

**STRUCTURAL SEPARATION RECOMMENDATIONS: COUNTRY EXPERIENCE**  
***HUNGARY***  
**21-Sep-2004**

1. In the followings structural separation issues would be presented relating to three industries electricity, railway and telecommunications.

**A) Liberalisation of the electricity sector in Hungary**

**1) *General information***

2. The Hungarian electricity sector in comparison with the largest member states of the EC is very small. The whole annual electric turnover is about 40.000 GWh.

**2) *Changes in the structure of the market***

3. Before 1989 the electricity sector was wholly state owned and integrated in Hungary (MVM Trust) with central planning and extensively regulated prices. During the 1990s a massive privatisation campaign was carried out and a regulatory regime was introduced. Due to the restructuring certain parts of the electricity sector became vertically separated. The MVM remained state owned. MVM was exclusive importer, grid owner, exclusive wholesaler, while most of the producers (generation), and all distributors were separated from the MVM (but still state owned). After privatisation most of the producers (generators) became private but some of them remained owned by MVM or state (for example the only nuclear power plant in Paks with about 30-40% share in total domestic generation). Actually, the (directly or indirectly) state owned firms have the majority of capacities, moreover MVM controls most of the privately owned generation capacities by long term power purchasing agreements. All of the 6 regional distributors (regional monopolies in distribution) became affiliated companies of large European undertakings (E.on, EDF, ENI, etc.). Hungary's EC integration required the harmonisation of national regulation to EC law. The liberalisation introduced by the harmonised Act No. 110 of 2001 partly opened up electricity sector for competition. Eligible costumers got the right to choose their suppliers.

**3) *Market for non eligible costumers***

4. Non-eligible consumers' market is not yet opened up for competition. It constitutes a separate vertically organised market segment (public service). In this segment the state owned MVM still has a combination of supply obligation and monopoly rights. It is acting as a public wholesaler, buys electricity as a single buyer and sells it to public distributors as a monopoly with exclusive rights. In other words, distributors may not buy electricity directly from the generators except for the MVM renounces the concerned capacity.

5. Supply of consumers remained obligatory in the segment, and generators are obliged to offer electricity for the purposes of the public segment. Surplus capacities of the MVM can be sold on the free market.

#### 4) *Separations*

6. Although the MVM remained the owner of the transmission grid, the tasks of the TSO are already fulfilled by the state owned MAVIR Rt established in 2002. It is a speciality of the Hungarian regime that the TSO is not the owner of the grid. MAVIR is responsible for the balancing, it provides counterbalancing electricity and organizes the capacity auctions. The re-integration of the TSO into the MVM is under discussion.

7. The distributor firms are public distributor licensees as well as supplier licensees. They own their grid (and the facilities belonging to it) as a distributor and they are unbundled (in terms of accounting) from the supplier.

8. The distributors and the MVM have affiliated companies dealing with energy trade but these firms are legally independent from the incumbents (by law). (Nevertheless, according to certain commentators, while legal unbundling is formally fulfilled by the licensees, it does not work properly in practice in all cases.)

#### 5) *Free market segment*

9. As from 2003 the market was opened up for eligible consumers. Consumers with a consumption above 6,5 GWh has the right to buy energy on the free market. In 2004 consumers with medium consumption got the same right. Individuals and other small consumers would be free to select supplier from 2007.

10. The liberalisation did not result the introduction of an electricity stock market or similar legal institute.

#### 6) *The first effects of market liberalisation*

11. The electricity sector works properly since the liberalisation (no blackouts or other difficulties). New institutions and instruments appeared - dealers, new contract types etc.

12. Right after the liberalisation 20 % of the eligible costumers left the former system and step out to the free market. Later a number of eligible costumers returned due to certain disturbances on the market unrelated to the effects of the liberalisation itself. Nowadays approximately 15% of the eligible consumers participate on the free market. The first mover's save up was significant, about 10% savings appeared on energy costs. However costumers who joined the market later, could buy only on higher price levels. The proportion of eligible costumers can be said acceptable in comparison with another liberalised countries.

