

GETTING THE DEAL THROUGH

# Electricity Regulation

in 31 jurisdictions worldwide

Contributing editor: Earle H O'Donnell

# 2008



Published by  
**GETTING THE DEAL THROUGH**  
in association with:

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# Hungary

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## Policy

### 1 What is the governmental policy and legislative framework for the electricity sector?

The liberalisation of the electricity market started in 1994 with the enactment of the legislative framework setting the stages for privatisation of the sector, beginning in 1995. In accordance with the requirements of Directive 2003/54/EC (concerning common rules for the internal electricity market), the liberalisation should have been completed by 1 July 2007. However, by that time only the market of non-household customers had effectively been liberalised, while the liberalisation of the household customers' market will in fact only be completed by 1 January 2010, by which time universal service customers will have to choose which universal service provider they contract, in line with the recently adopted new Electricity Act (Act 86 of 2007) and the related government decree No. 237/2007 on the execution of the new Electricity Act.

The draft of the proposed energy policy for the period 2007 to 2020 has been recently published. The policy has not yet been approved by either the government or parliament. The document states the primary objectives of the Hungarian energy policy, the most important being security and sustainability of energy supply, as well as competitiveness and social responsibility in the sector. In addition, the policy states the intention to increase energy efficiency and increase gradually the ratio of renewable energy sources (biomass, biofuel, wind, solar power and geothermal energy); it also proposes to continue extensive use of nuclear energy.

## Organisation of the market

### 2 What is the organisational structure for the generation, transmission, distribution and sale of power?

With the entry into force of the new Electricity Act on 1 January 2008, the previously existing hybrid model – which included a competitive segment for eligible, non-household customers, as well as a public utility segment for household customers and those eligible customers that had not chosen to be supplied from the competitive market – has been discontinued, and the first steps of a clearly competitive market have been introduced in the electricity sector. Generally speaking, the following players are currently active in the electricity market:

- power plants (generators);
- transmission system operator (MAVIR);
- distribution system licensees;
- electricity traders (may also act as universal service provider on the basis of separate licence);

- universal service providers;
- non-universal service customers;
- universal service customers; and
- supplier of last resort (potential market actor).

The power plants generate and supply the system with electricity, selling their capacity to the electricity traders, as well as to universal service providers. The nuclear power plant located in Paks produces 40 per cent of the electricity used in Hungary.

The transmission system operator, MAVIR, is in charge of the management, reliability, safety and balance of the entire system. MAVIR is responsible for operating, maintaining and developing the transmission grid, and granting transparent and non-discriminatory access thereto.

The distribution system licensees are required to operate, maintain and develop the distribution grid in their area in a secure and efficient way and to provide transparent and non-discriminatory access thereto.

The universal service customers are those household customers and small enterprises that have elected to purchase electricity in the framework of universal service (in line with Directive 2003/54/EC, the new Electricity Act sets forth that the aim of universal service is to provide customers vulnerable to market conditions with electricity of a specified quality at clearly comparable, transparent and reasonable prices). Universal service providers are obliged to contract with universal service customers in the area of Hungary that is covered by their licence. Universal service licence can be obtained by electricity traders that have attained a full-scope operation licence (see question 14).

However, in an interim period of two years after the entry into force of the new Electricity Act (ie, between 1 January 2008 and 31 December 2009), the public utility service contracts remain in force, and the universal service providers are considered as legal successors of the former public utility service providers in such contracts by force of law (former public utility service providers have been obliged to apply for and obtain universal service licence by 1 January 2008). As of 1 January 2009, any electricity trader will have the right to obtain universal service licence for a given area of Hungary (the smallest area, for which universal service licence can be attained, is one county). All public utility service contracts will automatically terminate on 31 December 2009, and universal service customers will have to conclude universal service contract with the universal service provider they choose. Since universal service providers must cover the entire territory of Hungary, should an area not be covered by such supplier at all, the Hungarian Energy Office (HEO) will have the right to oblige electricity suppliers with significant market power to apply for universal service licence in that particular area. The

universal service provider shall refrain from selling electricity to non-universal service customers on the basis of its universal service licence, and shall avoid to have the safety of its universal service supply threatened by its electricity trading activities.

