

COMBINED PUBLICATION

Report on the Activities and Finances
of the Energy Regulatory Office

&

National Report of the Energy Regulatory Office
on the Electricity and Gas Industries in the Czech Republic
for

2022



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1 INTRODUCTION

The Energy Regulatory Office ('ERO', 'the Regulator', or 'the Office') has been operating in the Czech Republic as an independent national regulator since 2001. ERO primarily regulates monopoly activities in the electricity, gas, and heat supply industries, determines aid for supported energy sources (SES (*POZE* in Czech)), provides consumer protection in the energy industries, and also supervises all these areas.

In 2022, the entire European energy sector felt the heavy pressure caused by the subsiding complicated period of the COVID-19 pandemic and, in particular, by the sanctions adopted by the European Union (EU) against Russia because of its unprovoked military invasion of Ukraine. Those developments intensified the energy crisis, subsequently resulting in profound changes in the energy sector when virtually all energy companies had to face a large number of shared and/or individual, but primarily adverse circumstances. One of the issues was the high prices that affected all customers, including households. The 2022 developments had a considerable impact on ERO's activities.

ERO presents its Report on the Activities and Finances of the Energy Regulatory Office [annual report] and its National Report on the Electricity and Gas Industries in the Czech Republic [national report] in a single combined publication to Parliament of the Czech Republic, the Czech Government, the European Commission (EC), the Agency for the Cooperation of Energy Regulators (ACER), and the Council of European Energy Regulators (CEER).

The first six chapters disclose the issues and information that are essential for the national report; the chapters offer, progressively, a summary of the development in the energy market (Chapter 0), consumer issues and REMIT (Chapter **Chyba! Nenalezen zdroj odkazů.**), the electricity industry (Chapter **Chyba! Nenalezen zdroj odkazů.**), and the gas industry (Chapter **Chyba! Nenalezen zdroj odkazů.**), while the Office's international activities, including ACER's and CEER's working groups, are described in Chapter **Chyba! Nenalezen zdroj odkazů.**. The remaining parts cover primarily the annual report's content important for experts in the Czech Republic (the heat supply industry in Chapter **Chyba! Nenalezen zdroj odkazů.** and SES in Chapter **Chyba! Nenalezen zdroj odkazů.**) and for Czech national institutions, such as the chapters on the ERO's budget management, human resource management, and internal control (Chapters **Chyba! Nenalezen zdroj odkazů.**, **Chyba! Nenalezen zdroj odkazů.** and **Chyba! Nenalezen zdroj odkazů.**). Chapter **Chyba! Nenalezen zdroj odkazů.** covers legislative and administrative activities. Annex 6 contains a report on the monitoring of the Czech wholesale and retail markets for 2022.

1.1 The ERO Board and organisation of the Office

ERO is headed by a five-member collective body (the ERO Board), the members of which are appointed by the Czech Government for a fixed five-year term in office. In 2022, Stanislav Trávníček (left) was the ERO Board Chairman, and (from left) Ladislav Havel, Martina Altera Krčová, Petr Kusý, and Markéta Zemanová were the other members.¹



See Annex 1 for ERO's organisational structure.

¹ Professional CVs and summaries of the ERO Board's meetings are available at <http://www.ero.cz/rada-eru>

3 DEVELOPMENT IN THE ENERGY MARKET

'Energy crisis' has become a synonym for the whole of 2022. The energy crisis had the first heavy impacts on the Czech energy market as early as the autumn of the preceding year when on 13 October 2021, a group of suppliers in the Bohemia Energy Group announced the end of their operation. (You can find more detailed information in the combined publication for 2021.)

The safety net of suppliers of last resort (SoLR) got into gear right away as regards the actual, physical supply of energy to consumers whose current supplier had folded. In the Czech Republic, this network consists of five companies. Looking back we can now see that the SoLR stood this historical acid test; in a few days, it accepted all customers of the folding businesses, and took over energy supply to them without any interruption. ERO played a crucial coordinating role in both the initial migration to SoLR (immediate transfer of large volumes of data between suppliers; instruction to hundreds of thousands of customers on the steps they should take in supplier switching) and the subsequent tackling of consumers' individual needs. ERO also intensively addressed collapses of various suppliers in the first half of 2022 when the then applicable six-month period granted by the law for using SoLR supply was ending for consumers (for most of them around mid-April) and they were facing the trap of illegal offtake and then energy supply termination. An amendment to the Energy Act has reduced the SoLR period to three months during which consumers have time to find a new supplier. After the end of this period, consumers no longer fall into the trap of illegal offtake but automatically transfer to their current SoLR's standard product and are then able to select a different supplier subsequently.

