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

STATUS OF GAS AND ELECTRICITY MARKET DEVELOPMENT

ENERGY COMMUNITY SECRETARIAT
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1. BACKGROUND AND SCOPE

This report provides overview about the development of the electricity and gas markets in the Energy Community and presents assessment of the progress made as of 30 April 2009. The analysis is based on the core aspects of market development, namely:

- Implementation of legislation;
- Unbundling;
- Third party access;
- Market opening;
- National regulators;
- Economic market development indicators
- Institution building;
- Regional integration and
- Security of supply.

The report divides its analysis by electricity and gas. The analysis is based on information gathered from publicly available official documents, missions of the staff of the Energy Community Secretariat to the Contracting Parties and meetings with responsible authorities, such as Ministries responsible for energy, national regulatory authorities (NRA), transmission and distribution system operators and others.

Where it comes to economic indicators data, has additionally been requested from the NRAs. To the extent NRAs have not been able to provide the relevant information, data has been collected from other sources, such as internet and annual reports.

It has to be underlined that complete and comparable data is a core pre-condition for a thorough market development analysis. The present analysis indicates that data transparency – both online data needed by the market participants and information required for monitoring purposes (by the national regulatory authorities, but also by the Energy Community Secretariat as reporting responsible body of the Energy Community) – still requires significant improvement in all Contracting Parties.
2. DEVELOPMENT OF THE ELECTRICITY MARKET

2.1. Implementation of Legislation

Pursuant to the Treaty\(^1\), all Contracting Parties agreed to fully implement the *acquis communautaire* on electricity market – consisting of Directive (EC) 2003/54\(^2\) and Regulation (EC) 1228/2003\(^3\) – in their national market frameworks by 1\(^{st}\) July 2007. The Treaty imposes that the national electricity markets should be opened for all non-household customers as of 1\(^{st}\) January 2008 and for all customers as of 1\(^{st}\) January 2015.

However, app. two years after the deadline for implementing the electricity acquis and more than one year after the deadline for market opening for non-household customers, the de facto degree of market opening has not reached an acceptable level offering customers an adequate choice. One of the main reasons for this is persistence of regulated electricity tariffs, available also to the ‘declared’ eligible customers, which still include elements of public service obligation, cross-subsidised and various kinds of state support aimed for protection of the households. Another equally important obstacle for efficient market opening is existing dominant, state-owned generation which provides the electricity required for supply of the captive final customers, under regulated prices.

So far, not all NRAs have approved non-discriminatory transmission and distribution tariffs, or more often such tariffs are not treated in a transparent and pertinent manner by responsible network operators. This further restrains the new entrants to access the market. Similarly, the market rules are either missing or pending for further improvement in most of the Contracting Parties.

In all Contracting Parties most of the legal provisions of the electricity acquis are implemented in the primary and secondary legislation up to a level that in practice can be deemed sufficient to support at least elementary forms of competition. Current considerations and developments are aimed to supplement the process of market liberalization by providing the missing legal substance required for full compliance and increasing the quality and applicability of the previously applied solutions.

On the other hand, implementation of practical measures such as specific technical rules, criteria and instruments, required for effective opening of the market, in many cases is lagging behind or showing suboptimal results, and deserves further attention.

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\(^1\) Treaty establishing the Energy Community ("the Treaty") entered into force on 01.07.2006.
\(^3\) OJ L/176 of 15 July 2003, p.1 et seqq.
National legislation for electricity has been recently upgraded in Albania, Bosnia and Herzegovina, Croatia and the Former Yugoslav Republic of Macedonia, while similar activities are under consideration in the other Contracting Parties. Thus:

- In Albania, a new market model has been enforced allowing for the development of competitive market relations in the area of supply.

- In Bosnia and Herzegovina the Electricity Law of the Republika Srpska has been amended in the areas of customer protection, security of supply and trading rights. Republika Srpska is heading to adopt its draft Energy Law, while the Federation of Bosnia and Herzegovina is still attempting to amend its Electricity Law. The existing legislation which enforces the operation of the electricity transmission system in Bosnia and Herzegovina (ISO and Transmission Company) still requires further reconsideration.

- Croatia has clarified several aspects of the market structure such as trader’s function, regulated supply and switching criteria.

- The Former Yugoslav Republic of Macedonia legally unbundled transmission system operation from supply activities.

- The legal framework is under development in Serbia, where the planned comprehensive amendments to the Energy Act are still under consideration.

- In Montenegro the Energy Law which - among others - is supposed to enforce legal unbundling of the utility and new market relations, has entered its final stages of adoption.

- UNMIK keeps upgrading its legal framework established over the past years through supplementary rules and regulations.

The transposition of Articles of Directive (EC) 2003/54 and Regulation (EC) 1228/2003 related to notifications or reporting to the European Commission or otherwise reflecting the need for direct involvement of the Commission in the organization of the electricity market in a Contracting Party are still subject to consideration by the Energy Community with a view to defining common criteria. The related Articles of Directive (EC) 2003/54 and Regulation (EC) 1228/2003 are therefore neither included in the compliance assessment nor in this Report.

Pursuant to a Ministerial Council Decision from June 2007, mandatory implementation by the Contracting Parties has been extended also to Directive 2005/89/EC related to

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4 The references to the entities of Bosnia and Herzegovina in this report are due to the fact that the entities have substantial competences in the energy sector.

5 See Conclusion 8 of the Ministerial Council meeting (29 June 2007).
security of electricity supply and targeted for implementation by the end of 2009. There are ongoing activities in this direction in all Contracting Parties and this process is closely monitored and supported within the Energy Community.

2.1.1. Directive (EC) 2003/54


Provisions for protection of customer rights and universal service related to the captive ("tariff") customers exist in all Contracting Parties’ frameworks and in practice apply primarily to households and small enterprises. Public Service Obligations (PSO) entail application of electricity supply tariffs to a vastly dominant part of the consumption and in some cases refer also to regulation of system operation and network access functions of the Transmission System Operator (TSO) and Distribution System Operator (DSO).

In all Contracting Parties the provisions for quality of supply and final-consumer rights need further attention. Schemes for protection of socially vulnerable customers are supported by the state budget in all Contracting Parties. However, no corresponding energy saving/substitution measures or energy efficiency instruments are applied.

Demand-side measures in the form of consumption-sensitive ("block") tariff, aimed to de-incentivise overly consumption, exist in Albania and UNMIK. Load-shedding schemes are regularly applied in UNMIK.

Basic provisions on security of electricity supply are generally available. The main instruments refer to annual balancing report for electricity supply and demand and planning the electricity balance for the following year. Long-term planning of generation and transmission is also implemented in Albania, Croatia, Montenegro, Serbia and UNMIK, Energy Strategy of the Former Yugoslav Republic of Macedonia is in preparation, and in Bosnia and Herzegovina such a development strategy is foreseen.

Operational safety of the transmission system is applied by the TSOs (ISO and Transmission Company in Bosnia and Herzegovina) in all Contracting Parties, mainly following UCTE Operation Handbook rules and criteria. There is a common practice to

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7 Detailed assessment of the acquis on security of electricity supply implementation is not covered in this report. However, the topic was subject to special report at the 12th PHLG meeting (17.03.2009; see Annex 2 to the agenda).
8 All Contracting Parties except Albania and UNMIK are members of the UCTE. The latter two Contracting Parties also apply and follow the UCTE Operation Handbook provisions as much as applicable.
apply state aid measures for extraordinary imports in case of unexpected deficit of electricity supply (Albania, Former Yugoslav Republic of Macedonia, UNMIK).

2.1.1.2. Unbundling of network operators

**TSOs** are established as state-owned network companies legally unbundled from commercial electricity activities in all Contracting Parties except Bosnia and Herzegovina and Montenegro. Their main functions are well defined and comprise transmission of electricity and system operation - including central dispatching, ancillary services and balancing, settlement of transactions, allocation of cross-border capacities and maintenance of transits. Technical operation and maintenance of the transmission system, its operational security, planning and development and access to the grid are also among common TSO tasks. In all cases except Croatia the TSO also performs as a market operator – in Croatia a separate entity acts as an independent Energy Market Operator.

Bosnia and Herzegovina has established an Independent System Operator (ISO) and a separate Transmission Company, both operated on a common (state-level) ground and owned by the entities (Republika Srpska and Federation of Bosnia and Herzegovina). The ISO tasks are related to the overall system operation and market functions, leaving the essential transmission/network responsibilities to its counterpart. Significant difficulties are registered over the past year on management and administrative level in the Transmission Company as well as in some aspects of mutual coordination of common activities. These developments reveal the urgent need for further development of the corresponding legal framework.

In Montenegro the TSO is still integrated in the state-owned electricity utility - unbundled on financial/accounting and decision-making level. Its legal unbundling is in progress. The TSO performs the same set of activities as in the other systems.

In all Contracting Parties **DSOs**’ network activities are still legally bundled to the supply of electricity to captive customers connected to the distribution network. In all cases there is financial/accounting unbundling along these lines. In addition, in the Federation of Bosnia and Herzegovina, in Montenegro, Serbia and UNMIK, DSOs are legally (but not in financial/accounting aspects) bundled to the regulated generation activities. In the Former Yugoslav Republic of Macedonia and in Albania the DSOs (together with the corresponding supply activities) are privatized.
Dominant, state-owned\(^9\) incumbent electricity generation dedicated for supply of domestic captive customers, exists in all Contracting Parties - used as favourable source of electricity delivered under regulated prices, also supplying the required power, balancing energy and ancillary services. In some cases incumbent generation capacities are being privatized (Montenegro, Former Yugoslav Republic of Macedonia).

2.1.1.3. Third Party Access

Regulated third party access to the transmission and distribution network is generally enforced in the legal framework of each Contracting Party.

The charges for access to the transmission and distribution networks in each Contracting Party are determined or verified by the corresponding regulatory authority according to adopted and publicly available methodologies. The relevant decisions are made publicly available by the regulatory authorities.

However in most cases (all except Bosnia and Herzegovina and Croatia) transparency on tariffs is insufficient. Even when displayed, these charges are usually presented only in the scope of the end-user regulated tariff structures.

In all Contracting Parties presented and disputed refusal of access to a network is subject to a due attention by the regulatory authority.

2.1.1.4. Market Opening

All non-household customers are legally eligible to switch their suppliers in Albania, Bosnia and Herzegovina, Croatia, Montenegro and Serbia, which brings these Contracting Parties in compliance with the Treaty in this respect. On the one hand, in Croatia the market is legally open 100% - for all customers including households. On the other hand, in the Former Yugoslav Republic of Macedonia the electricity market is legally open only for the customers directly connected to the high-voltage (110 kV) network, and in UNMIK only those customers connected to the network of 10 kV or above are allowed to switch their supplier.

In practical terms, the implementation of eligibility is less effective. The only exception is Croatia where a large number of commercial customers has switched from tariff supply and close to 40% of the consumed electricity is sold to eligible customers by the only supplier active on the free market - all high and medium-voltage customers\(^{10}\) are compelled to exercise their eligibility. In the Former Yugoslav Republic of Macedonia the

\(^9\) In the case of Bosnia and Herzegovina incumbent generation capacities are owned by Republika Srpska and the Federation of Bosnia and Herzegovina.

\(^{10}\) Starting from June 2009 – all non-household customers.
switching is mandatory for all eligible customers\textsuperscript{11} which results in an average of 30\% of the consumed electricity to be purchased on the market. In Montenegro there is only one (large) eligible customer who is purchasing part of its electricity on the market. In Albania the only eligible customer from 2006 has currently reiterated to a supply under tariff conditions which are more favourable. In UNMIK there is only one active (large) eligible customers, the same is the case in Bosnia and Herzegovina.

\textbf{2.1.2. Regulation (EC) 1228/2003}

Implementation of Regulation (EC) 1228/2003 has not advanced in a proper extent to allow for the desired market integration.

With the exception of Bosnia and Herzegovina’s ISO that still applies pro-rata \textbf{capacity allocation}, all others TSOs implemented capacity auctions split 50\%-50\%. None of the methods are in compliance with the principles of congestion management accepted by the Regulation that calls for joint capacity auctions.

Moreover, the interconnection capacity between Greece and Former Yugoslav Republic of Macedonia that used joint auctions performed by the Greek TSO, has been replaced with 50-50 capacity split starting from 2009.

In Serbia, Former Yugoslav Republic of Macedonia and Montenegro, the TSOs started to use ‘pay-as-bid’ method for the 50\% of their capacity shares in both senses with the neighbouring TSOs. As the corresponding neighbouring TSOs such as Croatia, Hungary, Romania and Greece use the market clearing price for capacity price settings, there is a significant distortive signal that is likely to affect the price of energy traded in the region. This inconsistency in setting of capacity prices is even activated by administrative charges imposed by the respective TSOs on trades.

