

The Czech Republic's National Report on the Electricity and Gas Industries for 2007

July 2008

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Most frequent abbreviations

| Czech | English | |
|--------------|----------------|--|
| ERÚ | ERO | Energy Regulatory Office |
| MPO | MIT | Ministry of Industry and Trade of the Czech Republic |
| ÚOHS | OPC | Office for the Protection of Competition |
| PPS | TSO | Transmission system operator |
| PDS | DSO | Distribution system operator |
| LDS | LDS | Local distribution system |
| PZP | UGS | Underground gas storage facility |
| VVN | EHV | Extra high voltage |
| VN | HV | High voltage |
| NN | LV | Low voltage |

1 Foreword

For the fourth 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 and repealing Directive 96/92/EC (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 and repealing Directive 98/30/EC (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.

This National Report also covers the development of energy markets in 2007. A new development on the already liberalised electricity market was the establishment of the Prague Energy Exchange, which launched its business in July 2007. The gas market was fully liberalised on 1 January 2007, when all final customers for natural gas became eligible customers; however, a fully functional competitive environment has not yet been achieved to any appreciable extent on the Czech market.

2 Summary information about regulation in the electricity and gas industries in 2007

2.1 Basic information about the structure and competences of the regulatory authority

The Energy Regulatory Office (hereinafter also referred to as “ERO” or “Office”) was set up on 1 January 2001 by Act No. 458/2000 on the Conditions for Business and State Administration in the Energy Industries and Changes to Certain Laws (the Energy Act), as amended, as an administrative authority in charge of regulation in the energy sector. Under Section 2(1), point 10 of Act No. 2/1969, on the Establishment of Ministries and other Central State Administration Authorities of the Czech Republic, as amended, the Ministry of Industry and Trade (‘MPO’) is the state administration authority which is in charge of the energy industries. Under the same law the Energy Regulatory Office is “another central authority of state administration” with its own national budget title. The Office is headed by its Chairman, who is appointed for a term of five years (and dismissed) by the Government. The Government may dismiss the Chairman before the expiry of the term for which he has been appointed only in the case of illness permanently preventing him from performing his assignments, gross breach of obligations, or on the basis of a court’s final judgment on commission of a crime, or if he himself resigns his chairmanship. The Energy Regulatory Office submits its Annual Reports for approval to the Government and Parliament’s Chamber of Deputies through the Ministry of Industry and Trade.

The Energy Regulatory Office’s main tasks include market regulation with a view to substituting market mechanisms in the areas of energy industries, in which competition is not feasible and in which there exists danger of abuse of a dominant position. The Office is involved in the drafting of the relevant laws. As part of carrying out its responsibilities, it is authorised to issue implementing regulations (primarily public notices and price decisions), whereby it regulates, *inter alia*, the following: the required quality of the supplies and services related to regulated activities, the method of regulation in the energy industries, and price control procedures and connection conditions. The Office also issues the Electricity Market Rules and the Gas Market Rules, and the principles of pricing the activities of the Electricity Market Operator; it is authorised to approve the Commercial Terms and Conditions of the Electricity Market Operator; the Rules of the Electricity Transmission System Operation (Grid Code); the Rules of the Electricity Distribution System Operation; the Rules of the Gas Transmission System Operation (Grid Code); and the Rules of the Gas Distribution System Operation.

The Energy Regulatory Office’s powers also include the opportunity to present suggestions to the State Energy Inspectorate (‘SEI’) to check the performance of the obligations under the Energy Act and, as applicable, to propose the imposition of penalties, and to notify the Office for the Protection of Competition (‘OPC’) of cases of abuse of a dominant position on the market. Further, the Office decides on the award, change, or revocation of licences for business in the energy industries. It is also within the Office’s competences to adjudicate disputes, for example, disputes between licence holders and their customers or those concerning failure to reach agreement on regulated access to the transmission system or a distribution system. Appeals against the Office’s decisions can be lodged in second instance proceedings (proceedings on remonstrances) with the ERO Chairman and, beyond that, with ordinary courts, or, in the case of licensing proceedings, with administrative courts. No other authority than a court of law may change the Office’s decisions.

The Energy Regulatory Office does not carry out any regulatory activities overlapping with those of other state administration authorities, i.e. there are no duplicities as regards competencies.

2.1.1 Legislative changes

In connection with the passing of Act No. 186/2006 ‘on changes to certain laws related to the adoption of the building law and the law on compulsory purchase’, 2007 saw amendments to the Energy Act. Act No. 186/2006 entered into force on 1 January 2007 and as from that date also changed certain provisions of the Energy Act; the reasons include the establishment of compulsory purchase offices and the facilitation of publicly beneficial and other construction in the protection zones for the electricity grid and gas and heat supply installations. In connection with the passing of the building law, there were also certain changes to the competences of the State Energy Inspectorate.

In 2007 the Energy Regulatory Office also continued work on amendments to implementing legal regulations [statutory instruments – public notices], the need for which was partly precipitated by the so-called large amendment to the Energy Act, i.e. Act No. 670/2004 amending Act No. 458/2000, the Energy Act, as amended, and, in part, by the knowledge gained from the application of the Office’s implementing legal regulations on the liberalised electricity and gas markets.

Due to the above changes the Office issued a new public notice, no. 150/2007 on regulatory methods in the energy industries and price control procedures. Effective from 1 July 2007 this instrument superseded public notice no. 438/2001 that set out the content of financial information and procedures for price control in the energy sector. The prices of electricity and gas supplies to final customers were deregulated while electricity and gas supply price control for suppliers of last resort was introduced. The Office also issued public notice no. 280/2007 on the execution of the Energy Act’s provisions on the Energy Regulation Fund, which set out the method for selecting the designated licence holder to perform obligations over and beyond its licence and provides for other relevant issues.

In the electricity industry, the Office issued public notice no. 365/2007 amending no. 541/2005 on the Electricity Market Rules and principles of pricing the electricity market operator’s activities and on the execution of certain other provisions of the Energy Act. This instrument responds to electricity market participants’ experience on the open market and introduces certain new facilities used in trading on the electricity market and adjusts the procedure for electricity supplier switching. In respect of renewable energy resources the Office issued public notice no. 364/2007, which amends no. 475/2005 implementing certain provisions of the law on support for the use of renewable resources.

In the gas industry, the Office issued public notices no. 184/2007 and no. 321/2007, which amend no. 524/2006 that lays down the rules for the organisation of the gas market and for the development, allocation and use of typical gas supply profiles. The first of the above instruments primarily eliminates a discriminatory system for the allocation of transmission and storage capacities in compliance with the reasoned opinion received by the Czech Republic from the European Commission on 18 December 2006 under Article 226 of the EC Treaty, with regard to Directive 2003/55/EC. This opinion was delivered because, *inter alia*, the Czech Republic had not provided for a non-discriminatory approach for third party access to systems as required by Article 18(1) and Article 8(b) of Directive 2003/55/EC. The other instrument mainly changes provisions on the gas supplier switching process and allocation of transmission capacity in cases of congestion.

In the licensing area, the Office issued its public notice no. 363/2007, which amends no. 426/2005 on details of the licensing of business in energy industries. The main reason for adopting this instrument was the change of legislation in the building industry.

2.2 Main developments in the electricity and gas markets

2.2.1 The electricity market

Wholesale market

The step-by-step opening of the Czech electricity market took place from 2002. Since 1 January 2006, when the last category of customers, households, became eligible customers and acquired the right to select their supplier, the market has been fully liberalised; in fact, one and a half year earlier than required by Directive 2003/54/EC. The Czech Republic's previous National Reports provided information about the completion of the extensive organisational changes in the electricity industry (the unbundling of the ČEZ Group, the E.ON Group and the PRE Group). No changes took place in this area in the year under review.

A new development on the electricity market was the establishment of the Prague Energy Exchange in 2007. Actual trading was started on 17 July 2007. In 2007 monthly, quarterly and yearly products were traded, all broken down to the base load (for all hours of the period) and the peak load (for 8 a.m. to 8 p.m., Monday to Friday). In general, financial products are traded, without any need to supply electricity; however, for the purpose of exceeding the so-called expiry period, these products become physical products with the obligation to supply/take electricity and have arrangements in place for responsibility for imbalance.

In respect of imbalance clearing, 2007 saw major changes in comparison with the previous situation; these changes responded to a negative trend in this area. Market participants relied more and more on the balancing of their imbalance in the clearing system with the help of a low clearing charge for negative imbalances when a negative system imbalance occurred (i.e., demand for power higher than supply of power in the electricity grid in the case of a system imbalance). The change was effected by setting the minimum charges for imbalance clearing for customers, at CZK 1,990/MWh, and introducing an increasing functional dependence of the clearing charge on the size of the system imbalance in the event of a negative system imbalance. For the event of a positive system imbalance (i.e., supply of power higher than demand in the electricity grid) the minimum clearing charge for customers was set at CZK 1/MWh. These adjustments have resulted in a significant reduction in the mean value of system imbalances and its shift from the area of negative system imbalances to the area of positive system imbalances.

Retail market

On the fully liberalised Czech electricity market, the business lines in which competition is feasible are not subject to regulation; these include electricity generation, imports, and trade. Subject to regulation are only activities having a monopoly nature, which include electricity transport from the generating plant over the transmission and distribution systems to the final customers and also those related to providing for the stability of the energy system in both technical and commercial terms. In 2007 a total of 46,016 customers changed their supplier in the Czech Republic; an overwhelming majority of these customers were those connected to the low voltage level (the household category and low-demand business category). As at 31 December 2007 the number of electricity trade licences awarded in the Czech Republic totalled 293, while as at 31 December 2006 the figure was 285 (up by

three per cent year on year). It is to be noted that, however, most of the traders are not active or hold a negligible market share. More detailed information about the retail market, including the supplier switching process, can be found in part 3.2.2.

The prices of electricity supplies to all customer categories for 2007 were influenced by the rising wholesale price of energy, which rose by more than 16 per cent on average in the Czech Republic year on year. This increase is not only attributable to the working of market mechanisms on the domestic market (structure of generating capacities, future demand, etc.), but also to electricity demand and prices in neighbouring countries due to the fact that the grids are interconnected.

The impact of the above increase in the price of energy on the various customer categories differs depending on the nature and, above all, size, of each particular customer's consumption, i.e. depending on the ratio between the charges for regulated items, which are set by the Office, and the uncontrolled price of energy. This is felt most strongly by customers who take electricity for space heating, where the commodity charge (the charge for energy) makes up the predominant part of the overall cost of supply.

Suppliers usually adjust their offering prices of energy once a year, i.e. as from 1 January of the new calendar year. For 2007 the average increase of 7.9 per cent in the price of electricity supply to households was mainly caused by the growth of the uncontrolled price of energy - by 16 per cent on average; this price accounts for more than 52 per cent of the overall costs for household customers (net of the effect of VAT). The electricity price hike for each individual customer differs in relation to their tariff and to the nature and size of their consumption. The overall increase in controlled prices for customers at the low voltage level, which the Office is able to influence, was 1.2 per cent on average across the country; basically, it only reflected external factors influencing network operation in technical and financial terms (development of electricity generation from supported environmentally friendly resources, line losses, the rate of inflation, etc.). More detailed information about electricity prices can be found in part 3.1.2.

Infrastructure

From the perspective of investment in electricity networks, 2007 saw only one major capital investment project. In September 2007 a new 400 kV line of the transmission system operator, between the Čechy-střed and Bezděčín substations, was put into operation. This project has helped to significantly improve the reliability of electrical energy supplies for the Central Bohemian and Liberec regions. The length of this project was 67 km.

Regulation and unbundling

The Office's competences for enforcing managerial and functional unbundling are limited by Directives 2003/54/EC and 2003/55/EC concerning common rules for the internal market in electricity and natural gas, respectively, as transposed to the Czech national legislation through the Energy Act.

The Office inspects unbundled accounts of legally unbundled companies, from which it requires separate accounts for each of the transmission and distribution activities with a view to preventing discriminatory practices. However, the regulator does not have any competences to impose sanctions; in the Czech Republic, this is fully within the competences of another central authority of state administration, the State Energy Inspectorate.

Security of supply

In 2007 the installed capacity of thermal power stations, including cogeneration, decreased by 43 MW in comparison with 2006; on the other hand, the installed capacity of gas-fired and combined cycle plants increased by 11 MW year on year. The installed capacity of plants that use renewable resources also went up year on year, by 86 MW. Most of this increase is attributable to wind power plants (70 MW). The overall year-on-year increase in the installed capacity of generating plants in the electricity grid was 54 MW; the overall installed capacity in the Czech electricity grid was 17,562 MW on 31 December 2007. Additional information is contained in part 3.2.1 and in chapter 5.

