

# **REPORT ON THE IMPLEMENTATION OF THE TREATY**

## **ENERGY COMMUNITY SECRETARIAT**

**For the occasion of  
the 5<sup>th</sup> Permanent High Level Group Meeting on 28 June 2007 and  
the 2<sup>nd</sup> Ministerial Council Meeting on 29 June 2007  
in Becici, Montenegro**

**May 2007**

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## 1 BACKGROUND

The *Report on the implementation of the Treaty* is prepared for the occasion of the 5<sup>th</sup> Permanent High Level Group Meeting on 28 June 2007 and the 2<sup>nd</sup> Ministerial Council Meeting on 29 June 2007 in Becici, Montenegro. It represents an extended version of the *2006 Annual Report on the Activities of the Energy Community to the European Parliament and to the Parliaments of the Adhering Parties and of the Participants* (submitted to the 2<sup>nd</sup> Ministerial Council Meeting) elaborating findings from its implementation part in more details.

The idea behind the *Report on the implementation of the Treaty* is a consolidation of all electricity and gas related reports on compliance with benchmarks and with regional market design which are drafted so far by the Energy Community Secretariat. It serves to present the overall findings related to the implementation of the Treaty exactly one year upon its entry into force. As the first priority in the past period has been given to the opening of the electricity and gas markets for non-household customers as determined from 1 January 2008, the present *Report* concerns only implementation of the *Acquis* on energy (electricity and natural gas) in the period until 1 July 2007 (one year upon entry into force of the Treaty). Other reports analyse the state of play in relation to the tasks from other areas of the Treaty such as competition, environment, renewables, security of supply statements, and generally applicable standards.

Therefore, this *Report* is directly related to the following previously delivered *Reports*:

- The *Report on power and gas road maps for state and regional market opening*<sup>1</sup>, delivered on 30 September 2006, which as for the ultimate scope developed a road map for regional power and gas market opening, including a time table of state and regional level actions required to support market opening with a regional dimension from 2008;
- The *Report on electricity benchmarks*<sup>2</sup>, and respectively the *Report on gas benchmarks*<sup>3</sup>, delivered on 31 October 2006, which proposed a benchmarking analysis including the benchmarks themselves on a state by state basis against the provisions of the *acquis communautaire* on energy (electricity and gas parts, respectively) under the Treaty (Directives 2003/54/EC and 2003/55/EC, and Regulation 1228/2003) and opened a way towards measurement of the progress;
- The *Report on compliance with electricity benchmarks*<sup>4</sup>, and respectively the *Report on compliance with gas benchmarks*<sup>5</sup>, delivered on 22 December 2006, which contained findings from the *Road Maps* and the *Action Plans*<sup>6</sup> for national and regional electricity and gas market opening, including a timetable of state and regional level actions required to support market opening with a regional dimension from 2008;
- The *Report on compliance with electricity benchmarks – Revised March 2007*<sup>7</sup>, delivered on 31 March 2007, which consolidated previous *Report* from

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<sup>1</sup> [Report on power and gas road maps for state and regional market opening](#), Energy Community Secretariat, September 2006

<sup>2</sup> [Report on electricity benchmarks](#), Energy Community Secretariat, October 2006

<sup>3</sup> [Report on gas benchmarks](#), Energy Community Secretariat, October 2006

<sup>4</sup> [Report on compliance with electricity benchmarks](#), Energy Community Secretariat, December 2006

<sup>5</sup> [Report on compliance with gas benchmarks](#), Energy Community Secretariat, December 2006

<sup>6</sup> [Road Maps and Action Plans, Ministerial Council Meeting, Skopje](#), November 2006

<sup>7</sup> [Report on compliance with electricity benchmarks – Revised March 2007](#), Energy Community Secretariat, March 2007

December 2006 by making the findings comparable at the same time level – end of March 2007. The reasoning behind this *Report* is that since the Action Plans and the Road Maps were drafted in September/October 2006 and presented in November 2006 to the Ministerial Council, there appeared a necessity to update the *Action Plans* with recent progress<sup>8</sup> achieved within the last six-month period (till the end of March 2007);

- The *Report on regional electricity market design*<sup>9</sup>, delivered on 28 February 2007, which analysed the existing works related to the SEE regional electricity market design and provided a framework for a peer review of the electricity market administration on a party-by-party basis to promote the best practice;
- The *Report on state level compliance with regional electricity market design*<sup>10</sup>, delivered on 31 March 2007, which analysed the electricity market administration and application of the peer review mechanisms to promote best practice, notified anomalies and abuses on a state by state and regional basis, and provided proposals to the Contracting Parties to remove anomalies and/or abuses; and
- The *Final Report on compliance with electricity benchmarks*<sup>11</sup>, delivered on 30 April 2007, which consolidated all reports on compliance with benchmarks and with regional electricity market design in order to form the final report on compliance as a consequence of necessity for adjustment of the project deliverables (electricity related) since the commencement date of the operation of the Secretariat (the adjustment is referred to bringing all the project deliverables since the commencement of the project to the same time level).

The operational activities under all previously noted electricity and gas related *Reports* have been described in the *ECSEE Annual Report*<sup>12</sup> (delivered on 30 March 2007). That *Report* contains not only description of the objectives, indicators of achievements, means of verification, risks and conditions, but also their actual realisation on individual basis.

State of play in relation to competition and environment was a subject of the *Good Governance Report*<sup>13</sup>, which addressed these topics from the perspective of the Treaty. The Contracting Parties also committed to foster the use of renewable energy, where the Secretariat provided support. More specifically, the Treaty asks not only for the implementation by the Contracting Parties of the *Acquis* on energy (electricity and gas) and competition, but also environment and renewables<sup>14</sup>.

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<sup>8</sup> [Progress notice in electricity, 4<sup>th</sup> PHLG Meeting](#), Vienna, March 2007

<sup>9</sup> [Report on regional electricity market design](#), Energy Community Secretariat, February 2007

<sup>10</sup> [Report on state level compliance with regional electricity market design](#), Energy Community Secretariat, March 2007 ([link](#))

<sup>11</sup> [Final Report on compliance with electricity benchmarks](#), Energy Community Secretariat, April 2007 ([link](#))

<sup>12</sup> [ECSEE Annual Report](#), Energy Community Secretariat, March 2007 ([link](#))

<sup>13</sup> [Good Governance Report](#), Energy Community Secretariat, January 2007 ([link](#))

<sup>14</sup> [Renewables and Environmental Policy within the Energy Community](#), Energy Community Secretariat, 4<sup>th</sup> PHLG Meeting, Vienna, March 2007 ([link](#))

## 2 OVERALL FINDINGS FROM THE ELECTRICITY RELATED REPORTS

This Chapter of the *Report on the implementation of the Treaty* presents hereafter the overall findings from all previously mentioned electricity related *Reports*, which are brought up at the same time level (end of March 2007) while estimating the compliance: compliance with electricity benchmarks and state level compliance with regional market design. Specific and detailed party-by-party<sup>15</sup> findings and conclusions are given in the mentioned *Reports*.

### 2.1 General

The process of adoption of the *Acquis* in the Contracting Parties is in different stages, with significant differences between them. But even so, the electricity sector reforms are more advanced than those in gas, in all Contracting Parties. The stage of reforms is also influenced by the Contracting Parties' respective positioning in relation to the negotiations with EU in relation to enlargement where energy is one of the topics, as described below.

Bulgaria and Romania, two acceding countries in 2006 and new EU Member States since 1 January 2007, are more advanced in the adoption, as well as in the implementation, given that they have completed the negotiation process for the accession, and adoption of the *Acquis* was a pre-requisite. Croatia as EU candidate country which started the negotiations for the EU accession will have to agree on a timetable for the adoption of the *Acquis* with the European Commission. In December 2005, a candidate country status was granted to the former Yugoslav Republic of Macedonia, but without stating a specific date for starting the negotiations. The former Yugoslav Republic of Macedonia signed the Stabilisation and Association Agreement (SAA) in 2001 and enforced it in 2004. Potential Candidate Countries include: Albania with which the SAA was signed in June 2006; Bosnia and Herzegovina for which the SAA talks were open in November 2005 (currently, the technical talks on the SAA are finalised, but the SAA itself has not been signed yet); Serbia for which the SAA talks were first open in October 2005 and then called off since May 2006; and Montenegro with which the SAA was initialled in March 2007. As it relates to UNMIK, in November 2006 the European Commission adopted an overall enlargement strategy document and a Progress Report on Kosovo under UN Security Council Resolution 1244.

### 2.2 Electricity Road Maps and Action Plans

Even when entirely achieved, the simple adoption of the *Acquis* on energy (electricity part) represents the minimum requirement to be able to comply with the Treaty, but it will not guarantee the successful creation of national functioning energy markets. When it comes to the implementation of the *Acquis*, the differences between the Contracting Parties become really important. The state level *Road Maps* and the *Action Plans* are expected to give a view on both the adoption and the implementation state of play, if properly prepared.

By fulfilling the tasks from the *Road Maps* and the *Action Plans* for opening state level electricity market, based on a common approach and the timetable given by the Treaty, each Contracting Party ensures not only desired harmonization of national rules and designs, but also provides political commitment to actions and deadlines, to achieve targets of the Treaty.

The drafting of the *Road Map* and the *Action Plan* for regional level actions shall be based on several pending agreements or models related to:

- *Interconnection capacity*: Adoption of a regional coordinated market based mechanism for allocation of interconnection capacity.

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<sup>15</sup> Romania and Bulgaria were the Contracting Parties in 2006 and since 1 January 2007 are the new EU Member States. As they ceded from being the Contracting Parties to the Participants, the European Commission has taken monitoring tasks from the ECS. However, the ECS retained them in the 2006 Comparison Tables throughout the *Reports* delivered in the first half of 2007 under the Grant Contract.

