

The Czech Republic's National Report on the Electricity and Gas Industries for 2006

July 2007

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1 Foreword

For the third time the Czech Republic is presenting a report on the implementation of the requirements of 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 (hereinafter Directive 2003/54/EC) and 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 (hereinafter Directive 2003/55/EC), and also Directive 2004/67/EC of the European Parliament and of the Council of 26 April 2003 concerning measures to safeguard security of natural gas supply (hereinafter Directive 2004/67/EC) to the European Commission, thereby meeting its reporting and notification obligation as set out in the Directives.

In comparison with the previous report, which provided information about the milestone period of 2005/2006, the present report covers the development of energy markets for 2006. Since the two reports partially cover the same period the authors have decided to retain some parts contained in the report for 2005 in this report for 2006 for the sake of continuity and clarity.

2 Summary information about regulation in the electricity and gas industries in 2006

2.1 Basic information about regulatory authorities' position on the Czech energy market

Administrative authorities' competencies within the structure of state administration in the energy industries are set out in Act No. 458/2000 on the Conditions of Business and State Administration in the Energy Industries and Changes to Certain Laws, as amended (hereinafter referred to as "the Energy Act"), and also in Act No. 143/2001 on the Protection of Competition and Changes to Certain Laws, and further in Act No. 2/1969, on the Establishment of Ministries and other Central State Administration Authorities of the Czech Republic, as amended ("the Competency Act").

The Energy Regulatory Office

The Energy Regulatory Office (hereinafter also referred to as "the ERO" or "the Office") was set up on 1 January 2001 by the Energy Act as an administrative authority in charge of regulation in the energy sector. Its functions and responsibilities were described in detail in the National Report for 2004.

Secondary legislation issued by the Energy Regulatory Office in 2006

In 2006 work continued on changes to and development 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.

The Office followed up on its legislative activities of 2005 and issued implementing regulations relating primarily to the introduction of the new gas market model; this model has been applicable since January 2007. The Office issued a new statutory instrument, 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, providing for the rules needed by the fully opened market, which responded to the latest changes on the Czech gas market. Related to it was Public Notice No. 545/2006, on the quality of gas supplies and related services in the gas industry, whereby the Office provided for the required quality of the supplies and services related to regulated activities in the gas industry.

In the electricity industry, a profound change was brought about by an amendment to Public Notice No. 552/2006 on electricity market rules, covering the evaluation of the pricing of secondary control and, in turn, changes to the pricing of system imbalances. In 2006 the Office also issued a new regulation, Public Notice No. 51/2006, on conditions of connection to the electricity grid. This regulation standardises the general conditions for the connection of market participants, simplifies the conditions for connection and provision of the required power input/output and, above all, clearly defines the applicant's share of the costs incurred in its connection to the distribution/transmission system.

The Energy Regulatory Office does not carry out any activities duplicating those of the other state administration authorities; i.e. in terms of jurisdictions, there exists no overlapping.

The Ministry of Industry and Trade

The powers and responsibilities of the **Ministry of Industry and Trade** ("MIT") are laid down in the Competency Act, i.e. Act No. 2/1969 as amended. Moreover, the Ministry is responsible for developing the National Energy Concept, observing international

commitments and treaties, and granting the State's consent to the building of new capacities in the electricity industry and the State's consent to the building of direct lines and selected gas facilities in the gas industry.

The Office for the Protection of Competition

The Office for the Protection of Competition ("ÚOHS") was set up by Act No. 272/1996, which implements certain measures in the Czech Republic's system of central state administration authorities. This Act also amends Czech National Council Act No. 2/1969 on the setting up of ministries and other central authorities of the Czech Republic's state administration, as amended, and Act No. 97/1993 on the powers and responsibilities of the Strategic Reserves Administration; the scope of its powers and responsibilities is contained in Act No. 273/1996 on the competencies of ÚOHS. In respect of the protection of competition, Act No. 143/2001 on the protection of competition and changes to certain laws, as amended, is the fundamental piece of legislation under which ÚOHS proceeds.

2.2 Main developments in the electricity and gas markets

2.2.1 The electricity market

The Czech electricity market was being opened up step-by-step from 2002. The market has been fully liberalised since 1 January 2006; on that day the last group of customers – households – became eligible customers and acquired the right of supplier choice. This took place one and a half years earlier than required by Directive 2003/54/EC. None of the activities in which competition is feasible, i.e. electricity generation, electricity imports, and electricity trading, are regulated on the open market any longer. Only activities having a monopoly nature continue to be subject to regulation; they include electricity transport from the generating plant over the transmission and distribution systems to the final customers and also activities related to providing for the energy system's stability in both technical and commercial terms.

By 1 January 2006 also extensive organisational changes had been finalised in the electricity industry. Under the Energy Act, operators of distribution systems serving more than 90,000 customers are obliged to separate distribution from the other licensed activities (unbundling). In practice, only the three largest groups operating in the electricity industry were obliged to effect unbundling, namely the ČEZ Group, the E.ON Group, and the PRE Group. Thus, on 1 January 2006 the Czech Republic met its obligation of the legal unbundling of the regulated activity of electricity distribution from the other activities, electricity generation and sale, which are not subject to regulation in integrated power utilities.

In connection with the separation of the various activities there was a need to meet the obligation of providing non-discriminatory access to distribution systems for all electricity traders. To support oversight over non-discriminatory conduct, which is the objective of unbundling, a so-called Compliance Programme was put in place. Under the Energy Act, distribution system operators are obliged to adopt, through their own internal directives, a programme that lays down measures precluding discriminatory behaviour to other electricity market participants, in particular as regards access to the DSOs' distribution systems and use of their services. In the initial Compliance Programmes, prepared in 2005, distribution companies set out their measures and undertook to carry them out. In 2006 distribution companies first drew up a Report on Implementing the Compliance Programme. The Office analysed the submitted reports and in October and November 2006 its staff met with the Compliance Officers of all distribution companies to gain thorough knowledge of the internal directives through which the specific ways of implementing each of the measures

were addressed. The Office did not identify any serious mistakes on the part of the distribution companies; however, the reports submitted failed to address specific problems, and were not uniform. The Office therefore initiated, in co-operation with the Ministry of Industry and Trade, a harmonisation of the relevant documents on the basis of a single structure.

Although the regional distributors' Compliance Programmes did not suffer from any serious formal defects, in practice vertically integrated groups continued to prefer their own traders. The main shortcomings could be felt in the entering into agreements with customers at newly set up supply points.

2.2.2 The gas market

Liberalisation of the Czech gas market continued in 2006 by the second stage of market opening. On 1 January 2006 all final customers for natural gas, with the exception of households, became eligible customers. Households continued to be protected customers. The market was therefore opened up for more than 140,000 customers with more than 194,000 supply points. Eligible customers' offtake exceeded 70 per cent of natural gas consumption in the Czech Republic. As from 1 January 2007 all customers, including households, are eligible customers and the Czech market is therefore completely open.

Three factors became the key features of the Czech gas market in 2006:

- Reimposition of the regulation of prices of gas supplies to eligible customers;
- New entrants on the gas market in trading; and
- The adoption of a new statutory instrument on gas market rules.

All of these factors are closely interrelated and influence one another. Related to the market opening are also the obligations arising for the Czech Republic from its membership of the EU, i.e. the division of gas companies through legal unbundling and the meeting of the requirements of 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 ("Regulation 1775/2005/EC").

The Czech Republic's National Report on the Electricity and Gas Industries for 2005 detailed the reasons that prompted the Office to decide to restrict, temporarily, gas supply prices from 1 January 2006, in the form of the maximum permissible prices of natural gas supplies and storage charged by RWE Transgas, a.s., and the maximum permissible price of gas supplies charged by the distribution companies' traders who bought gas from RWE Transgas, a.s. The measure adopted by the Office in no way constrained the emergence of competition on the Czech natural gas market, and did not prevent eligible customers from exercising particularly their right to gas supplier choice or to select a different pricing principle. According to the Office's calculations, this measure helped to reduce costs of natural gas purchase in 2006 by approximately 4.4 per cent, which helped eligible customers save approximately CZK 2 billion. The Office's decision to lift the controls on 31 March 2007 was preceded by a number of meetings with RWE Transgas, a.s. on the conditions and methods of pricing after 1 April 2007 and on the conditions for the RWE Group's operation on the market.

The key characteristic feature of 2006 was an effort to develop a competitive environment in the gas market. However, this was not achieved in the Czech gas market in 2006. Only Wingas, GmbH and VEMEX s.r.o. launched their gas trading business on the market from 1 January 2006. Among the other gas traders, worth mentioning is Moravské naftové doly Hodonín, a.s., which produces natural gas in the Czech Republic; however, this company uses this gas for consumption in its affiliated companies; and also OKD a.s., which supplies mine

surface drainage gas to Severomoravská plynárenská, a.s. These supplies are of a local importance only. The gas market's malfunctioning in 2005 resulted in the Office's decision to draw up a more liberal statutory instrument on gas market rules, effective as of 1 January 2006, in co-operation with gas companies and final customers. The new instrument also had to reflect the requirements of Regulation 1775/2005/EC, effective as of 1 July 2006, to put in place the preferred model of entry/exit capacity booking in Europe and to define the activities of the missing function of the market operator, determining in particular the place and exact conditions for gas trading, thereby reducing the risks for smaller traders and new trading entrants. The new gas market model, provided for in a public notice on gas market rules, brings a number of favourable changes; their objective is to create the preconditions for competitive trading, thereby ensuring all the advantages stemming from a fully functional liberalised environment. However, its further development and simplification is tied to the expected amendment to the Energy Act.

Major events also include the changes resulting from unbundling. The first company in which legal unbundling took place was RWE Transgas, a.s. From 1 January 2006 a new entity started to operate on the Czech market, RWE Transgas Net, s.r.o., the transmission system operator. The licensed activities of gas trading and gas storage were retained in RWE Transgas, a.s. Intensive preparations for the legal unbundling of the eight regional distribution companies that have more than 90,000 customers (Jihočeská plynárenská, a.s., Jihomoravská plynárenská, a.s., Pražská plynárenská, a.s., Severočeská plynárenská, a.s., Severomoravská plynárenská, a.s., Středočeská plynárenská, a.s., Východočeská plynárenská, a.s., and Západočeská plynárenská, a.s.) took place throughout 2006, with a view to effecting the unbundling as from 1 January 2007. The required deadline was met in compliance with the Energy Act.

Similarly as in the electricity industry (see part 2.2.1) also gas distribution companies prepared, pursuant to the Energy Act, their initial Compliance Programmes that set out their measures to preclude discriminatory approach to other gas market participants, particularly as regards access to the distribution system and use of the gas distribution companies' services.

2.3 Major issues dealt with by the Energy Regulatory Office in 2006

2.3.1 Regulation in the gas industry

All market participants as well as many members of Czech public paid great attention to the issue of the temporary caps on gas supply prices in the form of maximum natural gas supply and storage prices charged by RWE Transgas, a.s. and maximum sales prices charged by traders of distribution companies buying natural gas from RWE Transgas, a.s., with which the Office dealt intensively for the past two years.

Under Article 3(6) of Directive 2003/55/EC, on 4 December 2006 the Permanent Representation of the Czech Republic to the EU notified DG TREN of this measure. In the notification the Czech Republic noted that the measure, consisting in imposing controls on the prices of natural gas supplies to eligible customers from traders buying gas from RWE Transgas a.s., had been adopted in accordance with Article 3(2) of Directive 2003/55/EC. The notification was supplemented with an analysis of the reasons for adopting this measure.

2.3.2 Legislative changes

The specific pieces of legislation that the Office drew up in the period under review as part of its competencies in the development of delegated legislation are outlined in point 2.1. The

statutory instruments mentioned there are based on the needs of the fully opened electricity and gas markets.

2.3.3 *Unbundling costs in the gas industry*

In connection with their legal unbundling, gas distribution system operators requested the inclusion of the justifiable and demonstrable minimum costs of unbundling, which the Energy Regulatory Office has the remit to recognise under the Energy Act, into the prices of regulated activities. Similarly as for the electricity distribution system operators and the gas transmission system operator in 2005, the Office set the methodology for calculating and quantifying the minimum costs *ex ante*. During the course of preparing detailed analyses, which helped to eliminate unjustifiable costs and set the minimum level of justifiable costs, the following cost categories were identified:

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

2.3.4 *Talks on the compensation mechanism for cross-border electricity flows*

Within the Council of European Energy Regulators (CEER) and the European Regulators Group for Electricity and Gas (ERGEG), the European Commission's advisory group, the Energy Regulatory Office actively participated in the drafting of the Guidelines on Inter TSO Compensation. In January 2006 the respective CEER/ERGEG groups outlined the two basic methods, WWT and AP, for inclusion in the Guidelines. However, upon a proposal by the European Transmission System Operators organisation (ETSO) work on these methodologies was discontinued at the meetings that followed, because ETSO representatives proposed a new methodology, called IMICA. An analysis was carried out, and it made it apparent that the IMICA methodology, and the parameters set under this methodology, would not respect the actual physical flows across the Czech Republic. Under the methodology proposed the Czech Republic, as a transit country with sufficient cross-border transmission capacities in the central and eastern European region, would not be sufficiently compensated by the other TSOs. The Czech Republic therefore had to oppose the adoption of the IMICA method, which would have meant for it an unjustifiable financial burden of more than EUR 30 million/year. The Office promoted the Czech position within the respective EFG and CBT working groups, and also during the public consultation, as well as by letters to CEER President and the European Commission. Because of the rejecting attitude of more than one-third of regulatory authorities, including the ERO, ERGEG Chairman sent a letter to the European Commission, in which he noted that recommendations on the appropriate methodology would not be provided and that the European Commission should decide on further steps in co-operation with ETSO, which insisted on the IMICA methodology.

3 Regulation and structure of the electricity market

3.1 Regulatory issues

3.1.1 Management and allocation of interconnection capacity and mechanisms to deal with congestion management

There exist no bottlenecks in the Czech transmission grid; the grid is capable of transmitting the required volumes of electricity and there is no need to adopt any measures vis-à-vis the electricity market participants (with the exception of extraordinary situations in the grid, which are covered by the relevant legislation).

As regards electricity exports/imports, and, as the case may be, transit, the quantity of traded volumes is limited by the limited capacities of the lines on cross-border interconnections. The size of the available cross-border capacities depends on the physical electricity flows themselves and also on the contracted load at the respective cross-border interconnection. The TSO offers all available cross-border line capacities using non-discriminatory market mechanisms, i.e., annual, monthly and daily explicit auctions are organised for all interconnections. In the case of the Polish, Slovak and both German interconnections, coordinated explicit auctions are also organised in co-operation with the neighbouring TSOs.

