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ENERGY COMMUNITY FOR SOUTH EAST EUROPE: RATIONALE BEHIND AND IMPLEMENTATION TO DATE

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Abstract

The European Commission and the Stability Pact have launched the Athens Process in 2002 and the Energy Community Treaty, with the objective of creating a regional energy market in SEE, was signed in 2005. The purpose of this paper is to give an overview of the national but also reforms at regional level in the electricity systems in SEE, but also to underline the open questions with regard to the areas in which reforms are not complete and progress is still needed. The focus of the paper will be put on the implementation of the Energy Community Treaty covering its most relevant aspects. It does not aim however, to provide a detailed comparative analysis of the electricity systems in all nine countries from SEE, neither to study one specific issue. Therefore, real conclusions will not be drawn at the end, but rather questions for further research will be left open.

After the introduction of the development of European energy policy and the requirements for liberalization of the electricity markets in the Member States, a presentation of the Athens Process and the Energy Community as an example of a regional energy market will be done. In addition an explanation of the rationale behind the Energy Community will be provided. Afterwards, the progress made and the obstacles that still exist on the way to establishment of the SEE regional energy market are going to be presented, through the way of implementation of the electricity *acquis*.

Keywords

electricity, liberalization, regional electricity market, competition policy, Athens Process, South East Europe

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1 Introduction

The countries from South East Europe (SEE) have a clear perspective for membership in the European Union (EU) and therefore a process of reforms is going on in them, which encompasses reforms in their electricity sectors. Accepting the political obligation to adjust their legislation to the EC law in the energy sphere has been made explicit with signing the Athens Memoranda 2002[1] and 2003,[2] which were later implemented in the Treaty establishing the Energy Community for South East Europe (Energy Community Treaty - EnCT),[3] signed between the EU and the nine countries from SEE.[4] The EnCT has the objective of creating a regional energy market (REM) in SEE which should later be integrated in the internal energy market. Through its implementation, the SEE countries are set to become part of the EU internal market in a key economic sector – energy, even before their accession to the EU.

Due to the fact that there is no comprehensive overview of the development of the Energy Community in the existing academic literature up to date, this paper has as an objective to try to fill in that gap. Its purpose is to give an overview of the national but also reforms at regional level in the electricity systems in SEE taking place by now, but also to underline the open questions with regard to the areas in which reforms are not complete and progress is still needed. It does not aim however, to provide a detailed comparative analysis of the electricity systems in all nine countries from SEE, neither to study one specific issue.

After the introduction of the development of European energy policy and the requirements for liberalization of the electricity markets in the Member States, a presentation of the Athens Process and the Energy Community as an example of REM will be done. In order to answer the question whether the existence of the Energy Community is sustainable and whether is worth studying this topic, the paper tries to provide an explanation of the rationale that led the EU to launch the idea on the one hand, and the countries of SEE to undertake the obligations to establish REM, on the other. After giving certain legitimacy to the research, the progress made and the obstacles that still exist on the way to establishment of the SEE REM are going to be presented, through the way of implementation of the energy *acquis*. The discussion will be twofold: first, it will cover the national reforms in the SEE countries and then second, the proposed standard market design for the SEE REM addressing some important cross-border issues will be addressed.

The focus of the paper will not be put on one concrete problem only, but rather on implementation of the EnCT in more general terms covering the most relevant aspects. Therefore, real conclusions will not be drawn at the end of this paper, but rather questions for further research will be left open.

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[1] Memorandum of Understanding on the Regional Electricity Market in South East Europe and its Integration into the European Union Internal Electricity Market, signed in Athens on 15/11/02. *bis* D(2002) C2/BD/CA.

[2] Memorandum of Understanding on the Regional Electricity Market in South East Europe and its integration into the European Union Internal Electricity Market – Athens, on 8th December 2003, 15548/03/bis.

[3] Treaty establishing the Energy Community for South East Europe, signed on 25th October 2005, OJ 2006 L 198/18 (the text of the Treaty is attached to the Council Decision of 29 May 2006 on the conclusion by the European Community of the Energy Community Treaty, OJ 2006 L 198/15). The Treaty entered into force on 1 July 2006.

[4] The countries of the SEE are: the Republic of Albania, the Republic of Bulgaria, Bosnia and Herzegovina, the Republic of Croatia, the Republic of Macedonia, the Republic of Montenegro, Romania and the Republic of Serbia, as adhering parties, and, Kosovo through the United Nations Interim Administration Mission in Kosovo (UNMIK), pursuant to the United Nations Security Council 1244. Since 1st January 2007 Romania and Bulgaria have been full members of the EU.

2 Development of Energy Market in the European Union

Historically, national monopolies existed in the energy markets in Europe and a vertically integrated company operated in each country, meaning that the same company was dealing with production of electricity, its transport (transmission and distribution), as well as supply of electricity to the final consumers. Due to the strategic place of energy for military purposes and for the countries' economy, more regulation, nationalization and state control of the economy including the energy industry as well, was going on in the Western Europe after the Second World War.[5] State owned vertically integrated companies have been granted with exclusive rights to supply electricity in a certain territory in return for being obliged to provide public service obligations (PSOs).

During the years of European integration, the context in which the energy markets were developed has been changing in different ways. With regard to the technical issues, the "traditional paradigm"[6] and the idea that if the networks are not controlled physically the systems will collapse was changed because of the development of the electronic control of the networks. The innovations made vertical integration of different energy activities unnecessary. Furthermore, the increased demand which put pressure on the supply of electricity started to create fears of shortages. The first fear of energy shortage appeared in the 1970s (with the oil crisis). In that period, the first ideas for market opening were born, together with the ideas for fuel diversification and decreasing the dependence on imported energy. The issue of security of supply is highly relevant even today, and there is a fear that due to the great dependence on imported energy the market power of sellers might increase and prices of electricity in Europe might rise.

2.1 EC Legal Framework: Application of the Treaty Rules to the Electricity Sector

Until the 1960's – '70's large interconnected networks were already built and energy was an essential part of the integration process of the European Community (EC) since the very beginning. That could be seen from the fact that two of the three treaties signed in the 1950s[7] were specifically related to the energy sector.[8] The Treaty of Rome on the other hand, did not include any provision for a common energy policy[9] and due to the Member States' unwillingness to grant new competencies to the EC, specific energy chapter was not included in the EC Treaty neither with its later changes. Moreover, differences between the Member States persist with regard to the development of their national energy markets, which is further reflected through the different pace of development of their national as well as of the internal energy market.

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[5] PINTO M. I. C. P, *A Study on the Deregulation of the Electricity Sector and the Implications for the Portuguese Market*, January 2001. The document is available at:

http://in3.dem.ist.utl.pt/master/thesis/99files/thesis02.pdf (last visited, 02.06.2008).

[6] CAMERON, P. Competition in Energy Markets: Law and regulation in the European Union, 2nd edition, Oxford University Press, 2007, at 7.

[7] Treaty of Paris establishing the European Coal and Steel Community, Paris, signed on 18.04.1951, entered into force 25.07.1952 and expired 50 years later; Euroatom Treaty creating the European Atomic Energy Community, Rome, signed on 25.03.1957, entered into force on 01.01.1958.

[8] CROSS, E. D., Electric utility regulation in the European Union: a country by country guide, Chichester: Wiley, 1996.

[9] Two views are presented in CAMERON, P. (2007) at 42, *supra* to explain why energy rules were not included in the EEC Treaty: 1. the intention was to treat energy in the same manner as any other economic sector and therefore it did not deserve any special status in the primary EC law and 2. it was a mistake that needed to be corrected with the Constitution for Europe.

Nevertheless, the EC Treaty provides for establishment of a common market[10] and it is clear that the common market covers electricity and gas sectors as well. It was only in the 1990s when the European Court of Justice (ECJ) in its judgments in *Corbeau*[11] and *Porto di Genova*[12] cases, opened the ground for legal assessment under the competition law rules of the monopoly rights existing in the energy sector. In those cases it was recognised that granting special rights to undertakings is lawful, but exercise of those rights could be subject to the competition rules. Afterwards, the ECJ has started to apply articles 81 and 82 to the electricity sector, having in mind the fact that supply of electricity is a service of general economic interest under article 86(2)EC. Furthermore, the EC Treaty provisions on state aid are also applicable to the energy sector[13] as well as the EC mergers control legislation[14] which is necessary to monitor the co-operations between the former monopolists that might become direct competitors through the restructuring of the industry.

The free movement provisions are also applicable to the energy sector. In *Almelo* case,[15] the ECJ ruled that electricity is a good and therefore the rules on free movement of goods, set in articles 30-37EC, apply. In addition, even though there is no specific ruling by the ECJ, due to the fact that the supply of electricity is a service within the meaning of article 49EC, the rules on free movement of services are applicable to the energy sector as well.[16]

2.2 EC Legal Framework: Sector Specific Legislation

Even though there is no energy chapter in the EC Treaty as explained above, the idea for the completion of the internal market influences the European energy policy. For a long period of the European integration, there was lack of clear competence of the Community to take measures on energy matters and only with the Treaty of European Union (TEU), signed in Maastricht in 1992, article 3(1)(u) under which the Community is entitled to take measures in the sphere of energy, was added. In the past, measures in the sphere of energy have been taken on the legal basis of other EU competences, such as the internal market, environmental or external policy, as well as competition policy.

It is widely accepted that the main idea behind the Community's competition policy is to remove the factual obstacles to competition, avoiding that removed barriers between states are replaced by barriers between the undertakings having the same effect. However, due to the fact that the competition law relies on *ex-post* action, it was not an effective way of creating a pro-competitive regulatory framework in the energy sector and to introduce competition in markets where vertically integrated monopolies existed. The time and risks involved waiting for competition policy to take effect may even act as a barrier for new market entrants.[17] Therefore, the competition policy is complemented by sectoral legislation and there are now two sets of rules applicable to the energy

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[10] As defined in article 8(a) of the Single European Act [1987] OJ L169/1: "an area without internal frontiers in which the free movement of goods, persons, services and capital is ensured".

[11] Case C-320/91*Corbeau* [1993] ECRI-2533.

[12] Case C-179/90 *Merci Convenzionali Porto di Genova SpA v Siderurgica Gabriella SpA* [1991] ECR I-1979.

[13] The concept of state aid was discussed in the Case C-379/98 *PreussenElectra AG v Schleswag AG* [1998] ECR I-2099, in relation to obligation of purchasing electricity from producers which exploited renewable sources.

[14] Council Regulation (EC) No 139/2004 of 20 January 2004 on the Control of Concentrations between Undertakings OJ 2004 L 24/1, 29.1.2004

[15] Case C-393/92 *Gemeente Almelo and others v Energiebedrijf IJsselmij* [1994] ECR I-01477 para.28

[16] See: KLOM, A. M. *Liberalization of Regulated Markets and its Consequences for Trade: the Internal Market for Electricity as a Case Study*, Journal for Energy and Natural Resources Law Vol. 14, issue 1, 1996.

[17] KlACKENBERG D. at al, *Rethinking the EU Regulatory Strategy for the Internal energy Market*, No.52, December, CEPS Task Force Report, 2004.

sector: general competition and sector specific rules. According to some authors,[18] the idea of choosing sector specific legislation to supplement the general competition rules for opening the energy markets, worked as a legal rationale behind the liberalisation process, due to the threat of legal proceedings against the Member States which would fail to transpose the directives into their national law.[19]

After the Price Transparency Directive[20] and the Transit Directive[21] in the early 1990s, the first more ambitious phase towards the liberalisation of the European energy market, involved fixing of a specific timetable for liberalization in 1996 with the adoption of Directive 96/92/EC[22] and Directive 98/30/EC,[23] concerning electricity and gas markets respectively. The objective of that first generation of liberalisation directives was to open the energy markets through gradual introduction of competition, thereby increasing the efficiency of the energy sector and the competitiveness of the European economy as a whole. In its Communication of 2001,[24] the Commission has concluded that the effects of market opening have been positive, but it realized that in order to complete the internal energy market and to reap its full benefits, further measures were necessary. On the basis of those conclusions, the Commission has tabled a formal proposal for amendment of the first liberalisation directives and at the same time has proposed a Regulation setting out principles and procedures for cross-border exchanges of electricity. The result of these proposals was the adoption of the second generation of liberalisation legislation: Directive 2003/54/EC[25] (Electricity Directive) and Directive 2003/55/EC[26] (Gas Directive), as well as Regulation 1228/2003/EC on cross-border exchanges in electricity.[27]

This sector specific legislation was adopted on the basis of article 95EC,[28] due to the fact that, as explained above, the EC Treaty does not provide for a specific legal basis for adoption of measures in the energy network sector, such as article 71EC for the transport sector. Furthermore, unlike the liberalization process in the telecom sector which was done on the basis of article 86(3) EC[29] by a

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[18] MARQUIS, M., Introducing free markets and competition to the electricity sector in Europe, Imprint Leeds: Wisdom House, 2001.

[19] European Commission, Press Release: The Commission takes action against Member States which have still not properly opened up their energy markets, Brussels 12.12.2006, IP/06/1768.

[20] Council Directive 90/377/EEC of 29 June 1990 concerning a Community Procedure to Improve the Transparency of Gas and Electricity Prices Charged to Industrial End-Users, OJ 1990 L 185/16, 17.07.1990.

[21] Council Directive 90/547/EEC of 29 October 1990 on Transit of Electricity through Transmission Grids, OJ 1990/L 313/30, 13.11.1990

[22] Directive 96/92/EC of the European Parliament and of the Council of 19 December 1996 concerning common rules for the internal market in electricity, OJ 1996/L 27, 30.01.1997.

[23] Directive 98/30/EC of the European Parliament and of the Council of 22 June 1998 concerning common rules for the internal market in natural gas, OJ 1998/L 204, 21.07.1998.

[24] Communication from the Commission to the Council and the European Parliament: Completing the Internal Energy Market, Brussels, 13 March 2001, COM (2001) 125 final.

[25] Directive 2003/54/EC of the European Parliament and of the Council of 26 June 2003 Concerning Common Rules for the Internal Market in Electricity and Repealing Directive 96/92/EC, OJ 2003/L 176/37, 15.07.2003.

[26] Directive 2003/55/EC of the European Parliament and of the Council of 26 June 2003 concerning common rules for the internal market in natural gas and repealing Directive 98/30/EC, OJ L 176 of 15.7.2003.

[27] Regulation (EC) No 1228/2003 of the European Parliament and of the Council of 26 June 2003 on the Conditions of the Access to the Network for Cross-Border Exchanges in Electricity, OJ 2003/L 176/1, 15.07.2003.

[28] Article 95EC is a provision whereby the Community has the power to adopt measures for the approximation of the laws of the Member State in order to improve the conditions for functioning of the internal market.

[29] Article 86EC states that public undertakings and undertakings entrusted with special and exclusive rights and with provision of services of general economic interest, are subject to the rules of the EC Treaty, especially the competition law rules, and the third paragraph of this article allows the Commission "to address appropriate directives or decisions to Member States" in order to ensure the application of those rules.

Commission directive, "the lack of political courage meant that liberalization"[30] in the energy sector had to start on the basis of article 95 EC.

2.2.1 Overview of the Key Provisions of the Electricity Directive

Liberalization of network industries generally requires implementation of one or more of the following inter-related steps: sector restructuring, introduction of competition in wholesale generation and retail supply, incentive regulation of transmission and distribution networks, establishing an independent regulator and privatization.[31] Electricity liberalization means to build single European electricity market out of isolated national markets, through the introduction of competition between electricity suppliers for customers,[32] and it comprises both: deregulation and privatization.[33] Deregulation can be understood as the elimination of regulation no longer necessary and its substitution by new rules in areas where it is unavoidable, usually for ensuring fair and non-discriminatory access for new entrants to the markets. On the other hand, privatisation is not always necessarily part of the liberalization in every country,[34] and it is not required by the Electricity Directive. Having in mind the division between the competitive and non-competitive areas of the electricity industry, the Electricity Directive brought changes that affected both of these areas. In turn, the most important concepts of the Electricity Directives will be introduced briefly, because they will serve as basis for assessment of the national reforms in the SEE countries later in this paper as well.

With the first liberalisation Directive, the concept of ***unbundling*** was introduced, which means that non-competitive activities (transmission and distribution of electricity had to be separated from competitive activities (production and supply of electricity). The second package of Directives emphasized and strengthened the provisions on unbundling. Unlike the first generation of directives which only required creation of separate *accounts*[35] for the different activities of the energy companies, the second generation required establishment of a separate company, i.e. introduced the concept of *legal* unbundling[36] and defined the *management* or *functional* unbundling.[37]

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[30] For a summarized explanation of the politics in the negotiations leading to legislation in the energy sector, see: EGENHOFER C., *Understanding the Politics of European Energy Policy: The Driving and Stopping Forces, the Politics of European Energy, the Energy of European Politics and Maastricht II,* Vol. 2, No. 9, Centre for Energy, Petroleum & Mineral Law and Policy (CEPMLP); SLOT P. J. and SKUDDER A., *Common Features of Community Law Regulation in the Network-Bound Sectors*, Vol. 38, No. 1, CML Review (2001), at 87. In addition, for the different positions of the Member States, see: MARQUIS, M. (2001), *supra* and EISING, R. *Bounded Rationality and Policy Learning in EU Negotiations: the Liberalisation of the Electricity Supply Industry*, Robert Schuman Centre for Advanced Studies No.2000/26, European Forum Series, EUI Working Papers, 2001.

[31] JAMASB T. and POLLITT M., *Electricity Market Reform in the European Union: Review of Progress toward Liberalization & Integration*, Centre for Energy and Environmental Policy Research (CEEPR), 05-003 Working Paper, March, 2005.

[32] ALBERS M., *Energy Liberalization and EC Competition Law*, Fordham 28th Annual Conference of Antitrust Law and Policy, on 26th October 2001.

[33] Observatory of European SMEs, *SMEs and the Liberalization of the Network Industries: Telecommunications and Electricity Markets*, No.3 (2003). See also, KLOM A. M., (1996), *super*.

[34] Some of the countries with liberalized electricity industries have opened the electricity markets without privatization (Norway), whereas others have made privatization a central feature of their reforms (United Kingdom).