- *Inter TSO Compensation (ITC)*: Agreement on the merger of the EU and SEE or other transition options as increasing the injection fee; Development of a methodology to invoice or credit market participants in relation with ITC.
- *Market Design/Market Rules*: The European Commission shall state a preference on wholesale market opening; Adoption of guidelines for market opening, indicating measures to start up competition; Development of guidelines for market rules.
- *Licensing*: Analysis of the compatibility and harmonization of licensing for regional trading, including harmonization of the concepts of trade and supply.

### 2.3 Findings at the SEE Regional Level

The recognition of the SEE regional electricity market outlook is based on the findings from the *SEETEC Report*<sup>16</sup>, which was used in the Secretariat's pursue as a background paper for further development, by collecting and processing the information on a party-by-party basis. The Secretariat, on the basis of the *SEETEC Report*, drafted the *Road Maps* and the *Action Plans* for the transposition of the *Acquis* on energy as given by the Treaty and implementation of measures for electricity and gas market opening starting from January 2008 in each individual Contracting Party. The recommendations from the *SEETEC Report* have been introduced into the *Road Maps* and the *Action Plans* with specific outputs, target dates, and institutions responsible for the implementation. The following findings are recognised at the SEE regional level:

#### National Wholesale Markets and Initial Retail Market

- There is very little free market wholesale activity within most of the SEE countries since the supply business of the distribution company is either still integrated with the dominant generation company or is not eligible. Suppliers are obliged to buy from a wholesale supplier which is in fact a single buyer attached to the TSO, at regulated prices;
- Eligibility thresholds are quite different in the Contracting Parties, with only limited opening in terms of consumption threshold in many of these;
- Market rules have been formally approved by Regulators only in a few Contracting Parties.

#### Cross border allocation procedure

- Limited availability of interconnection capacity for most market participants;

#### ITC

- Lack of fair methodology for SEE countries/TSOs has conflict of interests with regard to handling the ITC funds;

#### Access to national networks and the role of the TSOs

- TSOs are being created as legal entities, but in many cases, they are carrying out the same business process as prior to unbundling;

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<sup>16</sup> *Study of the Obstacles to Trade and Compatibility of Market Rules*, CIDA/SEETEC, 9<sup>th</sup> Athens Forum, Athens, October 2006 ([link](#))

### **Market concentration and vertical foreclosure**

- High concentration in the generation;
- Presence of wholesale suppliers, limiting trade;

### **Operability of Market Rules at national level**

- Market rules are still under discussion in many Contracting Parties;
- Many constraints to free trade are included in the rules;
- Some participants are not bound by the rules;
- Many rules do not promote competition;

### **Tariff issues**

- Retail tariffs are often lower than wholesale regional prices;

### **Harmonisation/compatibility issues (e.g. compatibility of market rules)**

- Absence of a common approach to regional market design;
- Development of national market rules without regional consultation;
- Absence of compatibility between the Contracting Parties' rules;

### **Licensing issues**

- Wide divergence in regulation of licensing for traders and suppliers.

The regional level *Road Map* and the *Action Plan* is expected to include the next steps as listed below, and recommended by the *SEETEC Report*. The Secretariat believes the measures should be decided mainly by regional bodies (the Regulatory Board and the ETSO/SETSO TF) or ad-hoc groups (the Implementation Group for the Auction Office), and implemented by the Contracting Parties:

## **2006 - 2007**

### **Cross border allocation**

- Develop market based mechanisms for capacity allocation (by Regulators/TSOs).
- Complete application of Congestion Management Guidelines and Flow-based Coordinated Actions; Creation of an Auction Office and regional rules (by Regulators/TSOs).
- Develop rules in Tariff Methodology for utilization of auction revenues (by Regulators/TSOs).

### **ITC**

- Merging of the two funds (by ETSO).
- Develop rules in Tariff methodology for contribution of market participants to the ITC payments/credits (by Regulators/TSOs).

### **Access to national networks**

- Implement new market related processes such as scheduling of bilateral contracts, grid planning, etc. (by TSOs).

### **Market concentration and vertical foreclosure**

- State preference regarding alternatives for market opening and role of the wholesale supplier (by the European Commission).
- Develop guideline for market opening related to development of competition in generation-supply (by ad-hoc group Regulators/Market Operators).

### **Operability of market rules at national level**

- Confirm importance of implementation of market rules for transparency reasons (by the EC/Regulators/Market Operators).
- Develop guidelines for market rules development related to minimum national requirements (by ad-hoc group Regulators/Market Operators).

### **Tariff issues**

- Prepare Action Plans for tariff rationalization; regulation of suppliers' purchases (by Regulators/ERGEG).

### **Harmonization/compatibility issues (e.g. compatibility of market rules)**

- Define minimum level of compatibility between national markets (by ad-hoc group Regulators/Market Operators).
- Develop Discussion Paper on Regional Institutions (by ad-hoc group Regulators/Market Operators).

The reform process needs to be reinvigorated by re-launching the SEE regional electricity market design topic once again. It is necessary to agree on a definitive institutional basis (from the market perspective) that would shift responsibilities to the Contracting Parties and maintain a strong guiding role for the EC. The SEE electricity market should be fully incorporated into the European Community's Internal Electricity Market to create only one electricity market which would act under the rules of the UCTE and under legislative standards compatible with those of the EU.

Development of the SEE electricity market is envisaged in a phased three-step approach:

1. First phase, ending on December 2005. To conclude the legislative, regulatory and technical rules for the development of each national market in the SEE region, along the lines of the EU legislation and practices. To complete the institutional reforms on a national level.
2. Second phase, ending on December 2007. Envisage the regional aspects of the market, such as investments of a regional nature and their guarantees, the SMD for the regional market, regional licensing, regional scheduling and trading facilitation mechanisms.
3. Third phase, starting from January 2008. The actual, real-time operation of the integrated SEE electricity market.

As this phased approach entails the risk to focus all efforts on the national reforms during the delicate initial stages of development of the regional electricity market, it is also necessary to promote the regional perspective. Regional market arrangements should be investigated

now and not later, with the view to start building at least a regional market design which would act as the medium-term perspective for national market developments. However, any effort regarding regional market development should neither refrain nor jeopardize the developments undergoing in most of the national electricity markets. A balanced evolution of national and regional perspectives should be maintained.

The procedure undertaken and results achieved so far reveal that the following steps are necessary to develop the SEE electricity market further on:

- Increase convergence of national market designs and market rules;
- Increase convergence of system access rules and transmission tariffs;
- Make stronger co-ordination of national institutions;
- Regulators to elaborate proper market rules and monitor national markets;
- TSOs to ensure optimal use of cross-border capacity and balancing power exchange;
- Regulators and TSOs to make available sufficient transmission capacity to players;
- Give strong political support to the whole process.

Detailed regional electricity market design in SEE will have to take care of the following:

- Standardization of bilateral contracts with physical delivery;
- Regional day-ahead market (implementation of flow-based market coupling);
- Balancing arrangements (cross-border intraday and balancing trade);
- Harmonisation and improvements of the long term explicit auctions of transmission capacity (improvement of auction rules and firmness of cross-border capacity allocation);
- Common calculation of cross-border capacities (long and short term);
- Maximisation of the amount and of the utilisation of cross-border capacities;
- Congestion management;
- Capacity adequacy mechanisms (regional capacity investment plan);
- Regional SEE Market Operation Code;
- Market mitigation, monitoring and transparency;
- Harmonisation and improvement of data exchange;
- Power exchanges and financial institutions.

A strong need for international regulatory cooperation is necessary in order to ensure the compatibility of national arrangements, which is also linked to issues of jurisdiction and authority limited to the national territory leaving an empty space to the cross border ones. Compatibility of reforms and harmonization of the process is required throughout the SEE region, if the ultimate goal, an operational SEE market, is to be operable in 2008.

Obstacles to trade such as network operations, wholesale arrangements, and regulation across the SEE electricity market give a hint to what the priority areas for future actions are. Assessment of possible obstacles to effective trade is primarily based on a compatibility of national market arrangements. Within the SEE region, electricity trading is launched through bilateral contracts between suppliers and consumers. Bilateral contracts combined with the third party access (TPA), transparent capacity allocation and congestion management rules, and inter TSO compensation (ITC) mechanism, represent the very first – minimum – basis for electricity trading under the liberalized market regime.

Currently, it seems that the perspective of the SEE electricity market is rather based on a harmonized set of rules, or in other words on the regional market mechanisms that would operate as supplementary mechanisms to the national markets. But, besides putting in place a minimum common set of basic rules, such as regulatory authority, TSO, unbundling, cross-border trade (CBT), congestion management, it is also necessary to define the SMD model for the regional market to establish a common trading and market arrangement in a wider area than a single country. The SMD would enable suppliers and power generators to operate on an equal basis in a wider regional electricity market (REM) instead of a narrow national market, with electricity flowing among the countries of the region as if it was flowing within a single country. The degree of true market opening and the degree of partial protection of national interests shall depend on the choice of regulatory parameters and the pace of constraint removal.

## 2.4 Findings at the National Level

When it comes to the identification of the state of play at an individual level, the Contracting Parties will be requested to prepare their Annual National Reports, consisting of a descriptive text format document and a set of quantitative parameters – benchmarks. The National Reports have been structured to include all the information that relevant national authorities should submit to the European Commission in compliance with the reporting requirements of the Directive 2003/54/EC (2003/55/EC for gas) and the Regulation 1228/2003/EC.