In accordance 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 ("Regulation 1228/2003/EC"), all proceeds from these auctions are used for network investments to maintain or increase the interconnection capacity; they are reflected in the calculation of the charges for using the transmission network, or used for CBT compensation payments between TSOs in cross-border trading.

As part of regional activities on the electricity market, 2006 saw consultations on the option of launching coordinated auctions based on the principle of monitoring the actual physical flows (the flow-based approach). Coordinated auctions are to take place throughout the Central and Eastern Europe regions from 1 January 2008. It was agreed during the talks that the auction office would be based in Germany.

3.1.2 Transmission and distribution companies

One transmission system operator is active in the Czech Republic; the TSO is responsible for electricity transmission at the level of the transmission system (400 kV, 220 kV and selected 110 kV lines), for the development of the transmission system, and for providing the system services that help to ensure safe and reliable operation. At lower voltage levels (110 kV and lower), electricity distribution is provided by three distribution system operators (DSO) with more than 90,000 customers, whose facilities are connected directly to the transmission system. As at 31 December 2006, besides these regional distributors there were also 279 operators of other distribution systems, connected only to DSOs with more than 90,000 customers, who distributed electricity within areas specified in their electricity distribution licences.

Network tariffs

To calculate average charges for electricity transmission and distribution the Energy Regulatory Office uses the incentive-based revenue cap regulatory method. It will be applied throughout the second regulatory period, i.e. from 1 January 2005 to 31 December 2009. The pricing principles were described in the first National Report prepared in 2005 (see point 3.1.3, Network tariffs).

The structure of prices is defined in ERO Public Notice No. 438/2001, which lays down the content of the financial information and procedures for price control in the energy sector. The electricity price to eligible (final) customers, including households, is composed of regulated and unregulated items. The regulated items, which are set by the Energy Regulatory Office every year, include all charges for the monopoly activities related to electricity transport from the generator over the transmission and distribution systems to the final consumers, i.e. transmission and distribution services, system services, and contribution to support for renewable resources and combined heat and power generation, and, effective since the beginning of 2006, secondary resources. They also include the charges for the market operator's service of imbalance clearing. Electricity generation and imports and commercial activities related to electricity supply to final customers are not regulated and are fully subject to market mechanisms.

The regulator sets the parameters for the calculation of average prices of regulated activities for each of the licence holders and sends them to the regulated entities. On the basis of these parameters the regulated entities propose prices for customers by categories and bands. The Office reviews the proposals, approves the prices, and issues its price decision laying down these prices, every year in November with effect for the following calendar year. The complete wording of price decisions is published in the ERO's *Gazette*, and also on its website and the websites of the respective DSOs with more than 90,000 customers, and the TSO's website.

The structure of payments for distribution, or transmission if the customer's equipment is connected to the transmission/distribution system, is also composed of a fixed component and a variable component.

In respect of transmission service charges, the Czech Republic does not apply non-zero G, i.e. on the producer's side electricity transmission is not subject to charge. Only three regional distribution companies and one final customer are connected to the transmission system. In 2006 the charge for the use of the transmission system was CZK 21.13/MWh, and the unit charge for booking transmission capacity was CZK 511,266/MW/year.

For customers connected to the extra high voltage and high voltage levels the fixed component is a standing monthly charge for booked capacity, depending on the respective voltage level, in CZK/MW, while for small [low-demand] business and household customers connected to the low voltage level the standing monthly charge depends on the size of the circuit breaker (CZK/A). The variable component, in CZK/MWh, covers the cost of losses; bills to eligible customers also show the following separate items: the system service charge, contribution to support for renewable resources, CHP and secondary resources, and the charge for the market operator's service of imbalance clearing.

The Energy Regulatory Office sets the prices of regulated activities on the basis of voltage levels (see Table 1), and the specific prices as defined by Eurostat are therefore not available to it. For this reason it requested the Czech Statistical Office to provide it with data (prices) that match the categorisation of consumers in line with Eurostat definitions (see Table 2).

In respect of category I_b customers it is to be noted that the resulting price of electricity for this consumer category is markedly influenced by the voltage level to which the electricity supply point (demand take point) is connected; i.e., the degree of transformation (the required voltage level) has a significant impact on the overall payment for regulated activities (see Table 1).

High-demand customers

In the case of large [high-demand] customers connected to the extra high voltage and high voltage levels, suppliers usually do not publish their energy quotes; the customers receive offers quoting personalised prices based on their load profile and the prices of energy in each of the time bands on the wholesale market. In 2006 these prices ranged from CZK 980 to CZK 1,780 per MWh depending on the time band and the terms and conditions of the supply.

Low-demand business customers and households

For low-demand business customers and households connected to the low voltage level the structure of the energy price quoted by most of the suppliers corresponds with the structure of distribution rates; i.e., on the basis of the selected distribution rate, the customer receives an offer of the respective energy product, in 2006 quoted usually at CZK 860 to 1,200 per MWh for households, and at CZK 1,000 to 1,270 per MWh for businesses in the low rate period, and CZK 1,300 to 1,700 per MWh for households and CZK 1,420 to 1,760 per MWh for businesses in the high rate period.

Table 1 Regulated components of the price of electricity for eligible customers based on the voltage level (without 19% VAT) set for 2006

Customer category		Households	Low-demand business customers		High-demand industrial customers	
Annual electricity consumption	MWh/year	3.5	50	50	24,000	24,000
Maximum capacity	kW	-	50	50	4,000	4,000
Connected to voltage level	-	LV	LV	HV	HV	EHV
Average price for network services (transmission, distribution) w/o VAT	CZK/MWh	1,058.00	1,199.00	165.35	81.94	43.13
Capacity booking / standing charge	CZK/MW	-	-	100,086	100,086	44,444
Network use / energy	CZK/MWh	-	-	65.26	65.26	35.72
Other regulated electricity price items for services related to electricity supply, w/o VAT	CZK/MWh	189.17	189.17	189.17	189.17	189.17
Electricity market operator's clearing activity	CZK/MWh	4.63	4.63	4.63	4.63	4.63
Contribution to renewable resources and cogeneration	CZK/MWh	28.26	28.26	28.26	28.26	28.26
System services	CZK/MWh	156.28	156.28	156.28	156.28	156.28
Total regulated electricity price	CZK/MWh	1,247.17	1,388.17	354.52	271.11	232.30

Table 2 Average electricity prices to final customers based on Eurostat categories for 2006

Customer	Annual electricity consumption (kWh)	Electricity price w/o VAT (CZK/kWh)	Electricity price with VAT and other charges (CZK/kWh)
D_c	3,500	2.38	2.83
I_b	50,000	2.97	3.54
I_g	24,000,000	1.63	1.94

Supply quality indicators

The Energy Act provides for the TSO's and DSOs' obligation to connect customers and continuously supply them with electricity at a high level of quality; detailed connection conditions and the various quality standards are laid down in delegated legislation: ERO Public Notice No. 540/2005 on the quality of electricity supplies and related services in the electricity industry. It lays down the general standards that serve for benchmarking distribution system operators in terms of their performance, and the guaranteed standards that the DSOs must keep in each individual case. In the event the DSO fails to observe them, the customer has the right to demand compensation, specified in the public notice, for breaching a particular standard.

SAIDI and SAIFI in 2006 for DSOs with more than 90,000 customers are shown in Tables 3 and 4.

Table 3 SAIDI values

SAIDI [minutes/year/customer]	ČEZ	E.ON	PRE
Up to 1 kV	44.36	72.10	50.93
From 1 kV to 100 kV	213.69	256.00	31.59
110 kV	7.69	2.80	3.14

Table 4 SAIFI values

SAIFI [interruptions/year/customer]	ČEZ	E.ON	PRE
Up to 1 kV	0.31	0.28	0.67
From 1 kV to 100 kV	2.45	1.55	0.54
110 kV	0.27	0.26	0.10

Connection conditions

The conditions for connecting a new customer/generator to the distribution or transmission system, including the method for calculating the applicant's share of the costs incurred in the connection and in bringing the required power, are described in ERO Public Notice No. 51/2006. The technical conditions for connection are stipulated in the rules of the transmission/distribution system operation (the Grid Code). All of these documents are available on the respective companies' websites.

The balancing market

In this area basically no changes have taken place in comparison with the preceding period. State-owned Operátor trhu s elektřinou, a.s. [*Electricity Market Operator, plc*, 'OTE'] evaluates the contracted and actual electricity supply and take, and subsequently clears the imbalances. It also organises the day-ahead, intra-day and balancing electricity markets and also the market of electricity from combined heat and power generation. Most electricity trades take place under bilateral contracts, the gate closure of which is at 1 p.m. on the day before. Another option is using the day-ahead market, organised by OTE. This market is based on supply and demand prices in each trading hour, generating a resulting marginal price of electricity and the quantity traded (reconciled). The gate closure is at 11.30 a.m. on the day before. Market participants can also adjust their trading position on the intra-day and balancing markets, also organised by OTE. The system of intra-day and balancing markets,

which was described in detail in the National Report for 2004, continues to work on the principle of an offer/bid bulletin board. Unlike the day-ahead market, no marginal price is generated here; rather, each of the buying/selling bidders specifies their price. The prices at which trades take place on the balancing market serve as input to the calculation of the marginal price of the balancing energy. Both markets are operated round the clock yearlong.

3.1.3 Unbundling

In 2006 there were one TSO (ČEPS, a.s.), three DSOs with more than 90,000 customers (PREdistribuce, a.s., ČEZ Distribuce, a.s., and E.ON Distribuce, a.s.), which cover the largest part of the market, and as at 31 December 2006 also 279 operators of other distribution systems, in the Czech Republic.

Ownership unbundling

The ownership unbundling of transmission networks from the other activities in the electricity industry has been effected satisfactorily by separating the management of two companies, a state-owned company and a semi-state owned company. In terms of ownership, distribution system operators have not been unbundled.

Legal unbundling

Legal unbundling has been carried out in all electricity companies.

The TSO, ČEPS, a.s., has been in existence as an independent juristic person since 1998.

Under the Energy Act, DSOs with more than 90,000 customers were to effect the legal unbundling of their activities by 31 December 2006. Nevertheless, all operators carried out this obligation earlier. E.ON Distribuce, a.s. has been legally unbundled since 1 January 2005 and the other two companies, PREdistribuce, a.s. and ČEZ Distribuce, a.s., have been unbundled since 1 January 2006.

“The 100,000 customers rule”

The Czech Republic has made use of the opportunity to unbundle only the companies that have large numbers of customers. The Czech legislation provides for this opportunity, known as “the 90,000 customers rule”, in Section 25a, subsection 9 of the Energy Act: “The separation of activities hereunder shall be effected no later than by 31 December 2006, with the exception of the vertically integrated undertakings that provide services for less than 90,000 connected final customers.”

None of the three large operators has less than 90,000 customers. From this point of view, there are the above 279 operators of other distribution systems, which, therefore, are not obligated to effect unbundling under this rule.

Ownership structure

TSO - **ČEPS, a.s.**

On 31 December 2006 the ownership structure of this company was as follows:

- 51% Osinek, a.s.
- 34% Ministry of Finance
- 15% Ministry of Labour and Social Affairs

This suggests that ČEPS, a.s. is fully under the Czech Republic’s control, 49% direct control and 51% indirect control through a public limited company whose sole shareholder is the Czech Republic.

DSO - PREdistribuce, a.s.

On 31 December 2006 the ownership structure of this company was as follows:

- 100% Pražská energetika, a.s.

ČEZ Distribuce, a.s.

On 31 December 2006 the ownership structure of this company was as follows:

- 100% ČEZ a.s.

E.ON Distribuce, a.s.

On 31 December 2006 the ownership structure of this company was as follows:

- 100% E.ON Czech Holding Verwaltungs GmbH.

Asset ownership

After the unbundling the TSO and DSOs with more than 90,000 customers are the owners of the assets.

Employees of the companies

As at 31 December 2006 ČEZ Distribuce, a.s. had 1,150 employees, as against the total number of 6,404 employees of its parent company, ČEZ, a.s. As at 31 December 2006 E.ON Distribuce, a.s. had 29 employees, as against the total number of 2,277 employees of its parent company, E.ON Czech Holding, as at 31 December 2005. As at 31 December 2006 PREdistribuce, a.s. had 565 employees as against the total number of 851 employees of its parent company, Pražská energetika a.s.

Shared services

Distribution companies use shared services in logistics, human resource and personnel management, information technologies, and customer services (call centres). All of these services are provided under contracts within the companies' holding structures and are jointly used by their subsidiaries.

The Office currently has information only from PREdistribuce, a.s., where 57% of its distribution activities are carried out by its own employees.

Location of companies

E.ON Distribuce, a.s. and ČEZ Distribuce, a.s. are located in other buildings than the trading companies of these unbundled firms. Some 90% of PREdistribuce, a.s. are currently located in a separate building. Employees' access is monitored by a security service or allowed with the help security access chips.

Presentation of companies

In 2006 ČEZ Distribuce, a.s. set up its own domain. Even after the legal unbundling, the other companies present themselves to customers in a standardised format in shared domains and employing uniform brands, logos and design.

Unbundled accounts

Accounts for unbundled activities will not be published in general; they will be available solely for the ERO's purposes as part of regulatory reporting. Separate accounts might be published in the event of a particular system operator pursuing no other activity than electricity transmission or electricity distribution. The Energy Regulatory Office puts in place general principles and detailed rules for the compilation of unbundled accounts solely for the purpose of regulatory reporting, i.e. purely for the regulator's own needs. However, these do not include any allocation rules (such as cost allocation), but more typically the individual accounts and items that each of the operators must specifically report in more detail.

Unbundled accounts are not subject to a separate audit by certified accountants.

The role of the compliance officer

Under the Energy Act, distribution companies have set up a position of compliance officer, whose tasks include, in particular, supervision over adherence to the compliance programme, employee training, complaint handling, and the preparation of a report on adherence to the compliance programme.