13. Reserved capacities of generation level appeared on the free market.

#### 7) *Problems with open up process*

14. Liberalisation is hindered by problems appearing on different levels.

- there is no renewed, unified and up-to date energy policy (government concept still negotiated),
- lack of capacities, continuous enlargement of the grid and capacities to follow demand side,
- regulatory problems (adoption of inefficient rules),
- competition problems

- lower per cent of eligible consumers entered the market than expected,
- lower amount cross-border capacities were traded on auctions than expected,
- cheaper generators are controlled by long term PPAs by the incumbent,
- MVM is able to keep a high level of reserved capacities referring to the obligation to supply provision,
- legal obligation to renegotiate the former (but nowadays still existing) long term agreements proved to be ineffective – neither generators nor MVM has no real incentives to cancel these (the former find the status quo to be comfortable without commercial risk)
- practically the most important source of supply in the free market segment could be import, but here the cross-border capacities may constitute a bottle-neck.

## **B) The rail transport sector**

15. The Hungarian railway sector underwent serious changes in the past ten-fifteen years. The industrial structure based on heavy industry was decentralised and transformed, the production of raw materials decreased, the flow direction of transported goods changed – these all affected the (former important) role of the Hungarian State Railways (MÁV). Nowadays the rail services represent only about 40% of their level two decades before. The railway sector faces intensive inter-modal competition, road transport poses a serious challenge to MÁV, logistic service providers cream off the most profitable segments of the market. In relation to intra-modal competition, the main incumbent MÁV has to keep up with the railway companies of the surrounding countries, as transit transport is an important factor in this region. Most of the Hungarian railway lines are unexploited: only 60% of the network is frequently utilised. The infrastructure needs developments.

16. Before the sector was reformed, the infrastructure and the services were all controlled by the MÁV. In 1993 – in accordance with EC law – the new Act started to diffuse gradually the former state rail monopoly. The MÁV was transformed into a state owned one-person joint stock company. Nowadays MÁV has a market share of 98%, the other railway company (the Győr-Sopron-Ebenfurti Vasút) covers only 2% of the market.

17. On 1 May 2004 – as completion of the legal framework created the possibility – the rail freight transport market was liberalised. Still in May four Hungarian private TOCs filed in their requests for operating licences and two of them has already been granted licences. Their few-month operation has brought to light inconsistencies of legislation and application and the resistance of the incumbents.

### ***The legal framework***

18. The railway sector is regulated by the Act XCV of 1993 on Railway, which defines public railways as track railway (responsible for the construction, development, modernisation, maintenance and operation of the infrastructure) and train-operating railway (providing on the one hand passenger and on the other hand freight transport services). The three activities may be performed within one vertically integrated organisation – the railway company. The separation of the accounts of these activities is compulsory, but the Act does not require structural separation. The services provided by MÁV are currently carried out in four divisions (“quasi undertakings”): the infrastructure management, the passenger transport, the freight transport and the engineering and traction. In the short term, it is obvious that the MÁV will not be legally reorganised into two or three distinct undertakings. At present it cannot be

foreseen whether this partial (accounting and functional) separation is sufficient to eliminate the contingent non-competitive activity of the incumbents (e.g. cross-subsidisation or discriminatory treatment of new entrants). The ministerial decree setting out the principles and rules of accounting separation was issued in 2003. At the same time professional administrations for the separate activities were established. During the streamlining process, a range of activities – which do not belong directly to the basic activities – were also separated and formed into distinct companies (e.g. real estate management). The objectives of the accounting separation were to limit the financial responsibility of the state and the local authorities, to enable the establishment of competitive conditions for transport activities on the track railway and also to enable the liberalisation of market entry for other rail operators.

19. Freight services and engineering are operated on a commercial basis, while scheduled local and long-distance passenger transport services remain public services. Thus the railway company is obliged to conclude contracts in order to perform these services. Accordingly, the tariffs of rail passenger transport are officially regulated through the fixing of maximum prices. The infrastructure management is also governmental responsibility. The annual agreements between the state and MÁV set out the responsibilities and obligations of both parties, the role of state in financing of a basic level of service and in improving the efficiency of the operation. Aims of the separation of accounts were to ensure the supervision of the fulfilment of duties contained in this agreement, to justify the amount of state participation in the modernisation of railway lines and to render transparent and partial elimination of cross-subsidising.

20. The Railway Act states that the infrastructure manager (the track railway or the railway company) is obliged to grant access – in return for a specified fee – to the railway network and its accessories to:

- any domestic train-operating railway or any international grouping founded by a domestic operator;
- any train-operating railway seated abroad in case of international agreement or reciprocity;
- any train-operating railway seated in the EEA in order to provide international inter-modal freight transport services;
- any international grouping founded by a railway company seated in the EEA in order to provide transit services;
- any train-operating railway seated in the EEA in order to provide international freight transport services on certain tracks.

