5th Permanent High Level Group Meeting

28 June 2007

Becici, Montenegro

Progress notice in electricity

– Status H1 2007 –

Table 1: *Progress notice in electricity – Status H1 2007*

CONTRACTING PARTY	ELECTRICITY
Albania	▪ New scheme for the protection of vulnerable customers has been adopted by the Government through the Decree issued in August 2006. Funding will be made available. On the basis of this system the vulnerable consumers are to pay for the electricity consumption, while the Government through the Ministry of Social Issues and Equal Chances pays them a compensation for increase of tariff. In 2006, 225.000 vulnerable consumers were identified and qualified based on the requirements of the scheme. For the second half of 2006, the allocated fund was at the level of 1 billion Lek (close to 8 million Euro). For 2007, the allocated fund is 2 billion Lek (close to 16 million Euro). But, the number of vulnerable consumers has to be revised. ▪ Rules for tendering of new generation capacities and the Concession Law compatible with EU standards are in preparation. The Law on Concessions Nr. 9663 dated 18.12.2006 is in power from January 2007. ▪ TSO full ownership unbundling is foreseen by mid 2007. Based on a close cooperation between the TSO and the KESH, the final assets and liabilities of the TSO were identified. The Supervisory Board of the KESH approved it in early May 2007 – the Supervisory Board of the TSO is expected to approve it in early June 2007. Then, the Ministry will arrange for the final steps. For the 2nd half of 2007 the TSO will prepare its own balance sheet (within June 2007 it will be ready to do that). A process of legalization and formalization of the TSO ownership is in the pipeline, to be finalized very soon. ▪ Electricity Market Opening: ERE will propose further electricity thresholds in an amendment of the Power Sector Law. On the basis of the Power Sector Law amendments, the ERE is authorised to define electricity consumption threshold. By the end of 2006 the threshold was set at 100 GWh/year (one hundred million kWh; 2 eligible consumers), while currently - beginning of 2007 - the eligibility threshold is set at 10 GWh/year (ten million kWh), which has been fulfilled by 15 consumers. The ERE and the Government are aware of the obligation to implement the Treaty provisions in compliance with the timetable. The ERE will bring out appropriate decisions concerning the market opening. It is foreseen for the eligibility threshold to be granted to all non-household customers, in 2008. ▪ A number of infrastructural projects have been under different phases of development – expected to contribute to increase of security of supply situation in Albania:

1. Electrical interconnection by the HVDC submarine cable from Albania, FYROM and Bulgaria to Italy (SEETEC made the feasibility study financed by EBRD and CIDA; estimated costs 570 M€; line re-routings in Albania and the connection point in Italy are current issues; the parties agreed to start up a special implementation group to study interconnection between Albania and FYROM and related upgrades; joint statement for that purpose under discussion);
2. Construction of new transmission infrastructure 400 kV OHL Podgorica (MN) – Tirana (AL) – Elbasan (AL) in three phases: 1) Podgorica – Tirana (in construction procedure; KfW financing; the credit approved by the Albanian Parliament and effective; the contract awarded to Dalekovod Croatia and signing in July 2007; 40 M€ in total; implementation schedule 24 months; 25 km in Montenegro will be financed by the KESH/OST and repaid by the EPCG TSO; on-lending and separate agreement with EPCG and KfW negotiated and will be signed soon), 2) Tirana – Elbasan (bidding documentation prepared; bid to be launched soon; the contract before October 2007; implementation schedule 24 months; soft loan from Italy;); and 3) Tirana 400/220/110 kV substation (2x300 MVA and 2x120 MVA; Italian support; implementation schedule 18 months);
3. Transmission line 400 kV OHL Tirana – Prishtina (238 km) has been studied (feasibility study made previously by CESI under WB financing; KfW shown interest for financing the project; under KfW financing now an update of the feasibility study in order to facilitate the economic and investment costs; expected benefit is to come out from connecting the HPP system of Albania with the TPP one of Kosovo);
4. Rehabilitation of Fieri, Tirana and Elbasan 1 substations (APL 2 Project; under bid evaluation process; tentative completion by the end of 2009);
5. Rehabilitation of Vau Dejes, Fierza, Elbasan 2, Burreli and Komani substations (APL 2 Project; financed by EBRD; bidding documents under preparation; implementation schedule by the end of 2009);
6. Rehabilitation of Shkodra region project and rehabilitation of Tirana 1 and Elbasan 1 substation (financed by EIB; estimated costs 16 M€; the contract signed between KESH/OST and the contractor; implementation schedule by mid 2007);
7. Development of transmission and distribution network of southwest Albania (Riviera Project; estimated value 20 M€; KfW is making a due diligence in the beginning of June 2007; possible financing of the project by the end of 2007);
8. Development of 110 kV transmission line Erseke – Permet in southeast Albania (estimated value 8 M€; KfW is making a due diligence in the beginning of June 2007 to finance the project by the end of 2007);
9. New national dispatching centre. The centre is expected to become operable by 2011 through a support from Italy (Italian Cooperation financing; estimated cost 21 M€; tender documents prepared; final bidding documents sent to the Italian side for no objection and approval; the bid to be launched in July 2007; the contract to be

signed by the end of 2007; implementation schedule 36 months);

10. UCTE membership. The UCTE has a technical committee for Albania which serves as a focal point for discussions of technical problems. The Project Group is currently led by the HTSO, status report has been sent to the UCTE Steering Committee, catalogue of measures is in preparation. Some requirements are fulfilled, and some still remain to be solved. For example, the mini-SCADA project has been realised overseeing complete 220 kV transmission network (UCTE asks for the complete one). Further steps are expected in near future (linked to construction of the new national dispatching centre);

11. Program for installation of metering equipment at the generation/transmission/distribution borders is successfully implemented. It enables the OST to precisely know a flow of energy between transmission and generation/distribution. In this way, a transmission fee for the OST and a billing for the KESH get sound background (no new requests for transmission fees, the OST will issue a request by the end of 2007 for 2008 on the basis of existing methodology – the only difference is related to changes in ownership of the assets).