As all congestion revenues, including the administrative charges, are used to decrease the internal transmission tariffs, the respective TSOs apply methods that increase their revenues based on a price increase of the imported or transited electricity. For Serbia as a transiting, not importing country, the applied method leads to a transfer of these capacity costs to traders using the Serbian system for transiting electricity to the Former Yugoslav Republic of Macedonia, Montenegro or UNMIK as importing parties. The latter TSOs mainly pass the higher costs through increased electricity price to their domestic customers.

Applying the ‘pay-as-bid’ method has been reasoned by the TSOs in question as involving less ‘gaming’ and speculations with bids. However, the respective TSOs

\textsuperscript{11} For all such customers who do not perform a public service (i.e. railway transportation).
publish only the last accepted bid which does not provide adequate transparency for the market.

As of beginning of 2009, most of the TSOs also introduced yearly capacity auctions and some of them weekly auctions. Intra-day auctions are not yet available.

Starting from February 2009, the economic crisis led to a decrease of electricity consumption and changed the import/export behaviour: national demand of usually importing countries - such as Albania and Montenegro – could be covered from internal production sources and these countries even started to export in some periods.

Transparency has slightly improved; few TSOs started to publish the maintenance calendar for the transmission networks but not yet updated information about the availability or non-availability of generators.

The current picture requires appropriate and coordinated measures from national Regulators and at ECRB level to abolish the inconsistency both with regard to the congestion fee methods used and related to transparency for the SEE market.

2.2. National Regulators

All Contracting Parties has established regulatory authorities for the electricity market – in Bosnia and Herzegovina the state regulatory authority (SERC) regulates transmission and cross-border matter while the electricity market is regulated by the two regulators in Republika Srpska and Federation of Bosnia and Herzegovina. Independence of NRAs still needs to be achieved, mainly with regard to setting the electricity prices and tariff setting. The persistence of cross-subsidised electricity tariffs between non-households and households customers is a clear evidence for reduced regulatory independence in this respect.

The powers of NRAs are not yet adequately addressed in the Laws of most Contracting Parties in order to fully comply with the powers and responsibilities described in Directive (EC) 2003/54 and Regulation (EC) 1228/2003. These mainly refer to enforcing and monitoring the network access including the access to interconnections.

Market monitoring tools have to be improved by all the NRAs. At the same time adequate enforcement powers involving penalties for market participants that do not comply with the regulators’ decisions have to be implemented by the legislators.
2.3. Market development

2.3.1. Market Integration

The key elements for assessment of market development are linked to the identification of existing market structures and the definition of an appropriate market design.

More specifically this includes diversification; licensing; adequacy of generation; the time horizon of market opening within 100% of all customers can switch with appropriate handling of affordability and vulnerability issues; regulated third party access including clearly defined and implemented TSOs and DSOs roles and responsibilities; effective unbundling; public service standards and clearly defined obligations; effective and efficient regulation etc.

In all Contracting Parties market rules have been developed, which are effective and implemented – except for the Former Yugoslav Republic of Macedonia and Serbia – and in most cases led to a gradual introduction of competitive practices and procedures. In the Former Yugoslav Republic of Macedonia the market rules were developed by the market operator\textsuperscript{12} but have not been approved by the NRA. A final document – reflecting the changes requested by the NRA – is expected to be in place in 2009.

So far, TSOs have developed and published grid codes, capacity allocation mechanisms and interconnection capacity auction rules. Pricing rules for congested interconnection capacity are also published. Thus, transparency requirement for allocation of interconnection capacity has been achieved. However, monitoring of implementation is yet to be improved, although there are some regulatory rules and practices in place.

In addition, Contracting Parties have to ensure that use of income incurred from congested interconnection capacity, as approved by regulatory authority, is published and to ensure regular monitoring of it.

An urgent issue and a precondition for market opening which remains to be dealt with in Albania, Montenegro, Former Yugoslav Republic of Macedonia and UNMIK is the implementation of Article 23(2) Directive (EC) 2003/54, i.e. fixing or approving network tariffs for customers eligible to switch to competitive supply.

To enable retail market to open for competition, prior to determination of eligibility threshold, there are other preconditions that have to be met, as presented in the following table:

\textsuperscript{12} Established within the TSO.
Table 1: Preconditions for retail market functioning

<table>
<thead>
<tr>
<th>CP</th>
<th>CP</th>
<th>Market operator established / appointed</th>
<th>Market rules published</th>
<th>Switching procedure defined</th>
<th>Network Tariffs available TuoS</th>
<th>DUoS</th>
</tr>
</thead>
<tbody>
<tr>
<td>Albania</td>
<td>Yes, within TSO</td>
<td>Yes</td>
<td>No</td>
<td>Yes</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>BiH</td>
<td>Yes, within ISO</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Croatia</td>
<td>Yes, independent entity</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Former Yugoslav Republic of Macedonia</td>
<td>Yes, within TSO</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>Montenegro</td>
<td>Yes, within TSO</td>
<td>Yes</td>
<td>Yes</td>
<td>No</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>Serbia</td>
<td>Yes, within TSO</td>
<td>No</td>
<td>No</td>
<td>Yes</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>UNMIK</td>
<td>Yes, within TSO</td>
<td>Yes</td>
<td>No</td>
<td>Yes</td>
<td>No</td>
<td>No</td>
</tr>
</tbody>
</table>

Source: Energy Community Secretariat

In Albania and FYR of Macedonia, legislation defined conditions and procedure for switching from tariff to eligible status, but not the procedure for switching supplier in competitive market.

It is important to emphasize that all conditions listed in the Table 1 have to be fulfilled to allow for retail market opening.


In general, trading takes place in the form of bilateral contracts and negotiated OTC. Wholesale market design in all Contracting Parties in 2008 did not allow for competitive market development, since all indigenous generation was regulated and only power export / import has been negotiated at market prices.

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14 “Over The Counter” – bilateral trading agreements achieved through periodic public tenders for the electricity and power required over a defined future period. Prices and conditions are usually not publicly available.
So far there is no power exchange among Contracting Parties, however, there are two power exchanges in the Region (Borzen and Opcom). The volume of power traded there is almost negligible in terms of the Energy Community.

For the time being, electricity markets in Contracting Parties operate only as relevant markets for the respective regulatory area and there are so far no clear signs of regional market existence.

In addition to this, mutual recognition of licenses between the Contracting Parties remains an open issue for market integration. More effort is required from both the Contracting Parties and the Energy Community Institutions to harmonize license conditions and develop acceptable guidelines, procedure and timetables for mutual recognition.

2.3.2. Market concentration and consolidation (generation and supply)

Regional market integration and integration into the European market is primarily a regional issue, dealt by regional, namely Energy Community institutions. Substantial steps forward have been made towards the establishment of a Coordinated Auction Office in 2008 and so far in 2009 (see chapter 4.2).

All Contracting Parties reaffirm that there are no legal restrictions on who may enter the market other than the requirements that exist for everyone to obtain the relevant license.

According to the earlier cited “Study on Tariff Methodologies and Impact on Prices and Energy Consumption Patterns in the Energy Community,” by IPA Energy + Water Economics, national incumbents kept 100% market share in those Contracting Parties that opened up to competition and there have been no new market entrants. There have been no new entrants in retail markets so far, although there are no formal institutional or legislative obstacles.

This is explained by the negative effects of regulated retail tariffs which are below a level at which new entrants would be able to enter the market and compete effectively. In some cases prices are even below the wholesale energy price at which a new supplier would have to buy energy at. Moreover, there is often no effective competition in retail business and new entrants, if any, have limited their operation in wholesale supply.

Total retail supply - regulated or competitive – is basically performed by incumbent suppliers, although there are different legal forms of operation. The only exceptions are Montenegro and Bosnia and Herzegovina, where eligible buyers have to purchase the necessary “lacking” part of needed electricity on its own. But even in these two cases, the share does not indicate a significant sign of decreasing market concentration.
2.3.3. Electricity prices and tariffs

As already mentioned, there is no functioning trading platform in the SEE Region except for OTC. Data on wholesale market prices therefore is not available. However, most of generation operates within the regulated regime, intended for sale to retail suppliers of tariff customers.

The price convergence is an independent indicator of market integration reflecting effectiveness of all measures, rules and practices to integrate particular markets into functioning regional market. The level of prices for final users that were still fully regulated and the tendency in price development in contracting parties were analyzed in the “Study on Tariff Methodologies and Impact on Prices and Energy Consumption Patterns in the Energy Community”\textsuperscript{15}. The study concludes that “it may be another few years before the gaps are significantly closed because all of them are showing some increases.”\textsuperscript{16} The lowest prices are approximately half of the highest average prices in the Region but with the narrowing the gap over the period covered by the study (2005-2008) from 1:2 to 1:1,7 in 2007 and tending to 1:1,6 in 2008.

Although price convergence is an indicator of market integration, under the current circumstances when regional wholesale market institutions do not exist or do not yet function well, it can be interpreted only as an indication of enhanced chances for smooth implementation of other policy measures for integration of regional markets.

The newest development in tariff structure indicates possibly even increasing price gaps between Contracting Parties, although price increases are evident allover the region.

2.3.4. Consumer Dimension

There are different forms of customer protection in the Contracting Parties, but very often it is limited to protection of vulnerable household customers with cross-subsidized tariffs at the expense of non-household customers.

Public Service Obligation (PSO) generally is not addressed in a legislation to provide for customer protection in the sense defined by Article 3 Directive (EC) 2003/54 and especially Annex A to it.

Monitoring and reporting on service quality and transparency of information provided to customers are particularly important as regulatory tools for customer protection to ensure implementation of Article 3 and Annex A of the Directive.

\textsuperscript{15} See FN 13.
\textsuperscript{16} See FN 13, page 8.
In all Contracting Parties regulatory authorities are entrusted with dispute settlements, but their competencies and handling procedures vary.

Although there is lot of effort to improve protection of vulnerable customers in competitive environment, there is still a lot more to be done to properly define PSOs imposed on energy undertakings, in terms of content\textsuperscript{17} and imposition procedure\textsuperscript{18} including the appointment of a supplier of last resort.

Against the background of the development of a competitive market, Contracting Parties have to impose obligation on the energy undertaking to ensure an easy and simple \textbf{switching} procedure.

- So far, these rules have been developed and published in Bosnia and Herzegovina, Croatia and Montenegro.

- The Former Yugoslav Republic of Macedonia has defined rules (in 2006) for switching from tariff to competitive supply in a proceeding before establishment of the Regulatory Agency.

- The Energy Law of Serbia also imposes an obligation on the buyer to request the eligibility status but the switching procedure for a competitive retail market is not defined yet.

- In UNMIK the Electricity Law allows eligibility status to be granted by a government decision based on yearly defined conditions. The switching procedure for a competitive retail market is not defined. Adequate mandatory requirements have to be imposed on energy undertakings to ensure that administrative obstacles are eliminated and information on switching procedure are made public by network operators in a non-discriminatory manner, along with published network tariffs.

According to the internal market Directives, electricity consumers should be provided with unambiguous, transparent and sufficient information about the \textbf{costs of meeting} linked to their energy consumption. Therefore, system operators have to be independent.

As impact of regulated tariffs on market development is generally seen as detrimental and household tariffs are still regulated in all contracting parties, large share of consumption is expected to remain in regulated regime. In total consumption, households make the largest share (the region’s average for 2008 adds up to 47%).

\textsuperscript{17} Namely security, including security of supply, quality of service, regularity, fair pricing, environmental protection.