2.2.2 The gas market

Wholesale market

The year 2007 marked the completion of the liberalisation of the Czech gas market. On 1 January 2007 all final customers for natural gas became eligible customers and the market was therefore fully opened up.

In 2007 the key features of the gas market were as follows:

- Completion of the gas market liberalisation process;
- Completion of the legal unbundling of gas companies;
- Entry of new gas traders into the Czech market and gas supplier switching, chiefly in the large-offtake category;
- Decline in annual gas consumption in the Czech Republic;
- The drafting and adoption of an amended public notice on the gas market rules.

All of these areas are closely interrelated and influence one another. Related to market opening are also the obligations that arise for the Czech Republic from its membership of the EU, i.e. the legal unbundling of gas companies and meeting 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 key characteristic feature of the gas market in 2007 was the completion of liberalisation. All final customers acquired the right of supplier choice by way of a free-of-charge change of supplier, and, in turn, the opportunity to influence the uncontrolled part of their overall costs of gas supply, i.e. the commodity itself, and the services related to gas storage. However, there has not been much success in creating a fully functional competitive environment on the Czech gas market.

A step towards creating a competitive environment in the gas market was, in line with the EU legislation, the unbundling of regional gas companies (effective from 1 January 2007). In practical terms, this meant the separation of the various licensed activities so that the distribution business would henceforth be carried on by legally independent entities and to ensure distribution system operators' *de iure* and *de facto* decision-making independence, which is one of the basic preconditions for ensuring entities' non-discriminatory behaviour.

The year 2007 saw new entrants, traders, on the natural gas market. In addition to gas traders of the RWE Group and Jihočeská plynárenská, a.s. (E.ON Energie, a.s. since mid-2007), Pražská plynárenská, a.s., VEMEX, s.r.o., and Moravské naftové doly, a.s. (MND, a.s.), some more new traders started operating on the market, for example, Petr Lamich-LAMA, United Energy Trading, a.s., Česká energie, a.s., and VNG Energie Czech, a.s.

Another characteristic feature of the market's development in 2007 was a drop in natural gas consumption in the Czech Republic. According to the Balancing Centre, this consumption

decreased by 6.8 per cent year on year, to 8.645 billion cubic metres. The decline in consumption is attributable to the ambient temperatures, which have been rising slightly for a long time, and also demand-side saving measures adopted by final customers and the rising prices of natural gas.

The changes in the implementing regulations for this area are outlined at the end of part 2.1.

Retail market

The natural gas market was fully opened up on 1 January 2007. However, as described in detail in the two previous National Reports, with effect from 1 January 2006 the Office imposed price caps for eligible customers. All the reasons that had motivated the Office to take this decision were removed, and therefore the price caps were lifted on 31 March 2007. Thus, the market is now open, fully and without any exceptions, for 2,845,439 customers.

A total of 6,699 customers changed their supplier in the Czech Republic in 2007. However, some of the customers did not switch their supplier on the basis of their own decision; the supplier switching took place due to a change of the ownership of their old supplier. After deducting these customers the resulting number of switches is 103 customers, most of them, one hundred, large-offtake customers.

The changes in the gas market environment have not yet been felt too much in the other customer categories. The main reason is the current situation of the existence of eight supplier zones, which behave as self-standing units and within which the suppliers from the former vertically integrated company have a competitive advantage in terms of being able to leverage the portfolio effect of a large number of customers. New traders are therefore focusing on customers with large offtake, for whom no customer portfolio needs to be developed as with the small customers.

The switching ratio is a measurable indicator of the number of final customers who switched their gas supplier between 2006 and 2007. It is a percentage indicator calculated as the ratio of the number of supplier switches per year and the total number of supply points in the respective year. In the case of the Czech market, the large-offtake category has so far been most active in this respect; its switching ratio for 2007 is 3.8 per cent. On the basis of European experience, a market whose switching ratio is over ten per cent is regarded as a fully liberalised gas market; this has not yet been achieved in the Czech Republic.

The prices of natural gas supplies showed an upward trend from the perspective of the whole of 2007. Following a certain period of stagnant prices in the first quarter, the price dropped slightly during the second quarter of 2007. In the third and fourth quarter the prices of gas supplies continuously increased in relation to the development of oil product prices, from which the natural gas price is derived.

Infrastructure

As regards investment in new infrastructure, there was no major capital investment project in 2007. However, two market surveys were launched (the first stage of the Open Season) to gauge the demand in the Czech Republic for capacities in the newly planned pipelines. One of these pipelines is to be a continuation of the newly built northern route for natural gas transport from Russia to Europe through Nord Stream and the connected Opal pipeline in Germany. In the Czech Republic, this route is to continue by the Gazelle pipeline connecting the border points at Olbernhau and Waidhaus. The results of the survey indicate tentative demand for the capacity in this route to amount to 105 mcm/day. The other project being

considered is a pipeline connecting the Czech and Polish transmission system near Český Těšín, with tentative demand for capacity amounting to 1 mcm/day.

Regulation and unbundling

See the text in point 2.2.1 on page 9.

Security of supply

Security of supply as required by Directive 2004/67/EC has been implemented in Czech legislation through public notice no. 375/2005 on the states of emergency in the gas industry, which introduces procedures designed for preventing emergencies in the gas industry, procedures to be followed in the case of the occurrence, and elimination of the consequences of, emergencies, and the use of the gas supply security standard. The security standard for the required gas supply is understood to be providing safe and reliable gas supplies in connection with preventing an emergency and/or during an emergency for those final customers who cannot switch to any other source of energy, in particular the situations outlined in part 5.2.7.

Gas traders and the final customers who procure gas themselves can provide for the gas supply security standard to the extent applicable to the trader/customer through their gas supplier.

In the 2007 winter season the gas supply security standard was provided for, and totalled 65,915,000 cu m/day. Suppliers RWE Transgas, a.s., MND, a.s. and VEMEX, s.r.o. guaranteed supplies by their imports and withdrawal from underground gas storage facilities.

It can be noted in general that the above public notice has stricter requirements than the European directive.

In respect of investment in production, storage, LNG, transit, transmission and distribution, 2007 did not see any major activities from the perspective of security of supplies; only the storage capacity of underground gas storage facilities was increased by 66 mcm. In 2007 Russia and Norway remained the key sources of natural gas for the Czech Republic. Indigenous production increased, but since it only covers less than one per cent of gas consumption this increase can be regarded as rather unimportant from the point of view of gas supply security.

For further information please see point 5.2.7 on page 49.

Overall conclusions

In 2007 changes in the gas market were much more prominent than in the electricity market, which has stabilised for the most part, and is also more liquid. Together with other state administration authorities, the Office took a flexible approach to the changes required in the Czech legislative framework, as mentioned at the end of part 2.1. The Office also closely worked with the Czech Republic's Ministry of Industry and Trade, Ministry of Foreign Affairs, and Office of the Government of the Czech Republic, in the preparation of the Czech Republic's positions on the various aspects of the EU's energy policy, primarily as regards the further liberalisation of energy markets and the related enhancement of competition, and the harmonisation of regulatory authorities' competencies in cross-border trading. As part of the drafting of the third energy package, the Energy Regulatory Office accepted national responsibility over deliberations on the proposed regulation of European Parliament and of the Council on the establishment of an Agency for Co-operation of Energy Regulators (ACER), an amendment to Regulation (EC) 1228/2003/EC on the conditions for access to

networks for cross-border electricity exchanges and an amendment to Regulation 1775/2003/EC. It also became co-responsible over deliberations on the amendments to the respective Directives 2003/54/EC and 2003/55/EC, which fall within the remit of the Ministry of Industry and Trade.

2.3 Major issues dealt with by the Energy Regulatory Office in 2007

The rate of the liberalisation of the electricity and gas markets was relatively fast in the Czech Republic in comparison with the other countries. In 2007 both markets were fully open, although their liquidity, particularly as regards the gas market, remains low, with the relevant impacts on consumers. By law, the Office is only authorised to deal with consumer issues in the regulated part of the energy sector – monopoly network industries (by way of issuing its price decisions). The other components of the price and contractual relationships are left to the working of the liberalised market. The Czech Republic does not have in place any sector-specific legislation on customer protection; energy consumers are protected by general consumer protection legislation. Nevertheless, the Office continuously kept in touch with the main consumer organisations that represented all customer categories. The core of these contacts consisted in exchanging information. In its activities directed towards the general public the Office focused on providing detailed information on what the full market opening would bring to customers.

As regards suggestions from customers, in the period under review the Office received requests from E.ON Energie, a.s. and Pražská plynárenská, a.s. for commencing administrative proceedings concerning the problem of it not being possible to store natural gas in the Czech Republic in amounts matching their customers' annual consumption. Administrative proceedings against RWE Transgas, a.s. were therefore commenced; they were not concluded before the end of last year. This issue is being complicated by the fact that in the Czech Republic, negotiated access to storage is applied by law, but only negotiated access. The content of the disputes was divided into two separate parts: the issue of storage under old contracts, where the entire capacity of Czech UGS facilities is used by RWE Transgas, a.s., and the issue of capacity allocation in respect of newly built storage capacities. There are expectations that a comprehensive methodological approach will be taken to resolve these issues in 2008.

A highlight on the gas market was the fact that on 1 May 2007 RWE Transgas, a.s. effected its voluntary unbundling; a specialised subsidiary, called RWE Gas Storage, s.r.o. and dedicated to natural gas storage, was split off the company.

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

There are 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 traded quantities are 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 transmission system operator (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, all proceeds from these auctions are used for network investments to maintain or increase the interconnection capacities; they are also 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, since 2006 consultations on the option of launching coordinated auctions throughout the Central and Eastern Europe region have been under way, i.e., also the Austrian, Hungarian and Slovenian TSOs would join this joint project. On the basis of talks a joint auction office has been established in Germany. The results of the search for an appropriate method of determining available tradable capacities have been ambiguous so far, and therefore the launch of regional coordinated auctions has been postponed by one year. The launch is expected in 2009.

3.1.2 Transmission and distribution companies

One transmission system operator is active in the Czech Republic; the TSO, ČEPS, a.s., 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 of the electricity grid. The 400 kV lines are 2,968 km long, the 220 kV lines are 1,371 km long, and the length of selected 110 kV lines is 56 km. The total length of all the lines operated by the TSO is therefore 4,395 km.

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 installations are connected directly to the transmission system. As at 31 December 2007, besides these regional distributors there were also 277 operators of distribution systems connected only to these three DSOs in the Czech Republic. These local distribution system operators distribute electricity within areas specified in their electricity distribution licences. The length of 110 kV distribution lines is 15,746 km, the length of all high voltage (over 1 kV) lines is 90,244 km and the length of low voltage lines is 169,787 km. The total length of all the lines outside the transmission system is therefore more than 275,000 km.

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 electricity prices is defined in ERO public notice no. 404/2005, which lays down the content of the financial information, and no. 150/2007, which lays down the procedures for price control in the energy sector. The electricity price to all eligible (final) customers, including households, is composed of regulated and unregulated items. The regulated items, which are set by the 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, also contribution to support for electricity generation from 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 controlled 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 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 or distribution system, is 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 2007 the charge for the use of the transmission system networks was CZK 28.08/MWh, and the unit charge for booking transmission capacity was CZK 482,830.04/MW/year. These prices, similarly as all the other prices mentioned in point 3.1.2, are without VAT.

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 low-demand customers - 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, combined heat and power generation, 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 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 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 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 2007 these prices ranged from CZK 1,127 to CZK 2,047 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 the distribution rates; i.e., on the basis of the selected distribution rate, the customer receives an offer of the respective energy product, in 2007 quoted usually at CZK 950 to 1,319 per MWh for households, and at CZK 1,100 to 1,509 per MWh for businesses in the low-rate period, and CZK 1,501 to 1,724 per MWh for households and CZK 1,608 to 1,890 per MWh for businesses in the high-rate period. Standing monthly charges range from CZK 34 to 45 per month for households and from CZK 38 to 49 per month for businesses.

Table 1 Regulated components of the price of electricity for eligible customers based on the voltage level (without 19% VAT) set for 2007

| 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 | 1,134.43 | 1,245.25 | 185.99 | 95.91 | 43.76 |
| Capacity booking / standing charge | CZK/MW | - | - | 108,102 | 108,102 | 42,941 |
| Network use / energy | CZK/MWh | - | - | 77.89 | 77.89 | 43.04 |
| Other regulated electricity price items for services related to electricity supply, w/o VAT | CZK/MWh | 185.91 | 185.91 | 185.91 | 185.91 | 185.91 |
| 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 | 34.13 | 34.13 | 34.13 | 34.13 | 34.13 |
| System services | CZK/MWh | 147.15 | 147.15 | 147.15 | 147.15 | 147.15 |
| Total regulated electricity price | CZK/MWh | 1,320.34 | 1,431.16 | 371.90 | 281.82 | 229.67 |

Table 2 Average electricity prices to final customers based on Eurostat categories for 2007

| 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 | 2.50 | 2.97 |
| I_b | 50,000 | 3.13 | 3.72 |
| I_g | 24,000,000 | 1.88 | 2.24 |

Supply quality indicators

The Energy Act requires the TSO and DSOs 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 a DSO fails to observe them, its customer has the right to demand compensation, specified in the public notice, for breaching a particular standard.

