REPORT ON THE IMPLEMENTATION OF THE ACQUIS UNDER THE TREATY ESTABLISHING THE ENERGY COMMUNITY

ENERGY COMMUNITY SECRETARIAT

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1 BACKGROUND

In accordance with Article 67 (b) of the Treaty establishing the Energy Community, the Energy Community Secretariat (hereinafter ECS or the Secretariat) shall review the proper implementation by the Contracting Parties of their obligations under the Treaty, and submit yearly progress reports to the Ministerial Council of the Energy Community.

This report – using the previous report from November 2007 as a basis - has been prepared by the ECS on the ground of Secretariat’s analysis, on the information provided by the Contracting Parties, as well as data collected by third parties.

The report reflects the situation as of mid of February 2008.

2 SCOPE AND APPROACH

The Secretariat expresses its explicit gratitude to all Parties for their support and guidance in the process of collection and processing of the relevant information.

In this relation, the Secretariat notes the Parties that this report reflects in summary the major findings, which were outlined with the assistance of the national experts. However, the concrete details are being discussed between the experts from the Secretariat and the relevant PHLG members and shall be used for the preparation of the progress report to the Ministerial Council together with any update information on follow-up achievements.

The report focuses mostly on the transposition of the relevant Acquis requirements concerning electricity and gas in Title II of the Treaty, extended by the Regulation 1775/2005/EC. In this respect, the report provides summary information on the developments in each of the Contracting Parties taking the REPORT ON THE IMPLEMENTATION OF THE ACQUIS UNDER THE TREATY ESTABLISHING THE ENERGY COMMUNITY from November 2007 as a basis. Thus, it may be also a basis for further steps towards the monitoring process and towards concrete assistance to the Contracting Parties.

In the area of the Acquis on Energy it is to be noted that the legislation concerned shall be implemented until 1st July 2008 except the Regulation 1775/2005/EC which has to be implemented till the end of 2008. In this respect, the report provides mainly information on the key areas of the energy Acquis, as presented in the table below:
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3 SUMMARY INFORMATION ON THE IMPLEMENTATION OF TITLE II OF THE TREATY – ELECTRICITY AND GAS

Further to the developments as outlined in the November 2007 Report on the issue, it should be noted that all Contracting Parties continue actively with substantial changes in their legislative framework as to meet the Treaty requirements. The best example is active work on gas related legislation even in Contracting Parties, which do not have gas market at all. However, this is also valid for the electricity sector.

In both areas, the ongoing consultations between the Contracting Parties and the Secretariat provide positive and concrete results, which are indicated in concrete terms in the information for each of the Contracting parties below.

However, in parallel it should be noted that in some cases substantial provisions are still missing; further, the analysis of the Secretariat indicates that:

- there are cases of different interpretation of acquis requirements within some of the Contracting Parties (i.e. by the different national institutions);
- there are cases of misinterpretation of acquis requirements.
- There are cases where an adaptation of the of acquis communautaire in line with the Article 24 of the Treaty, taking into account the institutional framework of the Treaty and the situation of each of the Contracting Parties, seem to be reasonable to take more efficiently the given circumstances into account

All of the mentioned issues seem to hinder the process of effective and speedy development of the implementation of the acquis.

Still the most critical point is the market opening. The regional outlook indicates significant challenges ahead within the process. In electricity, only three Contracting Parties (Albania, Bosnia and Herzegovina and Croatia) have set a calendar and took concrete measures to open the market for non-household and household customers that are in line with the Treaty requirements. In gas, those Contracting Parties which have developed the primary legislation have set a calendar for the market opening but in most of them adaptation is needed to meet the Treaty –requirements. Some Contracting Parties are lagging behind.

Another critical point is related to cross border trade. In electricity, almost all Contracting Parties, but Croatia, have few provisions in force that are in line with Regulation 1228/2003/EC. However, it shall be noted that recently a majority of the SEE TSOs started to conduct explicit auctions of cross-border transmission capacity, while the rest of them announced their intentions to do the same by 1st July 2008.

In gas, there are currently very few provisions that really support cross border trade and transport and, consequently, competition and enhancement of security of supply.

Regarding the security of supply status (the improvement of the security of supply status is one of the core intentions of the Treaty), progress has been achieved from the provision of the legislative basis - perspective. Most Contracting Parties have adopted the security of supply provisions in their primary legislation although in gas some of them have to amend/extend their legislation. In any event, mechanisms for the practical implementation of the legislation call for further attention. Otherwise, security of supply may be at risk which might undermine activities related to the opening of the electricity and gas market.
4. FINDINGS AT THE CONTRACTING PARTIES’ LEVEL

In the following, specific findings with respect to each Contracting Party are provided.

4.1. Albania

4.1.1. Electricity

The Power Sector Law will be amended for the fourth time since its adoption in 2003 with special consideration for the privatisation of the DSO and the new Market Model. A new Market Model based on bilateral contracts has been approved in October 2007 and it is process of revision to better address the relations between the market participants.

• Institutional Organisation

Ministry of Economy, Trade and Energy (www.mete.gov.al) is responsible for the energy policy and Albanian Electricity Regulatory Authority (web: www.ere.gov.al ) is engaged in regulatory issues related to electricity market operation only. The Power Sector Law from 2003 defines its current position, independency and practice. ERE approves tariffs, licenses the companies in electricity sector and monitor their activity.

• Public Service Obligation and Customers Protection

Public service obligations are defined by the provisions of the Power Sector Law (Art. 25), detailed in the licenses and also in the provisions of the Grid Code and the type of contract. Supplier of last resort will be defined in the amendments of the Power Sector Law and will be assigned to the wholesale supplier. Customer switching procedure has to be issued. New Customer Protection Law has been drafted and it is in the Parliament to be approved.

The vulnerable customer protection is mainly addressed in a Governmental Decree issued in 2006. It was implemented a scheme to reimburse the vulnerable customers (low income customers) out of a fund financed through the state budget, customers get reimbursed immediately after paying their bills. In 2007, about 270.000 customers benefit from it.

• Monitoring Security of Supply

Monitoring of security of supply is enforced by the obligations defined the Power Sector Law (Arts. 34-36) and mostly related to issuance of licenses for electric power generation. Monitoring tasks of ERE are not explicitly stated in the Law but the Regulatory Authority started to monitor the security of supply, as well as the Ministry as the ultimate responsible. Operational supervision of the security of supply in Albania is made by the TSO, 2007 was a very difficult year for the security of supply in Albania. More than 50% of consumption has to be covered by imports as the hydro production dropped significantly. Due to limited interconnection capacities the demand cannot be met and many load shedding occurred.

Several infrastructure investment projects in generation, transmission and distribution are implemented to overcome the lack of generating capacity to meet the demand, to diversify the generation portfolio, to increase the interconnection capacities with the neighbouring countries and to decrease the technical and non-technical losses in the distribution/supply business. Steadily increased of demand of more than 5% per year can not be sustained on short and medium term if energy efficiency measure are not properly considered.

• Technical Rules

Technical rules related to the operation of the system and the grids are put in place.

The Market Model has to be implemented and the Market Rules, Transmission Code, Distribution Code and Metering Code have to be revised to be compatible. Dispatching
and balancing rules are included in Transmission Grid Code and Market Rules and have to be revised, as well.

- **Unbundling and Access to Accounts**

Power Sector Law envisages the unbundling of accounts of transmission and distribution from competitive activities (Art.33).

The TSO (OST) has been designated and its duties have been defined. It is unbundled in its legal form, organisation, and decision making since 2005. Starting 1st July 2007, the TSO will have its own financial statements. The auditor has been selected and by mid of 2008, the first financial statements will be published. TSO is also the Market Operator. Accounting unbundling has to be envisaged.

At the end of 2007, DSO has been registered in the Court of Tirana as an independent company unbundled from the electricity integrated company (KESH), 100% owned by KESH. The identification of assets and liabilities is in process and the shares will be transfer to the state ownership (Ministry of Economy, Trade and Energy) before the privatization process starts.

- **Third Party Access**

TPA to transmission and distribution grids is addressed in the Market Model and Grid Codes. Provisions for transparent, non-discriminatory third party access to the networks have to be set forth through the amendments of the Power Sector Law.

The TSO is obliged to justify to the interested party the denial of access to the grid according to provisions state in the Market Rules (Arts.11, 18). The cost reflective methodologies for setting the transmission and distribution tariffs have been approved and are based on 'price-cap' methodology. Transmission and distribution tariffs remain to be set and the contracts to be concluded.

- **Authorisation/Tendering Procedures for New Capacities**

According to the Power Sector Law (Art.13, 34-39), ERE issues licenses for construction, installation and operation of power plant. The proposed amendments of Power Sector Law envisaged assigning the responsibility for new capacities authorisation to the Council of Ministers. Objective, transparent and non-discriminatory criteria have to be adopted and an appeal procedure needs to be considered.

Tendering for new capacity is based on the Concession Law and on the criteria included in the “Rules for the Evaluation and Granting Concession” approved by the Council of Ministers in January 2007. Rules for tendering of new capacity which is not based on concessions are considered.

- **Market Opening**

ERE grant eligibility status to all non-household customers, begin of 1st January 2008. Currently, only one customer changed its supplier. Customer switching procedure has to be implemented. Reciprocity is not addressed in the legislation.

- **Cross-Border Trade Mechanism**

Albania had signed the pan-European ITC agreement for 2008-2009.