[35] Article 19 Electricity Directive, *supra.*

[36] The key message of the provisions for legal unbundling (Articles 10 and 15Electricity Directive, for transmission and distribution unbundling respectively) is that transmission and distribution have to be done by separate "network" companies. According to DG TREN, legal separation does not require the network company to own the network assets, but that it must have effective decision making rights, in line with the requirements of the functional unbundling. With this regard, see: European Commission, DG TREN, The Unbundling Regime; Note on the Directives 2003/54/EC and 2003/55/EC on the Internal Market in Electricity and Natural Gas. Brussels 16.01.2004.

Furthermore, non-competitive activities are generally considered to be natural monopolies, because it is not economically viable to build new networks which would be competitive to the networks of the incumbent. Therefore, it is very important that access to the incumbents' networks is granted to everyone who generates electricity in order to be able to deliver it to the consumers. This access to the incumbents' networks in the European legislation is known as *Third Party Access* (TPA).[38] Those third parties, who would like to use the incumbents' networks, should be granted access against paying tariffs set in a transparent and non-discriminatory manner, to the network owners. While the first liberalisation directives provided for a choice of three types of TPA – *single buyer concept*,[39] *negotiated*[40] or *regulated* TPA,[41] the second generation allows only one type of TPA – the regulated TPA (rTPA) which requires access to the network to be subject to published and regulated tariffs, applied under non-discriminatory terms and conditions to all system users.

In the past, regulation of tariffs meant that the tariffs for the final consumers should be set and regulated through checking the costs of the monopolies which at that time were operating in the energy markets. However, the new concept of regulation today covers incentive-based regulation. This changed concept means that only the tariff for transportation of electricity should be controlled and regulated, and that regulation covers not only the cost for the service but some margin of profit as well. For being able to fulfil their important role, the second generation of liberalisation directives strengthened the provisions of the independent *National Regulatory Authorities* (NRAs), which were established in the Member States with the minimum responsibility to "ensure non-discrimination, effective competition and the efficient functioning of the market".[42]

Parallel to restructuring of the electricity industry in Europe, several public interest policies have been discussed and implemented.[43] Given the importance of the electricity for peoples' daily life, the attainment of the highest possible standards of public services in this area is a primary objective of Community policy for electricity. The Electricity Directive in its article 3 regulates the *public service obligation* and *customers' protection*[44] and provides that it is essential that liberalization of the markets continues to maintain and even improve the provision of energy supplies at reasonable prices while at the same time adhering to a number of principles.

2.2.2 Sector Inquiry and the Third Package for Liberalisation

After couple of years of experience with the second legislative package for liberalization of energy markets, the single energy market was not established yet. This led the Commission to open an inquiry into the functioning of the European electricity and gas markets in June 2005,[45] pursuant to article 17

(Contd.)

[37] Separated entities to be managed independently but it is not required to be separate companies.

[38] For general overview of the negotiations between the Commission and the Member States for the introduction of the TPA see: JOHNSTON A., *Maintaining the Balance of Power: Liberalization, reciprocity and Electricity in the European Community*, Journal for Energy and Natural Resources Law, Vol. 17, No. 2, 121-*seq.*, 1999.

[39] Under the single buyer concept, Member States should designate one single buyer within the territory of the system operator. The generators will have to sell all the electricity to the single buyer and the customers should purchase electricity from the single buyer.

[40] Under the nTPA the supply undertakings and eligible customers have to negotiate with the system operator access to the system and the prices that they will pay for the access, in order to be able to conclude supply contracts with each other.

[41] Article 20 Electricity Directive, *supra.*

[42] Article 23 Electricity Directive, *supra.*

[43] Public service obligations and customers' protection are regulated in article 3 Electricity Directive, *supra.*

[44] Article 3 Electricity Directive, *supra.*

[45] Commission decision (EC) No (2005) 1682 of 13 June 2005 initiating an inquiry into the gas and electricity sectors pursuant to Article 17 of Council Regulation (EC) No 1/2003.

of the Regulation (EC) N.1/2003.[46] The Final Report of the Sector Inquiry[47] was presented on 10.01.2007 in parallel to the Commission's Strategic EU Energy Review: Communication from the Commission "An Energy Policy for Europe"[48] and the Energy Package[49] that included the "Communication on Prospects for the internal gas and electricity market".[50] It summarised the results of the inquiry and concentrated on the competition aspects of Europe's energy policy. It identified the remaining obstacles for creating a single energy market and envisaged the need for further measures. In parallel, Directorate General for Transport and Energy (DG TREN) has carried out an Impact Assessment to assess policy options for completion of the internal energy markets,[51] which included a stakeholder consultation as well.

In its Presidency conclusions of 8-9.03.2007,[52] the European Council endorsed the Commission's findings from the Sector Inquiry and adopted an Action Plan for 2007-2009, which set up the steps for completion of the Internal Energy Market. It invited the Commission to come up with relevant proposals with development of new legislation, where necessary. In addition, in a Resolution on Prospects for the internal gas and electricity market adopted on 10.07.2007,[53] the European Parliament expressed a strong political support in favour of a common energy policy.

On 19.09.2007, the European Commission presented its third package for liberalization of the energy markets in the EU in which it proposed competition, regulatory and structural measures to be taken. The competition law remedies were needed to address the problems of market concentration, vertical integration and lack of market integration, but they should be supplemented by regulatory and structural measures. The Commission tabled amendments of the Electricity and Gas directives strengthening their provisions.[54] In context of the issues discussed above, the provisions of unbundling were particularly strengthened and for the first time ownership unbundling was proposed, or establishment of an Independent System Operator (ISO) as a second best option for the countries that decide not to take the full step at once. In addition, besides strengthening the powers of the NRAs, the Commission proposed establishing an Agency for cooperation of the National Energy Regulators and European Network for Transmission System Operators.

2.3 Cross-border Trade and Regional Integration of Energy Markets in the EU

Besides the many important issues concerning the liberalisation of the electricity markets in Europe, the Electricity Directive did not include provisions on cross-border trade of electricity. It was decided

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[46] Council Regulation (EC) of 16 December 2002 on the implementation of the rules on competition laid down in Articles 81and 82 of the Treaty, OJ L 1, 04.01.2003.

[47] European Commission, Communication from the Commission Inquiry pursuant to Article 17 of Regulation (EC) No 1/2003 into the European gas and electricity sectors (Final Report) and its Technical Annex SEC(2006) 1724, Brussels, 10.01.2007, COM(2006) 851 final.

[48] European Commission, Communication from the Commission: An Energy Policy for Europe, Brussels, 10.01.2007, COM (2007) 1.

[49] European Commission, Explanatory Memorandum to the Third package for liberalization of the energy markets, Brussels, 19.09.2007, COM (2007) Draft.

[50] European Commission, Communication from the Commission: Prospects for the internal gas and electricity market, Brussels, 10.01.2007, COM (2006) 841.

[51] European Commission, DG TREN, Commission Staff Working Document Accompanying the legislative package on the internal market for electricity and gas COM(2007) 528 final COM(2007) 529 final, COM(2007) 530 final, COM(2007) 531 final, COM(2007) 532 final, SEC(2007) 1180: Impact Assessment, SEC(2007) 1179.

[52] Presidency of the European Council, Presidency Conclusions of 8/9.03.2007, 7224/1/07, REV 1.

[53] European Parliament, European Parliament Resolution: Prospects for the internal gas and electricity market, 10.07.2007, 2007/2089(INI).

[54] European Commission, Explanatory Memorandum, *supra*

that this issue should be dealt with directly applicable instrument, i.e. a regulation was seen as more suitable than a directive. Therefore, together with the second Electricity Directive, Regulation 1228/2003/EC[55] was adopted which sets the basic rule for cross-border exchanges in electricity through establishing a system for inter-TSO compensation mechanism,[56] harmonised principles for cross-border transmission charges[57] and measures for congestion management.[58] The Regulation 1228/2003 was supplemented by Guidelines on congestion management (CMG)[59] and by Trans-European Energy (TEN-E) Guidelines.[60]

It is widely accepted that the objective for establishing an internal energy market in the EU would be more easily achieved through establishment of several regional markets. Not only more harmonised rules, but also the physical, institutional and political links are stronger at regional level.[61] In spring 2006, European Regulators Group for Electricity and Gas (ERGEG) with support of the European Commission, launched two Regional Initiatives: Electricity Regional Initiative (ERI) and Gas Regional Initiative (GRI). They are seen as a natural interim step and consequence to the idea of moving from national electricity and gas markets to an internal market.[62] Furthermore, the importance of the experience gained from the Regional Initiatives is underlined, because it shows the most significant problems and issues that need to be resolved through legislative changes.[63]

3 The Athens Process

As it was announced in the paragraph above, in a liberalized electricity market cross-border trade of energy becomes more attractive and it should therefore be stimulated. A fundamental precondition to such liberalization is the existence of a comparable regulatory framework in all countries concerned.[64] Additionally, it is desirable to establish similar market structures in the neighbouring regions, which would both anticipate further integration and recognize the situation of the existing grid interconnections.[65] A common framework may be established notably through the conclusion of bilateral or regional agreements not only between the regions in the EU, but also between the EU and third countries. In this later case the third countries concerned have to have an electricity market organized in compliance with the basic principles of the energy *acquis*.

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[55] Regulation No 1228/2003, *supra*.

[56] Article 3 Regulation 1228/2003, *supra*

[57] Article 4 Regulation 1228/2003, *supra*

[58] Articles 5, 6 and 7 Regulation 1228/2003, *supra*

[59] Commission Decision (EC) No (2006) 770 of 9 November 2006 amending the Annex to Regulation (EC) No 1228/2003 on conditions for access to the network for cross-border exchanges in electricity OJ L312/59.

[60] Guidelines for Trans-European energy networks, Decision No 1364/2006/EC of the European Parliament and the Council of 6 September 2006 laying down guidelines for trans-European energy networks and repealing Decision 96/391/EC and Decision No 1229/2003/EC OJ L 262, 22.09.2006, p.1-23.

[61] CAMERON, P. (2007) *supra*, at 110

[62] Some authors see the Regional Initiatives as "a single market initiative in disguise". See: ZIMMENRMANN, F. and TALUS, K., *Regulation of Electricity Markets at the EU level*, European Energy and Environmental Law Review, February 2008 at 16.

[63] ERGEG, Regional Initiative Annual Report 2008: The Regional Initiatives – Europe's key to energy market integration, 26.02.2008.

[64] Communication from the Commission to the Council and the European Parliament, (2001), *supra*

[65] European Commission, DG TREN, Strategy Paper: Medium - Term Vision for the Internal Electricity Market, Brussels 01.03.2004. The document is available at: http://ec.europa.eu/energy/electricity/florence/10_en.htm (last visited, 02.06.2008)

Good example of such regional arrangement is the conclusion of the Energy Community Treaty (EnCT)[66] in 2005 between the EC and the countries of the SEE in the framework of the Athens Process, which will be introduced in the sections below. In addition to the Contracting Parties of the EnCT (the EC and the countries from SEE), any Member State of the EU may obtain the status of a Participant, which has the right to take part in all the institutional meetings of the Energy Community. For instance, Bulgaria and Romania were parties of the EnCT, but after their accession to the EU in 2007 their legal status has changed from Contracting Party to Participant. As of April 2008, there are fourteen participants to the Energy Community.[67] In addition, there are five countries with a status of Observers to the Energy Community.[68]

In the following paragraphs, the Athens Process will be presented in more details, explaining the requirements stemming from it for the SEE countries.

3.1 Athens Memoranda

In March 2002, the European Commission with the support of the Stability Pact[69] started the so-called Athens Process by proposing the creation of a regional SEE energy market to be eventually integrated into the EU energy market. In November 2002, a Memorandum of Understanding[70] (Athens Memorandum 2002) was signed by nine countries from the region, with the Commission and the Stability Pact acting as sponsors. The Athens Memorandum 2002 set up a number of institutions: Ministerial Council, the Permanent High Level Group (PHLG) and the South East Europe Electricity Regulation Forum (Athens Forum).[71] Two years later in 2004, after a proposal by the PHLG, the South East European Regulators Board for Electricity and Gas (ECRB) was established by the Ministerial Council with the Tirana Declaration.[72]

This cooperation was further expanded to the gas sector through a second Memorandum of Understanding[73] (Athens Memorandum 2003) in December 2003. Under these Memoranda the SEE countries committed themselves to adopt EU-inspired norms in their energy sectors and in particular, to create NRAs and Transmission System Operators (TSOs) by June 2003, to establish Distribution System Operators (DSOs) by January 2005 and to open their electricity markets by 2015. These documents did not constitute an agreement and were not binding for the parties. Moreover, these Memoranda representing the political intent did not provide for any legal commitment with regard to the parties, sponsors and the donors.

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[66] Treaty establishing the Energy Community for South East Europe, *supra*

[67] See: http://www.energy-community.org/portal/page/portal/ENC_HOME/ENERGY_COMMUNITY/Stakeholders/Participants (last visited, 02.06.2008)

[68] Georgia, Moldova, Norway, Turkey and Ukraine are granted with status of Observers.

[69] The Stability Pact is a political declaration of commitment and a framework agreement on international co-operation to develop a shared strategy for stability and growth in SEE. It is not a new international organisation nor does it have any independent financial resources. In February 2008, handed over responsibility for co-ordinating and monitoring regional co-operation processes in SEE to the newly created Regional Co-operation Council (RCC) which will be based in Sarajevo. For further information see: http://www.stabilitypact.org/ (last visited, 02.06.2008).

[70] Memorandum of Understanding 2002, *supra*

[71] For detailed information on the institutions, see: http://www.energy-community.org/ (last visited, 02.06.2008).

[72] Ministerial Council Decision on Establishing the South East European Board for Electricity and Gas, Tirana Declaration, 01.06.2004

[73] Memorandum of Understanding, 2003, *supra*

3.2 Treaty Establishing the Energy Community for South East Europe (EnCT)

In the Athens Memorandum 2003, it was stated that the participants will seek to replace it with a legally binding agreement. This was done on 25.10.2005, by signing the Treaty establishing the Energy Community[74] between the European Community on the one hand, and its nine partners in SEE on the other. The EnCT, which has been negotiated by the European Commission in accordance with the Council Decision of 17.05.2004, has been signed[75] under the EC Treaty provisions with regard to the functioning of the internal market (article 95), making a reference to the provisions for freedom of establishment, services, competition and state aids, as well as environment. This Treaty entered into force on 01.07.2006 after being ratified by all the signatories.[76] It was the first time in the history that all of these states and territories have signed a legally binding treaty. It has been held that the EnCT was consciously modelled on the European Steel and Coal Community that in the 1950s was the genesis for the EC.[77]

The EnCT aims at regulating the relations between the countries signing it, in a manner that would create a common legal and regulatory framework for the energy markets and would allow trading energy across their borders. Its objective was the creation of a single energy market, including the coordination of mutual assistance in case of serious disturbance to the energy networks or external disruptions, and which may include the achievement of a common external energy trade policy.[78] The EnCT would encompass the principles and policies of the EC, taking into considerations the specificities of all parties. This objective would be achieved through ensuring that the SEE countries adopt the *acquis communitaire* in areas such as energy, environment, competition and renewables.

The *acquis* on environment covers: the Environmental Impact Assessment Directive 85/337/EEC,[79] the Directive 1999/80/EC for reduction of sulphur content of fuels[80] and the Large Combustion Plants Directive 2001/80/EC,[81] while the *acquis* on renewables is related to adoption of the Directives for promotion of renawables[82] and promotion of the use of biofuels.[83] The energy *acquis* covers the Directives from the second package for liberalization of the energy markets, the Electricity and the

[74] Energy Community Treaty, *supra*

[75] Council Decision of 17 October 2005 on the signing by the European Community of the Energy Community Treaty, 2005/905/EC, OJ L 329, 16.12.2005, p. 30

[76] Council Decision of 29 May 2006 on the conclusion by the European Community of the Energy Community Treaty, (EC) No (2006) 500, OJ L 198, 20.7.2006, p. 15 The Treaty was ratified by the Republic of Macedonia on 03.05.2006 by the Law for Ratification of the Treaty for Establishing the Energy Community, published in the Official Gazette No. 59/2006 on 12.05.2006.

[77] European Commission, Press Release: The EU and South East Europe sign a historic treaty to boost energy integration, Brussels, 25.10.2005, IP/05/1346 and European Commission, Press Release: An Integrated Market for Electricity and Gas across 34 European Countries", 25.10.2005, MEMO/05/397.

[78] Article 2 Energy Community Treaty, *supra*

[79] Council Directive 85/337/EEC of 27 June 1985 on the assessment of the effects of certain public and private projects on the environment, as amended by Council Directive 97/11/EC of 3 March 1997 and Directive 2003/35/EC of the European Parliament and of the Council of 26 May 2003.

[80] Council Directive 93/12/EEC of 23 March 1993 relating to the sulphur content of certain liquid *fuels*, OJ 74/L, 27.3.1993, p. 81–83

[81] Directive 2001/80/EC of the European Parliament and of the Council of 23 October 2001 on the limitation of emissions of certain pollutants into the air from large combustion plants, OJ 309/L, 27.11.2001, p. 1–21.

[82] Directive 2001/77/EC of the European Parliament and of the Council of 27 September 2001 on the promotion of electricity produced from renewable energy sources in the internal electricity market, OJ L 283, 27.10.2001, p. 33–40.

[83] Directive 2003/30/EC of the European Parliament and of the Council of 8 May 2003 on the promotion of the use of biofuels or other renewable fuels for transport, OJ L 123, 17.5.2003, p. 42–46.

