In its resolution the Office decided that Mr Petr Ptáček was not a party to this proceeding, because a decision taken in this case could not prejudice his rights or obligations. Mr Petr Ptáček filed a remonstrance against the Office's resolution. Following deliberations in the remonstrance commission and upon its proposal, the ERO Chairman rejected the remonstrance and upheld the impugned decision. An administrative action has been brought in the case; it was still pending at the end of 2007.



### 7.3 Remonstrance proceedings commenced in 2007 and pending

In late 2007 proceedings on remonstrances against the Office's decisions were commenced in the following cases:

- 1) A dispute over the allocation of storage capacity between Pražská plynárenská, a.s., as the petitioner, and RWE Gas Storage, s.r.o., as the respondent;
- 2) A dispute over the allocation of storage capacity between E.ON Energie, a.s., as the petitioner, and RWE Gas Storage, s.r.o., as the respondent;
- 3) A dispute over connection to the distribution system between FitCraft Production a.s., as the petitioner, and ČEZ Distribuce, a.s., as the respondent;
- 4) Decision to revoke an electricity distribution licence of IMOLA s.r.o.;
- 5) A dispute over the execution of a thermal energy supply agreement between TEPLO T s.r.o., as the petitioner, and Společenství vlastníků jednotek pro dům čp. 1840 na ulici K Čimperku, Tišnov, as the respondent;
- 6) A dispute over the execution of a thermal energy supply agreement between TEPLO T s.r.o., as the petitioner, and Společenství vlastníků jednotek pro dům čp. 1841 na ulici K Čimperku, Tišnov, as the respondent;
- 7) A dispute over the execution of a thermal energy supply agreement between TEPLO T s.r.o., as the petitioner, and Společenství vlastníků jednotek pro dům čp. 1842 na ulici K Čimperku, Tišnov, as the respondent.





# 8 External relations

## 8.1 Co-operation with central state administration authorities

In accordance with the Energy Act and other general and special laws and regulations the Office cooperates primarily with the Ministry of Industry and Trade (MPO), Ministry of Foreign Affairs (MZV), Ministry of the Environment (MŽP), Office for the Protection of Competition (ÚOHS), State's Energy Inspectorate (SEI), and other administrative authorities in the energy sector.

This co-operation mainly focuses on drafting and applying laws and implementing regulations in the areas of regulation and competition and on creating an effective framework for the functioning of energy markets. As the central institution for the processing of operating and technical data on the electricity industry, the Office coordinates data processing for the electricity industry across state administration.

In co-operation with the Czech Statistical Office (ČSÚ) the Office offers and provides applicants for a licence, natural persons, who have not yet been issued with an identification number, with assistance with the related agenda.

In processing the information received from licensed electricity generators the Office closely cooperates with MPO.

In respect of recognition of professional qualifications the Office, as the recognition authority, works with the Ministry of Education, Youth and Sports, which plays the role of the national coordinator and with MPO under the IMI project.

In 2007 the Office worked with MPO's legal and energy experts on an assessment of the experience with the application of the Energy Act as the basic framework creating the environment for energy market participants' operations. Analysis of shared experience is the basis for drafting amendments to implementing regulations promulgated by the two authorities and also for drafting an amendment to the Energy Act.

In its activities, the Office proceeds from the framework established by the Czech Republic's National Energy Concept. The ERO Chairman informs the Minister of Industry and Trade about the Office's principal conceptual plans for the drafting of its price and other decisions that might have social and macroeconomic impacts. The Office submits information about important price decisions to the Czech Government.

The co-operation between the Office and SEI intensified; this co-operation stems from the legislative framework as well as the needs of the regulatory process. The Office and SEI communicated in respect of specific review actions and the preparation of documentation for administrative proceedings.

At the beginning of 2007 review actions in the various cases addressed by the Office and a system of drawing conclusions from administrative proceedings were specified in more detail. In nine cases the Office referred the complaints to SEI. In two cases SEI requested an expert opinion on complaints in line with ERO Measure No. 3/2006 Guidelines on Complaint Handling.

For the Council for Economic and Social Consensus ("the tripartite council") the Office prepared, at the beginning of 2007, a detailed report containing forecasts of prices in the electricity, gas and heat supply industries. With the Ministry of Foreign Affairs the Office continued in the preparation of the briefs to be used for the Czech Republic's positions on various documents of European institutions.

## 8.2 Co-operation with Czech Parliament

The Office has the obligation to inform the Chamber of Deputies of Czech Parliament about its activities by way of the *Report on the Activities and Finances of the Energy Regulatory Office* [an annual report]. Throughout the year the Office maintained continuous contacts with committees of the Chamber of Deputies, especially the Economic Committee, the Committee for Public Administration and Regional Development, and the Committee for the Environment, and, as the Czech presidency of the EU approaches, also the European Affairs Committee, the Foreign Committee, and the Security Committee.

The Office works with Senate committees: the Committee for Economy, Agriculture and Transport and the Committee for Regional Development, Public Administration and the Environment, and the EU Affairs Committee. In the committees of both chambers the Office's representatives regularly attended debates and technical seminars on the energy sector and renewable resources and energy security.

## 8.3 Public relations

### 8.3.1 Charter of the Electricity Consumer – The Year of the Consumer

The year 2007 was the first year when the electricity and natural gas markets were fully open for all customer categories. This means that every consumer in the European Union, and therefore also in the Czech Republic, has, effective from no later than 1 July 2007, the right to buy electricity and gas from any supplier in the EU countries. These new circumstances brought a number of tasks for the Office, related to extending the information activities targeted at the general public and the media. The Office communicates through its External and Internal Relations Unit, which keeps in touch, on an everyday basis, with news agencies, editorial offices, institutions and various organisations, and also with the public, and provides the required information in co-operation with the Office's technical departments.

The European Commission also deals with the issues related to the liberalisation of electricity and gas markets; following approval by the Council of Europe, in the spring of 2007 the European Commission declared in this connection, as part of its two-year energy action plan, the European Charter on the Rights of Energy Consumers that specifies consumers' rights in the single market.

In June 2007 the European Commission launched a public awareness campaign on the complete opening of the energy markets, targeted primarily at households, emphasising the protection of consumers' rights and promoting the shared "energy bond" in the EU countries, with a view to informing broad groups of consumers about the changes that becoming eligible customers would mean for them. The campaign, called The Year of the Consumer, was based on a multimedia concept; as part of the Office's work it involved, among other things, distribution of the posters that the European Commission (DG TREN) had, following consultation with the regulator, produced in the Czech version and with the ERO's logo. The posters contained a list of energy consumers' basic rights. The posters were placed in public areas, in particular in distribution companies' customer centres, consumer associations, and the Office's two buildings.

Simultaneously, and independently of the Commission's campaign, the Office took steps designed to provide the general public with comprehensive and intelligible information about what the liberalisation of energy markets would actually mean for final customers. One-page information adverts were carried in national and regional press to inform households about their right to change their supplier. The Office produced an information flier on the impact of energy market liberalisation on final customers, which provided detailed information to the public about, for example, the structure of electricity and gas prices, the Office's activities, the opportunity to change electricity and gas suppliers, the steps to be taken in supplier switching, and the main objectives of liberalisation. The fliers were placed in distribution companies' customer centres, consumer associations, and the Office's two buildings and they were also provided to the media through which they reached their audiences.

The Office devoted adequate attention to this issue on its website, where it created a special link, The Year of the Consumer. It placed on its website a ready reckoner helping to quantify the cost savings that customers can achieve by switching their energy supplier.

The Office's staff paid appropriate attention to the campaign and the issues of energy market opening when they appeared at energy forums.

As part of co-operation with Sdružení obrany spotřebitelů [SOS; Consumers Defence Association] a technical seminar was organised at the Office on its activities related to the Association's operations; its practical effects include, for example, ERO experts' participation in three on-line chats (covering the electricity, gas and heat supply industries) on the Association's website, where ERO experts answered consumers' specific questions.