Regarding the adoption of the Regulation 1228/2003 the work remains to be done and split-up within several by-laws. Currently, there is a pro-rata method applied for cross-border capacity allocation. Currently, the Market Rules (art. 11) oblige the TSO to give the priority to the tariff customers for the capacity allocation, and after that to the eligible consumers. There are no long term contracts for the use of the existing interconnectors. TSO does not publish information regarding safety, operational and planning standards. Also, the TSO does not publish estimates of the available transmission capacity at
interconnectors. Transparency has to increase; all non-confidential information has to be publicly available.

National legislation does not envisage specific penalties upon breaching the Regulation 1228/2003.

**Key Open Issues**

It is important to pay attention to increase the compliance with the acquis in the primary legislation especially in areas like authorisation procedure, monitoring security of supply and market, third party access, supplier of last resort, cross-border trade issues. The revision of the entire Power Sector Law could be considered after its first adoption in 2003.

Security of supply will be an issue of concern also in the upcoming period taking into account the steady increase in demand that cannot be supported only from domestic generation even in favourable hydrological conditions. Access to imported electricity is limited by the interconnection capacities and, to some extent, by the existing procedure of capacity allocation.

TSO tasks and responsibilities have to be revised in order to strengthen its key position in the electricity market and system. Institutional and capacity building, independence in decision making have to be further considered. It is expected that market transparency will increased after the TSO website will become operational in March 2008.

Adoption of the procedure for cross-border capacity allocation on market based principles has to be considered to become operational by 1st July 2008.
4.1.2. **Gas**

The Ministry of Economy, Trade and Energy has elaborated the draft Gas Act which transposes the EU requirements into national gas legal/technical framework. Although Albania does not have a gas market, the timely development of the legislative framework will enable Albania’s participation in the regional gas network.

- **Institutional Organisation:** The energy policy issues are dealt with by the Ministry for Economy, Trade and Energy; it is intended to include the gas sector in the competences of the existing regulatory authority which is currently responsible “just” for electricity.

- **Public Service Obligation and Customer Protection:** The draft Gas Act contains provisions with regard to PSO. More detailed specifications criteria – taking the specifics of Albania into account - for customer vulnerability will be needed. This could be done in the market rules.

- **Monitoring Security of Supply:** Instruments for the monitoring of security of supply are available in the draft Gas Act; mechanisms for their practical implementation have to be specified. This could be done in the market rules.

- **Technical Rules:** Technical rules are included in the draft Gas Act. More detailed mechanisms for their practical implementation could be specified in the market rules.

- **Unbundling and Access to Accounts:** Unbundling rules and access to accounts provisions are incorporated in the draft gas act, although they do not fully comply with the requirements of the Directive 2003/55/EC. However, minor changes are still needed.

- **Third Party Access:** Provisions on the TPA are available; further rules have to be developed to make the system operational this could be done in the market rules

- **Authorisation procedures for new capacities:** Rules for new infrastructure have been developed (in line with Directive 2003/55/EC);

- **Market Opening:** Relevant provisions are included; some more details are needed.

- **Cross Border Trade Mechanism:** Regulation 1775/2005/EC has to be implemented till the end of 2008; the provisions were discussed/explained during the mission.

**Assessment of the implementation of Title II of the Treaty**

Regarding the **gas sector** it can be stated that due to the lack of a gas market, there are not many incentives to develop and implement a Gas Act (besides the obligations of the Treaty). Nevertheless, as indicated above, a Gas Act, which will include the issues discussed at the mission, meets the key requirements of the directive.

Further to the objective lack of gas market, another critical point could be the insufficient administrative capacity in terms of human resources; its strengthening should be made priority.

Secondary legislation could be developed and implemented afterwards or – in order to save resources – in parallel to construction works of huge regional gas infrastructure projects related to Albania.
4.2. **Bosnia and Herzegovina**

4.2.1. **Electricity**

- **Institutional Organisation**

  The State Ministry of Foreign Trade and Economic Relations (MFTER) and the State Electricity Regulatory Commission (SERC) are accountable for regulation of the electricity transmission and wholesale market operation functions in Bosnia and Herzegovina (BiH), on state level. In the same time the Ministry of Energy, Mining and Industry (MEMI) along with the Federal Electricity Regulatory Commission (FERC) are responsible for the generation, distribution and supply in the Federation of Bosnia and Herzegovina and Herzeg-Bosna (FBiH). Likewise, the Ministry of Economy, Energy and Development (MEED) of the Republic of Srpska (RS) together with the Regulatory commission for Electricity of the Republic of Srpska (RERS) are accountable for generation, distribution and supply functions in RS.

  This complex structure is reflected in the electricity market organization, where the Independent System Operator (ISO BiH) operates the electricity transmission system and organizes the (wholesale) market on state level, together with the Electricity Transmission Company (TRANSCO). In parallel, the generation, distribution and supply are concentrated in four vertically integrated utilities: Electricity Utility of Bosnia and Herzegovina (EP-BiH) and Electricity Utility of Croatian Community of Herzeg-Bosna (EP-HZHB) – both in FBiH, Electricity Utility of the Republic of Srpska (EP-RS), and Electricity Utility of Brcko District (EP DB) in the small district of Brcko.

  The regulatory status is defined in the appropriate laws and well implemented in each environment. The competences however are both complementary (SERC vis-à-vis RERS and FERC) and corresponding (between RERS and FERC) which reflects in the need for efficient and continuous coordination between them.

  Likewise, with some substantial differences, the primary legal framework on state level consists of the Law on Transmission of Electric Power, Regulator and System Operator of BiH [2002], later complemented by the Law Establishing an Independent System Operator for the Transmission System of BiH [2004] and the Law Establishing the Company for the Transmission of Electricity in BiH [2004]. In FBiH the electricity system is governed by the Law on Electricity [2002], as it is in RS – Law on Electricity [2007], both related to generation, distribution, trade and supply of electricity.

- **Public Service Obligation and Customers Protection**

  The Public Services and customer protection are defined on entity level. In RS Law on Electricity provides a base for universal service and consumer protection provisions which are further stipulated in more detail in the General Conditions for Delivery and Supply of Electricity (RERS). The same issues are also addressed to some extent in the FBiH Law on Energy and in the General Conditions for Delivery of Electricity (EP-BiH).

  A program for protection of vulnerable customers within the scope of overall social protection mechanisms has been contemplated by the RS Government, with a view to provide for its implementation. Meanwhile, such a program is planned for consideration by the FBiH Government. The matter requires a special attention due to the complex administrative structure of this environment.

- **Monitoring Security of Supply**

  Security of Supply is treated in the Laws and implemented mainly as a responsibility of the ISO (NOS BiH) who is entitled to prepare 10 year indicative development plan, used also to plan the network development (TRANSCO). Currently the plan is treated on yearly
basis, still missing specific priority criteria. Monitoring of the security should be treated accordingly.

- **Technical Rules**

On the state level, Grid Code is adopted and published (NOS BiH), rules for connection to the transmission network are pending to be defined. RERS has adopted Distribution Code for RS (Rules for connection to the distribution network). In FBiH the Grid Code is under development (FERC).

The functions for distribution (DSO) and supply are addressed by the entity laws. The DSO may also have a supply function (referred to as delivery of electricity to tariff customers), unlike the supply for eligible customers (which is treated together with the trade function). There are no provisions in the entity laws for legal unbundling of DSOs, although the third party access to the distribution network is provided for. The three utilities perform as generators, DSOs and suppliers (both for tariff and eligible customers). All of these activities are functionally unbundled within the companies. Unbundling of the supply for eligible customers is supported through the licenses which distinguish between tariff supply (delivery of electricity) and market supply.

Law entitles the ISO (NOS BiH) to control the dispatching and to implement the balancing market. Provisional Market Rules [2006] define the same matter in more detail. However, implementation of the balancing market as contemplated thereby, is subject to further coordination with the entities (utilities) and implementation of required technical preconditions.

- **Unbundling and Access to Accounts**

Obligation to have unbundled accounts is well addressed in the entity Laws. In RS it is implemented while in FBiH distribution unbundling is considered as a priority task among the next steps. Entity regulators are entitled to have the access granted.

Functions of the TSO and transmission of electricity are well addressed in the legislation on state level, TSO (NOS BIH) is legally unbundled as well as the transmission company (TRANSCO).

- **Third Party Access**

TPA to the transmission network is well contemplated in the Grid Code. It is provisionally addressed in both entity Laws, as well as in the Rules for connection to the distribution network in RS. Regulated prices for the use of both transmission and distribution networks are applied.

- **Authorisation/Tendering Procedures for New Capacities**


Authorizations are given by the entity ministries. Concessions on use of primary resources are given on local (entity, cantonal, municipal) level, the necessary procedures and construction options are defined in the Spatial Plans (RS), such a plan is not developed in FBiH. Procedures are defined and implemented in diverse way. Development of clear, efficient and unified procedures for authorization and transparent tendering rules is understood as a necessity, further steps are considered in this direction.

- **Market Opening**

Eligibility thresholds are set for both entities, providing for phased market opening – after 01.01.2007 for all customers above 10 GWh, after 01.01.2008 for all non-household customers, after 01.01.2015 for all customers. The retail market is formally open to the applicable level, and competitive supply is achievable. However the overall structure is still
not sufficiently unbundled and the legal framework underestimates the role of competitive supply (trade) in favour of the tariff supply (delivery). In addition, it is still practically encapsulated within the entities (RS and FBiH). Lack of appropriate metering/control and adequate billing support is also an obstacle.