A major issue of 2022 was the impact of the energy crisis on energy prices. In the first wave, the price hike hit exactly the customers who had been compelled to migrate to SoLR. SoLR could not have had the volume of energy required for supplying covered by their long-term purchase contracts, and they were compelled to buy considerable energy quantities at wholesale spot markets, which already then were significantly more expensive. Nor were the standard products offered to customers priced the same as 'the year before' and the consumers who were changing their supplier or whose fixed-price contracts were ending experienced significantly higher energy prices. The across-the-board price increases at wholesale electricity and gas markets were heavily influenced by the geopolitical developments outside the Czech Republic.

ERO responded to the situation and society-wide demand in several ways:

- It mitigated the impact of the commodity price hikes on final customers through regulated prices, for the price hikes in energy markets were also reflected in the costs incurred in energy system operation. As early as mid-2022, the Office therefore warned that reducing the impact on final customers was contingent on subsidising certain regulated costs. These specifically included those of covering losses for distributors in the electricity grid and the gas system and those of ensuring balance in the electricity transmission system. The cabinet decided to reimburse the increased costs from the national budget to prevent the growth of energy prices' regulated component from counteracting the intention to alleviate the impacts of the energy crisis on customers through the earlier announced capping of energy prices' unregulated component (formed in the free market). For 2023, both the regulated and unregulated components of electricity and gas prices have *de facto* been capped in the Czech Republic. Until the beginning of 2023 (from October 2022), the cabinet helped households by a governmental contribution to their electricity advances (called 'economising tariff' in Czech) and the payment of all costs of support [required by law] for electricity.
- Immediate assistance to consumers: as in 2021, ERO addressed more than 22,000 consumers' submissions, i.e., two times more than in the pre-crisis years. The rising number of the submissions addressed was also reflected in its supervisory activity (ERO received over 1,500 consumer requests to start inspection, which was ten times more than in 2020) and its ADR activity (ERO received 440 applications from consumers to commence adversarial proceedings, which was eight times more than in the pre-crisis years). ERO also focused on mass-scale public education, i.e., problem prevention via its own website, seminars and webinars, cooperation with the media, training of institutions, etc.
- Legislative/conceptual framework: to reduce the risk and boost the transparency of the Czech energy market ERO prepared, and delivered to government representatives, several proposals for amendments to the legislation; these have not yet been incorporated into the Energy Act. They include, above all, an index of traders' energy provisions (the trader would provide information that it has bought the electricity/gas quantities to the supply of which it has committed in contracts),

'branding' the supplier (with a 'stigma' barring it from re-entering the industry; this would concern companies and individuals that failed to honour their obligations in the past, necessitating the migration of their customers to suppliers of last resort), tightening the licensing conditions for electricity/gas trading, and extending ERO's supervisory powers in connection with the process of making electricity and gas market monitoring more effective. An amendment transferring intermediation in energy industries under the Energy Act (until then it had been governed by the Trade Licensing Act) and extending ERO's powers to include the registration of and supervision over intermediaries entered into effect in 2022.

3.1 Extraordinary market situation and preparations for excessive revenue collection and compensations

In connection with the financial impacts of the energy crisis ERO has also been vested with powers concerning compensations for traders (granted due to the capping of energy prices for final customers) and compensation for DSOs' losses and reasonable profit, and the collection of excessive revenues from electricity generators. It has been decided that the actual payout of compensations from the national budget will be the responsibility of the market operator, OTE, a.s., while ERO will be in charge of checking the applications for justifiability and accuracy.

ERO has been appointed as the administrator of the collection of excessive revenues from generators. Compensations to suppliers and collection from generators are fundamentally different from ERO's responsibilities so far and constitute a completely novel expansion of its remit. Indeed, until now, ERO has not had any opportunity to inspect or interfere with energy producers' and suppliers' business strategies.

In 2022, ERO helped to draft some amendments to the Energy Act and, in particular, the related government orders. It also had to make appropriate changes to the staffing and organisation of its new responsibilities, but without any increase in its headcount or budgeted funds. A major part of the work on the new responsibilities is planned for 2023 when the actual collection and compensation have started.

3.2 Electricity industry

Apart from the immediate tackling of the impacts of the crisis the country is facing an immense challenge: the electricity industry's transformation, primarily involving decentralisation of generation. The heavier demands on the increasingly complicated control of the electricity grid and its reinforcement can be felt already now. According to DSOs, in 2023 alone some 75,000 new plants with a total capacity of over 5 GW are expected to be connected. This is a surge that can be felt in, for example, local overloading of systems (thus, new plants either cannot be connected or only with a lower capacity than requested). The required grid reinforcements will therefore cost dozens of billions of crowns in the near future.