### 8.3.2 Information provision

In compliance with Act No. 106/1999 on free access to information, as amended, the Office provides information on its activities and opportunities for problem resolution within its competencies. In 2007 requests for information were received from 33 citizens and organisations.

#### Number of received and handled requests for information in 2007

Area	Number of requests
Licences	1
Regulation	31
Other	1
Total	33

The subject of requests for information, which contained all the details required by the above law, mainly concerned the Office's activity in regulation and its price decisions. All requests for information were answered within the statutory time limit and were provided free of charge, similarly as in previous years.

In 2007 the Office's relevant technical departments also handled several hundred additional (technical) questions as part of their everyday correspondence.

Under an internal regulation, Chairman's Measure No. 3/2006 Guidelines on Complaint Handling, the Office addresses both the complaints that are filed under Act No. 500/2004, Rules of Administrative Procedure, and those filed against a third party.

Between 1 January and 31 December 2007 the Office received 99 complaints. In comparison with 2006, their number dropped by 49 per cent.

Of the total number of complaints, 14 were accepted under Section 175 of Act No. 500/2004, Rules of Administrative Procedure, while 85 complaints were directed at a third party by the complainants. Of this number, 71 complaints were viewed as unjustifiable and 19 as justifiable; in these cases the Office adopted the measures required for remedying the situation. In co-operation with the State's Energy Inspectorate, the Office resolved nine complaints. In three cases complaints were received and addressed repeatedly. No complaint accepted in 2007 was anonymous.

The Office presented its status and activities through press conferences, interviews and articles in the media and notices in the press and on its website. In 2007 it organised two press conferences at which its senior officers provided information about the Office's most

important decisions, in particular as regards prices and regulation. The press conference held in November 2007 on the Office's price decisions for 2008 was the first to be broadcast live on the nationwide ČT 24 channel.

The Office continuously communicated with all media in response to their requests. Its specialists published a number of articles in the trade press; they contributed to the content and focus of trade press by their participation in editorial boards. During the year, the ERO Chairman and other senior officers appeared on all television stations and participated in technical discussions on Czech Radio and other radio stations, both national and regional, and spoke at technical conferences held by respected economic periodicals. The Office pursued systematic co-operation with the Czech Press Agency and other news agencies, and on-line news servers.

The new circumstances emerging from the opening of energy markets were reflected in the updated content of the information panels installed in the lobby of the Office's building [ERO's registered office] in Jihlava, which provide basic information about the Office.

The Office's website at [www.ero.cz](http://www.ero.cz) was improved in 2007, primarily with a view to offering quicker and easier access to the users. The various links were expanded to include new information: in particular, sections such as FAQ, information about energy supplier switching, and a new link to the European Commission's campaign on the Year of the Consumer. There were also some changes in the link on reporting – an application designed for downloading by reporting entities was placed on the website. The application makes it easier to upload the reports furnished by the reporting entities to the central database in MS Dynamics Axapta 4.0 in a standardised format.

### 8.3.3 Publications

The Office produced its publications under the Energy Act. It publishes the *Energy Regulation Gazette*, which appeared with a circulation of 900 in 2007 (there were 793 subscriptions). SEVT, a.s. is responsible for the administration of the *Gazette*. In 2007 eleven issues of the *Gazette* were published, the same number as in 2006; four of them carried a list of holders of licences awarded for business in the energy industries, broken down to licences awarded, revoked and discharged, always at the end of a quarter. Twelve price decisions were published: five on electricity prices, three on natural gas prices, and four on thermal energy prices. The *Gazette* also carried two notices of the approval of the rules for the operation of energy grids, a notice on the assessment of the share of electricity produced from renewable resources in gross electricity consumption, and the expected impacts of support for electricity generation from renewable resources on the overall price to final customers, a report on the management of the Energy Regulation Fund for 2006, a notice on the average price of emission allowances and a report on the level achieved in maintaining the standards of electricity transmission and distribution for 2006 (The Quality Report).

On the basis of its duty under Act No. 230/2006 of 29 May 2006, amending Act No. 526/1990 on prices, the Office publishes in the Collection of Laws communications on its price decisions that have been published in the *Energy Regulation Gazette*.

The Office also publishes annual and monthly reports on the operation of the Czech electricity grid. All businesses active in the electricity industry furnish the Office, on a regular basis, with a set of operating and technical data, which forms the basis for preparing these reports. These businesses include electricity generators, distributors and traders, the TSO and the market operator. There are altogether 1,523 electricity generators having an aggregate installed capacity of less than 0.5 MWe, 202 electricity generators having an aggregate installed capacity of 0.5 MWe and more, 364 electricity distributors, 313 electricity traders, and the electricity transmission licence holder and the company licensed as the electricity market operator.

The monthly reports on operation are prepared at the end of the month following the end of the period under review and are published on the Office's website. Abridged reports are provided to energy magazines and other media.

Once a year the Office produces an *Annual Report on the Operation of the Czech National Electricity Grid*, which appears in Czech, while an executive summary of the report is also published in English (both hardcopy and electronic versions).

The above are very detailed publications. Nobody produced such reports, with a similar structure, before 2001 when the Office was established.

In 2007 ten years passed from the introduction of regulation in the energy sector. On this occasion the Office produced a publication, *Ten Years of Regulation in the Electricity Industry*, authored by Petr Kacvinský, Otakar Pártl, Martina Veselá and Jiří Janša. The publication offers a basic survey of the Czech experience with regulation and other systemic changes in the electricity industry that were first applied under the new Energy Act, i.e. Act No. 222/1994, and that continued via the establishment of an independent energy regulatory authority to result in a fully liberalised market and the Czech Republic's full integration within the EU's structures. The publication is intended for all who want to become acquainted with the theory and practice of regulation in this sector and/or work in this sector on a professional basis.

Both as hard copy and on CD-ROM, in both Czech and English, *The 2006 Report on the Activities and Finances of the Energy Regulatory Office* was produced. The Office submits this annual report to the Czech Government and the Chamber of Deputies of Czech Parliament every year in accordance with the Energy Act.

## 8.4 The Chairman's Advisory Corps

As in previous years, in 2007 the ERO Chairman's Advisory Corps included experts delegated by governmental authorities, consumer and business associations, and trade unions; on the basis of their own expert opinions and assessments they contributed to the Office's positions, in particular as regards the strategic issues of regulation and in an effort to defend the Czech Republic's interests in relation to the EU.

In 2007 the Advisory Corps held four meetings.

At the January meeting they discussed the ERO's brief for a Council for Economic and Social Consensus meeting on the development of energy prices and the factors causing electricity price hikes for 2007; electricity trading on the energy exchange; conditions and incentives for investors in the development of new capacities; the functioning of the market after liberalisation; options for ownership unbundling; and the functioning of 'mini-regions'. They took due note of information about on-line metering in the Czech Republic and the experience with the introduction of such systems in the EU countries, including the European regulators group's opinion on this project, and endorsed the Office's actions in this area.

At the June meeting they expressed support for the Office's actions taken to protect final customers, particularly in the area of price inspections and inputs to pricing. The Advisory Corps took due note of information about the administrative proceedings commenced on the grounds of failure to provide access to underground gas storage facilities. They discussed the development of electricity prices from the perspective of increased consumption, loss of capacities, prices of emission allowances, and the imposition of environmental taxes; the Office's initiative conducive to a methodology for providing coordinated support for electricity generation from renewable energy resources; development of European legislation; and the issue of cross-border transmission. They expressed their support for the Office's activities and steps.

At the September meeting the Advisory Corps took due note of information about factors influencing regulated electricity prices and about the drafting of price decisions and an amendment to public notice no. 475/2005, implementing certain provisions of the law on support for the use of renewable resources (the amendment was promulgated under no. 364 in the Collection of Laws, Part 112, of 28 December 2007), and about changes in the calculation of gas distribution and transmission charges. They expressed their affirmative view of the Office's steps in the preparations for setting support for electricity generation from renewable energy resources for 2008 and the procedure for distribution pricing, supported the Office's actions in respect of customer protection in connection with the drafting of the European Charter on the Rights of Energy Consumers and The Year of the Consumer campaign, including the Office's co-operation with the Consumers Defence Association, and expressed their approval of the comments on the setting of special rates that did not match the rules for an open energy market and that introduced cross subsidies between groups of customers. The Advisory Corps also took due note of information about the Prague Energy Exchange and the Office's analysis of the impacts of the tax reform.