Cost-reflectivity of prices is a general principle used to the applicable level. Average retail prices are on the level of 62 EUR/MWh.

Elements of the wholesale market are partially implemented; a general concept for the common market is not developed. There are no adequate instruments applied to address market concentration. Regulators are accountable for monitoring of the market within their jurisdictions, integral concept is missing.

- **Cross-Border Trade Mechanism**

The ITC agreement for 2008 – 2009 is signed. The ISO (NOS BiH) applies provisional rules for capacity allocation on its borders, new rules based on explicit auction are drafted and SERC is ready to approve it. ISO applies a pro-rata methodology (based on NTC, 50%) although congestions on the interconnection lines are not considered as a priority. BiH cooperates in the CAO project for SEE regional capacity allocation. There are no penalties applicable by SERC for non-compliance with the Regulation 1228/2003.

**Key Open Issues**

Legal framework is rather fragmented. Introduction of the regulatory practice is relatively well progressing in each of the areas and regulators appear to be relatively independent although not necessarily coherent in the applied criteria. Cooperation and coherence is substantial for efficient implementation of the reforms.

On the state level the jurisdiction is limited to common tasks of (inter)connecting and integrating the market in the wholesale domain. The functions have been significantly developed but their implementation faces difficulties. On the entity level, still integrated utilities tend to persist to existing practices and propagation of market reforms is still biased. Unlike the unbundling of ISO/Trans-Co which is well implemented in the transmission domain, the DSOs are integrated in the utility structures and still merged to the regulated supply. Losses are kept on a relatively limited level and the collection rate is not considered as a major problem. The customer protection is partially introduced. There is no sensation of lack of generation capacity or sufficient concern for the security of supply – BiH is the only EC Party which is exporting electricity. The market is formally open but the required instruments are not yet developed.

The areas of special concern are the following:

1. The process is complex and progressing rather slowly partially due to the specific political and regulatory structure, and requires additional efforts both in implementation and harmonization.
2. Enforcement of the ISO function, unbundling between the DSO and supply activities, unbundling of costs in the generation.
3. Mechanisms for protection of vulnerable customers should be considered. This process is just starting, and it usually takes relatively long period and involvement of different authorities in order to be properly introduced.
4. Authorization procedures imply rather diverse and lengthy processes, involving a number of stakeholders and authorities eventually with conflicting or competing interests.
5. Wholesale market structure is basically set, yet the balancing market is not integrated, market monitoring is not supported, cost reflectivity is to be confirmed.
• **Gas**

The developments in BiH have not progressed so far since the last review period in the sense that a (draft) gas act has been submitted to the Secretariat. There is an existing gas act available in the Republic of Srpska and there is a decree on the gas sector available in FBiH. The reforms appear to be observed as important to the level of their political relevance.

An expert group was established in order to develop and propose the proper frame for the gas sector in BiH.

The areas of special concern regarding the requirements of the Directive 2003/55/EC – which came up in the discussions - are the following:

- Implementation of the Acquis on gas – the process is complex and progressing slowly partially due to the specific political structure - requires additional efforts in the elaboration and in the implementation of:
  - Public service obligations
  - Customer protection – in particular mechanisms for protection of vulnerable customers.
  - Authorization procedures.
  - Tasks of system operators
  - Unbundling – of the TSO(s) including the compliance programme
  - Unbundling of accounts provisions
  - Refusal of access -rules
  - New infrastructure – exemptions from the third party access regime - provisions
  - Competences of the regulatory authorities
  - Derogations in relation to take or pay contracts
  - Emergent and isolated markets rules – linked with the possibility of derogation from some provisions in the Directive.

With regard to the Regulation 1775/2005/EC the presentation which was presented at the PHLG meeting in Belgrade (December 2007) was used as a basis in the "workshop". The rules were explained in details by the Secretariat and the stakeholders were made aware of the provisions which have to be properly “based” in the primary legislation with regard to the Directive 2003/55/EC.

**Assessment of the implementation of Title II of the Treaty**

With respect to **gas**, it can be concluded that if an agreement were achieved, the existing draft Gas Act could be developed and implemented relatively quickly. Any prediction with regard to an agreement is not possible. Another critical point is the insufficient administrative capacity in terms of human resources; its strengthening should be considered the first priority.
4.3. Croatia

4.3.1. Electricity

- Institutional Organisation

The Ministry of Economy, Labour and Entrepreneurship (Ministry) is accountable for the overall energy policy in Croatia, while the regulatory rule is applied by the Croatian Energy Regulatory Agency (2004) (HERA), established and operating according to the Act on Regulation of Energy Activities.


The Electricity Market Act governs the performance of generation, transmission, distribution and supply of electricity as well as the organization of the electricity market.

- Public service obligation and customers protection

Activities of generation of electricity for tariff customers, transmission and distribution of electricity, organization of the electricity market and supply of electricity to tariff customers are considered as regulated activities and are performed as public services, while the prices are set by application of tariff systems. Likewise, activities such as generation and supply of eligible customers as well as trading, mediation and representation on the electricity market are considered as market activities. All of these activities, however, are subject to licensing (except electricity generation for one’s own consumption or in facilities not exceeding 1 MW).

General customer protection principles related to the contractual agreements for electricity supply, connection fee, universal service and information provided to the end user are well addressed in the Energy Act (as amended (2004), and the General Conditions of Electricity Supply. The supplier of tariff customers (HEP – Supply) is accountable for performing the task of the supplier of last resort, contemplated as a public service. Protection of socially vulnerable customers is ruled by the Ministry of Health and Social Welfare. The major issue of identification of such customers is being addressed through the ongoing project. Non-tariff measures are foreseen. Collection rate is above 90%, simplified instruments for suppression of non-payments are in place. The overall losses in the distribution are not more that 2% above the estimated level of technically applicable ones, covered through the central and local government budget.

Meter readings and billing for households are applied semi-annually (aimed for reduction of costs). Facility for service monitoring and dispute settlement is established and rules are under development (HERA).

- Monitoring Security of Supply

The security of energy supply is regulated by the Energy Act. The Ministry (in cooperation with HERA) prepares and proposes the annual Energy Balance to be approved by the
Government. The security of electricity supply is related to the gas supply for thermal power plants. Long-term monitoring of the supply is applied for defining the requirements for new capacity construction. Demand forecast study is under way, including TSO and DSO capacity requirements forecast. The technical and operational security of the system is regulated by the Electricity Market Act and applied and monitored by the TSO, who is responsible to give reports.

- **Unbundling and Access to Accounts**

The functions and tasks of the market participants – for generation, transmission and distribution of electricity, supply and organization of the electricity market are stipulated in the Electricity Market Act. The TSO, DSO and MO are subsidiaries of the integrated holding “Hrvatska Elektroprivreda” (HEP), 100% in state ownership. All the companies are legally unbundled.

The market Operator (HROTE) (2005) is accountable for organization of the electricity market. The wholesale market model envisages bilateral contracts (market) between producers, traders and suppliers along with the contracts between suppliers and customers on the retail market. Two types of contracts are foreseen: for use of the network (on regulated tariffs) and for the supply of electricity (negotiated for the eligible and regulated for the tariff customers).

HERA is authorized to access any unbundled accounts and corresponding data.

- **Technical Rules**

Regulated TPA to the transmission and distribution networks is determined by the Electricity Market Act, and implemented through the Grid Code and General Conditions for Electricity Supply.

Grid Code and Distribution Code are approved by the Ministry and applied.

The Market Rules (2006) contain definition of the relations and detailed procedure for operation of the market. The balancing (including obligations for the balancing responsible party and cost of imbalances as defined by HERA) is described in the Balancing Rules.

Currently 5.6% of electricity is applied through non-regulated contracts for the electricity supply. Market monitoring (distortion and concentration of the market) is applied by HERA and reported to the assembly in the annual report.

Reciprocity rule is applied so the Supplier can not purchase electricity from a country with a less open market than Croatia (aimed to prevent transfer of the depreciated prices and avoid unfair competition).

- **Authorisation/Tendering Procedures for New Capacities**

The Ministry is entitled to provide new generation authorization and HERA is accountable for conducting the tendering procedures for new generation capacity. The administrative procedure is however quite complex and includes criteria for the generation options, spatial planning, provisions and rules for construction, various sector rules etc. Criteria also include Environmental Impact Study, rights for use of waters, protection of the nature monuments as well as national and cultural heritage etc.

- **Market Opening**

The electricity market is open for competition for all non-household customers (100.000 legal entities) since 01.07.2007. It is planned to open the market for all customers including households (2.200.000 customers) from 01.07.2008. The eligibility is on voluntary principle. A small number of switching cases registered up to date indicated practical problems related to metering, load curve estimation etc. It is planned to provide new meters for all customers above 30 KW in the period of 5 years, while the DSO is
entitled to publish standard load curves for the other consumer categories. The DSO applies the network charges while the supplier invoices the electricity including ancillary services paid to the TSO. Currently one retail supplier is registered outside of the regulated utility (HEP), along with a number of traders. There are no regulatory obstacles for switching the supplier.

- **Cross-Border Trade Mechanism**

The ITC agreement for 2008 – 2009 is signed. Tariffs for use of the transmission network have been approved by the Regulator and published.