- SoS situation in 2006 and prospects for 2007

A. <u>Background.</u>

- The Albanian Power System is predominantly hydro, more than 98 %;
- Hydro generators are located mainly in the north part of the country;
- The Power System reliability is very dependant on the hydro conditions;
- The Fierza HPP is the only HPP with an annual regulation;
- The other Drin River Cascade HPP's have an insignificant basin;
- Even in favourable hydrological conditions, the electricity demand can't be covered from domestic production;
- Since 1998 Albania is heavily dependant on imported electricity;
- Currently, Albania imports electricity on the basis of one year, or even less;
- Albania is facing difficulties when trying to arrange longer contracts;
- Even contracted supplies are subject to interruption as happened in 2006.

B. <u>The situation during 2006.</u>

- The main purpose of the Drin River Cascade is to maintain the Fierza Lake reserve during the summer time which is normally a dry season;
- Albania has no other thermal resource (thermal power plants) to compensate the decrease in power production from the Drin Cascade;
- So, it has always been necessary to import electricity during the dry season (July, August, September, and November);
- Albania also imports electricity during January, February, March, November, and December, but not to

preserve the use of the Drin River Cascade, but to support the electricity demand in these periods;

- During the first six months of 2006 the electricity situation was favorable and the Fierza Lake quotas in July 2006, compare to July 2005, was pretty high on its maximum level or 296 m a.s.l;
- During August and September 2006, according to our forecast, it was a normal situation of the water level, and water flows in Fierza Lake;
- The hydrological situation started to decline in October 2006 causing problems for electricity supply;
- This situation is still continuing.

C. The main reasons which have caused this situation.

- The lack of rainfall in the second part of 2006 and in the beginning of 2007 caused an wide drop of Fierza Lake water flows;
- The undelivered electricity of the contractual quantity during the period July-December 2006;
- The insufficient quantity of electricity imports offered in the last tendering process, for the period of January-March 2007;
- For that reasons KESH was forced to increase domestic production, undertake electricity load shedding and intensify its own efforts to increase the electricity imports.

▪ Action Plan with short term and medium term measures, in place to avoid power supply cuts;

A. Short term measures.

- Setting up of the Emergency Task Force, headed by the Minister of Economy, Trade and Energy;
- Periodical meetings of the Emergency Task Force, pushing the implementation of measures and interventions to overcome the critical situation;
- Attentive management of the Drin Cascade water reserves;
- Putting into operation of existing Fieri TPP with maximum possible capacity;
- A moderated load shedding in the country, taking into account the area with low collections;
- KESH has intensified the pressure towards companies that do not respect the signed contracts of imports;
- Negotiations and agreements with big industrial consumers in the country to go out of the operations and to proceed with their annual repairs/maintenance regime;
- KESH has made all efforts to import electricity from deposits located in neighbouring countries;
- The Government approved the new Law on Public Procurement, which allows to KESH, in very specific conditions, to buy electricity directly on the market;
- KESH has to make maximum efforts to increase the electricity imports;
- The Government approved the Procedures for Direct Procurement, for the period December 2006-January 2007.

B. Medium term and in some extensions long term measures.

a. Improvement of the legal framework.
- A new Law on public procurement for the import of electricity;
- Amendments of Law Nr. 8987, dated 24.12.2002: On Fiscal Facility for Construction of New Generation Capacities;
- A new Law on small HPP's.

b. Improvement of Power Sector Performance.
- The immediate focus on improving KESH commercial operation (improvement of losses and collection rates);
- Improving of the efficiency in the metering system;
- Enforced actions to cut illegal connections and customers that do not pay for electricity consumed;
- A special Action Plan of KESH was adopted for the year 2007, to improve its performance and financial situation;
- Other Action Plans for KESH in the time period 2008-2009, focusing on the improvement of billing and financial system in order to increase efficiency of collections for billed electricity;
- Gradually raising the electricity tariff over reasonable period of time, until they accurately reflect the cost of electricity supply;
- Unbundling of KESH operational functions, regarding Distribution Division;
- The establishment of open and competitive market;
- Distribution Company privatization;
- Concentration on the construction of the New TPP of Vlora, to put in operational work within 2009;
- Giving in the concession the existing Fieri TPP;
- Promotion of renewable resources and energy efficiency;
- Attracting the private investors in the frame of the new Law on Concessions;
- Focusing on the construction of Kalivac HPP;
- Construction of the 400 HVL Elbasan-Tirana-Podgorica, including Tirana 400/220/110 kV substation;
- Constructing of Tirana New Dispatching Center;
- Rehabilitation and development of existing substations 220/110 kV, as well as the construction of new ones such as Babica (Vlora), Lac, Shkoder, Koman, Kucove and Memaliaj;
- Construction of 400 kV HVL with Kosovo;
- Construction of 400 kV HVL with Macedonia.