Inspections and sanctions

Based on the allocation of competencies within the Czech Republic's state administration concerned with the energy sector, the Energy Regulatory Office is conceived as an administrative authority that carries out regulation through the competencies vested in it. However, these competencies do not include penalisation competencies, and it only has marginal inspection competencies. The State Energy Inspectorate is the inspection and penalising authority. In the event of detecting certain irregularities or breach of obligations by market participants, the Ministry of Industry and Trade or the Energy Regulatory Office may send a suggestion to the State Energy Inspectorate to start inspection; should it identify a violation of law, this institution may impose a fine pursuant to Section 95 of the Energy Act. Should there be a violation of material obligations related to licensed activities, the Energy Regulatory Office may, under Section 10, subsection 2 of the Energy Act, revoke the company's authorisation to carry on business, i.e. its licence.

3.2 Competition issues

3.2.1 Structure of the wholesale market

Electricity consumption, installed capacity and the peak demand in the grid

In 2006 total domestic net electricity consumption amounted to about 59.4 TWh, of which 34.6 TWh (58.2%) was taken by high-demand customers connected to the high voltage and extra high voltage levels, 8.0 TWh (13.5%) by low-demand business customers connected to the low voltage level, and 15.2 TWh (25.6%) by households. The balance of the demand, amounting to 1.6 TWh (2.7%), was taken by the energy sector itself, i.e. it was power stations' 'other load'. Total domestic electricity consumption, including network losses, amounted to 71.7 TWh.

The system registered the annual maximum, peak demand, on 25 January 2006 at 3 p.m., with a total load of 11,397 MW. The system registered the annual minimum on 6 August 2006 at 6 a.m., with a total load of 4,682 MW.

On 1 January 2007 the total installed capacity of power stations in the Czech Republic was 17,508 MW, with approximately 58% of the power stations' output connected directly to the transmission system and 42% to the distribution system.

The HHI index

Information pertaining to HHI (the Herfindahl-Hirschman Index) is not monitored in the Czech Republic's electricity or gas markets on an ongoing basis. The Office for the Protection of Competition evaluates such information solely as part of the specific proceedings it conducts.

The market for ancillary services

The TSO procures ancillary services of all categories using market mechanisms – primary, secondary and tertiary control, fast start, and operating reserve, which are procured via long-term and medium-term tendering processes based on the providers' bid prices. In this way some 90% of the volume of balancing power is procured. The remaining balancing reserves are bought on the day-ahead ancillary service market. A precondition for participating in the tendering processes and the day-ahead market is valid certification for the provision of the respective service, issued by an independent certification authority. At present thirteen entities, which participate in the ancillary service market depending on their technical capabilities and business strategies, hold valid certifications for the provision of a particular ancillary service. The dominant generator's share in the provision of ancillary services dropped by about 5% year-on-year, and is similar to its energy production, i.e. it accounts for approximately 65% of the volume of all ancillary services procured. The other providers' share is several per cent, depending on the ancillary service category and the ability of the various plants to provide such services.

In the case of certain ancillary services such as black start, island operation capability, and U/Q (reactive power) control, and in the case of newly procured ancillary services such as load change and generation shedding, talks are usually held directly with the service provider and the price of the service bought usually reflects the cost of providing such service. The extent to which these services are provided and their costs are not important in comparison with the main balancing reserves.

Electricity trading – long-term bilateral contracts, short-term market

Most of electricity trades (more than 99% of the volume of electricity) take place under bilateral contracts. The term of such contracts generally varies; one-year contracts are usually executed between generators and traders. The remaining volume of electricity is traded on the short-term market (day-ahead and intra-day markets), which account for less than one per cent of the total electricity traded in the Czech Republic. All cleared entities, i.e. not only traders and generators but also the eligible customers who are responsible for imbalances (so-called entities subject to clearing), can go to the short-term markets to procure electricity.

The degree of integration with neighbouring Member States

The national legislative framework for electricity exports/imports from/into the Czech Republic was described in detail in the previous National Report. A potential electricity exporter/importer from/into the Czech Republic over the transmission system must buy the respective capacity at the cross-border interconnection at auctions organised by the TSO. In 2006, 19.5 TWh were exported from the Czech Republic, while imports totalled 6.9 TWh. The Energy Regulatory Office does not have data on the prices or comparisons of the prices of the electricity traded with the neighbouring countries.

Mergers and acquisitions in the electricity industry in 2006

In 2006 the Office for the Protection of Competition assessed three mergers of undertakings in the electricity industry: the ENERGIE Holding a.s. / Teplárna Liberec, a.s. merger with a part of United Energy, a.s., the merger of Dalkia Česká republika, a.s. and Elektrárna Kolín a.s., and the merger of E.ON Energie, a.s. and Teplárna Otrokovice a.s. None of these mergers caused concerns about distortion of competition on electricity markets, because the mergers affected the energy sectors only very marginally.

ENERGIE Holding a.s. / Teplárna Liberec, a.s. and a part of United Energy, a.s.

This merger of undertakings was based on the acquisition of shares representing a 70% stake in the registered capital of Teplárna Liberec, a.s., and also the acquisition of a part of the business of United Energy, a.s., comprised of its Litoměřice, Louny and Mimoň operating units, by ENERGIE Holding a.s., itself a part of a group of companies led by MVV ENERGIE AG.

The business groups of which the merging undertakings are a part operate in the Czech Republic in district heating (heat generation and supply) in Uherské Hradiště, Jablonec nad Nisou, Jablonec v Podještědí, Studénka, Opava, Děčín, Vsetín, Liberec, Litoměřice, Louny and Mimoň, and in the generation of electrical energy which they produce in combination with the thermal energy and supply to electricity traders.

The merger under review did not elicit any concerns about distortion of competition, because in district heating the activities of the merging undertakings did not overlap in geographic terms, i.e. each of the merging undertakings operated in different towns and cities and their combined share of the Czech electricity generation market did not exceed one per cent.

Dalkia Česká republika, a.s. and Elektrárna Kolín a.s.

These two undertakings merged by the acquisition of shares representing a 90% stake in the registered capital of Elektrárna Kolín a.s. by Dalkia Česká republika, a.s., a part of a group of companies led by VIVENDI ENVIRONMENT.

These two undertaking operate in the Czech Republic in heat generation and supply in Ostrava, Olomouc, Přerov, Karviná, Havířov, Krnov, Frýdek-Místek, Nový Jičín, Ústí nad Labem, Praha and Kolín. To a lesser extent, the two merging undertakings also produce electrical energy, which they supply to electricity traders in the Czech Republic.

The merger under review did not elicit any concerns about distortion of competition, because in district heating the activities of the merging undertakings did not overlap in geographic terms, i.e. each of the merging undertakings operated in different towns and cities and their combined share of the Czech electricity generation market did not exceed five per cent.

E.ON Energie, a.s. and Teplárna Otrokovice a.s.

These two undertakings merged by the acquisition of shares representing a 66% stake in the registered capital of Teplárna Otrokovice a.s. by E.ON Energie, a.s.

The target company operates mainly as a heat producer and supplier in Otrokovice, Napajedla a Zlín; to a lesser extent it produces electrical energy, which it supplies to final customers. E.ON Energie, a.s. is a part of the E.ON Group, which operates in the Czech Republic mainly in electricity generation, distribution and supply, natural gas distribution and supply, and also on the heat generation and supply market of Tábor, Kyjov, Mydlovary and Zliv.

The merger under review did not elicit any concerns about distortion of competition, because in district heating the activities of the merging undertakings did not overlap in geographic terms, i.e. each of the merging undertakings operated in different towns and cities and their combined share of the Czech electricity generation market did not exceed one per cent; on the Czech electricity supply market the company resulting from the merger holds an about 20% market share, and the increase in E.ON's share due to the merger was less than one per cent.

3.2.2 Structure of the retail market

Companies with a market share of above 5%

Only three vertically integrated companies that hold both a licence for electricity distribution (DSOs with more than 90,000 customers) and for electricity trading on the electricity market are currently operating on the Czech electricity market. So far, most of eligible customers have selected the above companies as their electricity suppliers; the reasons are the relatively small number of active independent traders on the Czech market and the negligible differences in the supply prices offered. In the case of customers connected to the low voltage level (low-demand business customers and households), these three companies are the only electricity suppliers who regularly offer energy, as a product, to these low-demand categories. These three suppliers' electricity market share accounts for more than 95% of final customers' total consumption in the Czech Republic; in the case of customers connected to the low voltage level their share is more than 99%.

Independent electricity traders

Several (about ten) more important traders independent of regional distributors also operate on the market; their total market share is currently only up to a few per cent of eligible customers' total consumption. So far, these suppliers have been offering electricity bought from smaller generators or imported from other countries mainly to large industrial customers. The reason has been the gradual opening of the Czech electricity market. Going forward, these suppliers' share of the low-demand customers and households segments can be expected to grow. As at 31 December 2006 the total number of electricity trading licences issued in the Czech Republic was 285; however, most of the licensed traders are not active, or their share in the domestic market is negligible.

Other electricity generators

In addition to ČEZ a.s., some other major generators with an installed capacity of more than 200 MW operate on the Czech electricity market: International Power Opatovice, a.s. (until 30 September 2005 Elektrárny Opatovice, a.s.); Dalkia Česká republika, a.s.; Sokolovská uhelná, právní nástupce, a.s.; ECK Generating, s.r.o.; Energotrans, a.s.; and United Energy, a.s. These companies are usually parts of larger holdings, frequently multinational energy groups, which cover the whole range of activities from generation to trading. Direct connection through these ties, where the generator and trader operating in the Czech Republic are part of the same group, can be seen in the case of, for example, ECK Generating (Atel Energy GmbH). In addition to these producers, who mostly sell their electricity on the market, also some large industrial groups, namely Chemopetrol, a.s. and Mittal Steel Ostrava, a.s. have their own electricity generating plants with a total installed capacity of more than 200 MW.

Number of customers who have switched suppliers

13,153 customers switched their supplier in 2006. Since the beginning of the Czech electricity market liberalisation, i.e. 2002, a total of 17,085 entities changed their supplier. According to Operátor trhu s elektřinou, a.s., approximately 0.2% of customers connected to the low voltage level and up to 4% of customers connected to the high voltage and extra high voltage levels have changed their energy supplier since the start of the liberalisation.

The numbers of supplier switches are not followed by customer category, i.e. the size of their consumption; information about supplier switching by the type of metering at supply points is only available.

The supply points are specifically categorised as follows:

- A – continuous metering with remote data transmission;
- B – continuous metering with manual data transmission; and
- C – non-continuous metering.

Table 5 shows the number of electricity supplier switches by metering type since the beginning of the electricity market liberalisation.

Table 5 Electricity supplier switches by metering type

Type of metering	Electricity supplier change by type of metering			
	2003	2004	2005	2006
A	16	363	769	2,927
B	0	33	882	2,268
C	0	3	1,866	7,958
Total	16	399	3,517	13,153

Supplier switching procedure

As regards the option of electricity supplier switching, final customers may choose their suppliers of energy, and the choice is free of charge. However, the physical transport of electricity takes place through the distribution or, as applicable, transmission system to which the customer is connected. For this reason a final customer usually has two contracts in place, i.e. one agreement on distribution/transmission and one agreement on electricity supply. The distribution agreement is executed between the final customer and the respective operator of the distribution/transmission system to which the customer is connected. These agreements are usually signed in perpetuity (they apply for as long as the taking of electricity lasts), and supplier switching does not affect them. The supply agreement is executed between the final customer and his electricity supplier, i.e. an entity holding an electricity generation licence or an electricity trading licence. Electricity customers can also enter into a single aggregate agreement with their electricity suppliers (referred to as agreements on bundled services), which contains the supplier's obligation to arrange for electricity transport to the customer in addition to electricity supply. The terms and conditions governing electricity supply and billing, as well as the terms and conditions governing contract termination (including the relevant time limits and potential penalisation) are subject to a contractual relationship entered into under the Commercial Code.

ERO Public Notice No. 541/2005 on the electricity market rules, principles of pricing the electricity market operator's activities and the implementation of certain other provisions of the Energy Act, lays down the rules and obligations for the various market participants (final customers, electricity suppliers, DSOs, TSO, market operator); for supplier switching, the sequence of the steps to be taken and the applicable time limits are set out. The overall supplier switching process has been shortened and currently may not be longer than 17 business days (i.e. 23 calendar days) from the moment the customer files an application for supplier change. No fees are charged to the customer for such supplier switching.

3.2.3 Measures to avoid abuse of dominance

Market surveillance

In view of the nature of the undertakings that carry on business in the energy industries, i.e. network monopoly, there is a need for continuous surveillance by the competent

administrative authorities. One of them is the ERO, which sets in advance the conditions for business on the market, thereby creating a regulatory framework for business in the energy industries within the limits given by the Energy Act. The role of the ÚOHS, which watches undertakings' behaviour from the perspective of the law on the protection of competition, is as important as the ERO's role. The roles played by these two authorities differ, since the ERO lays down the rules in advance and comprehensively for the whole sector, while the ÚOHS may only intervene when manifestations incompatible with the rules of competition appear on the market. The ÚOHS's interventions are therefore always directed towards a specific undertaking, and it always assesses only one specific way of behaviour from the perspective of the law on the protection of competition.

The virtual power plant

Evaluation of the first year from launch - ÚOHS

The circumstances under which the virtual power plant was introduced, which was one of the ÚOHS's requirements when it permitted the merger of ČEZ, a.s. with five regional distribution companies, were described in detail in the National Report for 2005. The idea of the project is to make that part of the generating capacity owned by the dominant electricity generator, ČEZ a.s., which corresponds to the quantity of electricity supplied by ČEZ a.s. to the various regional distribution companies, available to independent undertakings competing on the market, who then compete with this electricity on electricity markets. The objective was to create the preconditions for the emergence of genuine competitors to the ČEZ Group on the electrical energy supply market. The auction for 2006 was declared on 31 May 2005 and its first round took place at the beginning of August 2005. The demand exceeded the offered capacity more than five times (5.5 times): 16 bidders presented 44 valid bids. Representatives of local and foreign traders and eligible customers took part in the auction. Four companies placed the best bids for the 400 MW capacity of the virtual power plant: two entities won one unit each, another company won two units, and another competitor to ČEZ a.s won a full half of the eight 50 MW units offered. The winning bid prices for the individual units were 14.6% to 15.1% higher than the wholesale electricity price for 2005. The resulting average price of electricity bought in the virtual power plant auction for 2006 was therefore 14.82% higher than electrical energy prices for 2005. The virtual power station's offer helped to increase the volume of the alternative offer on the Czech wholesale market by almost ten per cent, and so one-half of Czech consumption could be covered from sources other than ČEZ.