Rules for explicit auction for cross-border transmission capacity are applied on all borders on monthly and daily basis for 50% of the capacity (except on Hungarian border where a common auction on monthly basis is applied). Croatia provides a general support for the Coordinated Auction Office project in the SEE region, from the position that Croatia should be determined as an “overlapping country” with the CEE region.

No penalties are yet applied for misuse of the criteria provided in the Regulation 1228/2003.

The licenses (for trade) issued by other countries applying higher standards can be accepted, while tower standards for the license can not be recognized. It is expected a common regional rule to be developed in this respect.

**Key Open Issues**

Overall reforms in the electricity sector are in an advanced stage. The legal and regulatory framework well addresses most of the applicable provisions from the energy Acquis, except for those that reflect regional aspects or which are not applicable. Regulatory rules should be continually updated, improved and enforced where required. Implementation of the Treaty is advancing also with respect to the development of the market environment and conditions for liberalization of the electricity market.

The regulatory practice is applied wherever it is required, providing in the same time appropriate space and options for competition. It may be noted that, although not in breach with the Acquis, in some cases (approval of Grid Code, Tariff items and amount of compensation for connection to the network, among others) the Regulator may have been given a less conservative role and allowed to exercise higher level of regulatory power and independence from the Ministry.

The energy market is appropriately structured. The operation structures are legally unbundled, remaining as parts of a holding company. Such a position is still in compliance with the Acquis, however it calls for increased attention on their functional independence.

The areas of special attention are the following:

- Continue with implementation, monitoring and development of the market;
- Measures should be considered for enforcing the regulatory independence;
- Special attention should be paid to introduction of the compliance programs for the TSO and DSO and other unbundling enforcement measures
- Continue the cooperation on the cross-border trade issues on regional level.
4.3.2. Gas

The Ministry of Economy, Labour and Entrepreneurship has elaborated and implemented a Gas Act, transposing EU requirements into national gas legal and technical framework.

- **Institutional Organisation:** Topics related to primary legislation in gas are under the auspices of the Ministry of Economy, Labour and Entrepreneurship; Croatia has set up a regulatory authority responsible for setting the tariff methodologies.

- **Public Service Obligation and Customer Protection:** The Gas Act contains provisions on PSO. More detailed specifications are needed, which—taking the specifics of Croatia into account—could be provided for in the market rules.

- **Monitoring Security of Supply:** Provisions for the monitoring of security of supply are included; more detailed rules—which could be included in the market rules—for the practical operation of the system are needed.

- **Technical Rules:** Relevant technical rules are available. Detailed mechanisms for their practical implementation are needed—this could be done in the market rules.

- **Unbundling and Access to Accounts:** Relevant provisions are available; the rules for practical operation could be provided for in the market rules.

- **Third Party Access:** Provisions are included in the legislation; rules for practical operation have to be included in the market rules to make the system operational.

- **Authorisation procedures for new capacities:** Rules for new infrastructure have been developed (in line with the Directive 2003/55/EC); rules for practical operation have to be included in the market rules to make the system operational.

- **Market Opening:** Provisions with regard to the market opening are available.

- **Cross Border Trade Mechanism:** Regulation 1775/2005/EC has to be implemented till the end of 2008; the provisions were discussed/explained during the mission.

The market rules which have to be proposed by the regulatory authority, will probably not be available in due time—although it is planned to discuss the market model during March 2008, taking the results of the detailed market structure analysis, which is currently being conducted by the regulatory authority, into consideration and although it is intended to adopt the final market rules at the end of May 2008—because Croatia:

- Does not seem to have enough capacity/experience with respect to the development of market rules in such a short period of time, (experience in the EU MS shows that a significant longer period of time is needed to develop proper market rules) thus
- Needs help from consultants (the time consuming public procurement procedure has to be followed which in this case does not support the quick realisation of the market rules)
- The monitoring of, including technical assistance, for such a process by the ECS needs time in order to comply with the “Regional Approach”

**Assessment of the implementation of Title II of the Treaty**

The gas sector needs for practical operation detailed rules in the secondary legislation (market rules); more efforts are needed to complete the required provisions in due time. The temporarily strengthening of administrative capacity should be prioritised.
4.4. **The Former Yugoslav Republic of Macedonia**

4.4.1. **Electricity**

Amendments of the Energy Law (63/2006) have been proposed by the Ministry of Economy and are in the final stage of approval in Parliament. The market model, which is described in the Energy Law, has been changed, removing the wholesale supplier from the TSMO and introducing bilateral contracts between the regulated generator and regulated retail supplier for energy. Regulated contracts between the regulated generator and the networks operators will be applied only for the energy needed to cover the technical losses and ancillary services to the level approved by the Regulator. Another important change in the Law is related to the metering system ownership which has been passed to the Distribution operator.

- **Institutional Organisation:**
  The Ministry of Economy is responsible for energy policy, including renewables and energy efficiency. The Energy Regulatory Commission (ERC) is the regulatory authority for electricity, natural gas and district heating. An agreement between the Regulatory Commission and Competition Authority has been signed regarding the cooperation in assessing the level of competition in the electricity market (ex-post/ex-ante responsibilities).

- **Public Service Obligation and Customer Protection:**
  Public service obligations are explicitly enforced in the Energy Law and imposed through licenses. Customer protection rules can be derived from the Energy Law, licenses and regulatory rules.

  Currently, a new Social Protection Law is proposed in the Parliament and the Government intend to address the protection of vulnerable electricity customers. An EBRD project has been dedicated to address the problems of vulnerable customers group. In 2007 a working group has been set and the measures are envisaged to protect around 72,000 household customers (retired, with health problems or low income people).

  Supplier of last resort has not been appointed.

- **Monitoring Security of Supply:**
  Security of supply is addressed in the law and in the license requirements. The monitoring is shared between the Regulator and the TSO, and the energy balances are under responsibility of the Ministry of Economy. The law foresees special measures in case of a sudden crisis. Monitoring imports is performed regularly by the actual wholesale supplier (TSMO).

- **Technical Rules:**
  The Transmission Grid Code has been approved in 2006 and a Committee to monitor the Grid Code implementation has been established. The Distribution Code had the public hearing in January 2008 and it is possible to be approved in the first months of 2008. The Market Code is being prepared taking into consideration the new market model.

- **Unbundling and Access to Accounts:**
  The former integrated utility has been legally unbundled into generation, transmission and distribution companies. Energy Law authorises the Regulator to access the accounts.

  The TSO is licensed for transmission, system and market operation and is 100% state ownership. Compliance program has to be set for TSMO.
The DSO is not legally unbundled from the distribution utility. It is envisaged the legal separation of distribution from supply by mid 2008. Compliance program has to be set for TSMO.

- **Third Party Access:**

  Regulated TPA is explicitly addressed in the Energy Law and Grid Code. Transmission Grid Code includes the rules for connection to the grid and the method to cover the cost of the connection. It will be further regulated through the Distribution Code. Methodologies to set the transmission and distribution tariffs have been issued by the ERC. The transmission tariff is set and is type “postage stamp” (1.7 €/MWh). Contracts with transmission grid users have to be concluded.

- **Authorisation/Tendering Procedures for New Capacities**

  Construction of new generation capacities is subject to authorisation. The authorisation is issued by the Government upon the proposal of the Ministry of Economy. No specific criteria for tendering procedures are provided. Appeal procedures in case of refusal are not properly addressed.

- **Market Opening:**

  The electricity market is opened for all consumers directly connected to the transmission network that do not provide public services (40% of the consumption), without a possibility for tariff supply. The Law entitles the Government to further decide on the eligibility threshold; yet no specific schedule has been officially adopted yet. Reciprocity will be defined by ERC in the secondary legislation.

- **Cross Border Trade Mechanism:**

  MEPSO has signed the pan-European ITC agreement for the period 2008-2009. The transmission network charges are set and take into consideration the costs (MEPSO is a net payer) of the ITC mechanism.

  The cross-border capacity allocation is performed differently at each border. For the interconnection with Greece, a jointly explicit auction is performed by the Greek TSO and the revenues are shared. For the interconnection with Serbia, there is 50:50 allocation of NTC, pro-rata allocation is performed in direction Serbia-Former Yugoslav Republic of Macedonia. There is reserved capacity for the supplier of tariff customers. The revenues from the cross-border capacity allocation are used to decrease the tariff for access to the network. Some information on NTC, ATC, and temporary cross-border capacity allocation procedure are published on MEPSO website but not fully available in English. Transparency has to increase furthermore.

  No penalties for infringements of the cross-border trade provisions, as of Regulation 1228/2003 are in the legislation.

**Key Open Issues**

The latest amendments of the Energy Law did not consider all the aspects that are not fully in compliance with the electricity acquis and further harmonisation is needed.

Other issues of further concern are the market opening status due to the fact that the current infrastructure is not able to support all non-households switching. The regulated retail prices are well below costs and are among the lowest in the region.

In the Energy Law, ERC has no competences to monitor the cross-border trade or approving the rules for the capacity allocation. Significant work remains to be done regarding the full compliance with Regulation 1228/2003/EC by 1st of July 2008. Implementation of market based principles of congestion management and transparency are the main issues to be considered.
4.4.2. **Gas**

The concept of the gas market is defined in the Law on Energy. Many crucial provisions of the Directive 2003/55/EC have still not been transposed in the primary legislation. Besides the primary legislation, two acts (parts of the secondary legislation) are under preparation (Condition for Natural Gas Supply and Transmission Grid Code) - more details are to be found below.