Gas Directives, as well as the Regulation for cross-border trade in electricity.[84] In addition, adoption of the EC competition rules, in particular articles 81, 82 and 87 EC are applicable[85] in order to prevent trade between the Contracting Parties to be affected.[86]

Additionally to the adoption of the EC *acquis* on energy, the other obligations taken by the SEE countries in the sphere of electricity particularly may be summarized as follows:

- establishing common rules for the functioning of the national electricity markets i.e. improving the collection of payment for services (such as distribution of electricity), establishing mechanisms for crisis situations – safeguard measures,[87]
- establishing the regional electricity market itself – prohibition of taxes and quantitative restrictions for import and export of electricity,[88] common rules for trade with third countries[89] and
- opening of the markets after a suitable transition period (all non-household markets needed to be opened by 2008 and all household markets, by 2015).[90]

The EnCT formalises the institutions established by the Athens Memorandum 2002 and the Tirana Declaration. *Firstly*, the Ministerial Council which is composed of Ministers of Energy of the Contracting Parties and the European Commissioner for Energy takes place every six months and it takes strategic decisions and gives directions to the Treaty or formally adopts or endorses secondary legislation. The Presidency of this Council rotates on a six monthly basis. *Secondly*, the PHLG is composed of representatives of the Ministers of Energy of the Contracting Parties and the European Commission. The group prepares the Ministerial Council and ensures the follow up of its decisions. The Commission co-chairs this group along with the President in office. There is *thirdly*, the Treaty Secretariat which has its seat in Vienna and is the central co-ordinating body for the EnCT. It is also responsible for co-ordinating international donors, validating work and proposing technical, legal and regulatory developments. The ECRB is the *fourth* institution, which is based in Athens and considers issues of regulatory co-operation. It may develop into a regulatory decision making body and/or a dispute settlement mechanism. The European Commission considers its role as central to the operation of the enlarged market. *Fifthly*, similarly to the Florence and Madrid Fora in the EU,[91] there is a Forum set up by the Energy Community Treaty, which provides a possibility for discussion including all stakeholders and is called the Athens Forum. According to the Commission, the institutions established by the Energy Community are analogues to those in the EU such as the Energy Council, Energy Working Group of the Council and the Madrid and Florence Fora.[92]

The EnCT is concluded for a period of 10 years from the date of entry into force. The Ministerial Council acting by unanimity, may decide to extend its duration. If no such decision is taken, the Treaty

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[84] Article 11 Energy Community Treaty, *supra*

[85] Article 18 Energy Community Treaty, *supra*

[86] According to article 25 Energy Community Treaty, the Energy Community may take measures to implement amendments of the *acquis communautaire*.

[87] Article 36-39 Energy Community Treaty, *supra*

[88] Article 41 Energy Community Treaty, *supra*

[89] Article 43 Energy Community Treaty, *supra*

[90] Annex I Energy Community Treaty, *supra*: Timetable for the Implementation of the EC Directives 2003/54 and 2003/55, and the EC Regulation 1228/2003, of 26.06.2003.

[91] For detailed information see: http://ec.europa.eu/energy/electricity/florence/index_en.htm and http://ec.europa.eu/energy/gas/madrid/index_en.htm for electricity and gas, respectively (last visited, 02.06.2008)

[92] European Commission, DG TREN: Discussion and Consultation Note, The Regional Energy Market in South East Europe and its Integration into the European Community's Internal Energy Market, The Athens Forum, 3-4.06.2004.

may continue to apply between those Parties who voted in favour of extension, provided that their number amounted to at least two thirds of the Parties to the Energy Community.[93]

3.3 Rationale behind the Athens Process

After discussing the process of liberalisation and establishment of an internal energy market in the EU, the Athens Process with the EnCT as its result, have been introduced in the previous paragraphs. As explained, the idea behind the establishment of the Energy Community is to create a regional energy market in SEE which would be integrated into the EU internal energy market. This imposes obligation on the countries of SEE to establish their regional market which would be compatible and in accordance with the rules that govern the EU internal energy market. Nevertheless, it should be borne in mind that even though energy has been considered as one of the most important issues since the beginning of the European integration in the 1950s, the legislative and the real creation of the EU internal energy market itself begun only in the 1990s. This is after forty years, when the rest of the common market has been almost completed and when strong economic integration between the Member States was in place. This is not the case in SEE, because there is no such a strong regional integrated community between the countries from the region. Moreover, it should not be forgotten that the countries in SEE are developing countries, which are still in transition trying to reform their systems and to implement market economy after the central planned economy developed in the socialist period. Furthermore, countries in SEE are trying to stabilise their political and security situation at national and also at regional level by trying to re-build friendly relations with their neighbours after the wars that took place in the region in the 1990s.

Having stated these diametrically different situations present in the EU and SEE, the question of whether the existence of the Energy Community is sustainable and whether is worth working on it comes to ones mind. Therefore, it seems necessary and logical this paper to continue by trying to identify the rationale that led the EU to launch the idea of the Athens Process on the one hand, and the countries of SEE to undertake the obligations on the other. That would be a way to give legitimacy to the rest of this paper, in which the progress made and the obstacles that still exist on the way to the establishment of the regional electricity market in SEE is going to be presented, having in mind the implementation of the electricity *acquis* introduced in the previous sections.

3.3.1 Rationale of the EC

The completion of the EU's internal energy market strengthened the need for an explicit European Energy Policy. In its Green Paper of March 2006,[94] the Commission set the basis for such a policy, which is expected to meet three core objectives: sustainable development, competitiveness and security of supply. For that purpose it underlined six priority areas, one of which is the common external energy policy.[95] It should be noted that the idea for common external energy policy develops in a period in which Europe is facing great challenges in the energy field.[96] For example, there is a need for investment for changing the old infrastructure and for building new interconnections between the Member States. Furthermore, it should not be forgotten that the EU is dependent on import of primary fuels, such as oil and gas in around 50% of its total consumption. On the other hand, about

[93] Article 97 Energy Community Treaty, *supra*

[94] European Commission, Green Paper: A European Strategy for Sustainable, Competitive and Secure Energy, Brussels, 8 March 2006, COM (2006) 105 final.

[95] The other priority areas were: completion of the internal energy market, solidarity among Member States, sustainable, efficient and diverse energy mix, measures addressing the climate change, strategic energy technology plan.

[96] On the views about the challenges that EU is facing in the energy sphere see: BUSEK, E., *The Energy Community Treaty: Securing the Energy Supply in Southeast Europe and in the EU*, SÜDOSTEUROPA Mitteilungen Vol. 05-06/2006, p.16-21.

half of the known natural gas reserves are located in Russia and Iran, while most of the oil reserves are placed in Russia, Saudi Arabia, Iraq and Iran. Another important issue that has an impact on the European energy policy is that not only the EU's demand, but also the world's energy demand is expected to rise due to the growth in the global economy driven in particular by China and India. As a result of that, the oil and gas prices on a world wide level are rising which, certainly has an impact on the prices of electricity in the Member States of the EU, due to the fact that oil and gas are the main fuels used for production of electricity. In addition to all this, the growth in energy consumption is expected to increase the emission of greenhouse gases and to cause climate changes, issues addressed at European level as well.

Having in mind this global context, the EU has set the following priorities in the energy field: the creation of competitive internal energy markets; the diversification of the energy mix, suppliers and supply routes; energy efficiency; solidarity and an external energy policy. According to Erhard Busek, the Coordinator of the Stability Pact, the Energy Community which creates the largest internal energy market in the world bringing together all the Member States and the countries from SEE,[97] have a certain role in achieving all of the abovementioned priorities.[98] Therefore, the rationale behind the idea of the European Commission to launch the idea for establishing the Energy Community is going to be analysed in the light of those priorities:

a) *Firstly*, having in mind that the EU imports high percentage of its energy consumption one of the priorities would be a *diversification of the energy mix, suppliers and supply routes.* The countries from SEE, even though as the Member States of the EU, are free in making choice of their national fuel mix the obligations stemming from the EnCT would make them rethink and improve that mix. Renewable energy is already playing an important role in the region, namely thanks to the potential of the small hydropower plants (HPPs). At this point it is worth recalling that the SEE countries with the EnCT have undertaken the obligation to implement the Renewables and Biofuels Directives. Due to the fact that, except in Romania and Bulgaria, the gasification of the SEE region is very weak, most of the countries are making studies for the possibilities for increasing or building new gas pipelines. From the perspective of the EU's dependence on imported fuels used for production of electricity, SEE is considered to be able to provide for a substantial gas storage capacity and to serve as a transit area for new pipelines supplying the Member States. The diversification of suppliers and supply routes could be made possible by the construction of liquid natural gas (LNG) facilities, which would make it possible to import gas from the East.[99] In addition, pipelines to connect the region with Turkey could be built. There are two main projects that deserve to be mentioned at this point. The first one is the Nabucco pipeline, which connects the Caspian region, Middle East and Egypt via Turkey, Bulgaria, Romania and Hungary to Austria and further on with the Central and Western European gas markets. The pipeline's length would be approximately 3,300km and could supply between 5 to 10% of the EU's energy demand.[100] Another example would be the Trans-Adriatic Pipeline (TAP) which is a 520km long pipeline and will transport gas via Greece and Albania and across the Adriatic Sea to the Italian southern region of Puglia and further into Western Europe. It will interconnect Western Europe with Greece's existing pipeline system that is linked to the East with Turkey. This would furthermore, end the network isolation of one of the Member States, Greece. The TAP project is in its development phase supported by the EU as a "Priority Project" under the TEN-E Guidelines because it contributes

[97] European Commission, Ministers hail largest energy internal market in the world – Energy Community Treaty, Brussels, 08.06.2006, IP/06/757.

[98] BUSEK, E., *The Energy Community Treaty: Securing the Energy Supply in Southeast Europe and in the EU, supra*

[99] In its Discussion and Consultation Note of 2004, *supra* at 9, the Commission sees the possibilities for supply of gas from the East as key to energy security of supply for the region.

[100] For further details, see: http://www.nabucco-pipeline.com/ (last visited, 02.06.2008).

to the EU's objectives and policies aimed at diversification and security of gas supply.[101] These projects, in which SEE region plays great role, are designed to reduce the EU's dependence on Russian gas of the SEE region (which is more around 90%).

b) With regard to the objective for increasing *energy efficiency*, the aim of the European Commission is to reduce the consumption of energy by 20% by 2020. The Energy Community pays attention to achieving this goal as well, by enabling the Energy Community to take measures to foster effective demand management policies and to adopt measures to enhance development in the area of energy efficiency.[102] Due to the highly subsidized cost of energy, people and companies in the SEE had no incentive to save energy and the present levels of energy demand are significantly higher in this region than in the EU. Taking into consideration the perspective of the EU membership of the countries from SEE, if efficiency programmes are not implemented on time in the region, EU's objective for achieving its 20% by 2020 could be easily jeopardised.

c) In the EU, there are no mechanisms for *solidarity* among Member States to prevent energy supply crises and for the way in which they should be managed if they occur. On the other hand, in the EnCT there is an obligation of mutual assistance in the event of disruption in the energy supply.[103]

d) Last but not less important, the aim of the European Commission is that the Member States should speak with a common voice in their *external energy policy*. Even though the EnCT restricts the scope of this external policy to trading issues, it seems that by enlarging the European internal energy market to SEE countries, the Commission tries also to increase the potential bargaining power of the EU *vis-à-vis* its external energy partners. According to Mr. Busek, Europe could use this power in the negotiations with Gazprom to allow TPA to its pipelines in exchange for access to the European retail gas markets, due to the higher profits. In support of this argument, the recently announced intention of Gazprom to enter the EU's energy market through taking the control of Toscana Energia[104] makes the issue more relevant.[105] What is more, it would also not be easy for the EU to convince some Member States to abandon their benefits from the privileged relationships with Russia (ex. E.ON). Another place where the EU needs to strengthen its position and bargaining power is the Caspian Basin where Russia and China are very active. Shanghai Co-operation Organisation[106] has been used as a forum for China, India, Russia and Iran to sign energy deals with one another and have begun creating a central Asian "energy club" having its own energy market. This economic game goes against Europe's efforts to make use of the oil and natural gas reserves from the Caspian Basin.[107] This is another reason why the European Commission very much favours cross-border consolidation inside the European internal energy market covering the whole SEE region as well.

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[101] For further details see: http://www.trans-adriatic-pipeline.com/index.php?lang= (last visited, 02.06.2008).

[102] Articles 32 and 35 Energy Community Treaty, *supra*, respectively

[103] Articles 44-46 Energy Community Treaty *supra*

[104] Toscana Energia is the local distribution company in which ENI (the former state-owned monopoly in the gas sector) and the region of Toscany, are the main shareholders.

[105] Regione Toscana, Consiglio Regionale: Gazprom nell'azionariato di Toscana Energia? Danti e Remaschi sollevano dubbi ed interrogano la giunta regionale, 27.02.2008, available at: http://www.consiglio.regione.toscana.it/politica/comunicati-stampa-dei-gruppi-politici/comunicato/testo_comunicato.asp?id=3453&filtro=02 (last visited, 02.06.2008).

[106] The Shanghai Cooperation Organisation (SCO) is permanent intergovernmental international organisation, created on 15.06.2001 in Shanghai (China). One of its main goals is strengthening mutual confidence and good-neighbourly relations, promoting their effective cooperation in …energy… to move towards the establishment of a new rational political and economic international order. For further information, see: http://www.sectsco.org/home.asp?LanguageID=2 (last visited, 02.06.2008).

[107] In this context see: the Transport Corridor Europe – Caucasus – Asia or the "New Silk Road" (TRACECA) http://www.traceca-org.org/default.php?l=en (last visited 14.05.2008), the initiative for Baku-Tbilisi-Ceyhan pipeline, as well as Interstate Oil and Gas Transport to Europe http://www.inogate.org/en/ (last visited, 02.06.2008), funded through the EU's Technical Assistance to the Commonwealth of Independent States (TACIS) program.

European Neighbourhood Policy (ENP) also has a certain role in increasing the bargaining power of the EU through the Energy Community itself. The countries from SEE which are signatories of the EnCT are not part of the ENP, but are part of the enlargement Stabilisation and Association Process (SAP) of the EU, and all of them have a clear perspective for potential membership in the EU. However, the EnCT allows for the possibility to be further extended to the states which are now Observers of the Energy Community (Norway, Moldova, Turkey, Ukraine and Georgia), covered by the ENP at the same time. Article 96 of the EnCT states that "upon a reasoned request of a neighbouring third country, the Ministerial Council may, by unanimity, accept that country as an Observer." Moreover, in the same article it is stated that Moldova shall become an Observer within 6 months after the Treaty enters into force. At the first Ministerial Council on 17.11.2006 Moldova, Norway and Ukraine were granted an observer status. Turkey was granted an observer status as well, even though it is a signatory of the Athens Memoranda and therefore, it is a participant to the regional market. Norway and Ukraine have already applied to join the Energy Community and the Commission states that their inclusion "should be considered at the earliest possible moment."[108] Having in mind the broader perspective of the ENP, the Commissions consideration to carry out a "reflection concerning other possible membership applications" as well, becomes very relevant in this context.[109]

After explaining some of the motives behind the idea of the EC to launch and to support the creation of the Energy Community, next section will be devoted to the motives that led the countries from SEE to accept the obligations to reform their electricity systems and to create REM.

3.3.2 Rationale of the SEE: Benefits and Challenges

The motivation for reforms in the energy markets for the countries in SEE and the commitment to create REM could not be fully understood without brief explanation of the broader context and the challenges that these countries are facing and which have an impact on the achievement of this final goal. Unlike the reforms undertaken in Central and Eastern Europe, which were focused on establishment of transparent, democratic institutions to economic reform and recovery of the economic decline resulting from the dissolution of the Soviet Union, the countries from the SEE had to go through a process of recovery from the political conflicts and wars that took place in the 1990s in the region. Therefore, not the market reforms and democratic governance, but conflict prevention and reforms for establishing the stability and restructuring of the physical infrastructure took place in the last decade.[110]

When explaining the motivation of the SEE countries, it is very important to be held in mind that all countries signatories of the EnCT have a real perspective for membership in the EU. Besides Romania and Bulgaria, which are Member States since 01.01.2007, Croatia is engaged in accession negotiations and Macedonia obtained candidate status,[111] whereas the other countries are potential candidates. The European Council in Feira in June, 2000[112] for the first time expressed the view that all countries from the Western Balkans are potential candidates for EU membership, which was later

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[108] European Commission, Communication from the Commission to the European Council, External Energy relations – from Principles to Action, Brussels, 12.10.2006, COM(2006) 590 final at 5.

[109] European Commission, Communication from the Commission to the European Council, 2006, *supra*

[110] ERLER, G., *The Stability Pact: The Stability Pact, the Stabilisation and Association Process and the New EU Strategy: An Attempt to Set out the Political Context*, SÜDOSTEUROPA Mitteilungen 04/2004, p.10-29: "*The Stability Pact was seen as an engine to pull the entire crisis-torn region out of the vicious circle of chronic conflicts between neighbours and outbreaks of ethnically motivated violence after the ordeal of four wars, worldwide attention was focused on this first-ever plan to use the promotion of regional cooperation as a strategy for consolidating peace as well as for crisis prevention*".

[111] EU Presidency Conclusions – European Council, 15-16.12.2005, 15914/1/05 REV 1

[112] European Council, Presidency Conclusions, Santa Maria da Feira European Council, 19-20.06.2000, available at: http://www.consilium.europa.eu/ueDocs/cms_Data/docs/pressData/en/ec/00200-r1.en0.htm (last visited, 02.06.2008).

confirmed with the Thessaloniki Agenda in June, 2003.[113] The rapprochement of the Western Balkans towards the EU is developed under the SAP initiated in 1999, which is a policy framework of the EU accompanying the countries all the way to their final accession after fulfilling all the Copenhagen criteria from 1993.[114] The EU's regional approach towards the Western Balkans clearly expressed in the Declaration of the Zagreb Summit in November, 2000[115] is the main characteristic of the SAP. After the 2006 Communication[116] in which the Commission assessed the progress made after the Thessaloniki Summit, and the countries' Progress Reports published on annual basis, in March 2008 the Commission adopted new Communication[117] enhancing the existing initiatives and adopting new ones in order to accelerate the progress of these countries towards EU membership. One of the enhanced priorities in the last Communication was the regional cooperation, covering the Energy Community,[118] which has been said that is an "issue specific extension of the pre-accession status".[119] This was another expression of the strong commitment to the European perspective of these countries,[120] including the establishment of REM as well, which is the core of this paper.

