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USAID Regulatory Reform and Energy Sector Restructuring Project

**Czech Republic – Advice and Memoranda on Act 222
(the Czech Energy Law)**

1995 - 1997

Prepared for
United States Agency for International Development
Project Office - ENI/EUR/EEUD/EI
Project No 180-0030

Under the
**Regulatory Reform and Energy Sector Restructuring in Central
and Eastern Europe and The Baltics Project**
Contract No - DHR-C-00-95-00016-00

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22934-003-005



CZECH REPUBLIC – Pierce Atwood Deliverables

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MEMORANDUM

TO JWGulliver

FROM CRCConnors

RE Bechtel - Czech - workplan

DATE June 6, 1996

Following up on our conversation yesterday, and after reviewing my notes, the previously developed workplan was as follows

the powerbroker memo already completed (although I assume you will check while in Czech as to any response from the government and necessary follow up work)

The workshop on regulatory issues We identified the sub-topics for this task, to be both the subject of the workshop and a paper to be disseminated prior to the workshop as

- a separating regulated functions from non-regulated (e.g., when regulated entities own hotels)
- b how to unbundle or disaggregate rates, especially transmission pricing
- c specialized accounting principles, including decommissioning and revaluation of assets (due to inflation, etc., current book value could be far less than replacement value)

We described this workshop to Antos and the others in the meeting of March 19 as involving mostly Floyd Davis and the Arthur Andersen team, with relatively little legal involvement

A paper on defining the role of the MOIT on authorizing (licensing) and the role of the MOF on price regulation, with an explanation of how these two ministries' areas are coordinated We described this paper as involving more legal involvement, and as including a discussion as to how this bifurcated system works elsewhere, along with a recommendation as to implementation of a coordination mechanism

A general review of energy related laws and decrees This review will incorporate the previous work by Vanek, and identify what sections of the Act need changes, what should be supplemented

As to timing, Task #2 must be coordinated with the workshop That program was originally targeted for June Since our involvement should be less intense as to that task we need to determine when Bechtel and AA think they can put it together and when the optimum time for full involvement on the Czech side could occur The determination also involves deciding whether CMPI or any other group is going to participate, or whether this workshop should be coordinated with any other ongoing education and information effort in the Czech

Republic Obviously, the timing and nature of this effort also depends on where Ken Hobbes and AA have gone on revenue requirements with the regulatory bodies to date

Task #3 we contemplated as coming shortly after the workshop, although it does not seem dependent on that program, and so could come earlier or simultaneously Task #4 is the wrap-up, and comes last

I think you need to talk to our regulatory contacts in Czech, make sure that these are the items they still want, and pin them down on the most helpful timing for them Given the finite nature of this project, I would suppose sooner rather than later makes sense, unless the political situation is going to change in the near future in a way that could affect the direction of these tasks

Tell me if you want more input from me prior to your trip, or if there's anything you want me to do while you're gone I'll be here Monday, June 10 (I have a Law Court argument in the morning), then out until June 18, the next Tuesday There is a ship-to-shore telephone on the island Tell me if you need that number

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MEMORANDUM

TO: Vit Horáček

FROM: John Gulliver and Cathy Connors

RE: The European Union ("EU") Directive on Liberalization of the Electricity Sector and Related Provisions in the Treaty of Rome

DATE: April 9, 1997

INTRODUCTION

This paper describes the provisions in the "Directive 92/92/EC of the European Parliament and of the Council of 19 December 1996 Concerning Common Rules For The Internal Market In Electricity" ("the Directive") which could require changes in Act No 222/1996 Coll and other aspects of the legal framework for the electricity sector in the Czech Republic

The paper focuses only on the Directive, Article 90 of the Treaty of Rome from which the Directive flows, and a few other articles in the Treaty affecting the electricity industry (Articles 85-86 on competition policy, and Articles 30-34 on state monopolies) The paper does not discuss any other EU law

No attempt is made to compare these Directive or Treaty provisions with any specific aspects of current or proposed Czech law The purpose of the paper is to provide a general summary of the Directive's contents and requirements, so that you can give some thought as to how we can (1) make our proposed amendments

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to Act 222 as consistent with the Directive as possible, and (2) convey to the appropriate Czech authorities the need to make further changes in the law if they wish to comply with EU requirements

The implications of the Directive on the Czech electricity sector and its legal framework are based on the general concept, embraced in the Directive and supporting Treaty provisions, that, once the Directive comes fully into force, the relevant market unit becomes the EU and not the Czech market. Trade restrictions with non-EU members may be permitted on a common basis but, in general, restrictions on electricity trade against other EU member states (including other new Central and East European members) will be prohibited. Thus, competition in generation for the part of the Czech electricity market opened to competition must encompass all existing and new EU members

SUMMARY OF CONCLUSIONS

At least two major areas of existing Czech electricity law will need adjustment in order to meet Directive requirements

- 1 approval of the construction of new generating capacity
(see Articles 4-6 of the Directive),
and
- 2 allowance of direct contracting between generators and certain end-use customers, either through access to the transmission and distribution wires, or through a single buyer option
(see Articles 17-19 of the Directive)

Certain other aspects of existing Czech law could also be deemed anti-competitive by the EU under Articles 85, 86 and 90 of the Treaty of Rome For example

- 1 the EU could disapprove of certain long-term contracts (or certain terms in those contracts) entered into between CEZ and distributors, and/or any CEZ generating affiliates

(see Articles 85, 86 and 90 of the Treaty of Rome),

and

- 2 further disaggregation of generation, distribution and transmission, including an ownership limitation law, would probably make it easier to meet general Treaty principles

(see Articles 85 and 86 of the Treaty)

DISCUSSION

I NEW GENERATION CAPACITY

In order to meet Directive requirements, existing law should be clarified and supplemented to set out the specific criteria used to permit the construction of new capacity

Under the EU Directive, Member States can choose to permit construction of new generating capacity through either (1) an "authorization procedure", or (2) a tender process (Art 4) Either option -- authorization or tender -- must apply "objective, transparent and non-discriminatory" criteria (Art 4)

A EU Requirements

1 Authorization

Where the authorization option is chosen, "Member States shall lay down the criteria for the grant of authorizations for the construction of generating capacity in their territory" (Art

5(1)) These criteria "may relate" to

- (a) safety and security of the electricity system
- (b) protection of the environment
- (c) land use and siting,
- (d) use of public ground,
- (e) energy efficiency,
- (f) the nature of the primary sources,
- (g) characteristics particular to the applicant, such as technical, economic and financial capabilities, and
- (h) the provisions of Article 3¹

(Id)

The "detailed criteria and procedures" for authorization must be "made public," (Art 5(2)) and

applicants shall be informed of the reasons, which must be objective and non-discriminatory, for any refusal to grant an authorization, the reasons must be well

¹ Article 3 provides, among other things, that Member States shall insure that electricity undertakings (businesses) are operated "with a view to achieving a competitive market in electricity, and shall not discriminate"

founded and duly substantiated, they shall be forwarded to the Commission for information. Appeal procedures must be made available to the applicant.

(Art 5(3))

2 Tender Process

Where the tendering procedure is used, "Member States or any competent body designated by the Member State concerned shall draw up an inventory of new means of production, including replacement capacity, on the basis of the regular estimate referred to in paragraph 2. The requisite capacity shall be allocated by means of a tendering procedure in accordance with the procedure laid down in this Article." (Art 6(1)). Paragraph 2 then provides that "the transmission system operator or any other competent authority designated by the Member State concerned shall draw up and publish under State supervision, at least every two years, a regular estimate of the generating and transmission capacity which is likely to be connected to the system and of the demand for electricity." (Art 6(2)).

"Details" of the tendering procedure must be published at least six months prior to the closing date for tenders. Accordingly, the "tender specifications" must contain "a detailed description of the contract specifications and of the procedure to be followed by all tenderers and an exhaustive list of criteria governing the selection of tenderers and the award of the contract."

(Art 6(3))

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Member States must designate “an authority or a public body or a private body” “independent of electricity generation, transmission and distribution activities” “to be responsible for the organization, monitoring and control” of the tendering procedure (Art 6(5))

3 Self-Generation and IPPs

Finally, Member States must have an authorization process for self-generators and independent power producers (IPPs), even if a tender process is chosen² In other words, even if the State chooses the tender process option, it must still have a legal mechanism pursuant to which construction of self-generation and IPP plants (defined in Art 2(4) of the Directive as any generator that does not carry out transmission or distributor functions in the territory) can be authorized in order to serve that portion of the market required to be allowed to contract directly with generators³ Outside of the normal tender process for new capacity, IPPs must be able to obtain authorization to build and to supply directly to eligible consumers, and eligible consumers must be able to obtain authorization to build self-generation plants

² Art 6(6) provides

it must be possible for autoproducers and independent producers to obtain authorization, on the basis of objective, transparent and non-discriminatory criteria as laid down in Articles 4 and 5, in Member States which have opted for the tendering procedure

³ See Section II of this memorandum for the discussion of this required opening of the market The end-users required to be given this direct contracting choice are referred to in the Directive as “eligible customers ”

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This means that eligible consumers must be allowed to self-generate, and need not win a tender competition to be allowed to do so. Similarly, eligible consumers must be allowed to choose their generator, and that generator need not win a tender competition to supply those consumers (if the consumers choose that generator). Practically, if the number of eligible consumers remains small, this ability to choose probably does not undermine the viability of the tender process option. As the market opens up to a greater number of eligible consumers, however, the tender process option may be effectively superseded.

B Harmonization

We will leave to you in the first instance the comparison of Act 222 and other Czech law to these Directive requirements, including an analysis what provisions, if any, should be added to our proposed amendments to Article 22a in Act 222 to facilitate harmonization. We understand that the Ministry may not yet be ready to incorporate all the changes needed to comport with the Directive.

The authorization system contemplated in Article 22a should set forth "objective, transparent and non-discriminatory criteria" -- whether relating to the fields listed in Article 5(1) of the Directive or any other field. The process should be public and appealable. The law should indicate how self-generators and IPPs are treated and establish a procedure whereby IPPs can obtain authorization to build plant to serve willing eligible customers outside any tender process.

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Your draft amendment Article 22a(4) could be read as contemplating a tender process (“The Ministry may also call natural or legal persons to submit applications for approval of building a new installation in the event of public interest This invitation shall be publicized by the Ministry”) To meet the Directive’s requirements, this process must be run by an authority “independent of electricity generation, transmission and distribution activities” (Art 6(5)) All the criteria applied to pick the winner(s) of a bid (“an exhaustive list”) must be published as a part of the tender process (Art 6(3))⁴ While the Act itself might not need to include all these criteria, the Act should clearly identify all the avenues an applicant can pursue to obtain approval, the general criteria for approval, and, if a tender process is used, a mechanism by which the independent authority managing the tender publishes an exhaustive list of the criteria examined in that particular tender

Clarification should also be made as to how capacity needs are calculated Article 6(2) of the Directive sets forth the type of capacity calculation that triggers a tender process Any decision by the Ministry in Article 22a of Act 222 to authorize new capacity through a tender must be based on a forecast procedure that meets Article 6(2) of the Directive, and not any different calculation arrived at through unpublished, non-public procedures

⁴ As under the authorization process option, these criteria “may relate to the fields referred to in Articles 5(1)[a-h]” (Art 6(3))

The results of the tender process, like the results of an authorization determination, must be subject to review

II ACCESS TO THE TRANSMISSION AND DISTRIBUTION WIRES

The major substantive new requirement included in the Directive is provision in Member State law to facilitate direct contracting for power between certain end-use customers and generators. In order to meet this requirement, additions should be made to existing Czech law to permit such direct contracting, either through a direct access or single buyer process

A EU Requirements

1 Direct Contracting Between Generators and Eligible Customers

Article 19 of the Directive requires that, starting in 1999, Member States must open up 22% of their markets to direct contracting between generators and end-users. This percentage of the market gradually increases to 32% over a six year period (Art 19(2))

The consumers within this competitive share of the market are called "eligible customers". Member States must include as eligible customers all end-users using more than 100 Gwh per year, including self-generation (i.e., large industrial consumers). Distribution companies must also be allowed to contract for the power necessary to supply any eligible customer within their service territories.

As with new capacity, Member States are given two options in achieving this opening of their markets: negotiated access or single buyer procedure. As is also the case with new

capacity, both options must "operate in accordance with objective, transparent and non-discriminatory criteria" (Art 16)⁵

Under the negotiated access option (Art 17), Member States "shall take the necessary measures" to allow generators, distributors and eligible customers -- both within and outside the country -- to obtain access to the transmission and distribution system. Either published tariffs or negotiation can be used. If negotiation is used, an indicative range of prices must be published, reflecting as far as possible the average price agreed in negotiations in the previous 12-month period.

Under the single buyer option (Art 18), a single buyer manages the national grid and/or undertakes centralized purchasing and selling duties (Art 23(2)). Member States "shall take the necessary measures" to allow "eligible customers to be free to conclude supply contracts to cover their own needs with producers" (Art 18(1)(ii)). These contracts are implemented based on either negotiated access or published tariffs (the "use of system" method), or the single buyer must buy the electricity contracted by eligible consumers at a price equal to the sale price offered to eligible consumers by the single buyer, minus the price of the published use-of-system tariff (the "buy-back system").

Thus, under either the negotiated access or the single buyer option, eligible customers must be allowed to contract directly with generators. Under the single buyer option, whether

⁵ Article 16, unlike Article 5 relating to new generation capacity, does not list the fields to which these criteria may relate

these direct contracts are implemented through the use of system or buy-back system, the economic effect is the same⁶ The results between the single buyer or the negotiated access options must also be the same "The two approaches to system access referred to in Articles 17 and 18 must lead to equivalent economic results and hence to a directly comparable level of opening-up of markets and to a directly comparable degree of access to electricity markets" (Art 3(1))

2 Independence of the Transmission System Operator

The transmission system operator must be independent, at least in management terms, from generation and distribution activities (Art 7) This operator must dispatch generation on the basis of objective, published criteria, applied in a non-discriminatory manner

3 Pricing

Under the Directive, Member States must develop non-discriminatory use of system tariffs Member States are allowed to require the system operator to give priority to renewables

⁶ The practical similarity between the use of system and buy-back system is illustrated by the following example Eligible Customer ("EC") contracts with an IPP at price P The use of system tariff published by the Single Buyer ("SB") is U, and the bulk price at which EC could buy from SB is T

If use of system is provided, EC pays $P+U$ This can be higher or lower than T

If the buy-back system is used, the IPP still generates the same amount of power under its contract with EC, and EC still pays IPP P As the power is re-sold by SB, SB must pay $T-U$ for it EC buys its power requirements from SB at T Thus, EC pays a total of $P+T$ EC receives a total of $T-U$ EC's net payments are therefore $P+T - (T - U)$ So EC pays $P+U$ -- the same as under the use of system method

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or CHPs (Art 8(3)) They can also, for reasons of security of supply only, direct a priority of dispatch for plants using indigenous fuels, but only up to a maximum in any calendar year of "15% of the overall primary energy necessary to produce the electricity consumed in the Member State concerned" (Art 8(4))

4 Other Relevant Treaty of Rome Provisions

The Directive flows out of EU's interpretation of Article 90 of the Treaty of Rome In order to understand how the Directive will be interpreted, it is therefore helpful to understand, as general background, the underlying Treaty terms that the Directive is designed to implement

Articles 85 to 94 of the Treaty promote competition and trade across national boundaries Article 86, for example, prohibits abuses of a dominant position by one or more "undertakings" (businesses) Article 90(1) imposes obligations on Member States in connection with public undertakings or private undertakings to which they grant special or exclusive rights (*e g* , exclusive service territories) Read literally, it could prohibit transmission or distribution monopolies

When, however, an undertaking has been entrusted with public service obligations -- such as an obligation to serve all customers within an exclusive service territory -- Article 90(2) could exempt that monopoly from the prohibitions Article 90(1) Article 90(2) provides

"Undertakings entrusted with the operation of services of general economic interest or having the character of a revenue-producing monopoly shall be subject to the rules contained in this Treaty, in particular to the rules on competition, in so far as the application of such rules does not obstruct the performance, in law or in fact, of the particular tasks assigned to them The development of trade must not

be affected to such an extent as would be contrary to the interests of the Community ”

B Harmonization

1 Direct Contracting

To meet requirements of the Directive, Act 222 must be altered to adopt one of the Directive's access options -- negotiated access or single buyer Under current Czech law, neither exists At a minimum, if the single buyer option and buy-back system is adopted, and if CEZ is chosen to be the system operator ("CED"), and a new Central Distributor ("CD") is established, to be consistent with the Directive, the Act must be changed to require the CD to buy the power contracted for, by legally designated eligible customers, and to re-sell it at prices meeting the Directive's requirements, and to require CEZ to carry out the transmission services necessary to effect this result

2 Independence of the Transmission System Operator

Because CEZ owns generation, Czech law must be changed to require that the transmission system operation portion of CEZ's business (the CED) be independently maintained for management and accounting purposes Regulation must ensure non-discriminatory dispatch based on published, objective criteria

3 Pricing

Pricing laws and regulations must require that CEZ, the CD and the distribution companies establish published use-of-system tariffs, to use either as a basis for access or as an

indication of likely terms in the case of negotiated access, or to determine the appropriate price under the buy-back option

4 Import, Export and Renewables

We are unfamiliar with any restrictions on imports and exports in Czech law generally. Cross-border exchanges must be permitted within the EU. The Commission is currently challenging import restrictions by some Member States under Articles 30 and 34 of the Treaty of Rome (the prohibition on state monopolies). Cases are being pursued against France, Italy, the Netherlands and Spain for allegedly providing certain utilities (mostly state owned) with exclusive statutory rights to import and/or export electricity. Decisions are expected in the near future. The EU Advocate General, however, has already delivered his opinion, and has argued, in essence, that statutory monopolies on exports are not justified, restrictions on imports are only permissible where there is an overriding public security concern, and this security exemption should be interpreted strictly. The necessary changes to Czech law will become clearer when the EU Court of Justice delivers its verdicts.

D Potential Avenues for Exemption

The Directive allows for some deviation from its requirements.

As a threshold matter, as to all aspects of the Directive, Article 24 allows countries to extend the timetable for implementation of the Directive if they can show their systems are otherwise consistent with "commitments or guarantees of operation given before entry into force

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of the Directive ” In application, however, these extensions have been limited one year for Ireland and Belgium, and two years for Greece

More potential for deviation from the new generation capacity (Articles 5-6) and access provisions of the Directive (Articles 17 and 18) lies in Article 3 2's reference to public service obligations Just as Article 90(2) of the Treaty of Rome exempts some monopolies from prohibition under the competition provisions of the Treaty, Article 3 2 of the Directive potentially provides for some deviation from its access provisions if public service obligations are imposed

Act 222 includes certain service obligations, and the proposed amendments to the Act expands upon those obligations Article 3(2) of the Directive provides that Member States can impose such public service obligations on electricity undertakings, in the general economic interest, which “may relate to security, including security of supply, regularity, quality, and price of supplies and to environmental protection ”

Article 3(3) of the Directive provides that such public service obligations are possible grounds for not applying certain provisions of the Directive, including those going to system access

Member States may decide not to apply the provisions of Articles 5, 6, 17 18 and 21 insofar as the application of these provisions would obstruct the performance, in law or in fact, of the obligations imposed on electricity undertakings in the general economic interest and insofar as the development of trade would not be affected to such an extent as would be contrary to the interests of the Community The interests of the Community include, *inter alia*, competition with regard to eligible customers in accordance with this Directive and Article 90 of the Treaty

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The extent to which the public service obligations imposed on CEZ and the distribution companies could allow the Czech Republic to deviate from implementation of the negotiated access or single buyer systems in Article 17 and 18 is unclear. The best conclusion at this point is that significant deviation will not be tolerated.

First, Article 3(3) states specifically that the "interests of the Community include competition with regard to eligible customers in accordance with this Directive." Hence, at a minimum, eligible customers must be given choice.

Second, the whole purpose of the Directive is to provide a general interpretation of Article 90 of the Treaty of Rome's protections in the electricity sector. Hence, a broad, non-individualized attempt to avoid the access provisions of the Directive would conflict with the Directive's interpretation of Article 90 in general. The market share opening required under the Directive will probably be deemed the "Community interest," so that Member states will not be allowed to rely on public service obligations to avoid achieving this percentage of market opening.

Experience with Article 90(2) of the Treaty of Rome before passage of the Directive is instructive. Even before the Directive's general interpretation of Article 90 to require market opening, court decisions in the electricity field indicated that public service obligations could be used to limit application of the competitive provisions of the Treaty, but the Member State must show that the proposed restriction is the only way of achieving the objective of the public service

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obligation. Even if this can be shown, moreover, the restriction on competition is still only allowed up to a point

The following case is illustrative. Four local distribution companies in the Netherlands complained that their regional supplier (Ijsselcentral) was preventing them from importing electricity. Ijsselcentral (and the other regional distribution companies) had 25 year contracts with SEP, the Dutch transmission company. The regional distribution companies had public service obligations, including ensuring security of supply. The question presented was whether these obligations were sufficient to allow the ban.

Dutch courts, as well as EU courts, were involved in the decision-making. They concluded that there was no convincing commercial evidence to support the import ban and it was not strictly necessary. The Dutch courts said that the import ban was not the only way of guaranteeing security of supply, and that security could be achieved by, for example, requiring importers to conclude long-term contracts and notify SEP.

The implications of such reasoning on any Czech restrictions on imports and exports, as well as the broader lessons it provides as to the EU's views on competition in general, demonstrate that exemptions to the competitive provisions in the Directive and the Treaty could be narrowly applied.

III OTHER COMPETITION ISSUES

The Treaty of Rome in general requires competition and free trade among Member States

A Long-Term Contracts

Long-term contracts among generators, the transmitter and generators could be deemed to conflict with the Treaty's rules against anti-competitive behavior (Articles 85 and 86)

Article 85 prohibits "all agreements between undertakings, decisions by associations of undertakings and concerted practices which may affect trade between member-States and which have as their object or effect the prevention, restriction or distortion of competition within the common market" Any agreements or decisions prohibited by Article 85 "shall be automatically void"

Article 86 prohibits abuse of a dominant position (interpreted in court decisions to mean 40% or more of the market) The Article provides that "any abuse by one or more undertakings of a dominant position within the common market or in a substantial part of it shall be prohibited as incompatible with the common market in so far as it may affect trade between Member States"⁷

⁷ See also Article 22 of the Directive, which provides

Member States shall create appropriate and efficient mechanisms for regulation, control and transparency so as to avoid any abuse of dominant position, in particular to the detriment of consumers, and any predatory behaviour These mechanisms shall take account of the provisions of the Treaty, and in particular Article 86 thereof

The Czech Republic, if made a member of the EU, must notify the Commission about contracts which may be subject to Article 85(1). If it does not, and falls within Article 85, the contract is deemed void and substantial fines can be imposed on the parties to the agreement. Notification generally protects against the imposition of fines.

The Commission can find that the contracts fall outside the ambit of Article 85, grant an exemption, or prohibit them. In practice, a great deal of negotiation occurred between the British government and the Commission to clear the privatization agreements in the re-structuring of the electricity sector in England and Wales, the Commission objected to new long-term power purchase contracts in Portugal between the dominant company Electricidade de Portugal ("EDP") and new IPP plants, and the Commission objected to long-term contracts for power in Belgium. With respect to the EDP contracts, in 1993, based on pressure from the Commission, the contract for power from the Pego plant was reduced from 28 to 15 years (with EDP having a "first option" to purchase the power for the remaining 13 year term). In 1996, the Commission forced an EDP subsidiary to alter a 25 year contract from the Turbog plant to allow the generator to sell to others after 15 years. In Belgium, Electrabel sought to sell an equity stake to Belgium power distributors in exchange for 30 year supply contracts. After pressure from the Commission, Tractabel has shortened the contracts to 15 years, it is not yet clear whether this change will satisfy the Commission.

B Ownership Limitations

Nothing in the Directive requires disaggregation of the electricity sector. Vertically integrated systems can be retained if some competition is allowed for a portion of the market and with respect to eligible customers. Hence, nothing in the Directive requires the Czech Republic to require CEZ to disaggregate its generation, or enact an ownership limitation law prohibiting the current owners of generators, transmission and distribution companies to sell their assets and re-aggregate.

The Directive does, however, require integrated monopolies to functionally disaggregate and operate within limited parameters. Prices must be unbundled, the transmission system operator must remain independent, access must be permitted, tariffs must be published, discrimination is prohibited, and so on.

Articles 85 and 86 of the Treaty, moreover, prohibit abuses by dominant undertakings in the market. Article 22 of the Directive requires Member States to create mechanisms for "regulation, control and transparency so as to avoid any abuse of dominant position" and comply with Article 86.

The simplest way to avoid running afoul of these Treaty provisions, and the language used and restrictions imposed in the Directive, may simply be to disaggregate and prohibit re-aggregation, and thereby prevent any undertaking from obtaining a dominant position in the distribution or generation markets.