- **Institutional Organisation:** The energy policy issues are dealt with by the Ministry of Economy; the Energy Regulatory Commission is responsible for regulatory issues in the gas sector.

- **Public Service Obligation and Customer Protection:** the provisions in the Law on Energy are in accordance with the requirements of the Directive 2003/55/EC. More details – in particular with regard to provisions on the appointment of a supplier of last resort and with respect to provisions for vulnerable customers’ protection - are needed. It is envisaged that these rules should be part of the Conditions for Natural Gas Supply.

- **Monitoring Security of Supply:** Provisions for the monitoring of security of supply are provided; more detailed rules – which could be included in the market rules - for the practical operation of the system - are needed.

- **Technical Rules:** Technical rules are to some extent available. A grid code is not available and detailed mechanisms for practical application are needed. The Transmission Grid Code is under preparation and it is planned to finalize the code until 1st July 2008. Regarding the Distribution grid code it has to be mentioned that there is no DSO in place currently. The Energy Regulatory Commission is in the phase of development of a distribution grid code.

- **Unbundling and Access to Accounts:** Unbundling rules and access to accounts’ provisions are foreseen in the law, but not fully in compliance to the Directive 2003/55/EC - further details for practical operation are needed, these detailed rules could be provided for in the market rules.

- **Third Party Access:** The law contains provisions on the third party access; further rules have to be developed to make the system operational. The Rulebook on the Conditions, Manner and Procedure for granting and Depriving of the Capacity of Eligible Customer (OG 49/07) has been issued. Detailed rules on TPA are foreseen to be part of the Transmission Grid Code – which is in the phase of preparation.

- **Authorisation procedures for new capacities:** Rules for new infrastructure are partially available. The missing provisions should be included in accordance with the requirements of the Directive 2003/55/EC. These provisions have to be developed further on in more details, especially including provisions of the Article 22 of the Directive 2003/55/EC.

- **Market Opening:** Provisions are foreseen in the law but have to be accommodated with the requirements of the Treaty.

- **Cross Border Trade Mechanism:** Regulation 1775/2005/EC has to be implemented till the end of 2008; the provisions were discussed/explained during the mission.

The Market rules and all of the needed tariffs - which are essential for the efficient operation of the system - will probably not be available in due time because the former Yugoslav Republic of Macedonia:

- Does not seem to have enough capacity/experience with respect to the development of market rules in such a short period of time, (experience in the EU
MS shows that a significant longer period of time is needed to develop proper market rules) thus
- Needs help from consultants (the time consuming public procurement procedure has to be followed which in this case does not support the quick realisation of the market rules)
- The monitoring of, including technical assistance, for such a process by the ECS needs time in order to comply with the “Regional Approach”

Assessment of the implementation of Title II of the Treaty

The Law on Energy which includes, among others, the gas sector provides for partially the transposition of the Directive 2003/55/EC. More efforts are needed for the entire transposition of the requirements. In particular, the market structure is still to be established in a functional manner.
4.5. Montenegro

4.5.1. Electricity

- **Institutional Organisation**

  Energy policy is governed by the Ministry of Economic Development (Ministry). Regulatory practice in the electricity market is provided by the independent Energy Regulatory Agency of Montenegro (Regulator) (2004) established and operating under the Law (Articles 6 – 20). Competition on the energy market, along with the treatment of complaints, is addressed in the Law (Art. 21), as well as the responsibilities which are applied to the Regulator in this respect.

  The activities for generation, transmission, distribution and supply of electricity, as well as production of coal for electricity generation, are defined in the Law on Energy (2003) (Law), along with the electricity market functions and overall tasks and competences of the Regulator. All of the above activities are regulated and licenses are applied.

  The Energy Development Strategy of Montenegro by 2025 (December 2007) (Strategy) confirms the implementation of the Treaty among the strategic Government priorities, identifies the role of electricity sector in the overall energy over the observed period and outlines the development options for electricity generation, transmission and distribution infrastructure and prospects for overall supply of electricity with a view to provide for security of supply, self-sustainability and reduction of the dependence on imports.

- **Public Service Obligation and Customers Protection**

  Public services are well supported by the Law and defined in the Licenses as well as in the Rules for Electricity Supply (2005) published by the utility “Elektroprivreda Crne Gore” (EPCG). Universal service, as well as the consumer protection rules, should be extended to the supply of eligible customers (currently provided by the traders who are not licensed).

  Protection of socially vulnerable customers (Ministry of health, Labor and Social Welfare) is implemented through the Government Program for Subsidies to Socially Sensitive Groups (2007) aimed to provide support for minimum needs of electricity and heat, covering 75,284 households with a direct payments of an amount equal to 30% of the average monthly electricity bill (or 11.2 EUR) provided from the State Budget. Problems still exist in identification of such customers and insufficient metering (20%). Tariff related customer support (block-tariff) is not applied.

  Collection has improved from 50% (2000) up to 95% (2006). Losses in the distribution network decreased from 27% (2005) to a still high level of 21% (2007), projected to 19% in 2008, targeted to 12% over a 4 year period. This positive trend is supported by substitution of the meters and treatment of losses in the Energy Balance and regulated tariffs.

  The Retail market is practically 100% regulated. The only effectively eligible customer, who covers roughly 30% of the market, is the Aluminum Production Plant in Podgorica (KAP), supplied directly from the traders (imports). The only retail supplier is the tariff customers supplier (EPCG), which is contemplated also as the default supplier. Supply under competitive conditions is roughly outlined in the Law (Articles 24, 38) subject to a regulatory approval, pursuant to a general conclusion of the Regulator when the competitive market is developed (not yet applied). Customer eligibility is possible upon a proof that he can provide his electricity supplies on the market under equal or better conditions than the regulated ones (Art. 24), in which case he can address the traders (the only ones who currently provide the supply function on the competitive market). Some
aspects on the phased development of a competitive retail market are contemplated in the Decision on the Electricity Market Model brought by the Regulator (July 2007), underlining in particular the relation of this process to the need for more sophisticated metering.

The project (Regulator, technical assistance) for development of the electricity market is well developed; the market model is defined (2006) and currently activities are extended for defining the implementation plan. Obstacles are also observed in the deficit of generation (60% imports (2006)), size of the market, as well as in the structure of consumption (out of 310,000 consumers 270,000 are households).

Retail prices are on the level of 70 EUR/MWh, including significantly high level of cross-subsidies from the industry consumers (average tariffs 140 – 170 EUR/MWh) in favour of households. A tariff policy aimed to gradually alleviate the subsidies is considered necessary in the forthcoming period. Significantly lower regulated electricity prices compared to the market price are considered as the main reason for delayed effective opening of the market.

- **Monitoring Security of Supply**

The Security of Supply is treated in the Law through the criteria for technical safety and protection of the equipment, objects and infrastructure (Articles 36, 37) and the consumption planning through the annual Energy Balance approved by the Government (Art. 5). Long-term aspects are substantially reflected in the Strategy.

- **Unbundling and Access to Accounts:**

Unbundling is contemplated in the Law (Art. 22) as a “Functional unbundling” which includes unbundling of accounts, management and confidential information, while the legal unbundling is provided only as an option.

The functions and tasks of the market participants - Generator, TSO, DSO, Market Operator, and Supplier (for tariff customers) are stipulated in the Law (Art. 26 – 30).

In practice the electricity utility EPCG is still a legally integrated utility and operates as a holding company for generation, TSO, DSO, supply (for tariff customers) and also includes construction activities. Six licenses are issued to EPCG (for generation, transmission, TS operation, market operation, for distribution and DS operation and for supply). All of these functions are “functionally” unbundled in the context of the Law and according to the licenses, Articles of Association of EPCG and the Rules of Unbundling of the Integrated Utility EPCG (Regulator, 2004) (Rules), however no compliance programs have been applied. According to Government program for unbundling of EPCG and the Rules, this is considered as the first phase. The TSO is prepared for legal unbundling before 2009, and by 2010 all the subjects are planned to be legally unbundled (including ownership unbundling). Currently the assets of EPCG are 70% in state ownership (1.5% belong to the employees, the rest is privatized).

Accounts are unbundled for all the EPCG functional units. According to the law, the Regulator is entitled to have access to the accounts and any assessment of the assets.

- **Authorisation/Tendering Procedures for New Capacities**

Generation is concentrated in EPCG, capacity prices are regulated and engaged for supply of tariff customers (supply market is still not developed).

Authorizations (licenses) for new generation are granted by the Regulator after all administrative permits (concession on use of water resources, environmental licenses etc.) are submitted. In addition, permits for construction are issued by the competent ministry. However, the overall procedure is not clearly defined. The new Law on Concessions should resolve existing administrative conflicts.
Tendering for new generation capacity is also in the responsibility of the Regulator, according to the Law. The applicable procedure is well defined in the Law on Private Sector Participation in Delivery of Public Services (2002).

- **Technical Rules:**

TPA (for producers and suppliers) is defined by the Law (Art. 25) and administered by the Regulator. Refusal is limited to lack of capacity as well as safety, continuity and quality of supply. Complaints can be submitted to the Regulator. Specific regulatory act on the TPA (including pricing methodology) is being developed.

Grid Code and Distribution Code are adopted by the Regulator and applied as provisional ones while the final modifications are pending the adoption and implementation of the market model.