SAIDI and SAIFI in 2007 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 |
|-------------------------------|---------|---------|--------|
| Low voltage level | 48.268 | 98.000 | 19.650 |
| High voltage level | 220.705 | 259.000 | 14.420 |
| Extra high voltage level | 5.925 | 2.500 | 0.510 |

Table 4 SAIFI values

| SAIFI [interruptions/year/customer] | ČEZ | E.ON | PRE |
|-------------------------------------|-------|-------|-------|
| Up to 1 kV | 0.326 | 0.409 | 0.120 |
| From 1 kV to 100 kV | 2.434 | 1.733 | 0.370 |
| 110 kV | 0.287 | 0.209 | 0.020 |

SAIFI – average frequency of supply interruptions per final customer per year
[interruptions/year/customer]

SAIDI – average time of supply interruption in minutes per final customer per year
[minutes/year/customer]

Connection conditions

The conditions for connecting a new electricity customer or generator to the distribution or transmission system, including the method of calculating the applicant's share of the costs incurred in the connection and in bringing the required power, are set out 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 for 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 electricity supply and demand prices in each trading hour, generating a resulting marginal price of electricity and the quantity traded (reconciled). 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 2007 there were one TSO and 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 2007 also 277 operators of local distribution systems, in the Czech Republic.

Ownership unbundling

The ownership unbundling in the electricity industry has only been effected for the transmission network, which is a state-owned company through entities that are mentioned below. 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 only unbundle 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(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 277 operators of local distribution systems, which, therefore, are not obligated to effect unbundling under this rule.

Ownership structure

TSO - ČEPS, a.s.

On 31 December 2007 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, Osinek, a.s., whose sole shareholder is the Czech Republic. ČEPS is the only transmission company in the Czech Republic and uses 100% of transmission networks for its business.

DSO - PREdistribuce, a.s.

On 31 December 2007 the ownership structure of this company was as follows:

- 100% Pražská energetika, a.s.

DSO - ČEZ Distribuce, a.s.

On 31 December 2007 the ownership structure of this company was as follows:

- 99.72% ČEZ, a.s.
- 0.28% Energetika Vítkovice, a.s.

DSO - E.ON Distribuce, a.s.

On 31 December 2007 the ownership structure of this company was as follows:

- 100% E.ON Czech Holding Verwaltungs GmbH

Asset ownership

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

Location of companies

Some 90 per cent of PREdistribuce, a.s. is currently located in a separate building. Employees' access is monitored by a security service or allowed with the help security access chips. In the shared building, E.ON Distribuce, a.s. has its own floors allocated to it, the access to which is secured by access codes. ČEZ Distribuce, a.s. has offices in a different building than the trading company.

Presentation of companies

ČEZ Distribuce, a.s. uses its own separate domain for its presentation. Even after the legal unbundling, the other companies present themselves to customers in a standardised format in shared domains and employing uniform e-mail addresses, brands, logos and design.

Unbundled accounts

Accounts for unbundled activities were not published in general; they were available solely for the Office's purposes as part of regulatory reporting. The 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 separate audit. All distribution companies in the Czech Republic use bookkeeping and accounting services provided by an affiliated company, and both distribution and trading companies share them.

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. These competencies do not include penalisation at all, and the Office only has marginal inspection competencies. The State Energy Inspectorate is the inspection and penalising authority in the Czech Republic. In the event of detecting 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(2) of the Energy Act, revoke the company's authorisation to carry on business, i.e. its licence.

Regulatory powers in the enforcement of management and functional unbundling

The Czech Republic has transposed the EU Directive on the common rules for internal electricity market into its national legislation. The Czech legislation sets out the requirements for the unbundling of TSO and DSOs, but it does not provide any powers through which the regulator could enforce these requirements. This suggests that the regulator does not have sufficient powers required for enforcing effective management and functional unbundling.

Progress since unbundling

In 2007 there was no significant progress attributable to the implementation of mandatory legal unbundling.

3.2 Competition issues

3.2.1 Structure of the wholesale market

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

In 2007 total domestic net electricity consumption amounted to about 59.7 TWh, of which 35.7 TWh (59.8%) was taken by high-demand customers connected to the high voltage and extra high voltage levels, 7.9 TWh (13.2%) by low-demand business customers connected to the low voltage level, and 14.6 TWh (24.5%) by households. The balance of the demand, amounting to 1.5 TWh (2.5%), was taken by the energy sector itself, i.e. it was power stations' 'other load'. On the other hand, net electricity generation totalled 81.4 TWh (gross generation was 88.2 TWh). Electricity was consumed by final customers, and it was also used for covering line losses and, to a limited extent, exported to other countries.

The system registered the annual maximum, peak load, on 29 November 2007 at 5 p.m., with a total gross load of 11,059 MW. The system registered the annual minimum on 5 August 2007 at 6 a.m., with a total gross load of 4,881 MW.

On 31 December 2007 the total installed capacity of power stations in the Czech Republic was 17,562 MW, with approximately 58 per cent of the power stations' output connected directly to the transmission system and 42 per cent to the distribution system.

The degree of integration with neighbouring Member States

The national legislative framework for electricity export/import 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 a cross-border interconnection at auctions organised by the TSO. In 2007, 25.6 TWh were exported from the Czech Republic, while imports totalled 9.5 TWh. The free tradable capacity in cross-border lines in the direction to the Czech Republic, offered in yearly and monthly auctions by the TSO, i.e. ČEPS, a.s., made it possible in 2007 to import, in theory, at least 26 TWh as the yearly volume, which is more than 43 per cent of the Czech Republic's total net consumption in that year.

Electricity generators

The most important electricity generator on the Czech market is ČEZ a.s., which holds a share of almost 70 per cent of installed capacity and 74 per cent of the electricity generated. ČEZ, a.s. is also the only market participant that has a market share of more than five per cent in relation to the installed capacity or the quantity of electricity generated. The second largest generator is Sokolovská uhelná, právní nástupce, a.s. (a market share of 3.5 per cent), the third is Dalkia Česká republika, a.s. (a market share of three per cent). The following are the other important electricity producers with an installed capacity of more than 200 MW: International Power Opatovice, a.s. (Elektrárny Opatovice, a.s. until 30 September 2005), ECK Generating, s.r.o., Energotrans, a.s., and United Energy, a.s. These companies are usually a part of larger groups, frequently multinational energy groups, which operate the whole range of business lines, from generation to trade. We can track direct connection through these ties, where the generator and trader operating in the Czech Republic are a part of a single group, in the case of, for example, ECK Generating (Atel Energy GmbH), and others. In addition to these generators, who sell most of their electricity on the market, large industrial groups also have their electricity generating plants with an installed capacity of more than 200 MW, namely Unipetrol RPA, s.r.o., and Mittal Steel Ostrava, a.s.

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 various administrative proceedings that it conducts with the relevant party(ies) to the proceedings.

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' offering prices. In this way some 90 per cent of the volume of balancing power is procured; for 2007 most of the ancillary services had been bought in 2004 on the basis of a three-year tendering process. 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 15 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 four per cent year-on-year, and is similar to its energy production, i.e. it accounts for approximately 61 per cent 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

In 2007 most of electricity trades continued to take place under bilateral contracts. The term of such contracts generally varies; one-year contracts are usually executed between electricity generators and traders.

The remaining volume of electricity is traded on the short-term market (day-ahead and intra-day markets) organised by OTE. The short-term market accounts 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 (the so-called entities subject to clearing), can go to the short-term markets to procure electricity. In 2007 there were 45 active entities on the short-term markets.

Since July 2007 it has also been possible to buy electricity through the Prague Energy Exchange. Because trading on the exchange started halfway into the year and contracts had already been executed, the quantity of traded electricity with delivery dates in 2007 was negligible; most of the trades covered contracts for 2008 and 2009. On 31 December 2007 there were 27 registered traders on the exchange.

Mergers and acquisitions in the electricity industry in 2007

In 2007 the Office for the Protection of Competition (OPC) assessed one merger of undertakings in the electricity industry: ČEZ, a.s./Teplárenská, a.s.

ČEZ, a.s./Teplárenská, a.s.

On 26 January 2007 the OPC permitted, without any limitations, the merger between undertakings ČEZ, a.s., having its registered office at Duhová 2/1444, Praha 4, Company No. [IČ] 452 74 649, and Teplárenská, a.s., having its registered office at Teplárenská 2, Most - Komořany, Company No. [IČ] 273 09 941. This merger was effected by way of ČEZ acquiring control over Teplárenská.

The core business of ČEZ, and its subsidiaries, is generation and distribution of electrical energy and supply thereof to electricity traders and final customers, and provision of ancillary services to the electricity grid, particularly in the Czech Republic. Further, the ČEZ Group is one of the three largest thermal energy producers and suppliers in the Czech Republic. Through one of its subsidiaries, ČEZ is the most important brown coal company in the Czech Republic. The core business of Teplárenská, a.s. is thermal energy production and distribution, primarily in the towns of Bílina, Dubí, Duchcov, Hrob, Jirkov, Kadaň, Klášterec nad Ohří, Krupka, Osek and Teplice.

The merger concerned the area of the generation, distribution and sale of heat and thermal energy in the towns of Bílina, Dubí, Duchcov, Hrob, Jirkov, Kadaň, Klášterec nad Ohří, Krupka, Osek and Teplice. The undertakings' merger had largely a vertical nature, because on the relevant markets on which both of them were operating, ČEZ, as the only major heat generator in the above localities, sold all its heat output to Teplárenská, which then distributed it further and supplied it to customers. With regard to the already existing relationship of a supplier and customer between the merging undertakings and with regard to the fact that the remaining heat supplied by Teplárenská was produced in its own capacities or, marginally, in some other capacities, and also with regard to the regulation of the heat supply industry in the Czech Republic, the OPC did not see any significant opportunity for any distortion of competition in this vertical merger.

3.2.2 Structure of the retail market

Electricity consumption by sector

In the sectors of the country's economy, annual gross electricity consumption totalled 72.0 TWh. The various sectors had the following consumption: industry 25.3 TWh, energy 13.0 TWh, transport 3.0 TWh, the building industry 0.4 TWh, agriculture 1.3 TWh, households 14.7 TWh, services 6.6 TWh, and others 7.7 TWh. The Office has no data on net consumption broken down as above.

Companies with a market share of above five per cent

Only three vertically integrated companies whose subsidiaries hold a licence both for electricity distribution (DSOs with more than 90,000 customers) and for electricity trading are currently operating on the Czech electricity market. They are the ČEZ Group, the E.ON Group, and the PRE Group. In 2007 most of eligible customers selected the supplier companies belonging to the above Groups 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. These three suppliers' electricity market share accounts for more than 95 per cent 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 per cent.

Independent electricity traders

Several (about 20) more important independent traders also operate on the electricity market; their total market share is currently 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. In 2007 several independent traders also started to operate at the national level, focusing on the small customer and household categories. In most cases new electricity supply agreements are executed in perpetuity, with a three months' period of notice; in some cases they are fixed-term agreements, usually for a term of 12 or 24 months.

Number of customers who have switched suppliers

According to information available from Operátor trhu s elektřinou, a.s., in 2007 a total of 46,016 customers switched their supplier. Since the beginning of the liberalisation of the Czech electricity market, i.e. 2002, a total of 63,076 entities have changed their supplier.

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 in 2007.

Table 5 Electricity supplier switches by metering type

| Type of metering | Electricity supplier change by metering type |
|------------------|--|
| | 2007 |
| A | 1,615 |
| B | 2,738 |
| C | 41,637 |
| TOTAL | 46,016 |

Supplier switching procedure

As regards the option of electricity supplier switching, final customers can choose their supplier 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 electricity 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 supplier (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.

Inquiries and complaints addressed to the Energy Regulatory Office

Table 6 shows, by categories, the number of inquiries and complaints received from electricity market participants (usually customers), which were addressed to the Office in 2007. The Office has no data on market participants' questions and complaints addressed to electricity suppliers.