The main reason for this strong demand, which drove up the prices of the electrical energy bought in the virtual power plant auction, was the long-lasting growth in electricity prices on commodity markets in central and eastern Europe. The increasing demand for electricity, and in turn the increasing prices on these markets, are attributable to central European economies' growth and also the need to close down certain capacities in Slovakia, Poland and Hungary. In the last few months international prices have also been rising due to generators' increased uncertainty concerning the environmental protection conditions under which the development and replacement of capacities will be permitted. Moreover, traders' demand for electricity is increasing at a faster pace than the growth in domestic demand, which suggests – based on a comparison of wholesale electricity prices with those in neighbouring countries – that some of the traders reckoned with exporting the electricity they bought.

The purpose of the virtual power plant project was to create a functioning and competitive market that would help to ensure, in a transparent and non-discriminatory way, independent traders' access to available electric power. Since the prices of electrical energy in the various EU member states are converging (in the Czech Republic wholesale electricity prices are ten

and more per cent lower than those in the neighbouring countries), the requirement placed on ČEZ a.s. is only a short-term measure and its purpose is to serve as a tool for speeding up the development of the wholesale market. The increase in the wholesale prices of electrical energy, which occurred due to the working of the above mechanisms, was also reflected in rising prices to final customers. However, for example in the case of households the wholesale price makes up only a part (approximately one-third) of the whole rate, which also includes, in addition to electricity, charges for transmission, distribution, system services, support for renewable resources, and VAT, which mitigates the resulting effect of the growth of these prices.

The second half of 2006 saw another, and the last, auction for the allocation of the virtual power station's generating capacity for 2007; the National Report for 2007 will outline the results of this auction.

Evaluation of the first year from launch - ERO

The Energy Regulatory Office believes that the capacity offered in the virtual power plant auction was too low to have a favourable influence on the situation prevailing on the Czech electricity market. Another negative aspect was the timetable of the auction, when the bulk of ČEZ's output for the Czech market was sold only after the conclusion of the auction. The auction could therefore serve more as an alibi for across-the-board wholesale electricity price hikes on the Czech market.

4 Regulation and structure of the natural gas market

4.1 Regulatory issues

4.1.1 Management and allocation of cross-border capacity

In 2006 RWE Transgas Net, s.r.o., which holds the exclusive gas transmission licence in the Czech Republic, provided for natural gas transmission across the Czech Republic under an agreement with RWE Transgas, a.s., which provides for gas transmission under agreements in place for Gazexport Moscow, Verbundnetz Gas AG Leipzig, and Wintershall AG Kassel. The current capacity of the transmission system is such that neither physical nor commercial congestions occur.

In the period under review the respective provisions of Public Notice No. 673/2004 on the rules for gas market organisation (gas market rules), which applied in 2006 and set out the TSO's obligation to publish information on the operation of the transmission system, did not change. In connection with the applicability of Regulation 1775/2005/EC from 1 July 2006, as at that date the TSO extended the information provided to meet the requirements of point 3.3 of the annex to Regulation 1775/2005/EC.

Looking at the capacity of cross-border interconnections it is to be noted that the TSO applied the point-to-point principle of capacity booking, and there were no physical or commercial congestions at those points. RWE Transgas Net, s.r.o. provided information about the technical capacity available at its three border transfer stations in Lanžhot, Hora sv. Kateřiny and Waidhaus on its website from 1 July 2006, complying with the structure required by regulation 1775/2005/EC. In line with these requirements, the transmission capacity was offered on both the firm and interruptible basis for the term of daily, monthly, annual and multi-annual agreements.

Through its bulletin board, in 2006 the TSO enabled secondary capacity trading under the conditions set out in the market rules and its Grid Code. In 2006 the secondary market was not liquid, thanks to the abundance of primary capacity.

From the perspective of the national level there were higher rates of capacity utilisation only in distribution systems; nevertheless, this did not precipitate any need for limiting customers' capacity requirements or for pipeline reinforcement.

As regards the priorities in capacity allocation (national or cross-border) in the event of a commercial shortage of capacity, and the issues of gas transit, the same rules as in 2005 stayed in place in the period under review. Since there was sufficient primary capacity in the transmission system in 2006 these rules were not applied in practice.

4.1.2 The regulation of the tasks of transmission and distribution companies

The transmission system operator

Since 1 January 2006 RWE Transgas Net, s.r.o. has been the transmission system operator in the Czech Republic. Connected to the transmission system are the eight regional gas distribution systems (DSO), each of which has more than 90,000 final customers. In addition, approximately 105 smaller holders of licences for natural gas distribution in local distribution systems operate on the Czech market (LDS). The legislative framework for the operation of the TSO, DSOs and LDSs did not change in the period under review.

The Balancing Centre

For the purposes of the monitoring of gas planning, production, supplies and consumption, the capacities and performance of the transmission system, distribution systems and underground gas storage facilities, and the line pack, and the processing of this data into summary overviews of the gas system, a Balancing Centre was set up under Section 64 of the Energy Act. The Balancing Centre receives information from the TSO, DSOs with more than 90,000 customers, and SSOs.

On the basis of the overviews prepared throughout the gas chain, i.e. by the TSO, DSOs, LDSs, SSOs and gas traders, and on the basis of its own analyses, the Balancing Centre prepares overall overviews of the gas system. To this end, the Balancing Centre has certain rights specified in the Energy Act. At the same time it has the obligation under the law to provide the MIT and ERO, upon their request, with information required by the two institutions to exercise their powers and perform their obligations.

Also eligible customers have certain duties to the Balancing Centre under the legislation in place; these include provision of monthly data on gas supplies in cases where the eligible customers arrange for such supplies on their own, including imports. Further, where eligible customers exercise their right to switch suppliers, they must notify the Balancing Centre of such change.

Network tariffs

The principles of the pricing of gas transmission and distribution for final customers in the Czech Republic are in fact the same as those for electricity transmission and distribution, which were explained in the National Report for 2004 in the section on the electricity industry (see 3.1.3).

Transmission

The transmission rate was comprised of one component only, and it related to the contracted transmission capacity. For annual agreements, the Energy Regulatory Office set the 2006 transmission rate for inland transmission at CZK 23,953.80/1,000 cu m / day / year per entry/exit point pair in inland transmission. Transmission agreements could also be executed for shorter periods of time, starting from one-month periods, but for no more than twelve months. Setting prices for shorter periods than one year was based on the fact that in different months of the year the transmission system is used to a different extent, and therefore the efforts to provide transmission capacity for a shorter period depend on the specific month and the length of the period. The Office set factors for each of the calendar months. The values of these factors make it possible to derive transmission charges from the annual transmission rate for the purpose of monthly transmission agreements.

From 1 July 2006 it was also possible to enter into daily gas transmission agreements. The transmission charge for a day was set as 1/15 of the charge for monthly transmission agreements.

The charge for interruptible capacity, in the case of daily, monthly and annual agreements, was the same in 2006 as the charge for firm capacity under such agreements, providing that discount would be granted in the event of an interruption. There are no interruptions in practice.

As of 1 July 2006 the Office endorsed the methodology for pricing international transmission (transit). The transit pricing methodology was based on the benchmarking of competing natural gas transit routes. On the basis of the approved methodology the TSO put in place

a double-component transit rate for 2006. One component, fixed at CZK 66,000 / 1,000 cu m / day / year applied to contracted transmission capacity for a pair of entry/exit points in international transmission, and the other component covered compressor station fuel gas and accounted for 0.77% of the actually transported gas volume. It was also made possible to enter into agreements on transmission over the transit system for a shorter term, starting from the one-day term.

Distribution

For 2006 the distribution rates were set as double-component rates for all offtake bands in all customer categories. The component that was fixed for a particular supply point was related, in the large offtake and medium offtake categories and in the category of low-offtake and households taking over 63 MWh/year, to the booked distribution capacity for supply points with continuous metering and to the calculated distribution capacity for supply points with different types of metering. For the low-offtake category and households taking up to 63 MWh/year the fixed component had the form of the standing charge. For all customer categories the variable component of the distribution rate related to the total quantity taken.

Distribution agreements could be executed on an annual basis for at least twelve consecutive calendar months, and on a monthly basis for a maximum of twelve consecutive calendar months. Under an ERO price decision, the monthly distribution price was derived from the annual rate, similarly as the transmission price. To make sure that the respective TSO or DSOs did not take a discriminatory approach, distribution and transmission charges were set as fixed prices, i.e. no discounts could be granted, and the prices could not be increased. Thanks to the sufficient capacity in the distribution systems and the transmission system the interruptible capacity charge was set at the same level as the charge for firm capacity, but discounts were granted upon interruption in accordance with the more detailed specification in the TSO's and the DSOs' Codes. The interruptible capacity charges were set as the maximum prices because of the option to grant a discount for supply interruptions.

Table 6 shows the distribution charges for 2006 for the various categories of final customers by Eurostat categorisation, ranging from the least to the most expensive distribution system with more than 90,000 customers. The charges are in CZK/MWh and without VAT.

Table 6 Average distribution charges in 2006

Eurostat category	Distribution charge	
	Minimum, CZK	Maximum, CZK
I4-1	34.39	73.88
I1	95.89	174.18
D3	132.54	233.41

For the sake of comparison, Table 7 shows supply prices broken down by consumer category in accordance with Eurostat definitions provided by the Czech Statistical Office for the purpose of this National Report. The prices are in CZK/MWh and include all services, i.e. distribution, transmission, storage, commodity and other commercial services. Column A shows prices without VAT, column B shows the same prices with VAT.

Table 7 Gas prices to final customers by Eurostat categories for all quarters of 2006

Period	Standard Eurostat consumer					
	D3		I1		I4-1	
	A	B	A	B	A	B
1.1.200	871.1	1,036.7	786.4	935.8	720.5	857.4
1.4.200	883.5	1,051.4	827.5	984.7	742.6	883.7
1.7.200	883.5	1,051.4	826.6	983.7	742.6	883.7
1.10.200	834.4	992.9	805.0	958.0	699.5	832.4

Charges for access to UGS facilities

In accordance with the Energy Act the Czech Republic uses negotiated third party access to storage facilities. The Office therefore does not control the charges for gas storage, although a single company *de facto* controls almost all storage capacities in the Czech Republic. The Office does not even have the remit to influence the SSO's activities by approving the SSO Code.

Under ERO Public Notice No. 673/2004, which lays down the rules for gas market organisation in 2006, operators of underground gas storage facilities are obligated to offer "service bundles" (SBU) for all operated UGS facilities as a whole, to which the required injection and withdrawal capacities and working volume are tied. The market rules also provide for the option of capacity transferability. For SSOs, they also lay down the obligation to offer both firm and interruptible contracts.

Two SSOs operating in the Czech Republic, namely RWE Transgas, a.s. and Moravské naftové doly, a.s., set the charges for access to UGS facilities. On its website RWE Transgas, a.s. publishes indicative levels of storage charges in relation to the storage agreement term. In May 2006 the withdrawal capacity charge under one-year agreements was CZK 161.30 / cu m / day / year (CZK 2.54 per cubic metre of working volume); and under 20-year agreements CZK 100 / cu m / day / year (CZK 1.54 per cubic metre of working volume). There are another two UGS facilities in the Czech Republic, at Uhřice and Dolní Bojanovice (for details please see point 4.2.1, under 'Companies having at least a 5% market share'). In 2007 RWE Transgas a.s. changed its methodology for pricing the access to UGS facilities; the price is not tied to the term of the contract.

The entire current capacity in the Uhřice UGS facility is leased out to RWE Transgas, a.s. The Dolní Bojanovice UGS facility, operated by SPP Bohemia, a.s., is used as a bonded warehouse, and therefore is not used for the needs of customers in the Czech Republic.

However, the Energy Regulatory Office regulated the cost of storage included in the regulated price of supplies to protected customers and in the price of supply to eligible customers as outlined in point 2.3.1. It was a capacity-related component of the price of gas supplied by RWE Transgas, a.s. traders. This component included the costs related to the UGS facilities owned by RWE Transgas, a.s. and this company's costs incurred in leasing UGS facilities for the needs of customers in the Czech Republic from the other SSO in the Czech Republic and from companies outside the Czech Republic. This price therefore failed to accurately reflect the individual SSOs' storage charge, and did not make it possible to discern the withdrawal capacity price as such. As an indicative value we would note that on average, the storage charge amounted to CZK 0.81/cu m of the working volume.

Service quality

Once a year, the TSO, DSOs and SSOs are obligated to submit a report on the quality and maintenance of the transmission and distribution systems and UGS facilities pursuant to Section 58, subsection 9(y), Section 59, subsection 8(z), and Section 60, subsection 7(p) of the Energy Act. The content of these reports is specified in the MIT's and ERO's Common Methodological Guidelines (on the content of reports to be submitted by the TSOs, DSOs and SSOs on the quality and maintenance of the installations they operate), which are publicly available on the respective websites. No serious problems with service quality have been reported to date.

In 2006 an ERO public notice was being drafted for the legislative process; it focuses in detail on the monitoring, assessment and publication of the quality standards prescribed, and on the penalisation of failures to keep such standards. It contains similar quality-related provisions as the one on quality standards in the electricity industry currently in place. The public notice was promulgated with effect from 1 January 2007.

The balancing market

The character of the gas market model's functioning did not change in any material parameters of balancing in the period under review. There were only changes related to Regulation 1775/2005/EC. The balancing process continued to be based on the daily interval of imbalance evaluation.

The nomination and renomination conditions were applied in accordance with the EASEE-gas rules. The first half of 2006 saw the introduction of charges for renomination, related to the quantity of the gas supplied by each of the suppliers. To reflect the needs of small balancing entities the Energy Regulatory Office set a charge of CZK 800 for balancing entities with a total booked transmission capacity of more than 2 mcm/day. It also introduced a charge for every renomination amounting to more than 4,200 MWh on any given gas day, at CZK 0.20 per MWh of the difference between the value of the renomination and the value of the nomination accepted and registered by the TSO, or the last revised nomination accepted and registered by the TSO, or the last renomination accepted and registered by the TSO. From 1 July 2006 the renomination charge was abolished for all users under Regulation 1775/2005/EC.

The TSO was responsible for the physical balancing of the system; in addition to the line pack UGS withdrawal/injection capacities and a limited quantity of gas in UGS facilities were available to the TSO.