Balancing is supplied by the EPCG-TSO through a state-of-the-art SCADA system, on economic (cost-reflective) principles using indigenous hydro capacities, which are dominant and even partially engaged (HPP “Piva”) in a leasing agreement to be operated by an overseas utility (EPS from Serbia) upon a long-term electricity exchange scheme. No dependence on the regional balancing market is foreseen. While hydro potentials are considered as a strategic resource, specific plans for supplying any competitive balancing market in the region can not be considered at the moment due to the local deficit.

- **Market Opening:**

Wholesale supply is currently still concentrated in EPCG, the plans for implementation of the competitive market are in progress (focused on bilateral trade and local balancing market). Trading is not licensed. Market rules are partially prepared and currently still under development (to be completed once the model is adopted by the Regulator).

- **Cross Border Trade Mechanism:**

The ITC agreement for 2008 – 2009 is signed. Tariffs for use of the transmission network have been approved by the Regulator and published, including the Decision on the corresponding price for the aluminium production plant KAP.

The agreement for electricity exchange with Serbia (HPP “Piva and EPS) implicitly reflects on a special treatment of part of the capacity on this border (which should be reflected in the future annual updates of this agreement). There are no additional administrative levies on the cross-border trade or transits.

ATC values are provided on the TSO – EPCG web page. Explicit auctions for capacity allocation are applied. Montenegro participates in the process for establishment of CAO in the SEE region. Penalties for breaching the provisions from the Regulation 1228/2003 are foreseen.

**Key Open Issues**

Overall reforms in the electricity sector reflect moderate but steady progress. Taking into account past delays due to objective reasons; currently the understanding of the urgency, importance and of the appropriate next steps is prevailing. Making use of already developed drafts and applying the adopted plans and development strategy should well speed-up the process.

The policy makers and the entities that implement market functions are rather advanced in the considerations for security of supply and customer protection measures. However, there are still substantial obstacles for opening of the market to competition. Transparency is well applied. Specific characteristics of the system have also influenced some of the decisions in the past.
The regulatory authority is well established, operational and active both in the country and in the region.

The areas of special concern are the following:

- Application of the new market model and further development of the legal framework, including technical rules and possible upgrade of the primary legislation. Specific attention should be paid to the role of the supply function in the competitive market. Market opening commitments should be scheduled, monitoring instruments supported and developed.

- The planned legal unbundling of the utility should be precisely scheduled, prepared and implemented in the appropriate manner, taking into consideration possibilities for effective gradual opening of the market and extending the options of universal service and adequate protection of the eligible customers.

- Regulated Third Party Access principles should be sustained and reaffirmed in the regulatory framework, along with the competitive rules for allocation of the cross-border capacities and market-based principles of congestion management.

- The adopted Energy Development Strategy should be applied and investment climate in energy should be improved in order to provide incentives for investment in new generation capacities aimed to advance the security of supply, support the market and possibly lower the dependence on imports.

### 4.5.2. Gas

Currently there is no gas market in Montenegro. At this stage, there are some activities on the development of the gas market ongoing; the draft Law on production has been prepared, and the Declaration on support to the Ionian Adriatic Pipeline (IAP) project has been signed by the Ministry of Economic Development (international pipeline between Albania and Croatia, passing Montenegro). The possible corridor of the IAP has been included in the Urban and Space Plan of Montenegro (in the last phase of the adoption procedure).

**Assessment of the implementation of Title II of the Treaty**

Because of the lacking gas market there are not many incentives – besides the obligations arising from the Treaty - to develop and implement a Gas Act. If the so called Energy Community Ring should be realized this could have an impact on the establishment of a gas market in Montenegro, since the route of the Ring will cross Montenegro along the coast line, thus providing the chance for gasification along the coast. The Ministry of Economic Development signed the Declaration for the Ionian Adriatic Pipeline project, which is a possible part of the future Energy Community Gas Ring. A hurdle for the elaboration of a Gas Act could be the insufficient administrative capacity (human resources); its strengthening should be prioritised. The secondary legislation could be developed and implemented – in order to save resources – in parallel to construction works of regional infrastructure in Montenegro.
4.6. **Serbia**

4.6.1. **Electricity**

Ministry of Mining and Energy prepares amendments to the Energy Law (2004) to become in compliance with the requirements regarding the implementation of the acquis, the. The amendments have to consider the electricity, gas and, to some extent, the renewables provisions in a coordinated manner.

- **Institutional Organisation**

  The Regulatory Agency is in the final stage to approve the Transmission Grid Code. Transmission tariff values have been approved and contracts for access and use of the network are in the final stage to be signed with transmission network users. Distribution Code and Market Code are envisaged to be approved by mid 2008, as well as tariffs for distribution services.

- **Public Service Obligation and Customers Protection**

  Under the 2004 Energy Law the electricity activities have to fulfil a number of public service obligations. The provisions in the Energy Law are further developed in a specific Law adopted in 2005 for Public Utilities and public service obligations. Provisions for protection of final customers are described in the Energy Law, the Law on Public Utilities and will be defined also in the contract for electricity supply.

  The Energy Law amendments will define the wholesale supplier for tariff customers as the supplier of last resort. The amendments have to allow customers to switch the supplier at any time. The tariff customers have to be restricted to households and small and medium enterprises (SMEs).

  Protection of vulnerable consumers is addressed in the Decree on General Conditions for Power Delivery passed in December 2005. Coordination with the Ministry in charge with Social Policy to implement of the social protection scheme is considered to better target the number of vulnerable customers (low income people, including retired persons, with health problems). Currently, there is a scheme developed with the industry to offer a 30% discount on the electricity bills for vulnerable customers having consumption of less than 300 KWh/month. A fund has been set up out of the state budget and about 150,000 customers benefit from this scheme in 2007.

- **Monitoring Security of Supply**

  Security of supply is addressed in the Energy Law and in the Decree on General Conditions for Power Delivery with the Government of Serbia being the ultimate responsible. The Decree assigns responsibilities between the Autonomous Provinces, the Ministry responsible for Energy and the Transmission System Operator. In the Energy Law amendments it is envisaged that the Regulatory Agency will be in charge with monitoring and reporting on security of supply issues to the Ministry responsible for Energy. The amendments have to include the regularity of reporting (yearly or every two years)

  There are provisions regarding safeguard measures in case of sudden crisis that should be performed by the Government and the System Operator (Energy Law, Art.71-76, the Decree for Electricity Delivery Conditions and in the draft Grid Code). The obligation of reporting to the ECS and the Contracting Parties will be included in the Energy Law Amendments. The monitoring obligation of imports and reporting on quarterly basis have to be included in the Energy Law amendments.
• Technical Rules

The first draft of the Transmission Grid Code has been prepared by the TSO (EMS) in 2006 in accordance with the UCTE Operational Handbook. The second version of the Grid Code including Agency opinions have been made public in March 2007 and is now in the final stage to be approved by the Regulatory Agency Council.

The Transmission Grid Code including rules for connection to the grid, access to cross-border transmission capacities and metering is expected to enter into force by March 2008.

The Distribution Grid Code is responsibility of the DSO (EPS) to draft it and the first version had been submitted to the Regulatory Agency in 2007. The second version including Agency opinion will be sent in the first months of 2008. The Distribution Grid Code is expected to be approved by the Agency and to enter into force by June 2008.

The Market Rules are currently being drafted by the Market Operator (EMS) and will include among other issues the balancing arrangements. The Market Rules also requires the final approval of the Regulatory Agency.

The Regulatory Agency issued the methodology for setting the network users’ cost of connection to the Transmission and Distribution Networks in 2006 with the last revision in February 2007.

• Unbundling and Access to Accounts:

The Energy Law (Art. 43) envisages the unbundling of accounts for all energy activities performed by one energy entity. Accounts of electricity undertakings are audited by independent auditors and auditing reports are published and submitted to the relevant authorities. The energy regulatory authority has the right to access the accounts of electricity undertakings and the accounts are being continuously monitored by AERS.

EMS (www.ems.co.yu), established in 2005, is the Transmission Operator, System Operator and Market Operator, as well. In the future it is envisaged to spin off the Market Operator function from EMS, as a separate legal entity. The TSMO has to established a compliance program (Directive 2003/54, Art.10d) setting out measures to ensure that discriminatory conduct is excluded and to ensure that observance of it is adequately monitored. EMS published audited financial reports for 2005 and 2006 on TSO website.

There have been established five regional distribution companies under the ownership of the incumbent electricity company, EPS, which also has generation facilities. The Energy Law allows however Distribution System Operators to perform retailing to regulated customers without the need of legal and organisational unbundling. By July 2008 it is planned to make the accounting unbundling of supply from distribution activities. The DSO has to establish a compliance program (Directive 2003/54, Art.15d) setting out measures to ensure that discriminatory conduct is excluded and to ensure that observance of it is adequately monitored.

EPS published audited consolidated financial reports for 2006 on the company website.

• Third Party Access

Non discriminatory, transparent and regulated third party access is envisaged in the Energy Law (Art. 36-38). The Transmission System Operator and the Distribution System Operators are requested under the Energy Law to justify any TPA refusal based only on technical basis. Specific provision regarding access to the distribution network of generation capacities base on renewable sources is envisaged in the amendments of the Energy Law (Art 103a). There is no distinction in the Energy Law between direct and common lines (Art 31).

The methodologies for setting the tariffs system for access and use of networks are approved at the end of 2006 and are published on AERS webpage. Based on the cost plus methodology on rate of return, the Regulatory Agency proposed the transmission
tariff values and the Government of Serbia adopted the transmission charges in December 2007 (2.8 €/MWh). Starting 2008, contracts for transmission access and use of network with the transmission network users are underway. The distribution charges have to be determined by the Agency and approved by the Government and it is expected that distribution tariffs will be approved by mid 2008.