The need for regional cooperation of the SEE countries in the energy field derives from the common problems that these countries are facing discussed in a study from the World Bank dating from the year 2000,[121] and that will be addressed throughout this paper. The energy prices were below economic levels and pricing/tariff structures were inappropriate. Moreover, energy trade was prevented by poor infrastructure, as well as by the political and social legacy of the conflicts in the SEE region. On the other hand, state-owned vertically integrated companies existed in the region and the institutional capacity in all the countries was limited whereas energy policies, legislation and standards were very much different from those in the EU. The policy and institutional framework necessary for encouraging private sector investment needed for restoring the infrastructure and for constructing new power plants in the region, was not in place. After three years, the same problems have been identified by the International Energy Agency[122] in a paper drawing on the experience from the Central European countries, which after 10-12 years of reforms started to gradually open their energy markets. Grid reconnections, rehabilitation of existing infrastructure and the creation of a market economy after the socialism are seen as major challenges by other authors as well.[123]

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[113] Thessaloniki Agenda: Moving towards European Integration. See:

http://ec.europa.eu/enlargement/enlargement_process/accession_process/how_does_a_country_join_the_eu/sap/thessaloniki_agenda_en.htm (last visited, 02.06.2008).

[114] European Council, Presidency Conclusions, European Council in Copenhagen, 21-22.06.1993

[115] See:http://ec.europa.eu/enlargement/enlargement_process/accession_process/how_does_a_country_join_the_eu/sap/zagreb_summit_en.htm (last visited, 02.06.2008).

[116] European Commission, Communication from the Commission - The Western Balkans on the road to the EU: consolidating stability and raising prosperity, Brussels, 27.01.2006, COM (2006) 27final.

[117] European Commission, Communication from the Commission to the European Parliament and the Council, Western Balkans: Enhancing the European Perspective, Brussels, 05.03.2008, COM (2008) 127final.

[118] European Commission, Press Release: Regional cooperation: an overview of main activities, Brussels, 05.03.2008, MEMO/08/143.

[119] DEITZ, L., et al. *The Energy Community of South East Europe: Challenges of, and Obstacles to Europeanisation,* CCP Working Paper 08-4 at 7.

[120] European Commission, Press Release: Western Balkans: Enhancing the European Perspective, Brussels, 05.03.2008, IP/08/378.

[121] World Bank, The Road To Stability And Prosperity In South Eastern Europe: A Regional Strategy Paper, March 1, 2000.

[122] BERGASSE, E., International Energy Agency: Public service review, *What energy policy for South East Europe?* Spring, 2003.

[123] RYDING, H., IPA Energy Consulting, Energy in East Europe, 07.01.2005, Southeast Europe, No.55, at 12.

Another common problem of the SEE countries is the lack of transparency. Due to the fact that only Bulgaria and Bosnia and Herzegovina from the Contracting Parties are net exporters of electricity, there has always been some cross-border trade. But it was generally trade between utilities, governments or companies connected to them. Moreover, in the past the legal frameworks in all these countries have been unclear and investment and supply contracts often awarded without openness and transparency, which is not unusual even today in some parts of the region. Even where governments had been willing to privatize, foreign investors were lacking the incentive to invest in those separate markets which were not promising stable and investment-friendly climate.

Regional cooperation was therefore seen, not only as an answer to these common problems and challenges but also as a "crucial ingredient of stability" and a "key test" for these countries to show that will be able to cope with the requirements in order to live in the European family after the accession.[124] In order to tackle these problems in its Strategy Paper, the World Bank identified some benefits of a regional cooperation.[125] Firstly, reliable, low-cost and environment-friendly sources of energy would be available and would allow for sustainable economic development of the region. With regard to the supply of electricity, the regional approach would be beneficial for better utilization of the existing capacities, but would also attract foreign investments. Cross-border trade would be facilitated, which would in turn influence lowering the transaction costs. A regional approach would help strengthening the institutional arrangements and would assist SEE countries in adopting the EU standards for infrastructure development and regulation, having in mind the expected integration in the internal electricity market.

However, the coins always have two sides. Likewise, the benefits deriving from the regional cooperation in the establishment of REM are not free from certain challenges and obstacles. It should be noted that by accepting the binding obligations stemming from the EnCT, the countries from SEE are facing challenges and disincentives as well. Due to the fact that these countries are developing countries, they have specific needs which are in many aspects different from the needs of the developed countries such as the Member States of the EU.[126] Nevertheless, exactly the model of liberalisation of the energy markets in the EU is the model that SEE countries are given to follow. That should be born in mind as an issue which makes liberalisation in SEE different from the liberalisation in other developing countries. Therefore, the energy market reforms in the region are said to be "bold experiment in Europeanisation"[127] or even an "experiment for the whole world", closely watched by the many donors such as the World Bank, the European Bank for Reconstruction and Development (EBRD) and the EU.[128]

With regard to the challenges that SEE countries are facing, one of the most important issues is the necessity to minimise the price distortions and to introduce cost-reflective tariffs if investments are to be attracted. Due to the fact that highly subsidised tariffs well below the economic level are in place in

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[124] For the role of the Stability Pact and its compementarity with the SAP, see: PRIEBE, R., *The European Perspective of the Western Balkans, its Regional Dimension and the Contribution of the stability Pact*, SÜDOSTEUROPA Mitteilungen 04/2004, p.40-47.

[125] World Bank (2000), *supra*

[126] For assessment of the application of energy models from developed to the developing countries, taking into consideration the specific characteristics of the later, see: URBAN, F. et al., *Modelling energy systems for developing countries*, Energy Policy 35, 2007, 3473–3482. For the specificities of the developing countries see further: JAMSB, T., *Reform and Regulation of the Electricity Sectors in Developing Countries*, Working paper CMI EP 08/DAE 0226, 2002.

[127] WRIGHT, K. *The Energy Community of South East Europe: Challenges of, and Obstacles to Europeanisation*, CCP Working Paper 08-4 at 18.

[128] POLLITT, M. *Evaluating the Evidence on Electricity Reform: Lessons for the South East Europe (SEE) Market* CCP Working Paper 08-5, at 3.

almost all SEE countries, the reforms will bring raising the prices.[129] This might lead to the expectation that the consumers in a country with low production costs may loose from integration even if total welfare in that country increases; for example they may experience higher prices if it is cheaper for producers to transport to consumers at more distant locations in the market.[130] Furthermore, the privatisation which is supported by the World Bank and other donors is usually undertaken as part of the reforms in many developing countries. However, even though it is expected that privatisation will have positive impact on the economic growth and will lead to better production processes, some developing countries which have implemented this policy as a condition for getting grant or a debt relief from the financial institutions, experienced negative effects on the prices, employment rates and on the welfare of the great deal of their population.[131]

Measuring the benefits and challenges, it has been held that all the difficult but necessary reforms would not be possible without the clear membership perspective of all the countries from the SEE region.[132] The perspective of accession to the EU explained above, and not the European financial funds only, has been the key driving force for undertaking these difficult reforms. The Stability Pact Coordinator argues that even though the donor support is necessary, it has proven not to be sufficient in moving the reform process along.[133]

Finally, the economic impact of the creation of the Energy Community would be to create a larger and predictable market which should be attractive for investors, but its political significance should not be underestimated, neither.[134] Establishment of the Energy Community represents a very important political step in a key-economic sector before accession of the SEE countries to the EU. It is moreover, a part of the emerging regional economic strategy, giving it a "true credibility."[135] That is why the Energy Community was compared to the European Coal and Steel Community which paved the way for the European Community more then fifty years ago.[136]

After explaining the motivation for participating in the Energy Community of the EC on the one hand and the countries from SEE on the other, it could be concluded that there are strong driving forces on both sides, which led to development of the idea and now keep forcing the implementation of the EnCT in practice. In turn, the following sections of this paper will proceed with the establishment of the South East European Regional Electricity Market (SEE REM) itself, giving first some background information of the electricity sector in the region, and then turning to the reforms taking place at national level and addressing some cross-border issues as well.

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[129] For an analysis of the impact on prices of certain liberalisation measures (unbundling, independent regulator, wholesale spot market) in 83 developing countries from Latin America, Asia, former Soviet Union and Eastern Europe, see: NAGAYAMA, H. *Effects of Regulatory reforms in the Electricity Supply Industry on Electricity Prices in Developing Countries*, Energy Policy, 35, 2007, pp.3440-3462.

[130] DEITZ, et al., (2008), *supra*

[131] BAYLISS, K. *Privatisation and Poverty: the Distributional Impact of Utility Privatisation*, Annals of Public and Cooperative Economics, 73:4, 2002, pp.603-625

[132] BUSEK, E., *The Stability Pact: Adapting to a Changing Environment in South Eastern Europe – Successes and Remaining Challenges*, SÜDOSTEUROPA Mitteilungen 04/2004, at 23, and HOMBACH, B., *The Stability Pact – Lessons for the Future*, SÜDOSTEUROPA Mitteilungen 04/2004, at 27.

[133] BUSEK, E., *ibid*

[134] Stability Pact for South Eastern Europe, Fact Sheet: EU / South Eastern Europe Energy Community.

[135] BUSEK, E., *The Energy Community Treaty: Securing the Energy Supply in Southeast Europe and in the EU, supra*

[136] BUSEK, E., *The Stability Pact: Adapting to a Changing Environment in South Eastern Europe – Successes and Remaining Challenges, supra*

4 Establishment of the South East Europe Regional Electricity Market (SEE REM)

4.1 Definition of a Regional Market

The idea for establishing a regional electricity market in SEE is not unique. That became a "natural" way of establishing the internal electricity market.[137] In the EU there are already seven regional energy markets defined, and the idea for their establishment was discussed by the European Regulators even before the official launch of the Regional Initiative (ERI and GRI mentioned above) in spring 2006. According to the Council of European Energy Regulators (CEER), there are some preconditions which might be a signal that REM may exist. If there is sufficient transmission capacity between the markets within the region, and if that capacity is made available to market participants could be the technical signal. If furthermore, there are no distortions within the local markets which significantly could affect the functioning of the regional market could be another point of relevance. And if also an appropriate legal and regulatory framework is in place and if the national institutions from the countries (TSOs and NRAs in particular) co-ordinate and co-operate closely with each other within that appropriate framework, could strengthen the possibility for existence of a regional market.[138]

It should be stressed that defining the geographic scope of the regional electricity market is very important issue. For competition law purposes, one regional wholesale electricity market could be considered as one geographical market, where competition law could be applied and the behaviour of the companies participating in that market should be assessed with regard to their impact on the regional trade. On the other hand, defining the borders of a regional market is not an easy task. It depends on the national and cross-border transmission capacity, congestions in the interconnections and experienced peak demand.[139] Furthermore, there might be overlap between the markets and one national electricity market may tend to fall in different regional structures.

The Congestion Management Guidelines define the seven REMs in Europe without mentioning the SEE region. The definition and the geographical scope of this potential 8th region in Europe are still not clear and it shows the possibility for some of the countries to belong to more then one regional market. For example, Romania have expressed willingness to join the Central-East (CEE) REM[140] instead of remaining in SEE and Bulgaria have stated its own limited terms and conditions for participation.[141] Furthermore, Croatia have stated that it would give two borders to the CEE (with Slovenia and Hungary) and two to the SEE (with Bosnia and Herzegovina and Serbia), whereas Serbia retains full control over all interconnections, negating the existence of UNMIK interconnections.[142]

The ECRB recognizes the importance of defining the borders of this region and consequently the perimeter countries to it. Therefore, it has asked the ERGEG Electricity Working Group to make a recommendation to ERGEG with regards to establishing an 8th region in Europe, and the Commission to start the common Commitology procedure between the EU and the contracting parties of the Energy Community Treaty with that regard.[143] However, until the present moment, this has not been done

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[137] ERGEG, Regional Initiative Annual Report 2008, *supra*

[138] ERGEG, A Creation of Regional Electricity Markets, 08.06.2005, at pp.5-6

[139] DEITZ, L., et al., (2008), *supra*

[140] The CEE REM covers: Austria, Czech Republic, Germany, Hungary, Poland, Slovakia and Slovenia.

[141] Information from a presentation by Goran Majstrovic, Energy Institute Hrvoje Pozar Croatia, Network Issues in Electricity Markets-South East Europe Study Case, presented at the Advanced Training Course in Electricity Markets, Florence School of Regulation, 31.03-04.04.2008.

[142] *Ibid*

[143] Energy Community Secretariat, Report on the Implementation of Regulation 1228/2003/EC on Conditions for Access to the Network for Cross-Border Exchanges in Electricity in the Contracting Parties to the Treaty Establishing The Energy Community, Ref: 4thECRB/R1228/rev-final/12-10-2007(ECS), ECRB Ref: R07-

even though activities have been taken having in mind the abovementioned difficulties. Definition of the geographical scope is a very important issue because it is the first step towards the creation of the market itself.

4.2 Objectives of the SEE REM

As explained earlier in this paper, the EU's energy policy has three main objectives: competitiveness, security of supply and sustainability. In that line, in a recent article by Hooper and Medvedev it was stated that the motivations for regional trade in SEE have to be such as to meet these three energy policy objectives, which could be done in the following manner:[144]

With regard to the *competitiveness*, it is relevant that due to the fact that in small electricity markets competition could not be easily introduced or could not be introduced at all, unbundling of the vertically integrated companies may bring market concentration in the generation market (this will be addressed down in this paper when the generation market in SEE will be discussed). However, the market power of those generators is lower on regional level which is one incentive for establishing regional cooperation. In addition, more liquid wholesale markets with cost-reflective prices would exist, given that there are more competitors active in the region. There are many other questions linked to the establishment of a competitive regional electricity market, but due to the fact that they will be discussed in more details in the paragraphs below, here the other two objectives, security of supply and sustainability will be briefly addressed.

The regional integration lowers the dependence on external factors and brings diversification of sources, which is in line with the second objective, *security of supply*. According to a study done by World Bank, one of the benefits that countries can get from the promotion of the regional trade could be when regional market is established between systems which are based mostly on thermal power and others based on hydro power because by their interconnection it will be possible that thermal power is used in off-peak periods and water to be stored and used to cover peak periods.[145] Furthermore, if one country relies on hydro power mostly (for example Albania), it is dependent on the weather conditions and rainfalls, and that dependence is certainly lower in interconnected systems. Moreover, in a situation where one main generator fails in a small electricity system, if the system of that country is regionally interconnected, that failure will not have great impact on the stability of the whole system. It should be noted as well that different countries experience peak and off-peak periods in different times of the year which is an additional benefit (in SEE for example, only Greece experiences its peak in summer). Moreover, the prices of fuels vary among the countries. For that reason, exporting fuels from countries where the costs for fuels are lower to the countries which have more expensive fuels could be another benefit.

With regard to *sustainability*, it is relevant to be mentioned that power supply reliability is higher in interconnected systems. Lastly, better optimal fuel mix could be more easily achieved on regional level, where countries may export fuels such as coal and import hydro power, thereby contributing to lowering the CO2 emissions as well.

In 2001, the Commission put special attention to the regional dimension of the European transport and energy strategy in SEE, in the context of the European integration of countries from the region.[146]

(Contd.)
GA-04-05_final, October, 2007 at 7 (hereinafter, Energy Community Secretariat, Report on Implementation of Regulation 1228/2003).

[144] HOOPER, E. and MEDVEDEV, A. *Electrifying Integration: Electricity Production and the South East Europe Regional Energy Market* CCP Working Paper 08-6, January 2008.

[145] KENNEDY, D. and BESANT-JONES, J. *World Bank Framework for Development of Regional Energy Trade in South East Europe* World Bank, Energy and Mining Sector Board Discussion Paper, Paper No. 12, 2004 (hereinafter, World Bank 2004).

[146] European Commission, Transport and Energy Infrastructure in South East Europe, Brussels, 15.10.2001

The common problems, as earlier identified in the World Bank's study, such as limited primary sources and dependence on import, low level of energy efficiency and lack of reforms were outlined in the Commission's Strategy, but it was also underlined that the differences that exist between the countries in the region shall be taken into account.

Moreover, the differences between the developed and developing countries, briefly addressed above, are very relevant when regional integration of electricity systems is discussed.[147] Lowering the prices and improving the efficiency of the electricity system are the benefits which could be expected from the liberalization in the developed countries, but same could not be done for the developing countries. In the later, even though the prices will increase substantially in order to be raised to economic level, the benefit that deserves appreciation may be the fact that transparent and effective process of regulation, which is independent from the electricity industry and the government's influence, is going to be introduced for the first time. Furthermore, privatization which, even though is not required during the reforms, allows solving many problems which are characteristic for the developing countries only (such as overstaffed, non-payment and theft of electricity), which could not be solved by any government of a developing country without dissatisfaction and opposition from the population. Therefore, privatization, establishment of a wholesale market and independent regulation are considered to be key elements of reforms in a developing country. Moreover, addressing the problems such as necessity for investment, decreasing the level of power shortages, system losses and non-payment are important indicators to be taken into account when reforms are undertaken in developing countries, as opposed to lowering prices, rate of switching and costs of regulation which are indicators for reforms in the developed countries.[148]

4.3 Generation: Installed Capacity, Import and Export in SEE

Bulgaria and Bosnia and Herzegovina, as well as Slovenia even though not as a signatory of the EnCT, are three countries exporting electricity in SEE. In 2004, volume traded between the SEE countries was 9%.[149] Bulgaria has been supplying from 50 to 90% of the electricity shortfall in the region, with its total exports amounting to 7600GWh in 2005.[150] However, the whole region as such, is net importer. There was increase in import volumes in the period between 1995 and 2002 (from 1837GWh to 5549GWh), and then it decreased in 2003 (2657GWh).[151] Romania, Bulgaria and Serbia experienced decline in the production of electricity, whereas Macedonia, Albania and Slovenia remained with almost unchanged production. The electricity production in the region according to a recent article by Hooper and Medvedev about the electricity production, (excluding Greece and Turkey, and including Slovenia) was 190TWh in 2004.[152] In the same article there is an analysis of the fuel type used for production of electricity where it was found that in SEE there is 40% coal, 23% hydro, 23% gas, 7% oil and 7% nuclear.[153] With regard to the specific countries, gas is used in Turkey, Croatia, Romania and Greece, whereas nuclear power stations exist in Bulgaria, Romania and Slovenia. Most of the countries rely on coal (Macedonia produces 78% of its total electricity production from coal, and then is Serbia with 66% and Greece with 61%). Albania with 98% of its

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[147] POLLITT, M., (2008), *supra*

[148] POLLITT, M., *ibid*

[149] World Bank (2004), *supra*

[150] SEETEC Balkans: *"Study of the Obstacles to Trade and Compatibility of Market Rules"*, Southeastern Europe Electrical System Technical Support Project, Regional Activity REM-1202: Final Draft Report 014551-REM-1202-47RA-I-0001-01, June 2006, presented at the 9th Athens Forum, 23-25 October 2006, Athens at 20.