\textsuperscript{18} Granting of exclusive or special rights, in a non-discriminatory and transparent manner.
Table 2: Share of household consumption in total consumption

<table>
<thead>
<tr>
<th>Country</th>
<th>Total net consumption</th>
<th>Households consumption</th>
<th>%</th>
<th>Source of data</th>
</tr>
</thead>
<tbody>
<tr>
<td>Albania</td>
<td>4,157,000 MWh</td>
<td>2,287,000 MWh</td>
<td>55%</td>
<td>ERE report to ECRB</td>
</tr>
<tr>
<td>BiH</td>
<td>10,030,462 MWh</td>
<td>4,180,888 MWh</td>
<td>42%</td>
<td>SERC report to ECRB</td>
</tr>
<tr>
<td>Croatia</td>
<td>15,735,000 MWh</td>
<td>6,711,000 MWh</td>
<td>43%</td>
<td>HERE report to ECRB</td>
</tr>
<tr>
<td>Former Yugoslav Republic of Macedonia</td>
<td>7,243,064 MWh</td>
<td>3,134,206 MWh</td>
<td>43%</td>
<td>ERC annual report for 2008</td>
</tr>
<tr>
<td>Montenegro</td>
<td>3,958,700 MWh</td>
<td>1,155,000 MWh</td>
<td>29%</td>
<td>Data for 2007, Annual reports of EPCG for 2007</td>
</tr>
<tr>
<td>Serbia</td>
<td>27,843,000 MWh</td>
<td>14,313,000 MWh</td>
<td>52%</td>
<td>AERS report to ECRB</td>
</tr>
<tr>
<td>UNMIK</td>
<td>2,430,428 MWh</td>
<td>1,655,247 MWh</td>
<td>68%</td>
<td>Annual report of ERO for 2008</td>
</tr>
<tr>
<td>SUM</td>
<td>71,397,654 MWh</td>
<td>33,436,341 MWh</td>
<td>47%</td>
<td></td>
</tr>
</tbody>
</table>

Regulated household tariffs and affordability have been analysed in the EBRD Study on Affordability of Electricity in South East Europe (2003). Using the data for the year 2003 and data presented in IPA Study for the year 2007\textsuperscript{19}, where average net monthly wages per employee and average cost per 100 kWh of electricity for residential consumption were presented, the following can be concluded:

\textsuperscript{19} See fn 13.
Table 3: Affordability: tendency in average wages and electricity costs 2003-2007

<table>
<thead>
<tr>
<th>CP</th>
<th>AVERAGE MONTHLY WAGE (EUR)</th>
<th>AVERAGE PRICE ELECTRICITY (HOUSEHOLD S) (EUR/100 kWh)</th>
<th>Changes in percentage from 2003 to 2007</th>
</tr>
</thead>
<tbody>
<tr>
<td>ALBANIA</td>
<td>139</td>
<td>221.1</td>
<td>3.50</td>
</tr>
<tr>
<td>BIH</td>
<td>231</td>
<td>322.1</td>
<td>5.32</td>
</tr>
<tr>
<td>CROATIA</td>
<td>535</td>
<td>660.9</td>
<td>7.14</td>
</tr>
<tr>
<td>FORMER YUGOSLAV REPUBLIC OF MACEDONIA</td>
<td>178</td>
<td>238.4</td>
<td>3.90</td>
</tr>
<tr>
<td>MONTENEGRO</td>
<td>338.0</td>
<td>6.58</td>
<td></td>
</tr>
<tr>
<td>SERBIA</td>
<td>180</td>
<td>347.1</td>
<td>3.86</td>
</tr>
<tr>
<td>UNMIK</td>
<td></td>
<td>5.30</td>
<td></td>
</tr>
</tbody>
</table>

Source: EBRD Study on Affordability of Electricity in South East Europe (2003); IPA Study (2007); Average monthly wage per employee - data for 2007 from statistical bodies in Contracting Parties.

The table above shows that in all Contracting Parties, except Albania, average wages were growing more than average electricity tariffs for households, indicating that, under the other conditions unchanged, the affordability could have been improved.

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20 Average monthly wage per employee - data for 2007 from statistical bodies in Contracting Parties.
21 Statistical data for Montenegro in 2002 were not presented in the EBRD study.
22 Statistical data for UNMIK is not available.
3. DEVELOPMENT OF THE GAS MARKET

It has to be noted, that – unlike the electricity sector – gas infrastructure and gas markets do not exist in all seven Contracting Parties.

For the time being, three Contracting Parties do not have gas infrastructure and a market at all (Albania, Montenegro, UNMIK). Thus, for them, all findings of this report are related only to the legislation, as a ground for the market development in the future. Only for four Contracting Parties, the findings are related to the legislation in place and to the functioning of the existing gas markets.

3.1 Implementation of Legislation

The implementation of the Directive (EC) 2003/55\(^{23}\), except the deadlines for the market opening, has been stipulated by the Energy Community Treaty, as obligatory for the Contracting Parties from 1\(^{st}\) July 2007.

The EU acquis, within the scope of the Treaty, has been extended by the Ministerial Council decision in June 2007 (see footnote 5). The gas related acquis extension has included the Regulation (EC) 1775/2005 and the Directive 2004/67/EC, but with different time framework for implementation.

The implementation status of Regulation (EC) 1775/2005\(^{24}\) falls within the scope of this report due to fact that its implementation affects strongly the functioning of the national gas markets and even more significantly, the operational ground of the regional market.

Beside that, the deadline for the implementation of the Regulation has already passed\(^{25}\), which is not the case for the Directive (EC) 2004/67\(^{26}\). Therefore the findings on its implementation are not included within this report.


The status of the implementation of Directive (EC) 2003/55 strongly varies between the Contracting Parties and, surprisingly, it is not strictly related to the level of the gas market development.

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\(^{25}\) Deadline for implementation: end of 2008.
\(^{26}\) Deadline for implementation: end of 2009.
- Directive (EC) 2003/55 has been fully transposed\textsuperscript{27} into the national legislation by two Contracting Parties – by Croatia with the developed gas market and by Albania without gas market at all.

- Two Contracting Parties having the gas market, Serbia and the Former Yugoslav Republic of Macedonia, transposed most of the provisions of Directive (EC) 2003/55 into the primary legislation. But still, some of the crucial provisions have to be implemented more properly. The amendments to the Energy Laws, aiming to transpose all remaining provisions, are in preparation, by both Contracting Parties.

- Bosnia and Herzegovina, with more advanced gas sector than the Former Yugoslav Republic of Macedonia, has a significant delay in the implementation process of Directive (EC) 2003/55. The overall organisation of the gas sector in Bosnia and Herzegovina is still not defined at the state level, which negatively affects the further gas market development. Many provisions of Directive (EC) 2003/55 have been transposed only at the entities' levels and even those are mostly only implemented partially. Once the gas market structure will be defined at the state level, Directive (EC) 2003/55 can be fully implemented relatively quickly, having in mind expert resources in the relevant ministries and gas companies.

- Montenegro and UNMIK, without gas market for the time being, drafted the gas primary legislation during 2008. The both draft acts are in accordance with the Directive 2003/55/EC and both are in the advanced phase of the approval procedure. It can be expected that the gas related acts will be in force very soon, ensuring the proper legal basic in Montenegro and in UNMIK for the development of gas market in the near future.

Certainly, all provisions of the Directive 2003/55/EC have impact to the creation of the internal market in natural gas. However, the implementation status of some specific provisions in particular shows the status of the market development. Thus, for the purpose of this report, only their implementation status has been elaborated more in detail.

3.1.1.1. Unbundling of Network Operators

Unbundling of network operation from supply activities is fully defined in compliance with Directive (EC) 2003/55 by the legislation in Albania and Croatia (legislation in force) and in Montenegro and UNMIK (draft acts).

\textsuperscript{27} The way of transposition and applicability of some provisions of the Directive 2003/55/EC (mainly related to the role of the European Commission) still have to be clarified, according to the Conclusion No. 11 of the 10\textsuperscript{th} PHLG meeting in September 2008
In Serbia and the Former Yugoslav Republic of Macedonia only accounting unbundling has been defined as obligatory. There are some provisions on operators’ independence in Serbia, but very far from the criteria defined by the Directive. Even such vague criteria of operator’s independence are completely omitted by the Former Yugoslav Republic of Macedonia.

Complicated legal conditions of unbundling have been defined in Bosnia and Herzegovina. They are partially defined in line with Directive (EC) 2003/55, but with five years of implementation postponement (FBiH) and partially requiring only accounting unbundling with insufficient criteria of independence (RS).

The concrete companies (by the exact names) have been stipulated as the transmission system operators for a certain period of time by the legal acts in Croatia and in Bosnia and Herzegovina.

The possibility for exemption from unbundling requirements - as offered by the Directive for DSOs with less than 100,000 connected customers - is legally implemented in Croatia and Serbia, where the gas distribution sectors are developed. This legal possibility has not been considered by others Contracting Parties, with less developed distribution sectors (BiH) or without this type of consumers at all (Albania, Montenegro, UNMIK, Former Yugoslav Republic of Macedonia).

The tasks of network operators are predominantly implemented in line with Directive (EC) 2003/55. However, still some requirements (and mostly the same requirements in most of the Contracting Parties) are not included, namely provisions regard non-discriminatory criteria for procurement of energy for its own use, providing information to the other system operators, economic conditions for network development and balancing rules.

3.1.1.2. Third Party Access

Third Party Access (TPA) to transmission and distribution networks, in general, has been defined in line with Directive (EC) 2003/55 by the most of the Contracting Parties.

The Energy Law of the Former Yugoslav Republic of Macedonia rather describes TPA as the possibility of technical connection to the grid than as the basic gas market principle, namely non-discriminatory access to networks. More severe incompliance is legally defined partially in Bosnia and Herzegovina. A possibility for further decision on regulated or negotiated access to all infrastructures, not just to the storage, has been left to the Agency (which still has to be established).
In line with the definitions of TPA, the principles on tariffs for the access to transmission distribution networks have been defined by the legislation of all seven Contracting Parties (including Bosnia and Herzegovina but only partially). More details on tariffs are discussed in chapter 3.3.3.

Certain non-compliance has to be noted with regard to access to LNG and storage facilities, and especially to upstream networks. Some of the Contracting Parties with a theoretical possibility to build such infrastructure completely omitted to define access in general terms. Sometimes, a small inconsistency can be noted – for example, access to LNG facilities has been described as regulated, but a tariff for access to it is not listed among the tariffs which have to be approved by the NRA. Or vice versa, tariffs for access to storage have been defined as regulated, public and approved by the NRA but access to storage is not defined as regulated. Fortunately, those non-compliances and inconsistencies can not be found within the Contracting Parties where the related infrastructure exists or has been included in the concrete plans. A bigger problem is the access to the upstream networks which is not in conformity with the Directive, also where the concrete upstream network exists (like in Serbia).

Refusal of network access is mainly defined as provided by Directive (EC) 2003/55/ in most Contracting Parties, with the exception of the Former Yugoslav Republic of Macedonia. In addition, the missing link between refusals due to lack of capacity and further necessary (economic) enhancements by operators is a quite frequent incompliance in 4 out of 7 Contracting Parties.

Further details in relation to TPA, i.e. provisions related to the “take or pay” commitments and possibilities for exemption of TPA for new infrastructure, are implemented very differently in the Contracting Parties, and not always in full compliance with Directive (EC) 2003/55.

3.1.1.3. Market Opening

The time frameworks for market opening are not equally defined by the Energy Community Treaty and Directive (EC) 2003/55 for the EU Member States.

According to the Annex 1 of the Treaty, all non-household customers have to be eligible from 1st January 2008, and for all customers, markets have to be open on 1st January 2015.

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28 There the refusal of access is defined accordingly to the insufficient definition of TPA – it is possible only when the technical conditions of the connection are not fulfilled, independently on capacity issues.
The current status of the gas market opening, stipulated by the legislation of the Contracting Parties, it is shown in the diagram below.

Diagram 1: Conditions for the status of eligible customer in the CP

<table>
<thead>
<tr>
<th>Type of gas consumption</th>
<th>Existing gas market</th>
<th>Without gas market</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Croatia</td>
<td>Serbia</td>
</tr>
<tr>
<td>Non-households customers</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>eligible customers</td>
</tr>
<tr>
<td></td>
<td></td>
<td>eligible customers from September 2007</td>
</tr>
<tr>
<td></td>
<td>all customers are eligible since 1st August 2008</td>
<td>eligible customers from 1st January 2015</td>
</tr>
<tr>
<td>Households customers</td>
<td></td>
<td>eligible customers</td>
</tr>
<tr>
<td></td>
<td></td>
<td>eligible customers from September 2007</td>
</tr>
<tr>
<td></td>
<td>all customers with annual consumption &gt; 50,000 m³</td>
<td>eligible customers from 1st January 2015</td>
</tr>
<tr>
<td></td>
<td>all households customers</td>
<td>eligible customers from September 2007</td>
</tr>
</tbody>
</table>

Source: Energy Community Secretariat

3.1.2. Regulation (EC) 1775/2005

Although the deadline for implementing Regulation (EC) 1775/2005 has already passed 4 months ago, at the moment of preparation of this report, the process of implementation is completed by only one Contracting Party (Croatia).

- During the last and this year, Croatia has drafted several acts of secondary legislation which have to be in force to make the existing Gas Market Act fully operational. The General Conditions of Natural Gas Supply, the Ordinance on Natural Gas Market Organisation and the Transmission System Network Regulations have been approved recently, in April 2009. With all three mentioned acts of the secondary legislation in force, the Regulation (EC) 1775/2005 is fully implemented.

- Serbia has quite delayed with the implementation of the Regulation (EC) 1775/2005. The Transmission Grid Code is in very early stage of the preparation, as the new Amendments to the Energy Law.

- The Former Yugoslav Republic of Macedonia issued the Network Code on the Transport of Natural Gas, aimed at fully implementing Regulation (EC) 1775/2005. The Code has been approved by the Regulatory Energy Commission in March 2009 and is almost in full compliance with the Regulation (except secondary market provisions). A proper implementation of the Code is however doubtful due to the
missing provisions of Directive (EC) 2003/55 which still have to be transposed into the primary legislation.

- An obvious and strong link between the implementation of Directive (EC) 2003/55 and the implementation of the Regulation (EC) 1775/2005 can be emphasised especially in the case of Bosnia and Herzegovina. Without the implementation of Directive (EC) 2003/55 at the state level, it is hard even to start with the implementation of the Regulation on conditions for access to the natural gas transmission networks in an efficient way.

Contracting Parties without gas market have tried to extend the primary legislation to the Regulation (EC) 1775/2005, either by establishing a working group to prepare the Amendments to the Gas Law in force (as Albania) or by adding the relevant provisions into the existing draft before final approval (Montenegro) or trying to find some other satisfactory solution (UNMIK).