Before the Annual National Reports for 2006 will be prepared, and in order to lay the ground for this, and also to use it later as a monitoring tool, the ECS undertook a party-by-party comparison in the form of the Comparison Tables for benchmarking purposes, on a regular half-year basis. The first issue of the Comparison Tables was conducted and delivered in July 2006 covering period of the first half of 2006 (January 2006 – June 2006; H1 2006). The second issue appeared as an update covering period of the second half of 2006 (July 2006 – December 2006; H2 2006). At the end, for the purpose of consolidation of all findings, the Comparison Tables were updated once more and brought at the same time level – end of March 2007. The Comparison Tables contain results of the benchmarking activities undertaken by the ECS in the course of 2006/2007. These benchmarking activities were aimed at estimating the state of play with respect to the adoption of the *Acquis* on energy (electricity and gas), competition, environment and renewable energy sources. They were used as a reference starting point for the *Road Maps* and the *Action Plans*.

The benchmarking activities included the preparation and circulation of several questionnaires on the adoption of the *Acquis*, which were filled in by the Contracting Parties, assisted by the ECS, and checked through structured interviews with the relevant institutions in three rounds of country missions (1<sup>st</sup> round in April-May 2006; 2<sup>nd</sup> round in September-October 2006; and 3<sup>rd</sup> round in March 2007). The findings were incorporated in the Comparison Tables related to the *Acquis* adoption, with respect to Institutional Building, Electricity, Gas, Competition, Environment, Renewable Energy Sources, Energy Infrastructure Projects and finally Conclusions. The summary of findings is presented below.

The assessment reflects mostly the state of play with respect to the adoption of the *Acquis*, and represents in a lesser degree, an analysis of its effective implementation, or the functioning of the market. The scope of the coloured benchmarking was to trigger awareness with the Contracting Parties as well as the European Commission to the current state of play with respect to the provisions of the Treaty and the EC Directive/Regulation. The analysis, although far from being refined enough, gives at least a concise view of the ECS's understanding of the state of play. Being based mainly on information provided by the Contracting Parties, and some cross checks by the ECS through interviews, performed within a very short period of time, it may lack some accuracy.

Main findings, derived from the ECS assessment (Figure 1), are organised in the following chapters: Institutional Organisation; Public Service Obligations and Customer Protection; Monitoring Security of Supply; Technical Rules; Generation; Unbundling Provisions and Access to Accounts; Third Party Access; Market Opening; Cross Border Trade Mechanism:

- ***Institutional Organisation:*** From the regional perspective, the energy policy issues are dealt with by a ministry in all Contracting Parties, which gives the comfort that these are treated at the high political level; all Contracting Parties have set up a regulatory authority, which is at least responsible for the tariff calculation methodology, among others. The critical point under this subject is often an insufficient administrative capacity; its strengthening should be considered the first priority. ***Regional perspective:*** All Contracting Parties are anchored into the EU framework, either as EU accession countries/new Member States, EU candidate countries (with and without started negotiations) or the SAP related parties (with the SAA signed, being negotiated or with called off negotiations). As the three different general political vehicles are applied, the Contracting Parties have three (if not more) different speeds for fulfilment of taken EU related commitments. From the other side, the Treaty sets a common (minimum acceptable) speed level of reform progress in the energy sector. All Contracting Parties have ratified the Treaty. In general, the Contracting Parties have a well developed set of primary legislation in electricity. In very few cases it needs further alignment to the Directive 2003/54/EC (instead to 96/92). Secondary legislation shall be improved, especially regarding cross border issues. National electricity markets need further harmonisation at the regional level. All Contracting Parties shall satisfy UCTE operational and planning technical criteria to avoid deteriorating system security. Special care shall be paid to improvement of collection rate and decrease of technical and non-technical losses, which shall be accompanied by the social action plans. Cross-subsidization shall be avoided. Unbundling activities shall be extended to include not only the TSOs, but the DSOs as well.
- ***Public Service Obligation and Customer Protection:*** The regional outlook is rather positive, with most Contracting Parties having provisions for PSO in their electricity acts, or grid codes, or licensing obligations, etc. Nevertheless, when it comes to vulnerable customers' protection, this is either missing or not explicitly reflected in the legal framework. Some Contracting Parties seem to be lagging behind the average (Bosnia and Herzegovina, the former Yugoslav Republic of Macedonia and Montenegro). ***Regional perspective:*** Public service obligations are well defined. However, further work is needed on the provisions related to the appointment of a supplier of last resort, and especially to include provisions to protect vulnerable customers.
- ***Monitoring Security of Supply:*** The regional outlook is positive, with most Contracting Parties having adopted SoS provisions in their state legislation; only in Serbia these are not yet all in force. ***Regional perspective:*** In general, provisions on monitoring of security of supply are put in place. However, mechanisms for their practical implementation call for further attention. Otherwise, security of supply may be endangered which further on might undermine activities related to opening of the electricity market.
- ***Technical Rules:*** The outlook from the regional perspective is encouraging, as these are fully adopted in Albania, Bosnia and Herzegovina, Croatia, Bulgaria and Romania; partially available in Montenegro, the former Yugoslav Republic of Macedonia and UNMIK; in a less developed stage in Serbia. ***Regional perspective:*** Technical rules are mostly put either in place or in final phase of regulatory approval. The Contracting Parties that still do not have a complete set of technical rules are urgently finishing this work. Technical rules are one of

very important parts related to security of supply from operational, maintenance and planning viewpoints.

- **Generation:** Most Contracting Parties (6 out of 9) have adopted provisions regarding authorisation for new capacities, licensing, and tendering for new capacity, and the other three have partially adopted these. The regional outlook is rather favourable. **Regional perspective:** In general, electricity generation is subject to licensing. Construction of new generation capacity is subject to authorisation. However, some of the Contracting Parties do not have provisions on tendering of new capacity on the grounds of security of supply.
- **Unbundling and Access to Accounts:** In general, the unbundling and access to accounts of transmission system operators is more advanced than that of distribution system operators. From the regional perspective, the outlook is more positive than negative. Only one Contracting Party (Albania) seems to be lagging behind the average of the region in this respect. On the other hand, only three Contracting Parties (Croatia, the former Yugoslav Republic of Macedonia and UNMIK) have fully adopted these in their legislation. **Regional perspective:** In general, unbundling provisions and provisions related to access to accounts are put in place. However, their full practical implementation and monitoring shall be of immediate first priority to the Contracting Parties.
- **Third Party Access:** At the regional level, all Contracting Parties with only one exception (Serbia that lacks some provisions) have fully adopted the provisions ensuring TPA to the transmission and distribution networks. **Regional perspective:** Provisions related to regulated TPA to transmission and distribution grids are put in place, as well as obligations to justify the denial of access to the grid. However, substantial amount of work is left after putting in place of provisions related to application of the cost reflective methodology for determining network access tariffs.
- **Market Opening:** The regional outlook is not positive, with “only some provisions available” as an average ranking. Four Contracting Parties (Bosnia and Herzegovina, Bulgaria, Croatia and Romania) out of nine have set a calendar and took concrete measures to open the market for both non-household and household customers that are in line with the Treaty requirements. The rest of the Contracting Parties are lagging behind. **Regional perspective:** Implementation of the timetable for market opening from the Treaty is not likely in practical terms from today's perspective. Therefore, gradual opening of the electricity market with dynamics (eligibility threshold and timetable) shall be specified and harmonised with the Treaty provisions. Measures (in form of action plans) for the market opening shall be introduced and monitored on a regular basis in order to avoid likely numerous derogations and delays of reform process.
- **Cross Border Trade Mechanism:** The regional outlook is not positive, as almost all Contracting Parties (with the exception of Romania) have little formal provisions in force that are in line with the Regulation 1228/2003/EC. However, it shall be noted that recently majority of the SEE TSOs started to conduct explicit auctions of cross-border transmission capacity, while the rest of them announced the same intentions by mid-2007. **Regional perspective:** Cross border issues in electricity transmission (inter TSO compensation, network capacity allocation, congestion management, balancing mechanism) are of critical importance to opening of the electricity market. They need significant attention and substantial further support and work on their implementation.