[151] HOOPER, E. and MEDVEDEV, A. (2008), *supra* at 11

[152] Data available in: HOOPER, E. and MEDVEDEV, A. (2008), *supra* at 6.

[153] HOOPER, E. and MEDVEDEV, A. (2008), *supra* at 18

electricity production relies on hydro power, which is the biggest percentage in the region, after which Croatia follows with 53% and Bosnia and Herzegovina with 47%.[154]

In line with the discussion on the benefits from regional integration, this data shows that there is a possibility for substitution between thermal and hydro power in peak and off-peak periods in SEE. In addition, advantage could be taken from the differences in the fuels' price, and electricity should be produced in countries with lower fuel price that could be consumed in another country of the region. In this line is the observation that due to the fact that coal is mostly domestically supplied, price of the coal and nuclear power might be controlled at national level and could be considered predictable that is, there would not be a higher risk of sudden price fluctuations.[155] On the other hand, oil and gas, which together amount to 30% of the total fuels used in the SEE region, are extremely dependent on the prices world wide and there are risks from variations of the final price of electricity produced from them. Hydro power with its 23% depends on weather conditions, and therefore countries such as Albania and Bosnia and Herzegovina are those exposed to this kind of risks mostly. With regard to the periods of peak demand, the whole region except Greece is experiencing winter peak and that should be taken into account when planning the trading relations. In addition to all this, operating costs might be reduced 11-15% if regionally integrated power system operates in SEE.[156]

When talking about the generation markets in the SEE, it is important to come back to the issue of potential market power of the participants in this market briefly mentioned above. Due to the small size of most of the countries in the region national generation markets are very much concentrated after the unbundling of the utilities which is taking place during the reform process. For example, there is only one in Kosovo and three power generators in Montenegro. In Albania and Macedonia the biggest four generators have around 98%, after what Serbia follows with its four biggest generators amounting to 78% of the total installed capacity. Due to the small size of these markets, competition could not be introduced at national level and therefore, integrating the markets and allowing participation of these companies in a regional electricity market would have an effect on lowering their power and lowering the potential abuse of that market power. However, establishing a regional generation market as observed in the article of Hooper and Medvedev, might be supported by the smaller but opposed by the dominant players in the bigger countries such as Romania, Bulgaria and Greece, where competition could be introduced at national level as well.

Another point is the significant participation of the multinational companies (for example, ENEL, ENI, CEZ) in the SEE region as part of the investment strategy of these companies. In this regard, particular care should be taken when the REM is established, because having the same foreign company owing generators (now in different national markets, but afterwards in the REM) could lead to further concentration and significant market power.

4.4 Need for Investment in Generation Capacity

When considering the regional energy strategy for SEE region in 2001, the European Commission started with a premise that there is no need for new power generation because the installed capacity is enough to meet the regional demand and that the shortages and the import of electricity which this region faces is not due to lack of capacity, but due to the fact that the capacity is not used effectively because of physical, technical, administrative and political reasons.[157] Therefore, rehabilitation of the existing generators was the initial priority of the Commission. It was furthermore decided that the identified projects in the generation should be financed on commercial basis and from private

[154] HOOPER, E. and MEDVEDEV, A. (2008)

[155] HOOPER, E. and MEDVEDEV, A. (2008), *supra* at 19

[156] World Bank (2004), *supra*

[157] European Commission, Transport and Energy Infrastructure in South East Europe, Brussels, (2001) at 18

investors, and only the transmission lines and cross-border interconnection projects which usually do not attract investments, could be financed from state-owned or donors funds. Promotion of energy efficiency and rehabilitation of lignite mines, HPPs and increase of the electricity production taking into account the environmental standards, was another priority. Development of cogeneration of heat and power (CHP) plants in SEE was also part of the energy strategy developed by the European Commission. The countries from SEE were supposed to identify the infrastructure needs and to prepare a plan with priorities that starts from a regional perspective but has regard to state needs.[158]

Shortly after, the World Bank in its framework document for development of the regional energy trade in SEE considered that the installed capacity in SEE is low and in the simulations predicting demand growth it will not be enough to cover the needs of the region.[159] Later on, a Generation Investment Study (GIS) was financed by the EC and project-managed by the World Bank in which it was concluded that 11.6GW installed capacity needs to be rehabilitated and 13.5GW new capacity needs to be installed, which would require EUR16 billion of investment.[160] Those investments would be necessary for the energy demand of the region to be met in the period between 2005 and 2020, and the potential deficit of energy not to occur as a problem for the regional market development. Furthermore, competition which is supposed to be introduces in the energy markets in the region could be limited by the power outages, because power generators in situations when there is deficit of power do not have incentives for good performance, but instead could have more opportunity depending on their market power, to withhold capacity and raise prices.[161]

In order to attract investment, in addition to the capacity obligations which may need to be placed on transmission operators or also on load entities, long term contracts and Power Purchase Agreements (PPAs) which will guarantee purchasing of the power produced by the new generation plants, will be required. However, their compatibility with the EC competition law should be scrutinized by the national regulators and the competition authorities. In particular, their design i.e. scope and duration, should be analyzed on case by case basis. Pollitt shares the opinion expressed in the GIS that PPAs will be needed for attracting investment in the generation, but it suggests that security of property rights, incentive based regulation and competitive wholesale markets could be helpful as well and would not have negative effect on the competition in the market.[162]

Due to the phased approach of liberalisation in the region, the Commission advised that regionalisation of the investment should be done only in the second phase after the priority short-term reforms are in place.[163] In that case, the PHLG would have to ensure that criteria for determining the investment priorities are applied transparently and correctly.

4.5 Transmission Connections and Need for Investment

From technical point of view, establishing REM requires physical interconnection of the transmission systems of the countries in question. Functional transition lines at national level and sufficient interconnections are very important precondition for development of cross-border trade and for allowing flow of electricity among the countries preventing bottlenecks of the system. During the

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[158] European Commission: Strategy Paper on the Regional Electricity Market in South East Europe and its Integration into the European Union Internal Electricity Market, Brussels, 11.11.2002 D(2002), at 7.

[159] World Bank (2004), *supra*

[160] European Union CARDS programme for the Balkan Region, Contract No. 52276: Regional Balkans Infrastructure Study – Electricity (REBIS): Generation Investment Study (GIS), Final report, 31.12.2004.

[161] KENNEDY, D. *World Bank Framework for Development of Regional Energy Trade in South East Europe* World Bank, Energy and Mining Sector Board Discussion Paper, Paper No. 15, 2006 (hereinafter, World Bank, 2006).

[162] POLLITT, M. (2008), *supra*

[163] European Commission, DG TREN: Discussion and Consultation Note, *supra*.

existence of the Socialist Federal Republic of Yugoslavia (SFRY) the electricity systems of its republics were part of Yugoslavia's electric utility association, which in turn was part of the Union for Co-operation of Transmission of Electricity (UCTE).[164] Therefore, at that time the national electricity systems were not designed to be self sufficient, but rather part of a regional and through it, of the international system. After the break-up of SFRY with the damages of the system of Bosnia and Herzegovina in a war in the 1990s, the UCTE system was broken in two zones. Nevertheless, the re-connection of the system with the first synchronous zone was successfully performed in 2004 and now the UCTE norms and standards are again fully applicable in the region. It is only Albania's electricity system which has been underdeveloped for decades and whose transmission system was never connected to UCTE. Bulgaria and Romania on the other hand, are in a more advanced phase with their approximation to the EU because of their earlier implementation of the EU Directives as part of their accession negotiations.

Nevertheless, the borders of the electricity market in the region are congested and bottlenecks exist. For example, the capacity for exchange of Macedonia at the moment is close to the peak load of the internal system, and therefore investment in new inter-connections is necessary to increase the diversity and security of Macedonia's electricity exchange and for overcoming the congestions in the electricity market in the region.[165] This is of great importance for a small country as Macedonia, which is in the middle of the SEE region and which is dependant on import of electricity (characteristics shared by most of the SEE countries). The existing high voltage network of Macedonia is connected on 400kV level with the systems of Greece and Serbia, but the existing capacities are small and not enough to prevent congestions and better flow of electricity. With regard to the East–West interconnections, since 30.10.2005 there are two 110kV connections operating between Macedonia and Bulgaria and another 400kV transmission line is under construction. Macedonian transmission system for the moment is not connected only with one neighbouring country, Albania. There are projects for strengthening the interconnections by upgrading the existing line North–South and establishing new one East–West.[166] By finishing all the planned projects the system of Macedonia not only will be connected with the systems of all the neighbouring countries, but will also enlarge the possibilities for exchange of electricity in the region.

This is just one example of the necessity for investment in transmission lines and interconnections, which total amount for the SEE region is estimated on EUR340 millions in GIS.[167] The criteria for transmission investment in SEE are covered by the TEN-E Guidelines,[168] GIS (cost-reflectivity and consideration of the region as an interconnected power system), South Eastern Cooperative Initiative - SECI (technical and economic criteria for transmission network investment). The priority plans made by the countries from the region should ensure the complementarity of state and regional projects, but the projects shall clearly have regional focus.[169] Due to the importance of the congestion management, allocation of available capacities and other cross-border issues related to the interconnections, they will be addressed in the sections following the national reforms in the different countries.

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[164] The "Union for the Co-ordination of Transmission of Electricity" (UCTE) is an association of transmission system operators in continental Europe. For further details, see: http://www.ucte.org/ (last visited, 02.06.2008).

[165] Energy Community Secretariat, Statement on security of supply – Republic of Macedonia, Skopje, 2007 at 22, available at the website of the Energy Community Secretariat: http://www.energy-community.org/ (last visited, 02.06.2008).

[166] For the main transmission projects, see: Energy Community Secretariat, Statement on security of supply – Republic of Macedonia, Skopje, 2007, *supra* at 31.

[167] Generation Investment Study (GIS), Final report, 31.12.2004, *supra*. at 21.

[168] TEN-E Guidelines, *supra*

[169] European Commission: Strategy Paper on the Regional Electricity Market in South East Europe and its Integration into the European Union Internal Electricity Market, *supra* at 7.

5 Phase 1: National Reforms as Prerequisites for SEE REM

In order for a regional electricity market to be established it is necessary to make certain reforms at national level first, but not forgetting the regional objective at the same time. In 2003 Position Paper, CEER proposed a Standard Market Design (SMD) for the SEE REM,[170] and in 2004 the European Commission endorsing this design in Consultation Note developed a phased approach of the national reforms that should take place in the separate countries of the region.[171] Later the same year, CEER drawing on these two documents adopted a Discussion Paper.[172] It expressed its opinion that the two earlier documents are complementary and in order to mitigate the risk of focusing all efforts on national reforms and jeopardising the development of the REM it proposed concrete steps which incorporate both the phased approach suggested by the Commission and the benefits of the harmonised approach suggested earlier by CEER. According to CEER, the SMD is "based on a harmonized set of rules, with regional market mechanisms that would operate as supplementary mechanisms of the national electricity markets with suppliers and power generators who could operate on an equal basis in a wider regional energy market instead of a narrow national market and where electricity will flow among the countries of the region as if it was flowing within a single country."[173]

The approach in phases suggested by the Commission, required some prerequisites which were necessary to take place as national reforms in order to allow establishment of a more harmonised set of rules and compatible electricity systems on the way towards the SEE REM. These reforms follow the liberalisation process in the EU, because also in the Member States the national reforms stemming from the Electricity Directive presented in the first part of this paper preceded the establishment of regional electricity markets. These national reforms were expected to take place in short term, so that in a long run cross-border issues could be implemented in SEE. The Commission expressed its view that the preferred option is full, state control over the energy policy but all that with a regional dimension.

Addressing the payment problems and implementing a payment reform was one of the first priorities. This is important because it is characteristic for SEE that the biggest part of the electricity is consumed by households and not by the industry (for example, in Albania more then 70% and in Macedonia more then 50% from the total consumption of electricity is done by households). This makes the liberalisation very political issue, and there is opposition by the general public not only by the industry, which puts pressure on the politicians to refrain from reforms. The Commission held that even direct subsidies to the suppliers are preferred in the transitional phase to lower the negative impact of raising prices, instead of continuing with the hidden subsidies usually available in SEE. This would later be replaced with targeted subsidy to clearly identified groups of customers, all the time taking consideration the PSO requirements. Consolidation of the distribution companies and their "marketization"[174] was expected in short term as well. However, no requirements for privatisation were addressed even though it was considered to be a "good route to follow," which sent a clear massage to the countries in the region and had effect in some of them.[175] Furthermore, investments as identified in the GIS were expected to be realised and incentives for reasonable level of reserve generation capacity were needed. PPAs were considered necessary at this stage in order to serve the eligible customers for a period of five to twenty years getting capacity payment collected from the

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[170] CEER Position Paper: Standard Market Design of the SE Europe Electricity Market Basic Principles, 2003

[171] European Commission, DG TREN: Discussion and Consultation Note, 2004, *supra.*

[172] CEER Working Group South East European Electricity Regulation: Discussion Paper on the Options for the Transition Phase of ECSEE Regional Electricity Market, Final Version, 16.11.2004

[173] CEER Discussion Paper (2004), *ibid*

[174] Functioning according to the private sector principles and incentives was considered as marketization in: European Commission, DG TREN: Discussion and Consultation Note, 2004, *supra* at 12.

[175] Privatisation was undertaken as part of the reform process in Bulgaria, Romania, Macedonia.

levies on transmission tariffs, which would cover their capital costs no matter weather they would be dispatched or not in the competitive market.

Besides these primary reforms, the Commission addressed other actions necessary to be performed at national level, serving again the idea for establishment of a SEE REM. It was held that the regulatory and legal framework should be put in place, unbundling of the transmission and distribution should be completed and non-discriminatory regulated TPA to the national networks should be allowed.[176] Furthermore, definition of eligible customers was necessary as well. With regard to the tariffs, as the market opens regulation should exist only of the monopoly parts of the tariffs and not of the fuel price and retail tariffs. Implementation of the PSO and protection of vulnerable consumers, as well as designating a supplier of last resort were other questions that needed to be dealt with at national level. These phases, through which the national reforms in the electricity markets should go, were later confirmed by the Ministerial Council in its Electricity Transition Strategy in 2005.[177] The state of their implementation at national level in the countries of SEE will be addressed one after another in the following paragraphs.

5.1 Legislative Reforms

As presented above in this paper, there is an obligation stemming from the EnCT, that its signatories from SEE have to adopt the *acquis* in the areas of energy, environment, competition and renewables. The process of adoption of the *acquis* in the countries of SEE is in different stages and there are significant differences between them. The pace of reforms is influenced among the rest, by the position of the countries from the region in relation to the enlargement negotiations, because as explained above in this paper all SEE countries have a perspective of membership in the EU. With regard to the legislative reforms, most of the countries from the region are doing well, since they have adopted the primary legislation in the electricity and competition law sphere, and now they have a well developed set of basic rules in place. The environment and renewables will not be referred to, since they are out of the scope of the analysis in this paper. On the other hand, with regard to the secondary legislation the situation is not so positive. Some of the countries are lacking behind with their obligations and their secondary legislation shall be improved, especially regarding cross-border issues. In a recent article, Pollitt held that electricity reforms depend on the general institutional reforms as well as on the reforms in the competition law sphere, even though the relations between these two sets of reforms are not explored enough so far. Therein, this author concluded his analysis that the electricity reforms in SEE were going better and faster then the general institutional and competition policy reforms.[178]

Nevertheless, mere adoption of the *acquis* in the national legislative systems is only the minimum requirement from the EnCT, but its implementation in practice is more difficult and challenging task which shows even further differences between the countries from the region. Drawing on the key requirements from the Electricity Directive addressed in section 2.2.1, an overview of the liberalisation reforms implemented at national level in SEE, will be presented in the paragraphs below.

5.2 Institutional Reforms

With regard to the institutional reforms, it could be noted that the public administration together with the institutions established at national level dealing with energy issues, have very important role in maintaining the proper functioning of the sector. They are in charge with the obligations to ensure proper implementation of the new laws and reforms in conformity with the EC Law. In most of the

[176] European Commission, DG TREN: Discussion and Consultation Note, 2004, *supra.*

[177] Ministerial Council: Electricity Transition Strategy, 9.12.2005.

[178] POLLITT, M. (2008), *supra*

countries the administrative institution in charged with creating and conducting the national energy policy is the ministry dealing with energy exclusively, or the ministry dealing with economy issues in general.

Moreover, in accordance with the Athens Memoranda, the SEE countries committed themselves to create NRAs. At an early stage, when the countries of the SEE region begun to establish national regulators, the experience from Central and Eastern Europe as well as from some OECD countries was analysed in a study by the Stability Pact,[179] with regard to the independence of the competition authorities and the sectoral regulators in these countries. The importance of this experience and the proper sequencing of reforms were underlined as a lecture for SEE countries. In that study from the Stability Pact, it was underlined that the independence of the NRAs shall be institutionalised firmly from the beginning with their establishment and shall be balanced with the accountability and requirements for performance assessment.[180] By now, all contracting parties in SEE have established NRA and in most of the countries there is one regulator for the whole energy sector: electricity, gas, district heating, oil and geothermal energy.[181]

5.2.1 Independence and Competences of the NRAs

Even though a detailed analysis of the NRAs' independence in the separate countries from SEE is out of the scope of this paper, the attention will be drawn to some important issues with this regard. It is generally accepted that the NRA should enjoy appropriate independence from the politically appointed governments on the one hand, and from the interests of the electricity industry on the other. Independence from the governments is necessary to avoid decisions of the regulator being subject to undue influence, regarding local or short term political objectives. However, some forms of governance control are appropriate, given the extensive competences of the regulatory authorities and ensuring their activities are consistent with the energy policy. In most of the SEE countries (Croatia, Albania, Macedonia) the heads of the NRAs are appointed by the Parliament on a proposal from the Government, whereas in some of the other SEE countries (Romania and Montenegro for example) the heads of the regulatory authorities are appointed by the Prime Minister only.