ACT

dated 2 November 1994

**on Conditions for Business and the Performance of State Administration
in Energy Sectors and on the State Energy Inspectorate**

Parliament has passed this act of the Czech Republic

**PART I
GENERAL SECTION**

**Article 1
Subject Matter of the Act**

This act (hereinafter simply "Act") governs conditions for business in the electricity gas and heating industries (hereinafter simply 'energy sectors') as well as the related rights and obligations of natural or legal persons, and the performance of state administration in this sector as a whole

**Article 2
Subject of Business**

(1) The subject of business in energy sectors is the production of electricity, gas or heat and the distribution of electricity gas or heat to natural or legal persons supplied in the public interest

(2) For the purposes of this Act the distribution of electricity gas or heat shall be understood as the transmission transportation storage conversion and supply of electricity gas or heat.

**Article 3
Licensing**

(1) Natural or legal persons may do businesses in the energy sectors of the Czech Republic under the conditions set by this Act, only on the basis of a state license (hereinafter simply "license") granted by the Ministry of Industry and Trade (hereinafter simply "Ministry")

(2) A license shall be granted for a definite period at minimum 25 years for

- a) the production of electricity, gas or heat,
- b) the distribution of electricity gas or heat

(3) A license holder is entitled to request an extension of a license one year before the expiry of the period for which he was granted a license

(4) A license is not transferable to another natural or legal person

**Article 4
Conditions for Granting a License**

(1) The conditions for granting a license to a natural person are

- a) attainment of 21 years of age
- b) fitness to perform judicial acts
- c) irreproachability
- d) permanent residency in the Czech Republic
- e) professional qualification or appointment of an expert representative in accordance with article 5

(2) The conditions for granting a license to a legal person are

- a) a registered office in the Czech Republic
- b) appointment of a representative who fulfills the conditions in paragraph 1

(3) A natural or legal person who applies for a license must show that he has the financial, technical and material prerequisites for the performance of licensed activities and that these activities will not jeopardize interests in environmental protection in accordance with statutes

(4) For the purposes of this Act a person shall not be considered irreproachable who has been sentenced by authorities

- a) for a crime of which the circumstances relate to the subject of business of this Act
- b) for a different crime committed willfully if given the character of the business person, in light of the fact that he is performing licensed activities, it is feared that he will commit the same or another similar crime during the performance of licensed activities

(5) For the purposes of this Act professional qualification shall be understood as completed university education in a technical field and three years experience in that field, or complete specialized secondary education in a technical field with a diploma and six years experience in that field and for electricity generation of up to and including 1 MW of installed capacity training in the field and three years experience in the field or a requalification certificate for the operation of small energy sources

(6) Approval of the State Office for Nuclear Safety is required for granting a license for the generation of electricity or heat in nuclear facilities

(7) The public interest shall be taken into consideration during the decision-making on the granting of a license

**Article 5
Authorized Representative**

(1) For the purposes of this Act, an authorized representative shall be understood as a natural person appointed by a holder of a license for production or distribution (hereinafter simply "license holder") who is responsible for the proper performance of licensed activities in accordance with this Act.

(2) An authorized representative must fulfill the conditions for the granting of a license under article 4 paragraph 1

(3) The function of an authorized representative may be performed in every case only for one license holder

(4) All license holders who are legal persons shall be obliged to appoint a representative

(5) An authorized representative of a legal person may not be a member of the supervisory board or other management body of this legal person

(6) If a license holder is a natural person he may also

appoint a representative through whom licensed activities will be performed

(7) The Ministry shall make a record of the appointment of a representative

(8) If an authorized representative stops discharging his function during the performance of licensed activities the respective license holder must appoint a new representative within 15 days. The license holder shall be responsible for the performance of licensed activities until the appointment of a new representative

Article 6

License Application

(1) A written application for a license for a natural person shall contain

- a) his name and surname permanent residence birth registration number if he is appointing an authorized representative he shall supply the same data for the representative and a written proposal for his approval
- b) the subject place and scope of business, as well as the delimited region in the case of a license for distribution
- c) the business name and identification number if one has been assigned
- d) the period of business

(2) A written application for a license for a legal person shall contain

- a) the business name address and form of the legal person
- b) the subject place and scope of business, as well as the delimited region in the case of a license for distribution
- c) the identification number if one has been assigned
- d) data concerning an authorized representative and a written proposal for his approval,
- e) the period of business

(3) An application under paragraphs 1 and 2 shall have the following enclosures

- a) a notarized copy of the agreement or deed on organization or foundation of the legal person and for persons listed there an excerpt from the Commercial Register
- b) an excerpt from the Criminal Register concerning the natural person and the authorized representative which is not more than six months old,
- c) documents regarding professional qualification,
- d) financial statements which are not more than six months old on the date of the submission of the application, and, for legal persons already conducting business, verified by an auditor

Article 7

Granting a License

(1) The Ministry shall grant a license if the conditions for its granting under article 4 are fulfilled

(2) If the Ministry discovers before the issuance of a decision that an application is incomplete the Ministry shall grant the applicant a period adequate for the elimination of shortcomings. At the same time the Ministry shall remind

him that the proceedings will be suspended if the shortcomings are not eliminated within this period

(3) A decision on the granting of a license contains

- a) the business name of the natural or legal person who will perform licensed activities,
- b) the subject, place and scope of business as well as the delimited region in the case of a license for distribution
- c) the technical conditions with which the license holder is obliged to comply in the performance of licensed activities
- d) the period of validity of a license including the deadline for the commencement of the performance of licensed activities,
- e) approval of the authorized representative under article 5, paragraph 4 or article 5 paragraph 6

Article 8

Expiry of a License

(1) A license shall expire

- a) for natural persons by death or pronouncement of death
- b) by removal of a legal person from the Commercial Register;
- c) announcement of bankruptcy or rejection of a filing of bankruptcy due to a lack of assets
- d) expiration of the period for which the license was granted,
- e) a decision of the Ministry on the revocation of a license

(2) The Ministry shall revoke a license if it discovers that its holder

- a) stopped fulfilling the conditions for the granting of a license in accordance with this Act,
- b) violates statutes on environmental protection during the performance of licensed activities,
- c) endangers the lives, health or property of persons through the breach of obligations set down by this Act.

(3) The Ministry may revoke a license in the event that the license holder has not begun the performance of licensed activities by the deadline fixed in the decision on the granting of a license

(4) If a license holder requests it in writing, the Ministry shall revoke the respective license

(5) If a license holder requests the revocation of a license he is obliged to continue supplying electricity gas or heat for six months after the submission of this request. He does not have this obligation if he demonstrates that he is not able to fulfill his obligations due to difficulties that arose beyond his control and which are not within his powers to overcome

Article 9

Obligations and Rights of a License Holder

(1) A license holder is obliged to ensure that the work related to the performance of licensed activities, requiring professional qualification in accordance with special statutes¹⁾ is carried out only by persons possessing this professional qualification

¹⁾ For instance Act No. 174/1968 on special state supervision of work safety as amended by later statutes Decree No. 50/1978 of the Czech Office for Work Safety and the Czech Mining Office on professional qualification in electrical engineering Decree No. 21/1979 of the Czech Office for Work Safety and the Czech Mining Office which specifies backup gas facilities and sets some conditions for ensuring their safety is amended by Decree No. 554/1990

(2) A license holder is obliged to ensure that the technical equipment used for the performance of licensed activities fulfills the safety and reliability requirements set by work-safety statutes and official technical standards

(3) A holder of a license for distribution (hereinafter simply "supplier") is obliged, if it is technically and financially feasible to conclude a contract on the supply of a selected type of energy with every natural or legal person who requests and fulfills the conditions of this Act and is located in the place of performance of licensed activities (hereinafter simply "customer")

(4) A supplier has the right to limit or interrupt the supply of energy set by a valid contract to the necessary extent in these instances

- a) in direct endangerment of the lives, health or property of persons and during the elimination of these circumstances
- b) during states of emergency under article 12 paragraph 1 or during activities directly preventing their occurrence,
- c) during the implementation of planned renovation repairs maintenance and inspection,
- d) during the occurrence and elimination of breakdowns of equipment for energy distribution (hereinafter simply "distribution equipment"),
- e) during the implementation of necessary operational adjustments, for not more than 30 minutes in the case of electricity, 48 hours for gas, and 16 hours for heat,
- f) during unauthorized consumption according to the special section of this Act,
- g) if during the consumption of energy, a customer uses equipment which endangers the lives, health or property of persons,
- h) if the customer uses during the consumption of energy, equipment which affects the quality of energy to the detriment of other customers, and available technical measures were not taken to limit this effect,
- i) on the basis of the dispatching instruction under article 13 paragraph 8

(5) In the instances mentioned in paragraph 4, letter c), the supplier is obliged to announce the commencement and termination of the limitation or interruption of energy supply in a manner customary in the given location, at least 15 days in advance

(6) In the instances mentioned in paragraph 4, the supplier is obliged to restore the supply of energy immediately after the removal of the causes of its limitation or interruption

(7) In the instances mentioned in paragraph 4 the right to compensation for damages and lost profit is waived. This does not apply if the license holder did not fulfill the announcement obligation under paragraph 5

(8) A holder of a license for production or distribution is obliged

- a) to provide upon request of the Ministry, information necessary to discharge his rights and obligations ensuing from this Act
- b) allow accredited employees of the Ministry access to buildings in which licensed activities are performed

in order to verify the information provided

(9) A supplier is obliged to offer natural or legal persons who express legal interest, information on the location of distribution facilities and essential data about them

(10) Within three months after the granting of a license, its holder is obliged to develop an incident plan for the prevention and handling of states of emergency and to submit it to the Ministry, with the exception of electricity generating plants up to and including 10 MW of installed capacity and heat supply networks up to and including 10 MW

(11) A supplier has the right

- a) to enter someone else's property in the context of the establishment, operation, repair and maintenance of distribution equipment;
- b) to remove and prune trees and other vegetation threatening the safe and reliable operation of distribution equipment in instances in which after a previous warning the owner or user has not done so himself
- c) to set up and operate his own telecommunication network for the control, measurement, safeguarding and automation of the operation of electricity gas and heat networks and for data transmission for the operation of computers and information systems,
- d) to enter, in accordance with special regulations, closed premises and facilities for the performance of activities and services of a body of the Ministry of Defense Ministry of the Interior Ministry of Justice, as well as railway operational facilities and to enter property where special telecommunication equipment is located to the extent and in the manner necessary for the performance of licensed activities,
- e) to use consuming equipment of customers in states of emergency, to the necessary degree

(12) During the execution of authority under the previous paragraph a supplier is obliged to respect fully the rights of owners of the property in question and to notify them of entry into their property. After the conclusion of work the supplier is obliged to return the property to its previous condition

(13) If a property owner or tenant incurs property damage as a result of a supplier exercising rights under paragraph 10*, or is restricted in the normal use of property he has a right to lump-sum compensation. It is necessary to make a claim for this compensation with the supplier who caused property damage or limitation of the use of property within six months of the day on which the owner or tenant learned of it but not later than one year after the occurrence of property damage or limitation of the use of property otherwise the right expires

Article 10

Obligation of Public Service

(1) For the purposes of this Act, public service shall be understood as the obligation of a license holder to supply electricity, gas or heat outside of the framework specified in the license granted

(2) In the event of a pressing need in the public interest, a license holder shall have the obligation of public service based on a decision of the Ministry

(3) A decision of the Ministry shall be issued for a definite period at maximum six months. Appeal against this decision shall not have a delaying effect.

(4) Demonstrable loss incurred by a license holder by undertaking the obligation of public service shall be compensated from the budget of the Ministry.

Article 11 State Regulation

(1) License holders are subject to state regulation (hereinafter simply 'Regulation') performed by the Ministry.

(2) For the purposes of this Act, Regulation shall be understood as bringing influence to bear on the execution of licensed activities and new investments in sources and network equipment in accordance with this Act, in such a way as to provide a substitute for a competitive environment.

(3) The Ministry is the only body authorized to submit proposals for changes in the prices of electricity, gas and heat to the Ministry of Finance.²⁾

(4) The Ministry is authorized to inspect and review the reasonableness of costs incurred by individual license holders in the execution of licensed activities.

(5) For the purpose of performing Regulation, employees of the Ministry have the right to

- a) enter buildings in which licensed activities are carried out,
- b) look at (inspect) accounting and other documents of license holders necessary for the performance of Regulation and to request explanations of them.

(6) Employees of the Ministry who obtain information during the course of performing Regulation are obliged to maintain confidentiality about all the matters which they become aware of in their work.³⁾

(7) The Ministry shall establish, by decree, the procedure for the performance of Regulation.

Article 12 State of Emergency

(1) For the purposes of this Act, a state of emergency shall be understood as the limitation or interruption of supply of electricity, gas or heat throughout the Czech Republic or in part thereof as a result of

- a) natural disasters,
- b) measures of state authorities during a military state of alert,
- c) accidents at facilities for the production and distribution of energy,
- d) a long-term shortage of energy sources,
- e) a smog situation as defined by special statutes,⁴⁾
- f) an act of terrorism.

(2) During states of emergency license holders and customers are obliged to accept a limitation on consumption. The extent and method of consumption limitation shall be set by the Ministry by decree.

(3) The Government shall declare a state of emergency

for the entire country through the mass media. If a state of emergency concerns a specific part of the country, the Ministry shall declare it.

(4) License holders are obliged immediately after the occurrence of an accident or declaration of a state of emergency, to begin eliminating the consequences in accordance with incident plans.

(5) If, as a result of a state of emergency a serious interruption of the supply of electricity or gas occurs, especially during extensive accidents at facilities for their production and distribution, license holders whose technical conditions permit it are obliged to take part in the removal of damage and the restoration of supply.

(6) The removal of damage and restoration of supply in the previous paragraph shall be coordinated by the Ministry, the instructions of which license holders are obliged to follow.

(7) The Ministry shall determine, by decree, the procedure to be followed during the emergence and removal of the consequences of a state of emergency.

Article 13 Dispatching Facilities

(1) Dispatching facilities ensure a balance between energy sources and consumption as well as the safe and reliable operation of electricity and gas networks.

(2) For the purposes of this Act, an electricity network shall be understood as a set of interconnected facilities for the generation and distribution of electricity including connections to the main network, electricity-consuming equipment and the system of control and safety apparatus and metering as well as facilities for data transmission for the operation of computers and information systems.

(3) For the purposes of this Act, a gas network shall be understood as a set of interconnected facilities for the production and distribution of gas, underground storage facilities, connections to the pipeline network and gas-consuming equipment, including the system of control and safety apparatus and metering as well as facilities for data transmission for the operation of computers and information systems.

(4) Suppliers who operate distribution equipment at high and very high voltages and distribution equipment at pressure levels above 0.3 MPa are obliged to set up and operate, at their own expense, dispatching units to control a limited section of the electricity or gas network.

(5) Central electricity dispatching manages the electricity network of the Czech Republic, and central gas dispatching manages the gas network of the Czech Republic (hereinafter simply 'central dispatching facilities'). Suppliers under paragraph 4 and license holders operating generating equipment with unit outputs above 50 MW are obliged to set up central dispatching facilities on the basis of contracts of association.^{**}

(6) Central dispatching facilities ensure

- a) uniform control of the electricity network and gas net-

²⁾ Act No. 265/1991 of the Czech National Council, on the province of authorities of the Czech Republic in the field of prices, as amended by Act No. 135/1991.

³⁾ Article 17 of the Commercial Code.

⁴⁾ Act No. 309/1991 on the protection of the atmosphere against pollutants (the law on the atmosphere) as amended by later statutes.

^{**} Translator's note: contracts of association are defined in the Civil Code (Act No. 509/1991) at cl. 870.

work including the declaration of consumption levels during accidents at production and distribution facilities and during states of emergency,

- b) international cooperation in energy sectors
- c) effective use of sources with unit outputs above 50 MW, distribution equipment at 400 kV and 220 kV, and selected 110 kV distribution equipment,
- d) the effective use of sources of gas and gas distribution equipment with pressure levels above 4 MPa, and selected distribution equipment with pressure levels above 2.5 MPa, including underground storage facilities and the control of their operation

(7) The Ministry shall issue by decree dispatching regulations that set down the rules of dispatching. Dispatching regulations govern in detail the methods of operation of networks and their operational control, analysis, inspection and evaluation of results and the uniform system of data transmission in networks during routine operation and in states of emergency.

(8) License holders and other natural or legal persons are obliged to follow the instructions of the appropriate dispatching facility in compliance with the provisions of this Act and the approved dispatching regulations.

(9) License holders for the production and distribution of electricity or gas are obliged to report a state of emergency under article 12, paragraph 1 letters a), c), e) and f) to the central dispatching facility immediately after it arises.

Article 14

Inspection of Business in Energy Sectors

The State Energy Inspectorate shall carry out the inspection of business activity in energy sectors in accordance with this Act.

PART II SPECIAL SECTION CHAPTER I ELECTRICITY INDUSTRY

Article 15

Supply of Electricity

(1) A supplier is obliged to ensure the supply of electricity to every customer who

- a) has an installed electricity connection to the main network and electricity-consuming equipment in compliance with official technical standards and work-safety regulations
- b) fulfills the conditions regarding the place, method and date of connection set by the supplier
- c) has the consent of the owner of the property in question

(2) A supplier shall conclude a written contract with a customer for every place of consumption. This contract on the supply of electricity must include

- a) the output, amount and pattern of electricity consumption (hereinafter simply "demand diagram") in

cluding for states of emergency

- b) the price and method of payment for electricity consumed, including advance payments⁵¹
 - c) the method of measurement of electricity consumed including access of the supplier to metering equipment
- (3) The agreement on a demand diagram is not required of customers from low-voltage networks
- (4) A customer is obliged
- a) to ensure that his electricity consuming equipment connected to the supplier's distribution equipment has been equipped with the available technical means limiting the effect of feedback on the quality of electricity supplied to other customers and that it does not affect the operation of control, metering and safety apparatus and the operation of the system of network remote control
 - b) to consume electricity at an inductive power factor of 0.95–1.0 unless the supplier and customer agree otherwise with the exception of residential consumption; the method of ensuring and evaluating this value shall be set by the Ministry by decree

(5) A customer may operate his own backup or other source if it is connected to the supplier's distribution equipment, as well as add energy from his own source to this equipment only after agreement with the supplier.

(6) Interference must not be made to the equipment which consumes unmetered electricity without the supplier's prior consent.

(7) The supplier shall not connect an electricity network connection or electricity-consuming equipment which does not comply with official technical standards and work-safety regulations.

(8) A customer shall, according to the level of power demand, share in the reasonably incurred costs of the supplier related to connection and the provision of the power demand at a level calculated by a method set by decree.

(9) A customer is obliged to maintain the electricity-consuming equipment in a condition in compliance with official technical standards and work-safety regulations and to provide the supplier with technical data about it.

(10) In the event of a change in voltage implemented in the interest of technical development, owners of connected electricity-consuming equipment are obliged to adjust at their own expense and within adequate fixed periods their consuming equipment and appliances so that they conform to the given changes.

(11) The Ministry shall set, by decree, more detailed conditions of electricity supply.

Article 16

Electricity Connections

(1) An electricity connection to the main network starts at its branch off from the distribution equipment in the direction of a customer and is intended for the connection of electricity-consuming equipment of one customer.

(2) At an electricity substation, an electricity connection starts at its branch off the switches or bus-bars and outside the substation at overhead or underground lines.

(3) A low-voltage electricity connection ends in the case of an overhead line at the building's main fuse box, or

⁵¹ Act No. 526/1990 on prices, as amended by Act No. 135/1994

cable box. These boxes form part of the connection. The main fuse box or, as the case may be, main cable box shall be located in the customer's building or at the boundary or in the vicinity of the boundary of his property.

(4) If a main fuse box is not installed on a customer's property, the low-voltage overhead connection ends at the last supporting point situated on that property. A supporting point forms part of the connection.

(5) If a main cable box is not installed on a customer's property, the low-voltage electricity connection ends at the terminals of the main circuit breaker of the electricity-consuming equipment or in the cable box inside the building.

(6) An electricity connection of high and very high voltage ends at the anchoring insulators at a customer's substation in the case of overhead lines, and at the cable terminal in the customer's substation in the case of underground lines. Anchoring insulators and cable terminals form part of the connection.

(7) Costs for the installation of an electricity connection shall be borne by the person who benefited from its installation unless stated otherwise in this Act.

(8) Costs for the installation of a low-voltage connection for residential consumption to a length of 30 meters shall be paid by the supplier if the customer agrees to the method and technical conditions for the installation of such a connection.

(9) An owner of a connection is the one who pays the costs of its installation.

(10) The owner of an electricity connection is obliged to ensure its operation, maintenance and repairs so that it does not become a threat to the lives, health or property of persons.

(11) A supplier is obliged for payment to operate, maintain and repair an electricity connection if so requested by its owner.

Article 17 Metering

(1) The consumption of electricity is metered and billed by the supplier according to the data read from his own metering equipment. The supplier shall, at his own expense, connect, maintain and regularly check the accuracy of metering equipment for the customer. Metering transformers form a part of the electricity-consuming equipment.

(2) If a customer has doubts about the accuracy of metering data or if he discovers a defect in the respective metering equipment, he has the right to have it tested. A supplier is obliged, on the basis of a customer's written request, to replace the metering equipment for this purpose within 15 days of receipt of the request. The customer is obliged to cooperate as needed with the supplier during the replacement of metering equipment.

(3) If a defect is ascertained on the metering equipment, the supplier shall bear the costs related to its testing and replacement. If a defect is not ascertained, these costs are borne by the customer.

(4) Any interference with the metering equipment without the consent of its owner is prohibited.

(12) A supplier has the right to safeguard individual parts of the metering equipment against unauthorized tampering.

Article 18

Purchase of Electricity

(1) A supplier is obliged, if it is technically feasible, to purchase electricity:

- a) from combined heat and power plants in amounts corresponding to the technological requirements of heat generation,
- b) generated from renewable and secondary sources of energy.

(2) The costs related to the connection of a source under paragraph 1 shall be borne by the owner of the relevant facility.

(3) The method of connection of a source under paragraph 1 to distribution equipment shall be determined by the supplier.

(4) The price of electricity purchased in the context of paragraph 1 shall be set by price regulations.^{5)***}

Article 19

Protective Zones

(1) A facility for electricity generation (hereinafter simply "generating facility") and distribution equipment are safeguarded by protective zones.

(2) For the purposes of this Act, a protective zone shall be understood as an area in the immediate vicinity of a generating facility and distribution equipment which is set aside for their reliable operation and the protection of the lives, health and property of persons.

(3) Overhead lines, underground lines and electricity substations are safeguarded by protective zones.

(4) The protective zone of an overhead line is delimited by vertical planes running along both sides of the line at a horizontal distance measured perpendicularly to the lines from the outermost conductor on each side:

- a) for voltage above 1 kV to 35 kV inclusive, of 7 m,
- b) for voltage above 35 kV to 110 kV inclusive, of 12 m,
- c) for voltage above 110 kV to 220 kV inclusive, of 5 m,
- d) for voltage above 220 kV to 400 kV inclusive, of 20 m,
- e) for voltage above 400 kV, of 30 m.

(5) Owners and users of property on forest tracts are obliged to maintain a clear strip of land 4 meters wide on one side of the bases of the supporting points.

(6) In the protective zone of an overhead line, it shall be prohibited:

- a) to erect buildings or locate structures and other similar facilities as well as to store inflammable or explosive materials,
- b) to plant hops gardens and let any vegetation grow over 3 meters high,
- c) to perform activities endangering the overhead line, the reliability and safety of its operation or the lives, health and property of persons.

(7) A protective zone of an underground line to 110 kV inclusive and lines of metering and control and safety apparatus constitutes 1 meter on both sides of the outermost

Translator's note: this Act contains one footnote 5 but two references to it

cable It is 3 meters on both sides of the outermost cable if it is above 110 kV

(8) In a protective zone of an underground line it shall be prohibited

- a) to perform earthwork without the consent of its owner;
- b) to erect buildings or locate structures or other similar facilities and to perform activities which would make access to the underground line impossible or considerably more difficult or which could jeopardize the safety and reliability of its operation
- c) to plant permanent vegetation and traverse the line with machinery with a total weight over 3 tons

(9) A protective zone of an electricity substation is delimited by vertical planes at a horizontal distance of 20 meters perpendicular to the fenced or walled-in boundary of the substation building

(10) In the protective zone of an electricity substation it shall be prohibited to perform activities which could result in the endangerment of the lives, health or property of persons the safety and reliability of the substation's operation or make its maintenance impossible or considerably more difficult.