	▪ Promotion of other energy resources for heating purposes; o The LPG is recognised as an alternative to electricity for heating purposes in the frame of Albanian conditions. By setting custom and fiscal incentives (custom tariff and excise) the Government has facilitated the presentation of the LPG in the local market; o The LPG consumption is increased from year to year; o The LPG consumption in 2006 has been increased in comparison to 2005, from 63000 ton to 75000 ton; o The LPG consumption is doing more and more as an alternative to electricity for heating in residential areas and different service sectors.
Bosnia and Herzegovina	▪ The electricity market in BiH is open since 1 January 2007 what is in line with Regulators' *Decision on scope, condition and time schedule of electricity market opening*. The Decision defines the following market opening dynamics: a. 1 January 2007 – all customers >10GWh which are connected to transmission network; it creates 33% of the market which is open b. 1 January 2008 – all non-households customers; and c. 1 January 2015 – all customers. ▪ The FERC is in the process of defining the General Conditions for Electricity Supply (it has made a draft, conducted public consultations and expects its adoption very soon). ▪ Distributions System Operators have not been established yet. ▪ In 2005, BiH had a surplus of 2,216 GWh. ▪ Related to getting a comprehensive energy strategy at the state level and developing and adopting a blueprint for the period up to 2030: a) strategy project has been suspended by ECD; b) development of Energy Sector Study in BiH is under way; c) RS has decided to develop its own strategy; d) FBiH supports current strategy approach. ▪ Related to the implementation of the Action plans for restructuring and privatisation of the electricity sector in Bosnia and Herzegovina: a) the Action plan is being followed in RS; b) in F BIH reorganization of the two electricity utilities is in progress to satisfy the Action plan; c) no privatisation is being considered. ▪ Related to adoption of the General Conditions for Electricity Supply: a) REERS adopted; b) FERK in process (FERC will clear tariff issues first, then General Conditions). ▪ Related to the preparation of the Indicative Generation Development Plan for the next 10 years and the Demand

	Yearly Balance: a) Plan for 2007-2016 is completed - preparation in progress for period 2008-2017; b) data availability is a problem. Need to improve data availability with Entity Govts. ▪ Adoption of the technical rules for connection to the network is ongoing. The Third Party Access Rules are part of the Grid Code and the Rulebook. ▪ Adoption of the Distribution Grid Codes is ongoing. ▪ Related to remote reading of electricity meters as a precondition to full implementation of the Market Rules as to make the balancing market fully functioning: a) project is ongoing; b) target completion date is late 2007; c) tender to be issued in early March. Project schedule will be followed. ▪ Ongoing work on the permanent Rules for Use of Interconnectors' Capacity: ISO and SERC will complete it before July 2007. ▪ Related to consolidation of the state and the entities regulatory authorities and harmonisation of the regulatory practices at the state and the entity levels (including introduction of regulatory practise in the Brcko District) covering electricity generation, distribution and supply: a) no decision has been taken neither on state wide energy regulator nor on merging of existing regulators; b) agreement at political level is required. ▪ Related to effective operational implementation of the Grid Code and business processes (scheduling, planning, settlement of disputes, etc), and finalisation of the General Conditions for Connection to the Network and the Third Party Access Rules: a) procedures are completed for the Grid Code; b) ongoing work on the General Conditions. • Related to unbundling of the DSOs, the implementation of the Action Plans for restructuring and privatisation of the electricity sector in BiH is ongoing, but no privatisation is envisaged. Functional and accounting unbundling under way. ▪ Related to authorisation of appropriate body to conduct market surveillance tasks, three regulatory authorities are responsible with data provided by ISO. ▪ Related to development of a state wide policy for the protection of vulnerable customers: a) activities have been started; b) development of a policy paper with Entity Governments and three regulatory authorities.
Croatia	▪ Governing Board of HERA brought up on 6 March 2006 the Rules on Charges for Connection to the Network and for Increase in Connected Power, which entered into force from 1 April 2006 (published in NN no. 28 on 13 March 2006). It is to be implemented upon the Government's decision on the amount of charge for connection to the network and for increase in connected power. ▪ Government of Croatia brought up on 5 May 2006 the Decision on the Amount of Charge for Connection to Electric Network and for Increase in Connected Power, which entered into force from 10 May 2006 (published in NN no. 52 on 10 May 2006).