Table 6 Number of questions and complaints addressed to the Energy Regulatory Office

| | Inquiries | Complaints | Total | Share |
|--|------------------|-------------------|--------------|--------------|
| Prices, billing | 158 | 21 | 179 | 30% |
| Connection, supply interruption, unauthorised consumption, quality, metering | 77 | 24 | 101 | 17% |
| Information to customers – market rules | 38 | 2 | 40 | 7% |
| Information to market participants – supported capacities, reporting | 148 | 0 | 148 | 25% |
| Other | 122 | 10 | 132 | 22% |
| Total | 543 | 57 | 600 | 100% |

Consumers' complaints addressed by the State Energy Inspectorate

In 2007 the SEI dealt with 197 complaints. They concerned billing and invoicing, metering, sub-standard supplies, unauthorised consumption, connection of supply points, moving of installations, etc.

Consumers' complaints and inquiries conducted by the Office for the Protection of Competition (OPC)

In 2007 the OPC received a large number of complaints from consumers. They usually concerned the high electrical energy prices billed to them in 2007. In connection with these complaints the OPC conducted inquiries in the various cases, which did not prove any breach of Act No. 143/2001 on the protection of competition and changes to certain laws (the Competition Act), as amended (Act No. 143/2001). In the case of eligible customers, the overall amount paid by final customers for electricity supplies is composed of two basic parts. One part contains controlled prices for electricity transport, set by the Energy Regulatory Office for every calendar year. The other part contains charges for electrical energy as such, i.e. the commodity, and the related services, and it is not subject to regulation and depends on

the market environment. These inquiries have concluded that changes in electrical energy prices for eligible customers are primarily due to the growth of the wholesale electricity price, which results from a transparent match between supply and demand on the market. For particular eligible customers price changes may also be due to a number of other factors such as year-on-year changes of the load profile and the nature of consumption, selection of a different electrical energy product, change in controlled prices, etc. As part of its inquiries the OPC concluded that prices for households and small customers – judging by the presented price lists of the ČEZ Group, E.ON Group and PRE Group companies for 2007 – copied the prices of the supplier of last resort under Section 12a of the Energy Act, which the ERO had set in its relevant price decisions; the prices set by the above groups therefore do not exceed the prices controlled by the State.

The OPC referred complaints that were addressed to it but concerned in fact the issues that fell within the ERO's exclusive competencies, to the ERO on the grounds of the OPC's lack of jurisdiction. In the electricity industry, these were most frequently citizens' complaints about high electricity supply prices billed to them until the end of 2005 by utilities (the market has been fully liberalised since 1 January 2006) and issues such as electricity service lines, service billing, unauthorised consumption, etc.

In 2007 the OPC did not conduct any administrative proceedings on a potential breach of Section 3 or Section 11 of Act No. 143/2001 or breach of Article 81 or Article 82 of the EC Treaty in the electricity industry.

3.2.3 Measures to avoid abuses of dominance

Market surveillance

In the protection of competition, the OPC operates within a legislative framework defined by Act No. 143/2001, which specifies the group of entities the competition practices of which the law covers. Act No. 143/2001 applies to all entities that can be subsumed under the concise legislative term “undertaking” within the meaning of Section 2 of Act No. 143/2001, and to all sectors of the economy without any exceptions, including the energy sector, and to all public and private enterprises. The OPC is the only administrative authority that has the remit to assess any potential breach of the Competition Act. For the protection of competition, the OPC can *ex post* punish, through specific interventions in administrative proceedings, an undertaking's practices that transgress a separate regulatory law.

Surveillance by the OPC is necessary because energy installations and networks have, and will continue to have, a monopoly nature (so-called network monopolies), since alternative installations and networks cannot be expected to be built in the future due to their cost intensity and challenging implementation in practice.

The OPC welcomes the fact that economic operators have an opportunity to receive pricing signals on the electricity market as a result of free market forces, thanks to the so-called virtual power plant (see below, the OPC's decision on ČEZ and five regional distribution companies) and, since 2007, the Prague Energy Exchange, having its registered office at Rybná 682/14, Praha 1 (PXE), for products that already are traded on the PXE or on the basis of the expected prices of the products that are not yet traded on the PXE (in such cases, the prices are derived from the price level of the products currently traded on the PXE and the relation of these products to those that are not yet traded, which are taken over from stable and functioning markets). Although energy prices are continuously rising the OPC perceives this trend mainly as a result of the convergence of energy price levels in the Czech Republic and neighbouring countries.

The virtual power plant

The introduction of the so-called virtual power plant was one of the OPC's conditions for the protection of competition, contained in its decision of March 2005, which changed its earlier decision of March 2003 whereby the OPC had permitted the merger between ČEZ, a.s. and five regional distribution companies.

In line with the principles of the above decision ČEZ was obligated to allow third-party access to its own electricity generating capacity of 400 MW, located in the Czech Republic, and permit the third parties to take the electricity generated in this capacity in 2007.

More detailed information about the virtual power plant is contained in the previous National Reports of the Czech Republic, namely those for 2005 and 2006.

On 31 May 2006 an auction for 2007 was called. On 2 and 9 August 2006 this auction for the allocation of the virtual power plant's generating capacity for 2007 took place.

The virtual power plant was offered in the auction in eight units of 50 MW, or 30 MW in the summer months (June, July and August). The demand exceeded the offered capacity by a factor of five.

The winning prices for the various units were 16.4 to 18 per cent higher than the wholesale electricity price for 2006. The average price of electricity from the virtual power plant auction for 2007 increased by 17.1 per cent in comparison with 2006, and by 18.5 per cent in comparison with the virtual power plant prices for 2005. The price for an annual band for 2007 was therefore approximately CZK 1,220/MWh.

Domestic and foreign traders, suppliers and customers took part in the auction.

The purpose of this measure was, in particular, to create a functioning and competitive market ensuring, in a transparent and non-discriminatory way, independent traders' access to available electrical power. The electricity prices in each of the EU member states are converging, and therefore the condition imposed on ČEZ was only a short-term measure; its purpose was to serve as a tool for accelerating the development of the wholesale market.

4 Regulation and structure of the natural gas market

4.1 Regulatory issues

4.1.1 Management and allocation of interconnection capacity and mechanisms to deal with congestion

In 2007 RWE Transgas Net, s.r.o., which holds the exclusive gas transmission licence in the Czech Republic, provided natural gas transmission across the Czech Republic primarily under an agreement with RWE Transgas, a.s., which provides gas transmission under agreements in place for Gazprom export Ltd., Ontrans VNG Gastransport GmbH and Wintershall AG Kasel. The capacity at the entry and exit points of the transmission system is such that neither physical nor commercial congestions occur.

On 1 January 2007 a new public notice on gas market rules entered into force; it requires the TSO to publish information to an extent that will meet the requirements of point 3.3 of Annex A to Regulation 1775/2005/EC. The TSO shall publish the following information on a monthly basis:

- the annual plan of the shutdowns of the various parts of the transmission system and the maintenance plan,
- a long-term plan for the reinforcement of the transmission system,
- forecasts of free transmission capacity for the following ten-year period for each of the transmission system's entry and exit points;
- historical minimums and maximums of the monthly transmission capacity utilisation and annual average flows;
- actual values of gas supplies into the gas system, gas takes from the gas system, and the size and direction of the system imbalance by gas days;
- income from imbalances over the allowed tolerance, income from missing balancing gas, and outlays on excess balancing gas.

The TSO shall also publish the following information on a daily basis:

- the size of the technical capacity, the total committed firm capacity, the total committed interruptible capacity, and free transmission capacities for each of the transmission system's entry and exit points for the following 18 months;
- the indicative availability of daily transmission capacities for each of the transmission system's entry and exit points one day and one week in advance;
- preliminary values of gas supplies into the gas system, gas takes from the gas system, and the size and direction of the system imbalance for the previous gas day;

Looking at the capacity of cross-border interconnections it is to be noted that the new gas market rules have introduced the principle of capacity booking on the basis of entry and exit points for inland transmission, and that there were no physical or commercial congestions at those points in the period under review. RWE Transgas Net, s.r.o. provided information about the technical capacity available at all of its border transfer stations in Lanžhot, Hora sv. Kateřiny and Waidhaus on its website in 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.

There are no bottlenecks in the Czech transmission system; the system is capable of transporting the required gas volumes and there is no need to adopt any measures vis-à-vis gas market participants to deal with congestion in the gas system.

Through its bulletin board, in 2007 the TSO enabled secondary capacity trading under the conditions set out in the gas market rules and in its Grid Code. In 2007 the secondary market was not liquid, due 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 capacity reinforcement.

As regards the priorities in capacity allocation (national or cross-border) in the event of a commercial congestion, and the issue of gas transit, the same rules as in 2006 stayed in place in the period under review. Since there was sufficient primary capacity in the transmission system in 2007 these rules were not applied in practice.

4.1.2 The regulation of the tasks of transmission and distribution companies

The Czech gas system

Only one transmission system operator, RWE Transgas Net, s.r.o., is active in the Czech Republic; it was established on 1 January 2006 by legal unbundling from its parent company, RWE Transgas a.s. Connected to the transmission system are the eight regional gas distribution systems (DSO), each of which serving more than 90,000 final customers. In addition, approximately 88 smaller holders of licences for natural gas distribution in local distribution systems operate on the Czech market (LDS), via which natural gas reaches final customers under the same conditions as set out in the legislative framework, which did not change in the period under review in comparison with the previous year.

The Balancing Centre

The Balancing Centre monitors the development 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 presents the processing of this data into summary overviews of the gas system. The Balancing Centre receives information from the TSO, DSOs with more than 90,000 customers, and storage system operators (SSO).

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 Ministry of Industry and Trade and the Energy Regulatory Office, 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, eligible customers must notify the Balancing Centre of any change of their supplier.

Network tariffs

The principles of gas transmission and distribution pricing for final customers in the Czech Republic are similar to those of 2006; only in respect of gas transmission, 2007 saw a profound change in the finalisation of calculations, which will be described in the following.

Transmission

The inland transmission system is comprised of gas pipelines having a total length of 1,183 km, with nominal diameters ranging from DN 80 to DN 700 and nominal pressures of 4 MPa, 5.35 MPa and 6.1 MPa, of which approximately 85 per cent have been built for the highest of the above pressures.

The area of the Czech Republic is relatively small, and the charges for natural gas transmission are therefore unified for the whole Czech natural gas market, independently of distance (working on the “postage” principle). The charges depend on the quantity of the gas that needs to be transported over one day (the maximum daily capacity of all the values over a year) and are set for one-year and longer contracts.

Natural gas transmission charges are set for a period of one calendar year with effect from 1 January of the respective year. Throughout the second regulatory period (from 2005 to 2009, inclusive) the revenue cap method is used.

The final charges for transmission reflect the type of the gas transmission agreement. In addition to standard one-year agreements, parties can enter into daily agreements and those for a term of one to eleven months; pricing under agreements for a term of less than one year takes into account 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 term of the transmission agreement. This is done with the help of coefficients, the size of which differs for each of the months and puts at a disadvantage gas take in winter when the demand for this service is higher in general. Daily contracts are also priced on the basis of these coefficients.

The gas transmission charges for 2007 again included a part of the justifiable minimum costs of the TSO’s unbundling (the TSO has been separate from the trader since 1 January 2006); related to this is also the recognition of a part of revalued depreciation. Effective since 1 January 2007, the public notice laying down the rules for the organisation of the gas market has preserved the TSO’s important role of transmission system balancing. In this connection, sufficient withdrawal capacities of the storage facilities must be reserved to carry out this task. The costs incurred in reserving withdrawal capacity for transmission system balancing are also included in the transmission charges.

The entry into force on 1 January 2007 of the new public notice on gas market rules resulted in a major change in transmission pricing in comparison with the previous year. The new rules defined the entry/exit points on the Czech gas transmission system, which had to be evaluated and for which fixed charges for booked capacity were set. This resulted in six different fixed charges for daily booked firm capacity throughout the term of annual contracts, unlike the previous years when a single transmission charge was set on the point-to-point principle.

On the basis of the overall allowed revenues, which are set, each of the entry/exit points of the transmission system is evaluated. In this respect, these points are classified as points through which gas flows into the Czech Republic and down to the final customers, and points through which gas can be exported. Final customers in the Czech Republic pay the price of the transmission involved in gas import into, and gas transport within, the country.

The methodology for pricing international transmission (transit), in place as from 1 July 2006, was preserved. The transit pricing methodology is 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 fee for 2007. One component, effective from the beginning of the year at a fixed rate of CZK 68,148.30/1,000 cu m/day/year, and increased to CZK

69,248.90/1,000 cu m/day/year from 1 October, applied to contracted transmission capacity for a pair of entry and exit points in international transmission, and the other component covered compressor station fuel gas and accounted for 0.77 per cent 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

In 2007 eight regional companies carried on the licensed business of gas distribution in the Czech Republic. More than 90,000 supply points of final customers taking natural gas are connected to the distribution system of each of these companies. The length of the gas pipelines in all of these distribution systems totals 61,028 km.