(11) Natural or legal persons setting up facilities supplied with direct current in the immediate vicinity of a protective zone with the possibility of emergence of stray current damaging the underground line are obliged to notify the supplier of these circumstances and take measures to curb them

(12) The provisions of paragraphs 9 and 10 shall be applied where appropriate to the protection of power generating plants

(13) The Ministry shall permit exceptions concerning protective zones

Article 20

Relocation of Distribution Equipment

(1) For the purposes of this Act relocation of distribution equipment shall be understood as a partial change in the route of a line or relocation of some components of this equipment

(2) The relocation of distribution equipment shall be arranged by its owner at the expense of the person who created the need for its relocation

(3) The ownership of distribution equipment shall not change after the implementation of relocation

Article 21

Contact of Distribution Equipment with Other Facilities

In the event of contact of distribution equipment with roads waterways railroads and other facilities of all kinds owners or operators of distribution equipment are obliged in mutual cooperation to implement available technical measures to ensure the reliability and safety of equipment and the possibility of regular maintenance

Article 22

Unauthorized Consumption of Electricity

(1) Unauthorized consumption of electricity is

- a) consumption without a valid contract or at variance with a valid contract
- b) consumption from the part of equipment through which unmeasured electricity passes,

c) consumption without metering equipment or metering equipment which as a result of a customer's interference either does not record or records less than the actual consumption,

d) consumption with metering equipment which was not connected by the supplier or on which the anti-tamper device was damaged

(2) The Ministry shall set by decree, the method of calculation of damages incurred by a supplier through unauthorized consumption

CHAPTER II

GAS INDUSTRY

Article 23

Supply of Gas

(1) A supplier is obliged to ensure the supply of gas to every customer who

- a) has an installed connection to the pipeline network and gas-consuming equipment in compliance with official technical standards and work-safety regulations,
- b) fulfills the conditions regarding the place, method and date of connection set by the supplier;
- c) has the consent of the owner of the property in question

(2) A supplier shall conclude a written contract with a customer for every place of consumption This contract on the supply of gas must include

- a) the amount and pattern of gas consumption (hereinafter simply "demand diagram") including for states of emergency
- b) the price and method of payment for gas consumed, including advance payments,
- c) an agreement on the method of metering gas consumed and the supplier's access to metering equipment.

(3) For the purposes of this Act, gas shall be understood as natural gas, town gas, coke oven gas mine draining and generator gas, biogas, and propane butane and their mixes, if they are not transported in bottles

(4) For the purposes of this Act gas consuming equipment shall be understood as any and all equipment from the main gas shutoff up to and including equipment for the final use of gas

(5) A supplier shall not install a gas connection or gas-consuming equipment which does not comply with official technical standards and work-safety regulations

(6) An owner of connected gas-consuming equipment is obliged to keep it in a condition which complies with applicable official technical standards and work-safety regulations

(7) No interference may be made on gas consuming equipment through which unmeasured gas passes without prior consent of the supplier, with the exception of the closure of the main shutoff in the event of an imminent or occurring accident

(8) A customer shall according to the amount of gas consumed, share the reasonably incurred costs of the supplier related to connection and the provision of the gas supply requested at a level calculated by a method set by decree

(9) In the event of a change in pressure or type of gas implemented in the interest of technical development own-

... of connected gas equipment and appliances are obliged to adjust at their own expense and within adequate fixed periods their gas-consuming equipment and appliances so that they conform to the given changes

(10) The Ministry shall set by decree, more detailed conditions of gas supply

Article 24 Connection to the Pipeline Network

(1) A connection to the pipeline network (hereinafter simply "pipeline connection") starts at its branch off from the distribution equipment and ends in front of the main gas shutoff by which the gas-consuming equipment is connected in one building

(2) Costs for the installation of a pipeline connection shall be borne by the person who benefits from the connection

(3) An owner of a pipeline connection is the person who has paid the costs for its installation

(4) The owner of a pipeline connection is obliged to ensure its operation, maintenance and repair so that it does not become a threat to the lives, health or property of persons

(5) A supplier is obliged, for payment, to operate, maintain and repair a pipeline connection if so requested by its owner

Article 25 Metering

(1) Gas consumption is metered and billed by the supplier according to the data read from his own metering equipment (hereinafter simply "gas meter"). The supplier shall at his own expense, connect, maintain and regularly check the accuracy of the gas meter for the customer

(2) If a customer has doubts about the accuracy of metering data or if he discovers a defect in the respective gas meter, he has the right to have it tested. The supplier is obliged, on the basis of a customer's written request, to replace the gas meter for this purpose within 15 days of receipt of the request. The customer is obliged to cooperate as needed with the supplier during the replacement of the gas meter

(3) If a defect is ascertained on the gas meter, the supplier shall bear the costs related to its testing and replacement. If a defect is not ascertained, these costs are borne by the customer

(4) Any interference with the gas meter without the consent of its owner is prohibited

(5) A supplier has the right to safeguard the gas meter, including its connection, against unauthorized tampering

Article 26 Protective Zones

(1) Gas apparatus are safeguarded by protective zones

(2) For the purposes of this Act, gas apparatus shall be understood as gas pipelines, connections and engineering buildings

(3) For the purposes of this Act, a protective zone shall be understood as an area in the immediate vicinity of gas apparatus delimited by a horizontal distance from the ground plan of the gas apparatus measured perpendicularly to its outline and set aside for its reliable operation

(4) Protective zones are

- a) for pipelines and connections up to 200 mm in diameter inclusive 4 m

- b) for pipelines and connections between 200 and 500 mm inclusive 8 m
- c) for pipelines and connections above 500 mm in diameter 12 m
- d) for low-pressure and medium-pressure pipelines and connections through which gas is distributed in the built up area of a municipality 1 m
- e) for engineering buildings 4m

(5) In extraordinary circumstances, especially in the vicinity of mining facilities, waterworks and extensive underground structures which could affect the stability of the placement of gas apparatus, the Ministry may fix the extent of protective zones up to 200 meters

(6) Construction and landscaping in a protective zone may be performed only with the prior written consent of the supplier who is responsible for the operation of the respective gas apparatus

(7) For high-pressure and very high-pressure pipelines on forest tracts, owners and users of the property are obliged to maintain a clear strip of land 2 meters wide on both sides of the axis of the pipeline

Article 27 Safety Zones

(1) Safety zones are set aside to prevent or lessen the effects of possible breakdowns or accidents at gas facilities and for the protection of the lives, health and property of persons

(2) For the purposes of this Act, a safety zone shall be understood as an area delimited by a horizontal distance from the ground plan of a gas facility measured perpendicularly to its outline

(3) For the purposes of this Act, gas facilities shall be understood as facilities for the production and treatment of gas, underground storage facilities, pressure storage facilities of liquefied gas, gas tanks, filling plants, liquefaction, vaporization, compressor and regulator stations, and high-pressure and very high-pressure pipelines

(4) Structures may be erected in a safety zone only with the prior written consent of the natural or legal person responsible for the operation of the respective gas facility

(5) The extent of safety zones is specified in an appendix to this Act

Article 28 Relocation of Distribution Equipment

(1) For the purposes of this Act, relocation of distribution equipment shall be understood as a partial change in the route of a pipeline or pipeline connection or the relocation of distribution equipment or some components of this equipment

(2) The relocation of distribution equipment shall be arranged by its owner at the expense of the person who created the need for its relocation

(3) The ownership of distribution equipment shall not change after the implementation of relocation

Article 29 Unauthorized Consumption

(1) Unauthorized gas consumption is

- a) consumption without a valid contract or at variance with a valid contract,
- b) consumption without a gas meter or with a gas meter

which as a result of a customer's interference either does not record or records less than the actual consumption,

- c) consumption with a gas meter which was not connected by the supplier or on which the anti-tamper device was damaged

(2) The Ministry shall set by decree the method of calculation of damages incurred by a supplier through unauthorized consumption

CHAPTER III HEATING INDUSTRY

Article 30 Supply of Heat

(1) A license holder is obliged to ensure supply to every building owner who

- a) has an installed hot-water connection and heat-consuming equipment in compliance with official technical standards and work-safety regulations
- b) fulfills the conditions regarding the place, method and date of connection set by the supplier

(2) For the purposes of this Act, the supply of heat shall be understood as heat for space heating, preparation of hot water and other uses, a hot-water connection shall be understood as equipment carrying a heat-bearing medium between the equipment of the supplier and customer

(3) A license holder shall conclude a written contract with a customer for every place of consumption. This contract on the supply of heat must include

- a) the output, amount and pattern of heat consumption (hereinafter simply "demand diagram")
- b) the price and method of payment for heat consumed including advance payments
- c) an agreement on the method of metering heat consumed for space heating and the preparation of hot water and on the access of the license holder to metering and control equipment, in the event that the metering of heat for the preparation of hot water is measured together for many places of consumption the method of calculation of the use of heat and water by individual place of consumption
- d) the parameters of the supplied and returned heat-bearing medium

(4) For the purposes of this Act heat-consuming equipment shall be understood as equipment connected to a heat distribution system or a heat connection intended for the internal distribution and consumption of heat in a building or in a group of buildings of one customer

(5) A customer may operate his own backup or other source which is connected to the distribution equipment as well as supply heat to this equipment from his own source, only after agreement with the license holder

(6) There may not be any interference performed on heat-consuming equipment through which unmetered heat passes, without the prior consent of the license holder

(7) A customer shall according to the amount of heat output consumed, share the effectively incurred expenses of the supplier related to the connection and provision of heat supply at a level calculated by a method set by decree

(8) In the event of a change in the heat bearing medium or its parameters, implemented in accordance with approved

land-planning documentation and in the interest of technical development owners of connected heat-consuming equipment are obliged to adjust, at their own expense and within adequate fixed periods their equipment and appliances so that they conform to the given changes

Article 31 Hot-Water Connection

(1) A hot-water connection starts at its branch off from the respective heat generating plant or from distribution equipment and ends at the heat-consuming equipment

(2) Repairs and maintenance of a hot-water connection shall be provided by the respective owner

(3) A license holder is obliged for payment, to operate, maintain and repair a hot-water connection if so requested by its owner

(4) Costs for the installation of a connection shall be borne by the person who benefits from the connection unless otherwise agreed with the license holder

(5) An owner of a connection is the person who has paid the costs for its installation

Article 32 Metering

(1) Heat consumption is metered and billed by the license holder according to the data read from his own metering equipment. The license holder shall, at his own expense connect, maintain and regularly check the accuracy of metering equipment for the customer

(2) If a customer has doubts about the accuracy of metering data or if he discovers a defect in the respective metering equipment, he has the right to have it tested. The license holder is obliged, on the basis of a customer's written request, to replace the metering equipment for this purpose within 15 days of receipt of the request. The customer is obliged to cooperate as needed with the license holder during the replacement of the metering equipment

(3) If a defect is ascertained on the metering equipment the license holder shall bear the costs related to its testing and replacement. If a defect is not ascertained, these costs are borne by the customer

(4) Any interference with the metering equipment without the consent of its owner is prohibited

(5) A license holder has the right to safeguard individual parts of the metering equipment against unauthorized tampering

(6) The Ministry shall issue by decree rules for heating and the supply of hot water including the allocation of costs to buildings and among final consumers

Article 33 Purchase of Heat

(1) A license holder who has suitable technical conditions for the distribution of heat is obliged to purchase heat

- a) from combined heat and power plants,
- b) obtained as a by-product of technological processes

(2) A license holder does not have this obligation in the event that this would increase the customer's price of heat

(3) The costs related to the connection of a source under paragraph 1 shall be borne by the owner of the relevant facility

Article 34
Protective Zones

(1) For the purposes of this Act, a protective zone shall be understood as an area in the immediate vicinity of equipment for the generation or distribution of heat set aside for its reliable operation and the protection of the lives, health and property of persons

(2) The width of protective zones is delimited by vertical planes on both sides of equipment for the generation or distribution of heat at a horizontal distance of 2.5 meters measured perpendicularly to this equipment

(3) For exchange stations set aside for the modification of parameters of a heat-bearing medium in individual buildings the protective zone is delimited by vertical planes running at a horizontal distance 2.5 m perpendicularly to the ground plan of these stations

(4) Construction and landscaping in protective zones which could endanger the safe operation and maintenance of equipment for the generation or distribution of heat may be performed only with the prior written consent of the respective license holder who is responsible for the operation of this apparatus

(5) If heat-distribution equipment goes through buildings the protective zone shall not be delimited. However, owners of buildings are obliged to allow the license holder access to, and to perform necessary work on, this equipment

Article 35
Relocation of Distribution Equipment

(1) For the purposes of this Act, relocation of distribution equipment shall be understood as a partial change in its transmission route or the relocation of some components of this equipment

(2) The relocation of distribution equipment shall be arranged by its owner at the expense of the person who created the need for its relocation

(3) The ownership of distribution equipment shall not change after the implementation of relocation

Article 36
Unauthorized Consumption of Heat

(1) Unauthorized consumption of heat is

- a) consumption without a valid contract or at variance with a valid contract
- b) consumption without metering equipment or through metering equipment which, as a result of a customer's interference, either does not record or records less than the actual consumption,
- c) consumption with metering equipment which was relocated without the consent of the license holder
- d) consumption through metering equipment on which the anti-tamper device was damaged

(2) The Ministry shall set by decree the method of calculation of damages incurred by a license holder through unauthorized consumption

PART III
STATE ENERGY INSPECTORATE

Article 37

(1) The State Energy Inspectorate (hereinafter simply Inspectorate)

to the Ministry. It consists of a central inspectorate and regional inspectorates. The Inspectorate is a legal person.

(2) At the head of the central inspectorate is the executive director of the Inspectorate, who is appointed and recalled by the Minister of Industry and Trade. Every regional inspectorate is headed by a director appointed and recalled by the executive director of the Inspectorate.

(3) The executive director of the Inspectorate shall determine the seats of inspectorates.

(4) The Inspectorate is an organization funded by the state budget and located in Prague.

Article 38
Activities of the Inspectorate

(1) The Inspectorate shall inspect whether license holders comply with the provisions of this Act and regulations implementing them.

(2) The Inspectorate shall inspect whether customers comply with the obligations set by this Act.

(3) The Inspectorate shall inspect whether other natural and legal persons comply with the prohibitions and restrictions in protective and safety zones according to this Act.

(4) The Inspectorate shall offer professional assistance and consultation free of charge within the scope of its activities.

Article 39
Fines

(1) The Inspectorate may impose fines on persons inspected pursuant to article 38, paragraph 1, up to CZK 50 million for

- a) conducting business without a license
- b) breach of the obligation to perform licensed activities through persons with professional qualification under article 9 paragraph 1,
- c) breach of the obligation to conclude a contract on the supply of energy article 9, paragraph 3
- d) transgression of the permissible limits or interruption of the supply of energy under article 9, paragraph 4
- e) breach of the obligation to restore supply immediately after the elimination of the causes of its limitation or interruption under article 9, paragraph 6,
- f) breach of the obligation to provide information necessary for the performance of the rights and obligations of the Ministry under article 9, paragraph 8,
- g) breach of the obligation to submit to consumption limits under article 9, paragraph 4 and during states of emergency under article 12, paragraph 2,
- h) violation of the rules of dispatching control under article 13 paragraph 8
- i) breach of the obligations under article 15 paragraph 1 article 23 paragraph 1 and article 30 paragraph 1
- j) breach of the obligation to purchase electricity under article 18 paragraph 1 and heat under article 33 paragraph 1
- k) breach of the prohibition of performing activities under articles 19, 26, 27 and 34 in protective and safety zones

(2) It is possible to impose a fine up to CZK 1 million on persons inspected under the preceding paragraph who conduct business with an installed capacity of electricity up to 2 MW or of heat up to 3 MW.

(3) The Inspectorate may impose fines up to CZK 50

- a) breach of the obligation to submit to consumption limits under article 9, paragraph 4 and during states of emergency under article 12 paragraph 2,
- b) violation of the rules of dispatching control under article 13, paragraph 8,
- c) breach of the obligation under article 15, paragraph 4
- d) breach of the prohibition of interference with metering equipment without the consent of its owner under article 17, paragraph 4, with the gas meter under article 25 paragraph 4 and with the metering equipment under article 32 paragraph 4
- e) breach of the prohibition of performing activities under articles 19, 26 27 and 34 in protective and safety zones
- f) unauthorized consumption up to an amount twice the price of a customer's average annual consumption of electricity gas or heat

(4) In the event that a customer does not have a valid contract with a supplier and does not have metering equipment a fine may be imposed up to CZK 5 million

(5) In the event that the customer is a natural person who does not conduct business according to this Act or other statutes, a fine may be imposed according to paragraph 3 up to CZK 100 000

(6) The Inspectorate may impose fines up to CZK 50 million on persons inspected under article 38, paragraph 3 for the breach of the prohibition of performing activities under articles 19 26 27 and 34 in protective and safety zones

(7) The Inspectorate shall send a copy of the decision on imposition of a fine with a note of enforceability to the respective local financial office

Article 40

Deadlines for the Imposition of Fines

Fines may be imposed up to one year after the day of discovery of the breach of an obligation but not more than three years after the breach of obligation occurred

Article 41

Revenue from Fines

Fines are the income of the state budget. The Inspectorate shall perform their administration

Article 42

Inspection under article 38 paragraph 2 and 3 of buildings and facilities of the Ministry of Defense, Ministry of Interior, Ministry of Justice and Security Information Service shall be performed by these bodies to an extent and by a method agreed upon with the Ministry

Article 43

Administrative rules⁶⁾ apply to the procedure for imposing fines in that the executive director of the Inspectorate decides on appeals against their imposition by a director of a regional inspectorate, while the Minister of Industry and Trade decides on appeals against their imposition by the executive director of the Inspectorate

Article 44

The rights and obligations of the State Energy Inspectorate set by Act No 88/1987 on state energy inspection, including property and other rights and obligations, shall pass over to the Inspectorate

PART IV COMMON, INTERIM AND CLOSING PROVISIONS

Article 45

Common and Interim Provisions

(1) Unless stated otherwise in this Act, decisions regarding the rights and obligations of natural or legal persons shall be made according to administrative rules

(2) Natural or legal persons conducting business in energy sectors in accordance with regulations pertaining hitherto must apply for the granting of a license within one year of the day of effect of this Act, if they wish to do further business

(3) Rights to another person's property as well as restriction of its use which arose before this Act goes into effect shall remain unaffected

(4) Protective zones set pursuant to existing statutes and exceptions to the provisions on protective zones granted pursuant to existing statutes shall also be maintained after this Act goes into effect

(5) In the event of a change in electricity voltage a change in pressure or type of gas and during a change in a heat-bearing medium or its parameters begun before the effect of this Act, shall proceed in accordance with statutes in effect so far

(6) The Ministry shall issue decrees for the implementation of articles 3 to 8, 11, 12, 13, 15 22, 23, 29, 30 32 and 36 and for the establishment of the methods and levels of compensation for the limitation of property rights under article 19 paragraph 5 and article 26 paragraph 7

Article 46

Closing Provisions

The following shall be repealed

1 Act No 79/1957 on the generation, distribution and consumption of electricity (the electrification act)

2 Act No 67/1960 on the production, distribution and use of heating gas (the gas act)

3 Act No 88/1987 on state energy inspection.

4 Act No 89/1987 on the generation, distribution and consumption of heat

5 Government Ruling No 80/1957 which implements Act No 79/1957 on the generation, distribution and consumption of electricity (the electrification act)

6 Decree No 9/1958 of the Ministry of Energy which implements some provisions of Act No 79/1957

7 Decree No 10/1958 of the Ministry of Energy on individual conditions for the connection of electricity-consuming equipment to equipment for public distribution of electricity

8 Decree No 137/1958 of the Ministry of Energy and W

ter Management, on conditions of contact of energy works with roads, lines of all types water, water management works and equipment

9 Decree No 153/1961 of the Ministry of Fuels and Energy on the modification of the width of protective zones of high-voltage electricity lines

10 Decree No 140/1978 of the Federal Ministry of Fuels and Energy, on the supply of electricity to inhabitants

11 Decree No 140/1979 of the Federal Ministry of Fuels and Energy, on the supply of gas to inhabitants

12 Decree No 175/1975 of the Federal Ministry of Fuels and Energy, which implements some provisions of the gas act, as amended by Decree No 18/1986

13 Decree No 92/1987 of the Federal Ministry of Fuels and Energy, which implements the act on state energy inspection

Article 47

Effect

This Act shall go into effect on 1 January 1995

MEMORANDUM

TO. Dana Zelinkova

FROM: Catherine Connors, ~~cc: John Gulliver.~~ Howard Menaker,
Jacque DeRosa, Jan Pisko, Ken Hobbs

DATE. June 20, 1996

Following up on our telephone conversations this morning, please find attached the latest versions of the cover memos to Mr Antos, et al and the memorandum summarizing our proposed amendments to the Energy Act. You will see that I have incorporated all your comments, and that we have discussed most of the changes reflected in the red-line portions of the attachments. Most of these changes are meant to be nonsubstantive and intended to clarify the English version of our comments.

There are, however, a few minor changes which we did not discuss, because they are based on comments I received after our conversation from Ken Hobbs and Jan Pisko. The changes made to reflect Mr Hobbs' comments are basically reflected in the preamble bullets. The changes made to reflect Mr Pisko's comments are found in my transfer of the central dispatch point to Section B to highlight the importance of that issue.

Please give me a call to tell me whether we can now sign off finally on this version and have it translated. By carbon copy of this fax, you can see that I am sending it to everyone else also for their final comments. If anyone else has any further changes, I would appreciate it if they could communicate them to me as soon as possible.

Again, thanks for all your prompt and thoughtful work.

LIT 68111 1 DOC

PROPOSED AMENDMENTS TO THE ENERGY ACT NO. 222/1994

Presented below is a list of specific proposed amendments to the Energy Act No 222/1994 Coll (the Act). The proposals fall within three major categories (definition of the regulator, creation of the energy market, and the substantive and procedural development of existing provisions in the Act). Each and every proposal, however, is guided by common objectives fundamental to the development of a successful energy sector:

- creation of an efficient energy structure,
- minimization of cost to customers and all sector participants, through competition where appropriate and effective regulation where needed,
- provision of reasonable return on investment,
- assurance of safety and reliability of energy supply,
- encouragement of sustained economic growth, and
- development of a regulatory framework that combines the flexibility needed to adapt to an evolving market with the clear substance required to limit administrative discretion and provide predictability to market participants

A *The Regulator nature, powers and jurisdiction*

1 ISSUE Independence

DISCUSSION Currently the Act bestows regulatory authority on two bodies, the Ministry of Industry and Trade ("MOIT") and the Ministry of Finance ("MOF"). As non-independent regulators within government ministries, they are potentially subject to fluctuating political influences. To provide stability and ensure that decisionmaking is based on predictable economic and technological factors, changes should be made in the Act to increase the independence of the regulatory body.

RECOMMENDED ACTION Amend the Act to separate the regulatory body from the government ministries to the extent possible, e.g., create an independent regulatory board. Bestow upon that board the general power to regulate within the sector, instead of limiting its ability to issue decrees within limited, prescribed areas. Provide an independent budget for the board, based upon license fees, fines and other income separate from the general state budget.

2 ISSUE Unification of authority

DISCUSSION Currently control over pricing rests with the MOF, while other regulatory responsibility over participants in the energy sector, such as licensing, rests with the MOIT. While the MOIT is the sole entity authorized to recommend pricing decisions, this ultimately divided regulatory scheme can result in inconsistent rulings and a cumbersome regulatory procedure. For example, if the MOIT rules that a licensee must make certain investments to ensure safety or efficiency, it does not make sense to have a separate regulatory body set prices which determine whether the licensee can recover the costs of those investments, ~~in its rates~~

RECOMMENDED ACTION Consolidate all regulatory responsibilities, pricing, licensing and other supervisory control, into one regulatory body, preferably related to the MOIT. Clarify and streamline this regulatory body's relationship with inspectorates

B *The Market creation of a competitive energy structure*

3 ISSUE Development of market

DISCUSSION Currently there are multiple distribution companies, multiple generating companies, and one transmission company, CEZ. ~~There is no~~ The absence of a legal duty to wheel power under this existing structure this factor affects both the wholesale and retail markets, price and supply of energy, and decreases competition, to the potential detriment of an increasing efficiency and lowering of prices-

RECOMMENDED ACTION Amend the Act to provide for and set out principles of

(a) wholesale wheeling obligations--requiring the transmission company to wheel power at regulated prices

~~(b) contracting duty for energy supply. Namely (i) the parameters of such contracts (price determination, definition of the parties, time of contracting), (ii) the technical, economic feasibility as liberation test from the duty, (iii) legal regime and remedies and sanctions for breach of contractual obligations~~

(be) direct access and ~~contracting~~ with the generators for specific categories of customer (e.g. large industrial customers)

(c) definition of central dispatch and dispatch regimes, identifying their roles and setting out principles and methods to prevent discrimination

(d) Contractual duties for energy supply. Currently the law provides for some contracting duties, but is unclear when the "infeasibility" of entering the contractual relationship removes the duty. This issue not only needs to be clarified, but these contracts and duties need to be set in a proper competitive market context, by

(i) identifying who must or can enter contracts with each other, for direct and indirect sales, given expanded direct access and wheeling, (ii) clarifying when infeasibility releases a party from contractual duties, (iii) establishing the legal framework to enforce these duties, including sanctions and remedies, and (iv) establishing a mechanism for the regulatory body to set contractual terms when the parties do not agree.

(ed) self generation and sell-off conditions, rights and conditions

~~(e) pricing in the See~~

4 **ISSUE** Expansion of the regulation to meet a competitive market

DISCUSSION If, as recommended, the current structure of the sector, with one single buyer, changes to allow competition, regulation will be needed for all participants in the sector, including power brokers and/or marketers. Even in the absence of legislation requiring CEZ to wheel, entrepreneurs have been attempting to evade CEZ's market control by direct sales over the border over distribution lines. The Act needs to give the regulatory body the power to regulate all entities engaged in generating, selling, transmitting, importing/exporting and distributing power within the country.

RECOMMENDED ACTION Amend the Act to authorize the regulatory body to license power marketer/brokers, regulate import and export of power, and, if it chooses, to license all other participants in the energy sector.