Provisions for the supply function, designation, tasks and responsibilities of the supplier are defined in Art. 57, art. 108 and in newly proposed Art. 108a) of the Energy Law. The provisions are not clear in respect to the access to distribution networks and technical requirements for connection to the grid. A clear distinction in provisions related to the technical access to the grids and the access to the market has to be made.

- **Authorisation/Tendering Procedures for New Capacities**

The generation activity, as for all electricity activities, requires a license issued by the Energy Agency according to the Energy Law (2004) and the Energy License Code of the Regulatory Agency (2005).

In addition, the Energy Permit Code (2006) intended to grant authorisations for the construction or refurbishing of facilities is enforced and is the responsibility of the Ministry of Mining and Energy.

If needed, and on the grounds of Security of Supply, the legislation allows to tender new capacity. The tendering criteria are established in the Concession Law. Designation of the Authority in charge to supervise the tendering process has to be defined.

An appeal against a decision of the Ministry of Mining and Energy on issuing of an energy permit can be made to the Government or to the Ministry. The future Energy Law amendments have to address properly this issue to indicate a higher level of appeal or the Court as the ultimate authority. There is no appeal procedure in case of tendering procedure.

- **Market opening**

The national legislation does not include up to now provisions to define the eligibility status. Currently, the eligibility is based on consumption (3 GWh/year) and the status is granted by the Regulatory Agency which has to keep a register with the eligible customers.

The amendments of the 2004 Energy Law consider the timetable for the market opening in accordance with the Annex I of the Treaty, but cannot be made retroactively. Eligibility has to be granted and should not depend on any other act/rule. The Market Operator should propose a procedure for customer switching to be approved by the Regulatory Agency that have to be made it public afterwards.

Actually, no eligible customer exercised its eligibility status as the regulated retail tariffs are well below costs. Provisions on reciprocity of the eligibility status on third party markets are not provided in the legislation.

- **Cross Border Trade Mechanism:**

Serbian TSO has signed the pan-European ITC agreement for the period 2008-2009. The transmission network charges are set and take into consideration the revenues (Serbia is a net receiver, being a transited country) from the ITC mechanism.

The methodology for cross-border capacity allocation is issued and published on TSO webpage (available in Serbian language only) and the results of the auctions are published (available in Serbian language only). The methodology will be part of the Transmission Grid Code after approval by the Regulatory Agency.

Monthly explicit allocations are performed on all 8 borders, split 50%-50% with the neighbouring TSOs. The intentions are to introduce weekly allocation for the non-used
capacity from previous monthly auction. The capacity rights are not tradable on a secondary market. There is reserved capacity for the long term electricity contract between Serbia and Montenegro, Serbia and Republic of Srpska and for the suppliers of tariff customers. Curtailments are performed pro-rata and no compensation is paid.

Serbian TSO is participating in the Dry-Run study and in the Coordinated Auction Office establishment. Is the TSO opinion that the common market rules, including harmonization of licenses, common balancing rules and harmonization of gate closures deserve to be taken into consideration for the future CAO with the same priority like the location, the definition of the 8th region or agreement on the business plan.

The revenues from the cross-border capacity allocation are used to decrease the tariff for access to the network. Provisions regarding the treatment of new interconnections are not addressed in the law. Some information on cross-border capacity allocation, results and some network information are published on EMS website but not available in English. Transparency has to increase furthermore.

No penalties for infringements of the Cross Border Trade provisions, as of Regulation 1228/2003 are in the legislation. The future amendments of the Energy Law have to pay attention to enforce them.

**Key Open Issues**

Implementation of the Treaty and electricity market reforms in Serbia is progressing rapidly.

Energy Law amendments have to be carefully considered to provide an increased compliance with the Directive 2003/54 and Regulation 1228/2003 provisions. Further to this, the status of the Regulatory Agency in terms of tasks and responsibilities over the internal market has to increase (market monitoring, monitoring the security of supply, reporting requirements, provisions for regulatory cooperation at regional level and monitoring the cross-border trade).

Other issues of further concern are the market opening implementation, efficient unbundling of distribution from generation activities, development of the market framework for competition in supply, cost reflectivity of retail tariffs.
4.6.2. **Gas**

- **Institutional Organisation:** Topics related to primary and secondary legislation in gas are under the auspices of the Ministry of Mining and Energy; Serbia has set up a regulatory authority. The competences of the regulatory authority have to be brought line with the requirements of the Directive 2003/55/EC.

- **Public Service Obligation and Customer Protection:** The Energy Law contains provision with regard to PSO. More detailed specifications, which could be included in the market rules – taking the specifics of Serbia into account - are needed.

- **Monitoring Security of Supply:** Provisions for the monitoring of security of supply are included; more details – which could be included in the market rules - for the practical operation of the system are needed, the role of the regulatory authority has to be clarified; Art. 41 of the Treaty should be taken into consideration.

- **Technical Rules:** Relevant rules are available but the tasks of the system operators are not completely in line with the requirements of Directive.2003/55/EC. Detailed mechanisms for the practical operation are needed – this could be done in the market rules.

- **Unbundling and Access to Accounts:** Provisions are available although clarification with regard to unbundling requirements respectively unbundling approaches is needed, and provisions for the compliance programme are necessary. The rights of access to accounts should be precisely determined; the rules for practical operation could be provide for in the market rules.

- **Third Party Access:** Provisions on the third party access are available; the definition of costs should be clarified; the TPA provisions regarding access to storage facilities should be in line with the requirements of the Directive 2003/55/EC; more detailed rules have to be developed in order to make the intended system operational.

- **Authorisation procedures for new capacities:** Provisions for new infrastructure are to some extent available; the missing provisions have to be in line with the requirements of Directive 2003/55/EC; rules for the practical operation have to be included in the market rules to make the system workable.

- **Market Opening:** Provisions with regard to market opening are available but have to be adapted to the requirements of the Treaty.

- **Cross Border Trade Mechanism:** Regulation 1775/2005/EC has to be implemented till the end of 2008; the provisions were discussed/explained during the mission.

The Market rules and all of the needed tariffs - which are essential for the efficient operation of the system - will probably not be available in due time because Serbia:

- Does not seem to have enough capacity/experience with respect to the development of market rules in such a short period of time, (experience in the EU MS shows that a significant longer period of time is needed to develop proper market rules) thus
- Needs help from consultants (the time consuming public procurement procedure has to be followed which in this case does not support the quick realisation of the market rules)
- The monitoring of, including technical assistance, for such a process by the ECS needs time in order to comply with the “Regional Approach”
Assessment of the implementation of Title II of the Treaty

With regard to gas, it can be concluded that the energy law seems to be very complex because of the approach to establish in the same law also provisions for the electricity sector, etc. The energy law will need a lot of improvements/amendments to comply with the requirements of the Treaty. The secondary legislation - necessary to make the system operational - requires significant efforts to be completed in due time. A critical point could be the insufficient administrative capacity in terms of human resources; its strengthening should be considered the first priority.
4.7. UNMIK

4.7.1. Electricity

- **Institutional Organisation**

The Ministry of Energy and Mining (Ministry) is responsible for energy policy issues. The Energy Regulatory Office [UNMIK/ERO] has been established as an independent regulatory authority to exercise regulation in electricity, natural gas and district heating.

Electricity sector is governed by the Law on Energy [2004], Law on Electricity [2004] and Law on Energy Regulator [2004]. The legal framework is well in compliance with the majority of the applicable Acquis provisions. A detailed “Energy Strategy of Kosovo” has been approved [2005] along with corresponding implementation program.

- **Public Service Obligation and Customers Protection**

Public service obligation and Customer protection are substantially dealt with in the primary legislation, giving UNMIK/ERO explicit powers in this respect. Rule on Disconnection and Reconnection of Customers in the Energy Sector has been approved [2006] as well as the Rule on General Conditions of Energy Supply [2006], Rule on Dispute Settlement Procedure [2006], and Rule on Pricing and Tariff Methodology [2005]. A Consumer Protection Code is foreseen in the Law.

The public service obligations and customer protection are concretely dealt with in the Law on Energy and the Law on the Energy Regulator. Within UNMIK/ERO a Customer Protection Department has been established. Among the other general principles in this respect, particular legal provisions regarding the appointment of a supplier of last resort exist in the legislation.

Around 70% of the customers are households. There are no legal provisions in the energy legislation, directly concerning vulnerable customers. However, substantial set of rules, concerning the customers’ protection, have been developed. In its Tariff Methodology, UNMIK/ERO has envisaged the possibility social tariffs to be introduced. Block-tariffs are applied with three blocks ( margins are 200 and 600 MWh/month), with a view to remove subsidies and apply cost-reflectivity in a three-year period. In addition, the Electricity Utility (UNMIK/KEK) applies practical support measures for vulnerable customers.

Average retail price of electricity is estimated on 51 EUR/MWh.

- **Monitoring Security of Supply**

Security of electricity supply is sufficiently covered in the legislation. A set of rules and regulations, some being currently developed, also relate to this issue. The Law on Energy foresees special measures in case of sudden crisis. Provisions for long-term balance planning and provisional demand forecast are significantly developed. The security of supply statement has been approved.

