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EFET¹ concerns regarding the supervisory fees levied by MEKH

1 August 2019

Dear Minister

EFET would like to once again express great concerns regarding the supervisory fee levied by the Hungarian Energy and Public Utility Regulatory Authority (MEKH), in particular the way it is structured and it is being levied on market participants.

As we understand, also from previous communication with Hungarian authorities, the purpose of the supervisory fee is to cover the costs associated with performing regulatory functions and ensure the financial independence of the regulator. Whilst we understand the purpose of such fee, we are strongly concerned with its scope and application.

We understand that the fundamental issues with the supervisory fee have been inherited from a period when trading in the wholesale market was at much smaller scale. However, as liquidity developed over the past few years, the fundamental problems highlighted below resurface as a real danger to market development in Hungary.

Below we are providing our view on the impact of such fee and possible way forward.

1. Scope of the supervisory fee

One of the biggest problems with the fee is its wide scope of application. It is worth noting that if the aim of the fee is to charge companies on the basis of the benefit/gains they generate from wholesale energy trading activities on the Hungarian market, the fee should be applied to profit generated by trading within Hungary rather than individual trades (as is currently the case). A fee based on revenues imposes a cost to companies independently of whether they have made profit or loss throughout the year.

In the current charging framework, this fee is calculated based on all the sales of licensed participants, including exports. This means that a contract traded several times in the market would be subject to the fee any time it is traded. This creates pan-caking of fees into a single contract. Each contract traded in the market is at least subject to a double fee, (one for the seller, one for the buyer). In a liquid wholesale market such a contract changes hands several times before delivery to the final consumers. The application of the fee at each trade hence has a significant impact on the price. A 10 MW calendar base product traded 10 times (before actually being delivered) at a price of 54 EUR/MWh would generate a fee of 3, 548 EUR (about 9% of the energy price).

Moreover, it is not clear whether the fee does allow netting by counterparty, which we think is a major flaw. If a market participant sells to a certain counterparty and then buys back from the same counterparty, the fee will be still charged regardless of the fact that the market participant's position with the counterparty could even be zero. The netted part per counterparty in practice is not delivered, so the impact is same as if that volume was financially traded.

The minimum that should be done in this respect is to apply netting per counterparty on the delivered volume, so that the fee would only be charged to net delivered volume to counterparty A or B depending who would be the net seller instead of being charged on all the sales from counterparty A to B and all the

¹ The European Federation of Energy Traders (EFET) promotes competition, transparency and open access in the European energy sector. We build trust in power and gas markets across Europe, so that they may underpin a sustainable and secure energy supply and a competitive economy. We currently represent more than 100 energy trading companies, active in over 27 European countries. For more information: www.efet.org.

sales from counterparty B to counterparty A. A simple example of how this practice is currently applied and how we believe it could apply is given in the Table 1 below. Examples below are based on the way markets trade. The application of the fee without netting leads companies active in trading wholesale market, hence providing liquidity to the Hungarian market, to be subject to enormously high yearly fees.

In most European countries a fee financing regulatory activities is not charged to the trading firms. It is generally paid by the generators, suppliers when supplying end users, and network operators. The costs are passed through to the retail price without affecting the market price itself, regardless of the number of times a contract is traded in the market.

EFET's view is that the Hungarian supervisory fee, if applied, should be charged on a net delivered/scheduled basis so that it does not discourage companies from trading and providing liquidity to the market.