Moreover, it is very important that the regulatory authority can effectively operate independently in practice, which is influenced by the regulator's own organization and the use of the resources in terms of budget and professional know-how that the authority has at its disposal.[182] For most NRAs in SEE there are provisions in the legislation considering them independent in their operation and decision making process.[183] They are furthermore, mostly financed not by the state budget, but from own sources provided through collection of the license fees and through collection of a fee from the total income of the license holders for pursuing energy activities.[184] In addition, the independence is somewhere ensured by the fact that they perform this function professionally and cannot cumulate this office with other professional activities. The final point about the independence of the NRAs'

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[179] Stability Pact, Prepared by the OECD Public Governance and Territorial Development Directorate in cooperation with the Investment Compact Team: South East Europe Compact for Reform, Investment, Integrity and Growth: Regulatory Authorities in South East Europe, October, 2003.

[180] Stability Pact, (2003), *supra* at 19

[181] Example, the Energy Regulatory Commission in the Republic of Macedonia (ERC-RM)

[182] EURELECTRIC, Report on Regulatory Models in a Liberalized European Electricity Market, January 2004, Ref: 2004-030-0052. The document is available at: http://public.eurelectric.org/Content/Default.asp?PageID=35 (last visited, 02.06.2008).

[183] Article 18 Energy Law, "Official Gazette of RM" No. 63/2006, 23 May 2006.

[184] For the ERC-RM, see: Article 34 Energy Law and for a comparative analysis see: Stability Pact, Prepared by the OECD Public Governance and Territorial Development Directorate in cooperation with the Investment Compact Team: South East Europe Compact for Reform, Investment, Integrity and Growth: Regulatory Authorities in South East Europe, October, 2003, Annex 2, at 49.

members is related to their term of office. The regulators in SEE are usually appointed for 4-6 years with a possibility for renewal of their contract.[185]

Establishing a review and appeal mechanism for the NRAs' decisions is a challenging issue because balance is necessary between ensuring that the regulators act within their legislative powers, with allowing them to exercise appropriate discretion in applying their expertise.[186] As an example of the possibility for an appeal of the decisions is the Appellate Commission in Macedonia, which members are appointed and dismissed by the Parliament upon proposal by the Commission for election and appointment issues within the Parliament.[187] Accountablity of the NRAs is important as well, and the system of ensuring their proper exercise of powers may be done through legislative and executive oversight, public consultation and publication of their decisions. For instance, the Macedonian regulator shall submit a detailed annual report on the operations, containing information on its work and on the material and financial matters to the Parliament and the Government.[188] Furthermore, its sessions are held in public, except in cases when confidential information and business secrets are involved.

With regard to the competences of the NRAs, all of the SEE countries have granted them the possibility to adopt at least the methodologies for calculating the tariffs, and some of them have been granted the competence the set the tariffs for the final regulated consumers. In some countries methodologies for setting tariffs are approved, some have only the draft versions and some are to be drafted yet.[189] In the Report on the implementation of the EnCT[190] it was found that there are insufficient competences of the regulators in SEE with respect to the possibilities to file complaints to the regulator, the management and allocation of interconnection capacity and fixing the tariffs of access to the networks.

5.2.2 International Cooperation and Regional Institutional Activities

One of the institutions of the Energy Community is the ECRB which is composed of one representative of the NRAs of each Contracting Party to the EnCT, as well as a representative of the European Commission and the ERGEG.[191] The main powers of the ECRB are to advise the other institutions of the Energy Community (Ministerial Council or PHLG) on the details of statutory, technical and regulatory rules. In addition, it could issue recommendations on cross-border disputes.[192]

Moreover, NRAs from SEE are members of the Energy Regulators Regional Association (ERRA)[193] which is a voluntary association of the independent regulators from Central and Eastern Europe. The main objective of this body, in which working groups and activities the NRAs actively participate, is the share of information, experience and best practices from the energy sphere in the broader region.

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[185] Stability Pact, (2003) at 21, *supra*

[186] Stability Pact, (2003) at 23, *supra*

[187] Article 33 Energy Law, *supra*

[188] Article 35(1) Energy Law, *supra*

[189] World Bank (2006), *supra*

[190] CARDS Project 2005, Facilitating and Implementing the Energy Community in South East Europe: *Report on the Implementation of the Treaty Establishing the Energy Community*, May 2007.

[191] Article 59 Energy Community Treaty, *supra.*

[192] Article 58 Energy Community Treaty, *supra.*

[193] For further details on ERRA, see: http://www.erranet.org/ (last visited, 02.06.2008).

Finally, cooperation with CEER[194] is very important, because it has taken a central role in developing an effective and competitive electricity market in the Energy Community by issuing studies, opinions and reports on specific energy issues.

Despite the activities of the regulators from the region, with regard to the technical issues, there is a plan for other institutional reforms to be undertaken as well. Auctions office to manage allocation of cross-border transmission (CBT) capacity that was proposed to be established at the 10th Athens forum is in progress, and the developments will be explained below in this paper. Additionally, creation of a Regional Information Centre is expected, but there is no plan for the date yet.

5.3 Restructuring of the Electricity Industry: Unbundling

In the past, vertically integrated state-owned companies had the monopoly on the national electricity markets in SEE. They were dealing with all electricity activities: production, transmission, distribution and supply of electricity to all the customers in the country. Complying with the obligations from the EnCT, the SEE countries were required to comply with the provisions for unbundling of the transmission and distribution from the competitive activities, such as generation and supply following the requirements from the Electricity Directive. The main motivation behind the unbundling provisions is the removal of the incentives for discrimination and to improve effectiveness of regulation.[195] If the system operator also owns generation assets, it could discriminate against other generators, which have to access the network to deliver their electricity production. This can be done by setting high access prices, reserving transmission capacity for its own generation units, providing unequal access to technical information or imposing abusive technical requirements. Separately owned transmission companies exist in most of the SEE countries, except in Croatia where the TSO is a subsidiary from a holding company and in Montenegro, where the functional unbundling is completed but the legal unbundling is in process.[196] It is also interesting that an ISO is established in Bosnia and Herzegovina as a legally separated entity.[197] In order to achieve full unbundling and independence of the TSO Albania, Bulgaria, Croatia and Montenegro have to finalise the process.

Another possible form of discrimination arises when the owner of the distribution grid is also a competitor in the end-user supply market. Abusive distribution pricing, cross-subsidization, unnecessary technical requirements and procedural and implementation delays can be used to disadvantage competitors in the end-user supply market. The incumbent supplier benefits from a significant competitive advantage *vis-à-vis* new independent entrants, because it initially covers the entire market and it has an established reputation and recognition between the customers.[198] Therefore, unbundling of the distribution and supply activities is necessary and is thus required by the Electricity Directive.[199] Nevertheless, except in Croatia and Romania, there is no unbundling between the

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[194] The CEER is a voluntary association of the European regulators, which acts as a platform for cooperation, information exchange and assistance between them and is their interface at European level with the European Commission. For further information on CEER, see: http://www.energy-regulators.eu/portal/page/portal/EER_HOME (last visited, 02.06.2008).

[195] OCANA C., *Regulatory Reform in the Electricity Supply Industry: an Overview*, in cooperation with the Energy Diversification Division of the IEA, September, 2002

[196] CARDS Project 2005, Facilitating and Implementing the Energy Community in South East Europe: *Energy Community Report on Compliance with the Electricity Benchmarks*, Reference: 100231 Original December 2006 Revision March 2007, Annex 2: *Progress notice in electricity – Status H2 2006*, March 2007 at 23.

[197] CARDS Project 2005, Facilitating and Implementing the Energy Community in South East Europe: *Energy Community Report on Compliance with the Electricity Benchmarks*, Reference: 100231 Original December 2006 Revision March 2007, Annex 5: *Electricity Roadmaps (party-by-party)*, March 2007 at 107.

[198] For proposed unbundling between the distribution and supply activities, see: OCANA C. (2002), *supra*.

[199] Article 15 Electricity Directive, *supra.*

distribution and supply activities in SEE. In Macedonia for example, there are no even short-term plans for legal unbundling between the network and supply activities of the distribution system.[200]

Effective competition may also require unbundling of companies in the generation and retailing in order to reduce market concentration.[201] However, none of the EU Directives have required horizontal separation to control market concentration at the national or EU level. In SEE, only in Bulgaria there have been some horizontal unbundling, due to the privatisation process undertaken in 2003, when 32 small HPPs with an overall installed capacity of 243MW have been privatised.[202]

In general, the unbundling of the TSOs is more advanced than that of the DSOs in the region. From a regional perspective the benchmarks show more positive than negative results and only Albania seems to be behind the average of the region.[203] On the other hand, only Croatia, Macedonia and UNMIK have fully adopted the unbundling provisions in their legislation. Furthermore, their full practical implementation is still to take place. In addition to this, in the Report on the implementation of the EnCT it was concluded that there are still problems related to the unbundling of the TSOs and DSOs in the region, such as absence or insufficient functional and accounting as well as legal unbundling in order to guarantee their independence and absence of independence in the management.[204]

5.4 Third Party Access (TPA) and Technical Rules

Transmission and distribution are considered as non-competitive activities of the electricity industry. Due to the fact that it is not economically viable to build different network grids for connection of the generation and supply, they are considered to be natural monopolies. Moreover, it is usual that both transmission and distribution networks, stay monopolies even after effective liberalization in the market is introduced. Therefore, TPA to the transmission and the distribution grids should be ensured in a non-discriminatory and transparent way.

The respective system operators (TSO and DSO) are required to establish rules for connection to the corresponding grid and methodology for connection expenses calculation. They have to provide the entities which request connection to the grid, with detailed assessment of the expenses related to the connection. Entities which request connection to the grid shall obtain consent from the system operator according to those rules, and shall bear the expenses for connection determined with the connection rules. At regional level, all countries in SEE except Serbia (which lacks some provisions) have fully adopted the provisions ensuring TPA to the transmission and distribution networks, as well as the obligations to justify the denial of the access to the grid. Nevertheless, after putting in place of provisions related to cost reflective methodology for determining network access tariffs there is still to be done for their implementation.[205]

In Macedonia for instance, MEPSO as a TSO has adopted the Grid Code[206] after the approval by the regulator (ERC)[207] which describes the minimum technical requirements for connection and access

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[200] CARDS Project 2005, *Energy Community Report on Compliance with the Electricity Benchmarks*, Annex 5, March 2007, *supra* at 178.

[201] *Ibid*

[202] GANEV, P. *Bulgarian Electricity Market Restructuring*, CCP Working Paper 08-8, October 2007 at 13

[203] CARDS Project 2005, Facilitating and Implementing the Energy Community in South East Europe: *Energy Community Report on Compliance with the Electricity Benchmarks*, Reference: 100231 Original December 2006 Revision March 2007 at 8.

[204] CARDS Project 2005, May 2007, *supra* at 16

[205] CARDS Project 2005, March 2007, *supra* at 8

[206] Grid Code for Electricity Transmission, "Official Gazette of RM" No. 95/06

to the transmission network and basic technical and organizational instructions for operation and planning of transmission network. It consists of: General Introduction, Planning Code, Connection Condition and Operation Code. On the other hand, the Distribution Grid Code is in preparation and its Draft version is available on the DSO's (AD ESM) web site.[208] If the electric power system operator does not issue the consent for connection the entity which requests the connection may submit complaint to the ERC.[209]

Market rules are also very important secondary legislation and need to be in place if the national and regional electricity markets are to function properly. They need to be transparent and predictable allowing the level playing field for the participants in the market. From the SEE countries Albania, Macedonia, Montenegro, Serbia and UNMIK still have to adopt or improve their national market rules in compliance with the a*cquis*.

5.5 Eligible Customers and Opening the Electricity Markets

One of the indicators for assessing the liberalization is the market opening. Full opening of the electricity markets in the EU was done from 01.07.2004 for non-household customers and 01.07.2007 for all household customers. According to the obligations undertaken by the EnCT, the countries in SEE need to have open electricity market for non-household customers from 01.01.2008 and should do the same for all household customers from 01.01.2015.

The supply of electricity to end-users is largely determined by the market structure, measured in particular by the number of suppliers a customer can choose from and the technical degree of market opening.[210] In the SEE region, only some provisions are put in place and the outlook is not positive.[211] In March 2007 only four countries (Bosnia and Herzegovina, Bulgaria, Croatia and Romania) have set the timetable and took concrete measures to open the market for both non-household and household customers. Now however, there are some improvements in this regard in other countries as well. In accordance with the Macedonian Energy Law, eligible customers could choose to purchase their electricity from traders and generators inside or outside the country, except from the Regulated Generators (which need to sell all their power to the single buyer-the TSO, MEPSO), and shall notify each such agreement for electricity purchase to the Market Operator (MEPSO as well). As the threshold for becoming an eligible customer is reduced over time, the percentage of electric consumption that eligible customers contract with other suppliers would rise, and the regulated component of the wholesale market will become smaller. According to the current Energy Law,[212] consumers that consume or plan to consume at least 20GWh of electricity during each calendar year can be considered as eligible customers.[213] Eligibility threshold, if exercised, would cover 20% of the

(Contd.)

[207] ERC-RM, Decision for granting the approval of the Grid Code for Electricity Transmission, No. 02-1203/1 of 25.08.2006, available at:

http://www.erc.org.mk/Uploads/MK%20Grid%20Code%20for%20Electricity%20Transmission_Final.pdf (last visited, 02.06.2008).

[208] Draft Grid Code for Electricity Distribution is available at:

http://www.evn.com.mk/mk/download/mrezni_pravila.pdf (last visited, 02.06.2008).

[209] Article 116(2)Energy Law, *supra*

[210] European Commission DG TREN, Electricity Liberalization Indicators in Europe, October 2001

[211] CARDS Project 2005, March 2007, *supra* at 8

[212] Article 84 Energy Law, *supra*

[213] In Albania, the Power Sector Law No.9072, from 2003, provides for annual consumption of 100GW of electricity in order to comply with the eligibility requirements. This threshold was in place until 2006 and was fulfilled by two consumers only. With the amendments of the law, the eligibility threshold is set at 10GW and is fulfilled by 15 consumers. See: CARDS Project 2005, *Energy Community Report on Compliance with the Electricity Benchmarks*, Annex 5, March 2007, *supra* at 90.

consumption. The Government could extend the consumer category that can be considered as eligible customers with a decree based on criteria that include consumption, voltage level, consumer groups, or type of grid (transmission or distribution). Nevertheless, there is a substantial disparity in the regulated and market prices, which is a disincentive for the consumers to exercise their eligibility status. Moreover, as by now it was up to the Government to take a decision for changing the status and making some customers eligible, due to the pressure from the industry, that decisions were never taken. Nevertheless, because of the growing burden from the large (direct) consumers on the electricity supply system, amendment on the Energy Law is proposed that allows the wholesale tariff supplier (MEPSO) to limit the electricity supply under tariff conditions for the direct customers and to direct them to provide required excess electricity on the free market. This is in line with the obligation from the EnCT, for opening the market for non-household customers since 2008. After this change, all customers directly connected to the transmission network would become eligible customers and would lose the status of tariff customers. Furthermore, there is a Rulebook on conditions, method and procedure for acquiring and terminating the status of the eligible customer of electricity, which was issued by the ERC in June 2006.[214] The eligible customers are proclaimed by resolution within the period of 60 days from the day of submission of the request for obtaining the status of eligible customer. By now, eight decisions granting status of eligible customers to companies have been taken by the ERC.[215]

However, gradual opening of the electricity markets with dynamics still need to be specified and harmonised in the rest of the SEE region as well.

5.6 Tariff Reforms

Reform of the tariffs is an issue present in all the studies where the necessary reforms in the electricity sectors in the SEE countries are discussed. Firstly, it should be explained that the tariffs in these countries are not reflecting the real costs and are much lower then the tariffs in the EU. In 2004 as identified by the World Bank, the average SEE tariffs were between 2,8 and 7,6cents/kWh, and the average tariff for the region was around 4,8cents/kWh.[216] According to the Commission, an action plan for tariff reform in the SEE should include raising the tariffs towards cost-reflective level, including the operating cost plus debt service and return on equity.[217] Furthermore, cross-subsidies between the industrial and residential customers should not exist. This in 2004 was identified by the World Bank to be a problem in Albania, whereas in the other countries residential tariffs were exceeding those for the industrial customers.

Other problems that should be addressed with regard to the tariff reforms are the payment discipline and the distribution losses. In the region, the payment was only around 85% whereas everywhere in the EU was more then 90%. On the other hand, the losses in the distribution systems were very high, above 22% in the region compared to some 5-7% in the EU. In the same World Bank study it was proposed to improve the payment discipline through regulatory and market design by strengthening the legal framework, disconnecting non-payers, privatizing and restructuring.

It is widely accepted that the economic tariffs are necessary for minimising the price distortions, ensuring financial viability of efficient firms, attracting investment and promising quality of supply, as well as for sending correct price signals. When introducing the tariff reforms, if prices are to be raised to economic level in order for the system to function effectively, the final prices of electricity will rise.

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[214] ERC, Rulebook on conditions, method and procedure for acquiring and terminating the status of the eligible customer of electricity, June 2006, "Official Gazette of RM", No. 69/06

[215] Eight decisions have been taken by the ERC for acquiring the status of eligible customers in October and November 2007, which entered into force on 01.01.2008, available at: http://www.erc.org.mk/ (last visited, 02.06.2008)

[216] World Bank (2004), *supra*

[217] European Commission, Strategy Paper (2002), *supra*

Therefore, there should be mechanisms in place in order to protect the consumers from this increase of the electricity prices. The World Bank proposes an interim Regulated Tariffs Mechanism.[218] According to that mechanism, the market operator acting as a single buyer will buy electricity from the domestic generators a certain capacity, which from this reason would be withheld from the market, under regulated prices. Afterwards, this single buyer will sell that capacity to the residential customers under regulated prices as well. However, due to the effects on the competition in the market that this solution would have, there is a risk that liberalization will be endangered. One should be reminded that the Electricity Directive does not allow single buyer model to exist in the Member States of the EU. Therefore, this solution is to be implemented in SEE only for limited period of time for all consumers, and then as the market opens and more consumers become eligible, to be available only for certain clearly defined categories of consumers. This model is currently in place in Macedonia, but is considered a transitional step before full implementation of the bilateral contracts system.[219]

At later stage when there are eligible consumers on the market, there is a question whether all customers will be obliged to buy under regulated tariffs or will have possibility to choose. This is certainly not a question in the time when the regulated tariffs are below the economic level of the tariffs that exist in the open market, because in that case even the eligible customers would prefer to stay "faithful" to the regulated prices, as explained in para.5.5.[220] This however would be a question when the national tariffs are raised to an economic level. Additional question to be dealt at this later stage is also whether the distribution companies which will still have to provide electricity to the regulated consumers will be able to choose their supplier, i.e. whether the distribution companies will become eligible (which is not the case now for example in Macedonia where the distribution company is not eligible).

