

DECEMBER 2006

ELECTRICITY REGULATION 2007

HUNGARY

Answers have been provided based on legislation in force on 1 December 2006. The document is for information purposes only and does not constitute legal advice.

POLICY

- 1 Broadly speaking, what is the governmental policy and legislative framework for the electricity sector?

The liberalization of the electricity market started in 1994 with the enactment of the legislative framework setting the stage for privatizations in the sector commencing as of 1995. In accordance with the requirements of Directive 2003/54/EC, the liberalization will be completed by 1 July 2007. Currently, the market of non-household customers is liberalized, while the liberalization of the household customers' market will be completed by 1 July 2007.

The draft of the proposed energy policy for the period between 2006 and 2030 has been recently published. The policy has not yet been approved by either of the government or the parliament. The document states the primary objectives of the Hungarian energy policy in compliance with those stated in the EU's Green Paper of 29 November 2000. The most important objectives are security and sustainability of energy supply, as well as competitiveness and social responsibility in the sector. In addition, the policy states the intention of increasing energy efficiency and gradually increasing the ratio of renewable energy sources (biomass, biofuel, wind energy, solar power and geothermal energy); it also proposes to continue extensive use of nuclear energy.

Besides the relevant EU norms, the legislative framework consists of Act CX of 2001 on the electricity (the "Electricity Act") and the related government decree no. 180/2002. (VIII. 23.) on the execution of the Electricity Act. Additional lower ranking legislation provide for the detailed, technical rules applicable to various segments of the electricity sector.

There is a government intention to replace the existing Electricity Act with new legislation effective as of 1 July 2007 to reflect further liberalization of the market. The preparation of the new

laws is yet in a preliminary phase, therefore, very little is known about the new legislation or the proposed electricity structure. Competing market models have been proposed by market participants and the Hungarian Energy Office ("HEO"); however, no government decision is yet available.

ORGANISATION OF THE MARKET

2 In general, what is the organisational structure for the generation, transmission, distribution and sale of power (including electricity and other electric products)?

Generally speaking, the following players are currently active in the electricity market:

- power plants (generators)
- electricity system operator (MAVIR)
- transmission grid operator (MVM)
- distributors
- electricity traders
- public utility service providers (wholesale and retail)
- eligible customers (currently non-household customers)
- public utility customers (household customers)

The power plants generate and supply the system with electricity, selling their capacity to the wholesale public utility service provider, as well as to market participants. The nuclear power plant located in Paks produces 40% of the electricity used in Hungary.

The electricity system operator, MAVIR is in charge of the management, safety and balance of the entire system.

The transmission grid operator (MVM) and the distributors are required to provide non-discriminative access to the transmission grid.

There are two types of customers in the current regime: eligible (non-household) customers and household customers. Non-household customers are authorized to purchase under market conditions, while public utility customers purchase electricity at a fixed price from the public utility retail service providers (which gain the electricity through the wholesale service provider). Rules on public utility services are expected to change as of 1 July 2007 in line with the EU norms on universal service.

REGULATION OF ELECTRICITY UTILITIES – POWER GENERATION

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

Separate permission from the HEO is necessary for the construction and the operation of new power generating capacities (except if the total capacity is below 0,5 MW). More flexible rules of licensing apply to "small" power plants having a capacity of at least 0,5 MW, but below 50 MW. Furthermore, special 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.

In addition to the permits mentioned above, additional, less sector-specific licensing requirements exist, such as construction, occupancy, environmental, municipality or water use permits, etc.

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

All generators 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 constitute jeopardy to the safety or quality of 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 ratio of renewable energy sources should be increased gradually, in line with the country's financial capacity and its level of technical development. Still, the policy projects that the ratio of electricity originating from renewable sources will not exceed 7% by 2025.