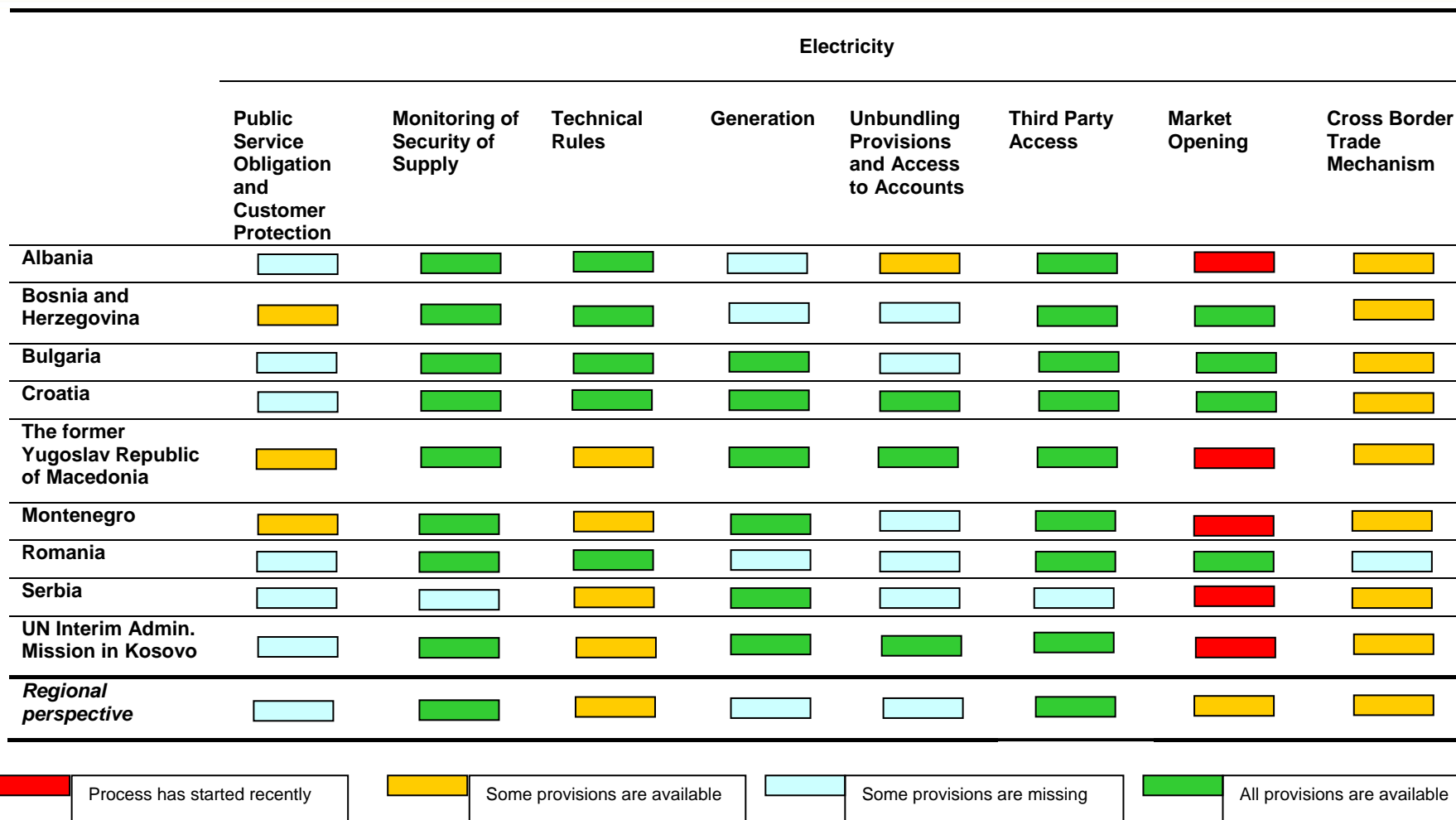


Figure 1: Benchmarking – Electricity

The implementation of the *Acquis* on energy (electricity part), and the adoption of necessary measures to open the electricity market for competition are supported by the development of tailor-made *Road Maps* and the *Action Plans*, per each Contracting Party. The *Road Maps* are derived out of the *Action Plans* by extracting the most outstanding issues that need further attention per each Contracting Party. Their time horizon is till the end of 2007. The adoption and implementation of the *Acquis* on energy is envisaged by July 2007. The adoption of the necessary measures that will ensure the minimum level of competition to guarantee eligibility for non-household customers is expected by January 2008.

The *Road Maps* aim to commit each of the Contracting Parties to undertake actions under a specific deadline. The Contracting Parties are free to choose the means. During the monitoring phase the ECS will request them to provide detailed information. On that basis, the Secretariat has composed the key indicators for the operation of the national and regional electricity markets, and set up a structure to monitor them.

Upon development and consolidation of the *Road Maps* and the *Action Plans*, the following problems are anticipated when it comes to the opening of the electricity market properly:

- Replication of some problems as experienced in some EU Member States<sup>17 18 19 20 21</sup>, and
- Materialization of the characteristic problems in the Contracting Parties:
  - Emergence of problems related to status of economies; and
  - Appearance of problems due to limited size, fragmentation and uncertain development of the electricity markets.

Based on the ECS findings up to date, it is expected that some problems as experienced in some EU Member States will be replicated in the Contracting Parties as well. The most important ones of these are the following:

- The persistence of regulated prices, especially for the benefits of eligible customers, putting obstacles in the path of new market entrants;
- The lack of legal unbundling and insufficient managerial separation of TSOs/DSOs to ensure their independence;
- Discriminatory Third Party Access and insufficiently transparent tariffs;
- The free choice of supplier;
- The power of regulatory authorities, in particular as regards setting tariffs for access to networks;
- The preferential access given in the case of certain long-standing electricity contracts; and
- Failure to notify Public Service Obligation and to indicate the origin of electricity (no labelling provisions).

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<sup>17</sup> *Infringement procedures opened in the gas and electricity market sector by Member State and Letters of formal notice for Directives 2003/54/EC and 2003/55/EC*, European Commission, Reference: MEMO/06/152, Date: 04/04/2006, Brussels, 4 April 2006 ([link](#))

<sup>18</sup> *The Commission takes action against Member States which have not opened up their energy markets properly*, European Commission, Reference: IP/06/430, Date: 04/04/2006, Brussels, 4 April 2006 ([link](#))

<sup>19</sup> *The Commission to act over EU energy markets*, European Commission, Reference: MEMO/06/481, Date: 12/12/2006, Brussels, 12 December 2006 ([link](#))

<sup>20</sup> *The Commission takes action against Member States which have still not properly opened up their energy markets*, European Commission, Reference: IP/06/1768, Date: 12/12/2006, Brussels, 12 December 2006 ([link](#))

<sup>21</sup> *European Commission sets out a new impetus for the internal energy market*, European Commission, Reference: MEMO/07/9, Date: 10/1/2007, Brussels, 10 January 2007 ([link](#))

It is obvious that the TSOs/DSOs and regulatory authorities related problems are of the utmost significance:

- TSO/DSO related problems:
  - Absence of or insufficient legal unbundling of TSO/DSO in order to guarantee their independence;
  - Absence of independence of TSO/DSO in the management;
  - Absence of or insufficient functional and accounting unbundling of TSO/DSO in order to guarantee their independence; and
  - Delay in the entry into force of legal unbundling of TSO/DSO.
- Regulatory authorities related problems:
  - Insufficient competences of the regulators in relation to the *acquis*, in particular with respect to
    - the possibilities to file complaints to the regulator,
    - the management and allocation of interconnection capacity, and
    - fixing the tariffs of access to the networks.

Besides the problems that have appeared in the EU, it is anticipated that some of the problems which are characteristic for the Contracting Parties will also materialize in the course of opening of the electricity market. The main economic indicators of the Contracting Parties give an impression on the current status of their economies, revealing (too) often a very low income on an average basis which may prevent timely introduction of cost-based market prices of electricity and network related services.

Explicitly, the following problems are the most characteristic ones in the Contracting Parties:

- Low level of tariffs which leads to regulate the whole energy chain;
- Metering, billing and invoicing of customers;
- Collection rates, both non payment and non invoicing as no data base of customers;
- Transparency in data and harmonisation of accounts;
- Lack of domestic generation which leads to high imports;
- Existence of wholesale suppliers;
- TSO bundled with Market Operator;
- Cross-border issues (Inter TSO Compensation mechanism, Capacity allocation procedures, Regional balancing mechanism);
- DSO bundled with retail; and
- Lack of investments in distribution.

Moreover, some problems related to limited size of the electricity markets in the Contracting Parties are also anticipated, especially when it comes to consequences of their fragmentation and uncertain future development.

The most notable cases of the work in progress in complying with the electricity and gas benchmarks, were highlighted. The work in progress was highlighted in relation to electricity, assessed as being the most critical one for continuation of the successful implementation of the *Acquis* on energy (electricity part), among the Contracting Parties; these could be divided into two groups: 1) *Acquis* related issues (Table 1); and 2) Market related issues (Table 2). The issues reflect also the areas where assistance is highly needed and expected. The updated assessment was made for all seven Contracting Parties, and Bulgaria and Romania, to reflect progress since October 2006 to March 2007.

<b>Main work in progress issues</b>	<b>Albania</b>	<b>Bosnia and Herzegovina</b>	<b>Bulgaria</b>	<b>Croatia</b>	<b>The former Yugoslav Republic of Macedonia</b>	<b>Montenegro</b>	<b>Romania</b>	<b>Serbia</b>	<b>UNMIK</b>
<b>Acquis related issues</b>									
Customer protection	X	X			X	X			
Authorisation procedures for new generation capacity	X	X				X			
Technical rules					X	X		X	X
TSO unbundling	X		X	X		X			
DSO unbundling (network operation and supply)	X	X	X		X	X		X	X
Development of the Market Operator's functions	X			X		X			
Eligibility status	X				X	X		X	X
Allocation of cross border transmission capacity	X	X	X	X	X	X		X	X
Participation in the ITC mechanism				X					X

Table 1: The work in progress on the *Road Maps* and the *Action Plans* of the Contracting Parties – *Acquis* related

<b>Main work in progress issues</b>	<b>Albania</b>	<b>Bosnia and Herzegovina</b>	<b>Bulgaria</b>	<b>Croatia</b>	<b>The former Yugoslav Republic of Macedonia</b>	<b>Montenegro</b>	<b>Romania</b>	<b>Serbia</b>	<b>UNMIK</b>
<b>Market related issues</b>									
Further structural development of incumbents	X	X	X					X	X
Generation unbundling and privatisation	X		X						
Restructuring and consolidation of the distribution companies before unbundling and privatisation	X								X
Business performance indicators, collection rate, reduction of losses	X				X	X			X
Market monitoring, including imports	X	X	X	X	X	X		X	X
Transparency of information related to market operation (i.e. TSO web pages)	X	X	X	X	X			X	X
Market rules	X				X	X		X	X
Application of technical measures and business procedures for customer switching	X	X	X	X	X	X		X	X
Remote automatic meter reading on a wide scale		X		X					
Balancing market and auxiliary services market	X			X	X	X		X	X
Development of cost-reflective tariff methodologies, including ones for balancing and auxiliary services	X	X			X	X		X	X
Prediction of correct load profiles for different customer groups for further development of tariff methodologies		X		X					