3.2 National Regulators

The jurisdiction over the gas sector has been legally stipulated to the energy regulatory authorities within six Contracting Parties, including those without a gas market and those without gas related laws in force. For Montenegro respective jurisdiction has been defined by the Energy Law (in force since 2003), and for UNMIK by the Law on Energy Regulator (in force since 2004).

Only one Contracting Party, Bosnia and Herzegovina, has neither established nor stipulated by law, a Regulatory Authority responsible for the gas market at the entire territory of the Contracting Party.\(^{29}\)

For all NRAs, the **Board** of Commissioners or the **Councils**\(^ {30}\) have to be approved by the parliament. The members of the Regulatory Councils/Boards are proposed to the parliaments according to the different procedures (in Montenegro after open public tender procedure), but in general, the proposals are submitted by the government. Thus, the NRA has to obligatory report to the parliament/assembly on annual basis and upon request to the government and/or the minister responsible for energy\(^ {31}\).

Furthermore, within the legislation of all six Contracting Parties it is stated that the NRA has to be **financially independent**. Funds for everyday operation of the regulatory authorities are mainly provided by revenues obtained from license fees and in some

\(^{29}\) Only the case at one entity's level.

\(^{30}\) Typically composed of five members.

\(^{31}\) Except for the Former Yugoslav Republic of Macedonia where the report, by default goes to the parliament and to the government.
cases by fees from the total revenue of companies performing energy activities. A minority of Regulatory Authorities has received funds from donors or from the state budget to finance their establishment.

3.3 Market development

3.3.1 Market Integration

Introduction of internal market regulation is advancing slowly, as described earlier. This is reflected on the market structure and its development towards competitive markets, as presented in the reports submitted by gas regulators to ECRB.

3.3.2 Market Concentration and Consolidation

On the wholesale level, supply is concentrated in the hands of dominant wholesale supplier(s) for each of the relevant Contracting Parties. The same picture is monitored on the retail markets although more suppliers could be present. However, still the dominant (incumbent) suppliers hold the largest market share.

As described earlier, the legislative framework in the four Contracting Parties has not developed synchronously – especially as regards the definition of transparency requirements especially at TSO level; the determination of access condition; network tariffs etc – so that consolidation of a competitive regional market could not be reasonably expected yet.

Import dependency is significant which contributes to the position of a dominant wholesale supplier(s). However, it may be worth noting that even in such a case, there is no significant sign of border-crossing undertakings at regional level.

3.3.3 Gas Prices and Tariffs

With only Croatia knowing strict requirements for unbundling of network operator(s), it is difficult to make any assessment of the cost-reflectivity or reasonableness of retail prices in Bosnia and Herzegovina, the Former Yugoslav Republic of Macedonia and Serbia. Tariff methodologies to determine network charges and regulated retail tariffs are developed and published in Croatia, the Former Yugoslav Republic of Macedonia and Serbia.

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32 Gas markets, regulated or competitive, exist in four contracting parties: Bosnia and Herzegovina, Croatia, Former Yugoslav Republic of Macedonia and Serbia.
In Bosnia and Herzegovina on the territory under jurisdiction of RS institution, legislation is more developed and includes licensing rules and tariff methodology. Tariffs in line with the Gas Law and adopted and published tariff methodology have not been determined yet. In Federation BiH territory, the Government sets the gas prices for tariff customers. Since regulatory power is not assigned yet, tariff methodology, either for use of network or gas end use has not been determined yet.

**Gas retail prices are still fully regulated.**

So far, Croatia, the Former Yugoslav Republic of Macedonia and Serbia have established and published network charges for access and use of gas network, as well as regulated retail prices. However, in the Former Yugoslav Republic of Macedonia the TSO does not publish effective tariffs and underlying conditions on its web page to ensure transparency.

- In Croatia the government approves the tariffs for transport, distribution and supply of gas to tariff buyers. These tariffs are publicly available.

- In Serbia the NRA adopted and published tariffs methodology. Tariff rates for transmission, distribution and supply of gas to tariff buyers are published by the gas undertakings after governmental review.

- In the Former Yugoslav Republic of Macedonia the NRA approved the tariff rates for end users, based on the published methodology, so that information on transmission network charges is available only within the structure of retail supply tariff.

Wholesale price levels applied in effective tariff calculations are:

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33 In the Former Yugoslav Republic of Macedonia all retail is connected to transport network, and distribution is yet to be developed.
Table 4: Wholesale price levels of gas

<table>
<thead>
<tr>
<th>CP</th>
<th>Gas supply price</th>
<th>source</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>NC/m³</td>
<td>EUR/m³</td>
</tr>
<tr>
<td>Bosnia and Herzegovina</td>
<td>0.80</td>
<td>0.40903 4</td>
</tr>
<tr>
<td>Croatia</td>
<td>1.32</td>
<td>0.18341 1</td>
</tr>
</tbody>
</table>

Source: Energy Community Secretariat, publicly available information

### 3.3.4 Consumer Dimension

As regards the consumer dimension the gas sector is almost fully regulated, although legislative obstacles for switching do not exist at least in Croatia and Serbia there is still no actual switching activity to competitive supply.

Despite of the still comprehensive regulation, end user prices compiled in a consistent manner are not publicly available in all relevant countries.

ERRA (Energy Regulators Regional Association, Budapest) database provide indicative gas prices for only two contracting parties. According to the ERRA database, average end-user gas prices in the second semester 2008 were as follows:

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34 Prices in EUR/m³ calculated on the basis of exchange rates effective at the time when the price was determined, as quoted at respective central bank web pages (Croatia: 7.196956 EUR/kn, Serbia: 84,991 EUR/din; Former Yugoslav Republic of Macedonia: 61.4119 EUR/den.

35 No information available on the official web pages, source is a news article citing FBIH Government decision XI-2008; in April 2009 a decrease in wholesale price was announced.

36 Eligibility to choose, published network tariffs.
Table 3 Natural gas end-user prices

<table>
<thead>
<tr>
<th></th>
<th>2008 / 4q</th>
<th></th>
<th>2008 / 3q</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Pre-tax</td>
<td>Total</td>
<td>Pre-tax</td>
<td>Total</td>
</tr>
<tr>
<td>Bosnia and Herzegovina</td>
<td>12.5624</td>
<td>14.6945</td>
<td>11.4171</td>
<td>13.3601</td>
</tr>
<tr>
<td>Croatia</td>
<td>n/a</td>
<td>n/a</td>
<td>n/a</td>
<td>n/a</td>
</tr>
<tr>
<td>Former Yugoslav Republic of Macedonia</td>
<td>12.5781</td>
<td>14.8422</td>
<td>10.6906</td>
<td>12.6149</td>
</tr>
<tr>
<td>Serbia</td>
<td>n/a</td>
<td>n/a</td>
<td>n/a</td>
<td>n/a</td>
</tr>
</tbody>
</table>

Source: ERRA

Transparency of information, along with development of confidentiality rules, is extremely important in this stage for all Contracting Parties to ensure customer protection. Once again it is to be emphasized that capacity building in energy statistics is a cornerstone for introduction and proper functioning of efficient energy market.

4. INSTITUTION BUILDING

4.1 National competition authorities

Competition law and its application by the competent national authorities can certainly make an important contribution to the opening up and accessibility of energy markets. To this end, the Treaty includes a set of competition rules basically covering prohibitions on cartels and abuse of dominant positions on one side (Article 18(1)(a) and (b)) and of State aid on the other side (Article 18(1)(c)). As energy markets in the Contracting Parties to the Energy Community continue to be under the influence of state intervention, the applicability of the competition rules to public undertakings (Article 19) is to be emphasized. The Secretariat continuously monitors the implementation by the Contracting Parties of the Energy Community competition acquis.37

Even though the Treaty does not contain specific rules on procedures, institutions and sanctions, it is clear from the overall efficiency principle enshrined in Article 6 of the Treaty that the Contracting Parties are called upon to ensure effective enforcement of competition rules. Both competition and State aid law enforcement require strong and independent authorities, efficient procedures and deterring sanctions. In terms of institution-building, the picture looks different for antitrust and State aid respectively.

37 http://www.energy-community.org/portal/page/portal/ENC_HOME/ENERGY_COMMUNITY/Legal/EU_Legislation
The antitrust authorities in Albania, Croatia and Serbia, followed to a lesser degree by Bosnia and Herzegovina and the Former Yugoslav Republic of Macedonia, are quite advanced in assuming their roles as competition law enforcers. Croatia and Serbia have a track record of well-argued decisions, which in the case of Croatia also covers the energy sector. Albania has recently concluded a sector enquiry into the energy sector, concluding that “the [wholesale] market may be characterized by a restricted competition, caused by the presence of undertakings with significant market power”. The competition authorities of both Bosnia and Herzegovina and the Former Yugoslav Republic of Macedonia have applied competition law to the energy sectors in several decisions. Whether the Directorate for Competition Protection in Montenegro and the Competition Commission in UNMIK will live up to the standards of independent and efficient enforcement still remains to be seen.

As regards state aid, the law of Croatia and the Former Yugoslav Republic of Macedonia task the competition authority with control functions, whereas Albania and Montenegro establish government-internal entities. In the cases of Croatia and the Former Yugoslav Republic of Macedonia, the Secretariat has taken note of case law applying state aid law to the energy sectors. Bosnia and Herzegovina, Serbia and UNMIK still completely lack rules and institutions in the area of State aid. In Serbia, however, a draft law on State aid is currently pending before Parliament. The bill envisages a control authority consisting of ministry and competition authority representatives.

In a workshop held in March 2009, the Secretariat together with the representatives of the Contracting Parties assessed the state of play of competition law enforcement in the Energy Community, highlighting in particular the complimentary role to be assumed by competition authorities in relation to the regulatory authorities applying sector-specific rules, the relevance of good cooperation as well as the importance of independence and clout towards both the private and public sector.38

4.2 Coordinated Auction Office – Blue Print for Regional Integration

The Energy Community Process aims at implementing the EU acquis communautaire on energy, competition, security of supply, social issues, environment, renewables and energy efficiency related issues in the countries of South East Europe and thus ensuring the stability vital for investment and create the conditions in which its economies can be rebuilt effectively. This includes Regulation (EC) No 1228/2003 on the conditions for access to the network for cross-border exchanges of electricity and the Congestion

38 http://www.energy-community.org/portal/page/portal/ENC_HOME/CALENDAR/Other_Meetings/meetings_2009/Workshop_Competition
Management Guidelines, setting the framework for the management and allocation of available transfer capacity of interconnections between national systems.

The Ministerial Council (MC) of the Energy Community on 27 June 2008 decided\textsuperscript{39} to implement a common procedure for congestion management and transmission capacity allocation on SEE regional level and thereby effectively establishing the so-called 8\textsuperscript{th} region\textsuperscript{40}.

Against the background of implementing the legal requirements in an optimal modus and with a view to eliminating cross border barriers to electricity trade by putting an efficient, transparent, market based, non discriminatory congestion management mechanism, the Energy Community investigated the possibility of establishing a Coordinated Auction Office for the region in South East Europe.

- Following the positive results of a Dry Run phase\textsuperscript{41} the stakeholders initiated discussions for the creation of a Coordinated Auction Office in South East Europe (i.e. SEE CAO) to be set up by the TSOs in one of the countries in South East Europe. A SEE CAO Implementation Group (IG)\textsuperscript{42} – involving regulators\textsuperscript{43}, Transmission System operators\textsuperscript{44} and users\textsuperscript{45} – has been set up within the Energy Community Regulatory Board (ECRB) providing a forum for discussions related to the setting up of the SEE CAO.

- Transmission System Operators (TSOs) expressed their wish to go on co-operating for establishing a SEE CAO by signing a “Memorandum of Understanding” (MoU)\textsuperscript{46}.

- Following the 5\textsuperscript{th} EnC Ministerial Council meeting (11 December 2008, Tirana), the location of the SEE-CAO will be in Montenegro.

- A first Business Plan for the formation of the SEE Auction Office has been prepared by SETSO and presented at the 13\textsuperscript{th} Athens Forum on 3 December 2008.

As its first task, the Implementation Group drafted an Action Plan which defines the necessary steps towards the establishment of the office and outlines an indicative time


\textsuperscript{40} The 8th region includes the following territories: Albania, Bosnia & Herzegovina, Croatia, the former Yugoslav Republic of Macedonia, Montenegro, Serbia, the territory under administration by the United Nations Interim Administration Mission in Kosovo (pursuant to United Nations Security Council Resolution 1244), Bulgaria, Greece, Hungary, Romania, Slovenia and Italy.

\textsuperscript{41} Performing coordinated flow based auctions on a monthly basis without real clearing or payments; Dry Run concluded in November 2007.

\textsuperscript{42} Draft SEE CAO IG General Issues and Priorities document (R07-IG-01-03); ECRB Terms of Reference on the SEE CAO Implementation Group (R07-IG-01-02).