- In October 2006, the Managing Board of HEP d.d. adopted the decision on separation of HROTE (Croatian Energy Market Operator) LLC from the HEP Group. The decision enters into force on the day of the adoption. Perceived deadline for finalising the process is 1 July 2007. In sight of the decision made, the Managing Board has empowered the Economic Affairs Division, IT and telecommunication department and HROTE LLC to execute and accomplish all the activities necessary in order for HROTE to be handed over under full ownership of Republic of Croatia on 1 July 2007.
- In October 2006, the Managing Board of HEP d.d. decided to establish a dother company for electricity trading thus transferring trading activities from the holding to subsidiary level. The official name of the company is HEP--Trade LLC. The Managing Board empowered a lawyer to handle this case on behalf of HEP d.d. The lawyer was acting as the responsible for signing and verifying the statute, processing incorporation documents and concluding activities necessary for the registration of the company with responsible legal entities in Croatia.
- In December 2006, HEP-TSO adopted and published the Rules on allocation and usage of cross border transfer capacity which entered into force on 1 January 2007. This is based on Article 16 of the Law on electricity market (NN no. 177/04). Link: http://ops.hep.hr/ops/dokument/akti/pravila_o_dodjeli_pr_moci_12_06_A1.pdf.
- Accordingly, first monthly explicit auctions on Croatian 50% of cross-border capacity started in February for Slovenian, Serbian and Bosnian-Herzegovian border (while common explicit monthly auctions on 100% of cross-border capacity on Croatian-Hungarian border has been performed since July 2006).
- Croatian Energy Market Operator (HROTE) brought up the Electricity Market Rules (published in NN no. 135 on 13 December 2006). It is based on the Law on electricity market, Article 30, Para 2 (NN no. 177/04) and on the decision of HERA on 8 December 2006 related to giving a consent to the Market Rules (class 310-02/06-01/71, no. 371-01/06-96. The Market Rules will enter into force from 1 January 2007.
- HEP-TSO adopted and published the Rules on balancing the electric power system (OG no. 133 on 11 December 2006) which entered into force on 1 January 2007. This is based on the Law on electricity market, Article 15, Para 1.
- The Steering Committee of HERA brought up the Methodology for provision of services related to balancing of electrical energy in electric power system (published in NN no. 133 on 11 December 2006) which entered into force on 1 January 2007. This is based on the Law on regulation of energy activities, Article 11, Para 1, Subpara 3.
- The Steering Committee of HERA brought up on 19 December 2006 the Tariff methodology for retail supply of electricity, apart from retail supply of electricity for eligible customers, without tariff rates, which entered into force from 1 January 2007 (published in NN no. 143 on 29 December 2006). This is based on the Law on Regulation of Energy Activities, Article 11, Para 1, Subpara 1.
- The Steering Committee of HERA brought up on 19 December 2006 the Tariff methodology for generation of electricity, apart from electricity generation for eligible customers, without tariff rates, which entered into force from 1

January 2007 (published in NN no. 143 on 29 December 2006). This is based on the Law on regulation of energy activities, Article 11, Para 1, Subpara 1.

- The Steering Committee of HERA brought up on 19 December 2006 the Tariff methodology for transmission of electricity, without tariff rates, which entered into force from 1 January 2007 (published in NN no. 143 on 29 December 2006). This is based on the Law on Regulation of Energy Activities, Article 11, Para 1, Subpara 1.
- The Steering Committee of HERA brought up on 19 December 2006 the Tariff methodology for distribution of electricity, without tariff rates, which entered into force from 1 January 2007 (published in NN no. 143 on 29 December 2006). This is based on the Law on Regulation of Energy Activities, Article 11, Para 1, Subpara 1.
- New secondary legislation in the domain of renewable sources was brought up in March 2007. Three documents apply: 1) Ordinance on minimum stake in electricity generated by renewable energy sources and cogeneration which production is promoted (NN 33/2007); 2) Ordinance on fees for promotion of electricity generated by renewable energy sources and cogeneration (NN 33/07); and 3) Tariff system for electricity generation from renewable energy sources and cogeneration (NN 33/07). Tariff system for RES also includes feed-in tariffs and mandatory quota of electricity from RES and CHP.
- HEP-TSO has applied for a full ETSO membership and awaits the resolution of the application.
- There is no national balancing market in Croatia. Instead there is on-going development of the regional balancing market in south east Europe.
- At present there are numerous offers by wind developers in amount 1500 MW, but the HEP-TSO has estimated recently a maximum capacity to be embedded in the system equal to 360 MW due to operational security concerns. Investors show less intense interest in other renewable sources than wind. http://www.hep.hr/ops/usluge/sustav/vjetroelektrane.aspx
- Until June 2007 transposition of the Directive on the assessment of the effects of certain public and private projects on the environment will be finished. Directive on limitation of emissions from large combustion power plants is implemented. The Article from the Directive on protection of wild birds will be adopted in the 2nd quarter of 2007. Transposition of the acquis on environment from the Treaty has progressed significantly ahead of the Treaty's timetable due to ongoing EU accession process.
- Croatia ratified the Kyoto Protocol in April 2007 (signed in 1999). It committed to 5% decrease of emissions until 2012 in relation to base 1990 (34.62 Mt CO_2/year). Its energy sector participates with >74% in the emissions.
- So far, work on transposition and adoption of legislation has been accomplished successfully and now the focus is put on the actual implementation.
- Currently, electricity market is open for all consumers above 9 GWh/year (113 customers). Electricity market will open