In November the Advisory Corps took due note of the procedure that the Office followed in drafting its price decisions; expressed support for the Office's position to defend the Czech Republic's interests and continue to reflect a part of the proceeds from cross-border auctions in the electricity transmission charge, thereby slowing the rise in the electricity transmission charge for final customers; and expressed their consenting position on the Office's procedure in addressing and calculating the amount of support for electricity generation from renewable energy resources for 2008. They took due note of information about the development of European legislation, including the Office's role in the process of its drafting, and information about talks with Slovak and Bulgarian regulators and activities within the region. They also supported the Office's effort to defend and promote the Czech Republic's interests in relation to strong EU countries' interests and attitudes with a view to preventing any adverse impacts on the Czech Republic.

## 8.5 Activities related to membership of commissions

In 2007 the Office cooperated with the Ministry for Regional Development in connection with the drafting of the Czech Republic's Regional Development Policy, and regularly attended the meetings of the Consultation Committee for the drafting of the Czech Republic's Regional Development Policy.

As part of its participation in the Coordination Group on Government Policy Objective No. 07.01 (93), the Office helped to draft materials intended to reduce excessive regulation and bureaucratic burden.

Through its membership of the Panel for Regulatory Reform and Effective Public Administration, the Office is, in connection with the Government's resolution on the general principles of regulatory impact assessment (RIA), helping to assess the burden on energy utilities caused by demands arising from the requirements of specific fundamental legal norms and secondary legislation.

# 9

International activities





## 9 International activities

In 2007 the Office's staff members attended numerous meetings of the Council of European Energy Regulators (CEER) and the European Regulators Group for Electricity and Gas (ERGEG), whose activities focus on achieving a single and competitive European energy market. The Office is a full member of both organisations, and its permanent representatives in the various working groups were also very active in relation to other European organisations. The Office's staff members contributed to the debate on the proposals for the third energy package in the working group for energy (H7) of the European Council.

### 9.1 The Czech National Report

By 30 July 2007 the Office delivered *The Czech Republic's National Report on the Electricity and Gas Industries for 2006* to the European Commission. Already third, this national report describes the progress in the development of a competitive environment in the electricity and gas markets achieved by the Czech Republic since the previous national report. The Energy Regulatory Office took on the role of the coordinator in the Czech Republic; the Ministry of Industry and Trade and the Office for the Protection of Competition also contributed to the preparation of the national report. The national report outlines the key changes in the legislative environment and the major players' position in the domestic market, and also covers important events and issues in the energy market in the period under review.

### 9.2 CEER and ERGEG

The Office's representatives took an active part in the meetings of various working groups and task forces (electricity, gas, unbundling, customers, the third energy package), which addressed, among other things, issues related to the market's transparency and competitiveness, cross-border interconnections, customer protection, security of supplies, and sustainable development and which produced the basic papers for the development of European energy legislation.

In the electricity industry, these included, for example, the *Convergence and Coherence Report*, *Congestion Management Guidelines*, *Compliance Monitoring*, *Guidelines of Good Practice on Harmonizing Market Design Issues* and *The 4th CEER Benchmarking Report on Quality of Electricity Supply*.

In the gas industry, there was primarily co-operation in the development of the *Public Consultation Paper on Calculation of Available Capacities*, which addresses the issues of the available capacities calculated by every TSO on the basis of its own scenario, and also *Guidelines for Good Practice for Gas Balancing* (general recommendations for creating an opportunity for balancing energy trading between TSOs), which entered into force on 1 April 2007. Another paper was the *Monitoring Report on Transparency*, which addressed compliance with 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 in the various member states.

### 9.3 Regional initiatives in the electricity and gas markets

As part of the so-called regional initiatives on the electricity market, the objective of which is to eliminate the barriers that stand in the way of free trade at the regional level and to gradually create a single European electricity market, last year's efforts concentrated on the issue of a coordinated allocation of transmission capacities of cross-border lines (coordinated congestion management) and on the issue of transparency in Central and Eastern European markets. The Office's staff members attended the meetings of the Regional Coordination Committee and those of the implementation group for congestion management and transparency. In 2007 transmission capacities of cross-border lines were allocated on the principle of the so-called coordinated explicit auctions, for which the Czech TSO, ČEPS, a.s., performed the role of the auction office. There were also discussions on the introduction of the so-called flow-based method, the adoption of which the Office would only support subject to capacity increases throughout the region.

Last year the European Union launched regional gas initiatives with a view to increasing liquidity of national markets and providing for the entry of active traders into the market, thereby ensuring competition on the natural gas market. The Czech Republic was included in the South South East Regional Market (SSE), chaired by the Italian and Austrian regulators. The year saw meetings of the Regional Coordination Committee, attended by regulators, and those of the implementation group for congestion management and transparency, attended by regulators and TSOs. The deliberations emphasised the favourable progress achieved in TSOs' and traders' involvement in the studies being drawn up in the regions. Agreement was reached on the timetable of further work on these studies, most of which will be drawn up by TSOs and traders; regulators will prepare, in particular, a study on the entry/exit model and finalise a paper on investments in the region.

### 9.4 The Czech Republic's positions on EU institutions' activities

The Office closely cooperated with the Ministry of Industry and Trade, Ministry of Foreign Affairs and the Deputy Prime Minister's office for European affairs in the formulation of the Czech Republic's positions on the various aspects of the European Union's energy policy. This included drafting briefs for the Czech Republic's delegates to the meetings of the energy task force and preparing the mandate of the Minister of Industry and Trade for meetings of the Transport, Telecommunications and Energy Council, and involvement

in the preparation of policy papers in connection with the Czech EU presidency in the first half of 2009. These documents dealt primarily with the liberalisation of energy markets and the related strengthening of competition, and the harmonisation of regulatory authorities' powers in cross-border trading. As part of the drafting of the third energy package, the Office accepted national responsibility over deliberations on the proposed regulation of European Parliament and of the Council on the establishment of an Agency for Co-operation of Energy Regulators (ACER), a regulation on the conditions for access to networks for cross-border electricity exchanges and an amendment to the regulation on the conditions for access to gas transmission systems. It also became co-responsible over deliberations on the amendments to the respective Directives 2003/54/EC and 2003/55/EC, which fall within the MPO's remit.

In the first half of 2007 the Office also closely worked with the Ministry of Industry and Trade on preparing the answer to the European Commission's letter of formal notice concerning the initiation of infringement procedure under Article 226 of the EC Treaty. The particular provisions of Directives 2003/54/EC and 2003/55/EC, which, according to the European Commission, the Czech Republic had not correctly transposed, were mentioned in the Office's annual report for 2006 (Articles 15(2), 3(6), 3(9) and 9(e), and Articles 13(2), 19(3), 3(6) and 18(1) of Directives 2003/54/EC and 2003/55/EC, respectively).

## 9.5 Twinning with Ukraine

March 2007 saw the launch of a Phare Twinning-out Project, "Regulatory and Legal Capacity Strengthening of Energy Regulation in NERC" in Ukraine. The Energy Regulatory Office and E-Control, the Austrian regulator, have the roles of the junior partners, and AEEG, the Italian regulator, and the Italian ministry of finance and economy are the contracting partners in the position of the project leader; the latter is in charge of the administrative aspect of the project.

The project's objective is to strengthen the position of the Ukrainian energy regulatory authority, NERC, to assist with the drafting of primary and secondary legislation complying with the EU *acquis* and also to help implement a new wholesale electricity market model.

## 9.6 Trips to other countries

In 2007 the Office's staff members attended a number of international meetings, meetings with counterpart 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 organisations. The 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 resources, unbundling, and market functioning from the European and global perspective.