Another interesting question in this line is the question whether the generators will need to be regulated and to be obliged to sell at home to the single buyer, or will be free to sell the power that they produce at the regional market. On this later question, the potential competitors in the regional generation market will also depend. National generators (ELEM and TPP Negotino) are regulated in Macedonia for instance, and they are obliged to sell all their power to the single buyer in the country.

In conclusion to this paragraph it could be stated that there are many important questions that should be dealt before opening the electricity markets for all customers. But, it is worth noting here that according to the World Bank the retail competition is not expected and is said to be "a long way off in SEE."[221]

5.7 Public Service Obligation (PSO) and Affordability Issue

All countries in SEE have adopted provisions in their legislation covering PSO. Nevertheless, the specific obligations with regard to the vulnerable customers' protection are mostly missing. Bosnia and Herzegovina, Macedonia and Montenegro are some of the countries which are behind the average development in the region as they do not have the relevant provisions in their legislation[222] Furthermore, appointment of a supplier of last resort is another area where further work is needed, because not all of the countries have fulfilled the requirements to designate a company which will provide that service.

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[218] World Bank (2004), *supra*

[219] Energy Community, Report on State Level Compliance with Regional Market Design, March 2007, at 15, available at: http://www.energy-community.org/ (last visited, 02.06.2008).

[220] The difficulties to put pressure on the eligible customers in Macedonia to buy energy on the free open market, para.5.5

[221] World Bank (2006), *supra*

[222] CARDS Project 2005, March 2007, *supra* at 7.

Even though the tariffs in the rest of the SEE region are very low, the collection rates are low as well. Whereas in the EU the collection is more then 95% for all categories of consumers, in the SEE region it varies among countries and within categories. For example, the household collections range from 73% (Albania) to 94% (Bosnia-Herzegovina), and the industrial collections from 73% (Macedonia) to 98% (Albania).[223] Besides the fact that after the privatization of the distribution company in Macedonia, the collection rate from household and small commercial sector increased significantly (from 72% in 2005 to 85% in 2006),[224] non-payment by Government,[225] high commercial losses and judicial problems in executing judgments for unpaid bills continue to undermine the achievement of higher rates of collection.[226] However, the private distribution and supply company started to exercise its right to disconnect the consumers in the country in case of non-payment.[227]

On the other hand, the population in SEE is facing the problem of affordability. It means that power will not be affordable for all of the population in case of price rising unless social safety net is established. According to the World Health Organisation, no more then 10% of the income should be spent on power.[228] However, if proper tariff methodologies are adopted in SEE, expenditures of the people will be raised for more then 10% in Montenegro, Macedonia, Croatia and Serbia.[229] Therefore, for systems in developing countries such as these in the SEE where the welfare system is not so much developed, Pollitt suggested that introducing general economic incentives might be more beneficial, such as raising the incomes of the population and improving the tax and benefits systems.[230] It is also clear that this kind of advice could be useful for other reforms in the developing countries as well, just it should be underlined that increasing incomes and better tax systems are part of those reforms which, even though very much desired, are most difficult to be implemented and it is even more difficult for their results to be felt by the general public. An affordability study by EBRD from 2005[231] found that the even with low tariffs, the poorest 10% of households in Macedonia spend more than 10% of their income on electric power, which explains that the affordability issue is a real problem.

Taking into consideration the common problems of SEE countries, such as that tariffs do not always reflect costs, that cross-subsidisation between customers exist, low collection rates and lack of competition and opening of the national markets, the ECRB adopted Guidelines on protection of vulnerable consumers,[232] which provide guidance for national action plans to promote secure energy supply to households. As the EBRD in its study from 2005, ECRB in its Guidelines as well suggests that there are two solutions for addressing the affordability problem: non-tariff[233] and tariff[234] based

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[223] USAID, Transmission and retail tariff benchmarking, Athens, October 2006

[224] ERC-RM, Slave Ivanovski, Energy Regulation and quality of service: Macedonian experience, presentation at 4th Poverty Reduction Strategy Forum, June, 2007.

[225] There are law suits against the Government for the debts of EUR 10.000.000. Source: ERC, Slave Ivanovski, *supra*.

[226] USAID, Energy Newsletter, Issue 2, March/April 2007.

[227] Guidelines for consumers, available at AD ESM website:

http://www.esmak.com.mk/mk/kunden/upatstvo_za_priklucok.asp (last visited, 02.06.2008).

[228] World Bank, 2004, *supra*

[229] POLLITT, M., (2008), *supra*

[230] POLLITT, M. (2008), *supra*

[231] EBRD: Samuel Fankhauser and Sladjana Tepic, *Can poor consumers pay for energy and water? An affordability analysis for transition countries*, Working Paper No. 92, May 2005

[232] ECRB, Best Practice Guidelines on the Protection of Vulnerable Household Customers, Ref: R07-WGC-01-05, 28.06.2007.

[233] Social allowances are provided from the state budget directly or indirectly to the beneficiaries without affecting the cost-reflective energy tariff or supply price structure. They usually cover parts of the expenses incurred and they have the advantage of not disturbing the market and do not give false incentives to increase the consumption.

support mechanisms, stating that the first one is the preferred option. It recognises though, that the most important and difficult issue for addressing this problem is identifying the target group i.e. the vulnerable consumers.[235]

In October, 2007 the Contracting Parties of the EnCT the countries from SEE and the EU, signed a Memorandum of Understanding on Social Issues.[236] With that Memorandum, the countries recognised the need to build a social dimension in the Energy Community with a view to promoting social progress, improved standards of living and working conditions, as well as to help the enterprises and workers to adapt to socio-economic changes which are arising from implementing the EnCT. They expressed their political will to develop highest possible level of social protection compatible with a competitive energy market and when necessary to implement safeguard measures, in particular with regard to vulnerable consumers. Given the importance of these issues, the parties suggested establishment of a Social Forum as a new institution of the Energy Community.

In practice however, the national legislation in most of the SEE countries does not include provisions for protection of the vulnerable consumers and no specific regulations are being adopted so far in that regard. Furthermore, the target group i.e. the vulnerable customers, have not been defined and supplier of last resort has not been appointed yet. Due to the fact that on the one hand, the affordability is a problem and the consumers started to face disconnection for unpaid bills after the privatisation of the distribution companies on the other, action needs to be taken to address these issues. In the Transition strategy, the Ministerial Council proposed that the ECRB should draw model contracts with minimum mandatory clauses for detailed PSO and the framework for disconnection.[237]

6 Phase 2: SEE REM Design and Cross-border Issues

As explained above, for creation of REM reforms in accordance with the Electricity Directive shall be undertaken at national level, which for SEE was presented in the preceding paragraphs. With their implementation, national electricity markets are liberalized and certain market designs are adopted in each county. In addition, cross-border issues are further prerequisites for effective functioning of REM. For SEE REM, CEER proposed a Standard Market Design (SMD).[238] In the subsequent paragraphs, differences in the national market designs in SEE countries as well as the SMD for SEE REM will be presented. Afterwards, the attention will be brought to some important cross-border issues showing the implementation of Regulation 1228/2003.

6.1 National Market Designs

There are three power exchanges in the SEE region and its neighbouring countries.[239] With regard to imports, and sometimes export of electricity there are tendering procedures in place, in addition to the bilateral contracts. However, bilateral contracts are the most usual model for trading electricity

(Contd.)

[234] Social tariffs are normally funded through a levy or tax on the grid charge, which is used to contribute to the costs of vulnerable customers. There may be situations which legitimate tariff based systems; however, there is a risk of distorting the market.

[235] Definition on vulnerable consumers from ERGEG is provided in the Guidelines as a reference.

[236] Memorandum of Understanding on Social Issues in the context of the Energy Community, Reg.No: MC2/4-7/22-05-07EC, Vienna, 18.10.2007.

[237] Ministerial Council: Electricity Transition Strategy, 9.12.2005

[238] CEER Position Paper, (2003), *supra*

[239] Austrian (Borzen), Romanian (OPCOM) and Slovenian exchange. In Greece on the other hand, there is a mandatory pool.

implemented in the different countries with regulated balancing market. Nevertheless, the marker designs differ among the different countries and five examples will be presented in turn.[240]

Croatia[241] could be an example of a small importing country with bilateral market and no competition developed yet. There are bilateral contracts in place for supply of electricity (between the eligible customers and suppliers), for trade of electricity (between supplier, trader or producer), as well as for use of the network (eligible customers or producers with the TSO or DSO) and for balancing (between the supplier of eligible customers and TSO). These contracts are performed against the background of existing vertically integrated company as a large importer and TSO and DSO being still integrated as subsidiary of the holding company (HEP group) whereas the MO is a separate entity and takes care of the contractual commitments of the market participants.

Macedonia[242] is as well small importing country, but it has a hybrid wholesale market with no competition developed yet. TSO (MEPSO) is a joint stock company ownership unbundled from the competitive activities that performs also the functions of a MO. DSO (AD ESM) is privatised but is not unbundled from the supply activities, and is also owner of distributed generation, owning 11 small HPPs. The TSO is regulated wholesale supplier of tariff customers acting as single buyer, and the DSO is regulated retail supplier of tariff customers which is not eligible. The generators (ELEM and TPP Negotino) in the country are regulated and need to sell all their power to the single buyer (TSO). At wholesale level there are regulated contracts between the generators and the TSO and unregulated contracts for TSO to purchase power from other sources, subject to tendering. At retail level, there are regulated contracts between the DSO and the TSO, as well as between the DSO and the distributed generation for purchasing power on behalf of the tariff customers, with which there are further regulated contracts with regulated tariffs in place. Eligible customers could choose to purchase their electricity from traders and generators inside or outside of Macedonia, except from the Regulated Generators, and shall notify each such agreement for electricity purchase to the MO.

Serbia[243] with its single generation/distribution company with also not developed competition could be another example for a balanced medium country. Generation/distribution company provides the function of a wholesale supplier for tariff customers, and the MO is within the TSO which on the other hand is unbundled legally.

Multi generation/distribution company with potential competition in small exporting country could be seen in *Bosnia and Herzegovina*.[244] There is transmission network, organised as an Independent System Operator (ISO) which is separate from the generators and distributors, but there is no MO designated. Generators and distributors are vertically integrated in three different areas and have PSO for supplying the tariff customers each in its own area. Eventually, there could be a scope for competition among the three generators/suppliers, if they move away gradually from an entity based business operation. There is a central market for procurement and sale of electricity led by the ISO and there is a possibility for bilateral contracts for the day-ahead and intra-day trading, but the later are not organised and institutionalised and there is therefore only bilateral trading under prices which are not publicly known.

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[240] The different examples of national markets explained here, were presented by Nijaz Dizdarevic Energy Institute Htvoje Pozar Croatia, Wholesale market design, functioning, monitoring and evaluation, at the Advanced Training Course in Electricity Markets, Florence School of Regulation, 31.03.-04.04.2008.

[241] CARDS Project 2005, March 2007, *supra* at 13

[242] CARDS Project 2005, March 2007, *supra* at 15

[243] CARDS Project 2005, March 2007, *supra* at 20

[244] CARDS Project 2005, March 2007, *supra* at 11

The best developed electricity market in the SEE is the *Romanian* one.[245] It is a well-balanced large country with multi generation companies (hydro, thermal, nuclear and Independent Power Plants - IPP) and multi suppliers with introduced competition. There are bilateral contracts in place, as well as established voluntary electricity exchange (Day Ahead Market - DAM), balancing market and settlements. TSO is unbundled in ownership terms and the MO is separate and independent. In the bilateral contracts there is a regulated as well as competitive component. The first one is between the producers and suppliers of tariff customers, while the second between the producers and suppliers of eligible customers, as well as for import and export contracts of the producers and suppliers. Besides contracts, participants to the wholesale electricity market can participate to a physical electricity market organized one day before the delivery date. This later market is administered by the Market Operator (MO-OPCOM), and the participation in it is voluntary. Market trades are concluded at the market clearing price. There is a central settlement for the DAM administered by the MO, and bilateral settlement, elaborated by the system operator. The TSO (Transelectrica) performs real time balancing of the market.

6.2 Standard Market Design for SEE REM

In a Position Paper in 2003, CEER proposed SMD for the electricity market in SEE[246] which was later endorsed by the World Bank[247] and the European Commission.[248] The later expected a regional market design which would take into consideration the regional gains but also provide for optimal use of the infrastructure. The proposed SMD took into account the specificities of the SEE region discussed above in this paper such as the need for investment, different pace of reforms in the different countries of the region, as well as the need to ensure smooth transition to liberalised regional market without exposing the consumers to risk from raising the prices of electricity or the national companies, from liberalising the market before national problems are solved. In this paper, CEER identifies the market participants, among which a regional market operator (SEEMO) was proposed to be established. In addition, a Technical Management Committee and Market Regulation Committee were other institutional requirements held necessary for proper functioning of the SEE REM.

At the time when the SMD for the region was discussed there was a certain trade of electricity between the utilities organised through tendering which were not always done in accordance with transparent procedures. The market model proposed was full competition at the wholesale market and it should be achieved by starting with bilateral contracts between the generators (which are suppose to be free to sell their power in the region) and the eligible customers from different countries. Those non-household eligible customers should at a later stage include the distribution companies as well, which shall be free to buy electricity from generators other then their national regulated generators. The bilateral contracts between the generators and the eligible customers should be backed by the existence of DAM. The DAM shall serve as additional place where the generators will be able to place additional capacity serving the eligible customers, which in turn would be able to buy at time closer to real time. This is supposed to diminish the difference between the contracted and the real necessity for power. The operation of the regional market should be done at two levels. One should be the regional commercial level which shall cover the bilateral contract (which shall be traded on a regional exchange expected to be established later) and the DAM. The other level should be the physical one, which shall comprise the national balancing mechanisms enforced by the TSOs. This would be an important level, because even though the existence of a SEEMO is envisaged, its role is not going to be to balance the capacities of power traded and balancing is planned to be done at national level only.

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[245] CARDS Project 2005, March 2007, *supra* at 18

[246] CEER Position Paper (2003), *supra*

[247] World Bank (2004), *supra*

[248] European Commission, DG TREN: Discussion and Consultation Note, 2004, *supra*

Therefore, the role of the TSO is held to be pivotal for the functioning of the SEE REM. Nevertheless, the relations between the SEEMO and the national MOs is, as well, very important.

Due to the small size of the national markets, wholesale competition cannot be effectively introduced at national level, which explains the reasons why neither DAM could be established in all the countries separately. Therefore, regional mechanisms are crucial and they shall take into consideration the experience from the countries where wholesale market could be established. Furthermore, the real time balancing and the provision of ancillary services are regulated differently in different countries in the region. The later might be even considered as separate services that should be provided for profit by the TSOs to the market participants.[249]

This type of market design and trade through bilateral contracts coupled with tendering by transmission companies or capacity obligations on load entities will lead to liberalization achieved through phases as suggested by the Commission. Nevertheless, some additional questions arise. The long term contracts and PPAs, which are held to be necessary for attracting investment in the SEE, might lead to vertical foreclosure of the downstream market and therefore, their compliance with the competition law rules by the regulatory authorities and the national competition authorities is supposed to be assessed on case by case basis. Due to the limited political commitments and the technical capacity, bilateral contracts are held to be favored.[250] Bilateral contracts are recommendable due to the problems that exist in SEE with regard to the payments discipline.[251] Furthermore, as already discussed above, when generation capacity is tight incentives for better performance are reduced and capacity may be withheld. This is certainly a problem at national level, but it could be dealt with by imports at regional level. However, this is possible only in situation when non-discriminatory access to the grids exist, a precondition for which is either unbundling, or the existence of a strong regulator.

6.3 Cross-border Issues

Being aware of the national reforms taking place in the different countries in SEE, and having explained the national market designs as well as the SMD for the SEE REM expected to be implemented in the region, it is necessary to address some important cross-border issues from Regulation 1228/2003, which are of a more technical then legal nature.

If cross-border trade is supposed to be performed, there is a necessity for sufficient amount of technical capacity to exist, which means that surplus has to exist in one country and deficit in another. Due to the fact that, as explained above already, only three countries in the SEE region export electricity (Bulgaria, Bosnia and Herzegovina and Slovenia) and the others are net importers, this precondition is fulfilled. For flow of electricity across borders, the systems should be synchronously operated and there shall be balance of the demand and the supply of electricity at regional level. This is achieved through application of the UCTE rules in SEE. Trading in a region is done through interconnections through which the reserve capacities flow for which in a functional REM, regional schedule and dispatching are expected to be organised.

SMD explained in the preceding paragraph shall be fully implemented only after the important steps and reforms at national level are advanced. This means that NRAs should be established, TSOs and DSOs need to be designated, the requirements for unbundling should be complied with and regulated TPA shall be allowed in a non-discriminatory and transparent manner. Furthermore, national markets should have been opened for all non-household customers as from 01.01.2008, as required by the EnCT. Tariff reforms and protection of customers at national level should have been part of the

[249] CEER Discussion Paper, 2004, *supra*

[250] DEITZ, L., et al. (2008), *supra*

[251] World Bank (2004), *supra*

first phase of the liberalization process in SEE. Only afterwards, when opening the REM the cross-border issues shall be fully put in place.[252] The Regulation 1228/2003 aims at setting fair rules for cross-border exchanges in electricity within the internal EC electricity market, and those rules in accordance with the obligation for implementing the energy a*cquis,* are to be implemented in the SEE electricity markets as well. According to the Regulation 1228/2003, there shall be a compensation mechanism for cross-border transit flows of electricity, harmonized principles for network access charges and rules for allocation of available capacities of interconnections between national transmission systems. As explained earlier in this paper, Guidelines for Congestion Management are supplementing Regulation 1228/2003. The cross-border issues such as ITC Mechanism, capacity allocation and congestion management, harmonizing the licenses for the market participants taking highly into consideration the transparency requirements will be, due to their technical nature, briefly introduced in the following paragraphs of this paper.