In addition to regional distribution companies, the licensed business of gas distribution is carried on, within limited areas, by entities operating local distribution systems, of which each has a length of only several kilometres. Twenty supply points of final customers are connected to these systems. An exception is only one company, the distribution system of which is 138 km long and approximately 3,000 supply points of final customers are connected to it. This local distribution system, supplies natural gas only to households and customers with an annual offtake of up to 630 MWh. The input delivery points of the local distribution systems are connected to the regional distribution systems.

Similarly as with transmission, distribution is priced on the basis of the revenue cap method. The charges are one-year charges effective from 1 January of the respective year. Charges for distribution are set separately for the operator of each regional distribution system. Final customers' supply points are included in offtake bands by the overall quantity distributed annually, provided that the dividing lines between offtake bands are identical for all DSOs.

The baseline parameters set for the whole regulatory period and also the data provided by regional distribution system operators in their regulatory reports, the furnishing of which is provided for in delegated legislation on energy, are used for pricing gas distribution.

For 2007 the distribution charges were set as double-component charges 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 businesses and households taking over 63 MWh/year, to the booked distribution capacity. For the low-offtake business category and households taking up to 63 MWh/year the fixed component had the form of a standing charge. For all customer categories the variable component of the distribution rate related to the total quantity taken.

Distribution charges are set on the basis of annual gas distribution agreements. The gas market rules also define shorter, monthly agreements, whose prices are derived from annual prices similarly as monthly transmission charges.

To make sure that the respective TSO or DSOs do not take a discriminatory approach, distribution and transmission charges are set as fixed prices, i.e. no discounts can be granted, and the prices cannot be increased.

Thanks to the sufficient capacity in the distribution systems and the transmission system the interruptible capacity charge is set at the same level as the charge for firm capacity, with discounts granted upon interruption. Because of the possibility to grant discounts for supply interruptions, the charges for interruptible capacity are set as the maximum prices.

Table 7 shows the distribution charges for 2007 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 supply points. The charges are in CZK/MWh and without VAT.

Table 7 Average distribution charges in 2007

| Eurostat category | Distribution charge | |
|-------------------|---------------------|--------------|
| | Minimum, CZK | Maximum, CZK |
| I4-1 | 42.92 | 87.91 |
| I1 | 135.96 | 238.23 |
| D3 | 158.63 | 268.42 |

Charges for access to storage facilities

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

In 2007 RWE Gas Storage, s.r.o., which came into existence on 1 May 2007 through ownership unbundling from the parent company, RWE Transgas, a.s., held a share of more than 90 per cent on the market of the service of gas storage in underground gas storage facilities. In comparison with 2006, the technical storage capacity of the facilities was increased by 66 mcm. This new capacity was offered, and allocated as free capacity to the market participants who requested it, from 1 April 2007.

More than 98 per cent of the gas stored in underground gas storage facilities owned by the RWE Group for supplies to the Czech market in 2007 was owned by RWE Transgas, a.s., and the balance was owned by VEMEX, s.r.o., Pražská plynárenská, a.s. and the Italian company ENOI S.p.A.

The licensed business of gas storage in underground gas storage facilities is not subject to regulation; each SSO determines its own price for natural gas storage. The average price for gas storage in the Czech Republic was CZK 1.11/cu m of the working gas volume in the 2007/2008 storage year (from 1 April 2007 to 31 March 2008); in the calendar year 2007 it was CZK 0.90/cu m of the working gas volume.

Service quality

Public notice no. 545/2006 on the quality of gas supplies and related services in the gas industry entered into force on 1 January 2007. This instrument does not only set out the required quality of natural gas supplies and the services related to regulated activities in the gas industry, but also compensation to final customers, to which they become entitled when the appropriate standard is not kept, and also the time limits for claiming such compensation and the procedures for reporting on the keeping of the quality of supplies and services.

The required quality is expressed in terms of standards, for the keeping of which in respect of final customers licence holders are responsible. Standards cover more than gas supplies to final customers: they also guarantee the provision of high-quality services in gas transmission, distribution and storage. In the event of failure to keep a standard in respect of a final customer, the respective licence holder is, under the Energy Act, obligated to provide compensation in the amount set out in the public notice. Final customers' entitlement to

compensation for failure to keep a standard should not be mistaken for their right to damages. This is a separate entitlement, the emergence of which is related to a licence holder's breach of an obligation set out in the Energy Act. Final customers can go to court to claim compensation for damage they may suffer.

Licence holders responsible for keeping the standards that pertain to their licensed business shall publish, in a manner permitting remote access and by 31 March of the calendar year, a summary report on their keeping of all the standards for the preceding calendar year. Standard keeping by the various licence holders helps to improve the quality of the services that they provide in connection with natural gas supplies for all end users. According to information available to the Office, the standard set for the time limit for handling complaints about gas supply billing was breached several times in 2007.

Information about gas transmission and distribution conditions

Gas market participants can find the information about the conditions for gas transmission for the purpose of gas consumption in the Czech Republic in the TSO's Grid Code, which is freely available on its website. The gas transmission charges set by the Office for each of the customer categories can be found on the Office's website in its price decisions.

Gas traders and final customers, and other gas market participants, can find the conditions for connection to distribution systems in the rules of gas distribution system operation, which are published on the Internet - on the website of the distribution company within the area of which the gas consumption equipment in question is located. The gas distribution charges for the various customer categories can be found in the price decisions issued by the Office every year and also on the respective distribution system operator's website.

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. The balancing process continued to be based on the daily interval of imbalance evaluation.

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

As regards commercial balancing, the principle of calculating the balancing tolerance using a formula identical for all entities subject to balancing was preserved.

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.

Unlike the situation in 2006, the balancing process put in place for 2007 already made it possible for entities subject to clearing to transfer their responsibility for imbalance by supply points, and also to transfer overall responsibility for imbalance; together with such transfer, also the transferring cleared entity's overall tolerance is transferred.

The Office determined the coefficients for calculating the balancing 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) the balancing imbalances were balanced by means of payments in kind. On the basis of preliminary results of metering, the individual entities balanced the imbalances for day D on

day D+2. Once the TSO evaluated a whole calendar month, these entities balanced the sum of the actual 'balancing imbalances' for that calendar month on the 15th to the 24th 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 price. The TSO paid for the excess balancing gas. In 2007 the maximum natural gas price for calculating the price for missing or excess balancing gas ranged from CZK 524.40 to CZK 583.42 per MWh, including both of these limit values.

Market model

A new public notice on gas market rules entered into force on 1 January 2007. Its purpose was to underpin the development of the liberalised gas market. From the perspective of gas supplies to customers in the Czech Republic the transmission system has been virtualised into eight domestic points; a domestic point consists of the aggregate of the delivery points between the transmission system and the distribution systems that are directly connected to the transmission system, assigned to the respective domestic zone. The entry/exit points of the transmission system are: border points, entry/exit points into/from the notional storage facility, and domestic points. In commercial terms, all entry and exit points are connected to a notional trading point, at which gas is traded. Under these gas market rules, traders nominate for each of the entry/exit points of the transmission system.

Gas transit took place in keeping with the requirements of Regulation 1775/2005/EC and preserved the system of point-to-point capacity booking as used in the preceding years.

No physical or commercial congestion occurred at any of the entry/exit points of the transmission system. Thus, there was no need to use a mechanism for dealing with congestion. Capacities could be traded on the secondary market, but thanks to the sufficient amount of primary capacities in reality there were no such trades.

4.1.3 Unbundling

In 2007 one TSO operated in the Czech Republic (RWE Transgas Net, s.r.o.), and eight DSOs (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., and Jihomoravská plynárenská Net, s.r.o.), each of them having more than 90,000 customers, which between them cover the largest part of the market. There were 86 operators of local distribution systems in the Czech Republic at the same time.

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 in accordance with the Energy Act. 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. On 1 January 2007 the legal unbundling process was finalised at the level of operators of the regional distribution companies to which more than 90,000 customers were connected. Gas trading companies were separated from natural gas

distribution companies. The above 86 operators of local distribution systems did not have the obligation 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(9) of the Energy Act.

Ownership structure

TSO:

RWE Transgas Net, s.r.o.

On 31 December 2007 the ownership structure of this company was as follows:

- 100% RWE Transgas, a.s.

RWE Transgas Net, s.r.o. is fully owned by a privately-held company, and it is also the only transmission company in the Czech Republic; it therefore uses 100 per cent of the transmission networks for its business.

DSO:

Pražská plynárenská Distribuce, a.s., člen koncernu Pražská plynárenská, a.s.

On 31 December 2007 the ownership structure of this company was as follows:

- 100% Pražská plynárenská, a.s.

JMP Net, s.r.o.

On 31 December 2007 the ownership structure of this company was as follows:

- 100% Jihomoravská plynárenská, a.s.

ZPČ Net, s.r.o.

On 31 December 2007 the ownership structure of this company was as follows:

- 100% Západočeská plynárenská, a.s.

STP Net, s.r.o.

On 31 December 2007 the ownership structure of this company was as follows:

- 100% Středočeská plynárenská, a.s.

SMP Net, s.r.o.

On 31 December 2007 the ownership structure of this company was as follows:

- 100% Severomoravská plynárenská, a.s.

VČP Net, s.r.o.

On 31 December 2007 the ownership structure of this company was as follows:

- 100% Východočeská plynárenská, a.s.

SČP Net, s.r.o.

On 31 December 2007 the ownership structure of this company was as follows:

- 100% Severočeská plynárenská, a.s.

JČP Distribuce, s.r.o.

On 31 December 2007 the ownership structure of this company was as follows:

- 100% E.ON Distribuce, a.s.

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. In the case of DSOs, employees' access to buildings is guarded by a security service or provided by means of access security chips.

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 2007 DSOs with more than 90,000 customers started to present their business using their own domains and logos.

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 out 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 subject to a separate audit by a certified accountant. All distribution companies in the Czech Republic use bookkeeping and accounting services provided by an affiliated company, and both distribution and trading companies share them.

Inspections and sanctions

See the text in point 3.1.3, page 20.

Regulatory powers in the enforcement of management and functional unbundling

The Czech Republic has transposed the EU Directive on the common rules for the internal gas market into its national legislation. The Czech legislation sets out the requirements for the unbundling of the TSO and DSOs, but it does not provide for any powers through which the regulator could enforce these requirements. This suggests that the regulator does not have sufficient powers required for enforcing effective managerial and functional unbundling. The State Energy Inspectorate is responsible for reviewing the observance of the Energy Act.

Progress since unbundling

In 2007 there were no developments attributable to a change in the amount of investment in networks or a change in the security of supplies by the TSO; nor was any change registered with DSOs after the mandatory unbundling of distribution.

4.2 Competition issues

4.2.1 Structure of the wholesale market

Gas consumption

Natural gas consumption in the Czech Republic has been decreasing slightly for the past few years, from the maximum consumption of about 9,500 mcm/year between 2001 and 2006. In 2007 the actual natural gas consumption amounted to 8,653 mcm. Consumption adjusted to normal monthly temperatures and temperature gradients of consumption amounted to 9,070 mcm. Over the past few years the net calorific value of the natural gas supplied to final customers has been increasing slightly. It is now approximately 9.50 kWh/cu m (34.2 MJ/cu m) – for more details please see point 5.2.1. 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 about one per cent of the country's domestic consumption. In 2007 supplies of indigenous gas amounted to 94.4 mcm. These resources include mainly the natural gas produced in southern Moravia by MND, a.s., with the gas supplied largely to Jihomoravská plynárenská, a.s. (JMP, a.s.), and the so-called surface drained gas, i.e., gas drained from hard coal mines in Northern Moravia by UNIGEO, UNIMASTER and OKD for local needs in the region of Severomoravská plynárenská, a.s. Since indigenous gas production is negligible the Czech Republic has to import almost all of the natural gas it needs. Natural gas was imported from Russia, Norway and Germany; from Russia 6,548 mcm, from Norway 1,829 mcm and from Germany 2 mcm (a supply for VEMEX from a VNG storage facility in the fourth quarter). Natural gas imports were secured primarily 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 the Russian producer (78 per cent); Norwegian producers supply the balance (22 per cent). In 2007 a new natural gas importer started to operate on the Czech market: Vemex, s.r.o., which took a market share of three per cent (a gas import agreement with Gazexport).