In the current legislation there are various legal requirements which aim to foster the use of alternative energy sources. Most importantly, the wholesale public utility service provider has an obligation to purchase energy from renewable sources up to a certain quantity set by the HEO. Additionally, there is an intention (declared in the Electricity Act) to introduce a system of trading with green certificates, which certificates are proposed to certify that electricity was generated from renewable sources. The rules applicable to this system have not been published yet.

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

REGULATION OF ELECTRICITY UTILITIES – TRANSMISSION

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

Most importantly, the license of the HEO is necessary. Additional (not sector specific) licenses, such as environmental permit, are also required for the construction of transmission grids.

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

Market participants (generators, electricity traders, eligible customers, public utility 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 constitute jeopardy to the safety or quality of electricity supply. Under special circumstances the electricity system operator (MAVIR) may refuse access to the transmission grid.

- 8 Is there any tariff or other regulation regarding the rates, terms or conditions for the provision of transmission services?

The price of transmission services and the related terms and conditions are currently fixed, and are expected to be fixed under the proposed new regime as of 1 July 2007. Presently, the HEO is responsible to set the price structure, based on which the minister of economy and transport in agreement with the minister of finance is authorized to fix the price of transmission services, as well as the related terms and conditions.

- 9 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 management, safety and balance of the entire electricity system. The transmission grid operator, MVM is in charge of the operation of the network. Under special circumstances (e.g., if there is a shortage of electricity, or if malfunctions occur) MAVIR is authorized to refuse or limit access to the transmission grid.

REGULATION OF ELECTRICITY UTILITIES – DISTRIBUTION

10 What governmental or administrative authorisations are required to construct and operate distribution networks?

Primarily, the license of the HEO is necessary. Additional (not sector specific) licenses, such as environmental permit, are also required for the construction of distribution networks.

11 Who is eligible to obtain access to the distribution grid and what are the requirements that must be met to obtain access?

In line with the rules applicable to accessing the transmission grid, the market participants (generators, electricity traders, eligible customers, public utility service providers) also have equal access to the distribution grid. The conditions of access must be free from discrimination, any unfair practices, or unjustified restrictions. Further, the terms must not constitute jeopardy to the safety or quality of electricity supply. Under special circumstances the electricity system operator (MAVIR) may refuse access to the distribution grid.

12 Is there any tariff or other regulation regarding the rates, terms or conditions for the provision of distribution services?

The price of distribution services and the related terms and conditions are currently fixed, and are expected to be fixed under the proposed new regime as of 1 July 2007. The HEO is responsible to set the price structure, based on which the minister of economy and transport in agreement with the minister of finance is authorized to fix the price of distribution services, as well as the related terms and conditions.

REGULATION OF ELECTRICITY UTILITIES – SALES OF POWER

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

Both public utility service providers (including wholesale and retail) and electricity traders must obtain a license from the HEO. Additional requirement is to provide for a financial security, currently in the range between HUF 20 million (approximately Euro 78,000) and HUF 500 million (approximately Euro 1.96 million) dependent on the annual electricity turnover of the company concerned.

14 Is there any tariff or other regulation regarding power sales?

In the current system (effective presumably until 30 June 2007), the prices in the public utility sector (household customers) are fixed, including prices charged to the household customers, as well as those charged to the retail public service providers. No fixed prices apply in the liberalized segment of the market.

Although the respective legislation is not yet available, it is expected that no fixed prices will apply for universal service as of the introduction of the proposed new rules on 1 July 2007. Hungarian legislation is expected to comply with Directive 2003/54/EC which provides that universal service must be offered at reasonable, easily and clearly comparable and transparent prices.

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

In the current system (effective presumably until 30 June 2007), the wholesale public utility service provider has an obligation to serve the retail public utility service providers, while retail providers are obliged to provide services to household customers located in the area defined in the license granted to such service provider.

Under the proposed universal service regime (effective presumably as of 1 July 2007), it is expected that household customers will continue to have the right to be supplied with electricity of a specified quality.