The HEO has the right to appoint a supplier of last resort, should in a particular area the electricity supply of universal service customers by their electricity supplier be endangered for any reason. In the lack of voluntary applicant, any universal service provider or electricity trader deemed suitable for such purpose may be selected by the HEO to act as supplier of last resort.

Naturally, as of 1 January 2008, customers previously involved in the public utility sector but not authorised to be provided with universal service (these are large and medium-sized enterprises) can only contract with an electricity trader, whereas customers authorised to be furnished with universal service are free to contract with an electricity trader, by which action they will become non-universal service customer. Hence, by making the first step to the wholly liberalised electricity market, the logic has been reversed: in the hybrid model, the state defined the eligible customers, who were free to enter the competitive market; in the competitive model, the state defines those who are free, because of their vulnerability, not to enter the electricity market, which is completely liberalised in terms of prices as well.

#### Regulation of electricity utilities – power generation

- 3** What governmental or administrative authorisations are required to construct and operate generation facilities?

In order to secure the safe operation of the electricity system, wind power plants (except for plants with a capacity below 50MW not connected to the transmission and distribution system as well as plants with a capacity not exceeding 50kVA) can only be constructed upon the tender of the HEO. Regarding power plants using other energy sources, separate permission from the HEO is necessary for the construction and operation of new power generating capacities (except if the total capacity is below 0.5MW). More flexible rules of licensing apply to ‘small’ power plants having a capacity of at least 0.5MW, but below 50MW. Furthermore, special, more stringent licensing requirements apply to nuclear energy generating facilities, for the construction and operation of which the permission of the Hungarian Atom Energy Authority (HAEA) is also required.

Regarding other licenses, it must be noted that procedures for building and occupancy permits have some sector-specific characteristics. Further to the building and occupancy permits, an operation permit is to be obtained from the building authority, as well. Additional, less sector-specific licensing requirements exist, such as environmental or water-use permits.

- 4** What are the policies with respect to interconnection of generation to the transmission grid?

All generators can access the transmission/distribution grid on equal terms. The conditions of access must be free from discrimination, unfair practices or unjustified restrictions. Furthermore, the terms must not jeopardise the safety or quality of the electricity supply.

- 5** Does the governmental policy or legislation foster power generation based on alternative energy sources such as renewable energies or combined heat and power?

The recently issued draft energy policy states that the proportion of renewable energy sources should be increased gradually, in line with Hungary’s financial capacity and its level of technical development.

In the current legislation there are various legal requirements that aim to foster the use of alternative energy sources. Most importantly, the electricity traders and the universal service providers have an obligation to purchase energy generated from renewable sources, waste and combined heat and power up to a certain quantity set by the HEO (compulsory purchase system). Additionally, there is an intention (declared in the new Electricity Act) to introduce a system of trading with green certificates, which would certify that electricity was generated from renewable sources or waste. The rules applicable to the green certificate system are planned to replace the compulsory purchase system, but have not yet even been published.

Less significant, but related, are the rules requiring that customers be informed of the sources of energy used in their supply, and the principle that the additional costs related to renewable energy sources must be equally distributed among customers.

#### Regulation of electricity utilities – transmission

- 6** What governmental or administrative authorisations are required to construct and operate transmission networks?

Most importantly, the licence of the HEO is necessary. Procedures for building and occupancy permits, conducted by the building authority, have some sector specific characteristics. In addition to the building and occupancy permits, an operation permit is also to be obtained from the building authority. Additional (not sector-specific) licences, such as environmental permits, are also required for the construction of transmission grids.

It shall be noted that the transmission licence and the electricity system operator licence is statutorily unified in the transmission system operator licence.

- 7** Who is eligible to obtain transmission services and what requirements must be met to obtain access?