	for all entrepreneurs (approx. non-household consumers) on 1 July 2007 (more than 165.000 customers). From 1 July 2008 all consumers will be eligible (2.1 mil; 1.913 households with 40% of total consumption). Automatic tele-metering and customer switching procedures are given priority in current and further work. ▪ Due to a warmer winter than usual, consumption was 10% less but because of the dry hydrological season the system was close to face major generation constraints this winter. Late rains helped to improve the situation and move it away from being critical. Larger imports at higher prices in the region were avoided this winter, but it can be expected again. ▪ HEP-TSO signed "*Interim ITC Clearing and Settlement Agreement June-December 2007*" along with most of EU and SEE TSOs under the same condition for all signatories.
The former Yugoslav Republic of Macedonia	▪ Based on the Road Map and the Action Plan, the Ministry of Economy drafted two sets of measures and activities, dedicated to electricity and gas markets. By the end of December 2006 these Dedicated Action Plans were approved by the Government as initial framework. ▪ In these documents the focus is put on the next steps in market reforms and outstanding diligence required to meet the commitments from the Treaty. Task Force was established among the markets' participants, the regulator and the policy makers to coordinate the activities and report on the results. The first round of assessment and reports is completed and next draft of the DAP is in preparation. ▪ From outside, the electricity market is strongly influenced by the electricity supply turbulences in the region. From within, the substantial unbundling that took place back in 2005 and the privatization of the distribution utility from 2006 require further steps of adjustment and settlement. ▪ Long period of underinvestment in certain areas, especially in generation, call for different kind of consideration with respect to the long-term security of supply. ▪ Generation: a) Privatisation of TPP Negotino will lead also to fuel substitution and increase of capacity; b) The construction of 2 new sHPPs will be tendered soon; c) Still dependent on imports of electricity. ▪ TSO: The Grid Code is approved by ERC and published on the website of MEPSO. ▪ DSO: a) Privatised recently; b) The privatised distribution company will disconnect in case of non-payment; c) Retail prices are too low - the proper pricing strategy is needed, but currently missing. ▪ The DSO (EVN/ESM) and TSO (MEPSO) functions are already financially unbundled. There is initiative GenCo (ELEM) to further unbundle its generation units and identify different services provided. ▪ The final draft of the Market Rules is with the Energy Regulatory Commission (ERC) waiting for approval. As the market develops, both the Grid Code and the Market Rules will have to be amended and harmonized accordingly. DSO (ESM/EVN) is preparing the Distribution Code, subject to approval by the ERC.

- Monitoring of account unbundling: Between DSO (EVN/ESM) distribution and supply functions it is already required under the Energy Law and the ERC licenses. More elaborate monitoring instruments are to be considered, as well as the options for legal unbundling between these functions.
- GenCo unbundling: Further unbundling of GenCo (ELEM) regulated sale contract is considered to identify different services provided by different units and include their costs in the pricing system. This will allow to avoid cross-subsidization between tariff and eligible customers, and provide a basis for more transparent pricing and facilitation of the market opening.
- The market model, as implemented to date, is undergoing a comprehensive review in order to determine necessary further steps. The current electricity market model implements both regulated and free tariff markets. The bilateral contract model is considered as the next step in the evolution of the wholesale market.
- Market opening: The requirement to have legal provisions allowing non-household customers to become eligible is possible within 2007. According to the Energy Law the initial (current) eligibility threshold is set to 20 GWh per annum and the Law stipulates any further modification of this threshold as responsibility of the Government.
- Currently, there is a substantial disparity in the tariff and market prices that disincentives the consumers to exercise their eligibility status. Subject to the growing pressure from the large (direct) consumers on the electricity supply system, amendment on the Energy Law is proposed that allows the wholesale tariff supplier (MEPSO) to limit the electricity supply under tariff conditions for these customers (being already compliant with the eligibility conditions) and direct them to provide required excess electricity on the free market.
- The short-term practical effects of the market opening will, however, be subject to other conditions, such as:

  (1) The infrastructure for real-time metering, switching and settling transactions at this level is not in place. The necessary investments are subdued to more pressing system upgrades, and introduction of a clear tariff mechanism to allow recovery of the needed investments for real market opening (even if few customers decide to exercise their eligibility status).

  (2) The settlement agent needs to be implemented and operational beforehand, and this cost included in the pricing mechanism. Initiatives are started in this respect.

  (3) GenCo (ELEM) revenue requirements need to be further unbundled into components to appropriately allocate costs for ancillary services. Activities in this direction are initiated.

  (4) Balancing price mechanism will need to be developed.

  (5) Supplier of last resort function will have to be established. This function is being considered by the ERC.
- Market Monitoring: a) All participants in the electricity and gas market are licensed; b) Eligibility threshold, if exercised, would cover 20% of the consumption; c) National consolidation of the restructured companies – expected by the end