Table 2: Work in progress on the *Road Maps* and the *Action Plans* of the Contracting Parties – Market related

A brief description on a party-by-party basis follows hereafter on the Acquis related issues:

- **Customer protection:** The following Contracting Parties still have to finalise adoption of the specific regulatory framework for vulnerable customer protection: Albania, Bosnia and Herzegovina, the former Yugoslav Republic of Macedonia and Montenegro;
- **Authorisation procedures for new generation capacity:** Albania, Bosnia and Herzegovina and Montenegro still have to develop and adopt these procedures;
- **Technical rules:** The former Yugoslav Republic of Macedonia, Montenegro, Serbia and UNMIK have to complete the preparation and adoption of the technical rules for TSO and DSOs;
- **TSO unbundling:** In order to achieve full unbundling and independence of the TSO, Albania, Bulgaria, Croatia and Montenegro have to finalise the process;
- **DSO unbundling** (separation of network operation from supply activities): In most Contracting Parties, with the exception of Croatia and Romania, the unbundling of the DSO(s) from the supply branches has not been achieved yet;
- **Development of Market Operator's functions:** Three of the Contracting Parties have shown an initiative to improve the process: Albania, Croatia and Montenegro;
- **Eligibility status:** Adoption of a plan to grant eligibility to all non – household customers by the deadline foreseen by the Treaty, of 1 January 2008, or actual fully opening the electricity market has been achieved in Bosnia and Herzegovina, Bulgaria, Croatia and Romania; the other Contracting Parties have not yet achieved this;
- **Allocation of cross-border transmission capacity:** With exception of Romania, in the remaining Contracting Parties there is still either a significant work to be done or a full alignment to be made;
- **Participation in the ITC mechanism:** Only Croatia and UNMIK remain yet to participate in the ITC mechanism(s).

The progress status is given hereafter with respect to issues that are essential to a functional electricity market on a party-by-party basis for the following categories:

- **Further structural development of incumbents:** There is still a need for progress in Albania, Bosnia and Herzegovina, Bulgaria, Serbia and UNMIK;
- **Generation unbundling and privatisation:** More work remains to be done in Albania and Bulgaria, in order to satisfy pre-stated objectives;
- **Restructuring and consolidation of distribution companies before unbundling and privatisation:** There is a recognised need for more progress in this area, in Albania and UNMIK;
- **Business performance indicators, collection rate, reduction of losses:** These issues require more attention and increased efforts in Albania, the former Yugoslav Republic of Macedonia, Montenegro and UNMIK;
- **Market monitoring, including imports:** All Contracting Parties, with the exception of Romania, should enhance the market monitoring;
- **Transparency of information related to market operation:** With the exception of Montenegro and Romania, all the other Contracting Parties have to continue improving the transparency in market operation;

- **Market rules:** Five Contracting Parties that include Albania, the former Yugoslav Republic of Macedonia, Montenegro, Serbia and UNMIK still have to adopt or improve market rules to be in full compliance with the *Acquis*;
- **Application of technical measures and business procedures for customer switching:** Most Contracting Parties are still working or have to start working on this;
- **Remote automatic meter reading on a wide scale:** Two Contracting Parties - Bosnia and Herzegovina and Croatia – explicitly expressed intentions to work on the wide scale introduction of remote automatic meter reading;
- **Balancing market and auxiliary services market:** More progress needs to be seen either in the introduction or significant further development of market mechanisms for purchase or sale of electricity for balancing demand and supply, as well as for purchasing electricity for ancillary services (Albania, Croatia, the former Yugoslav Republic of Macedonia, Montenegro, Serbia and UNMIK);
- **Development of cost-reflective tariff methodologies:** This is a key requirement for having a functional market and attracting investments in the Energy Community; nevertheless more work is needed to exercise cost-reflective tariff methodologies in Albania, Bosnia and Herzegovina, the former Yugoslav Republic of Macedonia, Montenegro, Serbia and UNMIK;
- **Prediction of correct load profiles for different customers group for further development of tariff methodologies:** In principle only two Contracting Parties – Bosnia and Herzegovina and Croatia – explicitly expressed intentions to enhance efforts in this area.

As for the overall key findings here, it seems so far that each Contracting Party has started to develop its own market arrangements while, more or less, respecting a minimum set of common rules on cross-border trade issues. Institutions, related to system and market operation at the SEE regional level, are yet to be established should truly SEE regional market be put into operation. Closer market integration is expected to be gradually pursued later on. In other words, system and market operators, regulators and participants currently function in the SEE region under very different legal and commercial conditions which makes it difficult to implement in one blow a single detailed operating framework full in all countries. The liberalization of the cross border trade of electricity has already started and currently awaits mutual harmonisation of operating rules and procedures at the SEE regional level as a prerequisite for further intensification. The main findings which are singled out in the present *Report* clearly show that. Apart from the ITC mechanism (voluntary/partially in place; difficulties in merging), other SEE wide regional mechanisms (capacity allocation; balancing mechanism) are still at the conceptual R&D level.

### 3 OVERALL FINDINGS FROM THE GAS RELATED REPORTS

This Chapter of the *Report on the implementation of the Treaty* presents hereafter the overall findings from all previously mentioned gas related *Reports*.

#### 3.1 Gas Road Maps and Action Plans

The same comment as for electricity (please see 2.1) applies to the gas sector; The adoption of the *Acquis* on gas represents the minimum requirement to be able to comply with the Treaty, but it will not guarantee the successful creation of national functioning gas markets. When it comes to the implementation of the *Acquis*, the differences between the Contracting Parties become really important.

Similar to electricity, by fulfilling the tasks from the *Road Maps* and the *Action Plans* for opening state level gas market, based on a common approach and the timetable given by the Treaty, each Contracting Party ensures not only desired harmonization of national rules and designs, but also provides political commitment to actions and deadlines, to achieve targets of the Treaty.

#### 3.2 Findings at the SEE Regional Level

The drafting of the *Gas Road Map* and the *Action Plan* for regional level actions shall be based on several pending agreements or models related to:

- *Interconnection/transmission capacities/transit capacity*: elaboration and implementation of a non-discriminatory transparent methodology for capacity allocation supporting cross border trade/competition
- *Cross border transport*: elaboration and implementation of a transparent non-discriminatory process facilitating cross border transport
- *Storage/LNG facilities also used abroad, if any (regulated or negotiated access)*: elaboration and implementation of non-discriminatory transparent published tariffs and or terms for storage/ LNG usage which facilitate cross border gas trade and competition
- *Licensing*: analyze the compatibility of licensing and develop and implement licensing provisions which foster cross border trade/transport

The Secretariat drafted the *Road Maps* and the *Action Plans* for the transposition of the *Acquis* on energy as given by the Treaty and implementation of measures for gas market opening starting from January 2008 in each individual Contracting Party. The following findings are recognised at the SEE regional level and are similar to electricity sector:

#### **Interconnection/transmission capacities/transit capacity:**

- interconnection capacity/transmission capacities/transit capacities are available however a non-discriminatory transparent methodology for capacity allocation supporting cross border trade/competition is not in place yet.

### **Access to national networks and the role of the TSOs**

- In those Contracting Parties where TSOs are being created as legal entities, they are still carrying out the same business process as prior to unbundling in most of the Contracting Parties;

### **Operability of Market Rules at national/regional level**

- Because of missing the primary legislation in many of the Contracting Parties, development of market rules has been partially started just in some of the Contracting Parties;

### **Tariff issues**

- Grid usage tariffs for transmission and transit mostly have not been developed yet;
- Storage access tariffs mostly have not been developed in accordance with the requirements of the Directive 2003/55/EC;

### **Harmonisation/compatibility issues (e.g. Interconnection agreements and operational balancing agreements)**

- Regional interconnection agreements have not been developed yet; also operational regional balancing agreements have not been developed yet.
- Generally Applicable Standards have not been adopted yet;
- Absence of compatibility between the Contracting Parties' - rules if any.

### **Licensing issues**

- If elaborated there is wide divergence in regulation of licensing for traders and suppliers.

The regional level *Road Map* and the *Action Plan* is expected to include the next steps as listed below. The Secretariat believes the measures should be decided mainly by regional bodies (the Energy Community Regulatory Board) and implemented by the Contracting Parties:

### **2006 - 2007**

#### **Interconnection/transmission capacities/transit capacity:**

- Starting the process of adoption and implementation of the Regulation 1775/2005 on conditions for access to the natural gas transmission networks

#### **Access to national networks and the role of the TSOs**

- Completion of the implementation of the Directive 2003/55/EC and starting the process of developing the necessary market rules

#### **Operability of Market Rules at national/regional level**

- Starting the process of adoption and implementation of the Regulation 1775/2005 on conditions for access to the natural gas transmission networks

## Tariff issues

- Completion of the implementation of the Directive 2003/55/EC and starting the process of developing at least the necessary methodology for tariff determination
- Starting the process of adoption and implementation of the Regulation 1775/2005 on conditions for access to the natural gas transmission networks

## Harmonisation/compatibility issues (e.g. Interconnection agreements and operational balancing agreements)

- Starting the process of adoption and implementation of the Regulation 1775/2005 on conditions for access to the natural gas transmission networks

## Harmonization/compatibility issues (e.g. compatibility of market rules)

- Starting the process of adoption and implementation of the Regulation 1775/2005 on conditions for access to the natural gas transmission networks

Regional market arrangements should be investigated now and not later, with the view to start building at least a regional gas market design which would act as the medium-term perspective for national gas market developments. A balanced evolution of national and regional perspectives should be maintained.