More than one half of business trips abroad were to Brussels, where the Office's delegates participated in the deliberations held by the CEER and ERGEG working groups and task forces and in the working group for energy (H7) of the Energy Council.

The Office's representatives also attended important international conferences abroad. For example, the 15th European Biomass Conference held in Berlin can be regarded as very beneficial; it concerned support for electricity generation from renewable resources in Europe and provided a forum for exchange of experiences and findings from the perspective of the updating of the technical and economic data on renewable resources.

Equally beneficial was the Competition and Market Power in Electricity and Gas workshop, an important event in the world of regulators; it provided an opportunity to hear about the current developments in the natural gas and electricity markets in both EU member states and other countries. The key topics of the programme included, for example, assessment of the level of energy market liberalisation based on the European Commission's sector inquiries and benchmarking report; obstacles to market functioning were identified.

The Office's new employees had an opportunity to broaden their knowledge and experience at a technical course organised by the Florence School of Regulation. The course was geared towards the basic economic, technical and legal principles of electricity and gas markets' functioning. These theoretical principles from various areas of energy regulation and licensing were often completed with the speakers' practical experience; some case studies were also presented. Further, information was provided about the energy markets in EU member states and the general approach to the single European market.

# 10

Human resource management



# 10 Human resource management

## 10.1 Personnel management agenda

In respect of personnel and organisation, the Office focused on the following tasks in 2007:

- **Personnel agenda** – Achieving the required number of qualified employees to provide for all of the Office's activities in all sections, in accordance with the organisational arrangements in place, providing for their further professional development and providing them with the required adequate working environment and facilities for their work.  
During the year mostly university graduates filled vacancies on the basis of competitions, in accordance with predefined qualification requirements;
- **Education** – Education was governed by two seminal documents adopted by the Office (the rules for training ERO employees, and the ERO plan of training and education). Both documents are based on Czech Government Resolution No. 1542/2005 of 30 November 2005 on the rules of administrative authority staff training.

## 10.2 Education and training

### Initial training

#### a) Introductory initial training

All employees took this course during the three-month trial period after joining the Office. Examination of their knowledge of the Office's internal regulations and the other regulations required for carrying out technical activities and their practical application is carried out by managers together with the evaluation of these employees' performance at the end of the trial period. This training also includes an introductory course in health and safety at work.

#### b) Continued initial training

The new employees study the structure of state administration and government finance, Czech law, basic legal regulations, including labour law, and, in particular, rules of administrative procedure, and also the code of conduct for civil servants. A basic course in environmental studies and EU affairs is also included in this training.

Altogether 17 employees attended initial training, seven of whom then attended follow-up training at the Public Administration Institute.

### Advanced training

#### a) Advanced management training

Its objective was to acquire and deepen certain knowledge and skills required in managerial positions. In 2007 it focused on issues related to corruption and the related adoption of the Code of Conduct for ERO Employees as an anti-corruption measure. All managerial personnel went through an expanded course in the EU agenda.

#### b) Language training

It was focused and organised to comply with Czech Government Resolution No. 1542/2005, by way of arranging standardised language examinations. The ERO Chairman has specified 56 official positions for which command of a selected western language is a prerequisite. However, for the seven employees who will actively prepare documents for the Czech EU presidency he has stipulated a higher level of language qualifications, or language training to acquire command of an additional foreign language, and set the dates for passing standardised language examinations in 2008. Language training is organised in line with the approved principles and the applicable internal regulation that provides for this area of training in detail.

**Table 12 Employees' command of languages**

	Number of selected positions subject to the qualification requirement of standardised language examinations, in the order of proficiency				Total number of requirements set for positions
	1st level	2nd level	3rd level	4th level	
<b>English</b>	22	22			44
<b>French</b>	2	1			3
<b>German</b>	5	1			6
<b>Total</b>	<b>29</b>	<b>24</b>			<b>53</b>

As at 31 December 2007 the qualification requirement of command of a foreign language was met by 91.3 per cent of the employees.

c) Other advanced training covered the following:

- Instruction and training as support for the implementation of the Office's information system and the related training in the document management service in the MS Dynamics AX information system;
- Ongoing training in the updating of legislation as a prerequisite for the employees' technical activities, and in IT user skills;
- Participation in technical seminars, workshops and conferences on the technical issues of energy regulation;
- A course on Act No. 500/2004, Rules of Administrative Procedure;
- Filing and archiving service in the MS Dynamics AX information system;
- A course on Act No. 262/2006, the Labour Code, and the related regulations, in particular as changed in an amendment to this law, which entered into force on 1 January 2008,
- Training of drivers of the Office's cars, and training in health and safety at work.

Altogether 107 training events were held, i.e., specialist courses, seminars and conferences. In the system of training, important positions were held by the technical training of employees as regards the effect of Act No. 500/2004, Rules of Administrative Procedure, and their training in the document management service in the MS Dynamics AX information system and the related preparations for adopting new filing and safe destruction rules, and, at the end of the year, a course on the new Labour Code and related regulations that entered into force on 1 January 2008. A total of 144 employees attended these events.

Education and training expenses totalled CZK 2,265,360, accounting for 5.48 per cent of the actual payroll costs.

Of this: – Language training            CZK 1,000,240  
           – Other training                CZK 1,265,120

In 2007 four employees attended four foreign and 18 employees attended ten domestic conferences and seminars dedicated to regulation in the energy sector, licensing issues and trading on the energy market.

### 10.3 Employees

The 'mandatory target' of salaries and other payments for work was met at a level of 92.59 per cent, CZK 41,619,470; of which, the mandatory target of employees' salaries was met at 94.46 per cent, CZK 41,346,860.

In 2007 the average number (FTE) of the Office's employees was 95, and the planned number was 102. The annual index was 102.15 per cent, i.e., plus three employees. The Office therefore did not manage to have the planned staffing level of 102; the actual number was 99 employees, which means meeting the plan at 97.06 per cent. As at 31 December 2007 the Office had 99 employees (i.e. plus one more than as at 31 December 2006).

The staffing level was maintained on an ongoing basis, and the need for employees in terms of their number and qualifications in the various organisational units under the Chairman's decisions in this area was met. However, it is to be noted that because of the general shortage of qualified workforce with tertiary education on the Prague labour market and also the keen competition in the energy sector, vacancies in the regulation section in Prague are being filled only with considerable difficulties.

**Table 13 Incoming and outgoing employees in 2007**

Month	New staff	Leaving staff	Total employees
January	0	1	<b>97</b>
February	0	1	<b>96</b>
March	0	4	<b>92</b>
April	3	0	<b>95</b>
May	1	2	<b>94</b>
June	1	0	<b>95</b>
July	1	1	<b>95</b>
August	1	0	<b>96</b>
September	1	2	<b>95</b>
October	0	1	<b>94</b>
November	4	0	<b>98</b>
December	1	0	<b>99</b>
<b>Total</b>	<b>13</b>	<b>12</b>	<b>–</b>

Of the overall number of 99 employees, 56 worked in Jihlava and 43 in Prague (actual numbers as at 31 December 2007). The staffing structure is described in detail in Tables 14, 15 and 16.

**Table 14 Employee structure by age and sex as at 31 December 2007**

Age	Men	Women	Total	[%]
Up to 20 years	0	0	0	0
21 to 30	16	7	23	23.2
31 to 40	9	9	18	18.2
41 to 50	10	17	27	27.3
51 to 60	14	7	21	21.2
61 years and older	4	6	10	10.1
<b>Total</b>	<b>53</b>	<b>46</b>	<b>99</b>	<b>100.0</b>
<b>Percentage</b>	<b>53.5</b>	<b>46.5</b>	<b>100.0</b>	<b>-</b>

The single largest number of employees falls within the 41 to 50 years age brackets, while those aged 21 to 30 years make up the second largest group. A favourable demographic structure of the Office's staff is expected in 2008 too.