	of 2007. ▪ Regulatory framework, being applied and continuously developed, still undergoes a period of testing and adjustments in order to improve its applicability. ▪ The overall tariff system is reconsidered by the ERC with a view to decide whether the pricing design for different classes of customers is justified and appropriate. New retail tariff system conditions are being analyzed by the ERC. The cost reflectivity of the tariffs is being analyzed with a view to compensate for the actual cost of service and to provide minimum incentive for eligible customers to exercise their eligibility status. ▪ Measures are taken for improvement of the collection rate. The outstanding payments are negotiated in order to be paid in tranches, over agreed period of time, and incentives are being provided in this direction. ▪ Social safety and public service obligation reflect in the policy considerations. ▪ Affordability Issues: the protection of socially vulnerable customers is approached through the EBRD project "Combat of the energy poverty" for abetment of energy poverty which is near its completion.
Montenegro	▪ EnC Treaty has been ratified by the Assembly of the Republic of Montenegro on the 26th October 2006. ▪ After adoption of the Road Map and the Action Plan for Montenegro in November 2006, it has proceeded with practical implementation of the adopted documents. However, the currently valid legislation and regulations in the country, together with the speed of ongoing technical assistance projects in support of EPCG (IPA consulting agency) and the Regulatory Agency (KEMA consulting agency) led to certain delays in the implementation. Ministry for Economic Development has therefore integrated the last proposals on required changes in the Road Map. ▪ Following completion of the Background Energy Sector Studies in mid 2006, the draft of „Energy Development Strategy of Montenegro until 2025" (Green Paper) is in final stage of preparation and subject to the Government approval before public consultation planned for April 2007. The Action Plan for the first 5 years of the implementation of the Strategy (2007-2011) will be prepared in the 2nd quarter of 2007. A special Strategy Promotion Donors' Conference is planned for the end of June 2007 in Montenegro (presumably at an occasion of the next Ministerial Council meeting). ▪ Since September 2006, in cooperation with EAR, activities on EPCG's restructuring have been intensified. EAR is actively involved in this project (IPA consulting agency). Preparation for legal unbundling and unbundling of transmission and distribution system in process. ▪ Functional unbundling of EPCG can be regarded as formally completed, however its implementation is hampered by non-implementation of the Rules on tariffs (i.e. tariffs are unbundled in practice). Four functional units have been defined (G, T, D, S) and six operational licences have been awarded by the Regulator which are valid until final legal unbundling of EPCG or establishment of separate legal entity(ies). Separate accounts have been established for each

of the four functional units. Management function has been unbundled too.

- Legal unbundling: Various models have been prepared and are currently under review. Government decision is pending shortly on the basis of which EPCG will be fully legally unbundled following stipulation of the EC Directives and laws and regulations applicable in Montenegro. Potential privatisation plans may impact the final decision.
- Privatisation Agency of Montenegro is preparing the tender documents for privatisation of 5 small hydro power plants owned by EPCG.
- Tender for privatisation of thermal power plant „Pljevlja“ (100% owned by EPCG) and approximately 31% state share in the coal mine is under way.
- EPCG has established and applied since 1 March 2007 new cross border transmission capacity allocation procedure: the explicit auction method. According to EC regulations the procedure is a market based and provides clear price signals.
- According to the Energy Law, the regulatory authority is supposed to decide about the market design while the Market Operator (EPCG Transmission) should submit the Market Rules based on that design to the regulator for approval. Following that procedure, preparation of the Market Design is in final phase before being approved by the Board of Regulatory Agency, after which the EPCG will submit the proposal of the Market Rules to the Regulatory Agency for approval.
- As all national as well as international regulation provides for tariffs fully covering the cost and divided tariffs for each electricity activity, there were adopted the Tariff Rules completely fulfilling these principles. Approval of the tariffs based on the new methodology is under way and is expected to be done until the middle of the 2007.
- Based on adopted Rules on tariffs, unbundled tariffs have been prepared and adopted for 2006 by the Regulator. However, never implemented in practice due to already expired year of 2006. At present, new tariffs for 2007 are under calculation, pending final approval by the Regulator. They are likely to be implemented by mid 2007 at the latest.
- More than 30% dependence of Montenegro on imported electricity, of very high prices recently, results in problems of social acceptability of new prices. According to new methodology, prices of retail customer in households should be increased by more than two times.
- Application of short-term measures for protection of vulnerable customers has started and the permanent system will be established by the next winter. Support programme for socially most vulnerable categories of citizens is related to payment of electricity power cost. The Working Group is established by the Government in order to analyse new situation created by the electric power price increase (January 2007) and its impact onto the most vulnerable groups of citizens. The Group proposes that the financial support should be primary provided for the most vulnerable

	categories of citizens. ▪ In May 2007 TSO signed ITC agreement which is getting into the force in June (agreement for charging of transition which is signed by TSOs from 27 countries). ▪ Board of the Energy Regulatory Agency adopted the Regulatory Revenue Decision for EPCG**.** EPCG is obliged to submit the chart with prices to the Regulatory Agency in the period of 5 days, according the Energy Law (art 18). New tariffs are expected to be taken into force by July 2007. ▪ Kyoto Protocol has been ratified by the Assembly of the Republic of Montenegro in March 2007 and Montenegro became the beneficiary country of CDM mechanism. ▪ The study on renewables (wind, sun and biomass) was adopted in April 2007 by the Government, and its purpose is to create, as soon as possible, the conditions for utilization of those important resources and thus contribute to sustainable development of Montenegro and also reduce electric power deficit.
Serbia	▪ The winter situation is expected to be stable with 600 GWh contracted. ▪ EMS brought up in December 2006 the Temporary rules for allocation of available transmission capacities on interconnectors valid in the period from 1 January 2007 to 30 June 2007. ▪ TSMO is compensated for transited electricity according to SEE ITC Agreement for 2006 and its addendum for the first three months of 2007, signed by “EMS” (SEE CBT Clearing and Settlement agreement). ▪ Pro-rata and market-based explicit auction transmission capacity allocation mechanisms are used in monthly capacity allocation procedure (as of 1 January 2007). Market-based explicit auction mechanism is currently used on Serbia/Croatia and Serbia/Bosnia and Herzegovina borders (both directions), but the Rules allows for gradual introduction of explicit auctions on all borders. Both pro-rata and explicit auctions are based on “no congestion no payment” principle. ▪ According to the allocation rules TSMO can curtail allocated capacity in case system security is endangered or on request from the neighbouring TSO (intra-daily curtailment of allocated capacity and curtailment of nominated and confirmed transactions). ▪ EMS is participating in Dry-run Coordinated Explicit Flow-based Auctions in SEE during 2007. ▪ For the time being, Serbian TSMO (“EMS”) is exclusively and strictly the only entity which is in charge of cross border mechanisms (ITC and transmission capacity allocation) in Serbia. Serbian TSMO is implementing SEE regional ITC rules according to SETSO/ETSO mechanism and the Temporary rules (pro-rata and market-based explicit auctions) for the allocation of transmission capacity. ▪ The Grid Code and the Market Code are being designed at the very moment, and only after its adoption the Energy

Agency of the Republic of Serbia will be responsible and authorized for monitoring all cross border procedures in Serbia.