The procedure undertaken and results achieved so far reveal that the following steps are necessary to develop the SEE gas market further on:

- Increase convergence of national market designs and market rules;
- Increase convergence of system access rules and transmission tariffs;
- Make stronger co-ordination of national institutions;
- Regulators to elaborate proper market rules and monitor national markets;
- TSOs to ensure optimal use of cross-border capacity and cross border balancing;
- Regulators and TSOs to make available sufficient transmission capacity to players;
- Give strong political support to the whole process.

Detailed regional gas market design in SEE will have to take care of the following:

- Standardization of contracts;
- Balancing arrangements - including cross-border balancing;
- Common calculation of cross-border capacities (long and short term);
- Maximisation of the amount and of the utilisation of cross-border capacities;
- Congestion management;
- Capacity adequacy mechanisms (regional capacity investment plan), if needed
- Market monitoring and transparency;
- Harmonisation and improvement of data exchange;
- Gas hub(s) and financial institutions.

A strong need for international regulatory cooperation is necessary in order to ensure the compatibility of national arrangements, which is also linked to issues of jurisdiction and

authority limited to the national territory leaving an empty space to the cross border ones. Compatibility of reforms and harmonization of the process is required throughout the SEE region, if the ultimate goal, an operational SEE market, is to be operable.

Obstacles to trade such as network operations- including interconnection agreements and operational balancing agreements, and regulation across the SEE gas market give a hint to what the priority areas for future actions are. Assessment of possible obstacles to effective trade is primarily based on a compatibility of national market arrangements. Within the SEE region, gas trading is launched through bilateral contracts between suppliers and consumers. Bilateral contracts combined with the third party access (TPA), transparent capacity allocation and congestion management rules, represent the minimum basis for gas trading under the liberalized market regime.

Currently, it seems that the perspective of the SEE gas market is rather based on a (harmonized) set of rules, or in other words on the regional market mechanisms that would operate as supplementary mechanisms to the national markets. But, besides putting in place a minimum common set of basic rules, such as regulatory authority, TSO, unbundling, cross-border trade (CBT), congestion management, it is also necessary to define the regional market model to establish a common trading and market arrangement in a wider area than a single country. The regional market model would enable suppliers to operate on an equal basis in a wider regional gas market instead of a narrow national market, with gas flowing among the countries of the region as if it was flowing within a single country. The degree of true market opening shall depend on the choice of regulatory parameters and the pace of constraint removal.

### 3.3 Findings at the National Level

When it comes to the identification of the state of play at an individual level, the Contracting Parties will be requested to prepare their Annual National Reports, consisting of a descriptive text format document and a set of quantitative parameters – benchmarks. The National Reports have been structured to include all the information that relevant national authorities should submit to the European Commission in compliance with the reporting requirements of the Directive 2003/55/EC.

Before the Annual National Reports will be prepared, and in order to lay the ground for this, and also to use it later as a monitoring tool, the ECS undertook a party-by-party comparison in the form of the Comparison Tables for benchmarking purposes, on a regular half-year basis. The first issue of the Comparison Tables was conducted and delivered in July 2006 covering period of the first half of 2006 (January 2006 – June 2006; H1 2006). The second issue appeared as an update covering period of the second half of 2006 (July 2006 – December 2006; H2 2006). At the end, for the purpose of consolidation of all findings, the Comparison Tables were updated once more and brought at the same time level – end of March 2007. The Comparison Tables contain results of the benchmarking activities undertaken by the ECS in the course of 2006/2007. These benchmarking activities were aimed at estimating the state of play with respect to the adoption of the *Acquis* on energy (electricity and gas), competition, environment and renewable energy sources. They were used as a reference starting point for the *Road Maps* and the *Action Plans*.

The benchmarking activities included the preparation and circulation of several questionnaires on the adoption of the *Acquis*, which were filled in by the Contracting Parties, assisted by the ECS, and checked through structured interviews with the relevant institutions in three rounds of country missions (1<sup>st</sup> round in April-May 2006; 2<sup>nd</sup> round in September-October 2006; and 3<sup>rd</sup> round in March 2007). The findings were incorporated in the Comparison Tables related to the *Acquis* adoption, with respect to Institutional Building, Electricity, Gas, Competition, Environment, Renewable Energy Sources, Energy Infrastructure Projects and finally Conclusions. The summary of findings is presented below.

The assessment reflects mostly the state of play with respect to the adoption of the *Acquis*, and represents in a lesser degree, an analysis of its effective implementation, or the functioning of the market. The scope of the coloured benchmarking was to trigger awareness with the Contracting Parties as well as the European Commission to the current state of play with respect to the provisions of the Treaty and the EC Directive/Regulation. The analysis, although far from being refined enough, gives at least a concise view of the ECS's understanding of the state of play. Being based mainly on information provided by the Contracting Parties, and some cross checks by the ECS through interviews, performed within a very short period of time, it may lack some accuracy.

Main findings, derived from the ECS assessment (Figure 2), are organised in the following chapters: Institutional Organisation; Public Service Obligations and Customer Protection; Monitoring Security of Supply; Technical Rules; Unbundling Provisions and Access to Accounts; Third Party Access; New Infrastructure and Exemption; Market Opening; Cross Border Trade Mechanism:

- ***Institutional Organisation:*** From the regional perspective, the energy policy issues are dealt with by a ministry in all Contracting Parties, which gives the comfort that these are treated at the high political level; most of the Contracting Parties have set up a regulatory authority, which is at least responsible for the tariff calculation methodology - among others. The critical point under this subject is often an insufficient administrative capacity; its strengthening should be considered the first priority. ***Regional perspective:*** All Contracting Parties are anchored into the EU framework, either as EU accession countries/new Member States, EU candidate countries (with and without started negotiations) or the SAP related parties (with the SAA signed, being negotiated or with called off negotiations). As the three different general political vehicles are applied, the Contracting Parties have three (if not more) different speeds for fulfilment of taken EU related commitments. From the other side, the Treaty sets a common (minimum acceptable) speed level of reform progress in the energy sector. All Contracting Parties have ratified the Treaty. In general, some of the Contracting Parties have a well developed set of primary legislation in electricity. In most cases it needs further alignment to the Directive 2003/55/EC. Secondary legislation shall be elaborated/improved in most of the Contracting Parties, especially regarding cross border issues. National gas markets, if any, need further harmonisation at the regional level. All Contracting Parties shall satisfy appropriate operational and planning technical criteria to avoid deteriorating system security. Special care shall be paid to improvement of collection rate and decrease of technical and non-technical losses, which shall be accompanied by the social action plans. Cross-subsidization shall be avoided. Unbundling activities shall be extended to include also the DSOs.
- ***Public Service Obligation and Customer Protection:*** The regional outlook is positive, with most Contracting Parties having provisions for PSO in their gas acts - if there are gas acts implemented - or grid codes, or licensing obligations, etc. Nevertheless, when it comes to vulnerable customers' protection, this is either missing or not explicitly reflected in the legal framework. Most Contracting Parties seem to be lagging behind the average (Albania, Bulgaria, Croatia, Bosnia and Herzegovina, the former Yugoslav Republic of Macedonia, Montenegro, Serbia and UNMIK). ***Regional perspective:*** Public service obligations are well defined if a gas act is implemented. However, further work is needed on the provisions related to the appointment of a supplier of last resort, and especially to include provisions to protect vulnerable customers.
- ***Monitoring Security of Supply:*** The regional outlook is positive, with most Contracting Parties having adopted SoS provisions in their state legislation if they have implemented a gas legislation. ***Regional perspective:*** In general,

provisions on monitoring of security of supply are put in place. However, mechanisms for their practical implementation call for further attention. Otherwise, security of supply may be endangered which further on might undermine activities related to opening of the gas market.

- **Technical Rules:** The outlook from the regional perspective is not encouraging, as these are mostly not adopted (Albania, Bosnia and Herzegovina, Croatia, Montenegro, the former Yugoslav Republic of Macedonia Serbia and UNMIK). **Regional perspective:** Technical rules are mostly not put in place. The Contracting Parties which do not have a complete set of technical rules are urged to finish this work. Technical rules are important parts related to security of supply from operational, maintenance and planning viewpoints.
- **Unbundling and Access to Accounts:** In general, the unbundling and access to accounts of transmission system operators is not advanced since just some of the Contracting Parties have implemented the Directive 2003/55/EC entirely. From the regional perspective, the outlook is more negative than positive. Most of the Contracting Parties (except partially Bulgaria and Croatia and Romania) have not implemented unbundling provisions in accordance with the requirements of the Directive 2003/55/EC. **Regional perspective:** In general, unbundling provisions and provisions related to access to accounts are not put in place. However, their full practical implementation and monitoring shall be of immediate first priority to the Contracting Parties.
- **Third Party Access:** At the regional level just Bulgaria and Romania have fully adopted the provisions ensuring TPA to the transmission and distribution networks. **Regional perspective:** Provisions related to regulated TPA to transmission and distribution grids are mostly not put in place, as well as obligations to justify the denial of access to the grid. Therefore, substantial amount of work is left. Provisions related to application of the cost reflective methodology for determining network access tariffs have to be put in place.
- **New Infrastructure and Exemption:** The regional outlook is not positive. Provisions with regard to new infrastructure and exemption are available partially in Albania, Bulgaria, Croatia and Romania. Even these provisions have to be more concretized. **Regional perspective:** Rules for new infrastructure are essential for the investment climate, improvement of security of supply, and improvement of competition and should be put in place as soon as possible.
- **Market Opening:** The regional outlook is not positive, with “only some provisions available” as an average ranking. Two Contracting Parties (Bulgaria, and Romania) out of nine have set a calendar and took concrete measures to open the market for both non-household and household customers that are in line with the Treaty requirements. The rest of the Contracting Parties are lagging behind. **Regional perspective:** Implementation of the timetable for market opening from the Treaty is not likely in practical terms from today’s perspective. Measures (in form of action plans) for the market opening shall be introduced and monitored on a regular basis in order to avoid likely numerous derogations and delays of reform process.
- **Cross Border Trade Mechanism:** The regional outlook is not positive, as most of the Contracting Parties (except Bulgaria and Romania) have little formal provisions in force that are in line with the needs for efficient cross border trade/transport (see substance Regulation 1775/2005). **Regional perspective:** Cross border issues in gas transmission/transit (network capacity allocation, congestion management, balancing mechanism, etc.) are of critical importance to opening of the gas market. They need significant attention and substantial further support and work on their implementation.