Market participants (generators, distribution system licensees, electricity traders and universal service providers) can access the transmission grid on equal terms. The conditions of access must be free from discrimination, any unfair practices, or unjustified restrictions. Further, the terms must not jeopardise the safety or quality of electricity supply. In special circumstances (eg, if the safety of life or property is threatened, if there is a shortage of electricity, or if malfunctions occur) the electricity system operator (MAVIR) may refuse access to the transmission grid.

- 8** Are there any governmental incentives to encourage expansion of the transmission grid?

There are no sector-specific state incentives. However, in general, the Corporate Income Tax Act provides for development tax benefits available to be deducted either from the tax base (development reserve) or from the payable tax (development benefit) if the company subject to the tax realises investments.

In fact, in the electricity sector, development is ‘encouraged’ by the force of law. To this effect, the Electricity Act obliges both the transmission system operator and the distribution system

licensees to draw up the development plan of the grid operated by them, respectively, which plans are thereafter consolidated into one document (Grid Development Plan of the Hungarian Electricity System) by the transmission system operator. The Grid Development Plan shall be prepared at least biannually and approved by the HEO. If the approved development plan is not fulfilled by any grid licensee, the HEO can publish tenders for the completion of such in lieu of the defaulting grid licensee.

- 9** Is there any tariff or other regulation regarding the rates and terms for the provision of transmission services?

The price of transmission services and the related terms and conditions are fixed. Presently, the HEO is responsible for proposing the pricing structure. Thereafter, the Minister of Economy and Transport, in agreement with the Minister of Finance, is authorised to fix the price of transmission services, as well as the related terms and conditions.

- 10** Which entities are responsible for assuring reliability of the transmission grid and what are their authorities and responsibilities?

The electricity system operator (MAVIR) is in charge of the management, reliability, safety and balance of the entire electricity system. MAVIR is responsible for operating, maintaining and developing the transmission grid, and granting transparent and non-discriminatory access thereto. In special circumstances (eg, if the safety of life or property is threatened, if there is a shortage of electricity or if malfunctions occur) MAVIR is authorised to refuse or limit access to the transmission grid.

#### Regulation of electricity utilities – distribution

- 11** What governmental or administrative authorisations are required to construct and operate distribution networks?

Primarily, a licence from the HEO is necessary. Procedures for building and occupancy permits, conducted by the building authority, have some sector-specific characteristics. In addition to the building and occupancy permits, an operation permit is also to be obtained from the building authority. Additional (not sector-specific) licences, such as environmental permits, are also required for the construction of distribution networks.

- 12** Who is eligible to obtain access to the distribution grid and what requirements must be met to obtain access?

In line with the rules applicable to accessing the transmission grid, the market participants (generators, electricity traders, universal service providers) also have equal access to the distribution grid. The same conditions listed in question 10 apply.

- 13** Is there any tariff or other regulation regarding the rates or terms for the provision of distribution services?

The price of distribution services and the related terms and conditions are fixed. The HEO is responsible for proposing the price structure. Then, the Minister of Economy and Transport, in agreement with the Minister of Finance, is authorised to fix the price of distribution services, as well as the related terms and conditions.

#### Regulation of electricity utilities – sales of power

- 14** What governmental or administrative authorisations are required for the sale of power to customers and which authorities grant such approvals?

Both electricity traders and universal service providers must obtain a licence from the HEO. The license is granted for 10 years, but this period can be prolonged.

Electricity traders may have either a full-scope operation licence (allowing the licensee to directly supply consumers) or a restricted operation licence (not allowing the licensee to directly supply consumers). A full-scope operation license can only be attained by Hungarian-registered limited liability companies and Hungarian-registered branch offices of companies that have their seat in another EU member state, whereas a restricted license can only be granted to a company registered in another EU member state, provided that such company is authorised to conduct electricity trading and undertakes to maintain an office in Hungary.