- The Council of AERS brought up a decision to decrease the eligibility status to 3 GWh/year (instead of 25 GWh/year so far) in December 2006. The decision will be implemented from 1 January 2007. There will be 350 customers with consumption larger than 3 GWh/year (so far 38), which makes 21% of total electricity consumption in Serbia.
- Competences of AERS in regulating prices include determining methodologies for setting tariff elements for calculating prices, drafting tariff systems as well as giving opinions on prices of energy and services that energy entities put forward. The Government approves tariff systems and prices of energy and services.
- AERS passed seven tariff systems in August 2006 and sent them for the consent to the Government in November 2006, which approved these tariff systems on 28 December 2006. The new system for regulating prices will apply from 1 April 2007. The tariff systems do not determine actual prices, since they are subject to calculation by the energy undertakings which upon previously obtained opinion of the Agency shall submit them to the Government for final approval.
- New cost reflective methodologies were passed by AERS (August 2006). On 1 February 2007, the new Methodology for the connection to the transmission and distribution System came into force, with new prices calculated by the distribution companies. AERS amended the new tariff methodologies on 2 February 2007.
- TPA is determined in the Energy Law, and will be operational when the relevant tariff systems are applied as of 1st of April 2007.
- Passing the cost reflective TPA tariffs is determined as an obligation in the Energy Law and was included within the new tariff systems which have been passed by AERS and approved by Government in December 2006 (the relevant methodologies have already been passed by AERS in August 2006). The tariff systems will be applied as of April 1st 2007.
- The licensing system is in place, and is conducted by the AERS.
- The Council of AERS approved the issue of energy licenses for electricity distribution to three distribution companies in October 2006. With the approval of these three licenses, all five (5) distribution companies in Serbia have acquired licenses for electricity distribution.
- All distribution companies have also obtained licenses for distribution system operation and retail trade (supply) to tariff customers.
- The MoME adopted the Register of issued energy permits in January 2007.
- Relevant secondary legislation is mainly in force, with the exception of the especially important Market Rules,

	Transmission Grid Code, and Distribution Grid Code that are currently being developed. ▪ The drafts of the Grid Code and the Market Rules have been drafted by the Transmission System Operator (Elektromreza Srbije-EMS) and the texts will soon be submitted to the Energy Regulatory Agency, for approval. ▪ Drafting of the Distribution Grid Code is responsibility of the Elektroprivreda Srbije-EPS. Distribution Grid Code is being drafted and is expected to be submitted to the Energy Agency for approval. The final version needs to be approved by the energy regulatory authority. ▪ It is expected that the Transmission and Distribution Grid Codes will be approved by the Energy Agency by the 1st of July 2007. ▪ Operational tasks have resulted in collection rate with level of 97.10% in year 2006, for electricity consumed in 2006 (excluding the earlier debts). ▪ In December 2006, the contract with French company SAGEM was signed for the purchase of 126 500 meters and with ENEL (Novi Sad) for the purchase of 4200 metering devices. This is only the beginning of the measurement system upgrade in the EPS. ▪ In the year 2005, the Energy Sector Development Strategy of the Republic of Serbia by 2015 was also adopted. The purpose of this document was to propose to the Government a set of recommendations in the area of energy policy in line with the legal framework set in the 2004 Energy Law. ▪ The MoME drafted and the Government adopted Programmes on Energy Sector Strategy Implementation on 18 January 2007. The Programmes facilitate potential investments in energy sector by defining potential locations for erecting new generation facilities. ▪ In May 2007, EMS (Serbian TSMO) started with market-based explicit auction transmission capacity allocation mechanisms (during monthly capacity allocation procedure) on all borders (both directions); explicit auctions are based on “no congestion no payment” principle. EMS is participating in Dry-run Coordinated Explicit Flow-based Auctions in SEE during 2007. ▪ The Energy Law was adopted in July 2004, and its amendments are currently discussed to align it to the Treaty.
United Nations Interim Administration Mission in Kosovo	▪ Task Force is set up of 7 experts to monitor the implementation of the EnC Treaty. ▪ Implementation of the Energy Strategy: new generation capacity up to 2100 MW is in the tender procedure. ▪ Plans are made to expand generation capacity associated with coal mining through private investments. ▪ In November 2006 in the framework of further unbundling of KEK sh.a., Government has decided to establish a separate mining company which will take over all mining assets and operations from KEK sh.a.