**Table 15 Duration of employment as at 31 December 2007**

Employment	Number	Share of total staff [%]
Up to 5 years	52	52.5
Up to 10 years	47	47.5
<b>Total</b>	<b>99</b>	<b>100</b>

**Table 16 Staffing breakdown by education and sex as at 31 December 2007**

Education	Men	Women	Total	[%]
Primary	0	0	0	0
Vocational	1	0	1	1.0
Vocational secondary	0	0	0	0
Complete secondary	0	0	0	0
Complete vocational secondary	7	19	26	26.3
Higher education college	0	0	0	0
University	45	27	72	72.7
<b>Total</b>	<b>53</b>	<b>46</b>	<b>99</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 employees, mostly with tertiary education. This is reflected in the staffing structure by education. In comparison with 2006, the category of employees with tertiary education grew stronger, having increased by 3.3 per cent in 2007. The predominance of staff with tertiary education corresponds to the structure of salary categories in relation to the challenging nature of the Office's work. This favourable trend is expected to continue in 2008.

## 10.4 Organisational activities

Internal regulations – organisational standards are documents required for supporting the Office's mission and business and all of its agendas. In 2007 organisational activities focused on the innovation of internal regulations as new laws and Government Orders entered into force, in particular regulations related to the new Labour Code, and related instruments. In 2007 the Office issued 28 internal regulations, i.e. 6 decisions, 17 measures of the ERO Chairman, and 5 methodological guidelines.





ERO budget management



# 11 ERO budget management

## 11.1 The Chapter's budget

The budget for Chapter 349 Energy Regulatory Office, was approved in Act No. 622/2006 on the Czech Republic's National Budget for 2007, passed by Czech Parliament's Chamber of Deputies in its Resolution No. 160 on the Government's bill on the national budget of the Czech Republic for 2007 of 13 December 2006.

The budget was approved at CZK 115,760,000. However, it was changed several times in 2007 – the Office carried out four 'budgetary measures' within the competencies of the Ministry of Finance.

Under Government Resolution No. 27 of 3 January 2007, 'on the staffing and financing of the activities of the government secretary for preparations for the presidency of the Czech Republic in the Council of the European Union and the executive secretariat for the preparation and performance of the presidency of the Czech Republic in the Council of the European Union, including the definition of their competencies', the Office's Chapter was increased by CZK 393,000. Subsequently, under Government Resolution No. 819 of 18 July 2007, 'on the proposal for the disbursement of the funds budgeted for preparations for the presidency of the Czech Republic in the Council of the European Union in the VPS [general treasury administration] for 2007 to central authorities and other state administration authorities on the basis of a reconsideration of their requirements and in accordance with the assumptions for the overall drawdown on the funds in the budget of the presidency until the end of 2007', there was an increase of CZK 392,000 by way of a transfer from Chapter 398 VPS. Further, the ERO Chapter's budget was increased by CZK 65,000 by way of a transfer from Chapter 398 VPS in compliance with Government Resolution No. 341 of 11 April 2007, 'on the financing and stronger staffing of central authorities and other state administration authorities in 2007 in relation to preparations for the presidency of the Czech Republic in the Council of the European Union'. The above budgetary measures therefore concern funds earmarked for the preparation and performance of the presidency of the Czech Republic in the Council of the European Union (a total of CZK 850,000).

The ERO Chapter's budget was further increased in connection with the abolishment of the Ministry of Informatics and, at the same time, with the termination of a master agreement between the Energy Regulatory Office, Ministry of Informatics, and Telefónica O2 (data services) by way of a transfer of CZK 1,139,000 from Chapter 314 Ministry of the Interior (successor to the Ministry of Informatics). This amount increased the ISPROFIN programme financing. These are funds related to the provision of KIVS data services, i.e., programme number 249 010 Development and Replacement of the Technical Facilities of the Energy Regulatory Office.

Thus, by the end of 2007 the originally approved budget of CZK 115,760,000 was increased to the final CZK 117,749,000.

A staffing level of 102 was approved for 2007.

No income was planned for the Chapter.

The Chapter is not authorised to provide subsidies or loans.

The Chapter does not pursue any economic activities.

The Chapter has no established or controlled instrumentalities of the State.

## 11.2 Revenues to the Chapter

No targets were planned or set on the income side. The revenues to the chapter are listed in Table 17.

**Table 17 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>327.02</b>
	of which:		
2141	interest accrued on accounts – FKSP, deposit account		3.24
2210	penalty for a lost shipment		0.50
2322	insurance compensation received		93.53
2324	billing of subscription, credit notes for services provided in previous years		133.84
2329	transfer of ČSOB account balance as at 31 December 2006		2.94
3113	proceeds from the sale of other tangible assets		14.35
4132	transfer of undrawn funds for wages, including insurance for 12/2006, from the deposit account		78.62

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.

### 11.3 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 18.

**Table 18 Meeting of the mandatory targets**

Mandatory targets	Approved budget [CZK '000]	Budget after changes [CZK '000]	Actual [CZK '000]	Actual/budgeted [3/2] [%]
	1	2	3	4
<b>Aggregate targets</b>				
Total income			327.02	
Total expenditure	115,760.00	117,749.00	101,130.08	85.89
<b>Specific targets – income</b>				
Non-tax revenues, capital revenues and transfers received			327.02	
<b>Specific targets – expenditure</b>				
Outlays to support the ERO's tasks	115,760.00	117,749.00	101,130.08	85.89
of which: outlays related to Czech EU presidency		850.00	717.38	84.40
other outlays on ERO's tasks	115,760.00	116,899.00	100,412.70	85.90
<b>Standard targets</b>				
Salaries for employees and other payments for work	44,857.00	44,952.00	41,619.47	92.59
of which: Salaries for employees	43,679.00	43,774.00	41,346.86	94.46
other payments for work	1,178	1,178	272.61	23.14
Statutory insurance premiums paid by the employer	15,700.00	15,733.00	14,539.21	92.41
Allocation to the Fund of Cultural and Social Needs (FKSP)	874.00	875.00	827.16	94.53
Salaries for employees in state administration	43,679.00	43,774.00	41,346.86	94.46
Salaries for civil servants in administrative authorities				
Arrangements for crisis situations under Act No. 240/2000				

An average salary of CZK 35,763 was planned for 2007. The actually achieved average salary was CZK 36,269, index 101.41 per cent. The 2007/2006 index of the actually achieved average salary was 106.65 per cent. In 2007 the average salary under tariffs, including reimbursements, amounted to CZK 22,900; the average salary, including personal performance supplements and management allowances, without bonuses, was CZK 31,011. The average salary increased year on year mainly due to the implementation of Government Order No. 564/2006 on salaries of employees in public services and administration (increase of tariff salaries, in the case of the Office to 106.79 per cent).

As regards expenses on other payments for work (item 502), the budgeted costs were not exceeded and the drawdown was 23.14 per cent, CZK 272,620.

The above amount can be broken down as follows:

	CZK
• Work related to the preparation of regulatory statutory instruments, forms, expert calculations and consultations	32,500
• Activities related to the remonstrance commission and expert services	109,850
• Other work	10,000
Cleaning work	65,540
• Undrawn funds in the deposit account (i.e. income in 2008)	54,730.

## 11.4 Cash funds

### Fund of Cultural and Social Needs

During 2007 the Fund of Cultural and Social Needs (FKSP) was accumulated and drawn on in line with the Office's internal principles. The principles of drawing and using funds from FKSP are provided for in the Office's internal directives in compliance with the legislation on this area of financial management. As at 31 December 2007 the funds in the Office's FKSP account amounted to CZK 432,050.

### Reserve Fund

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 had been transferred to the Reserve Fund in the previous years. Under Section 48, they will be used to support expenditure in the years to come. As at 1 January 2007 the Reserve Fund held CZK 34,594,550. In 2007 only the actions under Government Resolution No. 629 of 11 June 2007, on reserve funds of the State's instrumentalities, were carried out, i.e. the transfer of a part of the fund, amounting to CZK 17,297,000, to VPS to account no. 772-5921001/0710. In 2007 there were no other draw downs on the Reserve Fund or any allocations to it.

As at 31 December 2007 the funds in the Office's Reserve Fund totalled CZK 17,297,550.