\textsuperscript{43} Represented by the ECRB Electricity Working Group.

\textsuperscript{44} Represented by the Task Force of South Eastern European Transmission System Operators (SETSO).

\textsuperscript{45} Represented by the European Federation of Energy Traders (EFET).

\textsuperscript{46} Memorandum of Understanding on the implementation of common procedures for congestion management methods and the establishment of a South East European Auction Office for coordinated auction of transmission capacities.
The Action Plan has been presented to the 11th Athens Forum and approved at the 4th Implementation Group meeting in May 2008.

With the very recent discussions on establishing a Project Team (May 2009) that would coordinate the TSO related activities and responsibilities in setting up the SEE CAO the SEE CAO development enters from a political to a practical level. This involves necessary decision on funding the Project Team and related agreements between the TSOs and International Financing Institutions, potentially offering financial support.

### 4.3 Security of Supply Coordination Group

Security of energy supply is one of the founding principles of the Energy Community. The Treaty itself makes several references to security of supply, most notably in Article 29 which requires the Parties to adopt and update security of supply statements. Further to this, the Ministerial Council in December 2007 decided to implement Directives (EC) 2004/67 and (EC) 2005/89 on gas and electricity security of supply respectively to the Energy Community by the end of 2009.

Whereas securing energy supply in compliance with the *acquis communautaire* is a task ultimately for national authorities to fulfill, origins and effects of security of supply crises or disruption certainly exceed the frontiers of one Party alone and make crises prevention and reaction issues of a genuine cross-border nature. For this reason the Ministerial Council decided in December 2008 to establish the *Security of Supply Coordination Group*, upon the establishment of and the experience gained within the EC Gas Coordination Group set up under Directive (EC) 2004/67. As security of supply is a challenge that involves not only one source of energy and given the interdependence of energy sources, the envisaged Security of Supply Coordination Group shall have similar tasks in electricity.

The Procedural Act aims at providing the institutional and procedural framework for coordinating measures to be taken on a national level and for initiating measures to be taken at the Energy Community level. The Security of Supply Coordination Group is exclusively entrusted with the task of coordination and will not have the competence to adopt legally binding measures.

Besides governmental representatives of the Parties also the participation of non-governmental stakeholders has been foreseen in the form of associations of the energy industry as well as consumers. Those associations have a regional or, in the absence of regional associations, a pan-European character. The Permanent High Level Group
adopted the list of representative bodies of the industry and of the consumers at the meeting in March 2009.

4.4 Investments – Energy Community Gas Ring Group

The 12th Permanent High Level Group meeting accepted the proposal by the ECS to establish an Energy Community Gas Ring Group, which shall replace the Joint Gas Working Group.

The Joint Gas Working Group was considered as a preparatory tool for the Gas Forum, ensuring a flexible format for discussion on operational level major issues, concerning overall gas related developments in the Energy Community and particularly in the Contracting Parties.

The Energy Community Gas Ring Group should streamline the focus on investments and provide an operational group on infrastructure issues involving the transmission system operators. The activities within the Group shall include sharing information on the status of on-going and planned investment projects in gas transmission infrastructure and gas storage facilities and discussing investment options and priorities as regards interconnections – within the overarching concept of Energy Community Ring.

5. CONCLUSIONS

The overall assessment of the status and development of the gas and electricity markets in the Energy Community shows the following picture:

ELECTRICITY

Improvements have been made with regard to implementation of legislation: in all Contracting Parties most of the legal provisions of the electricity acquis are implemented in the primary and secondary legislation up to a level that in practice can be deemed be sufficient to support at least elementary forms of competition. Current considerations and developments are aimed to supplement the process of market liberalization by providing the missing legal substance required for full compliance and increasing the quality and applicability of the previously applied solutions. However, implementation of practical measures such as specific technical rules, criteria and instruments required for effective opening of the market in many cases is lagging behind or showing suboptimal results.
Persistent shortcomings are in particular monitored with regard to

- The provisions for quality of supply and end-consumer rights as well as energy savings/substitution measures or energy efficiency instruments and other demand side measures for the protection of socially vulnerable customers.

- Transparency on market relevant data, market rules and tariffs is still insufficient to allow for equal and adequate information of market participants.

- With the exemption of Croatia, switching activity in practical terms remains low although market opening requirements are theoretically broadly met. National incumbents predominantly keep 100% of the market share on both the wholesale and retail markets and the entrance of new market entrants has not been monitored. This is explained by the negative effects of regulated retail tariffs which are below a level at which new entrants would be able to enter the market and compete effectively. In some cases prices are even below the wholesale energy price at which a new supplier would have to buy energy at.

- Trading in general remains on a local level and the development of significant regional market integration has not developed. So far no functioning trading platform in the SEE Region except for OTC.

- Regulatory independence, powers and enforcement responsibilities are still inadequately implemented.

- Mutual recognition of licenses remains a core open issue for market integration.

- The “pay-as-bid” method applied for capacity allocation in Serbia, the former Yugoslav Republic of Macedonia and Montenegro is leading to market distortions and negative energy price effects in Contracting Parties importing through Serbian system.

- In Bosnia and Herzegovina due the lack of a state level TSO approach difficulties are registered over the past year on management and administrative level as well as in some aspects of mutual coordination.

**GAS**

The status of the implementation of Directive (EC) 2003/55 strongly varies between the Contracting Parties and, surprisingly, it is not strictly related to the level of the gas market development.
- **Third Party Access** (TPA) to transmission and distribution networks, in general, has been defined in line with Directive (EC) 2003/55 by the most of the Contracting Parties. However, some deficiencies are monitored in the Former Yugoslav Republic of Macedonia and severe incompliance is legally defined partially in Bosnia and Herzegovina.

- Certain non-compliance has to be noted with regard to access to LNG and storage facilities, and especially to upstream networks. While those non-compliances and inconsistencies fortunately can not be found within the Contracting Parties where the related infrastructure exists or has been included in the concrete plans, the access to the upstream networks is a serious problem and is not in conformity with the Directive, also where the concrete upstream network exists.

- In addition, the missing link between refusals of network access due to lack of capacity and a further necessary (economic) enhancement by operators is a quite frequent incompliance in 4 out of 7 Contracting Parties.

- Although the deadline for implementing Regulation (EC) 1775/2005 has already passed 4 months ago, at the moment of preparation of this report, the process of implementation is completed by only one Contracting Party (Croatia).

- Regulatory authorities are established in all Contracting Parties, except for Bosnia and Herzegovina, where is neither established nor stipulated by law a Regulatory Authority responsible for the gas market at the entire territory of the Contracting Party.

- On the wholesale level, supply is concentrated in the hands of dominant wholesale supplier(s) for each of the relevant Contracting Parties. As regards the consumer dimension the gas sector is almost fully regulated, although legislative obstacles for switching do not exist at least in Croatia and Serbia there is still no actual switching activity to competitive supply and the dominant (incumbent) suppliers continue to hold the largest market share. The negative effects of gas retail prices still being fully regulated contribute to this development.

- Import dependency is significant which contributes to the position of a dominant wholesale supplier(s).

- With only Croatia knowing strict requirements for unbundling of network operator(s), it is difficult to make any assessment of the cost-reflectivity or reasonableness of retail prices in Bosnia and Herzegovina, the Former Yugoslav Republic of Macedonia and Serbia. Despite of the still comprehensive regulation, end user prices compiled in a consistent manner are not publicly available in all relevant countries.
INSTITUTION BUILDING

The developments within the Energy Community in the context of the institution building indicate that all Contracting Parties realize the necessity of effective work in this area. Thus, concrete steps have been undertaken both on national level and in the frame of the Energy Community. The analysis, however, shows that the national regulatory authorities should remain a key target – these should be further strengthened and their independence on the substance of their work needs to remain in the focus of attention.

Further, the attention on the efficient structuring and work of the new bodies in the Energy Community context shall be considered priority within 2009.

NEXT STEPS

The report provides concrete frame and indication on the next steps needed in the area of market development within the Energy Community. It is on this ground that the PHLG and the Ministerial Council shall be invited to consider efficient reflection of the findings and respective guidance for upcoming activities in the context of the Energy Community Treaty.
ANNEX

FINDINGS ON CONTRACTING PARTIES’ LEVEL

Albania

Electricity

Significant steps ahead have been made in the last year demonstrate the political will to accelerate the electricity market reforms. The distribution company, recently unbundled from the vertically integrated company - KESH has been privatized, the Czech company - CEZ being the successful bidder. The Market Model has been revised to better address the new market conditions. Several big projects in hydro generation have been successfully tendered and the commissioning of Vlore TPP is expected by the end of 2009.

- **Institutional organization:** The Power Law from 2003 has been amended last time in 2008. The Law amendments were adopted with the aim to support the privatization process, fight distribution losses, enforce regulatory powers and take some practical measures to improve security of supply. According to the law, DSO is in charge of maintenance of the network, whereas the Market code defines DSO as an entity that owns, maintains, expands and operates the distribution system throughout Albania.

- **Public service obligation and customer protection:** Pursuant to the Power Sector Law (Art. 25), all energy activities, except supply to eligible buyers, are defined as public services. The same provisions define conditions to impose public service obligation on energy undertakings. For customer protection, specific scheme is in place where block tariff system is applied (a 300 kWh threshold) aimed to support household customers, to incentivize reduction of consumption and energy efficiency - however, it should be revised in the future towards more cost-reflective model. In order to reduce the high levels of distribution losses and to increase collection rates, the Power Sector Law prescribes penalty measures for illegal connections, tempering with meters and other sorts of breach of contractual terms and conditions by household customer. More has to be done to improve service quality, above all, monitoring and reporting of the existing levels in order to set targets to be observed by the energy undertakings.

- **Security of supply:** The Law authorized Council of Ministers to declare emergency situation allowing for restrictions in the use of power. The Law also tackles the issue of minimum reserves of fuel or generating capacities. Bearing in mind current status of security of supply, adequate transposition of security of supply provisions from the Directive 2005/89/EC, along with implementation of adopted measures has to be among
the priorities of Albania energy policy. So far, intensive activities are undertaken in reducing dependence on imports of electricity, large improvement is expected in 2009 and 2010 with planned commissioning of new capacities (TPP “Vlore” and HPP Kalivac). Other TPP and HPP capacities are planned for the future (about 1200 MW). Security of electricity supply will also improve due to planned commissioning of the 400 kV interconnection line with Montenegro which is foreseen to be in operation by the end of 2009. In this respect efforts should be put to speed up the transmission system development and rehabilitation and to acquire UCTE/ENTSO-E membership of OST.

- **Technical Rules:** In respect to the grid codes, there are already adopted the Transmission Grid Code, Distribution Grid Code and Metering Code and are published on ERE web page. The Power Law imposed obligation on Ministry to provide technical and safety standards to be observed by the energy undertakings. The implementation of security of supply provisions might require revision of the already adopted Technical Codes to fully comply with the requirements of the Directives 2003/54/EC and 2005/89/EC and UCTE interoperability criteria.

- **Unbundling and access to accounts:** The Law defines unbundling requirement that are further elaborated by Regulatory Authority (ERE). In addition to the Chart of Account prescribed by ERE based on Article 21 and 22 of the Power Law and following the Law amendments related to investment, ERE published the information requirements that the licensee should present to ERE. Accounting unbundling is mandatory pursuant to the Law, but provisions ensuring compliance with functional unbundling and management independence are not transposed yet.

- **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 in the Power Sector Law. The cost reflective methodologies for setting the transmission and distribution tariffs have been approved and are based on ‘price-cap’ methodology, however the methodology for calculation of distribution tariffs include also the energy component. Transmission tariff has been set by ERE at a value of 4.1 EUR/MWh in 2009. The tariff is included in the retail electricity tariff and it is not transparently published on ERE or TSO website. Separate distribution tariffs for network access (without the energy component) remain to be set and the agreements for access to the networks to be concluded. Conditions for connections to the networks and tariffs remain to be adopted by the Regulatory Authority.

- **Authorization and Tendering for New Capacities:** Objective, transparent and non-discriminatory criteria for authorization 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 have been adopted.

- **Market opening** - The New Market Model concept of Wholesale and Retail Supplier for tariff customers is still enforced aiming to support security of supply, and the implementation shall introduce bilateral contracts on a larger scale. Market opening threshold is set by regulatory authority in January every year. Currently all non-household customers can switch supplier, which makes approx 44% of the market, but there is only one customer that has switched since 2005 (with annual consumption of 48,5 GWh). The persistence of regulated tariffs and non-existence of effective competition in the retail market gives no incentives or options to declared eligible customers. Return from competitive to regulated tariff is permitted, with a surcharge payable by that eligible customer to the Public retail supplier. There are 3 licenses for "qualified supplier" in retail and one license for “retail public supplier”, as well as 6 licenses for trade in electricity, relating actually to export and import activity on the wholesale market. However, there is only one active retail supplier⁴⁷ and one wholesale supplier, acting as a public wholesale supplier. ERE should find methods to reduce the dominant positions of the wholesale supplier and retail supplier in the electricity market and to promote competition on supply side. The form and content of a contract between wholesale and retail supplier are also defined by regulatory authority. Required infrastructure for further market opening should be developed, switching rules as well.