C *Existing regulation substance, process and gap-filling*

5 **ISSUE** Clarification of regulatory standards

DISCUSSION Currently the Act does not include substantive standards to guide and limit the discretion of the regulator. For example, the Act gives only the most general guidance to the MOIT as to when a license should be awarded. Lack of clear standards can lead to arbitrary and unpredictable decisionmaking.

RECOMMENDED ACTION Amend the Act to include

(a) substantive standards for award of generation and distribution licenses -- what criteria are applied to demonstrate fulfillment of the public interest (e.g., EU compatibility, increase in capacity/import, least cost

principles, social and environmental factors, compatibility with other business activities), in what priority

- (b) substantive standards for authorizing new investment
- (c) substantive standards for import/export and marketers/brokers licenses
- (d) pricing principles, such as recoupment of costs plus a reasonable profit, using competition as opposed to imposed prices where feasible, and limitation of cross-subsidization to the extent possible

~~(e) definition of central dispatch and dispatch regimes, set out the principles and methods which would prevent discriminatory decisions being made by the dispatches as a result of imbalance of powers within them~~

- (ef) a clear, efficient, transparent process for reviewing a license application -- e.g., who should be consulted (municipalities, environmental authorities) and how, when and whether public hearings should be held, and procedures

6 ISSUE LICENSE REGIME

DISCUSSION Currently the Act does not provide the Regulator with sufficient tools to adjust to changing circumstances confronting existing licensees, including existing licence and position of its licence holders to particular circumstances which might occur during their operation, mainly in connection with the default of the licensee holder or termination of its license

RECOMMENDED ACTION Amend the Act to empower the Regulator to

- (a) suspend already awarded licenses
- (b) order forced management in limited circumstances
- (c) request continuance of provision of licensed activities unless a satisfactory substitution is found
- (d) change, alter and modify conditions of license

7 ISSUE Filling gaps in regulation

DISCUSSION Inevitably, the initial version of the Act left certain regulatory gaps that need to be addressed and clarified

RECOMMENDED ACTION

- (a) Amend the Act to clarify the authorized representative's position vis-a-vis the licensee and regulator and ensure that the licensee has an authorized representative at all times
- (b) Clarify and specify the extent and conditions for third party property access, the obligations of owners and occupiers and compensation rules
- ~~(b) Clarify and specify the extent and conditions for third party property access, the obligations of owners and occupiers and compensation rules~~
- (c) Expressly state that the inspectorates have power to monitor control and impose sanctions for breach of conditions of license and that the MOIT may revoke the licence for material breach of these conditions
- ~~(d) Clarify legal processes, including the procedure, appeal rights, whether appeals suspend rights, their suspensive effect, time limits for decisionmaking and when and where decisions, public hearings should be held, etc~~

M E M O R A N D U M

TO: Josef Antos, Zbynek Fousek, Vít Sponer, Josef Snítily

CC: Jan Pisko (U S AID Prague)

FROM: U S AID Team (Bechtel, Arthur Andersen, Pierce Atwood, Glatzova & Co , Petr Vanek)

RE: Proposed Amendments to Act 222

DATE: June 19, 1996

Pursuant to our meetings last week, attached please find a memorandum that describes the major changes we would propose for Act 222. Consistent with our discussions of last week, this memorandum intentionally describes the changes in summary style and does not propose specific legislative language. If and when you wish specific legislative drafts, we will be happy to furnish them. Our sense, though, is that it is premature to do so at this stage, while Ministry and Government decisions as to the scope of proposed amendments to Act 222 are still being discussed and analyzed.

The memo focuses on substantive issues and does not deal with more technical issues. The latter can be added as appropriate when the process moves forward.

The memorandum deals essentially with three types of changes: (a) those that clarify the role of and give substance, independence and authority to the regulator (for example, consolidating regulatory authority in one Ministry or agency, authorizing the regulator to adopt decrees to implement the standards enumerated under the Act), (b) new specific rights and

June 19, 1996
Page 2

responsibilities (for example, specifically granting third-party transmission access rights to large industrial consumers), and (c) gap filling the existing regulations. While we recommend that each set of changes be adopted, it is our experience that regulatory systems which have clear lines of regulatory authority, with defined, substantive standards, and opportunities for review and appeal have less need for laws that create specific rights, since the regulatory process itself generally results in the creation of the necessary specific rights and responsibilities, on the other hand, regulatory systems that do not create such clear standards for the regulator have an even greater need for laws which specifically mandate certain rights, such as third-party access and wheeling. You may wish to consider this balance as you review our suggestions.

We recognize that the ultimate decision as to which amendments to recommend lies with you and that you may wish to modify, alter, amend or delete certain of the ideas that we have set forth in the memorandum. That is fully your choice, and we respect that. However, we felt it important to suggest the most important amendments that we believe are advisable.

We look forward to your comments and suggestions. We will be happy to follow up with a revised memorandum after hearing from you. Please feel free to communicate through Jan Pisko of U S AID, Prague, or Vit Horacek, at Glatzova & Co. Either will get in touch with the rest of us.

PROPOSED AMENDMENTS TO ACT 222 TO INCLUDE IN THE PARLIAMENTARY PLAN

Presented below is a list of specific proposed amendments to Act 222. The proposals fall within three major categories (definition of the regulator, creation of the energy market, and the substantive and procedural development of existing provisions in the Act). Each and every proposal, however, is guided by common objectives fundamental to the development of a successful energy sector:

- creation of an efficient energy structure,
- minimization of cost, through competition where appropriate and effective regulation where needed,
- provision of reasonable return on investment,
- assurance of safety and reliability of energy supply,
- encouragement of sustained economic growth, and
- development of a regulatory framework that combines the flexibility needed to adapt to an evolving market with the clear substance required to limit administrative discretion and provide predictability to market participants

A The Regulator nature, powers and jurisdiction

1 ISSUE Independence

DISCUSSION Currently the Act grants regulatory authority on two bodies, the Ministry of Industry and Trade (“MOIT”) and the Ministry of Finance (“MOF”). As non-independent regulators within government ministries, they are potentially subject to fluctuating political influences. To provide stability and ensure that decisionmaking is based on predictable and technological factors, changes should be made in the Act to increase the independence of the regulatory body.

RECOMMENDED ACTION Amend the Act to separate the regulatory body from the government ministry to the extent possible, e.g., create an independent regulatory board. Grant that board the general power to regulate within the sector, instead of limiting its ability to issue decrees within limited, prescribed areas. Provide an

independent budget for the board, based upon license fees, fines and other income separate from the general state budget

2 **ISSUE** Unification of authority

DISCUSSION Currently control over pricing rests with the MOF, while other regulatory responsibility over participants in the energy sector, such as licensing, rests with the MOIT. While the MOIT is the sole entity authorized to recommend pricing decisions, this ultimately divided regulatory scheme can result in inconsistent rulings and cumbersome regulatory procedures. For example, if the MOIT rules that a licensee must make certain investments to ensure safety or efficiency, or to serve new load, it does not make sense to have a separate regulatory body determine whether the licensee can recover the costs of those investments in its rates.

RECOMMENDED ACTION Consolidate all regulatory responsibilities, pricing, licensing and other supervisory control, into one regulatory body, preferably related to the MOIT. Clarify and streamline this regulatory body's relationship with inspectorates.

B The Market creation of a competitive energy structure

3 **ISSUE** Development of a wholesale market

DISCUSSION Currently there are multiple distribution companies, multiple generating companies, one transmission company, CEZ, and one dominant generator, also CEZ. Because CEZ has no legal duty to wheel power, it is basically the single buyer of generation in the country, single seller, controls the market and defeats competition at the wholesale level.

RECOMMENDED ACTION CEZ's monopoly power can be addressed in one of two ways: (a) regulation or (b) deregulated competition. If route (a) is chosen, the Act should be amended either to require CEZ to wheel power at regulated prices, to regulate the price at which CEZ sells power to the distribution companies, or both. If route (b) is chosen, CEZ's monopoly power must be eliminated by breaking up CEZ into separate entities (transmission company, generation companies).

4 **ISSUE** Expansion of regulation to meet a competitive market

DISCUSSION If, as recommended, the current structure of the sector, with one single wholesale buyer/seller, changes to allow competition, regulation will be needed for all participants in the sector, including power brokers and/or marketers. Even in the absence of legislation requiring CEZ to wheel, entrepreneurs have been attempting to evade CEZ's market control by direct sales over the border over distribution lines. The Act needs to give the regulatory body the power to regulate all

entities engaged in generating, selling, transmitting, and distributing power within the country in order to assure safety and stability of supply

RECOMMENDED ACTION Amend the Act to authorize the regulatory body to license power marketer/brokers, regulate import and export of power, and, if it chooses, to license all other participants in the energy sector

C *Existing regulation substance, process and gap-filling*

5 **ISSUE** Clarification of regulatory standards

DISCUSSION Currently the Act does not include substantive standards to guide and limit the discretion of the regulator. For example, the Act gives only the most general guidance to the MOIT as to when a license should be awarded. Lack of clear standards can lead to arbitrary and unpredictable decisionmaking.

RECOMMENDED ACTION Amend the Act to include

- (a) substantive standards for award of generation and distribution licenses -- what criteria are applied to demonstrate fulfillment of the public interest (e.g., EU compatibility, increase in capacity/import, least cost principles, social and environmental factors), and in what priority
- (b) substantive standards for authorizing new investment
- (c) substantive standards for import/export licenses
- (d) pricing principles, such as recovery of costs plus a reasonable profit, using competition as opposed to imposed prices where feasible, and limitation of cross-subsidization to the extent possible, and a clear definition of regulated and non-regulated activities
- (e) definition of central dispatch and dispatch regimes
- (f) a clear, efficient, transparent process for reviewing a license application -- e.g., who should be consulted (municipalities, environmental authorities) and how, when and whether public hearings should be held, and appeal rights and procedures

6 **ISSUE** Filling gaps in regulation

DISCUSSION Inevitably, the initial version of the Act left certain regulatory gaps that need to be addressed. For example, the role of the authorized representative should be clarified.

RECOMMENDED ACTION

- (a) Amend the Act to clarify the authorized representative's position vis-a-vis the licensee and regulator and ensure that the licensee has an authorized representative at all times

- (b) Clarify the legal parameters of contracts among participants in the sector and establish a process for dispute resolution

M E M O R A N D U M

FROM: USAID Team (Bechtel, Pierce Atwood, Glatzova & Co ,
Petr Vanek)

RE: Summary of Recommended Amendments to the Energy
Act No 222/1994 Coll

DATE: 18 October 1996

CZECH REPUBLIC

**SUMMARY OF RECOMMENDED CHANGES
TO ENERGY ACT 222/1994 Coll**

As one would expect with any major change in a regulatory framework, experience under Act 222 indicates that amendments could be made to the Act that would respond to issues arising under the new regulatory regime. Issues with the present law generally pertain to four areas

- A Limitations regarding the scope of the Act, including a present inability to regulate imports and exports and other commercial transactions by energy sector participants,
- B The need for more accurate and fair pricing regulations,
- C The need for more stringent oversight of licensees, and

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- D Division of regulatory functions among several departments, without clearly defined authority, including the authority to conform the sector to emerging European Union standards, as appropriate

In order to address these problems, we recommend that the following amendments be made to Act 222. We recognize that changes flowing from the issues identified in Sections A, B, and C, above, tend to be more in the nature of clarifying and conforming changes within the context of the present law. Changes associated with the issues identified in Section D more substantially restructure the present regulatory status and may be more appropriate for later legislative action.

After the appropriate parties review and approve of these recommended areas of change, the USAID team would be happy to draft specific legislative text for further consideration.

A Clarify the Scope of the Act and the Activities Regulated by the Act

1. The Act should include power marketers within its scope and should provide for the licensing and regulation of such marketers and brokers. The Act should also provide for regulatory oversight of energy sector imports and exports. In addition to provisions specifically addressing imports, exports, and power marketers, Article 2 should be amended to include "sales" (of energy, transmission, and distribution services), and Article 3 should provide for licensing of persons who "sell" (as well as produce and distribute) electricity, gas, or heat.

2 Generally, Article 2 should be amended to define clearly “production,” “transmission,” and “distribution,” as well as sales

3 The definition of “customer” in Article 9 (3) is vague and should be revised to make clear with whom license holders are obliged to contract There should be a general distinction made in the Act between (1) customers who purchase energy for resale, (2) large commercial or industrial customers with the capability to provide their own power or maintain the efficiency of their electrical equipment, and (3) individual residential and small commercial customers The Act presently contains various obligations between all customers and energy suppliers that should not necessarily apply to all types of customers

4 Article 11 should be amended to define “competition” and the role of “central economic dispatching” in competition, so as to assist the regulatory agency in developing rules governing the operation of the central dispatching facility

5 Because one of the goals of the Act is to promote competition, there should be certain protections included to protect competitive advantages and to prevent disclosure of private business information to competitors Therefore, the Act should provide that the regulatory body may limit the dissemination of confidential data provided by sector participants

6 The permissible contractual relationships between licensees and customers should be clarified, including the duty to contract, the circumstances that excuse the duty to contract, and fundamental terms such as price and enforcement mechanisms

B Develop Effective and Fair Pricing Guidelines

1 Provide guidance in the Act on the criteria the regulatory body should use in developing marginal-cost-based, least-cost, and nondiscriminatory pricing. This guidance should allow the regulatory body to develop prices that treat both regulated entities (generation and distribution facilities) and nonregulated entities in a nondiscriminatory fashion with regard to their respective abilities to enter into long-term contracts and make spot market sales. Each licensee should be required to establish uniform prices for each customer class and to develop pricing methods that encourage reductions in peak usage (“top offtakes”)

2 The regulations should also require that energy prices are not based on, nor subsidize, the costs of unregulated activities. Thus, companies should separately account for the costs and revenues of particular business activities, regulated and nonregulated. In addition, to facilitate the determination of correct prices, the Act should impose a duty on the license holder to account separately for costs and expenses related to individual regulated activities (e.g., production,

transport, and distribution) Such price “unbundling” will send correct price signals to consumers, encourage competition where possible, and ultimately, lower prices

3 Price regulations should be limited to rate design and rate methodology. Prices should be determined in accordance with these regulations and should reflect actual costs of the regulated business and not be based on social aspects

C Enact Additional Requirements for Obtaining a License, and Provide a Method to Monitor Compliance

1 Certain licensing standards in the Act should be clarified. For example, the criteria relating to financial and technical requirements and the public interest standard should be more specifically defined. Also, the financing requirements should set forth financial capability standards required of licensees to ensure their ability to perform the licensing conditions and obligations

2 Article 3 should be amended to acknowledge that the license may be subject to other applicable trade and licensing laws

3 Article 4 should be amended to include a determination by one or more experts in the field that the proposed licensee has the appropriate professional qualifications. The regulatory body should have the authority to employ such experts

4 Provisions should be added to Article 4 to establish the clear liability of the licensee for the safe operation of the licensed facility and its continuing duty to observe the conditions of the license, and Article 10 should be amended to make clear that “public service” includes performance of the conditions of the license

5 Article 5 should be amended to clarify that the license holder remains responsible, together with the “authorized representative,” for performance of the licensed activities. In fact, the role of the authorized representative in the operation of the licensed facility should be more precisely defined. For example, the authorized representative should be responsible for filing all necessary documents with the regulatory body

6 The Act should expressly provide the regulatory body with the ability to deal with license defaults and terminations and to modify the terms of the license

7 The procedures to be followed by license applicants or persons affected by a decree of the regulatory agency should be set forth in detail. For example, the present Act does not contain provisions for hearings or appeals

8 The State Energy Inspectorate’s powers in Part III of the Act should be more definitely described. As presently structured, the Act does not circumscribe the Inspectorate’s authority, stating only that the Inspectorate “may inspect” whether persons comply with the Act. Such broad language could be interpreted as allowing the Inspectorate inappropriate access to licensees or customers

D Consolidate Regulatory Functions Under One Department with Broad Powers

1 The regulatory functions over the sector now divided among the multiple Ministries, e.g., the Ministry of Finance and Ministry of Industry & Trade, should be consolidated into one independent regulatory body with broad powers to regulate the entire energy sector. This body should have the power to issue rules and regulations, and its budget should be independent of the general governmental budget, sustained by assessments imposed on participants in the sector (e.g., licensing fees)

2 Provisions should be added to the Act to allow the central regulator to provide and control access to the transmission grid and to conform to emerging European Union standards, as appropriate. Wheeling provisions should be included to require CEZ to wheel power at regulated rates, to allow direct transmission access by certain large customers, and to provide for self-generation

MEMORANDUM

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TO Vit Horáček
FROM John Gulliver and Cathy Connors
RE Revisions to Act 222
DATE March 31, 1997

Pursuant to our telephone conversations, the following are our questions and comments on your draft amendments to Act No 222/1994 Coll. As we discussed, the proposed amendments are excellent, and our comments are only suggestions for your further consideration. We look forward to talking to you Tuesday, April 1 at 11 am our time (6 pm your time)

ARTICLE 2 (Scope of Regulated Business)

1 Definitions

- We agree that transmission and distribution should be separated as you have done
- We agree with your definition of trade, except that, as we read it, it could include CEZ (or, if the system is changed, the Central Distributor or "CD") CEZ buys electricity and sells it to distributors. Does that mean it needs a trading license?

2 Scope of Business Activities

- We agree that trade should be included. Please make sure that this change is carried out throughout the entire text of the Act (e.g. Sections 5(1), 9(8) and (10))

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3 Additional Amendments

- This may be the appropriate place to exempt regulation of small plant We recommend focusing on size, rather than monetary value (see your Article 22a) A policy choice must then be made about the exemption size - 20 MW? 50 MW? A gas storage or distribution facility less than x Mcf or pressure levels less than 2.5 Mpa? An electricity distributor with equipment at x kV? A decision must also be made whether to include self-generating plant at all (or at least whether to limit regulation of self-generation plants to a larger size than plants attached to the grid) Do we need a definition for a self-generator (e.g., what percentage of power produced by the self-generator must be used by that owner, or, alternatively, not transmitted onto the grid, in order to maintain self-generation status?)
- Another relevant exemption to be included in the appropriate place is elimination of the need for a distribution license for pass-through of electricity at the same place of consumption (e.g., landlords who supply their tenants with electricity IPPs into supply electricity "within the fence")

ARTICLE 3 (Licensing)

1 Your Article 3(1)

- We discussed whether all licensees should be obligated to undertake business, and agreed that at least trade should be exempted
- If you add to the end of your sentence something like "on such conditions as the Ministry shall establish pursuant to Article 7," this makes clear that the Ministry has the power to impose conditions in licenses As we discussed, this power is critical

2 Your Article 3(2)

- Again, it seems to us that trading is sufficiently different from the other authorizations that a shorter license period makes sense

3 Your Article 3(3)

- We discussed whether authorizations should be non-transferable, or just need Ministry approval to be transferred We leave the choice to you

ARTICLE 4 (Conditions For Granting A License)

1 Financial, Technical and Material Prerequisites

- You made no specific change but indicated that financial, technical and material prerequisites should be provided for in greater detail. We discussed whether any specifics on, for example, financial prerequisites should go into the Act itself, and you indicated that Mr. Kacvinsky showed an interest in developing a financial prerequisite based on capitalization ratios.
- We agree that these details should go into secondary legislation or regulation, and not the Act itself. Some financial tests used in U.S. law generally include meeting two of the following three ratios: a ratio of total liabilities to net worth less than 2.0, a ratio of the sum of net income plus depreciation, depletion, and amortization to total liabilities greater than 0.1, and a ratio of current assets to current liabilities greater than 1.5. Other financial tests can include net working capital and tangible net worth at some specified multiple of identified annual operation costs, a tangible net worth of at least \$X depending on the size of the project, assets located in the US amounting to at least 90% of total assets or at least some specified multiple of identified annual operation costs, and a current rating for the applicant's most recent bond issuance of AAA, AA, A or BBB as issued by Standard and Poor's or Aaa, Aa, A or Baa as issued by Moody's. Similar criteria with appropriate modifications could be adopted for projects in the Czech Republic.

2 Expansion of Public Interest Reference

- Add to Article 4(7) "The public interest shall be taken into consideration during the decision-making on the granting of a license and the Ministry may deny a license if it finds that the license is not in the public interest."
- Add a new Article 4(8) "For the purposes of this Act, the term 'public interest' shall mean safe, reliable and adequate service at prices that are fair and reasonable to customers and license holders, taking into account safety, health and environmental consequences."

ARTICLE 7 (Conditions For Granting A License)

1 Service Territories

- Your commentary on service territories has suffered somewhat in the translation. We assume you are discussing the advantages and disadvantages of exclusive service territories for distributors (not transmission, as the translation indicates). If so, we have already discussed that it is Mr. Kacvinsky's preference to make service territories exclusive. We should communicate to him the potential future difficulties of awarding long-term exclusive territories. Some competition for some portions of the market will be required under the EU Directive, and the longer the license terms and the more unconditional the exclusivity of the service territory, the greater the stranded cost problem in the future, should the sector be restructured to allow competition.

3 Your Additional Provisions on Change of Authorization

- We agree with your new Article 7(a)(1), imposing reporting obligations. The translation of your new Article 7(a)(2) is somewhat unclear. It appears that it simply leaves discretion in the Ministry to do nothing, modify the license or withdraw the license, based on the new reported information. If this conclusion is correct, then we agree with the addition. The Standards for Ministry action should be specified.
- Your new Article 7(a)(3), allowing the Ministry to modify an authorization at any time could be viewed as too broad by investors. Some limiting language may be appropriate, e.g., "The Ministry may, after hearing if requested by the license holder, modify the conditions of a license at any time, consistent with paragraph 3."

3 Additional Amendments

- We suggest adding the following to Article 7(3): "If, after hearing if requested by the applicant, the Ministry determines that granting a license is in the public interest, [a] decision on the granting of a license
- Add as Article 7(3)(f): "Such other terms and conditions relating to ownership and control of licensed facilities, financial and technical qualifications, periodic reporting obligations or any other requirements that the Ministry finds necessary in the public interest."

- Add as Article 7(4) "Upon application, the Ministry may extend the initial term of a license for a period not to exceed five years. Subsequent requests for extension will be treated as an application for new license under Articles 6 and 7"

ARTICLE 8 (Termination Of A License)

- We agree with your division into two categories of situations where termination is discretionary, and where termination is mandatory. Just as the ability to modify a license should not be too vague or broad, so also should these provisions be clear and limited, in order to provide some assurance to investors. For example, your Article 8(2)(a) could be viewed as too broad - how long must activities have ceased to mandate withdrawal? Can even a minor breach of the conditions for license issuance trigger this requirement? Mandatory withdrawals seem appropriate if there is an immediate, serious threat to health, safety, the environment or system reliability and integrity, or if the license holder has engaged in repeated breaches of license terms and/or the law after previous notice. Otherwise, withdrawals should be discretionary. The discretionary withdrawal should also be clear enough to provide notice to the license holder while at the same time preventing withdrawals on the basis of a minor or technical failure to follow the law or obey the license. Hence, the language of your new Article 8(3)(a) or (b) might benefit from further development along these lines.
- A license holder should have the right to a hearing for a withdrawal of its license. If the threat to safety, health, the environment, or the system is immediate and serious, the hearing could take place after the withdrawal.

ARTICLE 9 (Obligations and Rights of A License Holder)

Articles 9(3) and (4)

- You have changed this provision, imposing the duty to serve, by imposing the duty unless it is unfeasible, as opposed to when it is feasible. This change is fine, and, we understand, comports with Mr. Kacvinsky's desires. He should, however, be aware of the implications that the duty to serve can have when calculating stranded costs should competition be introduced into the sector in the future.
- You have imposed the duty on the transmitter in Article 9(3) to enter contracts with generators and traders. You have not included a duty to serve the distributors. We agree that the transmitter should be obligated to contract with

generators and traders in order to allow third-party access. Shouldn't the transmitter also have a similar obligation to enter into contracts with the distributors paralleling the obligation to serve the customers imposed on the distributors in Article 9(4)? The distributors will buy their power from the Central Distributor ("CD"). But the transmitter (also Central Energy Dispatching or "CED") will transmit the power the distributors purchase over its wires. Do you anticipate this relationship to be governed by contract?

ARTICLE 11 (State Regulation)

- You have re-phrased the definition in Article 11(2) in terms of investments, operations, and pricing. Why investment as opposed to construction?

ARTICLE 14 (Adding CD and CED Provisions)

- You have eliminated existing Article 14 (replacing it with your new Article 11(4)), and have added new provisions on generation, transmission, trading, distribution, CD, CED and supply. From a structural point of view, we assume that new Article 14 is now the beginning of Part II (on the Electricity Industry) and not the end of Part I. If this is not correct, tell us.
- We will make our comments on the new CD-CED system generally.
 - Again, the Ministry needs to understand that the framework described here is not fully consistent with the EU Directive, because it does not allow eligible customers to contract directly with generators and does not force the single buyer (CD) to sell to the end-user at a price equal to this direct contract price (plus an objective, transparent and non-discriminatory transmission fee).
 - We can nevertheless make some language changes which do comport with EU principles. For example, in the appropriate place, we can state that prices will be published or negotiated and dispatch will be based on objective, transparent and non-discriminatory principals. See the EU Directive memo we are sending to you separately for amplification on the terms required and/or recommended by the Directive.
 - It should be made clear at the appropriate place that the transmitter and the CED is the same entity.