Gas

	Public Service Obligation and Customer Protection	Monitoring of Security of Supply	Technical Rules	Unbundling Provisions and Access to Accounts	Third Party Access	New Infrastructure and Exemptions	Market Opening	Cross Border Trade Mechanism
Albania	Some provisions are missing	Some provisions are missing	Some provisions are available	Some provisions are missing	Some provisions are missing	Some provisions are missing	Process has started recently	Process has started recently
Bosnia and Herzegovina	Process has started recently	Process has started recently	Process has started recently	Process has started recently	Process has started recently	Process has started recently	Process has started recently	Process has started recently
Bulgaria	Some provisions are missing	All provisions are available	All provisions are available	All provisions are available	All provisions are available	Some provisions are available	Some provisions are missing	Process has started recently
Croatia	Some provisions are available	Some provisions are available	Some provisions are missing	Some provisions are missing	Some provisions are missing	Some provisions are missing	Some provisions are available	Process has started recently
The former Yugoslav Republic of Macedonia	Some provisions are missing	Some provisions are missing	Process has started recently	Some provisions are available	All provisions are available	Process has started recently	Process has started recently	Process has started recently
Montenegro	Process has started recently	Process has started recently	Process has started recently	Process has started recently	Process has started recently	Process has started recently	Process has started recently	Process has started recently
Romania	Some provisions are missing	All provisions are available	All provisions are available	Some provisions are missing	All provisions are available	All provisions are available	All provisions are available	Process has started recently
Serbia	Some provisions are missing	All provisions are available	All provisions are available	Some provisions are missing	All provisions are available	Process has started recently	Process has started recently	Process has started recently
UN Interim Admin. Mission in Kosovo	Process has started recently	Process has started recently	Process has started recently	Process has started recently	Process has started recently	Process has started recently	Process has started recently	Process has started recently
<b>Regional perspective</b>	Process has started recently	Some provisions are available	Some provisions are available	Some provisions are available	Some provisions are available	Process has started recently	Process has started recently	Process has started recently

Process has started recently

Some provisions are available

Some provisions are missing

All provisions are available

Figure 2: Benchmarking – Gas

The implementation of the *Acquis* on gas and the adoption of necessary measures to open the gas market for competition are supported by the development of tailor-made *Road Maps* and the *Action Plans*, per each Contracting Party. The *Road Maps* are derived out of the *Action Plans* by extracting the most outstanding issues that need further attention per each Contracting Party. Their time horizon is till the end of 2007. The adoption and implementation of the *Acquis* on energy is envisaged by July 2007. The adoption of the necessary measures that will ensure the minimum level of competition to guarantee eligibility for non-household customers is expected by January 2008.

The *Road Maps* aimed to commit each of the Contracting Parties to undertake actions under a specific deadline. The Contracting Parties are free to choose the means. During the monitoring phase the ECS will request them to provide detailed information. On that basis, the Secretariat has composed the key indicators for the operation of the national and regional gas markets, and set up a structure to monitor them.

Upon implementation of the *Road Maps* and the *Action Plans*, the following issues are anticipated when it comes to the opening of the gas market properly:

- Materialization of the characteristic problems in the Contracting Parties:
  - Related to status of economies; and
  - Mainly due to limited size, fragmentation and uncertain development of the gas markets.

Based on the ECS findings up to date, it is expected that the following general problems will be common to the Contracting Parties:

- The persistence of regulated prices, especially for the benefits of eligible customers, putting obstacles in the path of new market entrants;
- The lack of legal unbundling and insufficient managerial separation of TSOs/DSOs to ensure their independence;
- Discriminatory Third Party Access and insufficiently transparent tariffs;
- The free choice of supplier;
- The power of regulatory authorities, in particular as regards setting tariffs for access to networks;
- The preferential access given in the case of certain long-standing gas contracts; and
- Failure to notify Public Service Obligation.

It is obvious that the TSOs/DSOs and regulatory authorities related problems are of the utmost significance:

- TSO/DSO related problems:
  - Absence of or insufficient legal unbundling of TSO/DSO in order to guarantee their independence;
  - Absence of independence of TSO/DSO in the management;
  - Absence of or insufficient functional and accounting unbundling of TSO/DSO in order to guarantee their independence; and
  - Delay in the entry into force of legal unbundling of TSO/DSO.
- Regulatory authorities related problems:
  - Insufficient competences of the regulators in relation to the *acquis*, in particular with respect to
    - the possibilities to file complaints to the regulator,
    - the management and allocation of interconnection capacity, and

- fixing the tariffs of access to the networks.

Besides the above mentioned problems it is anticipated that some of the problems which are characteristic for the Contracting Parties will also materialize in the course of opening of the gas market.

Explicitly, the following problems are the most characteristic ones in the Contracting Parties:

- Low level of tariffs which leads to regulate the whole energy chain;
- Metering, billing and invoicing of customers;
- Collection rates, both non payment and non invoicing as no data base of customers;
- Transparency in data and harmonisation of accounts;
- Lack of domestic production which leads to high imports;
- Existence of wholesale suppliers;
- Cross-border issues (Capacity allocation procedures, Regional balancing mechanism, etc.);
- DSO bundled with retail; and
- Lack of investments in transmission and distribution.

Moreover, some problems related to limited size of the gas markets in the Contracting Parties are also anticipated, especially when it comes to consequences of their fragmentation and uncertain future development.

The most notable cases of the work in progress in complying with the electricity and gas benchmarks, were highlighted. The work in progress was highlighted in relation to gas, assessed as being the most critical one for continuation of the successful implementation of the *Acquis* on energy (gas part), among the Contracting Parties; these could be divided into two groups: 1) *Acquis* related issues; and Market related issues (Table 1). The issues reflect also the areas where assistance is highly needed and expected. The updated assessment was made for all seven Contracting Parties, and Bulgaria and Romania, to reflect progress since October 2006 to March 2007.

	Albania	Bosnia and Herzegovina	Bulgaria	Croatia	The former Yugoslav Republic of Macedonia	Montenegro	Romania	Serbia	UNMIK
<b>Main bottlenecks</b>									
<b>Acquis related bottlenecks</b>									
Gas Law (Energy Law including gas)		X				X			X
Public Service Obligation and Customer Protection		X		X		X			X
Monitoring of Security of Supply		X				X			X
Technical Rules	X	X		X	X	X			X
Unbundling Provisions and Access to Accounts		X				X			X
Third Party Access		X				X			X
New Infrastructure and Exemptions		X	X		X	X	X	X	X
Market Opening	X	X			X	X		X	X
<b>Market related bottlenecks</b>									
Further structural development of incumbent companies	X	X	X	X	X	X	X	X	X
Unbundling and Privatisation	X	X	X	X	X	X		X	X
Market Monitoring, including imports	X	X		X	X	X		X	X
Market Rules	X	X		X	X	X		X	X
Development of cost reflective tariff methodologies	X	X		X	X	X			X

Table 3: Work in progress on the *Road Maps* and the *Action Plans* of the Contracting Parties

A brief description of a party-by-party basis follows hereafter, on the *Acquis* related issues:

- **Customer protection:** The following Contracting Parties still have to finalise adoption of the specific regulatory framework for vulnerable customer protection: Albania, Croatia, Bulgaria, Bosnia and Herzegovina, the former Yugoslav Republic of Macedonia, Montenegro, Serbia and UNMIK.
- **Authorisation procedures:** partially Albania, Bosnia and Herzegovina, Montenegro and UNMIK still have to develop and adopt these procedures;
- **Technical rules:** Albania, Bosnia and Herzegovina, Croatia, the former Yugoslav Republic of Macedonia, Montenegro, Serbia and UNMIK have to complete the preparation and adoption of the technical rules for TSO and DSOs;
- **TSO unbundling:** In order to achieve full unbundling and independence of the TSO, partially Albania, Bosnia and Herzegovina, partially Croatia, the former Yugoslav Republic of Macedonia, Montenegro, Serbia and UNMIK have to finalise the process;
- **DSO unbundling** (separation of network operation from supply activities): In most Contracting Parties, with the exception of Bulgaria and partially Romania, the unbundling of the DSO(s) from the supply branches has not been achieved yet;
- **Eligibility status:** Adoption of a plan to grant eligibility to all non – household customers by the deadline foreseen by the Treaty, of 1 January 2008, or actual fully opening the gas market has been achieved only in Bulgaria and Romania.
- **Allocation of cross-border transmission capacity:** In all Contracting Parties there is still either a significant work to be done or a full alignment to be made;

The progress status is given hereafter with respect to issues that are essential to a functional gas market on a party-by-party basis for the following categories:

- **Further structural development of incumbents:** There is still a need for progress in all Contracting Parties;
- **Privatisation:** More work remains to be done in all Contracting Parties;
- **Restructuring and consolidation of distribution companies:** There is a recognised need for more progress in this area, in all of the Contracting Parties where a gas market is in place;
- **Business performance indicators, collection rate, reduction of losses:** These issues require more attention and increased efforts;
- **Market monitoring, including imports:** All Contracting Parties, with the exception of Bulgaria, Romania and Serbia should enhance the market monitoring;
- **Transparency of information related to market operation:** With the exception of Bulgaria and Romania, all the other Contracting Parties have to continue improving the transparency in market operation;
- **Market rules:** All Contracting Parties except Bulgaria and Romania include still have to adopt or improve market rules to be in full compliance with the *Acquis*;
- **Application of technical measures and business procedures for customer switching:** Most Contracting Parties are still working or have started to work on this;
- **Balancing market and auxiliary services market:** More progress needs to be seen either in the introduction or significant further development of market

mechanisms for purchase or sale of gas for balancing demand and supply, as well as for purchasing gas for ancillary services in all Contracting Parties;

- **Development of cost-reflective tariff methodologies:** This is a key requirement for having a functional market and attracting investments in the Energy Community; nevertheless more work is needed to exercise cost-reflective tariff methodologies in all of the Contracting Parties except partially Bulgaria and Romania.