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

**Table 19 Funds transferred to the Reserve Fund and their use**

Item	Amount [CZK'000]
Balance of undrawn funds transferred to RF under Section 47 as at 1/1/07	<b>34,594.55</b>
of which: included in income in 2006	0.00
used in 2007 – transfer to VPS	17,297.00
Transfer of funds under Section 47 for 2007	0.00
Balance of undrawn funds transferred to RF under Section 47 as at 31/12/07	<b>17,297.55</b>
of which: national budget funds allocated to finance programmes	3,039.04
other	14,258.51

## 11.5 The Energy Regulation Fund

In accordance with the Energy Act, the Office held the ERF funds in a separate current account kept with the Czech National Bank, account number 3029001/0710.

As at 1 January 2007 the opening balance in the ERF stood at CZK 50,449,810. No payments were made from the ERF during 2007. After adding the interest (see the Energy Act and the new rules for the ERF, which were put in place in 2005), the closing balance in the ERF was CZK 50,702,540 as at 31 December 2007.

Under Section 14(11) of the Energy Act, the Energy Regulatory Office is obliged to furnish 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 ERF books were kept in compliance with the legal regulations in force and present fairly the ERF's position for the fiscal year 2007 (Appendix 5).

## 11.6 Administrative fees and fines

In addition to the income mentioned in the foregoing, the Office also collected CZK 8,761,200 through its administrative fee account no. 3711-2421001/0710 for January to December 2007. These are administrative fees collected by the Office from businesses in connection with licensing under Act No. 458/2000, the Energy Act as amended, and Act No. 634/2004 on Administrative Fees. This income is not a part of the chapter's income. It is therefore not included in the reports and statements on the management of the chapter's funds.

In 2007 the Office did not impose any administrative fines.

## 11.7 Budget management results

The total actual drawdown on the budget can be seen in Table 20.

**Table 20 Total actual drawdown on the budget**

Drawdown on budget	Expenditure [CZK '000]	Percentage drawn [%]
<b>Total expenditure</b>	<b>101,130.08</b>	<b>85.89</b>
of which:		
capital expenditure drawn	8,965.45	89.81
current expenditure drawn	92,164.63	85.52

Performance vs. budget for January to December 2007 and total savings on the expenditure side of CZK 16,618,920 can be broken down as follows:

– Outlays on employees' salaries and other payments, including insurance premiums and FKSP	CZK 4,574,140
– ISPROFIN programme financing	CZK 3,171,640
– Other current costs (w/o ISPROFIN)	CZK 8,873,140.

### 11.7.1 Current and capital expenditure savings

Significant current and capital expenditure savings were achieved; see Table 21.

**Table 21 Current and capital expenditure savings**

Sub-groups of items	Description	Amount [CZK '000]
	<b>Total current and capital expenditure savings</b>	<b>16,618.92</b>
	of which:	
501	Salaries to employees	2,427.14
502	Other payments for work	905.38
503	Statutory premiums paid by the employer	1,193.79
513	Purchase of materials	1,429.09
515	Purchase of water, fuels and energy	337.96
516	Purchase of services	5,991.37
517	Other procurement	3,112.82
534	Transfers to internal funds	47.84
551	Non-investment transfers to international organisations	77.27
611	Procurement of intangible fixed assets	126.63
612	Procurement of tangible fixed assets	890.92
	Other items of the budget	78.71

### 11.7.2 Programme financing

In 2007 the Office continued to finance its projects in keeping with the approved programme financing documentation (programme 249 010 Development and Replacement of the Technical Facilities of the ERO), which had been prepared in detail for 2003 to 2007.

In 2007 the Office's key priorities included the completion of the new comprehensive information system and the finalisation of all projects under programme 249 010 by 31 December 2007. Throughout the period under review intensive work was under way on the Office's new information system with a view to completing the work in line with the delivery timetable. In relation to this, in late 2007 the most important payments were made. Programme 249 010 was completed by 31 December 2007.

From 2003 to 2007, CZK 82,772,000 was spent on the programme, i.e. 87.17 per cent of the overall amount of CZK 94,952,000. CZK 3,039,040 was transferred to the Reserve Fund in the past few years.

It can be noted in principle that the targets and plans of ISPROFIN programme financing for 2003 to 2007 have been met and that savings have been achieved.

Table 22 shows the results for 2007 by sub-programmes and Table 23 shows the results by current and capital expenditure. In 2007 the approved mandatory target of CZK 17,971,000 for the ISPROFIN chapter was increased in connection with the abolishment of the Ministry of Informatics and, at the same time, with the termination of a master agreement between the Energy Regulatory Office, Ministry of Informatics, and Telefónica O2, by way of transfer from Chapter 314 Ministry of the Interior (successor to the Ministry of Informatics) of CZK 1,139,000, to an overall amount of CZK 19,110,000. These are funds related to the provision of KIVS data services, i.e., sub-programme 249 011 Procurement, Replacement and Operation of ICT of the Energy Regulatory Office. The budget was somewhat modified in relation to the current developments and the Office's new needs.

**Table 22 Results by the sub-programmes for 2007**

	Plan [CZK '000]	Actual [CZK '000]	Percentage [%]
<b>Total, Programme No. 249 010</b>	<b>19,110.00</b>	<b>15,938.36</b>	<b>83.40</b>
of which:			
Sub-programme 249 011 – ICT	16,262.00	14,031.39	86.28
Sub-programme 249 012	2,848.00	1,906.97	66.96

**Table 23 Results by current and capital expenditure for 2007**

	Plan [CZK '000]	Actual [CZK '000]	Percentage [%]
<b>Total programme financing</b>	<b>19,110.00</b>	<b>15,938.36</b>	<b>83.40</b>
of which:			
Current expenditure	9,127.00	6,972.90	76.40
Capital expenditure	9,983.00	8,965.46	89.81

The 2007 mandatory target 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.

### Information and telecommunications technology at the Office

The first half of 2007 saw the implementation of the third stage of the Integrated Information System. The Reporting module was put into operation and all data contained in the regulatory reports on the electricity, gas and heat supply industries returned by regulated entities from the establishment of the Office was migrated to the new system. In mid-2007 the Integrated Information System was put into routine operation.

The second half of 2007 saw continued relocation of servers from the Prague offices to the central data processing facility at the ERO registered office in Jihlava. The whole Office's hardware and software is being gradually concentrated there, including the connection to public data networks, which are also used by the Prague offices. The development of this centralised data processing facility will simplify IT management at the Office and improve data protection and security.

In co-operation with the Ministry of Informatics (after its abolishment, the Ministry of the Interior), a tendering process was organised for voice and data services in 2007. In mid-2007 the Office therefore had to provide for a smooth transition to data services from the new provider, the winner of the tendering process.

### 11.7.3 Assets, receivables and liabilities

The assets that the Office is authorised to manage are listed in Table 24.

As at 31 December 2007 these assets were worth a total of CZK 122,610,970.



**Table 24 Assets as at 31 December 2007**

Account no.	Account name	Amount [CZK '000]
	<b>Total assets as at 31 December 2007</b>	<b>122,610.97</b>
	of which:	
013	intangible fixed assets - software	28,466.11
018	sundry intangible fixed assets	6,247.14
021	buildings	40,160.70
022	self-standing movables and sets of movables	31,911.44
028	sundry tangible fixed assets	11,772.61
031	land	3,390.45
032	objects of art	291.24
041	intangible fixed assets in progress	371.28

In 2007 mainly intangible fixed assets increased, by CZK 15,432,720, primarily due to the completion of the Office's new information system. The account of self-standing movables increased by CZK 1,392,040 due to the purchase of new tangible assets (new hardware, passenger cars, etc.).

Under Act No. 563/1991 on Accounting, as amended, taken together with regulation no. 505/2002 as amended, instrumentalities of the State, i.e. the Office's Chapter, do not depreciate assets. Assets are recognised in books at cost throughout the time for which they are used.

As at 31 December 2007 receivables totalled CZK 631,120. The Office does not post any overdue receivables or receivables due from debtors in insolvency proceedings. The Office only posts operating advances paid to suppliers, CZK 590,770, and also receivables due from employees, CZK 40,350 (loans from FKSP and damages).

