

## THE SECRETARIAT'S APPROCH TO BOOSTING THE IMPLEMENTATION OF THE TREATY

### I. BACKGROUND

In September 2010, the Secretariat published its Annual Implementation Report, which was presented to the Ministerial Council at its meeting on 24 September in Skopje. While welcoming that in general the Contracting Parties in all sectors established legal frameworks based on the elements contained in the *acquis*, the Ministerial Council regretted that *"the progress is mitigated by the lack of transposition of certain elements, or the lack of implementation and application of these elements in practice. Thus, the Ministers expressed their concerns that the demonstrated political will is not sufficiently followed by concrete actions in the form of legislative work. Further, the formal transposition needs additional efforts for actual implementation and enforcement. Therefore, the Ministerial Council recalled the need that both the political and the expert level work should focus mainly in this direction."*

Against this background, the Ministerial Council requested the Secretariat to elaborate a document drawing conclusions from the report and identifying next steps, which is hereby presented.

The main general findings of the Implementation Report concerning open implementation issues may be summarized as follows:

Whilst many individual elements from the gas and electricity directives have been transposed, the market design in general falls short of providing an appropriate framework of open, competitive and integrated markets. Based on the idea that domestic generation should satisfy the consumption of captive customers, energy legislation in many cases establish exclusive links between public generators, wholesale and retail suppliers, without the possibility for new players to enter into any of those segments. That structural problem is often aggravated by the expansion of the captive market to certain (or all) categories of non-household customers, which may choose to be supplied by the public supplier and are incentivized to do so by unlimited price regulation below market prices. This default constellation, based on a boundless understanding of public service obligations, does not provide the results expected under the Energy Community framework, of integrated and open energy markets. In the majority of cases, the national institutions in charge of enforcing a competitive market structure – national regulatory authorities, competition authorities and State aid authorities, fail to counterbalance or even mitigate the structural problems of national legislation.

In sum, it is fair to say that the low-hanging fruit have been picked in terms of transposition of the *acquis*. Implementation, understood as achieving the objectives of the Treaty even beyond the individual elements of the Directives, will be more complex and challenging, as it will require more profound changes in the energy sectors of each Contracting Party. At the same time, proper reform of the domestic energy sectors, as well as the establishment of regional markets, are *sine qua non* not only for attracting investments but also a precondition for further harmonization with the EU internal market, e.g. by incorporating the 3<sup>rd</sup> energy package.

## **II. IMPLEMENTATION OF THE ENERGY COMMUNITY ACQUIS - STRUCTURE AND ROLES**

The bulk of the Energy Community *acquis communautaire*, i.e. primary and secondary Energy Community law,<sup>1</sup> is binding on the Parties to the Treaty. The binding character entails the obligation to implement the *acquis* in wording and spirit. Implementation goes beyond mere transposition into domestic legislation and requires also the full application in practice. This requires the readiness to reform the energy sectors beyond the individual elements of the Directives, which, as a matter of fact, mainly focus on certain aspects of network separation and operation only. The ultimate goal of Treaty implementation, however, is to achieve the objectives described in Article 2 of the Treaty. As the Secretariat's Implementation Report describes, the Contracting Parties to the Energy Community are still far away from that goal.

While the responsibility for the implementation of the *acquis* lies with the Parties, the Energy Community institutions have an important role to play in that process. The Secretariat, for its part, provides assistance and reviews the proper implementation of the Treaty under Article 67 of the Treaty. Under Article 90 of the Treaty, it may also refer cases of non-compliance by a Party to the Ministerial Council for decision, either upon complaint or on its own motion. The procedure for this so-called dispute settlement procedure was fleshed out by the Procedural Act on Dispute Settlement Rules of Procedure. At the same time, the Secretariat lacks own decision-making powers. In its efforts to promote implementation of the Treaty, it is therefore depending on the full cooperation by the Contracting Parties, including the readiness to share information and the will to continuously and thoroughly reform the energy sectors towards furthering compliance with the Treaty requirements. This will is not always present. When it comes to enforcement, the Secretariat needs to convince the Ministerial Council, a primarily political body, to adopt a decision of an essentially judicial character against one of its members. Moreover, the Treaty lacks appropriate sanctions deterring a Contracting Party from breaching the *acquis*. Under these circumstances, and except for very simple cases, negotiations often remain the only option. Their success will again depend on the goodwill of the Contracting Parties.

Furthermore, tackling each Contracting Party's shortcomings on an individual basis is a necessary, but not sufficient precondition for achieving the objectives of the Treaty. It is unlikely that issues such as the market structure or too low energy prices, which are common to all Contracting Parties and politically and socially highly sensitive, can be efficiently tackled by way of enforcement actions – individually or simultaneously – alone. The Secretariat is convinced that the Ministerial Council (and possibly PHLG and ECRB by delegation) will have to accompany the individual implementation efforts by adopting common, regional rules of the kind envisaged by Title III of the Treaty. The Secretariat will be pleased to prepare proposals in that respect, as foreseen by Article 82 of the Treaty.