- It is not clear what is happening with self-generation. By eliminating existing Article 15(5) do you intend to allow self-generation? If so, we agree, but, as we note in our comments on Section 2, this point and how self-generation is treated in general, needs to be clarified
- Article 14d(6), going to CD's ability to buy at "the most advantageous prices," needs some clarification. Does this anticipate a pool only? Does it allow for long-term contracting? How long-term?

SECTION 22a (New Installation For Performance Of Authorized Activity)

- See our comments on Section 2 regarding exemption of small plant
- The provisions on new capacity should be made to comport with EU Directive requirements, to the extent possible (See our separate EU memorandum) For example, we should include language indicating that licenses will be granted on the basis of objective, transparent and non-discriminatory criteria, which may related to the fields sets forth in Article 5 of the Directive. Any tender process used by the State will be similarly governed by objective, transparent and non-discriminatory criteria published prior to the tender

OTHER COMMENTS

- The Act should specify, consistent with EU requirements, that (1) the Ministry will issue written decisions explaining the basis of its rulings, and (2) interested parties (such as the applicant or other affected people or entities) have the right to appeal such decisions (perhaps consistent with an existing civil administrative procedure act?)
- Do we need to say anything further about import and export? You define trade to include import and export. Does this make it sufficiently clear that we are talking about cross-border exchanges? Must all purchasers of imported power or sellers of exported power need trade licenses as well as generation licenses? Should we add a provision indicating that the Ministry shall not restrict imports or exports except on the basis of security, to comport with the EU Directive and the Treaty of Rome?

We look forward to discussing these thoughts with you
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M E M O R A N D U M

TO: V Horacek

CC H Menaker, J Pisko, G Weynand

FROM: J Gulliver, C Connors

RE. Amendments to Act 222

DATE: June 4, 1997

This memorandum responds to your letter of May 27, 1997. In that letter, you attached (1) a recent newspaper article, (2) what we understand to be comments from Mr Kacvinsky as proposed amendments to Article 11 of Act 222, and (3) following up on these proposals and meetings in April, your most recent re-write of Act 222 as a whole.

The following are our comments and questions as to your re-write. Please give us a call at your convenience to discuss them. John will be out of the office for the rest of the week and is equally unavailable early next week. Cathy is available this week and Monday of next week, but is unavailable for the rest of next week. Please fax or call to set an appropriate time.

We look forward to hearing from you soon.

COMMENTS

I GENERAL

The following comments are non-specific to any particular provision in the draft amendments, but more generally apply to its structure and contents as a whole.

- *Third Party Access* The newspaper article you sent us indicates that the new energy policy being advanced by the MOIT embraces the concept of negotiated third-party access, based on a model prepared with the help of NERA through a Phare-sponsored program. Under this model, the article states, “customers would be able to select freely any producer and distributor.”

We do not see any express adoption of this model in the version of the proposed amendments you sent us. Although Section 9 seems to require third-party access, Section 7(b) refers to specific exclusive territories for distributors, and Sections 14 through 15 adopt a single purchaser model. The commentary to Section 7 questions whether the exclusivity concept should be retained, referring to potential adjustment of the concept of a single purchaser. The exact meaning of this commentary is somewhat unclear to us, however, and we do not understand whether this version of the draft amendments to Act 222 intends in any way to coordinate with a new model or not.

Right now, as we understand the draft, it adopts a single buyer model, and does not appear to allow any choice for final consumers -- they must buy from the distributor with the exclusive franchise for their territory. Is this a correct interpretation? If so, how does Section 9 work with Section 14 through 15? Should we instead try to coordinate with the model adopted by the MOIT, if the MOIT has in fact adopted a United Kingdom-type of model?

- *The EU Directive* Similarly, we do not see any incorporation of the direct contracting between larger, “eligible” customers and generators required under the EU Directive. Is this a conscious decision? Should we provide for such direct contracting in the draft?
- *Self-generation* It appears to us that, under the draft amendments you sent us, self-generators over 10 MW in size would need licenses, and they could not obtain back-up power absent agreement from the distributor serving its territory (see Section 15(5)). Is this interpretation correct? If so, is it a good idea? Should self-generators have to be licensed? Also, under the proposed language, couldn't the distributors effectively veto self-generation in their territories by refusing to agree to allow back-up connections?
- The discussion of the transmission licensee(s), the CD and CED remains somewhat unclear to us as to how these entities work together. What entity can there be that can hold a transmission license, but not be the CD or CED? Is that meant to be CEZ, so that CEZ will own the line, the CD will act as a single buyer and the CED will order economic dispatch?

- Did we conclude that no need existed to provide in Act 222 for rights to appeal and how they proceed? Also, there is nothing in this draft providing for the right to any kind of a hearing C, C

II SPECIFIC

The following comments apply to specific sections in the draft

- *New Section 1a(b) (definition of generation)* Why did you make the change from the April 4 version? Is "acquisition" too broad a term when referring to gas?
- *New Section 1a(c) (definition of transmission)* This is probably a translation issue, but it is unclear whether the phrase, "for the purposes of delivery to final consumers" modifies everything that goes before it, or "only transport of gas or heat" In any event, why would transmission include any transport to a final consumer -- isn't delivery to a final consumer distribution?
- *New Section 1a(e) (definition of distribution)* This definition looks fine. Our only question is, if there is going to be competition at the generation and distribution level, as indicated in the article, then should we separate distribution from supply? Is distribution -- the transport on the lower voltage wires -- really going to be competitive (we think this unlikely), or, more probably, will competition be limited to supply -- the metering, sales and service of the final consumer? If only supply will be competitive, then do we need to separate distribution and supply in the Act?
- *Section 2 (scope of business activities)* Does new Section 2(1) replace all of Section 2, or only old Section 2(1)? C, C
- *Section 3 (authorization)* With respect to Section 3(2), again, do we need a definition for supply? With respect to Section 3(3), do we want to except self-generation? If so, we need a definition. With respect to Section 3(4), the language in English is garbled -- do you mean to say "up to no more than 10 years"? Also, is old Section 3(3), regarding extensions, intentionally eliminated? If so, do we need to say somewhere whether extensions or renewals of licenses are permitted?
- *Section 4 (conditions of issuance of authorization)* C, C Is the elimination of the concept of public interest intentional? What is meant in the last sentence of the commentary - "The regulator's powers are also extended"?
- *Section 5 (responsible person)* We understand the explanation as to why the concept of appointment is being removed from Section 5(1). But Sections 5(4), 5(6), 5(7) and 5(8) refer to appointment. Do they need to be changed in any way? C, C

- *Section 7 (issuance of authorization)* We have already noted our question regarding Section 7(b) and exclusivity of territories. If we do in fact remove the concept of exclusivity, do we want to remove it with respect to suppliers, not distributors? Shouldn't the transmission licensee also be exclusive -- how could there be more than one transmitter?
- *Section 9 (rights and obligations of a holder of authorization)* Our general questions regarding the role of transmission licensees and third-party access apply to Section 9(3). Does Section 9(3) mean to require third-party access across CEZ's lines? How would that work when Section 14 adopts a single purchaser model?
- *Section 11 (state regulation)* How is the Regulatory Office "independent" (Section 11(1), if it is "established within the jurisdiction of the [MOIT]," with its head "subject" to the MOIT (Section 11(2)))? Can we make the Office more independent by, for example, making its head either a group of people (3-5 in number) and/or fixing their terms, so that they cannot be fired at the will of the Minister? How about giving the Office some budgetary independence from the Ministry? Finally, we are unclear as to what sort of decisionmaking power you intend to give the Office as opposed to the Ministry, for example, can the Office issue decrees? Section 11(9) appears to so indicate, but elsewhere (e.g., Section 11(16), the draft provides that procedural regulations will be issued by the Ministry. What sort of regulations are issued by the Office and what sort are issued by the Ministry?

With respect to Section 11(3), do you want to add, within the meaning of regulation, the concept of enforcement? *yes*

Does "social transfers" in Section 11(5) mean cross-subsidies? Does this raise issues with the EU Directive?

In order to show compliance with the EU Directive, you may want to include in the appropriate place in Section 11 (e.g., an added Section 11(17)) some restriction on the Regulatory Office/Ministry against arbitrary, capricious or discriminatory conduct, in order to ensure that similarly situated entities will be dealt with in a non-discriminatory way, in accordance with the public interest.

- *Section 14a (authorization for transmission)* Instead of the lengthy description in Section 14a(2), can we say that the transmitter (we assume CEZ) shall ensure safe and economical transmission in accordance with instructions of the CED and the rules and regulations of the Regulatory Office? Why is the regulation of the transmitter being left with the Ministry in 14a(4) and not the Regulatory Office or the CED?
- *Section 14b (authorization for trading)* If the single buyer model is being adopted, does a trader sell only to the CD? Again, why are the rules being set by the Ministry and not the Regulatory Office?

- *Section 14c (authorization for distribution)* Does the reference in Section 14(1) to CED really intend to refer to the CD? Again, why are the rules being set by the Ministry and not the Regulatory Office?
- *Section 14d (central distributor)* Do we want to include ownership limitations in Section 15(5)? The subsection currently implies that an entity can generate, trade and distribute, and no ownership limits are included elsewhere in the draft
- *Section 15 (supply of electricity to the consumer)* Does Section 15(2) contemplate a form contract for ordinary residential consumers and distributors? With respect to Section 15(5), we have already commented generally on the issue of self-generation. If it is concluded that self-generators should have to obtain licenses and agreements from distributors, then shouldn't we at least add a provision similar to that contained in Section 9, providing that a distributor must enter into a contract to provide back-up power, except if the distributor can prove that entry into such an agreement is not technically or economically feasible?
- *Section 39 (fines)* Why can't the Regulatory Office impose fines? When the commentary states that the amendment intends to impose penalties "even on the regulatory body, i.e. the Ministry," how is this accomplished in the text? Why is the regulatory body the Ministry and not the Regulatory Office? Do you want to impose monetary penalties on any regulatory body?

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MEMORANDUM

TO JWGulliver
FROM CRConnors
RE Bechtel - Czech - power marketer questions
DATE April 16, 1996

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Following up on our conversations regarding the copy of V Horacek's general memo on non-Energy laws, our receipt of memoranda from Peter Vanek, and our need to go forward on the power marketer issue, we agreed that I would (1) review Act 222, the Energy decrees and other non-Energy laws in our possession, (2) review Horacek's general memo and (3) see if I could make a list of specific questions for Horacek/Vanek on the power marketer issue in an effort to focus our Czech counterparts on the issues relevant for preparing a response to the power marketer question now facing the Ministry

Accordingly, I have completed my review of the laws in our possession, and, listed below are some specific questions designed to trigger responses useful to preparing a response for the MOIT. I have also updated this memorandum to include information provided from the Vanek memoranda we received last Friday

BACKGROUND

The power marketer question we have undertaken to answer has been prompted by ongoing sales at the Czech-Polish border, in which Polish generators are selling power to Czech distributors at the sub-transmission level. Through this mechanism, the generators and distributors are bypassing CEZ, the Czech monopoly transmission company, which currently has no legal duty to allow any wheeling

These cross-border, sub-transmission sales are apparently being facilitated by power marketers/brokers, *i.e.* entities which may or may not actually hold title to the power at any point in time, but which find, arrange, and otherwise advance the sale and derive profit therefrom

MOIT is concerned that these marketer/brokers are either breaking the law by carrying on such activities without licensing or other authorizations or if their activities are not illegal, that this marketer/broker conduct is not regulated and should be

Hence, the threshold legal question we want to pose to our Czech counterparts is whether anything in existing Czech law and regulation, either within or outside the Energy law context, regulates or otherwise relates to such marketing/brokering activities

In listing below the more specific questions designed to obtain information helpful in answering this general threshold legal question, you will note that I have inserted some commentary based on my review of the laws and regulations in our possession. You will also note that I have attached hereto as Appendix 1 a general summary of the law in our possession -- which I used as a starting point in drafting this commentary

QUESTION #1 *Does anything in Act 222 or any Energy decree apply to power marketers/brokers?*

COMMENTARY While the Act purports to cover the activities related to doing business in the energy sector, only actual generation and distribution appear to fall within the Act's definition of doing business. Thus, while all persons doing business in the sector must obtain a license under the Act, the only licenses issued are for production and distribution

Act 222 defines its scope as relating to "conditions for business" in the electricity, gas and heat industries, along with "related rights and obligations" of natural and legal

persons, and state administration (Art 1) The Act then provides that “the subject of business” in the energy sector is electricity, gas or heat production and distribution to natural or legal persons, supplied in the public interest. Distribution is broadly defined, to include transmission, transport, storage, conversion and supply (Art 2)

While the intent of these provisions appears to be broad application, nothing in the Act specifically refers to any activity other than production and distribution and “distribution,” while broadly defined, does not expressly include facilitation of sales as opposed to actual transportation of power.

Thus, while the Act provides that natural or legal persons “may do business in the energy sectors of the Czech Republic, under the conditions set by this Act, only on the basis of a state license” issued by MOIT (Art 3(1)), and again, this language is broad - “do business” -- licensing appears to extend only to the specific “production and distribution” activities defined as the “subject of business” in the energy sector. Decree No 129/1995 of MOIT on licensing provides that state licensing is granted to natural and legal persons allowing them to engage in following activities: generation of electricity, production of gas, generation of heat, and distribution of electricity, gas and heat (Art 1)

Thus, none of the specifically licensed activities appears to include marketing, and marketing appears to fall outside of the licensing decree, the licensing provisions of Act 222, and the definition of covered activities under the Act.

Horacek appears to agree that the Act does not include marketing as an activity that needs to be licensed under the Act (See his memo, p 2) Vanek also appears to agree that the definition of licensed activities governed by the Act is limited to generation and distribution, and no other energy related activity (See Vanek general memorandum, pp 14-

15, stating that “independent business activities, i.e. the purchase of energy and its sale, i.e. the purchase for the purpose of sale are not conditioned by corresponding technical prerequisites, and that they are not linked to the performance of an authorized activity - generation or distribution. This ‘purely’ business activity, in spite of being a key activity in the energy branch, does not fall within authorized activities.”)

No other energy decree in our possession treats marketing

QUESTION #2 *Does any non-Energy law or regulation require power marketers/brokers to be licensed in order to do business (i.e., to facilitate a sale and derive profit therefrom)?*

COMMENTARY Horacek states (p. 2) that, because marketing is not licensed under Act 222, such activity “can be carried out under the Trade License.” Hence, it would appear that the Trade Act applies in some manner. We don’t have a copy of the Trade Act to review this issue. Vanek states in his first, general memorandum (p. 11) that Section 3, paragraph 2, letter 2 of Act N. 455/1991 Coll., the Trades Licensing Act, provides “that the generation and distribution of electric power, gas and heat do not constitute a trade.” Hence, there would appear to be some kind of delineation. If the activity is generation or distribution, is governed by Act 222, if it is not, then it may be a trade. Vanek also states, however (p. 11), that pursuant to Act 222, a licensee “can possess several kinds of state authorization and simultaneously other entrepreneurial licenses under the Trades Licensing Act.” Hence, an Act 222 licensee can also engage in other activities licensing under the Trade Act.

Other potentially applicable non-Energy Czech laws (derived from Horacek’s memo) are listed in Appendix 1, Section II. The Commercial Code is a generic set of legal principles similar to a combined corporation code and codified set of contract laws, and does not treat

the licensing of any specific type of business activity. We do not have a copy of any other non-Energy Czech law or regulation to determine whether it has any applicability.

QUESTION #3 Does any technical standard prohibit these sub-transmission sales?

Act 222 alludes to official technical standards (e.g., §9(2)). Horacek states (p. 6) that the state standards which were enacted as binding before May 15, 1991 became non-binding and simply recommended as of December 31, 1994. The memo does not indicate whether new technical standards have been issued (binding or non-binding) since that date, or whether the old, non-binding standard would affect cross-border, sub-transmission sales.

MOIT is supposed to issue dispatching regulations by decree (Act 222, 13(7)). I don't know whether any such regulations have been issued, if so, whether they prohibit this sort of sub-transmission transferal, and, if so, whether market/brokers could be held liable for such transfers.

QUESTION #4 Does any import/export law or international treaty apply to these across-the-border sales?

Because these are cross-border sales, they might implicate import/export laws or international treaties. I don't see anything Act 222 specifically relating (prohibiting, regulating or otherwise treating) imports or exports. (Vanek appears to agree with this conclusion, stating, in his first, general memorandum (p. 10) "imports and exports of electric power which are not included at all as a business activity in Act No. 222/1994 Coll are entirely outside the conditions of energy supplies.")

Horacek states (p. 8) that there is a Decree (No. 560/1991) "on the conditions for the licensing of the exporting and importing of goods and services which (according to Annex A

to the Decree) apply to electric energy ” Hence, it appears that this Decree is relevant and could regulate the marketer/broker’s activities or provide a legal basis for doing so

Beyond this decree, Horacek (p 8) alludes to a “number of international treaties and bilateral agreements relating to the Energy Sector, ” and states that the Europe Treaty imposes “certain obligations and prescribes[s] specific procedures ” Hence, these treaties and agreements may or may not be relevant

QUESTION #5 Does any law or regulation limit the profit a power marketer/broker can make in facilitating a sale?

We need to examine pricing acts and decrees to determine whether any of them regulates or affects marketer’s sale prices or broker commissions We also need to determine whether any non-Energy law, like the Economic Code (alluded to in the Commercial Code, §761(1)) imposes any parameters on marketer/broker prices

QUESTION #6 Does any competition law or regulation affect power marketer/broker activities?

There are unfair competition provisions in the Commercial Code, there is an Anti-Monopoly Act, a Consumer Protection Act, and an Economic Code, the Civil Code may also regulate some business conduct on a general level Hence, some of the concerns the Ministry has about marketing/broker activities being unregulated may be alleviated by generally applicable limitations on predatory behavior contained in these laws

QUESTION #7 does any bidding requirement affect power marketer/broker transactions?

The draft decree on regulation in our possession provides that there must be a public tender for new generation over 50 mW There is no amplification on this statement, so I don’t know whether this rule applies to permanent installed capacity or imported sales, or regulates generators, distributors and/or any other specifically targeted group I don’t know

the level of cross-border sales occurring, to determine whether any 50 mW threshold is being met

Similarly, there is also a Public Procurement Act. Distributors have at least some public/municipal ownership. I don't know whether any aspect of marketer/broker activities could be affected by this Act. (Sections 281-288 of the Commercial Code discuss tender, but only rules applying if something is sent out to bid. It does not identify what purchases/services must or should be sent out to bid.) Horacek states (p. 5) that purchases by legal entities using money from state or municipal budgets could be regulated by the Public Procurement Act.

Question #8: Do any other laws affect power marketing/brokering?

In his general memo (p. 11), Vanek states that legal documents issued by licensees under Act 222 should meet the requirements "stipulated by Act No. 563/1991 Coll. or by other legal regulations as e.g. Act No. 588/1992 Coll. on the value-added tax." We need to identify these laws to determine their applicability to apparently unlicensed business activity, such as power marketing/brokering.

Vanek also lists various other acts at the end of his general memorandum as used in the preparation of the memo. We need to check those.

SUMMARY OF CZECH LAWS AND DECREES

I ENERGY LAWS AND DECREES

A Act 222

Summary everyone is licensed, even if below 10 mW. Distributors and generators over 50 mW must link with transmission grid based on acts of association. Distributors must supply customers on basis of contracts. Customers can have back up or other connected only by agreement with distributor. Distributors must buy from CHPs and renewable and secondaries, at prices set by regulation. Nothing requires the transmission company to buy from anyone. Enduser prices are set by decree.

draft decree on regulation - public tender for new generation over 50 mW

Scope (Art 1-2)

- “conditions for business” in e,g and h industries along with related rights and obligations” of natural and legal persons, and state admin (Art 1)
- “the subject of business” in the energy sectors is e,g or h production and distribution to natural or legal persons, supplied in the public interest. D means t, transport, storage, conversion and supply (Art 2)

Licenses (Art 3-9)

- natural or legal persons “may do business in the energy sectors of the Czech Republic, under the conditions set by this Act, only on the basis of a state license” issued by MOIT (Art 3(1))
- Licenses are granted for a definite period, minimum 25 years, for e,g or h production or distribution (Art 3(2)) Non-transferable, ask for extension one year before expiration (3(3))
- conditions for license - natural person 21, irreproachability (criminal record), permanent residence in Czech (4(1)), legal person office in Czech, appointment of authorized rep (4(2))
- applicant for license must show that he has the “financial technical and material prerequisites for the performance of licensed activities” and these activities “will not jeopardize” environment (4(3))
- “The public interest shall be taken into consideration during the decisionmaking on the granting of a license” (4(7))
- use “authorized reps” (5)
- contents of license application listed(name, address, scope of business, proposal for approval of authorized rep, financial statements) (6)
- MOIT “shall grant” the license if conditions in Art 4 fulfilled (7(1))

- the grant will id scope of business, area when distribution technical conditions which licensee must comply with, duration, approval of authorized rep (7)
- expires death, removal form Commercial Register, announcement of bankruptcy, expiration, MOIT decision on revocation (8(1))
- shall revoke when holder has “stopped fulfilling the conditions for the granting” of the license, “violates statutes on environmental protection”, “endangers lives, health or property” through breach of obligations set down by the Act licensee requests in license (8(2), (4)) (last situation, licensee has to keep supplying for 6 months after request unless can’t because beyond his control and can’t fix - 8(5))
- may revoke if licensee doesn’t begin performing by deadline in decision granting (8(3))

licensee duties and rights (Art 9-10, 15-18)

- licensee must make sure work requiring professional qualification done by pq (9(1)), equipment meets safety and reliability requirements set by work safety statutes and official technical standards (9(2))
- holder of a distribution license must, if “technically and financially feasible” enter “a contract on the supply of a selected type of energy with every natural or legal person who requests and fulfills the conditions of this Act and is located in the place of performance of licensed activities (9(3))
 - (can curtail power under specific circumstances, 9(4))
 - To be obliged to supply, the customer must have equipment meeting official standards, fulfill the conditions re place, method and date of connection set by supplier, and have consent of the owner of the property (15)(2)
 - distributors k with customers (15(2)), which includes output amount and pattern of consumption, price and method of payment, how to measure amount of electricity consumed Output, amount and pattern not required for low voltage (15(2))
 - customers can have own backup or other source if connected to distributor’s equipment, and can add energy from his own source only if distributor agrees (15(5))
 - decree sets out connection charges, which customer shares (15(8))
- every licensee must develop an incident plan and submit it to MOIT within 3 months of licensing, except generators of e and h 10 mW or below (9(10))
- distributor can enter property (with notice), prune vegetation set up and operate own telecommunication network (9(11), (12))
- beyond the e,g,h supply specified in the license, MOIT can decide in the event of a “pressing need in the public interest” to oblige the licensee to provide public service (10(1-2)) for maximum of six months, with compensation if demonstrable (10(3-4))
- distributor must if “technically feasible” buy e from CHPs in amounts corresponding to the technological requirements of heat generation” & e generated from renewable and secondary sources of e, with cost of connection born by generator and method of connection determined by distributor, with price set by regulation (18(3-4)) (h licensees same duty to buy from CHP or by-product of technological processes but not if increases the price of heat (33(1-2))

regulation (Art 11,13, 15, 45)

- license holders are subject to state reg by MOIT (11(1))
- reg defined as “bringing influence to bear on the execution of licensed activities and new investments in sources and network equipment in accordance with this Act, in such a way as to provide a substitute for a competitive environment (11(2))
- MOIT only body that submits proposals to MOF for price changes [prices see Act No 265/1991 amended by Act No 135/1994]
- MOIT reviews reasonableness of costs incurred by licensees in execution of licensed activities (11(4))
- MOIT employees must maintain confidentiality of information they learn [see Art 17 of Commercial Code] (11(6))
- MOIT establishes procedures for performing regulation by decree (11(7))
- MOIT issues dispatching regulations by decree (13(7))
- MOIT sets detailed supply conditions by decree (15(11)) and decree sets out connection sharing charges (15(8))
- MOIT issues decrees for implementing (1) licensing, (2) regulation, (3) states of emergency, (4) dispatching, (5) distribution, (6-9) unauthorized consumption of e, g, and h, (10) gas supply, (11) heat supply, and (12) heating rules including allocation of costs between buildings and endusers, and for the establishment of the methods and levels of compensation for limitation of property rights (45(6))

Central dispatching (Art 13)

- Central electricity dispatching “manages the electricity network of the Czech Republic” and central gas the gas network (network is defined) (13(5))
- Distributors and licensees operating generating equipment over 50 mW must set up central dispatching facilities on the basis of contracts of association [Civil Code, Act No 509/1991, art 829) and must obey the instructions of the appropriate dispatching facility in compliance with the Act and dispatching regulations (13(8))

State Energy Inspectorate (art 37-44)

- SEI body subordinate to MOIT, with central and regional inspectorates Head appointed and recalled by Minister of MOIT (37)
- SEI inspects whether licensees are complying with Act and regulation, whether customers complying with Act, whether “other natural and legal persons” are complying with protective and safety zones (38)
- can impose fines up to CZK 50 million for “conducting business without a license” and other listed breaches (39)
- administrative rules [see Act No 71/1967 on administrative procedure] apply to fines - executive director decides on appeals from regional, MOI on appeals from executive director (43)