- **Cross Border Trade Mechanism**: Compliance with the Regulation (EC) 1228/2003 is rather weak. According to the Market Rules published in June 2008, there is 25% reserved capacity on interconnections for the Wholesale public supplier and 50% for the Retail Public Supplier. The TSO website is even now under construction and no data requested by the Regulation (EC) 1228/2003 is available. Relevant information on the TSO operation, including development plans, conditions for connection, load, supply and demand, balancing, transmission capacities and net available capacities are not available.

### Gas

The Ministry of Economy, Trade and Energy has elaborated a Gas Law, in force since July 2008, which transposes the requirements of the Directive 2003/55/EC into national gas legal/technical framework. Although Albania does not have gas market, the timely development of the legislative framework will enable Albania’s participation in the regional gas network.

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⁴⁷ ERE: reply to ECRB questionnaire
• **Institutional Organisation**: The energy policy issues are dealt with by the Ministry for Economy, Trade and Energy. The Energy Regulatory Entity has jurisdiction over the gas sector by entering the Gas law in force.

• **Public Service Obligation and Customer Protection**: 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 foreseen in the Gas Law; mechanisms for their practical implementation have to be specified. This could be done in the market rules.

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

• **Unbundling and Access to Accounts**: These provisions are incorporated in the Gas Law, although they do not fully comply with the requirements of the Directive 2003/55/EC. However, minor changes are still needed, regard operators of the storage and LNG facilities, and combined operator as well.

• **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**: The Contracting Parties have been obliged to implement the Regulation (EC) 1775/2005 till the end of 2008, which was not fulfilled by Albania. At the beginning of 2009, the Working Group was established to elaborate the Amendments to the Gas Law, transposing the missing provisions of the Regulation (EC) 1775/2005 (and of the Directive 2004/67/EC as well).

### Assessment of the implementation of the energy acquis

In general, additional work remains to be done in order to fully implement the Acquis.

In the electricity sector, 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, Regulatory Authority competences, 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 electricity supply provisions have to be transposed and implemented by the end of 2009. TSO tasks and
responsibilities have to be further strengthened as it is a key institution in the electricity market and system. Institutional and capacity building of the TSO, independence in decision making have to be further considered.

Significant work remains to be done to comply with Regulation 1228/2003 regarding the implementation of the market based principles of congestion management and transparency requirements.

With regard to 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 Law (besides the obligations of the Treaty). Nevertheless, as indicated above, the Gas Law meets the key requirements of the basic directive on gas market organisation. Secondary legislation could be developed and implemented afterwards or in parallel to construction works of huge regional gas infrastructure projects related to Albania.

Bosnia and Herzegovina

Electricity

In February 2009 Republika Srpska amended the Electricity Law improving the provisions for customer protection, security of supply and trade licensing. Adoption of a new Energy Law is also expected soon. The Federation of Bosnia and Herzegovina is still in a procedure to amend its Law on Electricity.

- **Institutional Organisation:** The electricity market is under responsibility of the relevant authorities in the two entities (Republika Srpska and Federation of Bosnia and Herzegovina) – except for the transmission system operation which is implemented through a common Independent System Operator (ISO) and a Transmission Company, established and operated according to special state Laws and technical rules and regulated by the State Energy Regulatory Authority (SERC). The ISO is also in charge of provisional market operation activities and congestion management.

- Over the last year the Transmission Company is experiencing difficulties on operational level which alarms of the need for further adjustment and improvement of the relevant legal and regulatory framework in line with the commitments under the Treaty.

- **Public Service Obligation and Customer Protection:** Electricity supply is defined as activity of public interest, regulated tariffs are determined for all classes of customers and the general conditions for supply are supported by the regulatory authorities. However much of this is related primarily to the captive customers, while the rights of customers
related to switching their supplier and protection of their rights in such circumstances is yet to be enforced.

- In Republika Srpska social protection schemes in a form of Budget subsidies are largely implemented after the increase of household tariffs in the beginning of 2008.

- In the Federation of Bosnia and Herzegovina the vulnerable customers support is set on territorial grounds and is not fully consistent. In addition, there are initiatives for adoption of a common, state-level social action plan.

- **Monitoring Security of Supply:** Long and short-term balance of supply and demand is planned by the authorities in Republika Srpska and in Federation of Bosnia and Herzegovina. The need for new generation capacity is also determined by the entities, while an overall energy infrastructure development strategy calls for harmonized approach in defining the common priorities. The responsibilities for operational security of the transmission system are shared by the ISO and the Transmission Company.

- **Technical Rules:** Republika Srpska has amended its Distribution Grid Code in 2008 and adopted new Methodology on tariffs for connection to the network - decision on corresponding connection costs is expected in 2009.

- In the Federation of Bosnia and Herzegovina there is no Distribution Grid Code yet, common rules on connection costs are adopted by the Regulatory Authority while (separate) connection rules for both distribution utilities are still in the pipeline.

- **Unbundling and Access to Accounts:** The electricity utility in Republika Srpska with majority state interest has legally unbundled its generation (5 legal entities) from distribution and tariff supply activities (another 5 legal entities who also operate as DSOs).

- There are two vertically integrated electricity utilities operating in the Federation of Bosnia and Herzegovina, both still looking forward to legal unbundling of their generation, distribution and supply activities.

- The ISO and the Transmission Company are legally unbundled from any commercial activities - mutual cooperation and efficiency remain a challenge for further improvements.

- **Third Party Access:** TPA to the distribution network is becoming significantly better over the last period in both entities. Access to the transmission network is well supported in the law. Operational transparency of data can be improved.

- **Authorisation procedures for new capacities:** Authorization and tendering for new generation capacity are under responsibility of the entity authorities (ministries). In both
cases development of standard procedures aimed to increase transparency and efficiency of the process remain subject for further consideration.

- **Market Opening:** Provisions with regard to the market opening are available in line with the Treaty. Market rules are adopted and published as well as tariff methodologies and effective network tariffs for connection to the transmission / distribution networks. However, in real terms, there is no customer switching except in one single case - partial (one third of the total) supply of one large customer.

- **Cross Border Trade Mechanism:** Implementation of the Regulation (EC) 1228/2003 is partially accomplished and access to the data is provided related to development plans as well as the load, interconnection capacities, net available capacity and rules for allocation. The applied criteria (pro-rata) however do not reflect market-based principles of congestion management as required by the Acquis. Further improvements are also possible in communication of data between ISO and the Transmission Company.

**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. Since autumn 2007, there are an existing Law on Gas available in the Republic of Srpska and the Decree on organization and regulation of gas sector available in FBiH.

An expert group was established also in 2007 in order to develop and propose the proper frame for the gas sector in BiH – in line with the requirements of the Directive 2003/55/EC. Several meetings of this group took place but so far the needed progress has not been achieved in concrete terms because the process is complex and progressing slowly partially due to the specific political structure. Additional efforts in the elaboration and in the implementation are required, mostly with respect to the allocation of competences of the regulatory authorities, in the authorization procedure, with regard to customer protection, in particular vulnerable customers, and unbundling requirements are urgently needed.

With regard to the Regulation 1775/2005/EC it can be stated that these requirements are being dealt with – jointly with the rules of the Directive 2003/55/EC - by the expert group.

**Assessment of the implementation of the energy acquis**

In electricity, Bosnia and Herzegovina in general has shown progress in development and adoption of rules and publication of distribution and retail tariffs. Legal unbundling is not yet completed and legal framework needs further improvements along with development of adequate
support to competitive supply function and switching rules. The wholesale market support implemented on State level also requires improvement of the legal framework in transmission and market operation area and adoption of adequate market-based congestion management rules.

With respect to gas, it can be concluded that if an agreement were achieved, a Gas Act could be developed and implemented relatively quickly. Any prediction with regard to an agreement is not possible.

### Croatia

**Electricity**

By the beginning of 2009 Croatia adopted several important acts significantly improving its legal framework, such as amendments to the Energy Law and Electricity Market Law as well as Rules on Allocation and use of cross-border transfer capacities. A number of significant improvements are introduced in electricity trading and supply activities, tasks of the market operator, contractual arrangements, definition of the types of customers, their rights and obligations, supplier switching conditions, third party access, cross border congestion management, etc.

- **Institutional Organisation:** The electricity market environment is appropriately structured, legal and regulatory responsibilities are balanced between the Ministry of Economy, Labour and Entrepreneurship and the Energy Regulatory Agency (HERA). In addition to the TSO and DSO, electricity market operations are implemented also by the separate Energy Market Operator (HROTE).

- **Public Service Obligation and Customer Protection:** Currently public supply is performed by the DSO, under regulated tariffs, for all household and small commercial customers as well as for the eligible customers - over a 6 month grace period before they manage to switch the supplier for the first time and during one month in a case the supplier seizes its operation. Starting from June 2009 this will apply only for households and starting from January 2011 the tariffs for the households will be obtained through a public procurement procedure. Otherwise the DSO also performs as a supplier of last resort operating under commercial conditions. Public service obligation extends by definition over all regulated functions in the system.

- **Overall rules for customer rights** are well developed and applied. A short-term demand-side measure is applied in a form of consumption-sensitive subsidies backed by the state Budget, aimed at reduction of the consumption. Socially vulnerable customers are treated through the general social protection program.
• **Monitoring Security of Supply:** Most of the crucial provisions related to security of supply are implemented. Long-term planning is reflected in the 10-year Energy Development Strategy (currently under reconsideration). Operational security of the system is applied according UCTE rules and in cooperation with neighbouring TSOs, the same goes for planning of new transmission capacity.

• **Technical Rules:** Relevant technical rules are available, including balancing rules, switching rules and cross border transmission capacity allocation rules.

• **Unbundling and Access to Accounts:** Legal unbundling is applied across the electricity market which in turn is almost entirely implemented within a single, state-owned holding company. DSO is still bundled with public supply of electricity. The Unbundled accounts are subject to monitoring regime which requires continuous attention by the Regulator, required independence of the management is framed by a compliance program.

• **Third Party Access:** Both TSO and DSO apply connection tariffs approved by the Regulator who is entitled for periodic monitoring and reporting on the allocation practices as well as for treatment of any complaints related to TPA. The new rules eliminate priority allocations of cross-border transmission capacity (including priorities in the case of public supply).

• **Authorisation procedures for new capacities:** New Law on Construction should provide simplified tendering procedures and adequate authorization system. In some areas such as small hydro power plants the influence of the local government is decisive, which may bring a need for increased efficiency.

• **Market Opening:** The electricity market is legally open 100% and all customers, including households, are considered eligible as of 1st July 2008. Practical implementation of eligibility is appropriately phased out and enforced through the commercial conditions applied by the DSO (performing as the supplier of tariff customers).

• In practical terms, currently close to 45% of the consumed electricity is sold to eligible customers, by the only supplier active on the market. Eligibility is exercised by more than 20% of the non-household customers (including all the high-voltage and 30% of the low-voltage commercial customers), with no significant number of interested households yet. As many as 4 supply licences are issued, however there exists only one applicable option for switching from the public supplier. A number of trading companies are active on the bilateral wholesale market.

• **Cross Border Trade Mechanism:** Market-based capacity allocation methods are gradually applied on all borders except on the border with Bosnia and Herzegovina (there
- only for the 50% of the capacity split owned by Croatia). Bilateral auctions are applied on the border with Hungary (monthly on Croatian side and monthly and daily on the Hungarian side – plans are made to upgrade further to intra-day level). On the Slovenian border technical tests are in progress for daily auctions.

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—taking the specifics of Croatia into account—are provided for in the secondary legislation.

- **Monitoring Security of Supply**: Provisions for the monitoring of security of supply are included; more detailed rules are provided by the Regulation on Natural Gas Supply Security which was issued in September 2008.

- **Technical Rules**: Relevant technical rules are available. Detailed mechanisms for their practical implementation are provided by the System Operators Codes (Transmission, Distribution, Storage), approved in April 2009.

- **Unbundling and Access to Accounts**: Relevant provisions are available; the rules for practical operation have been provided for in the secondary legislation.

- **Third Party Access**: Provisions are included in the legislation; rules for practical operation have been included in the secondary legislation.

- **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 been included in the secondary legislation to make the system operational.

- **Market Opening**: Provisions with regard to the market opening are available and in line with the Treaty.

- **Cross Border Trade Mechanism**: Regulation 1775/2005/EC has been transposed into the secondary legislation approved in April 2009.

**Assessment of the implementation of the energy acquis**
As Croatia has become an EU candidate country it started negotiations for the EU accession along with the screening process for the implementation of the Acquis.

Most provisions of the electricity Acquis are transposed to the level of appropriate compliance. This includes all applicable provisions which are crucial for development and operation of a competitive electricity market. Latest set of amendments promote further improvement of the market environment.