New gas market players

New trading entrants have more or less been just monitoring the current situation on the market, trying to be successful in the large offtake category. The company that actually did supply gas was MND, a.s., whose market share was rather small as it supplied only four final customers (owned by MND). MND supplies its gas mainly to Jihomoravská plynárenská, a.s. Another trader that began to expand strongly and be visible on the Czech market was VEMEX, s.r.o., which is largely indirectly controlled by the Russian company Gazprom export Ltd. and which imported gas under a contract with this company. It began to be very successful mainly in the large offtake category of customers with an even load profile. The share held by the other new gas traders is negligible (see point 2.2.2, page 10).

Contractual relationships

The gas purchase agreements of DSOs with more than 90,000 customers, intended for gas supplies to eligible customers in 2007, were long-term take-or-pay agreements. Because of the limitations of the maximum prices allowed on the wholesale market, described in more detail in the previous two National Reports, the wholesalers' selling prices (the maximum level of such prices) were derived from the ERO's price decision.

Companies with a market share of above five per cent

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 five per cent. Since 10 July 2003 RWE Gas International B.V. has been the sole shareholder of this public limited company. Its core business includes natural gas storage (the storage business was transferred to its subsidiary RWE GAS Storage, s.r.o. from 1 May 2007) 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 4.1.3) 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 included 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 an agreement 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.

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

Due to an abuse of its dominant position by RWE Transgas, a.s. in 2006, the Office imposed price caps on the gas trader, which had booked with the TSO a capacity of more than 20,000,000 cu m/day and whose share of supplies to final customers in the respective domestic zone was more than 40 per cent. The measure pursued the objective of limiting the dominant position while not impeding market liberalisation by preventing final customers from gas trader switching.

Following the remedy of the practices pointed out, which were commented on in detail in the National Report for 2006, the measure was lifted subject to agreement reached between RWE Transgas, a.s., the ERO and the OPC on 31 March 2007. This date was chosen to coincide with the beginning of a storage year, thereby guaranteeing equal starting-point conditions for all market participants.

On 1 April 2007 the natural gas market was opened up *de facto*. To prevent any further potential abuse of its dominant position by RWE Transgas, a.s., this company proceeded to introduce gas sale at a notional trading point under transparent terms applicable to all market participants.

Mergers and acquisitions in the gas industry in 2007

In 2007 the OPC did not assess any merger of undertakings in the gas industry.

4.2.2 Structure of the retail market

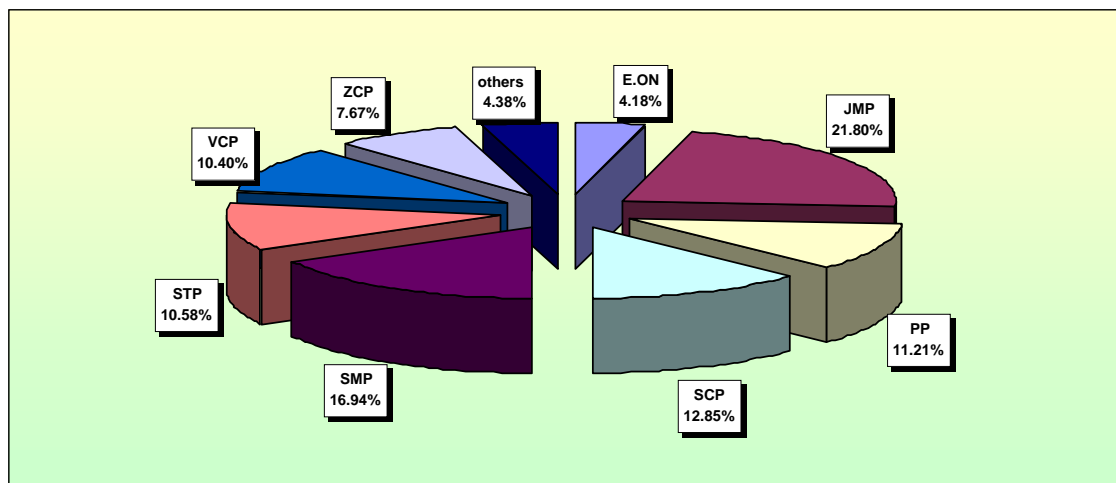
There are 88 gas trading licence holders in the Czech Republic. Only one decisive wholesale gas supplier operates on the market, RWE Transgas, a.s. In 2007 the other wholesale suppliers did not exceed ten per cent of the total gas supplied to the Czech Republic.

After the unbundling of regional gas companies with effect from 1 January 2007, the decisive supplier has been left on the retail market with eight gas trading licence holders, each of them

supplying natural gas to more than 90,000 customers. Historically, they supply gas within the domestic zones defined by the distribution system of the distributor that emerged, through unbundling, from the vertically integrated operator of such distribution system. The share held by regional gas traders in the total natural gas consumption in the Czech Republic can be seen in Chart 1. Six of the eight major suppliers are controlled by the RWE Group and the gas supplied by these suppliers accounts for 80.23 per cent of the total natural gas consumption in the Czech Republic.

The other gas trading licence holders also hold a gas distribution licence; they are local distribution system operators that do not have the obligation of legal unbundling and that operate within their respective local distribution system. Then there are traders with a small market share and licence holders that have not yet launched their licensed business. The aggregate supplies by all the other traders supplying gas to final customers, of which none supplied gas to at least 90,000 customers, did not exceed 4.83 per cent of the total gas supplied to all final customers in the Czech Republic.

Chart 1 Shares of traders supplying natural gas to final customers in the Czech Republic



Structure of final customers in the Czech Republic

In accordance with the Czech Republic's energy legislation, 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 eight relevant traders with more than 90,000 customers, supplying gas to final 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 | | | | | | | | | |
|----------------------------|-------|--------|--------|--------|--------|--------|--------|-------|--------|
| | E.ON | JMP | PP | SCP | SMP | STP | VČP | ZČP | Others |
| Large offtake | 4.23% | 19.18% | 8.68% | 18.21% | 19.04% | 12.33% | 9.97% | 8.45% | |
| Medium-sized offtake | 5.37% | 22.98% | 19.40% | 10.01% | 13.82% | 9.36% | 11.14% | 7.92% | |
| Households and low offtake | 4.29% | 26.68% | 13.20% | 9.08% | 17.20% | 10.09% | 11.89% | 7.57% | |
| Total, final customers | 4.18% | 21.80% | 11.21% | 12.85% | 16.94% | 10.58% | 10.40% | 7.67% | 4.38% |

In comparison with 2006 the number of gas trading licence holders went up from 83 to 88, i.e. by five.

For the sake of comparison, Table 9 shows prices of supplies broken down by Eurostat's consumer categories, 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 while column B shows the same prices with VAT. With the exception of VAT, in 2007 the price of natural gas supply to final customers did not include any other tax or levy.

Table 9 Prices of natural gas supply to final customers by Eurostat categories as at the first day of a quarter in the Czech Republic in 2007

| Period | Standard consumer by Eurostat | | | | | |
|----------------|-------------------------------|----------|--------|--------|--------|--------|
| | D3 | | II | | I4-1 | |
| | A | B | A | B | A | B |
| 1 January 2007 | 796.19 | 947.47 | 742.95 | 884.11 | 614.94 | 731.78 |
| 1 April 2007 | 801.02 | 953.21 | 744.09 | 885.47 | 611.39 | 727.55 |
| 1 July 2007 | 820.33 | 976.18 | 753.59 | 896.80 | 608.11 | 723.64 |
| 1 October 2007 | 856.34 | 1,019.04 | 779.33 | 927.40 | 635.77 | 756.57 |

The periodicity of the changes in natural gas supply prices over a calendar year differs for different traders and depends on their business policy. The changes are usually made on the basis of changes in the gas purchase prices and each particular trader's customer portfolio. For some large customers, traders put in place a price formula and the price for these customers changes on a monthly basis.

The gas supplier switching procedure

The natural gas supplier switching process is provided for in Sections 36 to 38 of the public notice on the gas market rules applicable for 2007. 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. Customers with type C metering can change their supplier once in a half year, with the exception of switching their supplier for a supplier of last resort.

First of all, the eligible customer requests the new supplier to enter into a gas supply agreement. The new supplier applies for distribution with the DSO and for the execution of supplier change with the TSO. Part of the application filed with the TSO is the new supplier's identification and registration number, the type of agreement, the supplier's agreement to accept responsibility for imbalances as a market participant, and a list and identification of the customer's supply points. 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.

Once registered, a change of supplier becomes effective as from the first day of the calendar month, with the exception of changing a supplier for a supplier of last resort.

The Office's discussions with eligible final customers in 2007 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 storage capacity in UGS facilities in the Czech Republic for new suppliers, are the main obstacles that impede gas supplier switching.

Consumers' complaints addressed by the State Energy Inspectorate

In the gas industry 31 complaints were handled in 2007. Complaints mainly concerned payments for gas supplies, incorrect procedure in gas supply billing, incorrect billing upon a gas price change, failure to include all advance payments in the final invoice, and failure to return overpayments.

Consumers' complaints, and inquiries conducted by the Office for the Protection of Competition

In 2007 the OPC received consumers' complaints concerning mainly the high natural gas prices billed to them from 1 April 2007. In response to these complaints the OPC conducted inquiries in the particular cases, which did not prove any breach of Act No. 143/2001.

The OPC referred complaints that were addressed to it but concerned in fact the issues that fell within the ERO's exclusive competencies to the ERO on the grounds of OPC's lack of jurisdiction. In the gas industry, these were most frequently citizens' complaints about high prices of natural gas supply billed to them until 31 March 2007 by gas companies and issues such as gas service lines, service billing, unauthorised consumption, etc.

In 2007 the OPC did not conduct any administrative proceedings on a potential breach of Section 3 or Section 11 of Act No. 143/2001 or breach of Article 81 or Article 82 of the EC Treaty in the gas industry.

4.2.3 Measures to avoid abuses of dominance

Market surveillance

Similarly as in the electricity industry, gas installations and networks are, and will continue to be, a monopoly (they are network monopolies), and surveillance by the OPC is therefore also necessary. Increased attention has been devoted to the gas industry since 1 April 2007 when the natural gas market was fully liberalised.

On 31 March 2007 the ERO's regulatory measure in the form of the imposition of price caps was revoked. Because of the fully liberalised market, gas prices have not been subject to regulation since 1 April 2007. Customers can influence the resulting price for their natural gas supply by selecting their supplier. Customers are no longer dependent on the distribution network to which they are connected; they can select a different natural gas supplier that operates on the Czech market, provided that the option of the free choice of natural gas supplier does not concern the household category, because gas traders did not show any interest in these customers in the period under review.

Every producer, regardless of its size or market share, has the right to use the gas produced for its own consumption or offer it to the TSO or a DSO, gas traders or eligible customers. Similarly, gas traders have the right to buy gas and sell it to the other gas market participants. Gas producers and traders are not subject to the obligation to inform customers about their business strategies (the planned amount of gas production or purchase, price, gas quantities available). Under Section 57(8)(f) of the Energy Act, producers are obligated to draw up daily, monthly, annual and five-year overviews of their production and provide this information to the Balancing Centre. Similarly, gas traders draw up overviews under

Section 61(2)(b), including information about gas exports/import from/into the Czech Republic, specifying the sources of such gas. The Balancing Centre then publishes these overviews, compiled into the form of an overall overview of the gas system, under Section 64(3)(b) of the Energy Act.

The State Energy Inspectorate is competent to oversee compliance with the rules set for the functioning of the gas market. Where a market participant's conduct results in prohibited restriction of competition under the law on the protection of competition, the Office for the Protection of Competition (OPC) is competent to protect competition.

Following consultations with the OPC and ERO, 2007 saw sale of natural gas for 2008 by the dominant market player, RWE Transgas, a.s., in a public and non-discriminatory way with a view to preventing any allegations of unfair competition. The dominant player made available the terms and conditions of the sale to all potential customers in May 2007 via an electronic interface. The sale process itself took place from June and August of 2007. In this way, all of the dominant player's natural gas deals were struck on the Czech market, outside the already executed contracts running from earlier periods of time. On the whole, approximately 95 per cent of the natural gas owned by RWE Transgas, a.s. was sold.

Transparency

In 2006 the transparency requirements of Regulation 1775/2005/EC were implemented into Czech legislation, specifically by an amendment to public notice no. 673/2004 on the rules for the gas market organisation, which was, effective from 1 January 2007, superseded by no. 524/2006 that lays down the rules for the organisation of the gas market and for the development, allocation and use of typical gas supply profiles, which took over the transparency requirements from the original instrument. The TSO fully complied with these requirements for public information in 2007; in this respect, the ERO did not receive any complaints about lack of public information.