REGULATORY AUTHORITIES

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

The Electricity Act provides for individual regulatory tasks of both the government and the minister of economy and transport. The HEO, a specialized administrative body can be considered to be the primary authority in the electricity sector with wide ranging competences. MAVIR, the electricity system operator also has some regulatory powers. The HAEA is a specialized administrative body responsible for the nuclear energy sector.

17 What is the scope of each regulator's authority?

The government's responsibilities are related to the overall administration of the electricity sector and include tasks like setting the detailed rules of licensing, the maximum amount of fines, or the electricity supply regulations.

The minister of economy and transport's administrative tasks are of a more technical nature. The minister is responsible, among others, 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, etc.

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 electricity system operator, enforcement of the rules applicable to licensed participants of the electricity sector, participation in consumer protection matters.

In some issues the electricity system operator has certain regulatory powers, like MAVIR's right to refuse or limit access to the transmission or distribution grid if special circumstances apply (e.g., if there is a shortage of electricity, or malfunctions in the operation of the system), or its obligation to prepare 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.

18 How is each regulator established and to what extent, if any, 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. MAVIR is a state-owned company limited by shares. HAEA is an administrative authority supervised by the minister of justice. All regulators are considered to be independent from market participants.

19 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

20 Which governmental body or bodies have the authority to approve or disapprove mergers or other changes in control over businesses in the sector (including the acquisition of ownership interest in an electricity utility) or acquisition of utility assets?

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

21 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 Office. The competition authority's examination focuses on the effects of the transaction, i.e. 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 (i.e., if the case requires more scrutiny by the competition authority) must be completed within 120 days. These deadlines do not include the time necessary to comply with supplementary document or information requests by the competition authority, 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 acquisitions of control (in respect of votes exceeding 25, 50 or 75% of the votes), mergers, de-mergers, terminations without legal successor, transfers of assets or sector-specific licenses, or transformations into another corporate form of any regulated businesses in the electricity sector. Similarly, approval is required for the decrease by at least 25% 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.

22 Which governmental or administrative authorities have the power to prevent or prosecute anti-competitive practices in the electricity sector (other than through the exercise of authority over acquisitions and mergers)?

The Hungarian Competition Office is authorized to handle cases related to anti-competitive acts.

23 What substantive standards are applied to determine whether conduct is anti-competitive?

In the absence of sector specific regulations, the general Hungarian and EC competition rules apply to any anti-competitive behaviour, such as dominant position or cartel regulations.

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

Most importantly, the Competition Office may impose fines for anti-competitive behaviour in the maximum amount of 10% of the undertaking's net turnover in the preceding year. Additionally,

the competition authority may issue a resolution obligating the undertaking to refrain from anti-competitive behaviour.

INTERNATIONAL

25 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 state ownership. The electricity system operator (MAVIR), the nuclear power plant located in Paks and the transmission grid operator are described by law as permanently state-owned assets. Additionally, the state has maintained shares vested with special rights in certain power plants and electricity service providers.

26 What rules, if any, apply to cross-border electricity supply, especially interconnection issues (including cross-border fees)?

Cross-border transmission activities are subject to licensing by the HEO. Transmissions must be reported to the electricity system operator, who may refuse access to the electricity system if the electricity fails to comply with statutory requirements, or the electricity originates from unsafe sources. Additionally, access may also be refused if it is considered to have adverse effect on the use of renewable energy sources, or in the absence of reciprocity, i.e., if the electricity originates from a country where the customer which qualifies as eligible customer under the Hungarian rules does not qualify eligible.

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

TRANSACTIONS BETWEEN AFFILIATES

27 What restrictions, if any, exist on transactions between electricity utilities and their affiliates?

No sector-specific restrictions apply; however, 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.

28 Who enforces the affiliate restrictions and what are the sanctions for non-compliance?

The HEO is authorized to enforce compliance with the above requirements. In case 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 licenses of the company.

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