- Net importer.
- Electricity market opening: eligibility criteria set based on voltage level and not on consumption. In January 2007 eligibility conditions were set by Ministry of Energy and Mining for 2007. MEM has developed conditions for market opening for all customers connected down to 35 kV.
- Based on the Rule on Licensing, ERO has issued at the end of 2006 licenses to all existing energy sector undertakings. Impositions are included in the conditions associating licenses.
- In December 2006 Public Service Obligation is imposed to KEK sh.a and KOSTT through licenses issued by ERO to both of these energy undertakings.
- TSO: a) legally unbundled from the KEK since July 2006; b) the PISG of Kosovo nominated the Kosovo Transmission System and Market Operator J.S.C (KOSTT) as TSO and MO enterprise in Kosovo in July 2006; c) ERO licensed it in October 2006.
- As of 13 October 2006 KOSTT is a full member of the SETSO. KOSTT is looking forward to professionally and technically accept the CBT/ITC mechanism. Since July 2004, KOSTT has not received any compensation for transits, the amount being approx 3 million Euro while the Serbian TSO has already received this money and is holding it. Despite this problem, KOSTT is still operating in a transparent manner.
- In December 2006 ERO Board approved the technical results of the Tariff Calculations of KOSTT and KEK for 2007 including a new cost reflective Retail Tariff for Kosovo and a support mechanism for vulnerable customers. A new Retail Tariff is expected in April 2007. In January 2007 support mechanism for vulnerable customers accompanied the package.
- In December 2006 ERO has approved the allowed revenues for KOSTT and KEK sh.a. and has requested both of them to apply for new tariffs that have to come in effect by 1st April 2007. Support mechanism for vulnerable customers will start to be applied as of 1st April 2007.
- In January 2007 KOSTT has compiled the long-term and annual energy balances for electricity which were submitted to the Ministry of Energy and Mining for approval.
- Secondary legislation is under preparation. The Rule on Licensing is approved. Licensing of energy activities is ongoing. Authorisation procedure is under discussion.
- In January 2007 KOSTT finalized and ERO approved the following technical rules: a) Grid Code; b) Metering Code. Other codes are under development, such as Electricity Standards Code, Connection Agreement, and Electricity Equipment Code etc.
- From January 2007 KOSTT allows third party access on the basis of ERO regulation. ERO approved use of system

tariffs.

- In January 2007 the ERO Board has determined the need for an interim transmission charging arrangement to apply prior to the coming into effect of new Transmission Use of System (TUOS) charges for the year 2007.
- In January 2007 based on KOSTT application ERO has approved the Transmission Capacity Allocation Procedures (TCAP) for interconnection lines with aim of application as soon as possible. KOSTT will negotiate with all adjacent TSOs regarding the NTC values of all interconnection lines.
- Separate accounts for the generation, distribution and supply activities are being introduced as part of KEK sh.a's internal accounting. In addition, separate accounts for supply activities for eligible and non-eligible customers are being introduced.
- KOSTT JSC is entitled to keep separate account for Market Operation Business and for System Operation Business.
- In January 2007 ERO has commenced a review on the allowed costs and revenues of the individual business activities of KEK sh.a.
- Starting from January 2007 a transitional market design is being implemented for the whole year, although the much modified Bilateral/Net pool model with balancing mechanism is proposed & prepared.
- In January 2007 transitional market rules were developed by KOSTT and approved by ERO.
- Renewables: the small hydro potential has been identified.
- Energy efficiency: a program for public consumption is put in place.

Key problems (as seen by UNMIK as the Contracting Party)

- Continued technical assistance is required in order to keep up with the implementation of both Road Maps on electricity and gas. In this respect, the requirements were presented in mid-October 2006;
- Although UNMIK is doing its best, there exists the possibility that, particularly for technical reasons in the power distribution network, it couldn't be able to open the electricity market for all non-household customers by 1st of January 2008. But, it has to be mentioned that the policy decision for opening the market in line with the obligations of the EnC Treaty is firm.
- Energy sector reform and restructuring related issues have critical social implication. UNMIK would kindly request the PHLG and donors to assign the required special attention to social issues. The case of UNMIK is particular, and it deserves special attention.
- Regarding the implementation of Regulation 1228/2003, UNMIK rights for ITC fund are not recognized by Serbia. From July 2004 Serbia refuses to pay UNMIK's part of this fund. Although the Serbian TSO has agreed on the

volumes and values, payment to KOSTT was not made. Furthermore, KOSTT has not been recognized as the TSO of UNMIK with claims that Serbia retains the ownership of Transmission Network of UNMIK. KOSTT is maintaining its transmission assets and covering losses caused by transit. Also it is paying regularly for the secondary regulation to Serbia, thus accomplishing its responsibilities as the TSO. *The EnC and EC are kindly requested to intervene for resolving this pending but very important issue*;

- Rehabilitation and upgrade of energy systems and network is a priority need of UNMIK, which is making its best to facilitate the environment for attraction of private investment in these systems. Development of new generating capacity is a priority of the Government. But, concerns are being raised by a number of non-government institutions and civil society organizations regarding protection of the environment. UNMIK does not have any environment monitoring systems. There exists an urgent need for such systems, and it would request the support of the PHLG for building awareness among donors on such issues and needs. Without any environment monitoring systems that perform regular measurements, it will be impossible for UNMIK to adequately take care of the environment.
- Implementation of energy efficiency and renewables projects and programmes is constrained by lack of substantial funding from the Government Budget. UNMIK would expect that, in the near future, all EnC Treaty Parties become officially eligible to mobilize funding on such areas from the relevant EE programmes.