At the same time, the transformation is inevitable from the perspective of boosting the country's and Europe's independence of non-European fuel suppliers, primarily the unfathomable Russian Federation. ERO considers community energy development to be crucial, but it is conditional on amending the Energy Act. In 2022, ERO itself supported, within its very limited powers, community energy development by amending the Electricity Market Rules (public notice 408/2015, as amended). They now make it possible to implement the model of sharing electricity generated by a shared electricity generating plant installed in residential buildings. Thus, ERO has extended the range of the models already existing in the market to include a new one allowing almost 200,000 residential buildings in the Czech Republic to turn their residents into prosumers and to enjoy the same opportunities for electricity generation and consumption as, for example, owners of domestic buildings.

2022 was a breakthrough year for the balancing services market: the Czech Republic became the first user of the European platforms (PICASSO and MARI) for cross-border balancing energy exchanges. Balancing energy sale/purchase and obtaining the required cross-border transmission capacity take place at a single point for all the bidding zones involved and the relevant national borders. It is a historical milestone due to the fact that until then, balancing energy trading had been a purely national matter in the Czech Republic.

In the day-ahead electricity market organised by the market operator, 24,308 GWh of electricity was traded in 2022, approximately the same as in 2021. In 2022, the weighted average of the prices of electricity traded in the day-ahead market skyrocketed to EUR 260.71/MWh. At the end of 2022, 133 market participants had access to the electricity spot market (the figure was 122 in 2021).

3.2.1 Tariff structure innovation: The concept

The changing electricity industry requires changes in the tariff structure. In 2022, ERO released its Concept of Interlinking the New Electricity Market Design with Requirements for Changes in Regulated Prices and Tariffs. The concept follows up on the existing price regulation procedures, identifies the emerging shortcomings of the current tariff system, describes the changing environment in the electricity industry, outlines the legislative framework and technology development, and specifies the future objectives and principles in respect of regulated prices and tariffs.

The key objectives of system innovation in respect of regulated prices are as follows:

- ▮ the price paid by the customer matches the costs and benefits that the customer causes in and brings into the system;
- ▮ the tariff system is predictable for a long time and directed towards new energy;
- ▮ greater usage and efficiency of the operation and development of the electricity grid.

The concept constitutes the basic framework for the tariff structure, which will offer the relevant functionalities and ensure a cost-causative linkage between the cost driver and the price paid by customers for network services in the electricity industry.

The concept sets forth the key areas of the tariff structure for prompt implementation and those for gradual implementation by the proposed timetable. Part of the prompt implementation was introducing the system of electricity sharing in residential houses as of the beginning of 2023. Electricity sharing is expected to be extended to include additional electricity sharing methods via an amendment to the Energy Act. Another area for prompt implementation is changes to the tariff system at the high voltage and medium voltage (HV and MV) levels; the allocation unit based on reserved capacity is expected to be replaced with a combination of a unit of booked input power and a unit of the highest taken power as of 2024, and a change in the pricing of reactive energy is expected in 2025.

The areas for gradual implementation primarily include the tariff structure at the level of low voltage (LV) and their implementation is conditional on some other necessary steps, such as the completion of a partial deployment of smart metering in the second half of 2027. Pending the full completion of these steps, the concept envisages that the proposed principles will be verified on a small sample of supply points with the simultaneous running of the current tariff structure at the LV level.

3.2.2 Community energy: Electricity sharing models

The full implementation of the community energy concept under the EU legislation requires a change in the Energy Act, which did not take place in 2022. Nevertheless, ERO continued in its proactive approach to community energy development under the applicable legislation via an amendment to the Electricity Market Rules, and with effect from 1 January 2023 specified the method for sharing renewable electricity in a residential house from a generating plant connected at the customer's supply point (see part **Chyba! N enalezen zdroj odkazů.**). Thus, customers in one residential house can share electricity generated, usually, in a photovoltaic plant on the roof of the residential building.

In 2022, ERO and the Ministry of Industry and Trade (MIT) completed their joint project called Community and Local Energy. Its primary objective was to network state administration bodies horizontally, coordinate the activities at the various Ministries, and explore the state administration's role in the various directions of community energy development, with a view to helping them to jointly analyse the options for the justified development of energy communities and community energy in the relevant locations. The outcomes include a specification of the various entities' initial positions and a specification of the fundamental problems from the perspective of each particular entity, and an amendment to a public notice (see above). In 2022, the project also supported the joint distribution of MIT's and ERO's results and activities to energy agencies and associations, contributed to the regional promotion of the energy theme at the level of

municipalities and Regions, and helped to propose measures related to community energy within the SMART Cities concept.