As regards commercial balancing, the principle of calculating the balancing tolerance using a formula was preserved. However, in the first half of 2006 the Office took small balancing entities' needs into consideration; the balancing tolerance for balancing entities with a booked transmission capacity of less than or equal to 2 mcm/day was set at 5% of the sum of all daily booked firm or interruptible capacities of the respective balancing entity agreed in contract(s) at each of the exit points. From 1 July 2006 the advantage to small entities was abolished to meet the requirements of Article 7 of Regulation 1775/2005/EC. After that date the balancing tolerance was calculated using a formula identical for all balancing entities.

In terms of the evaluation of the 'balancing imbalance' and the opportunity to use the balancing tolerances, the whole of the Czech Republic was a single balancing zone. When the balancing tolerance was exceeded, the so-called off-tolerance balancing imbalance arose, which was subject to a charge set by the Office in its price decision.

Balancing entities also had to keep the values nominated to the TSO within a gas day. A failure to keep the nominated gas quantity at the respective exit from the transmission system gave rise to a nomination imbalance, also subject to a charge set out in an ERO price decision. Nevertheless, there was a nomination tolerance based on a formula for these cases too and in practice, it was almost never exceeded.

The parameters of the balancing process in 2006 did not make it possible to transfer the responsibility for imbalances, whether *ex-post* or *ex-ante*.

The Office determined the coefficients for calculating the balancing and nomination tolerances on the basis of an analysis of the line pack in the transmission system in relation to the utilisation of the system. Because of the non-existence of a sufficiently liquid market with a daily reference price resulting from an effective match between supply and demand (perfect competition), imbalances were resolved by means of payments in kind. On the basis of preliminary results of metering, the individual entities balanced the imbalances for day D, or, for the immediately preceding non-working days, on day D+2. Once the TSO evaluated a whole calendar month, these entities settled the sum of the actual imbalances for that calendar month on the 15th day of the following month.

If a balancing entity did not opt for payment in kind, it paid for the missing balancing gas at a price that the Office had, because of the non-existence of a daily market price of natural gas, set at 1.6 times the maximum price of the gas from RWE Transgas, a.s., and the price for excess balancing gas was 0.4 times the above maximum price. The TSO paid for the excess balancing gas.

4.1.3 Unbundling

In 2006 one TSO operated in the Czech Republic (RWE Transgas Net, s.r.o.), and eight DSOs (Jihočeská plynárenská, a.s., Jihomoravská plynárenská, a.s., Pražská plynárenská, a.s., Severočeská plynárenská, a.s., Severomoravská plynárenská, a.s., Středočeská plynárenská, a.s., Východočeská plynárenská, a.s., and Západočeská plynárenská, a.s.), each of them having more than 90,000 customers, which between them cover the largest part of the market. There were 105 operators of local distribution systems.

Ownership unbundling

From the perspective of ownership neither the TSO nor the DSOs have been unbundled.

Legal unbundling

The TSO, RWE Transgas, a.s., has effected legal unbundling. Since 1 January 2006 the TSO has been operating under a new name, RWE Transgas Net, s.r.o. Under the Energy Act, DSOs with more than 90,000 customers were to effect unbundling by 31 December 2006. During the year intensive preparations for legal unbundling were under way and on 31 December 2006 the process of legal unbundling was finalised, also at the level of operators of regional distribution companies to which more than 90,000 customers were connected, resulting in gas trading companies and gas distribution subsidiaries. On 1 January 2007 companies with the following names came into existence:

Pražská plynárenská Distribuce, a.s.
Středočeská plynárenská Net, s.r.o.
Jihočeská plynárenská Distribuce, s.r.o.
Západočeská plynárenská Net, s.r.o.
Východočeská plynárenská Net, s.r.o.
Severočeská plynárenská Net, s.r.o.

Severomoravská plynárenská Net, s.r.o.
Jihomoravská plynárenská Net, s.r.o.

The 105 operators of local distribution systems are not obligated to effect legal unbundling.

“The 100,000 customers” rule

The Czech Republic has used the option to effect unbundling solely in respect of companies that have a large number of customers. In Czech legislation, this option is known as “the 90,000 customers” rule, and is provided for in Section 59a, subsection 9 of the Energy Act.

Ownership structure

TSO - **RWE Transgas Net, s.r.o.**

On 31 December 2006 the ownership structure of this company was as follows:

- 100% RWE Transgas a.s.

DSO - **Pražská plynárenská, a.s. (PP)**

On 31 December 2006 the ownership structure of this company was as follows:

- 50.2% Pražská plynárenská Holding a.s.
- 49.35% RWE Gas International B.V.
- 0.45% other shareholders

Jihomoravská plynárenská, a.s. (JMP)

On 31 December 2006 the ownership structure of this company was as follows:

- 47.65% RWE Gas International B.V.
- 43.73% E.ON Czech Holding AG
- 2.46% RWE Transgas, a.s.
- 2.33% SPP Bohemia a.s.
- 3.83% other shareholders

Západočeská plynárenská, a.s. (ZČP)

On 31 December 2006 the ownership structure of this company was as follows:

- 97.99% RWE Gas International B.V.
- 2.01% other shareholders

Středočeská plynárenská, a.s. (STP)

On 31 December 2006 the ownership structure of this company was as follows:

- 100% RWE Gas International B.V.

Severomoravská plynárenská, a.s. (SMP)

On 31 December 2006 the ownership structure of this company was as follows:

- 49.65% RWE Gas International B.V.
- 20.65% SPP Bohemia a.s.
- 18.09% RWE Transgas a.s.
- 8.52% SPP a.s.
- 3.09% other shareholders

Východočeská plynárenská, a.s. (VČP)

On 31 December 2006 the ownership structure of this company was as follows:

- 63.62% RWE Gas International B.V.
- 18.89% SPP Bohemia a.s.
- 10.0% SPP a.s.
- 3.21% GDF International,
- 2.95% RWE Transgas, a.s.
- 1.45% other shareholders

Severočeská plynárenská, a.s. (SČP)

On 31 December 2006 the ownership structure of this company was as follows:

- 100% RWE Gas International B.V.

Jihočeská plynárenská, a.s. (JČP)

On 31 December 2006 the ownership structure of this company was as follows:

- 99.04% E.ON Czech Holding AG
- 0.96% other shareholders

Companies' employees

Gas companies have provided the Office with information about the proportion of shared employees within their holding structure; the figures are approximately 30% in gas distribution and 5% in gas transmission.

Shared services

Transmission and distribution companies use shared services in logistics, human resource and personnel management, information technologies, and customer services (call centres). All of these services are provided under agreements within the holding structure of the companies, and are jointly used by the subsidiaries.

In 2006 the proportion of shared services was as follows on average: 40% gas distribution and 20% gas transmission.

Location of companies

The TSO, RWE Transgas Net s.r.o., has physically moved to a separate building and employees' access is monitored by a security service.

No information about the physical separation of the workplaces of DSOs with more than 90,000 customers is currently available.

Presentation of companies

After its legal unbundling the TSO has set up its own domain, at which it presents its activities using the holding company's shared brands, logos and design.

In 2006 DSOs with more than 90,000 customers prepared presentations of their own activities.

Unbundled accounts

In general, accounts for unbundled activities were not published; they were available only for the ERO's purposes as part of regulatory reporting.

The Energy Regulatory Office sets forth the general principles and detailed rules for the preparation of unbundled accounts only for the purpose of regulatory reporting, i.e. purely for the regulator's needs. However, this does not involve allocation rules (such as cost allocation), but individual accounts and items that the various operators have to report in a specific and detailed manner.

Unbundled accounts are not the subject of a separate audit by a certified accountant.

The role of the compliance officer

Under the Energy Act, DSOs with more than 90,000 customers and the TSO have set up the position of compliance officer, who is responsible, in particular, for supervising the performance of the compliance programme, employee training, complaint handling, and for producing a report on performance under the compliance programme.

Inspections and sanctions

On the basis of the allocation of competencies within state administration in the Czech energy sector, the Energy Regulatory Office is conceived as an administrative authority that carries out regulation through the competencies vested in it. However, these competencies do not include penalisation powers, and the Office only has marginal inspection competencies. The State Energy Inspectorate is the inspection and penalising authority. Should certain irregularities or breach of obligations be found on the part of companies, the Energy Regulatory Office may suggest to the State Energy Inspectorate to conduct inspections; if the latter finds a violation of law it may impose a fine pursuant to Section 95 of the Energy Act. In the event of a serious violation of obligations attendant on licensed activities the Energy Regulatory Office may, under Section 10, subsection 2 of the Energy Act, revoke that company's authorisation to carry on business, i.e. its licence.

4.2 Competition issues

4.2.1 Structure of the wholesale market

Gas consumption

Natural gas consumption in the Czech Republic has been stable in the past few years, at around 9,500 mcm/year, with slight variations depending on the weather. In the past few years the net calorific value of the natural gas supplied to final customers has been increasing slightly. It is approximately 9.50 kWh/cu m (34.2 MJ/cu m) – for more details please see point 5.2.2. The gross calorific value is approximately 10.55 kWh/cu m (37.98 MJ/cu m).

Indigenous resources and imports

The Czech Republic's indigenous natural gas resources account for less than 1% of the country's domestic consumption. These resources include natural gas produced in southern Moravia, mainly for local consumption. Since domestic gas production is almost negligible, the Czech Republic has to import almost all of the natural gas it needs. Natural gas imports have therefore been secured by long-term take-or-pay natural gas supply agreements. These agreements are owned in the Czech Republic by RWE Transgas, a.s. Three-quarters of the country's annual consumption are covered by gas supplied by Russian producers; Norwegian producers supply the balance. In 2006 new natural gas importers started to operate on the Czech market: Vemex, s.r.o. and Wingas GmbH; however, their market share was negligible, approximately 0.5 per cent.

New gas market players

New entrants have more or less been just monitoring the current situation on the market. The companies that actually did supply gas are Wingas GmbH and Moravské naftové doly, a.s., whose market share was rather negligible as they supplied only four final customers (see point 2.2). From the last quarter of 2006 Vemex, s.r.o., largely indirectly controlled by the Russian company GAZPROM, could be felt more strongly on the Czech market.

Contractual relationships

In 2006 the gas purchase agreements of DSOs with more than 90,000 customers, intended for gas supplies to eligible customers, were long-term take-or-pay agreements. Because of the limitations on the maximum prices allowed on the wholesale market, described in more detail in point 2.3.1, wholesalers' selling prices (the maximum level of such prices) were derived from the ERO's price decision.

Companies having at least a 5% market share

RWE Transgas, a.s. is one of the most important companies on the Czech market; on the wholesale market it is the only player having a market share of more than 5%. Since 10 July 2003 RWE Gas International B.V. has been the sole shareholder of this company. Its core business includes natural gas storage and trading under the Energy Act. RWE Transgas a.s. holds exclusive control over its subsidiary RWE Transgas Net, s.r.o., which has been operating as the TSO since 1 January 2006. The ownership structure (see point 4.1.4) suggests that the RWE international energy group also controls natural gas trading and distribution in six DSOs with more than 90,000 customers. Thus, the RWE Group is a vertically integrated group that provides comprehensive services in the gas industry.

The other major DSOs with more than 90,000 customers include Pražská plynárenská, a.s. (PP) and Jihočeská plynárenská, a.s. (JČP), in which the E.ON energy group is acquiring majority stakes step by step. E.ON Czech Holding AG has executed agreements on swapping equity interests in the Czech gas industry with companies in the RWE Group, under which it has strengthened its position in JČP (its 13% interest has increased to 99%) and in PP (it has acquired a 49% interest in PP and, at the same time, a 49% interest in Pražská plynárenská Holding a.s., which holds a 50% interest in PP). This agreement having been carried out, E.ON Czech Holding AG has become another major undertaking on the Czech market.

On the Czech gas storage market, in addition to RWE Transgas, a.s., which owns six of the eight UGS facilities located in the Czech Republic, there is also Moravské naftové doly, a.s., in which SPP Bohemia, a.s. holds more than 50%. The Dolní Bojanovice UGS facility, operated by SPP Bohemia, a.s., is fully used for the needs of the Slovak gas industry, and is operated as a bonded warehouse. It is therefore not included in the above data on quantities.

Other traders

By 31 December 2006 the Energy Regulatory Office had issued 83 gas trading licences. However, the Office currently does not monitor the extent to which these traders are active on the gas market.

Abuse of dominant position by RWE Transgas, a.s.

The ÚOHS delivered a decision in 2006, which became final at the beginning of 2007, in which it noted that RWE Transgas, a.s. abused its dominant position on the market of natural gas supplies to eligible customers. From 5 November 2004 to 10 August 2006 the company did not make it possible for operators of competing regional distribution systems (Jihočeská plynárenská, a.s. and Pražská plynárenská, a.s.) to enter into agreements on natural gas purchase and sale such as would have realistically enabled these distributors to effectively compete with the operators of the regional distribution systems included in the RWE holding. Jihočeská plynárenská, a.s. and Pražská plynárenská, a.s. were therefore at a disadvantage in competition for eligible customers. RWE also refused to supply natural gas to other places than the balancing zones of the various regional distributors, thereby blocking and restraining the emergence of a competitive environment. In a situation where regional distributors bought gas at the entry to their respective balancing zone they basically had to accept the terms and

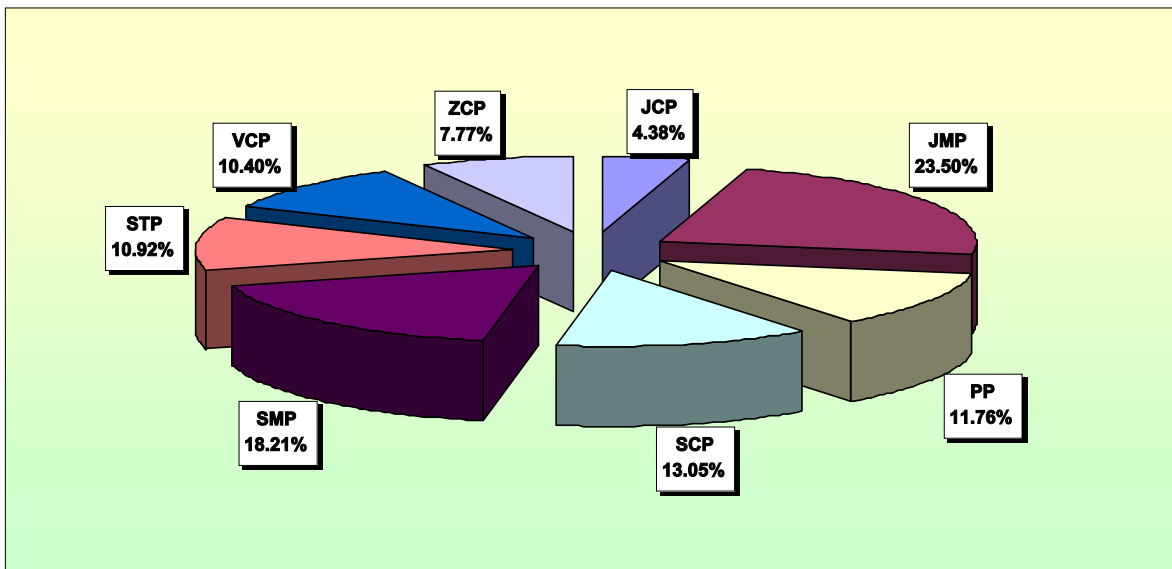
conditions that were unilaterally dictated by RWE. For example, Jihočeská plynárenská, a.s. was interested in supplies outside its balancing zone, but RWE Transgas, a.s. refused that repeatedly. The dominant company therefore created artificial barriers to new undertakings' entry into the market, or rather, barriers to the expansion of the then existing competitors to its own regional distributors.