21. According to derogatory provisions, from 1 May 2004 until 31 December 2006 only 20% of the network capacity of the TERFN can be used by railway undertakings seated in the EEA.<sup>1</sup> From 1 January 2007, they will have access to the 100% of TERFN.

22. A ministerial decree (issued in 2002) regulated the licensing of railway undertakings. It defines the operating licence as a prerequisite for any transport activity carried out on the traction. The licence is granted by the Central Transport Authority (KKF). The detailed conditions of granting the licence are laid down in the decree. The regulation ensures that the applicant is obliged to meet the requirements relating to good repute, financial fitness and professional competence. The regulation entered into force in July 2002, providing that the incumbents should obtain the licence within a certain period of time. Other ministerial

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<sup>1</sup> The TERFN covers most of the Hungarian railway lines.

decrees (issued in 2003, but entered into force on 1 May 2004) set up the independent, state-owned institution (in form of a limited liability company) responsible for the allocation of railway infrastructure capacity and the charging of infrastructure fees and the regulatory body (RB) of the rail sector. To ensure the independence of the rail regulator from any infrastructure manager, charging or allocation body, it was prescribed that the RB operates besides the Supreme Transport Authority (KFF). Notwithstanding that the RB has sector specific competences and the competition authority continues to perform its general competition tasks in the railway sector, the conclusion of a co-operation agreement on the possible overlapping powers might be necessary.

### **C) The Telecommunications sector**

23. Before 1990, telecommunications, postal services and broadcasting were provided by a single undertaking. As the privatisation process started after the transition, these activities were restructured into three undertakings: the telecommunications operator became a private undertaking (the state has a golden share, though), while postal services and broadcasting are still provided by public companies (the privatisation of the broadcasting company is just under preparation). Below, we only elaborate on telecommunications and postal services, since broadcasting services are not covered by the questionnaire.

#### ***Telecommunications***

24. When privatising the former state monopoly, it was considered to separate the network from services, but these considerations did not prevail. Low penetration rates in fixed telephony even lead decision makers to give new concessions for building new networks. It resulted in four local monopolies, which had the exclusive right to provide local and national telephony services on their newly built networks. Partial liberalisation took place from 1992 and accounting separation rules tried to handle the problem cross-subsidizing competitive activities from non-competitive ones.

25. The full liberalisation of the telecommunications market happened at the end of 2001. That time telecom regulations already contained provisions on accounting and functional separation, but structural separation has not been an issue since the early 90's.

26. Currently, Hungarian telecom regulations are harmonised to the new EU regulatory framework. According to this, the national regulatory authority (NRA) is to impose obligations on operators with significant market power. The Hungarian NRA is authorised by law to impose the obligation of accounting and functional separation, but the obligation of structural separation is not foreseen in the telecom act. The draft measures of the NRA concerning the retail fixed telephony markets are available on the NRA's web page. However, accounting and functional separation obligations can only be imposed on SMP operators in wholesale markets, where the incumbent provides interconnection and/or access services for new entrants. Draft measures concerning these markets are not yet published.

#### ***Postal services***

27. In Hungary, we had only one abuse case in the postal sector, which derived from the coexistence of competitive and the non-competitive activities of the incumbent postal operator, and could raise the question of structural separation.

28. In 2002 the Competition Council imposed a fine of HUF 20 million (EUR 81000) on Magyar Posta Rt. (MP) for abusing its dominant position through its discount policy in the postal item market. MP is the incumbent postal operator in the Hungarian market, active both in the not liberalised market (market of delivery) and in already competitive markets, connected to postal services (such as the relevant market of creating postal items, generally invoices). MP infringed the competition rules because it gave higher discount whenever the item to be delivered were created by MP itself.

29. This problem was solved ex-post by competition law, and the regulation came into force in 2004 (The Act of CI 2003 on the Post and its executive orders/decrees) is able to prevent similar cases, because it contains provisions on accounting separation and on transparent, non-discriminatory, and uniform pricing and discount system of universal service providers.

30. These obligations seem to be appropriate without structural separation in order to handle the symbiosis of the competitive and the non competitive activities, but in the future before the Hungarian Post will be in the process of privatisation (still there is no decision on that) the benefits and cost of structural separation and that of behavioural measures will have to be considered.