Based on the 'specification sheets' under NAP SG (National Action Plan for Smart Grids) and in coordination with other working groups, knowledge of and conditions for developing energy communities have been greatly advanced. Primarily, this involves a unified approach to the various market entities' rights and obligations to energy communities, DSOs' obligation to provide services to the communities (especially as regards access to networks, payment for network use, impacts on price controls, and responsibility for electrical energy quality), the TSO (as regards CENTSYS/DataHUB/EDC), ERO (as regards approval processes and review activities), and energy suppliers (as regards supplied/bought energy pricing, prediction models, etc.). Simultaneously, the related activities have been specified: they should result in reaching consensus on the above issues, clarifying the boundary and initial conditions given by the national legislation, and in a thorough mapping of the impacts on the implementing acts, on the various entities' activities, and on final consumers. The following key issues have been identified: models for electricity sharing (who with whom, how technically, for how much); transparent, effective, and quick formulation in implementing acts; RES connection conditions; business models ensuring the stability of energy traders; and energy and cost savings on the part of final consumers.

The end of 2022 saw a change in the management of the ZL21 specification sheet for the Energy Communities project under NAP SG. It will now be managed by the relevant DSOs, which fact will have a positive effect on preparing the propositions for all changes to the legislation through the relevant working groups. Worth mentioning is the role of ERO, which was, in its position as the expert guarantor, overseeing the projects implemented via TA ČR (Czech Technology Agency), some of them covering community energy, the deliverables of which will help to develop the implementing acts within ERO's and MIT's remit.

Another angle from which 2022 can be viewed is that the year saw a gradual formation of the above outputs/deliverables, ranging from simplicity (input analyses, literature searches, framework proposals and descriptions, identification of potentials, foundations for sociological research, etc.) to specificity and detail, which will be elaborated on in the future.

3.3 Gas industry

Work on the gas decarbonisation package, published by the Commission in December 2021 (a directive and regulation on the market in renewable and natural gases and for hydrogen and a regulation on methane emissions reduction in the energy sector) started in 2022. The Russian invasion of Ukraine, which *inter alia* influenced EU institutions' short-term legislative objectives, basically eclipsed these activities. There was a need to respond expeditiously to the loss of Russian gas and the impacts on the working of the gas market by promulgating the relevant legislation and introducing a number of measures. The mainstay legislation includes, without limitation, the following regulations:

- Regulation (EU) 2022/1032 of the European Parliament and of the Council of 29 June 2022 amending Regulations (EU) 2017/1938 and (EC) No 715/2009 with regard to gas storage;
- Council Regulation (EU) 2022/1369 of 5 August 2022 on coordinated demand-reduction measures for gas;
- Council Regulation (EU) 2022/1854 of 6 October 2022 on an emergency intervention to address high energy prices;
- Council Regulation (EU) 2022/2576 of 19 December 2022 enhancing solidarity through better coordination of gas purchases, reliable price benchmarks and exchanges of gas across borders; and
- Council Regulation (EU) 2022/2578 of 22 December 2022 establishing a market correction mechanism to protect Union citizens and the economy against excessively high prices.

In each of the countries, this legislation was felt in pressures for immediate changes to the relevant national legislation (in the Czech Republic, amendments to the Energy Act) and for designing national measures to support the functioning of the energy market, which also included caps on final energy prices and auctions for storage capacity to provide for gas supply security in the 2022/2023 winter season.

In 2022, ERO issued two *ad hoc* amendments to the Gas Market Rules (public notice 349/2015). It gradually introduced the 'use it or lose it' principle for gas storage. Another fundamental change concerned suppliers' financial deposit ('collateral') with the market operator; the time for the rapid supplier change

was reduced; the provisions were clarified in connection with the rules for taking away long-unused transmission capacity; and the required details of commercial adjustments of imbalances in the process of preventing emergencies in the gas industry.

A visible and extensively discussed consequence of the cabinet's and ERO's steps was the hitherto unseen high level of stores in Czech gas storage facilities. Gas storage has become a major and material issue in connection with departure from Russian gas supply and increasing LNG imports. Before the 2022/2023 winter, storage facilities were filled 100% and their capacity continued to be much higher than in the preceding years on a year-on-year basis.

A total of 4,423 GWh of gas was traded in the within-day gas market organised by the market operator. In 2022, the weighted average of the prices of gas traded in the within-day market increased to EUR 109.94/MWh, while in 2021 the figure was EUR 46.25/MWh. Towards the end of 2022, natural gas prices in the spot market even exceeded EUR 300/MWh. At the end of 2022, 125 market participants had access to the spot gas market (the figure was 115 in 2021).

In recent years, the prices in the Czech within-day gas market have been closely following the prices of comparable products in the German market area, Trading Hub Europe (THE within NCG), traded on the PEGAS platform operated by European Energy Exchange AG (EEX).