A universal service licence can be obtained by electricity traders having full-scope operation licence. However, for the purpose of securing energy supply, in an interim period of two years after the entry into force of the new Electricity Act, the public utility service contracts remain in force, and the universal service providers are considered as legal successors of the former public utility service providers in such contracts by force of law (former public utility service providers have been obliged to apply for and obtain universal service licence by 1 January 2008). As of 1 January 2009, any electricity trader will have the right to obtain universal service licence for a given area of Hungary (the smallest area, for which universal service licence can be attained, is one county). Since universal service providers must cover the entire territory of Hungary, should an area not be covered by such service provider at all, the HEO will have the right to oblige electricity suppliers with significant market power to apply for such.

The universal service provider shall refrain from selling electricity to non-universal service customers on the basis of its universal service licence, and shall avoid to have the safety of its universal service supply be threatened by its electricity trading activities.

There is an additional requirement for both electricity traders and universal service providers to have financial security deposited in a subsidiary bank account, the balance of which is to be made accessible for control by the HEO.

- 15** Is there any tariff or other regulation regarding power sales?

The price of energy sold by electricity traders to non-universal consumers is subject to the free agreement of the parties.

Unlike the former public utility sector, no fixed prices apply for universal service. In this regard Hungarian legislation complies with Directive 2003/54/EC, which provides that universal service must be offered at reasonable, easily and clearly comparable and transparent prices. To this effect, the benchmark market prices and the highest margins that can be realised by the universal service providers are statutorily set. The universal service price can be modified by any universal service provider, but only once per calendar quarter, and only after such modified price has been approved by the HEO and communicated to the universal service customers concerned.

Energy sale by electricity traders as well as energy purchase by customers are subject to energy tax, in which regard only household costumers are exempted (Act 88 of 2003 on Energy Tax). The tax base is made up of the sold or purchased electricity, the tax itself is 252 forint per MWh (approximately €1 per MWh).

**16** To what extent are electricity utilities that sell power subject to public service obligations?

Household customers and small enterprises have the right to be provided with universal service (meaning electricity of a specified quality at easily and clearly comparable, transparent and reasonable prices). Since universal service providers must cover the entire territory of Hungary, should an area not be covered by any one of such licensees, the HEO would have the right to oblige an electricity supplier with significant market power to apply for universal service licence in that area. The HEO also has the right to appoint a supplier of last resort in a particular area, should the electricity supply of universal service customers by their electricity provider be endangered for any reason there. In the lack of voluntary applicant, any universal service provider or electricity trader considered suitable for such purpose may be selected by the HEO to act as supplier of last resort.

#### Regulatory authorities

**17** Which governmental or administrative authorities determine regulatory policy with respect to the electricity sector?

The Electricity Act provides for the individual regulatory tasks of both the Government and the Minister of Economy and Transport. The HEO, a specialised governmental body can be considered to be the primary authority in the electricity sector with wide-ranging competences. MAVIR, the transmission system operator also has some regulatory powers. The HAEA is a specialised administrative body responsible for the nuclear energy sector.

**18** What is the scope of each regulator's authority?

The government's responsibilities relate to the overall regulation of the execution of the Electricity Act and include tasks like setting the detailed rules of licensing, the maximum amount of fines and electricity supply regulations.

The regulatory tasks of the Minister of Economy and Transport are of a more technical nature. The Minister is responsible, among other tasks, for setting the fixed prices in the electricity sector (in agreement with the Minister of Finance), the financial and technical conditions of using transmission and distribution services.

The HEO has wide-ranging administrative powers, including (not exclusively) licensing related to the electricity sector, approval of the standard terms and conditions used in the sector, preparation of the fixed price structures, approval of the grid development plans of the transmission system operator, approval of the modification of universal service prices as proposed by universal service providers, enforcement of the rules applicable to licensed participants of the electricity sector, participation in consumer protection matters.

The transmission system operator has administrative powers in some matters, such as MAVIR's right to refuse or limit access to the transmission or distribution grid if special circumstances apply (eg, if the safety of life or property is threatened, if there is a shortage of electricity, or malfunctions occur in the operation of the system), or its obligation to prepare the Grid Development Plan as well as the rules applicable to the functioning of the electricity system.