- rights and obligations of SEI set by Act No 88/1987 on state energy inspection, passes to SEI (44)

Decisionmaking

- unless otherwise stated in Act, decisions “regarding the rights and obligations” of natural or legal persons “shall be made according to administrative rules” (45(1))

B Decrees

1 Decree No 129/1995 of MOIT on licensing

- state licensing is granted to natural and legal persons allowing them to engage in following activities generation of e, production of g, generation of h, distribution of e, d of g, d of h (Art 1)
- pre-printed forms for each type of license (Art 2(1)) [attached as Appendices]

2 Decree No 196/1995 of MOIT on supply of e and damages for unauthorized consumption

- sets out the conditions for the supply of e to consuming equipment, method of id and evaluation of power ratings method of calculation of the share of reasonable incurred costs of a supplier related to connection and provision of a requested power rating, and method of calculating damages from unauthorized consumption

3 draft Decrees

- on method and amount of compensation for the limitation of ownership rights to forest land and forest vegetation for overhead e lines and g pipelines
- rules for heating, hot water supply, including allocation of costs to buildings and among final customers
- setting the method of calculation of compensation for reasonably incurred costs of a supplier related to the connection and provision of the supply of heat and the method of calculation of damages incurred by a license holder as a result of unauthorized consumption of heat
- setting the procedure for the performance of state regulation in energy sectors
 - licensees must provide to the MOIT annual drafts of business plans and data reflected in appendices to the decree on costs, revenues, profit, new investment and investments in energy conservation (2(1))
 - if there are any changes in the data after performance of an audit, the change shall be immediately reported to the MOIT (2(2))
 - in co-gen, heat and e monitored separately (2(3))

- more procedural instructions to follow in bulletin of the MOIT r classification and evaluation of the data listed in the appendix to be submitted, including division of data of e and h (2(4))
 - this data will be monitored, assessed and reviewed separately for e, g and h, d at different voltages, g different Mpa (3)
 - the results of the monitoring, assessment and review of the info will be published regularly in the MOIT's bulletin (5)
 - on the basis of the review and assessment of this data, the MOIT shall submit proposals for changes in the regulation of prices of e g and h at least four months before the proposed date of the changes
 - public tender for new generation capacities over 50 mW in the event of a need to ensure an increase in output in generation (7)
- on states of emergency in the gas industry and on dispatching control of the gas network (with regulation as appendix)
 - setting in detail conditions for the supply of gas and the method of calculation of damages incurred by a supplier as a result of unauthorized consumption of gas

4 Decrees we don't have mentioned by Horacek

- No 169/1995 (see H memo 4 4 96, p 1)
- Regulation No 85/1978 on Control and Examination of Gas Facilities
- Regulation No 50/1978 on Professional qualification in Electrical Engineering

II OTHER LAWS

A The Commercial Code (Act No 513/1991 Coll as subsequently amended)(basically the Corporate Code and rules of contract law)

1 business activity (profit purpose at own responsibility) is carried on by entrepreneurs Entrepreneurs are people recorded in the commercial register, people engaged in business activity on the basis of a license to practice a certain trade, people engaged in business activity on the basis of a permit issued under special legislative acts or regulations other than trade authorizations, recorded farmers (§2) [Horacek says in 4 4 96 memo that individuals - entrepreneurs do not have to register in the "Company Register"] [Vanek says -- general memo p 11 -- that licensed persons under Act 222 fall under §2(c) of the Code, which defines an entrepreneur to include "a person engaged in business activity on the basis of an authorization (permit) issued under special legislative acts or regulations different from the provisions governing the issue of a trade authorization"]

2 unless a special law stipulates otherwise, an applicant for registration in the Commercial Register must prove that he has an effective trade or other permit

to engage in the activity which is to be entered in the register as the object of his business activity (§30(1))

3 some contracts are governed by this Code others by the Civil Code, one can opt out of some, not all provisions of this Code in k relations (§261(6), 263)

4 public tender rules are listed at §§281-288

5 re int trade ks (§§729-755) - must duly apply for import/export license, transit license or any other official license required (§731)

B The Civil Code

C Administrative Procedure Law (Law No 71 of 1967) (same as civil procedure?)

D The Trade Act

E The Construction Act

F The Anti-Monopoly Act

G Consumer Protection Act

H Municipalities Act

I Public Procurement Act

J Act on Telecommunication

K Decree No 560 of 1991 on import/export

L The Economic Code (see Commercial Code §761(1))

One Monument
Square
Portland Maine
04101-1110

MEMORANDUM

TO: Vit Horáček, Petr Vanek, Peter Vallert
FROM: John Gulliver, Catherine Connors
RE: Power marketing/broker follow-up
DATE: May 3, 1996

BACKGROUND

The power marketer question we have undertaken to answer has been prompted by ongoing sales at the Czech-Polish border, in which Polish generators are selling power to Czech distributors at the sub-transmission level. Through this mechanism, the generators and distributors are bypassing CEZ, the Czech monopoly transmission company, which currently has no legal duty to allow any wheeling.

These cross-border, sub-transmission sales are apparently being facilitated by power marketers/brokers, *i.e.* entities which may or may not actually hold title to the power at any point in time, but which find, arrange, and otherwise advance the sale and derive profit therefrom.

MOIT is concerned that these marketer/brokers are either breaking the law by carrying on such activities without licensing or other authorizations, or, if their activities are not illegal, that this marketer/broker conduct is not regulated and should be

Hence, the threshold legal question we need answered is whether anything in existing Czech law and regulation either within or outside the energy law context,

regulates or otherwise relates to such marketing/brokering activities. The more specific questions listed below are designed to obtain information helpful in answering this general threshold legal question.

You will note that we have inserted some commentary below these questions. This is to give you some of our thoughts, which are based on your previous memoranda and on our reading of the limited number of laws and regulations in our possession (in English). We thought it would be helpful to include the commentary, so you can correct any misunderstandings we have, and so you know in what our general direction our thinking is going.

QUESTION #1 *Does anything in Act 222 or any Energy decree apply to power marketers/brokers?*

COMMENTARY While the Act purports to cover the activities related to doing business in the energy sector, only actual generation and distribution appear to fall within the Act's definition of doing business. Thus, while all persons doing business in the sector must obtain a license under the Act, the only licenses issued are for production and distribution.

- Act 222 defines its scope as relating to "conditions for business" in the electricity, gas and heat industries, along with "related rights and obligations" of natural and legal persons, and state administration (Art 1). The Act then provides that "the subject of business" in the energy sector is electricity, gas or heat production and distribution to natural or legal persons, supplied in the public interest. Distribution is broadly defined, to include transmission, transport, storage, conversion and supply (Art 2).

While the intent of these provisions appears to be broad application, nothing in the Act specifically refers to any activity other than “production and distribution,” and “distribution,” while broadly defined, does not expressly include facilitation of sales, as opposed to actual transportation of power

Thus, while the Act provides that natural or legal persons “may do business in the energy sectors of the Czech Republic under the conditions set by this Act, only on the basis of a state license” issued by MOIT (Art 3(1)), and, again, this language is broad - “do business” -- licensing appears to extend only to the specific “production and distribution” activities defined as the “subject of business” in the energy sector Decree No 129/1995 of MOIT on licensing provides that state licensing is granted to natural and legal persons allowing them to engage in following activities generation of electricity, production of gas, generation of heat, and distribution of electricity, gas and heat (Art 1)

Thus, none of the specifically licensed activities appears to include marketing, and marketing appears to fall outside of the licensing decree, the licensing provisions of Act 222, and the definition of covered activities under the Act

Vit Horacek appears to agree that the Act does not include marketing as an activity that needs to be licensed under the Act (See his memo, p 2) Petr Vanek also appears to agree that the definition of licensed activities governed by the Act is limited to generation and distribution, and no other energy related activity (See Vanek general memorandum, pp 14-15, stating that “independent business activities, i e the purchase of energy and its sale, i e the purchase for the purpose of sale are not conditioned by

corresponding technical prerequisites, and that they are not linked to the performance of an authorized activity - generation or distribution. This 'purely' business activity, in spite of being a key activity in the energy branch, does not fall within authorized activities")

No other energy decree in our possession treats marketing

QUESTION #2 *Does any non-Energy law or regulation require power marketers/brokers to be licensed in order to do business (i.e. to facilitate a sale and derive profit therefrom)?*

COMMENTARY Vit Horacek states (p 2) that, because marketing is not licensed under Act 222, such activity "can be carried out under the Trade License". Hence, it would appear that the Trade Act applies in some manner. We don't have a copy of the Trade Act to review this issue. Petr Vanek states, in his first, general memorandum (p 11) that Section 3, paragraph 2, letter 2 of Act N 455/1991 Coll., the Trades Licensing Act, provides "that the generation and distribution of electric power, gas and heat do not constitute a trade". Hence, there would appear to be some kind of delineation: if the activity is generation or distribution, it is governed by Act 222, if it is not, then it may be a trade. Petr Vanek also states, however (p 11), that pursuant to Act 222, a licensee "can possess several kinds of state authorization and simultaneously other entrepreneurial licenses under the Trades Licensing Act". Hence, an Act 222 licensee can also engage in other activities licensing under the Trade Act.

Other potentially applicable non-energy Czech laws (derived from Vit Horacek's memo) are listed in Appendix 1. The Commercial Code is a generic set of legal principles similar to a combined corporation code and codified set of contract laws, and

does not treat the licensing of any specific type of business activity We do not have a copy of any other non-energy Czech law or regulation to determine whether it has any applicability

QUESTION #3 *Does any technical standard prohibit these sub-transmission sales?*

Act 222 alludes to official technical standards (e.g., §9(2)) Vít Horacek states (p. 6) that the state standards which were enacted as binding before May 15, 1991 became non-binding and simply recommended as of December 31, 1994 The memo does not indicate whether new technical standards have been issued (binding or non-binding) since that date, or whether the old, non-binding standard would affect cross-border, sub-transmission sales

MOIT is supposed to issue dispatching regulations by decree (Act 222, 13(7)) We don't know whether any such regulations have been issued, if so, whether they prohibit this sort of sub-transmission transferal, and, if so, whether marketer/brokers could be held liable for such transfers

QUESTION #4 *Does any import/export law or international treaty apply to these across-the-border sales?*

- Because these are cross-border sales, they might implicate import/export laws or international treaties We don't see anything in Act 222 specifically relating (prohibiting, regulating or otherwise treating) imports or exports (Petr Vanek appears to agree with this conclusion, stating, in his first, general memorandum (p. 10) "imports and exports of electric power which are not included at all as a business activity in Act No. 222/1994 Coll. are entirely outside the conditions of energy supplies")

Vit Horacek states (p 8) that there is a Decree (No 560/1991) “on the conditions for the licensing of the exporting and importing of goods and services, which (according to Annex A to the Decree) apply to electric energy” Hence, it appears that this Decree is relevant and could regulate the marketer/broker’s activities or provide a legal basis for doing so

Beyond this decree, Vit Horacek (p 8) alludes to a “number of international treaties and bilateral agreements relating to the Energy Sector,” and states that the Europe Treaty imposes “certain obligations and prescribes[s] specific procedures” Hence, these treaties and agreements may or may not be relevant

QUESTION #5 Does any law or regulation limit the profit a power marketer/broker can make in facilitating a sale?

We need to examine pricing acts and decrees to determine whether any of them regulates or affects marketer’s sale prices or broker commissions We also need to determine whether any non-energy law, like the Economic Code (alluded to in the Commercial Code, §761(1)) imposes any parameters on marketer/broker prices

QUESTION #6 Does any competition law or regulation affect power marketer/broker activities?

There are unfair competition provisions in the Commercial Code, there is an Anti-Monopoly Act, a Consumer Protection Act, and an Economic Code, the Civil Code may also regulate some business conduct on a general level Hence, some of the concerns the Ministry has about marketing/broker activities being unregulated may be alleviated by generally applicable limitations on predatory behavior contained in these laws

QUESTION #7 *does any bidding requirement affect power marketer/broker transactions?*

The draft decree on regulation in our possession provides that there must be a public tender for new generation over 50 mW. There is no amplification on this statement, so we don't know whether this rule (if in effect) applies to permanent installed capacity or imported sales, or regulates generators, distributors and/or any other specifically targeted group. We don't know the level of cross-border sales occurring, to determine whether any 50 mW threshold is being met.

Similarly, there is also a Public Procurement Act. Distributors have at least some public/municipal ownership. We don't know whether any aspect of marketer/broker activities could be affected by this Act (Sections 281-288 of the Commercial Code discuss tender, but only rules applying if something is sent out to bid, it does not identify what purchases/services must or should be sent out to bid). Vit Horacek states (p. 5) that purchases by legal entities using money from state or municipal budgets could be regulated by the Public Procurement Act.

Question #8 Do any other laws affect power marketing/brokering?

In his general memo (p. 11), Petr Vanek states that legal documents issued by licensees under Act 222 should meet the requirements "stipulated by Act No. 563/1991 Coll. or by other legal regulations as e.g. Act No. 588/1992 Coll. on the value-added tax." We need to identify these laws to determine their applicability to apparently unlicensed business activity, such as power marketing/brokering.

Petr Vanek also lists various other acts at the end of his general memorandum as used in the preparation of the memo. We need to review those.

MEMORANDUM

One Monument
Square
Portland Maine
04101 1110

TO Mr Tvrznik, Mr Antos

FROM John Gulliver, Catherine Connors, Vit Horacek, Petr Vanek, Peter Vallert

CC: Jacque De Rosa, Jan Pisko, Howard Menaker and Floyd Davis

RE: Power marketer/brokers

DATE May 15, 1996

QUESTION PRESENTED

What regulations, if any, apply or should apply to power marketers and/or brokers doing business in the Czech Republic?

SUMMARY OF CONCLUSIONS

- 1 Currently, no laws or rules substantively and directly regulate power marketer/broker activities. The Ministry of Industry and Trade ("MOIT") may or may not have the authority to regulate such activities indirectly should it choose to enact new regulation.
- 2 MOIT can choose either to (a) do nothing, or (b) take steps to open the grid and license marketer/brokers. Under the first alternative, since the *status quo*, including no duty on CEZ's part to wheel, results in only small, cross-border subtransmission sales, MOIT could choose to leave the situation as it is. Under the second alternative, if the grid is opened up, permitting greater competition and use of marketer/brokers, then MOIT could promulgate regulation prohibiting retail use of marketer/brokers and encouraging licensed wholesale marketer/broker activities. The latter choice would require amending Act 222.

BACKGROUND

Polish generators are selling power at wholesale to Czech distributors across the border, at the subtransmission level. Through this mechanism, the generators and distributors are bypassing CEZ, which, under current law, has no legal duty to allow any wheeling across its transmission lines, and which, in fact, controls all dispatching activities on the transmission level.

These cross-border, subtransmission sales are apparently being facilitated by power marketers/brokers, *i.e.* entities which may or may not actually hold title to the power at any point in time, but which find, arrange, and otherwise advance the sale of the power and derive profit therefrom.¹

The questions presented are whether these marketer/brokers are breaking the law by carrying on such activities without licensing or other authorizations in the energy sector, or, if their activities are not illegal, whether this marketer/broker conduct should be regulated and, if so, how.

DISCUSSION

The discussion in this memorandum is divided into three parts. Part I explains the lack of regulation of power marketer/broker activity under existing Czech law. Part II

¹ The United States energy regulatory agency ("FERC") differentiates between power marketers and brokers as follows:

Power marketers take title to electric energy. Power brokers, in contrast, do not take title; they are limited to a "matchmaking" role of identifying trade opportunities and then arranging for the principals to make the trade.

Citizens Power & Light Corp, 48 FERC ¶ 61,210 at 61,776 n. 7 (1989)

explains how power marketer/broker activity is regulated under existing United States law Part III sets forth recommendations for future Czech treatment of such activity, including the reasoning behind the recommendations

I Current Czech Law

A Energy Laws and Regulations

Act 222 requires participants in the energy sector to obtain a license from the Ministry of Industry and Trade The Act's definition of participation in that sector, however, only includes actual generation and distribution Hence, power marketing and brokering -- whether or not the marketer/broker ever holds title to the power -- is not regulated under Act 222 ²

Since Act 222 does not authorize the regulation of power marketer/broker activity, no decree or regulation issued pursuant to that Act includes regulation of such activity ³

² More precisely, Act 222 defines its scope as relating to "conditions for business" in the electricity, gas and heat industries, along with "related rights and obligations" of natural and legal persons, and state administration (Art 1) The Act then provides that "the subject of business" in the energy sector is electricity, gas or heat production and distribution to natural or legal persons, supplied in the public interest Distribution is broadly defined, to include transmission, transport, storage, conversion and supply (Art 2)

While the intent of these provisions appears to be broad application, nothing in the Act specifically refers to any activity other than "production and distribution," and "distribution," while broadly defined, does not expressly include facilitation of sales, as opposed to actual transportation of power Thus, while the Act provides that natural or legal persons "may do business in the energy sectors of the Czech Republic, under the conditions set by this Act, only on the basis of a state license" issued by MOIT (Art 3(1)), and, again, this language is broad - "do business" -- licensing appears to extend only to the specific "production and distribution" activities defined in the Act as the "subject of business" in the energy sector

³ For example, MOIT Decree No 129/1995 provides that state licensing is granted to natural and legal persons allowing them to engage in following activities generation of

Similarly, while the retail price of power is regulated under Czech law (Act 526 of 1990 and Ministry of Finance Regulation 150 of 1995), there is no regulation of the wholesale prices paid between generators and distributors. Hence, currently, the price of wholesale power sold through a marketer/broker is whatever the market will bear.

B Non-energy Laws and Regulations

Looking outside Act 222 and associated energy regulation, while power marketer/brokers must meet certain non-energy licensing requirements, these requirements are nonsubstantive and do not focus on energy sector concerns.

For example, in order to do business, like any other entrepreneur in the Czech Republic, power marketers and brokers must obtain free trade licenses under the Trade Licensing Act (Act 455/1991 Coll.) from the district/local authority where the marketer/broker is seated. Such a license, however, is easy to obtain, and does not regulate the licensee's activities in the energy sector.

Similarly, an import/export license must be obtained from MOIT under Decree 560/1991, but again, such a license is easy to obtain when importing, is directed toward informational purposes only, and does not substantively regulate the importing or exporting activity. By virtue of this decree, for example, MOIT does not have authority to prohibit an import of electricity by a marketer or broker.

Finally, while some distribution companies are owned in part by municipalities, and although the Public Procurement Act regulates municipal purchases, the Act

electricity, production of gas, generation of heat, and distribution of electricity, gas and heat (Art. 1) No mention is made of marketing or brokering.

regulates only those purchases that affect the municipal budget. Energy purchases made by a distributor in which a municipality acts purely as a shareholder do not implicate the Act.

In sum, not only does no existing law or regulation effectively regulate power marketer/broker activity, because Act 222 does not give MOIT authority to regulate such activity, a legislative act would be required to permit *direct* regulation of the activity.

C Potential avenues for *indirect* regulation absent legislation

The only existing potential avenue for indirectly affecting ongoing power marketer or broker activities absent amendment of Act 222 or other legislation is via dispatching regulations. Because CEZ has no duty to wheel power, absent CEZ consent, generators and distributors must avoid CEZ transmission lines in order to consummate their transactions. For this reason, the only marketed or brokered sales going on today are at the Polish border, where electricity can be transported on subtransmission lines owned by the distributors.

MOIT has the authority under Act 222 to promulgate technical standards, technical norms and dispatching rules. (See Act 222, Arts 9(2), 13(7)). Currently, the technical norms which were enacted as binding before May 15, 1991 are nonbinding and simply recommended. The MOIT is supposed to issue dispatching regulations by decree, but to date has not. If for safety reasons, the MOIT prohibited subtransmission transportation of power across the border (or prohibited any transportation from generator to distributor or among distributors which avoided use of CEZ's transmission lines), then

such regulations would effectively eliminate power marketing and brokering in the Czech Republic

Theoretically, MOIT could also exercise indirect control over marketer/brokers through its regulatory control over the purchaser of the marketed/brokered power. Currently, all marketed/brokered sales are at the wholesale level, with the purchaser a licensed distributor. Presumably, MOIT could regulate, through its licensing power over distributors, the distributors' resales of such power. Similarly, if the marketer/broker attempted to sell power at retail, to end-users, it would be engaging in distribution activity, requiring a licensing under Act 222.

In sum, MOIT currently has some power indirectly to limit marketed/brokered sales. It does not, however, have the authority to regulate marketer/broker activity itself. While MOIT probably has the power, under its dispatching authority, to *restrict* marketing/brokering activities, regulation *encouraging* such activities would probably require enabling legislation.

II Regulation of marketer/brokers in the United States

Power marketing began in the United States in 1986, when a nonprofit company first applied for and received authority from FERC to market electricity. The company received permission to purchase wholesale electricity from utilities and resell the electricity to other utilities at attractive rates. The profits from these transactions were then put in a fund to assist needy ratepayers in paying their electric bills. *Citizens Energy Corp*, 35 FERC ¶ 61,198 (1986). By 1995, 116 companies had applied for FERC power

marketing certificates, and applications are regularly filed with FERC by other entities seeking to become power marketers

Under US law, power marketers are regulated by FERC, power brokers, however, are not regulated. Regulation of power marketers in the United States falls under FERC's general grant of authority given to it by Congress to regulate the rates and charges of public utilities engaged in the sale of electricity at wholesale in interstate commerce. 16 U.S.C. § 824(a) (West 1985). Power brokers, which as explained *supra*, note 1, do not take title to electric energy, are not deemed public utilities and are therefore not regulated by FERC.⁴

The reason for this dichotomy is simple -- brokered sales are already regulated through oversight of the generator-seller. Since the sale *arranged* by a power broker is already under FERC's jurisdiction and filed with FERC by the seller, FERC has an opportunity to review the rates and terms of the transaction in that proceeding. *Howell Gas Management Co.*, 40 FERC ¶ 61,336 at 62,023-24 (1987). In contrast, because a power marketer essentially becomes a re-seller, if the power marketer's sale to a purchaser were not regulated by FERC, no one would regulate it. *See id.* at 62,024 (quoting *Citizens Energy Corp.*, 35 FERC ¶ 61,198 (1986)).

⁴ FERC's governing statute defines "public utility" as a person owning or operating facilities subject to the jurisdiction of the Commission. Power marketers are considered public utilities because of their corporate organization, contracts, accounts and other records ("facilities") utilized in conjunction with wholesale sales of power and energy in interstate commerce (subject to the jurisdiction of the Commission). Power brokers, in contrast, may have similar facilities but do not *themselves* engage in selling or purchasing power and energy and therefore the facilities are not utilized in FERC jurisdictional transactions.

Thus, under the US scheme, all marketed/brokered sales are regulated, in the sense that they must be filed with FERC and the prices approved by that agency

FERC has determined, however, that the degree of its oversight over those prices should be limited. As “public utilities” under the Federal Power Act, power marketers must file schedules of rates and charges with the FERC, and such rates are subject to the same standards applied to the filings of generating and transmitting utilities. Importantly, however, the cost-of-service approach does not apply. FERC will approve a power marketer’s proposed market-based rates after determining that those rates fall within a “zone of reasonableness,”⁵ and that the power marketer lacks market power. *Citizens Power & Light Co*, 48 FERC ¶ 61,210 (1989)

Similarly, regulatory control is relaxed, in that each individual marketed contract need not be filed separately with FERC, instead, the marketer makes quarterly informational filings describing the purchase and sale contracts for generation and transmission. *Id.* at 61,788, *Heatland Energy Servs., Inc.*, 68 FERC ¶ 61,223 (1994)

FERC typically attaches conditions to its approval of pricing flexibility for power marketers to safeguard against changing circumstances, and imposes these conditions on a “case-by-case,” as-needed basis. FERC has required, for example, the prompt filing of any change in the power marketer’s status vis-a-vis the ownership of or affiliation with transmission facilities, and certificates from the buyers that the price paid is less than or

⁵ “[B]ounded at one end by the investor interest against confiscation and at the other end by the consumer interest against exorbitant rates” *Citizens Power & Light Corp.*, 48 FERC ¶ 61,210 at 61,776 (1989)

equal to the buyer's cost for alternative power *Citizens Power & Light Co* at 61,788, *Heartland Energy Servs , Inc* , 68 FERC ¶ 61,223

As additional protection, Section 206 of the Federal Power Act provides that interested parties may file complaints with FERC concerning the marketer's exercise of market power, or the Commission staff can request an investigation based on its analysis of the quarterly filings

III Recommendations

The threshold question that must be asked is whether any regulation of power marketing/brokering activity is necessary. Because CEZ has no current duty to wheel, the level of such activity is limited and, absent safety concerns, perhaps below the level triggering regulatory scrutiny

Indeed, these power marketers and brokers are injecting competition into what is otherwise a monopoly situation. The natural result of such competition is salutary -- to reduce the cost of wholesale power. Hence, MOIT may not want to take any steps that would limit or otherwise make marketing/brokering more difficult. In the existing Czech environment, where the level of sales is low and limited to cross-border transactions, there seems little point in creating a regulatory scheme for entities that not only have no market power, but are essentially carrying out small and narrow exceptions to the current monopolistic situation

To the contrary, any future regulation should encourage and facilitate such wholesale competitive activities, starting by forcing CEZ to wheel. Once open wheeling

is required, the level of power marketing/brokering activities could become sufficiently substantial that some sort of regulatory process similar to that used in the US might prove beneficial

Such regulation could include, aside from rules effecting the open wheeling, a licensing scheme whereby marketers/brokers must show minimum financial competency to participate in the energy sector. Wholesale prices could remain unregulated, because regulation of retail prices would keep the wholesale prices within reason. Marketer/brokers would not be permitted to sell at retail, in order to avoid the complications that arise with retail wheeling at least until competition is introduced and working at the wholesale level.