The company's practices have to be viewed as all the more serious for the fact that it applied them at the very beginning of the liberalisation of the Czech gas industry. This had an adverse impact on the market, which was gradually opening up to competition and on which the dominant undertaking's eliminating practices of whatever nature could slow down or otherwise jeopardise the onset of the positive factors associated with liberalisation and greater competition for the final customers. They also affected a sector that plays a key role in the meeting the energy requirements of both final customers and the economy as a whole; within this sector any anti-competitive practices have extensive negative consequences. In fact, such practices may be reflected, directly or indirectly, negatively in the sphere of basically any business or consumer. For its practices a fine of CZK 240 million was imposed on RWE Transgas, a.s. At that time it was the highest fine that the ÚOHS had ever imposed on a single company.

4.2.2 Structure of the retail market

In the Czech Republic DSOs are broken down by the number of their customers. The DSOs that have up to 90,000 customers, which operated on the gas market in 2006, serve only very small areas and as competitors they have only marginal influence. The major players were the eight vertically integrated DSOs with more than 90,000 customers, which historically supply the regions delineated for them. The shares held by each of the DSOs with more than 90,000 customers in the total natural gas consumption in the Czech Republic can be seen in Chart 1.

Chart 1 Shares held by each of the companies on the Czech natural gas market



Six of the eight DSOs with more than 90,000 customers are controlled by the RWE Group, accounting for 83.86% of gas sales in the Czech Republic. All of the eight relevant companies usually limited their supplies to the region defined by the vertically integrated operator's distribution system and did not compete with one another; there are *de facto* eight monopoly markets. There was only one relevant wholesale gas supplier (RWE Transgas, a.s.) on the

market, while the supplies from the other three suppliers (Moravské naftové doly, a.s., Wingas GmbH and Vemex, s.r.o) did not cover more than 1.98 per cent of the Czech Republic's total consumption in 2006. The above factors result in the fact that although multiple companies operate on the retail gas market, they do not engage in any effective competition.

Structure of DSOs' customers

In the Czech Republic customers are categorised by their annual natural gas consumption into the following segments:

- Households and low-offtake customers (annual consumption up to 630 MWh/year);
- Medium-sized customers (annual consumption from 630 to 4,200 MWh/year); and
- Large offtake customers (annual consumption over 4,200 MWh/year).

Table 8 lists the physical shares held by each of the DSOs with more than 90,000 customers on the natural gas market, broken down by segment. In the Czech Republic, gas-fired power stations are used to only a very limited extent, mainly as peak-shaving capacities or CHP.

Table 8 Segmentation of the natural gas market and companies' physical market shares

Market segment	Companies' shares of segments							
	JCP	JMP	PP	SCP	SMP	STP	VCP	ZCP
Large offtake	4.27%	20.02%	8.85%	17.90%	19.87%	12.43%	8.66%	8.00%
Medium sized offtake	5.03%	23.62%	19.65%	8.92%	14.26%	9.36%	10.82%	8.35%
Households and low offtake	4.33%	27.15%	13.05%	8.88%	17.35%	9.68%	12.15%	7.40%
Total Czech Republic	4.38%	23.50%	11.76%	13.05%	18.21%	10.92%	10.40%	7.77%

Number of customers who have changed suppliers

In 2006 only five eligible customers switched suppliers. In the large-offtake category, it was Vetropak Moravia Glass, a.s.; in the category of medium offtake and at the same time low offtake, they were Moravské naftové doly, a.s., MND Servisní, a.s., and MND Stavotrans, a.s., and also Pražská plynárenská, a.s., a DSO, extended its supply portfolio to include an additional supplier. Additional supplier switches in respect of 21 supply points in the medium-offtake category and 425 supply points in the low-offtake category took place as the result of the acquisition of local distributor Českomoravská plynárenská, a.s. by RWE Gas International B.V. and its inclusion in the vertically integrated DSOs in the RWE Group.

The gas supplier switching procedure

Effective since 1 January 2006 all customers have become eligible customers, with the exception of households, and they have the right to change their gas supplier free of charge. The procedure to be followed in gas supplier switching is described in Section 23 of Public Notice No. 673/2004, which was applicable in 2006. For eligible customers supplier switching is possible as from the first day of a month and is subject to registration with the administrator of the respective balancing zone.

The eligible customer and the new gas supplier enter into a gas supply agreement first of all. The next step is the assignment of the eligible customer's supply point to the new gas supplier by the administrator of the respective balancing zone. Finally, the new gas supplier informs the eligible customer's old gas supplier of the execution of the above agreement.

The new gas supplier shall apply with the balancing zone administrator for the registration of the switch no later than 15 calendar days before the beginning of the month from which the

change is to take place. The balancing zone administrator shall inform the old and new gas suppliers whether it has accepted or rejected the application for registration no later than ten calendar days before the beginning of the month from which the change is to take place.

The ERO's discussions with eligible final customers indicate that the actual non-existence of competitive offers, the agreements currently in place, mainly their periods of notice of termination, and potential shortage of gas in UGS facilities from the new supplier are the main obstacles that impede gas supplier switching.

Mergers and acquisitions in the gas industry in 2006

In 2006 in the gas industry, the ÚOHS assessed only one merger of undertakings, E.ON Czech Holding AG and Jihočeská plynárenská, a.s. This merger of undertakings took place as a result of a change in the quality of control over Jihočeská plynárenská, a.s., from control exercised jointly by E.ON Czech Holding AG and Oberösterreichische Ferngas AG to control exercised exclusively by E.ON Czech Holding AG.

This merger did not elicit any concerns about distortion of competition, because E.ON Czech Holding AG operated on the gas markets, i.e. the natural gas distribution market and the market of natural gas supplies to protected and eligible customers, only through JČP, and nothing of importance changed on the market due to this merger.

5 Security of supply

5.1 The electricity market in 2006

5.1.1 Levels of peak annual demand and electricity consumption

The country's total electricity consumption, including network losses, was 71.7 TWh in 2006, which implies an increase of 2.4% in comparison with 2005. The grid experienced the annual peak demand on 25 January 2006 at 3 p.m., when gross consumption amounted to 11,397 MW. The trend of growth in the country's electricity consumption was somewhat faster in 2006. Electricity imports contributed to meeting domestic demand approximately the same as in the previous year. On the generation side, the influence of the preference for renewable resources in electricity generation under the respective EU Directive and Czech legislation could be felt throughout the year.

No marked increase in consumption or peak demand can be expected in the next few years; savings and energy intensity reductions in industry compensate retail customers' rising electricity consumption. Annual increases in consumption until 2010 are estimated at 1.0 to 2.1%.

5.1.2 Installed capacity

On 1 January 2007 the total installed capacity of power stations in the Czech Republic was 17,508 MW, with approximately 58% of the power stations' output connected directly to the transmission system and 42% to the distribution system.

The current structure of generation capacity by the size of installed capacities is as follows:

- 10,691 MW thermal power stations (61.1%),
- 3,760 MW nuclear power plants (21.5%),
- 2,175 MW hydroelectric power stations, including pumped storage and small hydroelectric power stations (12.4%),
- 804 MW gas-fired and combined cycle power stations (4.6%),
- 78 MW renewable – wind, photovoltaic, etc. (0.4%).

In comparison with 2005, in 2006 the installed capacity of thermal power stations, including cogeneration, increased by 27 MW and that of gas-fired and combined cycle power stations increased by 24 MW. The installed capacity of hydroelectric power stations increased by 9 MW and that of the other renewable resources (mainly wind farms) by 36 MW. The total annual increase in the installed generation capacity in the electrical grid amounted to 96 MW.

There are no expectations of the commissioning of a new large plant having an installed capacity of over 50 MW and firing fossil fuels or using nuclear energy in the next three years. However, in connection with the new law on renewable resources, which entered into force in August 2005, the development of a larger number of plants using renewable resources and having smaller unit capacities can be expected. Under the conditions prevailing in the Czech Republic the development of biomass firing in local heat & power plants has the most promising prospects; to a limited extent, new small hydroelectric power stations and wind power stations can also be expected. The Czech Republic does not have suitable conditions (potential) for the other renewable resources (photovoltaic, or geothermal energy). On the whole, the construction of up to several hundreds of MW of capacity to generate electricity from renewable resources can be expected in the next few years.

5.1.3 Authorisation criteria for new generation investments

The building of a new electricity generating plant may be started upon obtaining a building permit issued by the planning office having the relevant local jurisdiction. One of the main preconditions for issuing a building permit is the submittal of an expert study proving that the new plant will not have negative environmental impacts. In the case of electricity generating plants having a total installed capacity of 30 MW and more, there is also the need to obtain an authorisation for the construction, which is issued by the Ministry of Industry and Trade in line with the National Energy Policy. An electrical energy generator has the right to connect its plant to the grid subject to the connection conditions defined in the relevant energy legislation; upon obtaining an electricity generation licence from the Energy Regulatory Office, it has the right to supply electricity in line with the rules for the operation of distribution systems or, as applicable, the transmission system (the Grid Code). A precondition for obtaining an electricity generation licence is, in particular, obtaining the permit to commission the plant and proving the professional competence and financial standing to operate the energy generating plant.

In general, the national budget does not provide support for investment in new generating capacity; however, certain subsidies can be obtained from governmental and non-governmental agencies and funds, subject to the required conditions. For plants having an installed capacity of up to 1 MW the generator may benefit from tax holidays for the first five years of operation.

5.1.4 Incentives for new capacity development

The new law on support for the use of renewable resources is a breakthrough in the development of electricity production from environmentally friendly resources. For investors in renewable resources, the law guarantees a 15-year payback period for their investment in the various categories of renewable resources. Since 2006 producers of electricity from renewable resources have had the opportunity under the law to choose between guaranteed purchase by regional DSOs/TSO in the system of buyout prices and a premium to the market price of electricity (the system of green premiums). The support in the form of buyout prices cannot be applied in the case of biomass and fossil fuel co-firing or parallel firing.

Effective from 2006 the amendment to the Energy Act also provides for support for electricity generation in CHP, which is provided only through market price premiums for all categories of generating plants. However, since 2006 there has been new support for electricity production from secondary resources, which is also provided through premiums to the market prices of electricity.

5.1.5 Investment in transmission

The TSO is primarily reinforcing the existing lines as a precaution; for example, by replacing single-circuit lines with double-circuit lines or with high transmission capacity conductors. There are currently plans to build a 400 kV line on the Krasíkov – Horní Životice route and to replace the 400 kV Prosenice – Nošovice single-circuit line by a double-circuit line.

However, the building of lines for connecting new generating capacities, mainly at the distribution system level, can be expected in the future. An illustrative example is renewable resources, for example wind farms, the development of which is planned for areas currently having a relatively low density of networks.

The Czech TSO is not planning to build any new cross-border lines in the next few years; the reason is the neighbouring TSOs' insufficient domestic transmission capacities. ČEPS, a.s.

plans to upgrade the Slavětice – Dürnrohr 400 kV cross-border single-circuit line to a double-circuit line. For this transmission capacity reinforcement to have the desired effect certain lines within the Austrian grid would have to be reinforced too.

5.2 The gas market in 2006

5.2.1 Natural gas consumption levels in 2006

Natural gas supplies for the Czech Republic were smooth throughout 2006, and from both Russia and Norway, the key sources of natural gas.

In 2006 the total quantity of the natural gas at points of entry to the Czech transmission system amounted to 35,869.6 mcm at 15 °C. The quantity of gas at points of exit from the Czech transmission system, flowing to foreign customers, amounted to 26,599.1 mcm at 15 °C.

In 2006 the actual natural gas consumption amounted to 9,269 mcm (i.e. 97,806 GWh), which is 3.1% (294 mcm) less than in 2005. Consumption adjusted to normal monthly temperatures and temperature gradients of consumption amounted to 9,312 mcm, which implies a decline by 3.1% y/y.

Table 9 Natural gas sources and consumption in the Czech Republic

(Figures in mcm at 15°C)	2006	2005	2004	2003
Total purchase	9,794.0	9,358.6	9,014.2	9,688.1
Withdrawal from foreign UGS	461.5	808.4	1,063.3	988.8
Injection into foreign UGS	-499.6	- 499.1	-968.7	-950.4
Withdrawal from Czech UGS	1,806.1	1,640.7	1,873.5	1,498.4
Injection into Czech UGS	-2,353.5	-1,942.4	-1,322.5	-1,541.4
Supplies from MND Hodonín	57.5	49.2	40.5	33.3
Drained gas from mines OKD Paskov	19.5	11.6	5.3	7.9
Total supplies	9,285.5	9,427.0	9,705.6	9,724.7
Difference on balancing (change in the line pack, in-house consumption)	-16.1	135.0	14.5	14.6
Total consumption	9,269.4	9,562.0	9,691.1	9,739.3

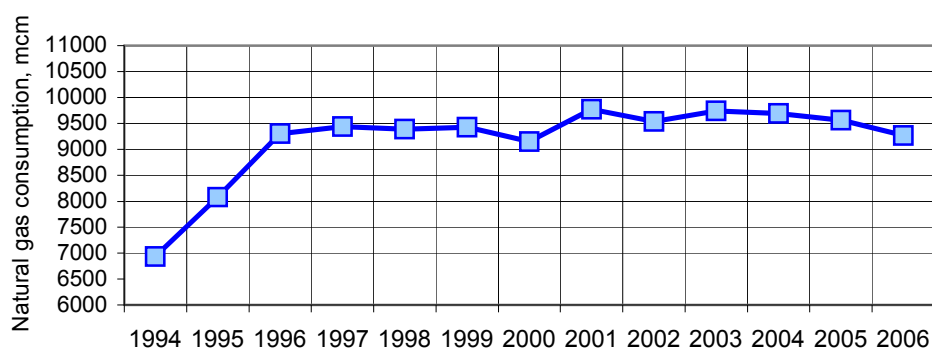
Overall, mainly ambient temperatures influenced natural gas consumption during the heating season, which in 2006 covered the periods from 1 January to 30 April and from 20 October to 31 December.