As at 31 December 2007 liabilities totalled CZK 56,309,290. They included liabilities to employees, liabilities under social and health insurance, and income tax liabilities related to employees totalling CZK 5,499,530, which result from the accounting of wages for December 2007; these tax liabilities were paid on 10 January 2008 (the payday). They also include the Energy Regulation Fund (see point 11.5), CZK 50,702,540, balance in the payment card account at ČSOB, CZK 1,220, financial surety in the deposit account, CZK 80,000 and the balance of the allocation to FKSP for 2007 in the deposit account, CZK 26,000. The Office had no payables to suppliers; suppliers' invoices received by the Office before the end of 2007 were paid.

#### 11.7.4 Outlays on business trips abroad

Outlays on business trips abroad totalled CZK 2,667,830 and are shown in Table 25.

**Table 25 Outlays on business trips abroad**

Item no.	Description	Amount [CZK '000]
	<b>Total outlays on business trips abroad</b>	<b>2,667.83</b>
	of which:	
5142	Exchange rate losses	0.11
5156	Fuels and lubricants	3.83
5163	Financial services (insurance)	0.22
5169	Purchase of other services	7.45
5173	Travel expenses (subsistence, pocket money, air fare, accommodation)	2,521.38
5175	Entertainment allowance	5.92
5176	Conference registration fees	126.77
5179	Other purchases (visas)	2.15

In comparison with the previous year, there was a significant drop in cost item 5176, conference registration fees, and cost item 5173, travel expenses. Compared with 2006, overall outlays on foreign business trips were CZK 739,750 lower.

In the area of 'non-investment transfers to international organisations', item 5511, the actual expenditure reported at CZK 802,730 relates to the annual membership dues to CEER, Brussels, for 2007 – see Government Resolution No. 996 of 23 August 2006 on the payment of the membership dues to the Council of European Energy Regulators (CEER) in 2006 to 2008.

### **11.7.5 Costs incurred in connection with the Czech EU presidency**

In relation to preparations in 2007 for the Czech EU presidency, CZK 850,000 was released from the general treasury for the Office under the relevant Czech Government resolutions, and the Office's Chapter was increased by this amount.

In respect of the specific mandatory target of outlays incurred in connection with the Czech EU presidency, which had been set for the Office for 2007, expenses totalled CZK 717,380 (i.e., 84.40 per cent of the funds planned) between January and December 2007. The largest part of these expenses, CZK 512,150, covers language education and technical training of experts.

### **11.7.6 Costs incurred in twinning with Ukraine**

In 2007 the Office joined the Regulatory and Legal Capacity Strengthening of Energy Regulation in NERC project in Ukraine under Twinning Contract no. UA/2006/PCA/EY/02 in the position of a junior partner.

Under the EU's legislation, project accounts are kept completely independently and separately from the national budget, Chapter 349 ERO, by an external company; the funds are kept in a separate euro account with ČSOB. As at 31 December 2007 the balance in the account stood at EUR 495.73. In 2007 expenses on the project totalled EUR 10,292.68. As at the balance sheet day, 31 December 2007, the project had no liabilities to the budget of Chapter 349 ERO, and the project therefore did not burden the national budget.

### **11.7.7 Evaluation of the economy, efficiency and efficacy of the Office's financial management**

Section 39(3) of Act No. 218/2000 on budgetary rules, as amended, requires the chapter manager to disclose in its annual report the results of the monitoring and evaluation of the economy, efficiency and efficacy of the costs spent within the whole chapter.

The Office evaluates the spending of the chapter's budgetary funds on the basis of quarterly reports on financial management and in a summary annual evaluation. In the chapter's closing accounts the Office includes, among other things, an overview of the cost intensity of the chapter since the beginning of its establishment, i.e. 2001, measured by expenses in absolute terms and also by average expenses per employee. These calculations are based on expenses without allocations to reserve funds (to have a comparable basis) and also on expenses inclusive of allocations to the reserve funds. Expenses in absolute and relative terms are listed in Table 26, and are broken down by cost categories.

**Table 26 Comparison of actual expenses for 2001 to 2007**

Item	Actual 2001	Actual 2002	Actual 2003	Actual 2004	Actual 2005	Actual 2006	Actual 2007	Index 07/06
<b>Total expenses</b>	<b>97,487</b>	<b>77,637</b>	<b>93,978</b>	<b>116,770</b>	<b>105,018</b>	<b>98,556</b>	<b>101,130</b>	102.61
of which:								
– Salaries, other payments, insurance premiums and FKSP	19,955	36,081	41,772	46,967	48,532	52,524	56,986	108.50
– Expenses on the asset replacement financing programme	54,201	11,976	15,741	15,561	19,526	16,006	15,938	99.58
– Total other expenses	23,331	29,580	36,465	54,242	36,960	30,026	28,206	93.94
of which:								
– Allocations to the Reserve Fund	2,142	2,299	2,351	27,200	2,602	0	0	0
– Other expenses w/o RF	21,189	27,281	34,114	27,042	34,358	30,026	28,206	93.94
Expenses on salaries and other payments for work	14,741	26,470	30,656	34,397	35,493	38,466	41,619	108.20
Salaries to employees	14,158	26,001	30,197	34,122	35,225	37,953	41,347	108.94
Staffing levels (FTE)	40	73	82	89	90	93	95	102.15
Average monthly salary	29,496	29,682	30,688	31,949	32,616	34,008	36,269	106.65
<b>Payroll and social costs per employee</b>	<b>499</b>	<b>494</b>	<b>509</b>	<b>528</b>	<b>539</b>	<b>565</b>	<b>600</b>	106.19
<b>Programme financing costs per employee</b>	<b>1,355</b>	<b>164</b>	<b>192</b>	<b>175</b>	<b>217</b>	<b>172</b>	<b>168</b>	97.67
<b>Other expenses per employee</b>	<b>583</b>	<b>406</b>	<b>445</b>	<b>609</b>	<b>411</b>	<b>323</b>	<b>297</b>	91.95
<b>Total expenses per employee</b>	<b>2,437</b>	<b>1,064</b>	<b>1,146</b>	<b>1,312</b>	<b>1,167</b>	<b>1,060</b>	<b>1,065</b>	100.47
<b>Other expenses per employee w/o RF</b>	<b>530</b>	<b>374</b>	<b>416</b>	<b>304</b>	<b>382</b>	<b>323</b>	<b>297</b>	91.95
<b>Total expenses per employee w/o RF</b>	<b>2,384</b>	<b>1,032</b>	<b>1,093</b>	<b>1,007</b>	<b>1,138</b>	<b>1,060</b>	<b>1,065</b>	100.47

Note: The figures are in CZK'000 (with the exception of the staffing levels and average wages).

The above figures indicate that in 2007, the chapter's expenses per employee were higher by 0.47 per cent than in 2006. From this perspective it is to be noted that the overall cost intensity is less than one percentage point of official inflation. At the same time, adequate salary raises were provided.

It is to be taken into account in connection with the above indicators that year-on-year comparisons and ratios should be regarded as indicative only, because every year some extraordinary costs are incurred, both in terms of the cost category and amounts. Expenditure should therefore be viewed within the specific context and situation in the respective year. Various factors have an impact on the level of these indicators every year; primarily the Reserve Fund may have a distorting influence on them.

The Office evaluates the criteria of economy, efficiency and efficacy as part of the *ex ante* management inspection before the operation is made, and also as part of ongoing management inspections. These are checks carried out by budget managers before each individual expense is made; i.e., this approach is a practical application of Act No. 320/2001 on financial control in public administration and changes to certain laws (the Financial Control Act) and regulation no. 416/2004, which implements Act No. 320/2001 as amended in Act No. 309/2002, Act No. 320/2002 and Act No. 123/2003.

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Oversight



# 12 Oversight

## 12.1 External inspections

In 2007 no external inspection was carried out.