The HAEA is responsible for licensing and other administrative matters in the nuclear energy sector.

**19** How is each regulator established and to what extent is it considered to be independent of the regulated business and of elected officials?

The HEO is an administrative authority, solely competent in most electricity regulatory matters. The HEO's dependence on the government is non-questionable, as it is supervised by the Minister of Economy and Transport. Additionally, the president and vice-president of the HEO are appointed and can be dismissed by the prime minister upon the proposal of the minister of economy and transport. MAVIR is an indirectly state-owned company limited by shares. HAEA is an administrative authority supervised by the minister of justice. All regulators are required and considered to be independent from market participants.

**20** To what extent can decisions of the regulator be challenged or appealed, and to whom? What are the grounds and procedures for appeal?

No appeal to another administrative body is available against the resolutions of the HEO, but, similarly to other administrative proceedings, the HEO's decision may be subject to court review.

Certain decisions of the MAVIR can be subject to appeal to the HEO, while appeal against the resolutions of the HAEA is available to the president of the HAEA. Second-instance decisions of the HEO or the president of the HAEA can be subject to court review.

#### Acquisition and merger control – competition

**21** Which governmental body or bodies have the authority to approve or disapprove mergers or other changes in control over businesses in the sector or acquisition of utility assets?

The Hungarian and EC competition authorities are generally responsible for change of control transactions; however, the HEO has special authorisation to review and approve transactions involving players of the electricity market.

**22** What criteria and procedures are applied with respect to the review of mergers, acquisitions and other transfers of control? How long does it typically take to obtain a decision approving or disapproving the transaction?

In accordance with the rules generally applicable to concentrations, transactions in excess of the statutory thresholds must be notified to the Hungarian Competition Authority (HCA). The HCA's examination focuses on the effects of the transaction, ie, whether it creates or strengthens dominant position in the relevant market. The applicable deadline is dependent on whether the case is completed in a first-phase procedure or subject to second-phase proceedings. First-phase proceedings must be completed within 45 days. Second-phase proceedings (ie, if the case requires more scrutiny by the HCA) must be completed within 120 days. These deadlines do not include the time necessary to comply with supplementary document or information requests made by the HCA, and may also be subject to extension.

Apart from the above generally applicable rules, additional restrictions apply to companies active in the electricity sector. The approval of the HEO is necessary for the following transactions:

- acquisition of control (in respect of votes exceeding 25, 50 or 75 per cent of the total number of votes) in the licensee;
- merger, de-merger and termination without legal successor of the licensee,
- outsourcing of the significant part of the activities set in the licence, and

- transferring, leasing or encumbering of the fundamental assets or rights of the licensee.

Similarly, approval is required for the decrease by 25 per cent or more of the registered capital of such company. The HEO's approval may not be granted or only subject to specific conditions set by the authority, if the transaction constitutes a risk to the safety, the fee structure or the quality of electricity services, or causes non-compliance with statutory requirements.

- 23** Which governmental or administrative authorities have the power to prevent or prosecute anti-competitive or manipulative practices in the electricity sector?

In order to foster efficient competition and protect the interests of customers, the HEO is obliged to conduct market analysis investigations if market conditions necessitate such, but at least once in every three years (the first such market analysis is to be completed by 15 June 2008). Licensees can also request the HEO to conduct such investigation. If, as a result of the market analysis, the HEO finds that competition is not adequately efficient in the investigated sector of the electricity market, it may identify one or more licensees as being in dominant position. The HEO is obliged to cooperate with the HCA during conducting the market analysis investigation and in respect of identifying the licensee(s) in dominant position. In the scope of this cooperation, the HEO shall observe the opinion of the HCA and may deviate from such opinion only with the accompanying reasoning.

- 24** What substantive standards are applied to determine whether conduct is anti-competitive or manipulative?

According to the test set forth in the Electricity Act, dominant position shall mean such market condition that enables the licensee to conduct its activities largely independently from its competitors, the other licensees, and, ultimately, the customers of the concerned market.