To the extent the Secretariat can act independently under Articles 67 and 90 of the Treaty, and in view of both the urgency of further and deeper reforms and the structural particularities and challenges under the present framework, the Secretariat in the following offers some thoughts on how the implementation process might be supported and sped up. They will guide the Secretariat in its future activities. It needs again to be underlined, however, that the ultimate responsibility for implementing the *acquis* and complying with their obligations remains with the Contracting Parties alone, and that joint action and further harmonization may be required.

## **III. NEW APPROACHES TO IMPLEMENTATION – THE SECRETARIAT'S CONTRIBUTION**

### **1. Implementation of the existing acquis**

Given the delay in full Treaty implementation and its consequences for the future of the regional energy markets, the Secretariat envisages the **end of 2011** as a deadline for implementation of the 2<sup>nd</sup> energy

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<sup>1</sup> With the exception of Recommendations.

package by all Contracting Parties. That would not only include the adoption of (compliant) primary legislation, but also all necessary secondary legislation.

This target is ambitious and requires increased efforts by all stakeholders involved. The following key elements shall be relied upon by the Secretariat in order to support the goal.

a. True and fair reporting

The annual Implementation Report of 2009/10 constitutes a shift in the reporting approach by the Secretariat in terms of concreteness and comprehensiveness. The Secretariat will continue and further refine this approach. **Descriptive reporting** has been and will be complemented by **normative reporting**, i.e. by identifying instances of non-compliance in a very concrete way. For these purposes, the Secretariat will use detailed and objective compliance templates.

Where progress has been achieved – as in the wake of the last Implementation Report in not less than three Contracting Parties – this will be duly highlighted.

In the spirit of full transparency, the Secretariat will also revert to public communication on all issues regarding the implementation of the *acquis*.

b. Concrete and continuous assistance

The Secretariat has always offered and provided comprehensive assistance to the Contracting Parties in their efforts to reform their energy sectors. It has analyzed draft legislation for compliance, made recommendations in writing and on missions, offered legal assessments etc. On this ground the Secretariat's clear position is that that **any draft legislation in the energy sectors should not be adopted without having consulted the Secretariat in advance**.

In the future, the Secretariat will intensify its efforts and become more proactive by, *inter alia*,

- Compiling **detailed Contracting Parties compliance profiles**, concretely spelling out what is missing for compliance with the 2<sup>nd</sup> energy package, and proposing deadlines for implementation. These profiles will be finalized by the end of March 2011 and will function as a to-do-list for progress to be achieved by the end of 2011;
- **Tailoring all missions** in a way so as to ensure that each mission is linked to a concrete implementation agenda and results in well-defined deliverables for follow-up immediately after the mission:
- Keeping each Contracting Party under continuous review and keeping in continuous communication; for this purpose, the Secretariat may complement its sectoral structure by appointing individual focal points for each Contracting Party.

c. Differentiated approach

One of the outcomes of the Implementation Report is that the **gap** between the performance of individual Contracting Parties is **widening**. While all Contracting Parties will be subject to more intense review and assistance by the Secretariat, this requires a differentiated approach. In the course of 2011, Bosnia and Herzegovina as well as Serbia and possibly Albania will be under **particular scrutiny**, as they lag behind in their implementation performance.

Particular attention will also be paid to **Moldova and the Ukraine** as newcomers to the Energy Community. The Secretariat will establish task forces to make sure these Contracting Parties can catch up as soon as possible.

#### d. Implementation Partnerships

It would be illusionary to believe that implementation can be imposed upon Contracting Parties by the Secretariat or other parties. Implementation is a process requiring both the will and broad consensus among all relevant stakeholders within each Contracting Parties. For these reasons, the Secretariat will propose “**Implementation Partnerships**” to all Contracting Parties, e.g. by signature of Memoranda of Understanding. These Implementation Partnerships will be based on the Party-specific reports by the Secretariat and could encompass the establishment of intra-Party **working groups** composed of all relevant stakeholders (government, regulators, companies etc.), coordinated by the Secretariat. Such an approach seems to be particularly promising for the development of secondary legislation defining the market design.

#### e. Cooperation with and among regulatory institutions

The Implementation Report notes explicitly that the regulatory institutions in all Contracting Parties do not properly function as expected under the *acquis*, both in terms of structure and output.

- (1) Under the Energy Community framework, **regulatory authorities** are coordinated within ECRB. Convening in several working groups, that coordination mainly relates to substantial aspects of regulatory work. Principle issues related to their independence, but also their performance (adoption of secondary legislation, enforcement of the *acquis* by individual decisions, regulating tariffs and prices, transparency etc.), remain largely uncoordinated.