## 12.2 Internal inspections and internal audit

In 2007 the internal audit department carried out internal audit in accordance with the annual plan that had been compiled in line with the requirements of international standards and best practice recommendations according to the Institute of Internal Auditors, Czech Republic, in relation to the medium-term plan of internal audit. The other basis for preparing the annual plan of internal audit was the Risk Map complying with Section 30 of Act No. 320/2001, the Financial Control Act, as amended and compiled in the internal audit department in late 2006.

Internal audit independently and objectively reviewed all of the Office's activities, working processes and control and oversight systems. It assessed whether the internal inspection system in place was efficient and flexible enough to respond to changes in legal, economic, operating and other conditions and whether it had the capability of providing the ERO Chairman with reliable and timely information.

The functional independence of the internal audit department is fully and continuously provided for in the Office's Rules of Organisation, which set forth the status of the internal audit department and the code of conduct for internal auditors. In its work, internal audit follows internationally recognised standards and best practice recommendations included in the methodology of the Institute of Internal Auditors and the methodology of the Ministry of Finance for internal audit performance.

In accordance with the internal audit plan, 2007 saw 13 audit actions as follows:

- audit of the system of storing and archiving information files from the intranet and Internet;
- audit of the application of employees' pecuniary responsibility (agreements, confirmation of acceptance);
- audit of the compliance of administrative proceedings conducted on complaints with the rules of administrative procedure and compliance of the handling of requests for information with Act No. 106/1999 on free access to information, as amended;
- audit of the completeness of the records of documents on car fleet operation and their conformity with records of business trips;
- audit of the keeping and archiving of documentation on active licences and of the completeness of the documents that prove adherence to licence conditions;
- audit of adherence to the rules for the Office's security measures against damage to and leakage of information and for the security of classified information and information in electronic form and on hardcopy;
- audit of the process of including employees in salary categories and levels; assessment of the situation as at 30 June 2007, and review of the list of education exemptions granted;
- audit of the process of allocations to and draw down on the Energy Regulation Fund;
- audit of the records and approvals of contracts for advisory and consultancy services in the regulation section;
- audit of the completeness of the information recorded in the Office's filing service system and compliance with legal regulations;
- audit of compliance with the directive on the reimbursement of business trip costs and expenses;
- audit of adherence to signature mandates on the 'preliminary approval of a proposed operation' documents;
- audit of adherence to the rules for the education and training of ERO employees under Czech Government Resolution No. 1542 of 30 November 2005 on the Rules of Employee Training in Administrative Authorities.

Internal audit also carried out the respective provisions on management inspections, reviewed the plan of training and prepared a report on the results of financial control for the Ministry of Finance and a summary report on the results of internal audit in 2007 for ERO management.

The reports on the audits carried out, and the recommendations following from them, were discussed with the responsible managers. Of the 25 recommendations suggested, all were accepted. Differences in opinion when discussing some recommendations were resolved by repeated talks and adopting compromise solutions in line with the criterion of economy. The efficacy of the adopted recommendations is verified during the monitoring carried out as part of the new audits planned.

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. ERO managers consistently develop and fine-tune the system of financial control in their subordinated sections and departments. The Office's management meetings regularly discuss topics where the most serious risks occur. The principles of *ex ante*, ongoing and *ex post* management inspections are provided for in internal organisational and control standards (Rules of Organisation, Signature Authority Rules, and Directive on Accounting Document Circulation).

The main purpose of both components of the internal audit system is to prevent potential damage and unfavourable development with impacts of uncontrolled risks. The Office has therefore prepared, and issues as internal standards and updates according to new knowledge, standardised working procedures for all units in its organisation. The transparency of working and information processes and records of their standardised structure and values are a precondition for internal auditors' success. To improve the management processes and to produce a favourable effect on the internal audit planning process, a directive on risk management at the Office was

prepared and issued as Chairman's Measure No. 17/2007. The directive reflects the experience with risk assessment in the internal audit department and the ISMS information system project and contains provisions from Instruction No. 6 of the Central Harmonisation Unit [(CHJ)HJ] of the Ministry of Finance.

The report on the results of financial audits and reviews in 2007 was prepared and sent to the Ministry of Finance in electronic form in keeping with the relevant provisions of the law on financial control and the respective implementing regulation.

13

Contacts





# 13 Contacts



## **Energy Regulatory Office**

Masarykovo náměstí 5  
586 01 Jihlava  
Tel: 564 578 666 (switch room)

## **Prague offices:**

Partyzánská 1/7  
170 00 Praha 7 – Holešovice  
Tel: 255 715 555 (switch room)

E-mail: [eru@eru.cz](mailto:eru@eru.cz) or [forename.surname@eru.cz](mailto:forename.surname@eru.cz)  
ERO electronic mail room  
Central fax: 564 578 640

External and Internal Relations Unit:  
Partyzánská 1/7  
170 00 Praha 7 – Holešovice  
Tel: 255 715 513



# Appendix 1

## Expenditure from the National Budget

Period: January to December 2007

Chapter: 349, the Energy Regulatory Office

in CZK '000

Expenditure item	Description	2007 budget		2007 actual	% drawn (3:2)
		approved	after changes		
		1	2	3	4
501	Salaries	43,679	43,774	41,346.86	94.46
502	Other payments for work	1,178	1,178	272.62	23.14
503	Statutory insurance premiums paid by the employer	15,700	15,733	14,539.21	92.41
513	Purchase of materials	3,522	3,122	1,692.91	54.23
514	Interest paid and other financial costs	0	50	14.21	28.42
515	Purchase of water, fuels and energy	1,960	1,960	1,622.04	82.76
516	Purchase of services	28,804	31,993	26,001.63	81.27
	of which:				
	5164 rental	3,050	3,050	2,485.81	81.50
	5166 consulting, advisory and legal services	11,400	11,400	8,545.45	74.96
	5167 education and training services	3,200	3,150	2,265.36	71.92
	5169 purchase of other services	7,720	10,263	9,796.60	95.46
517	Other purchases	9,125	8,146	5,033.18	61.79
	of which:				
	5171 repairs and maintenance	3,250	2,050	1,518.18	74.06
	5172 software	400	400	80.09	20.02
	5173 travel expenses (domestic and abroad)	4,325	4,546	2,961.45	65.14
518	Advances, sureties, guarantees and government loans provided	0	0	0.00	0.00
519	Costs of non-investment purchases, contributions, etc.	5	5	0.00	0.00
534	Transfers to internal funds	874	875	827.16	94.53
	of which:				
	5342 non-investment transfers to FKSP	874	875	827.16	94.53
	5346 transfers to funds of the State's instrumentalities				
536	Other non-investment transfers to other public budgets	30	30	12.08	40.27
542	Compensations paid to citizens	20	20	0.00	0.00
551	Non-investment transfers to international organisation and multinational bodies	880	880	802.73	91.22
<b>5</b>	<b>Total current expenditure</b>	<b>105,777</b>	<b>107,766</b>	<b>92,164.63</b>	<b>85.52</b>
611	Intangible fixed assets purchased	2,948	5,000	4,873.37	97.47
612	Tangible fixed assets purchased	7,035	4,983	4,092.08	82.12
636	Investment transfers				
	of which:				
	6361 investment transfers to the Reserve Fund				
<b>6</b>	<b>Capital expenditure</b>	<b>9,983</b>	<b>9,983</b>	<b>8,965.45</b>	<b>89.81</b>
<b>0</b>	<b>Total</b>	<b>115,760</b>	<b>117,749</b>	<b>101,130.08</b>	<b>85.89</b>



## Auditor's Report

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 2007.

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 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.

Recipient of the Report: Management of the Energy Regulatory Office

Name of the accounting unit: Energy Regulatory Office

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 2007.

Registered office: Masarykovo náměstí 5, 586 01 Jihlava

Reg. No. 70894451

Period under review: 2007



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

At Jihlava, on 25 January 2008

A-CONT, s. r. o., se sídlem Poiní 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









Energy Regulatory Office  
Masarykovo nám. 5  
586 01 Jihlava  
[www.ero.cz](http://www.ero.cz)