Table 10 Actual gas consumption from 1995 to 2006

Year	Average temperature in the heating season (°C)	Average annual temperature (°C)	Annual consumption (mcm)	Year on year change	
				(mcm)	(%)
1995	3.1	8.3	8,075	+1,141	+16.4
1996	1.0	6.6	9,306	+1,231	+15.2
1997	2.3	7.9	9,441	+135	+1.5
1998	3.3	8.5	9,390	-51	-0.5
1999	3.2	8.7	9,427	+37	+0.4
2000	4.8	9.5	9,148	-279	-2.9
2001	2.9	8.2	9,773	+625	+6.8
2002	3.6	9.0	9,542	-231	-2.4
2003	3.6	8.6	9,739	+197	2.1
2004	3.1	8.2	9,691	-48	-0.5
2005	2.5	8.0	9,562	-129	-1.3
2006	3.3	8.5	9,269	-294	-3.1

5.2.2 Natural gas consumption expected from 2007 to 2010

The upward trend in the Czech Republic's natural gas consumption came to a stop in 1997. Since that year gas consumption has been stagnant (notwithstanding the continued gas penetration by bringing gas supplies to new areas); over the last three years consumption declined slightly, see Chart 2. In 2007 the current trend can be expected to continue, with gas consumption stable at around 9,400 mcm.

Chart 2 Actual consumption of natural gas between 1994 and 2006

The main reason for the currently decreasing consumption is the oil prices, which are rising and which also cause natural gas price hikes. When the prices of other energies, for example, solid fuels (coal, wood) grow at a slower rate many customers switch to these solid fuels because of the price.

Other causes for the downward trend in gas consumption include final customers' efforts to achieve energy savings and the installation of better and more modern boilers, thermal insulation on buildings, the use of dual-fuel systems (oils, coal, etc.), energy savings thanks to

energy audits, and the almost complete gas penetration – connection of towns and villages to gas supplies from the perspective of return on investment.

Projections for 2008 to 2010 expect slight year-on-year increases of about 0.5% to 1.2% related to the long-term normal temperature (see the following table), in particular if this period sees a certain stabilisation of prices and preference for the benefits of natural gas as an environmentally-friendly fuel.

Table 11 Natural gas consumption expected between 2007 and 2010

Consumption, mcm	Actual	Actual	Actual	Forecast			
	2004	2005	2006	2007	2008	2009	2010
Actual consumption	9,691	9,563	9,269				
Adjusted consumption	9,821.9	9,608	9,312.0	9,400	9,490	9,600	9,700
Change in %	1.19%	-2.2%	-3.1%	0.53%	0.96%	1.16%	1.04%
Actual temperature °C	8.1	8.0	8.5				
Normal temperature °C	7.8	7.8	7.8	7.8	7.8	7.8	7.8

One of the objectives of the National Energy Concept is to prevent the Czech Republic's dependence on imports of energy resources from increasing. However, the market decides about the actual consumption; on the basis of rising prices, energy savings and the other reasons mentioned above, the market vindicates the forecast of the National Energy Concept, which does not expect any significant increase in natural gas consumption in the years to come.

However, thanks to the very warm 2006/2007 winter season forecasts of consumption in 2007 have been downscaled to 9 bcm as against the original forecasts of 9.4 bcm.

The natural gas market is changing continuously, and it is influenced by various factors, like the other energy markets. The strongest factor at play in gas sales levels is the price of the gas, which depends on factors that are beyond the Czech Republic's control completely, or can be influenced by the country to only a minimum extent (world prices of oil and oil products, the Czech currency's dollar rate).

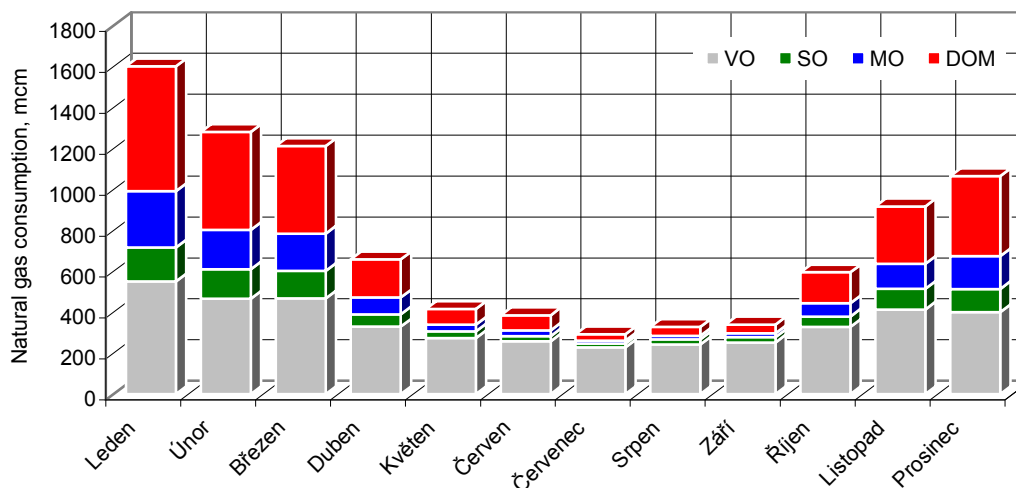
5.2.3 Indigenous natural gas production and imports

RWE Transgas, a.s., Wingas GmbH, and, from 1 October 2006, also VEMEX, s.r.o. were responsible for imports, which are crucial for the Czech Republic as regards natural gas sources, under long-term agreements with Norwegian and Russian producers. The long-term agreement between RWE Transgas a.s. and Gazprom export Ltd. (formerly Gazexport) on natural gas supplies was extended at the end of 2006 to remain in effect until 2035; the gas sales agreement with Norwegian producers will remain in effect until 2017.

Only a low volume of indigenous production supplemented the imports. Indigenous production included mine surface drained gas, which is of local importance for the north Moravian region only, and the gas lifted by Hodonín-based Moravské naftové doly, a.s. from fields located in south Moravia. MND's and OKD's domestic supplies amounted to 76.9 mcm/year, i.e. 0.8% of total supplies. Of MND Hodonín's total output of 94.2 mcm/year, 57.5 mcm were supplied to JMP, another 18.2 mcm were re-injected into the company's own Uhřice 2 field, and 18.5 mcm covered MND's own consumption and supplies to customers.

Natural gas intended for supplying the Czech Republic was imported from Russia and Norway. Total purchases (imports) of natural gas for the country's needs amounted to 9,794 mcm at 15 °C. In comparison with 2005, the imports were 436 mcm higher.

Chart 3 Monthly natural gas consumption by customer category [x axis, January to December]



VO – large offtake
 SO – medium offtake
 MO – low offtake
 DOM – households

5.2.4 Production and import investment and the role of the regulatory authority

Under the Energy Act, the construction of infrastructure for natural gas imports is subject to the State's consent, which has the form of authorisation for construction. In this respect the Ministry of Industry and Trade plays the role of the regulatory authority. In 2006 RWE Transgas, s.r.o. applied to the Ministry of Industry and Trade for an authorisation to build a gas pipeline connecting the Czech gas system with Poland (the Třanovice – Chotěbuz gas pipeline). Authorisation to build the gas pipeline in the Czech Republic was granted on 10 August 2006.

Certain gas companies consider additional investment in their capital expenditure plans for the next three years (specifically the Záhoří – Spáleníšťě (Austria) and Břeclav – Reintal (Austria) gas pipelines). The European Commission has been informed of them through the 'report to the Commission of the European Union on investment projects in the Community's interest in the oil, natural gas and electricity sectors', but the investors have not yet approved such projects with finality, and the consent (in the form of the State's authorisation for construction) required for implementing such projects has not been requested.

5.2.5 Effect of measures under Articles 3 and 4 of Directive 2004/67/EC on competitiveness

In accordance with the provisions of the Directive concerning measures to safeguard security of natural gas supply, the Czech Republic has set security of supply standards for gas supplies, which all gas traders are obliged to observe. In addition, certain other measures such as long-term gas supply agreements, diversification of gas sources, coordinated dispatch

control between the TSO and DSOs, gas storage in UGS facilities, etc., have been adopted to support security of supply. These measures are applied in a non-discriminatory manner, do not place an unreasonable burden on gas market participants, and are compatible with the requirements for a competitive internal gas market.

5.2.6 *Underground gas storage facilities*

The summer/winter supply and consumption swings were covered by underground gas storage facilities (UGS), which serve for gas storage in summer and gas production in winter when daily consumption exceeds the daily contract quantities imported from abroad.

In 2006, 500 mcm and 461 mcm (15 °C) of natural gas was stored in and withdrawn from, respectively, the Láb UGS facility in Slovakia; withdrawal from the Rehden UGS facility was terminated on 31 March 2005.

In domestic UGS facilities 2,354 mcm of gas were stored and 1,806 mcm (15 °C) of gas were withdrawn from them; on the whole, injection into UGS facilities therefore exceeded withdrawal from them by 585 mcm.

On 1 January 2006 UGS facilities in the Czech Republic held 1,655 mcm, the Láb UGS facility held 270 mcm, and the total available volume stored in UGS facilities amounted to 1,925 mcm. After the end of withdrawal in April the stores amounted to only 261 mcm.

Injection was started in April. From April to October before the 2006/2007 winter season total operating reserves of 3,000 mcm were accumulated in UGS facilities. In the fourth quarter of 2006 withdrawal from UGS facilities in the Czech Republic was low, only 550 mcm.

On 31 December 2006 the closing amount of reserves in UGS facilities for the Czech Republic's needs was 2,365 mcm, of which 2,057 mcm in Czech UGS facilities, while 308 mcm was available from the Láb UGS facility.

The total initial available daily capacity of withdrawal from Czech UGS before the 2006/2007 winter season was 50.2 mcm, and together with Láb this capacity stood at 56.2 mcm.

5.2.7 *Long-term contracts*

Until 1996 the Czech Republic depended on only one source of natural gas, Russia; the gas was transported through the Bratrství [Brotherhood] gas transmission system, which had been put into operation in 1974 and which at the same time was used for natural gas transit to western European countries.

With a view to diversifying natural gas supplies to the Czech Republic, in 1997 RWE Transgas, a.s. signed with Norwegian producers (Statoil, Norsk Hydro, and Saga Petroleum) a long-term gas supply agreement with effect until 2017 for an annual volume of 2.5 bcm, and in 1998 it signed with Russian Gazexport a contract until 2013 for annual volumes ranging from 8 to 9 bcm. Currently 25% of gas imports come from Norway and 75% from Russia.

In 2006 RWE Transgas, a.s., which supplies about 97% of total demand, extended its long-term agreement on gas supplies from Russia until 2035, with annual volumes of 9.0 bcm.

Also VEMEX, s.r.o. signed, in 2006, a long-term contract for natural gas supplies to the Czech Republic; at present it supplies eleven final customers with this gas.

5.2.8 *Security of supply standards*

In connection with an amendment to the Energy Act, which was enacted in Act No. 670/2005 of 30 December 2004, Directive 2004/67/ES has been implemented in Czech law. This is now

also reflected in the statutory obligation imposed on gas traders to observe security of supply standards. The details are set out in MIT Public Notice No. 375/2005 on states of emergency in the gas industry, which entered into force on 1 October 2005. The security of supply standard is understood to consist in ensuring a safe and reliable supply of gas when preventing a state of emergency, and in states of emergency, to households and those of final customers who are not able to switch to other sources of energy, in particular for the following situations:

- a) In the winter season, a partial interruption in gas supply for eight weeks, to the extent of 20% of the total daily volume of all import contracts intended for supplying the final customers of the respective trader in the Czech Republic or for providing for the consumption of the customers who procure gas on their own;
- b) Gas consumption in five consecutive extremely cold calendar days, provided that an extremely cold calendar day is understood to be a day on which the average daily temperature does not rise over $-14\text{ }^{\circ}\text{C}$;
- c) To meet the demand for gas for all possibilities of the range of demand caused by the development of ambient temperatures during the coldest period from 1 October to 31 March, which occurred in the last 20 years preceding the respective year.

In the Czech Republic the security of supply standard for the peak daily demand at an average daily temperature of $-14\text{ }^{\circ}\text{C}$ is, under the above criteria, 63,786,000 cubic metres; it has been set taking into account the number and size of the customers connected to each of the gas traders. Table 12 shows it for the most important traders.

Table 12 Security of supply standards for gas traders

Gas trader	Supplier	SSS for maximum daily offtake in the year ($-14\text{ }^{\circ}\text{C}$)	
		Thousand m^3	MWh
Pražská plynárenská, a.s.	RWE Transgas, a.s.	8,778	92,649
Středočeská plynárenská, a.s.		5,891	61,858
Jihočeská plynárenská, a.s.		2,670	28,207
Západočeská plynárenská, a.s.		4,444	46,897
Severočeská plynárenská, a.s.		6,388	67,075
Východočeská plynárenská, a.s.		7,104	74,602
Jihomoravská plynárenská, a.s.		16,500	173,250
Severomoravská plynárenská, a.s.		12,066	127,300
VEMEX, s.r.o.	Gazprom export Ltd.	45	475
WINGAS GmbH, Kassel, Germany	Gazprom export Ltd.	90	950
MND Hodonín, a.s.	MND Hodonín, a.s.	1	11
Total CR		63,976	672,799

The above quantification of the security of supply standard was vindicated on 23 January 2006, when at an average ambient temperature of $-16.9\text{ }^{\circ}\text{C}$ the highest ever daily consumption of natural gas for 24 hours was registered in the Czech gas system: 67,639,000 cubic metres, while no problems at all occurred in respect of supplying final customers with natural gas. Similarly, the situation caused in Europe at the end of 2005 and the beginning of 2006 by reduced supplies from the Russia to Ukraine did not affect the final customers at all.

6 Public service issues

6.1.1 Key information

The Czech Republic has implemented the obligations of public service and consumer protection in the energy sector, which the EU member states are to introduce under, in particular, Directives 2003/54/EC and 2003/55/EC, in Act No. 670/2004, which amends the existing Energy Act, and also partly in Act No. 180/2005 on support for the use of renewable resources.