As a point of departure, the Secretariat, through its ECRB Section, will create **individual profiles** on each national regulatory authority with a view to evaluating the degree of compliance with tasks, competences and structural requirements of the *acquis*. This might include scoreboards for benchmarking independence. The assessment of the structure and performance of regulatory authorities will also feature more distinctly in the Secretariat’s implementation reports and country profiles. The **ECRB Section** of the Secretariat’s will also become more involved in compliance assessment (including through missions) and providing assistance to regulatory authorities in drafting the required secondary legislation.

- (2) Furthermore, the **competition authorities** do not play the role expected from them in applying European competition law to the energy sectors. Ideally, they could provide a strong impetus towards shifting the Contracting Parties energy markets from captive, state-dominated and prone to abuse to being open and competitive. Not only will the Secretariat, in the future, observe the activities of competition authorities more closely than before. It also will propose a scheme for cooperation of competition authorities in the energy sectors in a **regional network**. That network should allow for awareness raising and continuous training on typical issues of competition laws persisting in the energy sectors, as well as an exchange of experience and expertise in individual cases. Where appropriate, elements of the ECN may be taken over. The network should also be linked to the existing cooperation schemes for regulatory authorities.

- (3) A similar approach may have to be taken with respect to the institutions in charge of enforcing the **State aid** prohibition.

#### f. Linking investment support and compliance

To the extent the Secretariat promotes and assists in individual investment projects, it will link its activities to a **review of the legal framework applying to the project** at issue. This includes authorization and tendering procedures, environmental impact assessment, State aid rules etc. No projects, which are not in compliance with the *acquis*, should be supported in the future.

#### g. Enforcement

The Secretariat will continue developing the **dispute settlement mechanism under Article 90** of the Treaty towards a tool of Treaty enforcement by following up, on its own motion, on all issues of non-compliance with the Treaty. This will be done by cases addressing issues of non-compliance individually for each Contracting Party concerned, as well by simultaneous cases pertaining across the board to all Contracting Parties in one way or other. The Secretariat will prioritize cases where individual elements of the 2<sup>nd</sup> energy package have not been implemented, including also non-compliant market models, impediments to cross-border trade, unduly regulated energy prices and the lack of coordinated capacity allocation.

Past experience shows that the recourse to enforcement action was most efficient where the Secretariat **combined it with its assisting role**, i.e. where the finding of non-compliance issues was linked with proposing redrafting of laws and by-laws. The Secretariat will continue to bundle its individual activities in that respect.

In the first half of 2011, the Secretariat will also review the existing **Dispute Settlement Rules of Procedures**, and propose appropriate changes to the Ministerial Council in close cooperation with the European Commission.

#### h. Enhancing the regional dimension

The benefits of regional energy markets have been barely yielded in the past, despite the evident importance of a regional approach. Apart from a few individual projects such as the Coordinated Auction Office or the Gas Ring concept, which often suffer from a mismatch between declared political support and the lack of implementation, the regional market lacks a vision. At the first PHLG meeting in 2011, the Secretariat will therefore propose a **Regional Energy Strategy** which could be the starting point for agreeing on further steps towards regionalizing the markets.

In close cooperation with the European Commission, the Secretariat will also make **proposals to the Ministerial Council** for the adoption of further rules harmonizing specific aspects of the regional markets, where it thinks this might support the development. Such rules could relate, *inter alia*, to the phasing out of regulated prices and the protection of vulnerable customers, harmonization of licensing, etc.

## 2. Implementing new *acquis*

Full implementation of the existing *acquis* (2<sup>nd</sup> energy package) constitutes a precondition for a successful implementation of the new *acquis* still awaiting implementation, such as the 3<sup>rd</sup> energy package, the Renewables Directive, the Emergency Oil Stocks Directive, the energy efficiency directives or the environmental directives listed in Article 16 where the deadline for implementation has not yet expired.

While the issues listed above apply *mutatis mutandis*, the Secretariat's focus in its role assisting the Contracting Parties will be mainly one of **ensuring the timely preparation for implementation**. As to avoid some mistakes, made in the past, the Secretariat will develop a structured approach ensuring that all Contracting Parties keep the implementation deadlines. This approach will be based on **detailed roadmaps** to be developed by the Secretariat within 2011. It will also be accompanied by well-targeted missions explaining the requirements of the new *acquis* and proposing optimal implementation strategies.

Where appropriate – eg. in renewables, energy efficiency and environment – this individual approach will be complemented by involving **task forces** or other means apt to include all relevant stakeholders in the Energy Community.

#### IV. CONCLUSIONS

With the present paper, the Secretariat shows its readiness to step up the efforts, also from its side, for implementation of the 2<sup>nd</sup> package acquis within the immediate future. As the consecutive implementation reports have shown, it is high time to move from complaining about the lack of implementation to concrete action. This requires a new boost to reform endeavours from all stakeholders involved in the Energy Community. Five years after the entry into force of the Treaty, and in view of the immense challenges ahead, the Secretariat is convinced that such renewed endeavours are indeed essential.