- 25** What authority does the governmental body have to preclude or remedy anti-competitive or manipulative practices?

The HEO can prescribe, for the licensee that has been identified as being in dominant position as a result of the market analysis, such obligations which are suitable to prevent abuse of the dominant position, to encourage competition and to promote customers' interests (eg, disclosure obligations can be set to foster transparency, non-discriminatory behaviour can be required, and price limitation or cost-base pricing can be requested) For the first time, this market regulation shall be completed by 30 June 2008. The HEO is obliged to cooperate with the HCA during conducting the market analysis investigation, identifying the licensee(s) in dominant position and setting the market regulation (the preventive obligations). In the scope of this cooperation, the HEO shall observe the opinion of the HCA and may deviate from such opinion only with the accompanying reasoning.

#### International

- 26** Are there any special requirements or limitations on acquisitions of interests in the electricity sector by foreign companies?

Special rules apply to ownership structure in the electricity sector to secure permanent - either direct or indirect - state ownership of certain companies. 99 per cent of the shares in MAVIR and the company operating the nuclear power plant located in Paks are

#### Update and trends

Unquestionably, the most crucial topic is the introduction of the new market model as regulated by the new Electricity Act, aimed at bringing about a fully competitive electricity market. The question is how smoothly this new model will be implemented in the two-year interim period after the the new Electricity Act comes into force, as well as what difficulties will arise in the meantime and they will be tackled by the regulator and the administrative bodies responsible for enforcing the regulation.

owned by Hungarian Power Companies Holding Ltd (MVM). In MVM, the votes of the Hungarian state are statutorily not allowed to fall under 75 per cent plus one vote (ie, it qualifies as a permanently state-owned asset). The acquisition of interest in the above three companies by any (either Hungarian or foreign) entities is not expressly prohibited by statutory law, but it is subject to tendering procedures and, in fact, such a tendering procedure is practically inconceivable at present.

Regarding acquisition of interest in market participants of the electricity sector other than the above three companies, the approval of the HEO is required to be obtained for the acquisition of control in respect of votes exceeding 25, 50 or 75 per cent of the votes.

- 27** What rules apply to cross-border electricity supply, especially interconnection issues?

Since the concerning EU regulation does not allow to discriminate between access to inland grids and access to cross-border grids, no separate license is required for cross-border electricity supply. Notwithstanding the above, the transmission system operator may refuse access to the transmission/distribution grid, if the electricity supplied through the border originates from sources, the operation of which endangers or may endanger the life or property of persons in Hungary, the nature or the environment. Additionally, access may be refused if it is considered to have an adverse effect on the use of renewable energy sources or the production of energy generated from waste or combined heat and power.

Given the relatively low transfer capacity of cross-border networks as compared to the demand for cross-border transfer of electricity, available transfer capacities are sold through capacity auctions arranged by the transmission system operator.

#### Transactions between affiliates

- 28** What restrictions exist on transactions between electricity utilities and their affiliates?

In order to ensure non-discriminatory transmission/distribution grid access to all market participants, vertically integrated electricity undertakings must meet certain unbundling obligations, meaning that the transmission system operator and the distribution system licensees must be independent from other market players (generators and suppliers) in terms of legal personality, organization and decision making. Furthermore, grid licensees can not acquire shareholding in companies active in generation or supply. Since grid licensees are statutorily obliged to ensure non-discriminatory network access, and the requirements of unbun-

dling are also required to be fulfilled as a guarantee for network access on equal terms, there is no 'extra restriction' applied for transactions between grid licensees and their affiliates active in either generation or supply. Further to the above, special accounting rules exist for integrated energy companies, which require that the various business activities are separately indicated (as if the activities were carried out by independent companies) in the finances.

**29** Who enforces the restrictions on utilities dealing with affiliates and what are the sanctions for non-compliance?

The HEO is authorised to enforce compliance with the above requirements. In the event of non-compliance with statutory requirements, the HEO may notify the company concerned to comply with the relevant legal provisions, impose fines or even withdraw the company's licences.

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