Licence holders' basic duties concerning the public service obligation and protection of consumers' interest include, in particular, the following:

- a) The duty to carry on the licensed activity so as to ensure continually safe and reliable energy supply if the Energy Act imposes such obligation (i.e., to supply energy) on the licence holder;
- b) The duty to ensure that equipment and installations meeting the safety and reliability requirements set out in legal regulations and technical standards are employed for the licensed activity;
- c) The duty to keep the specified parameters of supply and service quality; in the event of failure to keep them, to provide compensation as set out in the respective public notice.

The Energy Act requires the following of system operators and UGS facility operators:

- a) To ensure reliable operation and development of the systems and storage facilities they operate;
- b) To connect to such system any person who requests so and meets the connection conditions set out in the Energy Act, implementing legal regulations, and, in certain cases, the technical (operating) code;
- c) To ensure that all market participants enjoy non-discriminatory conditions for receiving the services provided by the system operated by the system operators, i.e., electricity and gas transmission, electricity and gas distribution and, partly, gas storage.
- d) To carry out the obligation of electricity/gas distribution over and beyond the licence in the event of sudden crises on the electricity/gas market, when the danger of an interruption or termination of electricity/gas supply is imminent and the Office has imposed such obligation on them.

Public service obligations apply to electricity/gas suppliers themselves; these entities are obligated, in particular, but without limitation, to:

- Offer final customers a fair and non-discriminatory choice of the way of paying for the electricity supplied;
- Advise small customers and households of the supplier's intention to change the contract terms and conditions at least two months in advance in the case of electricity and at least one month in the case of gas;
- Keep the parameters of supply and service quality that are set out in an implementing legal regulation;
- Specify in electricity bills to final customers the following items:
 - 1 The share of each electricity source in the total mix of the supplier's fuels for the preceding year;

2 Reference to a source of information in the public domain on the impacts of electricity generation on the environment.

The Energy Act also imposes the obligation to carry out the activities of a supplier of last resort on selected electricity/gas suppliers and, as applicable, those specified by the law.

6.1.2 Obligations over and beyond the licence

In the event of sudden crises when, for example, due to the disconnection of a large number of customers or the licence holder's difficult financial situation there exists real danger that energy supply to final customers will be interrupted, the Energy Act allows in its Section 12 to employ the institute of the so-called obligation over and beyond the licence. In such cases, i.e. in cases of urgent need and general interest, the Energy Regulatory Office has the right to decide to impose an obligation over and beyond the licence, whereby the entity to which the Office's decision applies must distribute electricity/gas outside its own delineated supply area, and the owners of the required distribution facilities must make their facilities available to enable the performance of the obligation over and beyond the licence. The Office may impose such an obligation for no more than twelve months. The Office has used its authorisation in this respect, and in two cases issued decisions imposing an obligation over and beyond the licence.

The obligation over and beyond the licence, in this case the obligation to supply thermal energy, applies also, and above all, in the heat supply industry; however, this industry is not the subject of this report.

6.1.3 Supplier of last resort

In its Article 3(3) the Directive permits Member States to appoint the supplier of last resort so that certain groups of customers can enjoy universal service, that is, the right to be supplied with electricity/gas of a specified quality within their territory at reasonable, easily and clearly comparable and transparent prices. The Czech Republic has implemented the above provisions in Section 12a of the Energy Act, as amended in Act No. 670/2004. Under this section the supplier of last resort is obligated to supply electricity/gas for prices set by the Office to households and small customers who request so. The time for which the specified groups of customers are entitled to use this service is not limited. The supplier of last resort is a holder of an electricity/gas trading licence, selected by the Office for a defined area. However, before the Office issues such decision, this obligation is carried out by the electricity/gas trading licence holder who is, or was, a part of the same vertically integrated undertaking where the supply point of the affected final customer is located. The process of requesting supplies from a supplier of last resort, i.e. the steps that have to be taken to make it possible to take supplies from the supplier of last resort, is provided for in Section 31 of Public Notice 541/2005 on the electricity market rules, principles of pricing the electricity market operator's activities and the implementation of certain other provisions of the Energy Act, as amended in No. 552/2006.

To date the Office has not issued any decision on the selection of a supplier of last resort. For this reason, the traders specified by the Energy Act are such suppliers.

The Energy Act defines that a household is understood to be a final customer who does not buy electricity/gas for any other purpose than for his own consumption in a household, and a small customer is understood to be a final customer that employs less than 50 employees under a contract of employment, and the net turnover of which for the past accounting period does not exceed CZK 250 million.

The prices of supplies of last resort, which are set out in ERO price decisions, are based on the wholesale electricity/gas price on the Czech electricity/gas market.

In respect of electricity, the obligation of supply of last resort is provided for in the Czech Republic also for a special case as follows: such supplier of last resort shall also supply, for a stipulated period of time and for regulated prices, electricity to a customer who has exercised his right of supplier choice but whose electricity supplier loses during the course of performing its licensed activity the authorisation or possibility to supply electricity to eligible customers and on the day of the interruption or termination of the supplier's business these customers do not have in place any other source of supply. In such a case the supplier of last resort shall supply electricity to these eligible customers for prices set by the Office for a maximum of three months of the day on which the electricity market operator (OTE) bars, in accordance with the Electricity Market Rules, this supplier from participating in the electricity markets organised by OTE. The supplier of last resort shall notify the eligible customers concerned of these circumstances without any delay.

6.1.4 Labelling of primary energy sources/guarantees of origin

In respect of the labelling of primary energy sources, these obligations have been implemented in national legislation in the amendment to the Energy Act, i.e., through Act No. 670/2004. Under Section 23, subsection 2(k) of this law electricity generators are obliged to inform the market participants about the shares of the sources used for electricity generation, and the share of CO₂ emissions and the amount of radioactive waste produced in electricity generation in the preceding year. Under Section 30, subsection 2(e) of the Energy Act, in billing the electricity supply to final customers electricity traders are obliged to include in the data shown in the billing document, data indicating each electricity source's share in the supplier's overall mix of fuels in the preceding year, and a reference to a public source of information on the impact of electricity generation on the environment.

6.1.5 Disconnection of final customers

From the perspective of supply interruption or disconnection, there exists no differentiation by customer groups. Under the Energy Act, a final customer can be disconnected, or its energy supply interrupted, only for reasons that are exhaustively listed in the law, i.e. chiefly due to unauthorised take of energy, in particular when the customer fails to pay; in the event of imminent danger to life, health or property and in dealing with such situations; in states of emergency and in preventing such states; and in the event of failures on installations and repair of such failures. Distribution system operators keep statistics on the number of disconnected customers and provide them to the Office.

6.1.6 Protection of final customers under contract

The provisions of Annex A to Directives 2003/54/EC and 2003/55/EC, which set out the rules for the internal electricity and gas markets, have been implemented through the Energy Act, which stipulates the 'essential provisions' of electricity/gas supply agreements. Thus, every final customer has the right to enter into a supply agreement that will contain all the required essentials envisaged in Annex A to Directives 2003/54/EC and 2003/55/EC.

6.1.7 Pricing for final customers on the electricity market

In 2006 the transfer of the last large group of protected customers (households) to the category of eligible customers influenced the pricing of electricity transmission for final customers. In the electricity industry, this transfer prompted the necessary changes to the pricing principles in place for this customer category until then. The Energy Regulatory Office opted for the alternative - similarly as in the case of small business customers - of the differentiation of charges for distribution services at the low voltage level in relation to the nature of the demand. At the low voltage level approximately the original range of tariffs has therefore been maintained, which makes it possible for the customers to optimise their costs of the services related to electricity supply.

In the second half of 2006 electricity supplies were no longer subject to price control for any final customer category in the Czech Republic, with the exception of price controls on electricity supplies to customer in the households and small customer categories who used the services of a supplier of last resort. The Office regulates price of electricity supply from a supplier of last resort as the maximum permissible price in compliance with Article 3(3) of Directive 2003/54/EC.

ERO Price Decision No. 9/2006 of 27 November 2006, which lays down the prices of electricity and related services, set the price levels of electricity of last resort for 2006. The Office regulated the price of electricity from a supplier of last resort as the maximum permissible price for all customer categories entitled to use such electricity supplies; the price was composed of a standing charge, payment for electricity supply at the high rate and payment for electricity supply at the low rate. Individual prices vary in relation to the nature of load and the way of using the electricity taken.

The Office bases its pricing of electricity from suppliers of last resort on the market prices of electricity and on the way of electricity procurement by entities appointed as suppliers of last resort, i.e. they contract most of their electricity for one whole year ahead, and therefore there is no need for any special procedure to check and/or adjust the set prices during the respective calendar year. Changes in the electricity market during the year, if any, are negligible thanks to the above way of electricity procurement.

Because of the above way of controlling the price of electricity supplied by suppliers of last resort and also since no additional extra costs are incurred in performing the obligations of a supplier of last resort, no mechanism has yet been developed for compensating additional costs, if any, incurred in relation to performing this obligation. In general, the price of the electricity supply from a supplier of last resort includes the market cost of procuring the electricity to be supplied, including a certain margin, and so a supplier of last resort should not incur any additional unpredictable costs for which it would have to be reimbursed.

Under the Energy Act, customers in the household category (household is understood to be a final customer who does not buy electricity for any other purpose than for his own consumption in a household) and in the small customer category (small customer is understood to be a final customer that employs less than 50 employees under a contract of employment, and the net turnover of which for the past accounting period does not exceed CZK 250 million and the supply point of which is connected to the low voltage network) have the right to request electricity supplies from a supplier of last resort. The obligation of suppliers of last resort to supply electricity also applies to other customers who have exercised their right of supplier choice but whose electricity supplier loses during the course of performing its licensed activity the authorisation or possibility to supply electricity to eligible customers and on the day of the interruption or termination of the supplier's business these

customers do not have in place any other source of supply. In such a case the supplier of last resort shall supply electricity to these eligible customers for prices set by the Office for a maximum of three months of the day on which the electricity market operator (OTE) bars, in accordance with the Electricity Market Rules, this supplier from participating in the electricity markets organised by OTE. However, according to the information available to the Office the option of the supplier of last resort is rather a matter of theory, and it is not possible to provide any information about the distribution/pattern of customers using the right to supplies of last resort, because in 2006 no customer used this right.

6.1.8 Pricing for protected customers on the gas market

In the gas industry the Energy Regulatory Office sets the charges for gas transmission and gas distribution once a year, at all times effective from 1 January; the Office can change the prices of gas supply to protected customers once every three months.

In the second half of 2006 the Office also continued to set, on a temporary basis, price caps on natural gas supplies for eligible customers. In 2006 all final customer categories were subject to price control: price controls applied to final customers in the household category, and to eligible customers in the low-offtake, medium-offtake and large-offtake categories.

The 2006 price levels for the various categories of final customers were set in ERO Price Decision No. 2/2006 of 28 February 2006, on prices of gases, and in ERO Price Decision No. 6/2006 of 28 August 2006, on prices of gases. The price caps were imposed as the maximum permissible prices of natural gas supplies to protected customers (household category) and eligible customers (low-offtake, medium-offtake and large-offtake categories). The level of the price cap on natural gas supplies was set in relation to the final customer's annual natural gas take in MWh. For final customers taking gas from a supplier of last resort, the price was set for the second half of 2006 also by ERO Price Decisions No. 2/2006 and No. 6/2006. The supply price was subject to a cap, which was imposed as the maximum permissible price of natural gas supply to eligible customers.

In 2006 natural gas supply prices for all final customers were increased as from 1 January and 1 April due to the increased prices for which RWE Transgas, a.s. bought natural gas. On 1 October they were decreased. The price charged by a trader who supplied gas to protected customers connected to a distribution system was, to the extent of supplies to protected customers, a double-component price. The basis for determining this price was forecasts of the development of natural gas import prices, and forecasts of the Czech currency's US dollar and euro rates. The price was also adjusted by the difference between the actual cost of gas purchase incurred by RWE Transgas, a.s., and the price set by the Office in the preceding closed quarter.

The maximum prices of natural gas supplies were reviewed and updated with the use of an adjustment of the price by the difference between the actual cost of natural gas purchase and the planned costs of natural gas procurement. The natural gas supply price was adjusted by this difference for the next calendar period. The process of price level review and update was provided for in Public Notice No. 438/2001 as amended.

For suppliers appointed to perform the obligation of supplying natural gas to final customers for controlled prices in the regime of supplies of last resort, no special mechanisms for compensating the costs incurred in performing this obligation were put in place in view of the way in which this price was controlled.

No final customers received supplies of last resort in the second half of 2006.

6.1.9 Public administration and terms of supply contracts

The Energy Act provides that the terms and conditions of supply agreements are ‘essential provisions’ of agreements, i.e. any such agreement executed under the Energy Act must contain all the essential provisions so required. The Energy Regulatory Office has no competencies in this respect, that is, in respect of ensuring the transparency of the terms and conditions of supplier agreements, but for two exceptions:

a) It is competent to adjudicate certain disputes between licence holders or between licence holders and their customers over the execution of agreements the subject matter of which is a regulated activity, that is, in particular, electricity/gas connection, transmission and distribution, and also agreements on thermal energy supply, and certain other types.

b) It is competent to approve the rules for the operation of the electricity transmission and distribution system and the gas transmission and distribution system operators’ codes. The Energy Act envisages (and this essential element is provided for explicitly in the part on the electricity industry) that the commercial terms and conditions of the provision of these regulated services shall be included in the above documents, which are subject to approval.

The administrative authority in charge of inspection in the energy sector is the State Energy Inspectorate. The State Energy Inspectorate’s remit includes review of compliance with the Energy Act, including checks that contracts were executed with the content required by the Energy Act for supply agreements and the content required by Annex A to Directives 2003/54/EC and 2003/55/EC for consumer protection.

The Office for the Protection of Competition (ÚOHS), which regulates on an *ex post* basis, is another authority of review on the energy market, mainly in its liberalised part. The ÚOHS’s competencies include, for example, conducting inquiries into discriminatory practices applied by energy suppliers having a dominant market position (coercion to unreasonable contract terms and conditions, applying different conditions for identical or comparable supplies to different market participants, etc.). These cases very often involve traders of vertically integrated undertakings in the electricity and gas industries. The ÚOHS reviews the compliance of their practices under Act No. 143/2001 on the protection of competition, as amended.