Table 1: Application of supervisory (license) fee

Entity A contracts with entity B	
<u>Cal base products (all same products)</u>	
A sales to B	B sales to A
30 MW @ 43 EUR/MWh	20 MW @ 43.5 EUR/MWh
40 MW @ 44.5 EUR/MWh	25MW @ 44 EUR/MWh
10 MW @ 45 EUR/MWh	10 MW @ 45 EUR/MWh
	5 MW @ 45.5 EUR/MWh
<i>Payments on GROSS sales basis (existing)</i>	
Total Sales A to B	Total Sales B to A
80 MW BASE (8760h)	60 MW BASE (8760h)
700,800 MWh	525,600 MWh
30,835,200 EUR	23,192,100 EUR
<i>Supervisory fee: 0.075%</i>	<i>Supervisory fee: 0.075%</i>
Fee paid by A: € 23,126	Fee paid by B: € 17,394
Total fee paid to Regulator for the above transactions: € 40,520	
<i>Payments on NET sales basis (proposed)</i>	
Net Sales A to B	
20 MW BASE (8760h)	
175,200 MWh	
7,708,800 EUR (Weighted average price used, 44 EUR/MWh)	
<i>Supervisory fee: 0.075%</i>	
Fee paid by A: € 5,782	

Total fee paid to Regulator for the above transactions:	€ 5,782
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2. Market liquidity (trading physical versus financial)

In recent years we have witnessed two important impacts on the liquidity of physical traded products in the Hungarian market. Firstly, the Hungarian power market was in a strong bullish trend in recent years, calendar base load prices peaked well above 60 EUR/MWh in 2018, almost doubled compared to the lows of 2016. As a result, the amount of the supervisory fee for the same product, to be paid by the market participants also doubled, just because the price of the underlying product increased significantly.

Secondly, the rule 2018.XCIX.§60 modified the fee to be paid to MEKH as of 2019 from 0,06% to 0,075%, a significant increase of 25%.

EFET believes these two factors have a significant impact on market liquidity. The Hungarian market has experienced a welcome upward trend in traded volumes that lasted since the market opening in 2003 and well until 2016. In recent years we experience a decline in the liquidity of physical trading practically in all product segments. Market participants are trading fewer physical forwards and now prefer financial products on the Hungarian market. The liquidity levels of the Hungarian market made it a reference market for the entire Balkan region that is now in danger. EFET believes that physical liquidity is important both for international traders and locally based market participants.

Traders have seen similar market developments in other Eastern European countries, e.g. in Romania where a similar fee was intended to be increased significantly. As an immediate effect, physical forward trading collapsed in Romania. In the end, the ANRE fee was modified to be calculated based on benefit/gains of trading companies, which makes much more sense from a socio-economic point of view.

3. Conclusion and recommendations

The structure and scope of application of the supervisory fee applied by MEKH has a negative impact on the liquidity of the market, it increases the cost of trading for market participants that support the liquidity in the wholesale market, and hence the cost of energy for end-consumers.

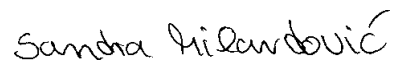
EFET strongly believes that there are fundamental issues with the application of supervisory fee by MEKH. We urge Hungarian authorities to consider an immediate review of the supervisory fee calculation method so that, going forward, it is applied on a netted basis rather than on gross sales as it is currently the case. This would not endanger the financing of the regulator. Instead it provides certainty as it is based on delivered volumes rather than traded volumes and support physical trading. The increase in traded volume in the wholesale market over recent years has enormously boosted the absolute yearly fee payments made by market participants to MEKH. The fee has not been reduced to reflect that. Rather the contrary, as the fee was increased in 2012 and 2018 and it is acting as a tax as bulk part of it goes to the state budgeted, while only a portion of it is used to finance regulatory activities in Hungary.

We are keen to further discuss and explain our views on the matters outlined above.

We thank you for considering our views and would appreciate your response to the views and proposals we have set out in this letter.

Yours sincerely,

On behalf of the European Federation of Energy Traders

A handwritten signature in black ink that reads "Sandra Milardovic". The signature is written in a cursive style with a capital 'S' and 'M'.

Sandra Milardovic,

EFET TF Eastern Europe Electricity

² Article 36f (1) defines the persons required to contribute to the Electricity System Security Fund, which includes in 2. traders importing electric power.