As for the overall key findings here, it seems so far that each Contracting Party has started to develop its own market arrangements while, more or less, respecting a minimum set of common rules on cross-border trade issues. Institutions, related to system and market operation at the SEE regional level, are yet to be established should truly SEE regional market be put into operation. Closer market integration is expected to be gradually pursued later on. In other words, regulators and participants currently function in the SEE region under very different legal and commercial conditions which makes it difficult to implement in one blow a single detailed operating framework full in all countries. The liberalization of the cross border trade of gas has not started fully yet and currently awaits for mutual harmonisation of operating rules and procedures at the SEE regional level, as a prerequisite for trade intensification. The main findings which are singled out in the present *Report* clearly show that. SEE wide regional mechanisms (capacity allocation; balancing mechanism) are still at the conceptual R&D level.

## 4 CONCLUSIONS

This *Report on the implementation of the Treaty* first notes all of the electricity and gas related *Reports* submitted under the Grant Contract, and then continues with elaboration of primarily compliance with electricity and gas benchmarks and regional market design. The key overall findings are given here based on the information collected so far, brought up at the same time level (end of March 2007), and presented in an explicit and mutually comparable table format per each Contracting Party. Regular updates of the information are necessary and envisaged further on.

The objectives of the work on the compliance with electricity and gas benchmarks, as emerging from development of the *Road Maps* and the *Action Plans*, have been the following:

- Provide summary of the information on current state of play;
- Identify work in progress for each of the Contracting Parties;
- Recognize needs for assistance in the most critical areas; and
- Propose scheme for monitoring the implementation of the *Acquis*.

All Contracting Parties are anchored into the EU framework, either as EU accession countries/new Member States, EU candidate countries (with and without started negotiations), or the SAP related parties (with the SAA signed, being negotiated or with called off negotiations). It gives a comfort towards fulfilment of taken EU related commitments.

As for the concluding remarks on the electricity benchmarking, the following may be stated. Public service obligations are well defined. However, further work is needed on the provisions related to the appointment of a supplier of last resort, and especially to include provisions to protect vulnerable customers. In general, provisions on monitoring of security of supply are put in place. However, mechanisms for their practical implementation call for further attention. Otherwise, security of supply may be endangered which further on might undermine activities related to opening of the electricity market. Technical rules are mostly either put in place or are in final phase of regulatory approval. The Contracting Parties which still do not have a complete set of technical rules are urgently finishing this work. In general, electricity generation is subject to licensing. Construction of new generation capacity is subject to authorisation. However, some of the Contracting Parties do not have provisions on tendering of new capacity on the grounds of security of supply. In general, unbundling provisions and provisions related to access to accounts are put in place. However, their full practical implementation and monitoring shall be of immediate first priority to the Contracting Parties. Provisions related to regulated TPA to transmission and distribution networks are put in place, as well as obligations to justify the denial of access to network. However, substantial amount of work is left after putting in place of provisions related to application of the cost reflective methodology for determining network access tariffs. Implementation of the timetable for market opening from the Treaty is not likely in practical terms from today's perspective. Therefore, gradual opening of the electricity market with dynamics (eligibility threshold and timetable) shall be specified and harmonised with the Treaty provisions. Measures (in form of action plans) for the market opening shall be introduced and monitored on a regular basis in order to avoid likely numerous derogations and delays of reform process. Cross border issues in electricity transmission (inter TSO compensation, network capacity allocation, congestion management, balancing mechanism) are of critical importance to opening of the electricity market. As being the work in progress, they still need significant attention and substantial further support to the implementation.

In addition to the problems that have appeared in the EU, the following ones characteristic for the Contracting Parties will also materialize when opening the electricity market:

- Low level of tariffs which leads to regulate the whole energy chain;
- Metering, billing and invoicing of customers;
- Collection rates, non payment and non invoicing as no data base of customers;
- Transparency in data and harmonisation of accounts;
- Lack of domestic generation which leads to high imports;
- Existence of wholesale suppliers;
- TSO bundled with Market Operator;
- Cross-border issues;
- DSO bundled with retail; and
- Lack of investments in distribution.

Similar to electricity, as for the concluding remarks on the gas benchmarking, the following may be stated.

Public service obligations are mostly defined if there is a gas market in the Contracting Party. However, further work on public service obligation is needed in those Contracting Parties where a gas market still does not exist or is emerging. In all Contracting Parties provisions related to the appointment of a supplier of last resort, and especially to include provisions to protect vulnerable customers, are needed. In general, provisions on monitoring of security of supply are put in place in those Contracting Parties where gas legislation has been implemented. However, mechanisms for their practical implementation call for further attention. In some Contracting parties provisions on monitoring security of supply have to be put in place, otherwise, security of supply may be endangered which further on might undermine activities related to opening of the gas market. Technical rules are mostly not put in place. The Contracting Parties which do not have a complete set of technical rules are urged to finish this work. Construction of new transmission and distribution capacity is subject to authorisation. However, some of the Contracting Parties do not have provisions on tendering of new capacity. In general, unbundling provisions and provisions related to access to accounts are not advanced. Most of the Contracting Parties (except partially Bulgaria and Croatia and Romania) have not implemented unbundling provisions in accordance with the requirements of the Directive 2003/55/EC. However, their full practical implementation and monitoring shall be of immediate first priority to the Contracting Parties. Provisions related to regulated TPA to transmission and distribution networks as well as obligations to justify the denial of access to network are fully put in place in Bulgaria and Romania. In the other Contracting Parties significant progress is needed. However, substantial amount of work is left after putting in place of provisions related to application of the cost reflective methodology for determining network access tariffs. Provisions with regard to new infrastructure and exemption are available partially in Albania, in Bulgaria, Croatia and Romania. These provisions are essential for the investment climate, improvement of security of supply, and improvement of competition and should be put in place as soon as possible also in the other Contracting Parties. Implementation of the timetable for market opening from the Treaty is not likely in practical terms from today's perspective. Measures (in form of action plans) for the market opening shall be introduced and monitored on a regular basis in order to avoid likely numerous derogations and delays of reform process. Cross border issues in gas transmission (network capacity allocation, congestion management, balancing mechanism, etc.) are of critical importance to opening of the gas market. As being the work in progress, they still need significant attention and substantial further support to the implementation.

Upon implementation of the *Road Maps* and the *Action Plans*, the following issues are anticipated when it comes to the opening of the gas market properly:

Based on the ECS findings up to date- similar to electricity- it is expected that the general problems when it comes to the opening of the gas market will be also common to the Contracting Parties:

Besides the above mentioned general problems it is anticipated that some of the problems which are characteristic for the Contracting Parties will also materialize in the course of opening of the gas market.

Explicitly the following problems are the most characteristic ones in the Contracting Parties:

- Low level of tariffs which leads to regulate the whole energy chain;
- Metering, billing and invoicing of customers;
- Collection rates, both non payment and non invoicing as no data base of customers;
- Transparency in data and harmonisation of accounts;
- Lack of domestic production which leads to high imports;
- Existence of wholesale suppliers;
- Cross-border issues (Capacity allocation procedures, Regional balancing mechanism);
- DSO bundled with retail; and
- Lack of investments in transmission and distribution.

The main economic indicators of the Contracting Parties give an impression on the current status of their economies, revealing (too) often a very low income on an average basis which may prevent timely introduction of cost-based market prices of electricity and gas and network related services. Moreover, some problems related to limited size of the electricity and even more of the gas markets in the Contracting Parties are also anticipated, especially when it comes to consequences of their fragmentation and uncertain future development.

The ECS in its common work with the PHLG and other national stakeholders - mainly transmission system operators and regulatory authorities - has identified the main activities needed per each Contracting Party and singled them out in so called *Road Maps* and the *Action Plans* for the implementation of the *Acquis* on energy (electricity part: Directive 2003/54/EC and Regulation 1228/2003/EC; gas part: Directive 2003/55/EC) and the adoption of necessary measures to open the electricity and gas market to competition.

All electricity and gas related Reports contain results of an introspection conducted through the *Road Maps* and the *Action Plans* in an attempt to further endorse competition to the benefit of the final consumers, especially starting from 1 January 2008 when all non-households shall be given eligibility status as per Annex I of the Treaty. The ECS will continue with monitoring of the key indicators through established structure and make the monitoring results publicly available to all relevant stakeholders within the Energy Community process (MC, PHLG, Electricity Forum) by issuing adequate benchmarking reports.