In sum, we recommend either doing nothing about power marketing and brokering at this time, or taking steps to change the current situation to expand non-monopoly sales. The latter route would require amendment of Act 222 or passage of other legislation to compel CEZ to wheel power. If MOIT is interested in this regulatory alternative, we would be happy to draft legislative and regulatory language to effect these changes and facilitate competition.

LIT 65857-1 DOC

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APPROACHES TO REGULATION OF ENERGY ENTERPRISES IN THE CZECH REPUBLIC

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"The Regulatory Framework: Mandarins, Markets and Managers"

Chateau Melnik, Czech Republic
October 10-11, 1995

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OVERVIEW

- I. OVERALL APPROACH
- II. THE PLAYERS
- III. KEY ATTRIBUTES OF EFFECTIVE
REGULATION
- IV. CZECH REGULATORY FRAMEWORK
- V. FOR THE FUTURE

I. OVERALL APPROACH

- Application of Theory Tested against Real World Experience
- Practical Solutions
 - » What works
 - » What doesn't
- Czech Experience
 - » Energy Act 222 and Decrees
 - » Other Laws and Decrees

I. OVERALL APPROACH (cont'd)

- » Existing status of industry restructuring
 - ~ CEZ and distribution companies
 - ~ Transgas and distribution companies
 - ~ Diversified district heating industry

- Czech Concerns

- » Social, political

I. OVERALL APPROACH (cont'd)

- » National strategies
- » Other
- Impact on Capital Markets
 - » Capital intensive industry
 - » Privatization
 - » Private and foreign investment
 - » Lenders

II. THE PLAYERS

- Mandarins -- Regulators
 - » Ministry of Industry and Trade (MIT)
 - » Ministry of Finance (MOF)
 - » Substitute principled decision-making for market forces (licensing, investments, pricing)
 - ~ Natural monopolies, or
 - ~ Sectors where State has elected to continue monopoly despite market potential

II. THE PLAYERS (cont'd)

- Markets -- Competitive Markets
 - » Most effective means of insuring lowest possible prices, widest selection of products and service
 - » But not always available
 - ~ Natural monopolies
 - ~ Policy decisions
 - » Risk of market dominance, bottlenecks
 - » McKinsey & Company April, 1995 Report

II. THE PLAYERS (cont'd)

- Managers -- Energy (Regulated) Enterprises
 - » Duty to owners (shareholders)
 - » Customer service
 - » Running of enterprise
- Successful Regulatory Regime
 - » Balance of powers and functions among players --
Mandarin, Markets and Managers

III. KEY ATTRIBUTES OF EFFECTIVE REGULATION

- Clear Assignment of Powers
 - » Regulatory Institutions (Mandarins)
 - » Markets
 - » Energy Enterprises (Managers)
- Regulatory Accountability
 - » "The Left Hand and the Right Hand"
 - » Judicial Review

III. KEY ATTRIBUTES OF EFFECTIVE REGULATION (cont'd)

- Substantive Standards for Decision-Making
 - » Licensing
 - » Investment decisions
 - » Pricing
- Procedures to Address Market Dominance, Bottlenecks
- Open, Understandable (Transparent) Method of Regulation
 - » Published standards

III. KEY ATTRIBUTES OF EFFECTIVE REGULATION (cont'd)

- » Public participation
- » Written orders justifying and explaining decisions
- Balance of Risk and Reward
 - » "The rat must smell the cheese"
- Effective, Well-Defined and Predictable Appeals Procedure

IV. CZECH REGULATORY FRAMEWORK

- Clear Grant of Authority to MIT and MOF
- Regulatory Accountability
 - » MIT review function over investment and expenditure
 - ~ MIT expertise (finance, economics, technical, legal)
 - » But MOF approves pricing
 - ~ Expertise? Interplay with MOI?
 - » Potential tension

IV. CZECH REGULATORY FRAMEWORK (cont'd)

- Role of Markets
 - » CEZ
 - » Transgas
- Management Discretion?
- Substantive Standards for Decision-Making
 - » Licensing
 - ~ Precise standards for applicant qualifications, but

IV. CZECH REGULATORY FRAMEWORK (cont'd)

- ~ No substantive standards for issuance
 - price?
 - compatibility with strategic national objectives?
- ~ Revocation standards
 - severe sanction
 - process vague
- ~ Franchises -- exclusive or non-exclusive

IV. CZECH REGULATORY FRAMEWORK (cont'd)

» Pricing

- ~ Detailed informational requirements, but
- ~ No substantive standards for price setting
 - Cost only?
 - Return on equity?
 - Ability to pay?

IV. CZECH REGULATORY FRAMEWORK (cont'd)

- Power to Eliminate Market Constraints
 - » Not apparent, yet real needs
 - ~ CEZ and local distribution companies
- Balance of risk and reward
 - » Clear technical standards, performance standards, emergency operating standards
 - » Clear sanction for failure to meet operating standards
 - » But reward potential unclear

IV. CZECH REGULATORY FRAMEWORK (cont'd)

- Open Regulatory Process
 - » Participation by affected parties? (only MOI)
 - » Written decisions, explicit rationale?
- Appeals Procedure
 - » Lack of standards, predictability
 - » Recourse under current process
 - ~ Judicial appeal?
 - ~ Political process?

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V. FOR THE FUTURE

- Czech Republic is Engaged in Thoughtful and Thought-Provoking Energy and Regulatory Restructuring
- Sector Privatization is Impressive
- Development and Reliance on Markets Where Appropriate
- Compares Favorably to Other Countries in Europe, Elsewhere

V. FOR THE FUTURE (cont'd)

- Essential Points to Consider for Next Successful Steps
 1. Establish clear, substantive standards for issuance and revocation of licenses
 2. Establish clear standards for price setting
 3. Develop framework either to
 - (a) regulate prices between CEZ and local distributors or
 - (b) create effective competitive market
 - ~ currently neither exists

V. FOR THE FUTURE (cont'd)

4. Require written, explanatory orders by regulators
 5. Identify effective, predictable procedures for administrative review and judicial appeals
- These are Straightforward Steps, Easily Accomplished
 - Will Further Enhance Private and Foreign Investment in Sector
 - » Promote competition
 - » Produce reasonable prices, superior service
 - Strong, Vibrant Economy

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APPROACHES TO REGULATION OF ENERGY ENTERPRISES IN THE CZECH REPUBLIC

"The Legal Framework: *Creating Mandarins, Markets and Managers*"

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OVERVIEW

- I. HALLMARKS OF AN EFFECTIVE LEGAL FRAMEWORK
- II. LAWS vs. REGULATIONS
- III. CZECH ENERGY LAW -- INTERNAL CONSIDERATIONS
- IV. POLICIES (LAW) vs. IMPLEMENTATION (REGULATION)
- V. CONSISTENCY WITH NATIONAL GOALS
- VI. FINAL THOUGHTS



I. HALLMARKS OF AN EFFECTIVE LEGAL FRAMEWORK

- Similar to Attributes of Successful Regulatory Structure
 - » Clear assignment of powers and duties
 - » Substantive standards
 - » Appeals procedure



I. HALLMARKS OF AN EFFECTIVE LEGAL FRAMEWORK (cont'd)

Additional Elements of Effective Legal Structure

- Internally Consistent
 - » Balance obligations with authority
 - » Balance duties with rewards
 - » Balance market pricing forces with open, effective markets

I. HALLMARKS OF AN EFFECTIVE LEGAL FRAMEWORK (cont'd)

- Consistency with Other Laws
 - » Environmental
 - » Financial, commercial
- Promote Overall National Policies
 - » Private investment
 - » National energy security issues

II. LAWS vs. REGULATIONS

- Laws Address Broad Policy Issues
 - » Markets vs. regulation (Mandarins)
 - » Franchises vs. competition
 - » Cost based pricing vs. incentives
 - » Delegation to Managers vs. state oversight
 - » Transitional considerations vs. long term strategies

II. LAWS vs. REGULATIONS (cont'd)

- Delegate to Regulators (Mandarins)
 - » Implementation of policy
 - » Transitional issues
 - » Decisions within expertise of regulator
- Change in Laws Generally More Significant than Change in Regulatory Decisions
- Power of Regulator (Appointed) Should Only Flow from Legislature (Elected)

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II. LAWS vs. REGULATIONS (cont'd)

- Legislature as Check on Regulator
- Judicial Process as Check on Regulator
 - » Adherence to substantive standards
 - » Procedural rights
 - » Not exceed delegated authority

III. CZECH ENERGY LAW -- INTERNAL CONSIDERATIONS

- Duty to Serve
 - » Exclusive franchise?
- Duty to Serve (New Transmission and Distribution to Meet Customer Load)
 - » Eminent domain authority ?
- Price Regulation to Substitute for Competition
 - » Standards for cost recovery? profit?

III. CZECH ENERGY LAW -- INTERNAL CONSIDERATIONS (cont'd)

- Market Prices for Wholesale Electric Generation Prices
 - » Mechanism for breaking CEZ market dominance?
- Promotion of Reasonable Cost Energy
 - » Incentives (rewards)?
 - » Transgas example

III. CZECH ENERGY LAW -- INTERNAL CONSIDERATIONS (cont'd)

- Require Purchases From CHP Plants
 - » Price guidelines?
 - » Third party sales?
- Permit Heat Plant Backup Units
 - » But only upon agreement of license holder
- Establish Permits and Licenses
 - » Standards for award?

III. CZECH ENERGY LAW -- INTERNAL
CONSIDERATIONS (cont'd)

- Sanction for Violation of Act
 - » But No "Cheese" for the "Rat"

IV. POLICIES (LAWS) vs. IMPLEMENTATION (REGULATOR)

Laws

Regulators

- License and concession system
 - » Establish Policy
 - » Set Principal Standards
 - » Define Basic Rights and Obligations
- » Qualifications
- » Required Information
- » Review Process
- » Details on Duties, Performance, Revocation
- » Expertise of Agency
- » Decision-Making

IV. POLICIES (LAWS) vs. IMPLEMENTATION
(REGULATOR) (cont'd)

Laws

Regulators

- Investment and expenditure

- » Decision to regulate
- » General Policies
 - ~ Least Cost
 - ~ DSM

- » Approval Process
- » Required Information
- » Expertise of Agency
- » Management Review
- » Decision-Making

IV. POLICIES (LAWS) vs. IMPLEMENTATION
(REGULATOR) (cont'd)

Laws

Regulators

- Pricing
 - » Substantive standards
 - » Participant Rights
 - » Essential Time Tables
- » Required Information
- » Public participation
- » Hearing process
- » Expertise of Agency
- » Decision-making

V. CONSISTENCY WITH NATIONAL GOALS

- Consistency with Environmental Laws
 - » Cost of environmental compliance vs. cost (rate) recovery
- Privatization and Investment
 - » Fair, non-discriminatory access to legal system for private and foreign lenders and investors
 - » Timely resolution of commercial disputes in courts, with finality

V. CONSISTENCY WITH NATIONAL GOALS (cont'd)

- » Enforceability of energy agreement terms
 - ~ Minimum payment obligations
 - ~ Force majeure clauses
 - ~ Liquidated damage clauses
 - ~ Security clauses
 - ~ Indemnifications
 - ~ Alternative dispute resolution, choice of law
 - ~ Assignability and transferability

V. **CONSISTENCY WITH NATIONAL GOALS**
(cont'd)

- Without Extensive Regulatory Involvement in Energy Agreements After Initial Approvals
 - » Fair compensation to investors if regulatory ability to terminate or modify transactions after initial approval
- General Predictability of Outcome With Laws that Are Fair, Understandable and Non-Discriminatory

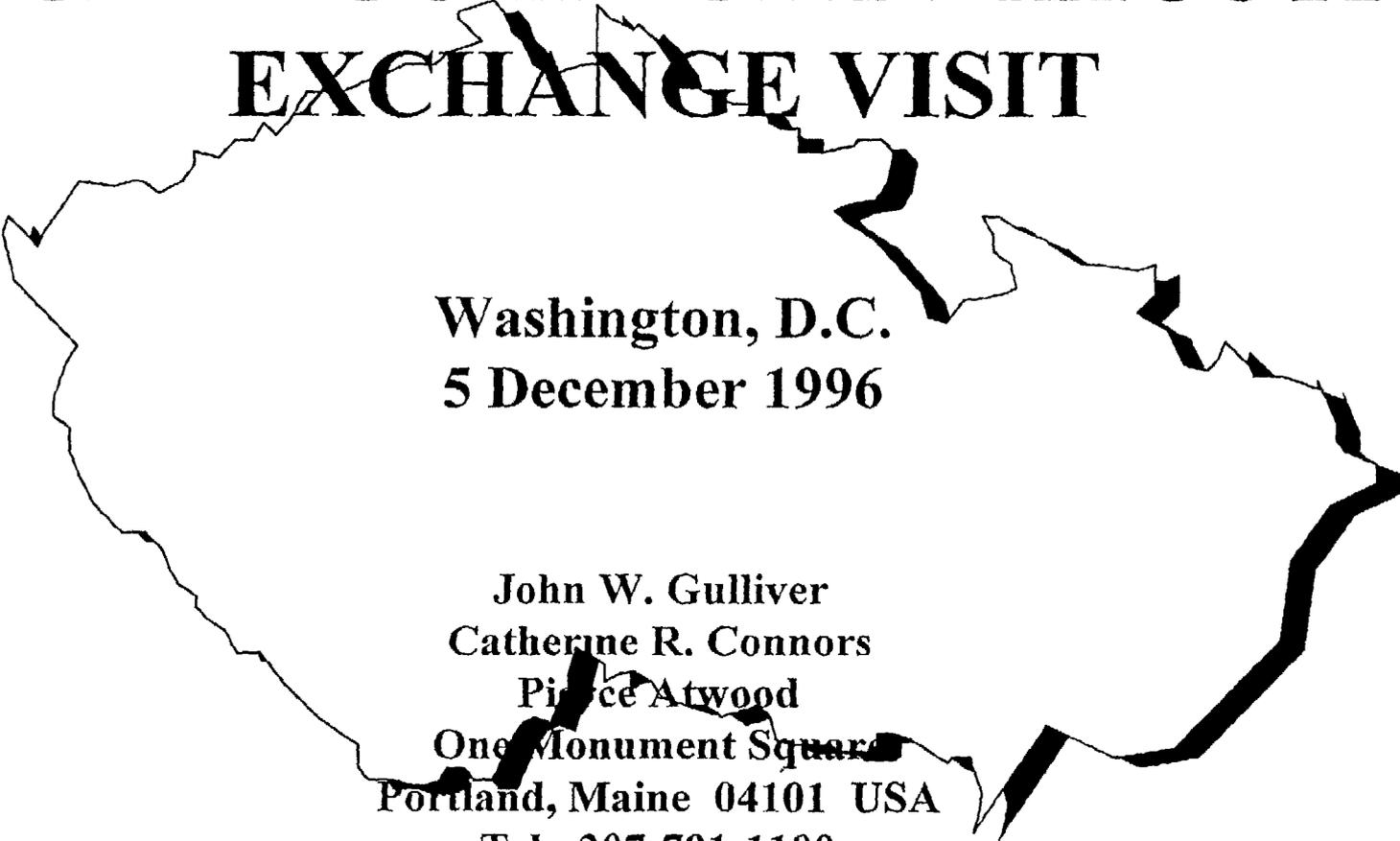
VI. FINAL THOUGHTS

- Market Has Spoken -- General Legal System Conducive to Private and Foreign Investment -- Much Success
- Work Within Existing Energy Act 222
 - » Clear articulation of certain core issues
 - » Internally consistent
 - » Generally consistent with national policies
 - » Compares favorably with energy laws in neighboring countries

VI. FINAL THOUGHTS (cont'd)

- Adopt Substantive Standards in General Decrees
 - » Decree on licensing standards
 - » Decree on pricing standards
 - » Decree on franchise exclusively
 - » Decree on eminent domain rights
 - » Decree addressing market bottlenecks
- Confirm Rights to Judicial Review
- Market Will Communicate Additional Needs

CZECH REGULATORY EXECUTIVE EXCHANGE VISIT



Washington, D.C.
5 December 1996

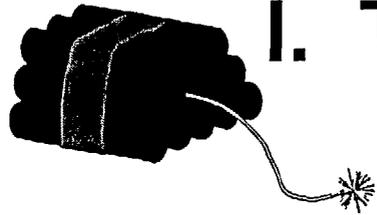
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THE “BIG BANG”



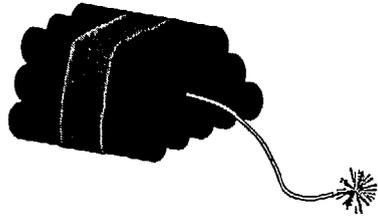
HUNGARY: A CASE STUDY IN PRIVATIZATION AND REGULATORY REFORM

U.S.AID/Bechtel/USEA -- Czech Regulatory Executive Exchange Visit



I. THE FUSE: PRE-“BANG” ECONOMIC AND POLITICAL FACTORS

- **NEED FOR CAPITAL**
 - » Investment in Energy Sector
 - » For State Budget
- **DESIRE FOR DEMOCRATIZATION**
- **DESIRE TO RETURN ECONOMY TO PRIVATE OWNERSHIP**
- **LOOK TOWARD THE WEST**
 - » Competition
 - » EU
 - » Strategic Partners



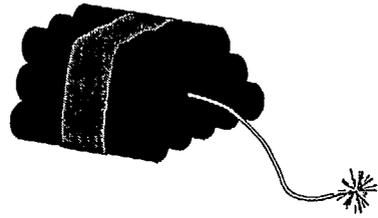
I. THE FUSE: PRE-“BANG” TECHNICAL FACTORS

- **FUEL SUPPLY**
 - » **Lignite**
 - » **Nuclear**
 - » **Little Domestic Natural Gas**
 - » **Few Hydro Resources**

- **GRID CONNECTIONS**

- **DISTRICT HEAT**

- **MANAGEMENT SKILLS**

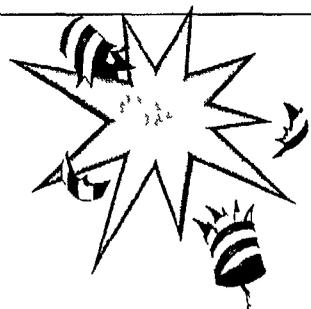


I. THE FUSE: PRE-“BANG” PRICING FACTORS

- **SUBSIDIZATION**
 - » **Industrial - Residential - Commercial**
 - » **Electricity - Heat**

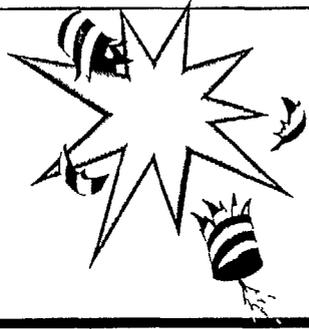
- **NO TRANSPARENCY**
 - » **In Price-Setting Process**
 - » **In Price Result -- Lack of Separate Accounting**

- **NOT COST-BASED**
 - » **No Depreciation**
 - » **No Marginal Cost or Least Cost Concepts**



II. "BOOM": SUMMARY

- **AGGRESSIVE PRIVATIZATION -- "JUST DO IT" ... AND THEY DID**
- **SIGNIFICANT DISAGGREGATION -- THROUGH PRIVATIZATION AND LEGAL LIMITS**
- **RE-STRUCTURED LEGAL AND REGULATORY ORGANIZATION -- FROM PARLIAMENT TO HEO**

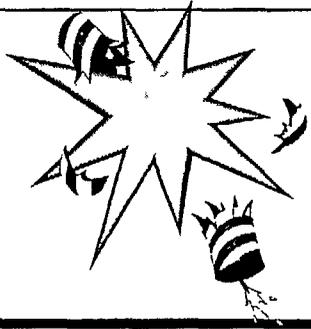


II. "BOOM": PRIVATIZATION

- **SCHEDULE**
 - » **The First Round - the Fuse Sputters**
 - » **The Second Round - the Fuse Lights**
 - » **Later Sales/Future Sales**

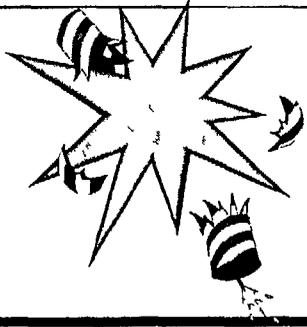
- **PARTICIPANTS**
 - » **APV**
 - » **Bidders**
 - » **HEO Involvement (Second Round)**
 - » **Schroeders (Second Round)**

- **SALES PRICES -- IN EXCESS OF BOOK**



II. "BOOM": UNIQUE ISSUES

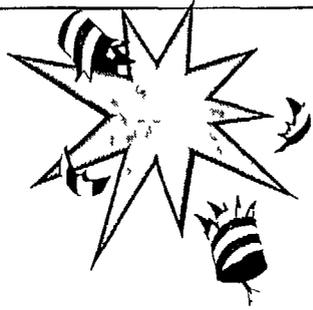
- MVM
- NUCLEAR
- TIE-INS
 - » Good Plant With Bad
 - » New Capacity
 - » Mines
- THE SALESMAN'S FACTOR
 - » Industrial Plants
 - » Promised Expansions



II. "BOOM": DISAGGREGATION

- **SEPARATION OF GENERATION, TRANSMISSION AND DISTRIBUTION**
 - » **Sold Separately; Bidding Limits in Second Round**
 - » **MVM Must Sell Remaining Generation**
 - » **Limits on Distribution Companies**
 - » **Nuclear**
 - » **Municipalities**

- **CURRENT OWNERSHIP LIMITATIONS**
 - » **Monopoly Law**
 - » **Licenses**
 - » **Proposed Specific Limitations: Tender Process, Share Ownership**

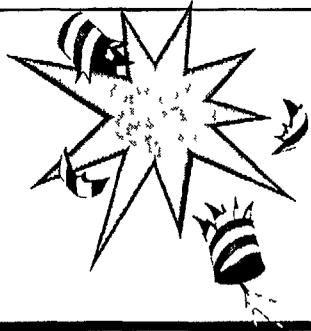


II. “BOOM”: LIMITS ON COMPETITION

- **NO THIRD PARTY ACCESS**
 - » **Monopoly Distribution**
 - » **Except Limited “Direct Supply”**
 - » **Forced Purchase by MVM or Distribution Companies of Renewables, CHP**

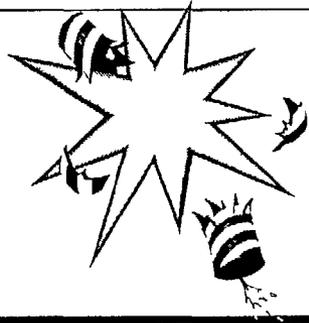
- **CENTRALIZED STATE RESOURCE PLANNING**

- **REGULATED PRICES**
 - » **Wholesale**
 - » **Retail**
 - » **Inability to Contract**



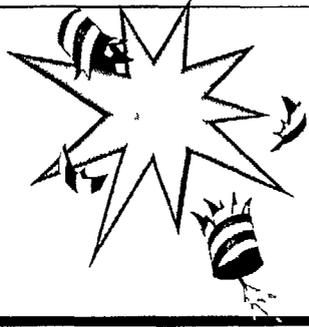
II. "BOOM": LEGAL AND REGULATORY STRUCTURE

- **GOVERNING LAWS**
 - » **No New Constitution Yet (in the Works)**
 - » **Electricity Act**
 - » **Pricing Acts**
 - » **Government Decrees**
 - » **Ministerial Resolutions**
 - » **Operational Code**
 - » **Licenses**
 - » **Individual HEO Resolutions**
 - » **Environmental**
 - » **Labor**



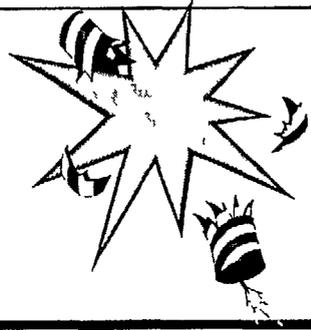
II. “BOOM”: LEGAL AND REGULATORY STRUCTURE

- **GOVERNING BODIES**
 - » **Parliament**
 - » **Government (Cabinet)**
 - » **MOIT**
 - » **MOF**
 - » **HEO**
 - » **Environmental**
 - » **Public/NGOs**
 - ~ **Consumers’ interest group**



II. "BOOM": ROLE OF THE HEO - OFFICIAL

- LICENSING
- PRICING
- CONSUMER PROTECTION
- RESOURCE AND CAPACITY PLANNING
- ENFORCEMENT

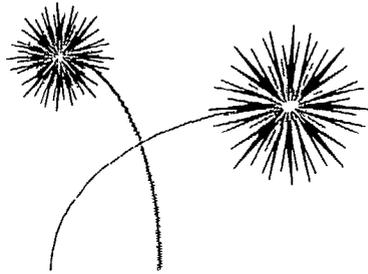


II. “BOOM”: ROLE OF THE HEO - PRACTICAL

- **VOICE FOR COMPETITION**
 - » **Tender Process**
 - » **License Terms on Ownership Limitations**

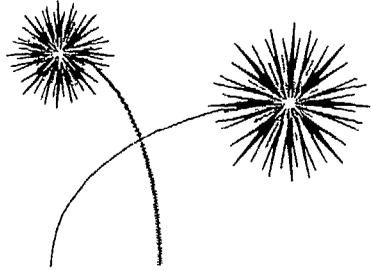
- **VOICE FOR STRONG, INDEPENDENT REGULATOR**
 - » **Important Role in Tender Process/Selections**
 - » **Full Exercise of Existing Powers, With Limited Resources**
 - » **Without Centralized Planning of Private Transactions**
 - » **Big Picture View**

- **CONSULTED BY OTHERS IN AREA OF EXPERTISE**



III. POST-“BANG”: IMPLEMENTATION ISSUES

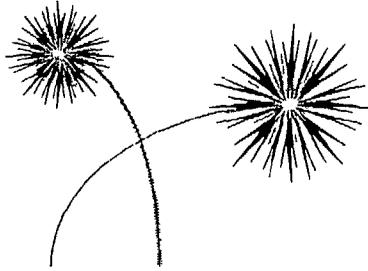
- **PRICING -- TENSION BETWEEN**
 - » **Price Rationalization and Social Costs**
 - » **Price Rationalization and Inflation**
- **RE-AGGREGATION**
 - » **Natural Tendency Without Constraints - e.g., UK**
 - » **Foreign Buyers**
- **DISPATCH ISSUES**
- **DEVELOPING NEW CAPACITY**
 - » **Security of Supply**
 - » **Current Pricing Questions**



III. POST-“BANG”: LESSONS FOR POLAND?

- **SUCCESS OF PRIVATIZATION**
- **IMPACT OF NO THIRD PARTY ACCESS**
- **LIMITATIONS ON HEO AUTHORITY**
 - » **Individual Decisions Without General Application**
 - » **Funding and Hiring Constraints**
 - » **Pricing -- Investor Confidence**
- **CHP, OTHER PREFERENCE LOOPHOLES**
- **STRIKE LAWS**

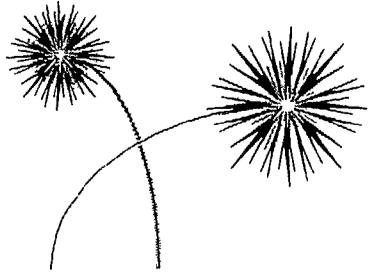
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III. POST-“BANG”: ROLE OF THE REGULATOR

Why is Independence Good?

