

## Submission of Hungary concerning the application of the recommendations of the OECD in the energy industry

The submission presents the views of the Ministry of Economy and Transport.

In Hungary the electricity market opening and liberalization process began on 1 January 2003, and since then it has achieved great success. In the course of creating Act CX of 2001 on electricity (VET) it was a basic principle – in line with the main principle of the EU legislation – to create a more efficient and dynamic energy sector providing high standards of public service, extending competition and encouraging cross-border transactions and investments in the production and transport facilities.

Parallel with the abovementioned principle, we wanted to provide an opportunity for the consumers to go out to the free market, in the case they regard the free market situation as better than staying in the public service. We have made such a solution, that the two distinct markets do not create any barriers for each other, and the (eligible) consumers have real choices to decide, which market is better for them. We succeeded in keeping also the high standards in the public service sector.

Besides ensuring public service, of course we wanted to increase competition in the electricity market. The market opening has brought great success in this field: in the first year of market opening (2003) the consumption of the consumers in the free market reached 18% of the total electricity consumption, and now, in the first half of 2005 it reached 27%, so the share of free market is continuously growing. From 1 July 2004 every non-household customer is eligible, so we expect that the rate of free market consumption will increase further. According to the EU legislation, from 1 July 2007 all customers, even the household customers will become eligible, so there is a significant growth potential for the electricity free market. The results of the Hungarian market opening process can be well demonstrated by the fact, that the consumers going out to the free market could realized approximately 2,20-2,60 HUF/kWh, altogether 15-18 billion HUF/year price benefit, so their (price) competitiveness increased with this extent.

The 4<sup>th</sup> Electricity and Natural Gas Market Benchmarking Report of the European Commission, published in January 2005, stated also, that the electricity market opening and liberalization is very successful in Hungary, and it is the most significant progress among the new Member States of the EU, and is also comparable with the performance of some old Member States.

Nevertheless, the aim of the Hungarian state administration is of course to go further with this process based on the achieved results, to help the consumers to cut their energy costs and to further increase the competition. The necessary analyzing work and preparation have begun. Many factors should be taken into consideration: keeping security of supply; increasing competition; the influence of modification of the current legislation on the electricity prices, primarily on the household prices; encouraging investments in the electricity sector etc. This work is currently in progress.

The electricity transmission activities (excluding the tasks of transmission system operator, which is separated from MVM) are carried out by Hungarian Power Companies Ltd. (MVM Magyar Villamos Művek Rt.). This is a holding-type company, which has two licenses, the public wholesaler license and the license for the operation of the national high voltage electricity grid. Although the second license is also in the hands of the “mother” company, the activity is practically carried out by National Power Line Company Ltd. (OVIT Országos Villamos Távvezeték Rt.), which is a legally separated subsidiary of MVM. The public wholesaler license will exist only until 1 July 2007, when all customers will become eligible, in consistence with the EU provisions set out in Directive 2003/54/EC. MVM has no shares in the distribution and retail companies, all its former shares in these companies were privatized, and sold predominantly to foreign investors, so it has no opportunity to discriminate against other competitors. There is a subsidiary (MVM Partner Plc.), which is a licensed electricity trader in the free market, legally separated from the “mother” company. The MVM holding has only two power plants, Paks Nuclear Power Plant and Vértes Power Plant Ltd; all the other former MVM power plants were privatized. Since the market opening, all eligible customers, electricity traders, distribution companies can purchase electricity directly from internal power plants or from import, since then MVM is not a monopolistic electricity buyer and seller. All market competitors have equal access to the primary energy sources at cost-reflective prices, as well. The long-term system planning function was shifted to the Independent System Operator (MAVIR Ltd.) in cooperation with the regulatory authority, which is the Hungarian Energy Office (HEO). The authorization of new power plants is carried out by the HEO; the MVM has no influence on these proceedings.

There are 6 distribution system operators, which were separated and privatized; MVM has no shares in these companies. According to the EU Directive 2003/54/EC, the accounting and management separation of the distribution and the retail businesses within these companies were carried out by VET, the legal separation will be required from 1 July 2007, based on the referred EU Directive.