Some of the areas for potential further progress are related to further unbundling of the DSO function, conditions to facilitate entry of new suppliers on the market, energy-related measures for supporting the vulnerable customers, penalties for non-compliant behaviour with respect to the Regulation (EC) 1228/2003, further implementation of market-based congestion management mechanisms, implementation of the missing aspects for compliance with the Directive for Security of Electricity Supply, etc.

The Gas Act has required a lot of provisions in the secondary legislation to make the system operational. That has been ensured since April 2009, by the set of the secondary legislation in force.

In view of the accession process of Croatia towards the membership of the European Union, the only missing issue in the national legislation is the intended role of the European Commission in line with the requirements of the directives respectively regulation. At present a possible application of the role of the European Commission in the Energy Community is being analyzed and discussed with the Contracting Parties, and it still need to be clarified according to the Conclusion No. 11 of the 10th PHLG meeting in September 2008

The Former Yugoslav Republic of Macedonia

Electricity

In recent months, the Contracting Party has undertaken several steps that may lead to better transposition of energy acquis in their legislation. These include: the Energy Strategy, Strategy on promotion of Renewable Energy and revision of the Energy Law. The primary legislation has not changed so far in order to correct shortcomings mentioned in the previous report, but significant work in progress must be noted. The Energy Strategy is in the stage of finalization and it should serve as a basis to establish security of supply policies and methods, and in addition, to identify and to develop energy diversification policies.

- **Institutional organisation:** Energy Regulatory Commission (ERC) powers given through the Energy Law has to be enhanced to consider the minimum required by the Directives 2003/54/EC, 2005/89/EC and Regulation 1228/2003 (monitoring the rules on the management and allocation of interconnection capacities, access to the networks, level
of transparency and competition, TSO and DSO tasks fulfilments, impose penalties, exemption from third party access etc).

- **Public service obligation and customer protection**: In the Energy Law public service is defined too wide, including all energy activities except trade and supply to eligible customers, whereas universal service is not defined at all. The Customer Protection Law from 2004 defines sale of electricity in distribution network and sale of heat as a public service. This law sets an obligation of an undertaking to inform customers about terms and conditions of supply timely, in advance in at least two public media. Regarding customers protection, the law authorizes the Regulator to prescribe general conditions for supply, which is another pending task necessary to provide non-discrimination and customer protection both in regulated and competitive energy markets. Until then, market participants apply general conditions from 1999. Both issues have to be urgently dealt with by competent authorities in order to bring them in compliance with Article 3 and Annex A of the Directive 2003/54/EC.

- **Security of supply**: In general, the efforts undertaken by the Contracting Party to develop an energy strategy is an important step contributing to achieve long-term balance of energy demand and supply and security of supply. Two more documents are under the preparation: the first draft of the Strategy on promotion of Renewable Energy is expected to be finalised by the end of June 2009, as well as the update of the Strategy on Energy Efficiency. These all should contribute to better access security of supply position, but also calls for further transposition of the provisions of Directive 2005/89/EC.

- **Technical rules**: After the Regulator’s approval, the network operators have published the Grid Codes. In addition, the Government adopted the Conditions for supply of electricity (2006) which are currently under revision. Ministry in charge of energy has to prescribe technical standards and rules for energy facilities. The process to bring these provisions in compliance with UCTE and Generally Applicable Standards has started.

- **Unbundling and access to accounts**: The Law requires energy undertakings to keep separate accounts for different energy activities. This is further elaborated by Regulator in its secondary legislation. Management unbundling is prescribed in the effective Law (Article 73), but reporting on compliance is not explicitly required. This should be addressed in the expected revised Law.

- **Third Party Access**: Distribution network tariffs are not developed, and there is not yet adopted the methodology for calculation of the distribution network tariffs. The adoption of the distribution tariff methodology and calculation of distribution tariffs for access to networks should be the priority task for Regulator in the upcoming period.
• **Authorisation and Tendering 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. The authorisation procedure needs to be developed. Non-discriminatory and transparent criteria for tendering procedures have to be considered. Appeal procedures in case of refusal are not properly addressed.

• **Market opening:** Electricity market is open for buyers whose facilities are connected to transmission network (110 kV and above), and full opening is scheduled for all buyers except household as of 01.01.2010. However, it is important to note that only few market players exist on supply level, which could make it difficult for a liquid and competitive market to develop, in addition to pending regulatory obligation to develop tariff methodology and determine distribution network tariffs. Market rules are in drafting phase and are not approved yet by Regulator, which is precondition for its effectiveness according to the Law. Another issue of concern is the dominant position of the wholesale supplier bundled with the dominant generation company as is defined by the amendment of the Energy Law in 2008.

• **Cross Border Trade Mechanism:** The TSO published temporary rules for allocation of available interconnection capacity as the permanent ones will be included in the future Market Rules. The implemented explicit auctions (split 50%-50%) for all the interconnections with Serbian, Greek and Bulgarian TSOs. Yearly capacity auctions have been introduced although reserved capacity for the supplier of tariff customers on the country’s territory was explicitly required for the security of electricity supply. ‘Pay-as-bid’ method for congestion pricing induces distortion on the interconnections with the Bulgarian and Greek TSO as the method used on the 50% of the capacity is ‘marginal price’. This allows traders’ arbitration on interconnections and does not provide the desired market integration. Transparency has to increase furthermore and all required information to be available timely on TSO webpage. No penalties for infringements of Regulation 1228/2003 provisions are addressed in the legislation.

**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. According to information received during the last mission, the new Amendments to the Law on Energy are under the preparation.

• **Institutional Organisation:** The energy policy issues are dealt with by the Ministry of Economy; the Energy Regulatory Commission is responsible for regulatory issues.
• **Public Service Obligation and Customer Protection:** The provisions in the law are partially in line 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:** The related principles are provided in the law; but the needed detailed rules for the operation of the system could be included in the market rules, or by the Amendments in the preparation (also including transposition of the Directive 2004/67/EC).

• **Technical Rules:** The provisions are to some extent available. The Transmission Grid Code was approved in March 2009. The Energy Regulatory Commission is in the phase of development of a distribution grid code although there is no DSO in place currently.

• **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. And that is one of the area which has to be improved by the Amendments. Additionally, further details for practical operation are needed, these detailed rules could be provided for in the market rules.

• **Third Party Access:** The law does not provide for sufficient provisions on the third party access- which are needed 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. Some details on TPA are included in the Transmission Grid Code, but this is not sufficient – basic principle of third party access has to be implemented by primary legislation.

• **Authorisation procedures for new capacities:** Rules for new infrastructure are partially available. The missing provisions should be included, in particular provisions dealing with New Infrastructure in accordance with the Article 22 of the Directive 2003/55/EC.

• **Market Opening:** Available provisions have to be accommodated with the requirements of the Treaty.

• **Cross Border Trade Mechanism:** Regulation 1775/2005/EC was obliged to be implemented till the end of 2008. The Transmission Grid Code, in force since March 2009, transposed most of the related provisions, but to make the Code operational, some crucial provisions still have to be transposed into the primary legislation.

**Assessment of the implementation of the energy acquis**
The priorities in electricity in the following period should be: the transposition of the security of supply provisions, where ongoing activities on energy strategy should be crucial, development of tariff methodology for distribution system users and transparent network tariffs to enable for efficient market opening, adoption of market rules in compliance with the relevant acquis, further development of technical rules and standards, and finally definition of mandatory requirements in terms of quality of service and customer protection.

The transmission and regulated retail electricity tariffs have to increase furthermore as are well below costs and are among the lowest in the region preventing the companies to maintain a sustainable development of their business.

More work remains to be done regarding the full compliance with Regulation 1228/2003/EC. Implementation of congestion management principles and transparency requirements are the main issues to be considered. Participation of TSO representatives in the Energy Community events at regional level has been negligible in the latest period and prevents the integration of TSO and the electricity system in the regional electricity market.

The Law on Energy includes in the gas sector 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.

The market rules - which are essential for the efficient operation of the system – still are not available because the Former Yugoslav Republic of Macedonia does not seem to have enough capacity/experience for 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 public procurement procedure – which is time consuming - has to be followed which does not support the quick realisation) and the monitoring of, including technical assistance, such a process by the ECS needs time in order to comply with the “Regional Approach”.

Montenegro

Electricity

Montenegrin legislation has been significantly improving in recent months, particularly as regards secondary legislation related to electricity market definition. Primary legislation is also in process of further upgrading with an expected aim to bring it in compliance with the Treaty requirements.

It is expected that the Energy Law revision should properly transpose provisions of Directive 2003/54/EC and Regulation (EC) 1228/2003 in order to ensure full implementation of the Treaty, particularly security of supply, universal service, customer protection, public service obligations,
Regulator’s tasks and competences, authorization and tendering for new capacity, third party access and other issues

- **Institutional organization:** Ministry of economic development is in charge of energy market issues. Regulatory agency has been established with competencies defined in the Energy Law (2003). Currently, Montenegro is preparing new Energy Law with an aim to improve assignment of competencies in energy field, particularly regulatory responsibilities to prescribe methodologies for network tariffs and to report on its finding upon market monitoring. There is still in operation vertically integrated public utility whose accounting and functional unbundling was prescribed by secondary legislation.

- **Public service obligation and customer protection:** Public service obligation is defined in the Energy Law comprising wide area, where energy activities are defined as activities of public interest and basically targeting tariff customer. It has to be improved and brought in line with requirements defined in Article 3 of the Directive 2003/54/EC. Customer protection is partially covered by the Energy Law and partially left to secondary legislation. In this respect, legislation has to be further developed to provide customer protection in the sense given to it in the Annex A to the Directive 2003/54/EC.

- **Monitoring of security of supply:** Effective Energy Law (2003) under the title "Security of supply" prescribes rules for technical safety and protection of energy facilities and separately rules for supply in emergency. This is reportedly also subject to changes in the new Law.

- **Technical rules:** Obligations of energy undertakings and other institutions involved in energy sector are prescribed by the Energy Law and with more details in secondary legislation. Temporary network codes are in place, as well as rules for supply of electricity. Rulebook on technical conditions for connection of small HPPs is also adopted by competent Ministry and published.

- **Unbundling and access to accounts:** Legislative framework enables regulatory agency to define and thoroughly scrutinize compliance with unbundling requirements. Regulator prescribes accounting and functional unbundling within VIU, with detailed implementation rules. However, monitoring report on compliance was not required to be published. Although legal unbundling of TSO was expected to be finalized by end 2008, it did not happen within the planned timeframe. Reportedly TSO has legally unbundled from the rest of VIU in April 2009. As the plan to privatize part of vertically integrated utility are becoming operational, part of this process would be further unbundling within the company, precisely legal unbundling generation and supply from network (distribution) business.
• **Market Legislation:** Regulatory agency has adopted the Rules on establishment and functioning of energy market and approved the Market rules of market operator. Eligibility threshold is set in compliance with Annex I of the Treaty (all non-households buyers), but this is not really effective because network tariffs are not developed and publicly available, except only within overall supply tariffs for tariff customers.

• **Rules for Third Party Access** to Transmission and Distribution Network are adopted by Regulator and published. The rulebook prescribes that Regulator shall bring decision on connection charges, but this decision has not been brought yet.

• **Cross border trade mechanism:** In April 2009, Board of Directors of Transmission Company adopted the Rules for allocation of available transmission capacities on interconnection lines with neighboring control zones. The price is set as “pay as bid” for congested capacity and available capacity is determined in bilateral agreement with neighboring systems. The rules are publicly available, as well as information related to available capacity, allocated in explicit auctions.

**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 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/Space Plan of Montenegro, which was approved at the end of 2007. Furthermore, the Gas Law was drafted in the late spring 2008 and it has been discussed with Secretariat during the several missions. Finally, at the end of 2008, the draft Gas Law has been integrated into the new Energy Law, which is in very advanced phase of preparation process and it can be expected to be approved very soon.

• **Institutional Organisation:** Topics related to primary and secondary legislation in gas are under the auspices of the Ministry of Economic Development. The regulatory authority with a jurisdiction over gas sector was set up in 2003, by the Energy Law. By the new Energy Law, where the much comprehensive gas part has been included, the competences of the regulatory authority have to be brought in line with the requirements of the Directive 2003/55/EC.

• **Public Service Obligation and Customer Protection:** The principles have been defined in the line with the Directive 2003/55/EC.

• **Monitoring Security of Supply:** Instruments for the monitoring of security of supply are foreseen in the draft Energy Law.
• **Technical Rules:** Technical rules (except for the LNG facilities) are included. More detailed mechanisms for their practical implementation could be specified in the Grid Codes, in parallel with the development of related infrastructure.

• **Unbundling and Access to Accounts:** These provisions are incorporated in the draft Energy Law, although they do not fully comply with the requirements of the Directive 2003/55/EC. However, minor changes are still needed, regard separated accounts for eligible and non-eligible customers.

• **Third Party Access:** Provisions on the TPA are available; further rules should to be developed to make the system operational, by the secondary legislation.

• **Authorisation procedures for new capacities:** Rules for new infrastructure have been developed in line with Directive 2003/55/EC.