Overall annual production of electricity from indigenous resources is on the level of 4000 GWh - almost exclusively from thermal (coal) generation, imports are on the level of 6% [2006]. Total losses amount 46%, of which 15% are estimated as technical, the rest are caused by inappropriate metering, lack of metering or non-payment. This extremely high and continuous amount of losses is a major constraint for faster corporate reform of the utility.

Security of supply is covered in the Law on Electricity and Law on Energy Regulator, as well as in the rules. The law foresees special measures in case of sudden crisis. UNMIK/ERO and the Energy Inspectorate (under the Ministry) are the responsible institutions for monitoring of security, mechanisms are provided in the rules and licenses.
The Government has adopted Rules on Restrictive Measures on Energy Supply [2005] which establishes clear and non-discriminatory principles on the manner and way the use of electricity can be restricted or special obligations can be imposed on energy enterprises for the purpose of protecting customers, and the safety and security of the system. The Ministry brought up Statement of Security of Supply to UNMIK [2007], according to which the power generation in the near future (2007 – 2010) will focus on meeting the growing demand of the consumers in UNMIK.

- **Technical Rules**

The Grid Code and the Metering Code are approved by UNMIK/ERO [2007], as well as Governance Procedures for Technical/Operational Codes [2007]. The Distribution Code is to be developed. A set of related codes and rules stipulated by the basic Law are pending for adoption (Electricity Standards Code, Electricity Equipment Code, etc.).

- **Unbundling and Access to Accounts**

The Transmission System (and Market) Operator is legally unbundled and the utility (UNMIK/KEK) performs generation and distribution functions. The tasks of the TSO are described in the law, as well as in the relevant secondary legislation (Transmission Grid Code and Market Rules). The appointed TSO (UNMIK/KOSTT) [January 2006] is a former part of the vertically integrated UNMIK/KEK (the UNMIK/Kosovo Electricity Company). It has been separated in accordance with the Decision of the Government on Restructuring/Unbundling of UNMIK/KEK [June 2005].

UNMIK/KOSTT owns all transmission assets and bears the responsibility for operation of the electricity system and market. According to the conditions in the Grid Code, the System Operator plays an essential role in physical balancing and it uses the commercial rules for trading ancillary services, while in a capacity of trading agent it administers the mechanism of balancing (in the cases where trading parties trade balancing energy). The main role of the Market Operator is its responsibility for organizing and administering energy trading and financial settlement of payments between producers, suppliers and eligible customers.

Currently, the remaining integrated utility UNMIK/KEK JSC encompasses the generation, distribution and supply of electricity and the operation of the lignite mines. The key tasks of the distribution network operator are outlined in the Law on Electricity. The Law on Energy Regulator gives particular right to the regulator to authorize and control its activity in accordance with the licensing regime. The planning of further unbundling of UNMIK/KEK is in progress with a view for further legal unbundling the DSO from the supply activities. The legal unbundling of the DSO should be further enforced and implemented. Management unbundling provisions should also be further specified.

Accounts have to be unbundled for each energy licensed activity and the Regulator is entitled to access the accounts. The electricity undertakings must submit annually to the Energy Regulator their financial statements and the audit reports. For the purpose of price regulation, the Energy Regulator is entitled to request any accounting, technical or economical information from the companies.

- **Third Party Access**

TPA is explicitly regulated both for the transmission and distribution networks - provided in the law and supported by the Grid Code. The law envisages that transmission and distribution companies shall grant access to the networks to producers, suppliers and eligible customers in accordance with the rules and regulations, approved by the Regulator. The Law also envisages obligations for concrete justification of refusal of access. Related charges for use of transmission network are in place. TPA should still be further enforced through the Distribution Code and DSO tariffs.
• **Authorisation/Tendering Procedures for New Capacities**

The generation activity is subjected to authorisation. Rule on Authorization Procedure for Construction of New Generation Capacities is pending for adoption by UNMIK/ERO. Tendering for new capacity is done by the Regulator. Transparency criteria should further be developed and harmonized.

• **Market Opening**

Market Rules are in place and its implementation has commenced.

The electricity market is open [March 2006] for the consumers connected to high and medium voltage networks (35 kV and above), being declared eligible by a government decision in accordance with the Law on Electricity. The criteria for market opening are based on the voltage level due to inadequate supply; provisional market opening deadlines are defined. Need for intensive consumer protection and inappropriate retail prices are considered as obstacles to market opening.

• **Cross-Border Trade Mechanism**

Cross-border transmission of electricity is dealt with in the law and as a subject to licensing. UNMIK/ERO has also adopted the Transmission Capacity Allocation Procedures (January 2007), which promotes allocation of available transmission capacity on international transmission lines via explicit auctioning methods. The approved (UNMIK/ERO) auction-based capacity allocation mechanism should be arranged by UNMIK/KOSTT on bilateral basis with the neighbouring TSOs. In he case of no-agreement it is recommended (UNMIK/ERO) to UNMIK/KOSTT to allocate 50% of calculated capacity on the respective border.

However, in practical terms UNMIK faces financial problems and problems of operational nature, and is currently in a process of resolving ownership issues with a neighbouring TSO (EMS).

**Key Open Issues**

Legal framework is well developed and gradually improved. Introduction of the regulatory practice is relatively well progressing and the regulator operate as independent.

Unbundling process is advanced in the transmission domain, distribution activities should be further addressed in this respect. The economic conditions, deterioration of the infrastructure and social conditions have significant influence on the reforms in the electricity sector. Social aspects should be continuously addressed, especially for vulnerable customers. Security of supply is administratively well supported, but deserves continuous attention.

In practical terms market opening is biased by the adverse supply conditions and phased out according to voltage level criteria. Cross-border trade issues should be addressed and implemented in cooperation with the other TSOs in the region.

The areas of special concern are the following:

• Security of supply is a continuous concern and should be permanently addressed and monitored. Investment climate should be put in function of construction of new generation capacities. Energy efficiency measures should also be gradually introduced.

• Improvement of collection and suppression of losses is subject to adequate measures, including investments into metering equipment and efficient billing practice. In addition, social protection measures based on non-tariff principles (including identification and protection of socially vulnerable customers) should be supported and introduced, along with improved payment discipline.
• Unbundling should be extended in the distribution domain. Provisions for competitive supply conditions should be enforced.
• Cross-border trade issues should be further addressed.

4.7.2. Gas

The Ministry of Energy and Mining has elaborated the draft Law on Gas which transposes partially the requirements of the Directive 2003/55/EC into a national gas legal/technical framework. This will enable UNMIK to participate in the regional gas network.

- **Institutional Organisation:** The energy policy issues are dealt with by the Ministry of Energy and Mining. A regulatory body for gas has been established by the Law No.2004/9 (the same regulatory body as for electricity); the competences of the regulatory authority have to be brought in line with the requirements of Directive 2003/55/EC. Clarification with regard to the Market Operator (Art 24) is needed.

- **Public Service Obligation and Customer Protection:** The draft Law on Gas includes provisions regarding customer protection which are in line with the requirements of the Directive 2003/55/EC. The role of the TSO, related to the transit, is not clearly determined.

- **Monitoring Security of Supply:** The rules for the security of supply issues are not determined, and in Art 6 of the Law on Energy it is not clear if these provisions are applicable “just” for electricity, or generally for energy (including gas provisions with respect to the scope of the measures with respect to safeguard measures as well as the provisions regarding the duration and the provisions regarding the obligation of reporting are not available).

- **Technical Rules:** Rules are mostly defined in line with the Directive 2003/55/EC.

- **Unbundling and Access to Accounts:** The unbundling requirements need more clarification in terms of ownership of the assets. Art. 8 (1) indicates an ownership unbundling whereas the subsequent provisions indicate a legal, functional and organisational unbundling; the provisions with regard to confidentiality have to be included.

- **Third Party Access:** Provisions on the TPA are available but clarification is needed with respect to granting TPA in terms of provisions which require a non-discriminatory and transparent basis. It should also be mentioned that the proposed price for the usage of the infrastructure shall be calculated in accordance with the methodology approved by the regulator authority. Additionally, the provisions of Art. 18 (2) of the Directive 2003/55/EC should be included in the Law on Gas. It should be clarified whether the access to the storage facility is a regulated or negotiated access. Clearly specified rules should be used to describe what steps could be taken in the event of a refusal of access to the system -is the decision of the Regulatory office a final decision or is there a possibility to appeal to a court?

- **Authorisation procedures for new capacities:** These important provisions are not available (Article 22 of the Directive 2003/55/EC), although they are crucial for the development of a gas market.

- **Market Opening:** Status of the non-household customers is defined in accordance to the Energy Community Treaty deadline, but the opening of the market for the
household customers is not defined. In Art. 22 (2) c the criteria for the purchase of gas which was foreseen for the supply of non-eligible customers should be defined.

- **Cross Border Trade Mechanism:** Regulation 1775/2005/EC has to be implemented till the end of 2008.

**Assessment of the implementation of Title II of the Treaty**

Because of the lacking gas market there are not many incentives – besides the obligations under the Treaty - to develop and implement a Gas Act. Nevertheless, such an act has been developed, which provides the proper legal framework for potential investments in the field of energy. If the so called Energy Community Ring should be realized this could have an impact on the establishment of a gas market, since the Ring would provide a possibility for gasification of UNMIK. A proper elaboration of the Gas Act requests sufficient administrative capacity in terms of human resources and its strengthening should be prioritised. The secondary legislation could be developed and implemented afterwards or – in order to save resources – in parallel to construction works of huge regional gas infrastructure projects related to UNMIK.