As for long term purchasing contracts, the governmental decree 183/2002 (23.8.) puts an obligation on MVM to renegotiate the existing PPAs. §5. and §6. of the decree sets the general rules and conditions of the renegotiating process. Based on these rules, MVM and the concerned generating companies have opened discussions in order to review the long-term power purchase agreements, but for the time being there has been no real agreement between the concerned companies to modify any of the PPAs. It is important to mention, that the PPAs are contracts with the nature of civil law, so no real legal instruments are available for the governmental bodies to force the concerned companies (which are mainly in private hands) to the modification of PPAs. The existing PPAs do not diminish the effective competition; you can see that the share of free market is continuously growing; in the first half of 2005 it reached 27% of the total consumption.

According to §62. of VET, the centralized electricity market (power exchange) shall be a business association operating as a company limited by shares, so private investors have the possibility to found a power exchange. Based on the application, the authorization will be granted by the HEO.

In Hungary, the Hungarian Energy Office (HEO) is the regulatory authority of the gas, electricity and district heating sectors. From 1994 HEO functions as an independent authority. Its budget is independent from the state budget, based on the fees gathered for its procedures. HEO reports annually to the Parliament, not to the Government or Ministry, this also ensures

its independence. The President and Vice President of HEO are appointed and removed from office by the Prime Minister. Their terms of office shall be for six years. The cases of removal from office are specifically regulated (§7. of VET): the president or vice-president shall only be removed from office if

- found guilty of a crime in a final and legally binding court ruling, or he discredits his position in any other way;
- he becomes permanently incapable of performing his duties;
- a conflict of interests, if any, is not terminated within three months;
- his activities jeopardize the operation of HEO.

The appeals against the decisions by the HEO should be addressed directly to court, not to the Ministry of Economy and Transport. VET gives strong rights to HEO concerning the monitoring of the sector, the compliance with legal regulations. HEO may also establish the requirements of the quality of supply separately for each licence holder. HEO examines the cases of gaining influence over a licence holder, and may deny its approval in case the security of supply or the functioning of the electricity market is violated. HEO may require any kind of data from the licence holders. HEO has about 95 employees, which in comparison with the regulatory institutions of the new EU member states, and taking into consideration the size of the monitored sectors gives sufficient resources for the appropriate functioning.

In the electricity and gas markets the public utility end-user prices are determined by the independent HEO; §.96. of VET says, that the detailed rules pertaining to pricing and the price regime shall be drawn up by HEO based on the principle of minimum cost. The Minister of Economy and Transport only declares them officially in a decree, because according to the current Hungarian legal framework, in Hungary public utility prices can only be declared by the Government, the ministers and the local municipalities. This basic principle is set in the Act LXXXVII of 1990 on setting the prices. This method does not infringe the provisions of Directive 2003/54/EC of the European Parliament and of the Council concerning common rules for the internal market in electricity and repealing Directive 96/92/EC, as Article 23 (3) of that Directive states, that "...Member States may provide that the regulatory authorities shall submit, for formal decision, to the relevant body in the Member State the tariffs or at least the methodologies...". It is important to mention, that this price-setting principle is general in Hungary, it does not only apply to the energy sector. From our point of view, this principle also contributes to the strengthening of legal safety. Nor the HEO, neither the Minister has capabilities to affect the prices applied in the free markets. It is also important to mention, that from 1 January 2004 there are no official price regulations for the electricity generators/power stations, the prices applied are subject of the agreements between the generators/power stations and wholesalers.

The transmission tariffs are subject to the official price regulation, the HEO prepares the proposal, and the Ministry declares them in a decree. According to the Act LXXXVII of 1990 on setting the prices and VET, the tariffs shall be non-discriminatory, transparent and cost-reflective.

As regards competition law, VET gives a detailed regulation of the competences of HEO (§.7-§.11. of VET), and the Act LVII of 1996 on the prohibition of unfair and restrictive market practices set out the responsibilities of the Office of Economic Competition. The responsibilities of the two authorities are well determined, separated and clear; there is an effective and continuous cooperation between them.

There is also a good cooperation and permanent consultation between the Ministry of Economy and Transport and HEO in the field of preparation of energy policy decisions and legislations. There are significant efforts to ensure the publicity of the decision- and legislation-making: the draft legislative proposals are often published on the Internet for public debate.

The VET encourages the use of interruptible contracts, as an important tool of Demand Side Management. However, the use of this tool is not really widespread; the Hungarian customers regard the security and continuity of supply as the most important factor, and they do not want to undertake risks. Nevertheless, there is more success in redirecting the consumption of certain facilities to the so called off-peak consumption periods.