• **Market Opening:** Provisions on market opening are in line with the Treaty.

• **Cross Border Trade Mechanism:** Many of the provisions of the Regulation (EC) 1775/2005 have been included in the draft Energy Law, but some provisions still have to be transposed (specific definitions, type of the TPA Services, transparency requirements, and secondary market principles). More detailed rules can be developed in future by the secondary legislation.

**Assessment of the implementation of the energy acquis**

The priorities of electricity sector in the following period should be: transposition of security of supply provisions, development of tariff methodology for distribution system users, transparent network tariffs including publicly available connection charges to enable efficient market opening, and finally definition of mandatory requirements in terms of universal service, quality of service and customer protection.

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, it 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. Furthermore, there are plans on off-shore gas production in Montenegro, which also can have impact on the development of gas infrastructure and gasification. The secondary legislation could be developed and implemented – in order to save resources – in parallel to construction works of regional infrastructure in Montenegro.
Electricity
The Ministry Energy and Mining is preparing extended amendments to the Energy Law (2004) to transpose also the requirements of the Security of Supply Directive 2005/89/EC and to increase compliance with the Directive 2003/54/EC and Regulation (EC) 1228/2003. The second draft amendments that incorporate also the security of supply provisions are expected to be submitted for revision to the Energy Community Secretariat.

- **Institutional Organization:** The institutional organization is developed. The powers of the Regulatory Agency (AERS) have to be enhanced to comply with the minimum requirements of the Directives 2003/54/EC, 2005/89/EC and Regulation (EC) 1228/2003. Further measures to insure sufficient independence of the Regulatory Agency need to be considered.

- **Public Service Obligation and Customer Protection:** Public Service Obligations are defined in the current Energy Law. The Energy Law amendments envisage the assignment of 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 and the tariff customers have to be restricted to households and small and medium enterprises (SMEs). Customer protection is partially covered by the primary legislation and partially left to the secondary legislation. The amendments to the Energy Law have to consider also the customer protection as described in the Annex A of the Directive 2003/54/EC.

- **Monitoring Security of Supply:** Security of electricity supply is well defined in the primary and secondary legislation. The Energy Law amendments envisage the transposition of Directive 2005/89/EC provisions. It is foreseen that the Regulatory Agency will be in charge with monitoring security of supply and will report to the Ministry responsible for Energy.

- **Technical Rules:** The Transmission Grid Code has been approved by the Regulatory Agency in April 2008. The Distribution Code and Market Code are still in the final stage of preparation.

- **Unbundling and Access to Accounts:** Unbundling provisions for the TSO and DSOs are in place. The TSO and the five DSOs are legally unbundled from the other electricity undertakings. The Regulatory Agency has access to accounts as stipulated in the Energy Law, but practical enforcement remains to be achieved. Compliance programs have to be set for the TSO and DSOs and monitored by the Regulatory Agency as the generation and distribution activities are performed by EPS in an integrated ownership structure.

- **Third Party Access:** Provisions on third party access are available. The tariff methodologies for access to the networks have been issued by the Energy Regulatory
Agency in January 2007 and are based on cost plus methodology. The transmission tariff set for 2009 is calculated based on 1% rate of return that doesn’t allow adequate investments in the grid development. Distribution tariffs remain to be set and published.

- **Authorisation and Tendering for New Capacities:** are addressed in the primary legislation. 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 electricity and gas market was formally open on February 27, 2008, as the Regulatory Agency granted the eligibility status to all non-households customers. The procedure for customer switching have to be approved and made public by the Regulatory Agency. Actually, no eligible customer exercised its eligibility status as the eligible customers can still benefit from regulated retail tariffs that are well below any electricity price that can be provided by a private supplier. Methods to open the internal generation to competition need to be considered as the current electricity market prices in the region decreased significantly and the level of regional generation adequacy is good. Provisions on reciprocity of the eligibility status on third party markets have to be considered.

- **Cross Border Trade Mechanism:** Implementation of Regulation (EC) 1228/2003 has progressed with publication of more information related to capacity auctioning on TSO website and the introduction of the yearly and weekly explicit capacity auctions starting with 2009. Yearly, monthly and weekly explicit capacity auctions are performed on all 8 borders, split 50%-50% with the neighbouring TSOs. Capacity split 50%-50% is not full in compliance with the Regulation (EC) 1228/2003 that calls for joint capacity auctions. Moreover, ‘Pay-as-bid’ method has been chosen for the capacity pricing and does not provide market integration. As the neighbouring TSOs from Croatia, Hungary and Romania apply marginal price there is a distortive signal on the market and allows traders’ arbitrage on interconnections. The transparency has to increase furthermore to comply with all the requirements of Regulation (EC) 1228/2003.

**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 in a proper way. According to information received by the Contracting Party, the new Amendments to the Law on Energy are under the preparation.
• **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 in 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 rules for the practical operation are needed – this could be done in the market rules.

• **Unbundling and Access to Accounts:** The available provisions need clarification with regard to unbundling requirements; provisions for the compliance programme are missing. The rights of access to accounts should be precisely determined; the rules for practical operation could be provided 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 (Article 22 of the Directive 2003/55/EC) are to some extent available; the missing provisions have to be developed; 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; since end of February 2008, by the Energy Agency decision, all non-households customers are eligible and all household customers will be eligible according to the Treaty.

• **Cross Border Trade Mechanism:** The Regulation 1775/2005 was obliged to be implemented till the end of 2008, which has still not fulfilled. The Transmission Grid Code is in the very early stage of preparation.

**Assessment of the implementation of energy acquis**
The implementation of the electricity acquis and electricity market reforms in Serbia has to advance furthermore. The Energy Law amendments have been delayed to carefully consider the transposition of Directive 2005/89/EC and to provide an increased compliance with the Directive 2003/54/EC and Regulation (EC) 1228/2003 provisions. The status of the Regulatory Agency in terms of powers, tasks and responsibilities over the internal market has to increase (monitoring the rules on the management and allocation of interconnection capacities, access to the networks, level of transparency and competition, TSO and DSOs tasks fulfilsments, the security of supply, reporting requirements, provisions for regulatory cooperation at regional level etc). Other issues of further concern are efficient unbundling of distribution from generation activities, the approval of network tariffs, development of the market framework for competition in supply, cost reflectivity of retail tariffs. Further compliance with Regulation (EC) 1228/2003 is needed to ensure the regional market integration.

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; the draft Amendments to the Energy law will need significant improvements to comply with the requirements of the Treaty. The secondary legislation - necessary to make the system operational - requires significant efforts to be completed.

The market rules - which are essential for the efficient operation of the system – still are not available because Serbia does not seem to have enough capacity/experience for 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 public procurement procedure – which is time consuming - has to be followed which does not support the quick realisation) and the monitoring of, including technical assistance, such a process by the ECS needs time in order to comply with the “Regional Approach”.

### UNMIK

#### Electricity

Draft amendments are under consideration for all three existing basic legal acts in the energy sector of UNMIK (Law on Energy, Law on Electricity and Law on Energy Regulator). In addition, a new Law on Energy Efficiency is in the pipeline.

- **Institutional Organisation:** The independent Energy Regulatory Office (ERO) has been the leading institution in the energy sector reforms, along with the Ministry of Energy and Mining (Ministry). After overcoming a period of budget constraints ERO has recovered its operational capacity. Current amendments in the Legislation should preserve and further
enforce independent position of the Regulatory Office in the energy sector. The Ministry is currently upgrading its administrative capacity through technical assistance and consultancy, and gaining initiative in implementation of the energy policy.

- **Public Service Obligation and Customer Protection:** Regulated supply is implemented as a public service available to all classes of customers. Due to scarce resources, the supply is subject to continuous load shedding patterns which are sensitive to the rate of payment and serve as demand side incentives for improvement of payments and reduction of losses. Collection rate for the 1st Quarter of 2009 is 74% (which is by 32% better than the same period in 2008), however overall losses remain on the same level as in 2008 (ERO approved allowance of 17.1% for technical losses and 20% of commercial losses to be covered by the tariff), access for meter reading and billing has improved as well. An amount of 4.5 Million EUR has been allocated in the UNMIK Budget for 2009 aimed to compensate the socially vulnerable customers by as much as 20 EUR worth of electricity. Working groups has been established for quality of supply and service standards, as well as for preparation of a Social Action Plan.

- **Monitoring Security of Supply:** Consumption-sensitive tariff pattern is applied (with thresholds on 200 and 600 kWh) aimed to incentivise reduction of the level of consumption. Electricity demand is balanced on annual basis. In the 1st Quarter of 2009, 24.5 Million EUR worth of imports is registered. The Ministry is responsible for overall energy policy and development projects in electricity generation while ERO implements authorization and tendering procedures. ERO has adopted a Transmission and Distribution Development Plan (2009 – 2011) – stronger cooperation with the Ministry is needed for increased efficiency. Further implementation of the Directive on Security of Electricity Supply is also required.

- **Technical Rules:** In addition to several recently adopted Rules (such as Rule on Authorization for Construction of New Generation Capacity and Rule on Confidentiality of Information) amendments are in progress for the Rule on General Conditions for Electricity Supply, Rule on Disconnection and Reconnection of Customers and Rule on Dispute Settlement. The Ministry has brought new Instrucion on Eligible Customers for 2009.

- **Unbundling and Access to Accounts:** The TSO is legally unbundled and the vertically integrated utility is undergoing a process of further legal unbundling by spinning out the DSO and supply activities in a new company leaving the generation bundled with the embedded mining activities. The Distribution network together with the retail supply services are planned to undergo privatization in a near future. Further unbundling between these functions may be considered on a longer term basis.
• **Third Party Access:** Transmission Grid Code is applied, and the TSO has prepared Connection Charging Methodology which has been approved by ERO. Tariff methodology for connection to Distribution network is also submitted to ERO for approval.

• **Authorisation procedures for new capacities:** The Regulatory Office has adopted Rules on Authorization Procedure – effective implementation is needed in cooperation with the other responsible authorities including the Ministry.

• **Market Opening:** Starting with 2009 the electricity market is open for all customers connected to networks of 10 kV and above. Appropriate criteria need to be developed in order to bring the market opening calendar in compliance with the legal framework of the Treaty. Regardless, only one large customer is exercising its eligibility rights. Transitional Market Rules are applied – modifications are considered for the end of 2009.

• **Cross Border Trade Mechanism:** Cross-border capacity allocation procedures are developed by the TSO and approved by ERO. However such procedures are not yet implemented due to unresolved ongoing dispute with the neighbouring TSO of Serbia over the rights for allocation of interconnection capacities. UNMIK is active participant to the Project for establishment of a Coordinated Auction Office (CAO) in SEE.

**Gas**

The Ministry of Energy and Mining has elaborated the draft Law on Gas which has been discussed during the missions and improved in line with the remarks by the ECS. The draft transposes the requirements of the Directive 2003/55/EC into a national gas legal/technical framework and it is in final stage of the approval procedure. This basic gas legal framework 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 in 2004 (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.

• **Public Service Obligation and Customer Protection:** The provisions regarding customer protection 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 explicitly determined, and Art 6 of the Law on Energy does not clarify whether these provisions are applicable “just” for electricity, or generally for energy (including gas
provisions with respect to the scope of the safeguard measures as well as the provisions regarding the duration and the provisions).

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

- **Unbundling and Access to Accounts**: The unbundling requirements are consistent with the requirements of the Directive.

- **Third Party Access**: Provisions on the TPA are in compliance with the Directive.

- **Authorisation procedures for new capacities**: The provisions are in line with the Article 22 of the Directive 2003/55/EC. The category of “direct pipelines for the transit of natural gas” should be explained in more details and in line with the Directive.

- **Market Opening**: The provisions require an open market for all customers.

- **Cross Border Trade Mechanism**: Regulation 1775/2005/EC should be implemented from the end of 2008. Due to the advanced stage of the approval procedure of the Law on Gas, there is no possibility to transpose the Regulation’s provisions in the same act. During the mission in April 2009, possible approach regard overcoming this gap has been discussed.

**Assessment of the implementation of the energy acquis**

A number of Amendments to the relevant legal framework on electricity and new Regulatory acts are under development aimed to upgrade the UNMIK electricity market environment and sustain the independent regulatory power. Security of supply is continuously critical – in addition to the other applied measures further reduction of losses (which are still extremely high) and improvement of collection rate should be accomplished in order to provide commercially viable basis for cost-reflectivity of the tariffs, sufficient imports and investment incentives for new generation capacity. Market opening criteria need to be brought in line with the Treaty and supplier function to be further developed along with adequate switching rules. What also remains as an important task in practical terms is to reach agreement on the cross-border capacity allocation rights with the neighbouring TSO of Serbia, and apply market-based rules for congestion management as soon as it is feasible.

Because of the lacking gas market there are not many incentives – besides the obligations under the Treaty - to develop and implement a Gas Law. Nevertheless, such an act has been developed, which provides the proper legal framework for potential investments in the gas sector. 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. 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.