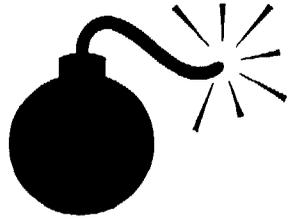
- **CONSUMER CONFIDENCE**
- **INVESTOR CONFIDENCE**
- **DEFENSE OF COMPETITION, PRICE EFFECTS**
- **STABILITY AND PREDICTABILITY**
- **FAIRNESS**
 - » **Public Perception**
 - » **Transparency**



III. POST-“BANG”: ROLE OF THE REGULATOR

How Do You Support Independence?

- **SELF-FUNDING AND ADEQUATE BUDGETS**
- **PROTECTION FROM POLITICAL MISCHIEF -- FIXED TERMS**
- **DEVELOPMENT OF REQUIRED SKILLS (ECONOMIC, ENGINEERING, LEGAL, MANAGEMENT)**
- **POWER TO ISSUE GENERAL DECREES**



IV. THE “BIG BANG”: CONCLUSIONS

- **EFFECTIVE REGULATION/COMPETITION KEY TO SECTOR REFORM**
- **CLEAR LEGAL BASIS FOR STRONG, INDEPENDENT REGULATOR**
- **MOVE QUICKLY, DECISIVELY**
- **LEADERSHIP SKILLS, CAPABLE STAFF CRUCIAL TO SUCCESS**

MEMORANDUM

TO: Czech File

FROM: JWGulliver

RE: Follow up from trip

DATE: 15 June 1996

This memorandum briefly notes the major items from the trip to the Czech Republic-
11-13 June 1996

MEETING AT GLATZOVA & CO

1 Power Marketers/Brokers

Per the meeting Tuesday afternoon with Vit Horacek, Dana Zelinkova, Peter Vallert, Petr Vanek and Howard Menaker, the Ministry had an independent commission look at the same issue shortly after we did our memo. Vit didn't know who was on the commission. The commission came to the same results we did. Act currently doesn't allow regulation and should be amended to give Ministry authority over these areas. Query: Did our memo influence the Ministry Commission?

2 Government

Per Horacek, press, Ken Hobbs, etc., Dlhovy will remain as Minister and will pick up an additional area of responsibility as the number of cabinet ministries is reduced and another one (ministry of economic development) is rolled into his. Dlhovy is in the opposition party, Cerny may return to the #2 post, since Tvrznic is regarded as a fill-in while Cerny campaigned. Klaus is likely to be Prime Minister, and Zeman, of opposition party, will head Parliament. None of this is certain.

3 Vanek Paper

We briefly reviewed Vanek's paper and concluded that the most critical issues he identified were the lack of price setting/contract at the wholesale level between CEZ and distributors, lack of licensing criteria, lack of clear central dispatch authority. The other holes (e.g., failure to require that license holder be named on certain other government forms) seemed to be in the nature of technical corrections and amendments and of lesser importance.

4 Horacek List

See file for list of discussion topics that Vit Horacek prepared. These items either repeat the Vanek piece or are issues that we have discussed previously. Most important on his list are the failure of the act clearly to define who has what authority, to consolidate authority with one regulator, and to spell out the regulatory process and appeals process.

5 Critique of Act 222

At the Tuesday meeting at Glatzova, we discussed that most appropriate means of moving forward with amending Act 222. Horacek et al, described the process whereby the Government (Prime Minister and Cabinet) prepares a Parliamentary Plan, which essentially is a wish list for the next legislative session. The plan describes major proposed legislative initiatives, though not exclusive or binding, the Plan had tremendous influence on what bills get introduced and passed at the Parliamentary session. Our conclusion was that Howard Menaker and I should raise with Mr. Antos the question of how next to proceed on marketers/brokers, suggest that we'd be happy to prepare a short summary for the Parliamentary Plan and see if we could assist by noting other needed amendments to Act 222 as part of the Plan. Horacek thought that this process would get underway sometime in September or October, after the Government is formed and after the summer holidays. SURPRISE! See below.

MEETINGS AT MINISTRY

Present were Bechtel team members Howard Menaker, Ken Hobbs, Josef Pivonka, Marlana, a translator from AA, Jan Pisko, and JWG, from the Ministry were Antos, Sponer, Snetjlie, Foucek, a Mrs. Sedlakova, and Mr. Novy, and a woman from MOF who said nothing.

6 Assessment of Project

See materials handed out at the meeting. The Ministry prepared an assessment of the project to date. Neither Howard nor I knew this was coming. Several of the items overlapped with our work plan list (e.g., regulated vs. unregulated activities), some apparently overlapped but had a twist (e.g., evaluation of economic effectiveness of investments might tie into the seminar topics we discussed), some were completely new items (e.g., tie in to separate tariff study).

7 Accounting And Related Types Of Reports

See list. Ken Hobbs will deliver three distinct reports in July and August, these will cover revenue requirements and related methodologies, with case studies based on PRE and East Bohemia Gas, ROE methodology, and regulated vs. non-regulated activities. The seminar we originally talked about in June likely will occur in Sept-Oct, Ken will coordinate with Floyd Davis.

8 Amendments to Act 222

The pace for this item, which at our March meeting with the Ministry we all had agreed would be targeted for late 1996, has accelerated dramatically. That morning, just two hours before our meeting, Minister Dlouhy, evidently reconfirmed for his post, gathered Antos, Sponer, Snetjlie et al and asked for a memo immediately outlining comprehensive changes that the regulators would recommend for Act. Antos, Sponer et al want our help ASAP and initially asked for something by Friday, 14 June. We agreed to have a memo to them by Friday, 21 June. JWG/CRC will prepare in consultation with Czech counsel. The memo will not purport to draft legislation or outline terms in detail at this early stage, rather, it will identify in bullet style the core issues to be changed, it will not deal with technical corrections and amendments. Sponer repeatedly made references to a memo of 29 January 1996 as a starting point for the list. This memo is an item Jan Pisko prepared as the solicitation document for retaining local Czech counsel. Frankly, the document was not familiar to me and the areas listed don't always make sense. In discussions at the Ministry, it became apparent that their hot issues include (1) their own lack of authority ("we can recommend but we have no force"), their power sharing with MOF and the not entirely clear lines of demarcations, the broker/marketer issue, standards for authorizing new investment in the sector, standards generally for pricing (e.g., index, rev requirements, other), and defining central dispatch and dispatch regimes).

9 Evaluation of Effectiveness of Investments

The Ministry people asked how to evaluate the "effectiveness" of investments and talked a lot with Ken Hobbs about lessons in NPV, IRR, ROE, CapM, DCF etc. However, I think there are (and spoke on) two elements here. One side is the investor side, which the above comments address, the other is the regulator's side, which will include some different criteria, such as need, testing sensitivity cases re need, once need is established whether the proposal is the least cost way to meet need, definition of least cost, sensitivity studies on options, review of management of project after authorized, etc. Ken Hobbs is going to prepare something on this, with input from Floyd and JWG, JWG will also include this as appropriate in the list of amendments to Act 222.

10 Tariff Study

CEZ and the distribution companies have commissioned a Czech consulting group based in Brno to do a tariff study, that will review structure of tariffs, recovery of costs, etc. I don't think this will be a full blown cost of service study but will more generally review tariffs. CEZ and discos will pay, Ministry wants to review and evaluate correctness of methodology, results, etc. Floyd Davis will handle.

11 Study Tour

The Ministry people are anxious to get this item going. Previously, Howard had wanted to hold off on the "field trip" until we see more of a commitment from the Czechs. Howard committed to an outline by mid August.

FOLLOW UP AT GLATZOVA

12 Memo on Act 222

I arranged a meeting with Horacek, Vallert and Zelonkova on Thursday to brief them on the meeting at the Ministry and the need to have the memo by 21 June. Horacek is out of the office all week on vacation and Vallert is in London 2 weeks for a deal, Zelinkova will be the work horse from their end with input from Vanek as well, who will be in town. Horacek and Vallert will give Zelinkova their refined thoughts as to a list of key topics, she will merge this and fax to us on Monday, CRC and I will call here at 11 AM Monday, Howard Menaker will join in that call. The format will be as follows

ISSUE [Brief listing of issue]

DISCUSSION [One or two sentences on why it is important]

RECOMMENDED ACTION [Short description of legislation, e.g., amend act to consolidate all regulatory and price setting authority into one agency]

The goal is focus, brevity, 3-5 pages maximum

JWG preliminary cut on issues

- (a) independence of regulator
- (b) avoid split in regulatory authority
- (c) either regulate clearly or permit true market for wholesale prices from producers to discos
- (d) consider breakup of CEZ
- (e) identify general decision-making principles - e.g., least cost on expansion, marginal cost on pricing, etc., and give regulator authority to promulgate decrees consistent therewith to get specific standards
- (f) define scope of regulation (broker/marketer)
- (g) specifics on letting markets rule

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MEMORANDUM

JOHN W GULLIVER

DIRECT
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E MAIL
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TO Howard Menaker and Jacque DeRosa
FROM John Gulliver
TRIP REPORT October 22-25, 1996
PROJECT NAME Regulatory Reform and Energy Sector Restructuring in
Central and Eastern Europe and the Baltics
COUNTRY Czech Republic

This trip to the Czech Republic involved two major tasks (1) attending the second International Conference on Commercial Opportunities in the Development of the Energy Sector in Central and Eastern Europe, and (2) meeting with various Czech government officials and USAID representatives and sub-contractors in pursuit of regulatory reform and energy sector restructuring efforts

Aside from attendance at the conference, Howard Menaker and I met with Mrs Furstova of the Ministry of Finance ("MOIT"), Messrs Tvznik, Antos, Brychta, Fousek and Kacvinsky of the Ministry of Industry and Trade ("MOIT"), Vit Horacek and Peter Valert, our legal experts in the Czech Republic, and Jan Pisko, Bob Posner, Jim Bendar, Ken Hobbs and Josef Pivonka, our in-country USAID and sub-contractor representatives

In these meetings, we reviewed (1) price regulation and the division of authority on this subject matter between the MOF and MOIT, (2) the significance of the MOIT's energy policy paper, (3) import/export issues, (4) central dispatch issues, (5) potential amendments to the energy act (Act 222), (6) the scope of authority between ministries in general, (7) the scope of regulation within the sector, and (8) pre-privatization activities We also planned for the December study tour of Czech governmental representatives to the United States

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MEMORANDUM

TO Bechtel - Czech File
FROM. JWGulliver
RE: Notes from Meetings of October 24 and 25, 1996
DATE October 31, 1996

This memo will briefly summarize the discussions and meetings we had with various Czech officials

Meeting with Mr Antos at the Ministry of Industry and Trade (also attended by Mr Pisko, Mr Horacek, Mr Pivonka and Mr Menaker)

1 Mr Antos advised that it is better in memos to speak less about the advantages of competition and more about the "same conditions" as the market

2 He generally likes competition, saw a brief memo describing the changes in Massachusetts and thinks that there may be some lessons for Czech, although the Czech is different than Massachusetts, "due to CEZ"

3 Mr Antos would like large customers to have the right of direct access, but believes that third party access cannot be introduced directly across the board for all classes. He also believes that the Act itself cannot be amended in the near future to allow for general third party access, though perhaps it could be allowed for very, very large customers

4 Mr Antos would like to see transfer prices for distributions companies

5 In this spirit, our suggestion that the Act required disaggregated pricing is very important, and he would like to see that pushed. He would like to see enabling legislation so that when distribution prices are set a disco will be able to contract for long term supply if it wanted to but would be under no obligation to enter into an agreement.

6 Mr. Antos feels that of all the suggestions we have made the most important is to calculate an unbundled price for distribution. The Act will need to be amended to do this. The Act will have to define that a principle of energy policy is to have unbundled pricing, there will be pressure from large companies to permit choice among supply companies, there will be pressure from the Legislature so that large companies can choose directly from generators.

7 Mr. Antos referred to special Decree 300, which is an older law and deals with strategic purchases. Note we should obtain

8 Note. Both during our discussion with Mr. Antos and afterwards with Mr. Brychta and Mr. Tvrznik, it was very obvious that Mr. Antos is sliding more and more out of power, is no longer a decision-maker, and is really at a third or fourth level. His comments thus should be taken in that light.

Meeting with Mr. Brychta, Mr. Tvrznik and Mr. Kacvinsky

1 The new structure is as follows. Tvrznik reports directly to the Minister Dlhov. Brychta reports directly to Tvrznik and handles policy and planning, Kacvinsky also reports to Tvrznik and handles another area of energy planning. Antos reports to Brychta.

2 Brychta's groups have prepared a new proposed Czech energy policy which proposes changes in Act 222. This is about a 50 page document. The most recent draft dates

from October, 1996 There is a draft in English from July, 1996 Vit Horacek will have the most recent draft translated into English, building off the previously-translated July draft.

3 Brychta wants to target the following amendments to Act 222 (a) authorization -- link authorization to regulation There is no direct link between authorization and regulation currently in the Act, (b) detailed, concrete explanations of certain terms in the law, such as "competition" or "customer", (c) central dispatch -- the role of central dispatch in the organization of the energy sector as a whole, and links to other elements of competition and restructuring, is wholly absent in Act 222

4 Laws and regulations for sector should work together, according to Brychta The structure and ownership issues need to be addressed, and the pricing act, the regulatory accounting act, and financial accounting should all be linked

5 Pricing will still remain with Ministry of Finance It cannot be merged into Ministry of Trade at this point However, according to Mr Brychta, the Ministry of Finance acts from the macro-economic view, what is socially acceptable, whereas the Ministry of Industry and Trade acts from what is appropriate for the sector, without political influence

6 Mr Tvrznik arrived and spent about half an hour with us He wants the study tour as soon as possible but may not be able to go himself because of the atomic law That is working its way through Parliament He has worked on atomic issues for the last two or three years and comes from the industry

7 There is no current schedule or rush for changes to Act 222, so we have the opportunity to think through the best changes and get them right Mr Tvrznik would like to think of a way to continue the collaboration even after U S AID pulls out

8 Tvrznik would like the product on proposed legislative changes to be as detailed as possible. However, MOIT attorneys can put it into express legislative language, the proposed changes, however, should be detailed in specific

9 Tvrznik very much liked the format we used in our June memo of identifying the issue, a discussion, recommended action, with a fourth point to be added, recommended language. It is important in any paper we prepare to discuss the reasoning of the amendments

10 Kacvinsky again emphasized that combining activities into one agency may be preferable in the long term but is not something that should be advocated immediately. He feels that the memo we prepared should take into account the approach that is normal in continental Europe where there is split authority between regulation and finance in various countries including Germany

11 We left matters as follows

(a) Horacek will complete the translation of the energy document and get it to us. We will review it

(b) After our review, we will discuss proposed changes with Horacek. He will meet with Kacvinsky and Antos to discuss further the amendments to be targeted

(c) JWG and Howard Menaker will collaborate with Horacek in drafting a new memo along the lines outlined above

(d) We will plan a study tour for two weeks with Brychta, Kacvinsky, et al commencing at the end of November, early December for about two weeks. Tvrznik will attend if possible. Note: In discussions among us subsequent to the meeting with Ministry officials, we thought it would be best to leave it up to the Ministry to decide

whom to invite after we assure ourselves that Brychta can attend Presumably, Ferstova
from Finance will attend also

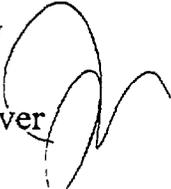
(e) JWG will follow up with California and other materials for Czechs
to review

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MEMORANDUM

TO: Czech File

CC: DLShaw

FROM: JWGulliver 

RE: Items from December, 1996 Visit

DATE: February 26, 1997

In meetings with Messrs Brychta, Kacvinsky, Horacek, and Howard Menaker, Messrs Brychta and Kacvinsky made the following points

- 1 Concrete steps need to be taken on pricing (actual prices) and pricing policies
- 2 Coal mining sector is a problem (jobs)
- 3 More detailed steps are needed in the draft policy statement
- 4 Energy law and policy need to be revised on several important points
 - Connection between authorization (licensing) and regulation (pricing)
Now authorization is only technical, but need to have economic information and conditions for authorization based on economics Also better definition of regulation
- 5 Paragraph 11 of Act 222 is not a good formulation of the procedures, right to appeal and so forth Also, better definition of competition, more explanation of price and the preparation for a rate case
- 6 Dispatch and organization of the whole power system needs to be better defined
There is a new organization of the power sector but no laws governing it What is

the participation of the state and the control of dispatch? Can dispatch be separated from CEZ? All of this must be in the law

7 Tender for new capacity is a very big problem Right now Czech is 1,000 megawatts short on capacity CEZ plans to build a new plant for 300 to 600 megawatts There are other plans to build another 2,000 or 2,500 megawatts How can the law deal with competition and new capacity

8 Mr Kacvinsky also spoke about the role of regulator and resource planning (as a deficiency in Act 222) Right now coal plants are automatically licensed There are strategic supply and public policy issues Low price Malaysian coal is coming into the market There are issues in terms of gas interruption Also, there are environmental issues There needs to be a better handle on this (No specific suggestions from Brychta and Kacvinsky)

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MEMORANDUM

TO: Bechtel-Czech Files

FROM: JWGulliver

RE: Meetings during week of April 7, 1997

DATE May 1, 1997

On Monday, April 7, Howard Menaker and I met with Vit Horacek. We reviewed with Vit the proposed legislative amendments we had jointly prepared, the paper on EU membership that Cathy Connors and I prepared, and Vit's recent meeting with Mr Kacvinsky. We also prepared for our upcoming meeting with Mr Kacvinsky.

Vit indicated that Mr Kacvinsky preliminarily thought the materials we prepared were on target. He thought the timetable for a parliamentary submission was likely to be in the next two to three months. The CEZ and other privatizations will likely be pushed off, but we should try to conclude these materials and items before the USAID program wraps up since the MOIT has no independent means of obtaining this assistance. He expected that the PHARE assistance would be minimal.

The next day, Tuesday, April 8, we met at length with Mr Kacvinsky, Jan Pisko of USAID, Vit Horacek and Petr Vanek.

Mr Kacvinsky indicated that amendment of Act 222 is priority number 1. The regulator does not currently have the ability to issue decrees. Mr Tvrznik is very concerned about this lack of power and the lack of regulatory competence to deal with energy efficiency, regulatory risks, contracts and other issues.

Mr Tvrznik wanted the legislation to carry an emergency preamble which means that the Parliament could act very quickly.

The two core amendments deal with added regulatory authority and EU harmonization.

A new central dispatch authority is slated to be put in place on April 17, but there is missing any regulatory link between central dispatch and the Czech distributors.

Mr Kacvinsky indicated that he was very pleased with the proposed amendments that we added for paragraphs 10, 8, and 9 and the appeal proceedings under the act.

He believes that ultimately the rights and obligations of what to appeal and what can be appealed have to be an Act 222 and not simply cross-referenced from the Czech Administrative Procedures Act

Contrary to his prior thinking, Mr Kacvinský would now like to separate pricing authority from Ministry of Finance to the extent possible and place it with the Ministry of Industry and Trade. While somewhat unclear in the ultimate delineation, he sees the Ministry of Industry and Trade as being empowered to set the "microeconomic" aspects of pricing for the industry, with Ministry of Finance having the opportunity to review "pricing" from a "macroeconomic" or "societal" perspective.

We should review the separate pricing act and determine if Section 11(3) is specific enough or if we need additional legislative authority for the MOIT.

When asked, Kacvinsky was unable to indicate how he would propose to resolve conflicts between MOF and MOIT.

He also feels there is a problem with respect to issuing decisions involving specific entrepreneurs. Vit Horacek and I indicated we thought we had cured that with the proposed legislative language but we would review this Article.

Mr Kacvinsky indicated he would review the materials and get back to Mr Horacek in the next week or two. He would like to have some materials to Minister Dlouhy by the end of April or early May.

He also has put together a working group to put together a model of the Czech Energy Sector involving CEZ, Central Dispatch, the distribution companies and MOIT.

Anthony Steiner and Ken Hobbs joined us for part of the meeting. Steiner indicated that Euro Energy is working on a project to split CEZ from the transmission company. He has a contract with CEZ and a contract with the disco to do so. He is also reviewing tariff structures.

He is going to be presenting the results of his studies on June 24 and 25 and sees some conflict with the pricing seminar that USAID has been planning earlier, since he does not expect to have his tariff work done at that point.

We had some discussion over coordination of the programs. We thought that maybe the first day would be a group meeting and the second day would be an open forum.

Mr Kacvinsky was sympathetic with the need to coordinate the two seminars but did not think that one needed to cancel either seminar.

We left matters that we would coordinate between the seminars but not reschedule

Later that afternoon, Howard Menaker, Jan Pisko and I met with Jim Bendar. Jim indicated that USAID is preparing a final report that will require review by Bechtel of certain sections of it. We reviewed with Jim generally the meetings of the last several days with Mr. Kacvinsky et al.

Later the same day, we met at CEZ with, among others, Mr. Ruta, Mr. Vacick, Mr. Sponer, Mr. Antos, Mrs. Fursteva and others who had attended the December meetings in Washington. The purpose of the meeting was to generally follow-up on the issues we had identified in Washington and subsequently.

We discussed at some length the new central dispatch organization that is to be set up on 17 April. It will deal with production, consumption, international corporation, domestic priorities at the 400 Kv and 220 Kv levels, possibly will deal with authorization for additional generating capacity and will work on a new model for the industry. The intent is to have an ISO as the independent regulator of the grid. The new organization will be 20% owned by CEZ, 40% by the distribution companies, 20% by the Ministry and 20% by IPPs.

Obviously, there is a great deal of detail that needs to be implemented to make this dispatch organization move forward in a transparent, non-discriminatory, efficient and non-monopolistic manner.

The participants reported some progress on pricing. The MOIT has moved forward with cost analysis on both the generation and distribution side and will prepare tariffs reflecting true costs while consumers by October 1, 1997. The Ministry of Finance still has the ultimate say on changes and prices. Two tariff issues that the group identified were (1) the actual structure or design of the tariffs and (2) the fact that current levels of prices may be insufficient.

The indicated a two step increase: one in July, 1997 of 50% and one in January of 1998 of another 16.5% to bring prices back to reflect cost.

Everyone felt additional principals and rules on regulation, including privatization, EU harmonization, market versus regulatory structures had to be set.

There are no rules yet on ownership limitations. We discussed at some length the Hungarian problem of reintegration and lack of effective regulatory authority to deal with this issue.

In terms of regional issues, we discussed the fact that the Czech model seemed to be moving toward a regulated third party access as a means of achieving EU harmonization.

The conclusion of the group was that continuing to focus n these issues in the context of regional meetings will be important even after the direct USAID-Czech program is wrapped up

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