5 Security of supply

5.1 The electricity market in 2007

5.1.1 Levels of peak annual demand and electricity consumption

The country's total electricity consumption, including network losses, was 72.0 TWh in 2007, which implies an increase of 0.5 per cent in comparison with 2006. The grid experienced the annual peak demand on 29 November 2007 at 5 p.m., when gross consumption amounted to 11,059 MW. The trend of a slight growth in the country's electricity consumption was confirmed in 2007. Electricity imports contributed to meeting domestic demand less than in the previous year (on the whole, 1.26 TWh less was imported). 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 help to offset low-demand customers' rising electricity consumption. Annual increases in consumption until 2010 are estimated at 1.0 to 2.1 per cent.

5.1.2 Installed capacity

On 31 December 2007 the total installed capacity of power stations in the Czech Republic was 17,562 MW, with approximately 58 per cent of the power stations' output connected directly to the transmission system and 42 per cent to the distribution systems.

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

| | |
|------------------|--|
| 10,648 MW | thermal power stations (60.7%), |
| 3,760 MW | nuclear power plants (21.4%), |
| 2,176 MW | hydroelectric power stations, including pumped storage (12.4%), |
| 815 MW | gas-fired and combined cycle power plants (4.6%), |
| 163 MW | alternative, of which, wind power plants 114 MW (0.9%). |

In comparison with 2006, in 2007 the installed capacity of thermal power stations, including cogeneration, decreased by 43 MW, whereas that of gas-fired power stations and combined cycle units increased by 11 MW. The installed capacity of hydroelectric power stations remained constant year-on-year. The largest increase was registered with renewable resources (mainly wind farms), by 86 MW. The predominant part of this increase is attributable to new wind power plants (70 MW). The total annual increase in the generation capacity installed in the electricity grid amounted to 54 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. Due to the continued support for renewable resources 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 plants can also be expected. The Czech Republic does not have suitable conditions for the other renewable resources (photovoltaic or geothermal energy). 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 Concept. An electrical energy generator has the right to connect its plant to the electricity grid subject to the connection conditions defined in the relevant energy legislation and upon obtaining an electricity generation licence from the Energy Regulatory Office. It also 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; nevertheless, 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 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 buyout by regional DSOs or the TSO in the system of feed-in tariffs, and a premium on the market price of electricity (the system of green premiums). The support in the form of feed-in tariffs 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 plant. Since 2006 there has also been new support for electricity production from secondary resources, which is also provided through premiums on 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. The end of 2007 saw the commissioning of a 400 kV line from Čechy Střed to Bezděčín. There are also plans to erect or refurbish several 400 kV lines (Krasíkov – Horní Životice, Výškov – Chotějovice, Hradec – Verněřov, Výškov – Čechy Střed and Výškov – Babylon). The only increase in cross-border capacity is the upgrade of the Slavětice – Dürnröhr 400 kV single-circuit line to a double-circuit line, which is to be completed in November 2008. The upgrade of the 400 kV Prosenice – Nošovice line from a single-circuit to a double-circuit line is currently under way.

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.

5.2 The gas market in 2007

5.2.1 Natural gas supply and consumption in 2007

Natural gas supplies for the Czech Republic were smooth throughout 2007, in line with the first degree of load; 78 per cent came from Russia and 22 per cent from Norway.

In 2007 the actual natural gas consumption amounted to 8,653 mcm (i.e. 7,008.7 Mtoe), which is 6.7% (616 mcm) less than in 2006. Consumption adjusted to normal monthly temperatures and temperature gradients of consumption amounted to 9,070 mcm (i.e. 7,346.5 Mtoe), which implies a decline by 2.6% year-on-year.

Table 10 Natural gas sources and consumption in the Czech Republic

| (Figures in mcm at 15°C) | 2007 | 2006 | 2005 | 2004 | 2003 |
|--|---------|----------|----------|----------|----------|
| Total purchase | 8,733 | 9,794.0 | 9,358.6 | 9,014.2 | 9,688.1 |
| Withdrawal from foreign UGS | 483 | 461.5 | 808.4 | 1,063.3 | 988.8 |
| Injection into foreign UGS | -549 | -499.6 | - 499.1 | -968.7 | -950.4 |
| Withdrawal from Czech UGS | 1,653 | 1,806.1 | 1,640.7 | 1,873.5 | 1,498.4 |
| Injection into Czech UGS | -1,362 | -2,353.5 | -1,942.4 | -1,322.5 | -1,541.4 |
| Supplies from MND Hodonín | 77.6 | 57.5 | 49.2 | 40.5 | 33.3 |
| Drained gas from mines OKD Paskov | 18.8 | 19.5 | 11.6 | 5.3 | 7.9 |
| Total supplies | 8,378.8 | 9,285.5 | 9,427.0 | 9,705.6 | 9,724.7 |
| Difference on balancing (change in the line pack, in-house consumption) | 46.7 | -16.1 | 135.0 | 14.5 | 14.6 |
| Total consumption | 8,653 | 9,269.4 | 9,562.0 | 9,691.1 | 9,739.3 |

Mainly ambient temperatures influenced overall natural gas consumption during the heating season.

In the course of the historical development of natural gas consumption, 2007 saw the lowest actual consumption from 1996. The overall level of natural gas consumption in 2007 was strongly influenced by the above-normal ambient temperatures in the first half of the year, displaying a large deviation of +3.1° C from the long-term normal temperature. Also, on the whole, marked by a temperature higher by +9.4° C the year 2007 was one of the warmest over

the past 14 years. In addition to warm weather, the other reasons for lower consumption include the impact of the continuously changing prices of energies, the absence of major projects for connecting large customers, general savings in energy costs on the part of consumers, etc.

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

Natural gas was supplied to the Czech Republic from Russia (6,548 mcm), Norway (1, 829 mcm) and Germany (2 mcm for VEMEX s.r.o.), with the total purchase (imports) of natural gas for the country's needs amounting to 8,379 mcm at 15° C. In comparison with 2006 imports were lower by 1,415 mcm.

Only a low volume of indigenous production, which includes surface drained gas, which is of local importance for the north Moravian region, and the gas lifted by MND, a.s. from fields located in south Moravia, supplemented the imports. MND's and OKD Paskov's domestic supplies amounted to 96.4 mcm/year, i.e. one per cent of total supplies.

Table 11 Actual consumption of natural gas between 1995 and 2007

| Year | Average temperature in the heating season | Average annual temperature [°C] | Annual consumption [mcm] | Annual 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 |
| 2007 | 4.2 | 9.4 | 8,653 | -616 | -6.7 |

Natural gas consumption in the Czech Republic has been stagnant since as early as 1997 and it has been slightly decreasing in recent years; 2007 is an exception: due to the higher ambient temperatures in the heating season, demand dropped considerably. In 2008 the current trend of stagnant natural gas consumption and a return to values over 9,000 mcm can be expected.

The main reason for the currently decreasing consumption is oil prices, which are rising and also causing natural gas price hikes.

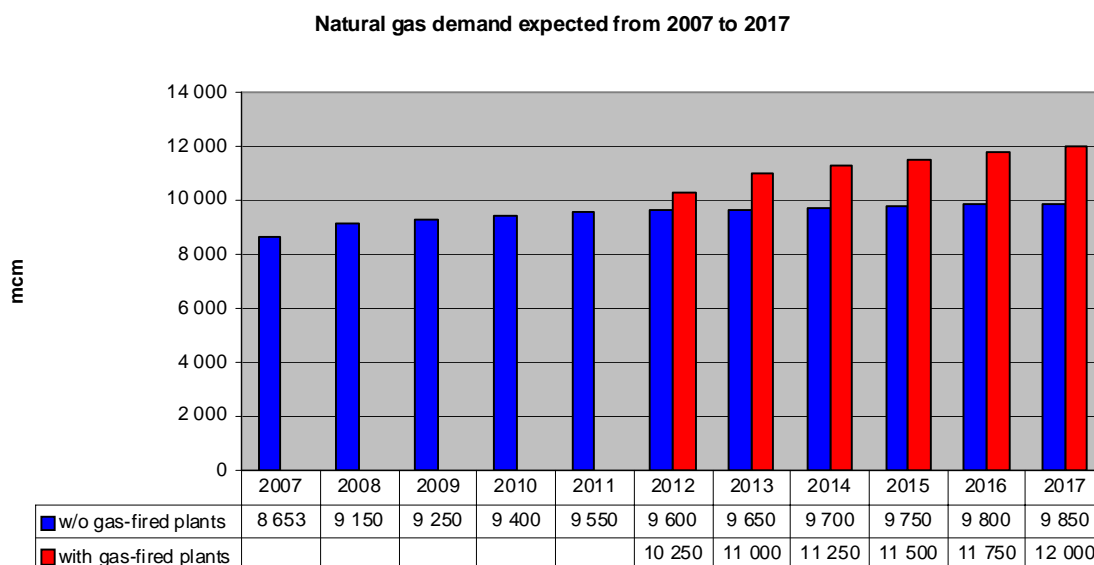
5.2.2 Natural gas consumption expected from 2007 to 2017

Projections for 2007 to 2017 expect slight annual increases of about 0.5 to 1.2 per cent related to the long-term normal temperature (see Chart 2), particularly if this period sees a certain stabilisation of prices and the highlighting of the benefits of natural gas as an environmentally

friendly fuel. If the gas-fired power stations currently being considered are actually built, from 2012 natural gas consumption will increase at a higher rate; however, it has not yet been decided whether such gas-fired power stations would fully replace a coal-fired power station, and be continuously operated, or whether they would serve as peak-shaving capacities; this will have a material impact on gas demand.

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 demand in the years to come.

Chart 2 Natural gas demand expected in the Czech Republic between 2007 and 2017



5.2.3 Import contracts

RWE Transgas, a.s., and 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, which originally was to terminate at the end of 2013, 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. Under both contracts 11.4 bcm/year can be imported into the Czech Republic in 2008.

In 2007 VEMEX, s.r.o. and Gazprom export Ltd. signed a five-year agreement on natural gas supplies to the Czech Republic, 0.5 bcm annually, with the option of doubling both the term of the contract and the annual volume.

5.2.4 Investment in system development

Investment in the development of the gas system should be prompted by the market's needs first of all. The role of the regulatory authority for the development of the gas system is played by the Czech Ministry of Industry and Trade, which awards authorisations for construction in the form of the State's consent under the Energy Act. In 2006 the Ministry

awarded to RWE Transgas Net, s.r.o. an authorisation to build a gas pipeline connecting the Czech gas system with Poland (the Třanovice – Chotěbuz gas pipeline). The construction of this interconnecting pipeline is to start in the second half of 2008 on the basis of an agreement between RWE Transgas Net, s.r.o. and Moravia Energo, a.s.

Another important project to connect to the Baltic gas pipeline will be the Gazelle transit gas pipeline, which will interconnect border transfer stations at Hora Sv. Kateřiny and Waidhaus across the Czech Republic, with an annual capacity planned at 25 bcm.

Certain gas companies are considering additional investment in their capital expenditure plans for the next three years (specifically the Záhohří – Spáleníště (Austria) and Břeclav – Reintal (Austria) gas pipelines).

The largest Czech SSO, RWE Gas Storage, s.r.o., is making preparations for investment in an increase of its storage capacity by 520 mcm over the next three years. Also the other SSOs, MND, a.s. and SPP Bohemia, a.s., are preparing investments in extending storage capacities.

The Ministry of Industry and Trade has informed the European Commission about these forthcoming capital investment projects 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 State's authorisation for construction has not yet been requested.

5.2.5 *Underground gas storage facilities*

Because of the summer/winter swings in gas consumption, underground gas storage facilities (UGS), which serve for gas storage in summer and gas production in winter when daily demand exceeds the daily contract quantities imported from abroad, helped to provide for a balance between supply and demand.

In 2007, 1,362 mcm of gas was injected into Czech UGS facilities, while 1,653 mcm at 15° C was withdrawn from them; withdrawal from UGS facilities therefore outweighed injection by 224 mcm.

In 2007, 549 mcm and 483 mcm of gas at 15° C was injected into and withdrawn from, respectively, the Láb UGS facility in Slovakia.

As at 1 January 2007 gas stores in the Czech Republic amounted to 2,057 mcm, while the stores in the Láb UGS facility amounted to 308 mcm. The total volume available in UGS facilities amounted to 2,366 mcm.

Because of the extremely warm winter, after the completion of withdrawal on 30 March 2007, gas stored in all UGS facilities amounted to 1,087 mcm.

Working gas stores before the 2007/2008 heating season amounted to 2,413 mcm in Czech UGS facilities and 550 mcm in foreign UGS facilities, i.e. 2,963 mcm on the whole, which accounted for 30 per cent of total annual gas consumption in the Czech Republic. At the beginning of a winter season the maximum daily withdrawal capacity in all UGS facilities amounts to 55.7 mcm, in those in the Czech Republic it amounts to 49.7 mcm.

On 31 December 2007 the closing amount of gas stores in UGS facilities for the Czech Republic's needs was 2,133 mcm, of which the closing amount in Czech facilities was 1,758 mcm and 375 mcm was available from the Láb UGS facility.

5.2.6 *Measures for states of emergency*

In accordance with Directive 2004/67/EC concerning measures to safeguard security of

natural gas supply, the Czech Republic has put in place a security of gas supply standard, which all gas traders must observe. This measure has been implemented in Czech legislation. In addition, some other measures have been adopted to safeguard security of supply, such as long-term gas supply agreements until 2035, diversification of natural gas sources from Russia and Norway, gas dispatch control coordinated between the TSO and DSOs and operators of gas storage in UGS facilities with a capacity of 30 per cent of annual consumption, and others. Measures for emergencies are provided for in Ministry of Industry and Trade implementing regulation no. 375/2005, which is binding on all gas businesses.

Under the Energy Act all gas businesses, with the exception of gas traders, are obliged to put in place emergency plans for the facilities and installations operated by them, follow these plans, and furnish them to the Ministry of Industry and Trade for review every year.

Gas businesses' standard emergency plans contain a classification of failures and accidents, a definition of the state of emergency and prevention thereof, declaration of states of emergency, general duties and responsibilities in coping with states of emergency, the composition of the Emergency Commission, and the preparation of emergency reports. The operating part of the plans set out the principles for eliminating failure situations on gas installations, the related documentation on gas distributions and equipment, and a plan of communication with and availability of the Emergency Commission.

5.2.7 Security of supply standards

The security standard of the required gas supply is understood to consist in ensuring safe and reliable gas supply when preventing a state of emergency, and during 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) A partial interruption in gas supply for eight weeks and to the extent of 20 per cent of the total daily volume under all import contracts intended for supplying the final customers of the respective trader in the Czech Republic or for securing the consumption of the respective customer who procures gas on his own in the winter season;
- b) Gas consumption on 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°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°C is, under the above criteria, 65,915,000 cubic metres; it is being provided for by each of the gas traders, taking into account the number and size of connected customers. Table 12 shows it for the most important traders.

Table 12 Security of supply standard for the key gas traders supplying final customers

| Gas trader | Supplier | SSS for maximum daily offtake in the year [-14° C] | |
|------------------------------------|--------------------|--|---------------|
| | | Thousand m ³ | Mtoe |
| Pražská plynárenská, a.s. | RWE Transgas, a.s. | 8,620 | 6.982 |
| Středočeská plynárenská, a.s. | | 5,891 | 4.772 |
| Jihočeská plynárenská, a.s. | | 2,670 | 2.163 |
| Západočeská plynárenská, a.s. | | 4,700 | 3.807 |
| Severočeská plynárenská, a.s. | | 6,388 | 5.174 |
| Východočeská plynárenská, a.s. | | 6,726 | 5.448 |
| Jihomoravská plynárenská, a.s. | | 17,224 | 13.951 |
| Severomoravská plynárenská, a.s. | | 12,806 | 10.373 |
| VEMEX, s.r.o. | Gazexport Ltd. | 840 | 0.680 |
| MND Hodonín, a.s. | MND Hodonín, a.s. | 50 | 0.041 |
| Total in the Czech Republic | | 65,915 | 53.391 |

5.2.8 Quality and level of system maintenance

Under the Energy Act, all operators of the gas transmission system, gas distribution systems and UGS facilities have the obligation to prepare, on an annual basis, a report on the quality and level of maintenance of the gas installations and facilities operated by them and furnish the report to the Ministry of Industry and Trade.

The basic part of a report on the quality and level of maintenance contains a list of internal regulations on the organisation and method of maintenance, and technical data on the operated gas facilities and installations on which maintenance is carried out. The operating part of a report on the quality and level of maintenance describes the way of providing for maintenance, methods employed for inspecting the condition of facilities and installations, and the equipment and technologies used for maintenance. Reports also describe the situation in gas pipeline corrosion control and checks of natural gas odorising at all odorising stations. In the event of a failure or accident on a gas facility or installation, the report must contain its description, way of repair, and the measures adopted.

The Ministry continuously monitors and evaluates reports on the quality and level of maintenance, which are furnished by all operators of gas facilities and installations, and is able to note that this activity is carried out at a very high level. This is borne out by the fact that throughout the time of the operation of the transit gas pipeline since 1972 (or on the Brotherhood pipeline since 1967) no interruption in natural gas supply has occurred.

5.2.9 Gas market liquidity

It can be noted in both legal and commercial terms that the domestic natural gas market is now fully liberalised and that particularly in respect of large customers some of these customers' switch to new competitors was registered in the second half of 2007, mainly in the beer, ceramic, glass, pulp & paper and refinery industries. Further information can be found in point 2.2.2, page 10.

5.2.10 Investment incentives

In line with Directive 2003/55/EC and the Energy Act, the so-called authorisation principle has been put in place for permitting new gas facilities and installations. In 2007 the Ministry of Industry and Trade awarded 30 authorisations in this respect, 29 of them for high-pressure gas pipelines and one for an underground gas storage facility.

As a direct investment incentive, the national legislation allows exemptions from third-party access to new infrastructure under Article 22 of Directive 2003/55/EC. No investor has used this exemption in the Czech Republic to date.

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 particularly Directives 2003/54/EC and 2003/55/EC, primarily 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 obligations of public service and protection of consumer interests include primarily the following:

- a) The duty to carry on the licensed business so as to ensure reliable and continually safe 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 meeting the safety and reliability requirements set out in legal regulations and technical standards are employed for the licensed business;
- 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 storage operators:

- a) Ensure reliable operation and development of the systems and storage facilities they operate;
- b) Connect to such system any person who requests so and meets the connection conditions set out in the Energy Act, implementing legal regulations, and, usually, the technical (operating) code;
- c) 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) 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 Energy Regulatory Office has imposed such obligation on them.

Public service obligations also apply to electricity/gas suppliers themselves; these entities are obligated, in particular, 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 set out in implementing legal regulations;
- Specify the following items in electricity bills to final customers:
 - 1 The share of each electricity source in the total mix of the supplier's fuels for the preceding year; and
 - 2 A 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.

In 2007 the ERO contributed, as part of infringement procedure under Article 226 of the EC Treaty, commenced in 2006 against the Czech Republic for failure to perform obligations under Directive 2003/54/EC and under Directive 2003/55/EC, to the answer to the European Commission's reasoned opinion of 18 December 2006. Having provided the answer, the Czech Republic received the European Commission's request to prepare an analysis of the measures adopted by the Czech Republic in accordance with Directive 2003/54/EC and Directive 2003/55/EC for performing public service obligations and their impact on the competitive environment, consumer protection and environmental protection. The ERO significantly contributed to the preparation of these analyses too. On the basis of these analyses, on 11 December 2007 the European Commission decided to discontinue the procedure against the Czech Republic and no action was brought against the Czech Republic.

6.1.2 Obligations over and beyond the licence

In cases of sudden crisis situations when, for example, the disconnection of a large number of customers or a licence holder's difficult financial situation results in a real danger of interruption of energy supply to final customers, Section 12 of the Energy Act permits the use of the so-called obligation over and beyond the licence. In cases of urgent need and existence of public interest, the Energy Regulatory Office has the remit to decide to impose the obligation over and beyond the licence, whereby the entity that is subject to such decision is obliged to carry out the activity of electricity/gas distribution also outside its own delineated area and the owners of the required distribution facilities and installations are obliged to provide them, for compensation, for the performance of the obligation over and beyond the licence. The Office can impose this obligation for 12 months at most. In 2007 the Office issued one decision imposing the obligation over and beyond a licence. The same obligation also applies in the heat supply industry, which, however, 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 specified quality 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, and is selected by the Office for a defined area. However, before the Office issues such decision, this obligation is performed 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 electricity 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 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, as amended in nos. 552/2006 and 365/2007. Similar provisions on the use of gas supplies from a supplier of last resort are contained in Sections 36 to 38 of public notice no. 524/2006 that lays down the rules for the organisation

of the gas market and for the development, allocation and use of typical gas supply profiles, as amended in nos. 184/2007 and 321/2007.

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 take 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 also provided for in the Czech Republic 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 carrying on its licensed business, 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 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(2)(k) of this law electricity generators are obliged to inform the market participants about the shares of the resources 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(2)(e) of the Energy Act, in billing electricity supply to final customers electricity traders are also obliged to include in the data shown in the billing documents, data indicating the share of each electricity source 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 have been implemented through the Energy Act, which defines them as 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 particulars 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 setting prices for final customers the Energy Regulatory Office followed up on 2006 and preserved 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 was therefore maintained, which makes it possible for the customers to optimise their costs of the services related to electricity supply.

In 2007 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 the customers in the household and small customer categories who used the services of a supplier of last resort. The Office regulates the 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 2007. The Office regulated the price of electricity from suppliers 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, a charge for electricity supply at the high rate and a charge for electricity supply at the low rate. Individual prices vary in relation to the nature of the load and the way of using the electricity taken.

The Office bases its pricing of electricity supplies 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 to compensate for additional costs, if any, incurred in relation to performing this obligation. In general, the price of 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 (a 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 (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 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 and to use the services thereof. 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 business, 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 2007 no customer used this right.

6.1.8 Pricing for final customers on the gas market

On 1 January 2007 all final customers, including households, became eligible customers. Thanks to this change, final customers have acquired the right of supplier choice by way of a free-of-charge change of supplier, and, in turn, the opportunity to influence the uncontrolled part of their overall costs of gas supply, i.e., the commodity itself, and the services related to gas storage.

In the gas industry the Office set the charges for gas transmission and gas distribution for the whole calendar year with effect from 1 January 2007. In the first quarter of 2007 the Office also continued to impose, on a temporary basis, price caps on natural gas supplies for eligible customers. In that period all final customer categories were subject to price control.

The 2007 price levels for the various categories of final customers were set out in ERO price decision no. 2/2006 of 28 November 2006, on prices of gases. The price caps were imposed as the maximum permissible prices of natural gas supplies to all categories of eligible customers (household, low-offtake, medium-sized 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 consumption in MWh. Once the purpose of the reimposition of regulation was met, the Office abolished the price controls for natural gas supply to eligible customers on 1 April 2007 by its price decision no. 1/2007 of 28 February 2007, on prices of gases. For final customers taking gas from a supplier of last resort, the price was set for the first quarter, also by ERO price decision no. 2/2006, and the supply price was subject to a cap, which was imposed as the maximum permissible price of natural gas supply to eligible customers. For the remaining part of the year ERO price decision no. 1/2007 set out a mandatory procedure for the pricing of supplies of last resort, provided that the resulting price of the supply was not allowed to exceed the price of supply charged to eligible customers in the low offtake and household categories.

Effective from 1 January 2007 natural gas supply prices for all final customers were decreased by 8.6 per cent on average, due to the lower prices for which RWE Transgas, a.s. bought natural gas. The basis for determining the prices was forecasts of the development of natural gas import prices, and those 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 last reviewed and updated through an adjustment of the price by the difference between the actual cost of natural gas purchase and the planned cost of natural gas procurement. The natural gas supply price was adjusted by this difference for the last regulated period. The process of price review and update, provided for

in public notice no. 438/2001 as amended, can no longer be used after 31 March 2007. On the liberalised market the choice of the final price is up to suppliers, who also decide on when the price change is to take place. On the basis of an agreement with the Office the adjustment for the first quarter of 2007 was returned to final customers by suppliers that had emerged from the incumbent vertically integrated distribution companies.

For suppliers appointed to perform the obligation of supplying natural gas to final customers for controlled prices in the mode of last resort, no special mechanisms for compensating the costs incurred in performing this obligation were put in place for the first quarter of 2007 in view of the way in which this price was controlled. For the remaining part of 2007 the pricing method was changed and compensation for the costs incurred in performing the obligation in the mode of last resort is no longer needed.

No final customers received supplies of last resort in 2007.

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 particulars 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 of agreement; and
- b) It is competent to approve the rules for the operation of the electricity transmission and distribution systems 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 State Energy Inspectorate (SEI) is the administrative authority responsible for inspection in the energy industries. The SEI’s remit includes overseeing compliance with the Energy Act, including the execution of agreements containing the particulars required by the Energy Act for supply agreements and the particulars of agreements on consumer protection within the meaning of Annex A to Directives 2003/54/EC and 2003/55/EC.

The Office for the Protection of Competition (OPC), which regulates on an *ex post* basis, is another authority of oversight on the energy market, mainly in its liberalised part. The OPC’s competencies include, for example, checks of 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 OPC assesses the compliance of their practices under Act No. 143/2001 on the protection of competition, as amended.