6.3.1 Inter-TSO Compensation Mechanism (ITC Mechanism)

The reasons for establishing ITC mechanism are to provide signals about the costs, upon which consumption decisions can be made and to compensate transmission companies for the costs incurred with regional power trade, in order to support their ongoing financial viability. When NRAs are dealing with cross-border issues they shall check,[253] among the rest, that the TSOs receive financial compensation for transit flows, which should cover the costs incurred, investment in infrastructure and proportion for using the existing infrastructure. On the other hand, the charges should be set in a transparent and non-discriminatory manner and not to be distance-related, i.e. not to depend on the states and origin of the electricity traded, and charges should not exist on individual transactions for transit of electricity.

An ITC mechanism has been in place in SEE since the second half of 2004 under the previously used term cross-border trade mechanism (CBT mechanism) and it remunerates the utilization of the transmission networks due to transits coming from cross-border transactions.[254] Regulation 1228/2003 in article 3 provides basis for compensation of the transit of electricity. The Regulation allows the Commission to adopt Guidelines governing these issues but that has not been done yet. Nevertheless, there is a voluntary agreement from June 2007 between the majority of the Member States, but including the countries from SEE, except Kosovo.[255] This agreement has evolved after the discussions at the meeting of the European TSOs (ETSO) in Slovenia in March, 2007 for the adoption of a new integrated mechanism which was put in place in June, 2007. The TSOs from SEE that were participating in the 2006 ITC mechanism, including also Croatia which did not participate in the old ITC mechanism, are included in the new one. This ITC agreement serves as a landmark, given that the formerly separate schemes and funds of ETSO and SEETSO now operate together.

The functioning of this mechanism for inter-TSO compensation, as described by the World Bank's Framework for Development of SEE market from 2006[256] drawing on the Report on ITC Mechanism among SEETSO,[257] can be summarised in the following manner. The proportion of the total

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[252] CEER, The current status on the market design of the SEE REM and the way forward, Paper presented at the 2nd Workshop MFG, Bucharest, 06.10.2003

[253] Goran Majstrovic, Energy Institute Hrvoje Pozar Croatia, Network Issues in Electricity Markets-South East Europe Study Case, presented at the Advanced Training Course in Electricity Markets, Florence School of Regulation, 31.03.-04.04.2008

[254] SETSO, Report on Inter-TSO compensation mechanism among SEE TSOs, For the Energy Community in South East Europe to the 10th Athens Forum, 24-25.04.2007

[255] Energy Community Secretariat, Report on the Implementation of Regulation 1228/2003/EC, at 8, *supra*.

[256] World Bank (2006), *supra*

[257] Report on Inter-TSO compensation Mechanism among SEE TSO by ETSO to Athens Forum, June 2005

transmission costs due to the regional power trade, are estimated on a forward looking basis for each country, which in turn determines the revenue requirement for the fund from which transmission companies are to be compensated. Transmission companies contribute to this fund in accordance with the costs imposed on underlined that only net importing and exporting countries are those that contribute to the fund, whereas the countries which use the transmission networks in SEE for transit only, do not contribute. The total contributions to the fund are equal to the revenue requirement. Due to the fact that not always the forecasted and real flows are the same, the differences between them are resolved through a final settlement, carried out at the end of a calendar year. In this manner, the approximate level of the costs is signalled to the participants.

However, there have been several problems with regard to the implementation of the CBT mechanism which might endanger both the willingness of countries to continue to participate in the mechanism and the regional trade of electricity, in general. *Firstly*, there are large difference between forecasted and actual costs; *secondly*, no loop flows are regulated, which means that the flows that come and get out of the regional market from the neighboring countries not participating in the CBT mechanism are not regulated and *thirdly,* the perimeter countries are not paying for these transmission costs.

6.3.2 Access Charges

Not only that Regulation 1228/2003 provides rules for compensation of transits, but in its article 4 it also aims at harmonising the transmission tariff systems because they differ across the countries. The charges for access to the networks need to be transparent with cost reflective comparable schemes and components (meaning that they have to include operational and capital costs of the transmission activity). Furthermore, they need to be entry-exit tariffs and not distance based and have, necessarily to be applied in a non-discriminatory manner to network users.

According to the latest Report on Implementation of Regulation 1228/2003 by the signatories of the EnCT in October, 2007 all of the SEE countries have regulations for access charges, but they need to be harmonized with those of the EU and to be brought up to economic level. This is important because in SEE they vary between 1.37 and 5.7 €/MWh (compared to a range of 3-14 €/MWh within EU).[258]

6.3.3 Capacity Allocation and Congestion Management

Congestion management is very important issue that shall be dealt with relation to cross-border trade. It is necessary to solve the congestions that occur before the system' security is jeopardized and to ensure non-discriminatory and competitive, transparent electricity market. Furthermore, setting fair prices of transmission capacity allocation and minimize market power issues could be tackled with proper congestion management. While Regulation 1228/2003 covers only the general principles of congestion management, the CMG regulate the mechanisms for congestion management, calculation of interconnection capacity, timetable for market operations, transparency and use of congestion income. Congestion Management procedures shall be coordinated among the TSOs and safety and operational rules shall be made available to the public. TSOs must publish estimates of available transfer power and its expected reliability. The congestion management methods should be such as not to discriminate the market participants, and regulators should not allow that the long-term capacity reservations to amount to exercise of market power. In addition, it should not be allowed for a single buyer to control large amount of the auctioned capacity and unused capacity should be made available for all buyers.

[258] Energy Community Secretariat, Report on the Implementation of Regulation 1228/2003/EC, *supra* at 8.

According to CMG only market based methods are allowed i.e. explicit and implicit auctions, and not the non-market based approaches like pro-rata allocation management. At intraday, when existing, also continuous trading is allowed. Furthermore, common allocation of the full capacity instead of capacity split of 50:50 is preferred, which shall be regularly evaluated by the national regulators. With regard to the transparency issue, publication of the congestion management methodologies and of the allocation results is required as well.

SETSO in its Overview of transmission capacity allocation methods in SEE[259] found that there are significant improvements of the allocation procedures in this region. Most of the pro-rata and priority list procedures that were used by the SEE countries are now changed with explicit auctions, and while in October 2006 there were only joint explicit auctions between Austria and Hungary, lately they were performed also between Austria and Italy, Italy and Greece, Greece and Macedonia, as well as between Hungary and Croatia.

In addition to the low values of Available Transmission Capacity (ATC) there are also Already Allocated Capacity (AAC) on some borders because of old cross-border contracts from the time of SFRY, and also because of withholding capacity for the supply for tariff customers (in Serbia, Macedonia, Montenegro and Croatia).[260] Here it should be noted that in the EU, reservations on interconnections for old contracts is forbidden having in mind their negative effect on competition and prevention of new entrants in the market.

Nevertheless, there are still some improvements needed for full compliance with the CMG. These include further switching to auctions in those countries where pro-rata mechanisms are still applied (Albania, Bosnia and Herzegovina, Montenegro and Macedonia)[261] and the overall objective is to introduce joint auctions all over the SEE region, substituting the capacity split 50:50 used at the moment. Furthermore, with regard to the transparency requirement, not all the data regarding the auction procedures and results, as well as commercial and physical flows are publicly available.

6.3.4 SEE – Coordinated Auction Office (CAO)

The experience has shown that market based cross-border allocation methods may lead to inefficient usage of interconnections if physical realities are not taken into consideration in appropriate manner. Thus, load flow based allocation methods were assessed by the TSOs. That is a supra-national approach, which means that all bids for energy and the related cross-border capacity are managed by a centralized entity that takes care of the actual allocation which is called “auction office.” The commercial transactions are not limited to the interconnections where they are reported, but they are converted into physical power flows by using a simplified representation of the network. In Europe, there is no flow-based capacity allocation scheme implemented and there is a dry-run proof-of-principle implementation in CEE, and a dry-run of coordinated auctioning project in SEE.[262] Even though, SEE is not formally defined in terms of CMG and the procedure of its formal definition will be initiated and guided by the EC. Nevertheless, for a number of years TSOs from the SEE region, voluntarily seek for the maximum coordination in the transmission capacity allocation process, by investigating the coordinated flow-based auctions.

Within the Athens Forum framework, they have launched the project of implementation of a system of Co-ordinated Explicit Flow-based Auctions for transmission capacity allocation (CAO).[263]

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[259] SETSO, Overview of transmission capacity Allocation methods in SEE (Status July 2007) & Report on the Coordinated Auctions dry-run simulation, Document for 11th Athens Forum, November 15th, 2007

[260] SEETEC study, *supra* at 39

[261] The information about countries which use pro-rata is given in the SEETEC study, *supra* at 37.

[262] Energy Community Secretariat, Report on the Implementation of Regulation 1228/2003/EC at 12, *supra*.

[263] SETSO, Report on CAO, 2007, *supra* at 14.

The expected advantages of the CAO using coordinated flow-based auctions are going to be: better utilization of existing interconnections, higher level of transmission system security, facilitating regional trading activities due to the efficient use of network capacities and the increase of firmness of transactions, increasing transparency and encouraging infrastructure investments.[264] By now, a software tool has been developed for the auctions office and it has been executing monthly simulations of use of this mechanism during 2006 and 2007.[265] Currently there is a discussion of questions such as: where to locate the CAO headquarters, what is its basic organizational structure and who will supervise it, the treatment of the interconnection capacities over the SEE borders. Furthermore, there are questions of what the nature of the CAO fund is, and whether it is a financial organization or a technical body.[266]

According to article 6 of Regulation 1228/2003, the income derived from allocation of the capacity interconnections should be used for guaranteeing the actual availability of the allocated capacity, network investment. Furthermore, this income is to be taken into account by regulatory authorities when approving the methodology for calculating network tariffs, and/or in assessing whether tariffs should be modified. Within the SEE region there is still no common procedure for the use of congestion income. Moreover, as there are still some countries with non-market based allocation scheme for cross border transmission capacities, there are also no provisions about the use of congestion rents within the national legislations.[267]

6.3.5 Licenses

Licensing regime is an issue characteristic for SEE and in a South Eastern Europe Electrical System Technical Support Project (SEETEC) Study of the obstacles to trade and compatibility of market rules" it was identified to be one of the key concerns for traders.[268] It was held that the traders see the licenses as an obstacle due to the fact that licensing regime is not harmonized and the requirements for obtaining licenses differ from country to country. Moreover, the procedures for obtaining a license in some countries are long and complicated and there are high initial as well as annual fees. In addition to this, there is lack of information with regard to the requirements for licensing.

Moreover, in the abovementioned SEETEC's study it was found that there is lack of consistency in the definition of 'traders' and 'suppliers' in the various jurisdictions in the SEE region. In particular, the concept of supplier does not exist in Bulgaria and the regulator issues only trading licenses, whereas the situation is opposite in Romania where the concept of trader does not exist and the regulator issues only supply license.[269] In Croatia and Macedonia on the other hand, both trader and supplier need to obtain a license for performing energy activities.[270]

It shall be noted however, that the Electricity Directive does not define either trader or supplier, though the meaning of supplier is implied by the definitions of supply and customer. It uses the term supplier to cover both retail and wholesale suppliers. There is no use of the term trader in the Directive. SEETEC furthermore provides for two possible differences between trader and supplier,

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[264] Energy Community Secretariat, Report on the Implementation of Regulation 1228/2003/EC at 12.

[265] See: www.drcat.at (last visited, 02.06.2008)

[266] For these and more detailed questions, see: Goran Majstrovic, Energy Institute Hrvoje Pozar Croatia, Network Issues in Electricity Markets-South East Europe Study Case, presented at the Advanced Training Course in Electricity Markets, Florence School of Regulation, 31.03.-04.04.2008

[267] Energy Community Secretariat, Report on the Implementation of Regulation 1228/2003/EC, *supra* at 15.

[268] SEETEC study, *supra*

[269] SEETEC study, *supra* at 56

[270] CARDS Project 2005, *Energy Community Report on State Level Compliance with Regional Market Design*, Annex 4: Compliance with the Electricity Action Plans-Chapter 3: Wholesale Markets, March 2007 at 138.

defining the two terms with regard to different characteristics. According to the first definition, the difference is in the fact that a supplier supplies an end customer, whereas a trader buys from a generator or other supplier and then sells further to a supplier, but both supplier and trader in this case, might need a license and could be held responsible for imbalances. According to the second definition, a supplier buys and sells physical products, whereas a trader buys and sells financial products, in which case only the supplier should be licensed and only the supplier could be held responsible for imbalances.

Due to the different regulatory requirements that are necessary for obtaining one or another license, in the SEETEC's study[271] but also in the Discussion Paper earlier by CEER,[272] it was concluded that the two concepts should be harmonised in order for the trade and operation of the SEE REM to be facilitated.

6.3.6 Transparency Requirements.

The transparency requirements are very important in order for the electricity market to function effectively. Transparency is necessary for allowing the new entrants on the electricity market to have the necessary data for taking investment decisions, for detecting price distortions and cross-subsidies as well as to prevent fraud in electricity contracts.[273] In addition, the bilateral contracts that are currently in place in some of the national electricity markets should be implemented in a transparent and non-discriminatory manner.[274] With regard to the transparency requirements of the Electricity Directive, TSOs have to publish all relevant information including network availability, network access and network use, as well as information regarding already allocated capacity and forecasted available capacity. Having in mind that problems with regard to the transparency issues exist in SEE countries, according to SETSO, possible approach for creating market transparency in the region could be the introduction of a common transparency platform, which would harmonize the way of providing information to market participants and create a level playing field in the region.[275]

6.4 Obstacles to Trade in SEE REM

Reforms at national level with regard to establishing national electricity markets, as well as the reforms with regard to the cross-border issues necessary for their integration into a REM taking place in the countries from SEE, have been explained in the sections above. Nevertheless, there are still obstacles which limit the volume and efficiency of trading. In this line are the four groups of potential obstacles that have been identified by SEETEC, all of which have been addressed in the separate parts of this paper, and will be summarised in succession.

The *first* group are issues related to the implementation of the EC Directives that as a priority include the cross-border allocation procedure and the ITC mechanism. It has been proposed that market based mechanisms should be developed rapidly and joint auctions need to be carried by the TSOs. Abolition of import/export monopoly should be abolished where it exists (Bulgaria). Furthermore, new ACC should not be issued while the old ones should be phased out and coordinated auction process across the whole SEE region should be established.[276]

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[271] SEETEC study, *supra* at 57

[272] CEER Discussion Paper, 2004, *supra*

[273] European Commission DG TREN: South East Europe Electricity Market Options Paper, Brussels, 5.12.2005

[274] CEER Discussion Paper, 2004, *supra*

[275] SETSO, , Report on CAO, 2007, *supra*

[276] SEETEC study, *supra* at 42

The *second* group of obstacles are again issues in relation to the EC Directives, such as the access to national networks and the role of the TSOs. Having in mind that the TSOs are the cornerstone of the reforms and incomplete implementation of the issues related to them (such as insufficient unbundling, TPA, access tariffs) is one of the key obstacles to efficient national and regional trade.[277]

The *third* group contains issues related to introduction of competition in the generation and supply: market concentration, vertical foreclosure and operability of market rules in particular. Due to the fact that the dominant market model in SEE has been to retain integrated generation and supply or to create a wholesale supply functions (single buyer for the regulated market and for eligible consumers which decide not to switch), it results with difficulties for new participants to enter the market and as an obstacle for creation of wholesale national competitive markets. Moreover, concentrated generation market and the small size of many countries were used as an excuse for not introducing national competition. Implementation of virtual auctions for capacity releases was recommended which means that the generation companies would be forced to sell through auctions some capacity.[278] In addition, implementation of market rules and their harmonisation at regional level should be another priority as well.

The *fourth* and last group of obstacles are issues that are specific for the SEE region such as tariff issues, harmonisation issues and licensing regimes. Tariff reform and increasing the tariffs to a cost-reflective level covering the real costs incurred, and at the same time having mechanisms for protection of the vulnerable groups of consumers was suggested. Furthermore, due to the fact that there was no follow up after the SMD for the whole SEE region suggested by CEER, each country has initiated the implementation of its own market model as shown above, and the development of their national market rules. Therefore, some harmonization and compatibility of the market structure and the timetable for the trading day could bring significant improvements.[279] In this line is the necessity for harmonising the licensing regime in the region as well, covering harmonisation of the definition for trader and supplier, as well as the administrative requirements for issuing and keeping a license.

All these obstacles identified by SEETEC and the recommendations made in that study, were later taken into account when drafting the benchmarks for the separate countries and the reports that have been drawn by the Energy Community on the establishment of the SEE REM.[280]

7 Summary of the Achievements and Remaining Open Issues

There is not enough competition in the SEE region due to the fact that in most of the countries the generation and supply companies are still integrated or there is a wholesale supplier which through the implemented single buyer model buys electricity for the regulated market. In addition, there is high concentration in the generation market in the region. Furthermore, the situation is similar in the neighbouring countries as well.[281] On the other hand, there are many traders in the region, most of them being owners of the generation assets in the EU. The distribution companies are either integrated with the dominant generation company (Montenegro) or are not eligible and need to buy all the electricity needed from the wholesale supplier (Macedonia). It should be noted as well, that there are

[277] SEETEC study, *supra* at 44

[278] SEETEC study, *supra* at 46

[279] SEETEC study, *supra* at 55

[280] CARDS Project 2005, Facilitating and Implementing the Energy Community in South East Europe: *Energy Community Report on Regional Market Design*, Reference: 100231, February 2007; *Energy Community Report on Compliance with the Electricity Benchmarks*, Reference: 100231 Original December 2006 Revision March 2007; *Quarterly Progress Report* (April - June 2007), Reference: 100-231, July 2007.

[281] There is a dominant generator-supplier in Greece and no supply businesses in Slovenia. Moreover, in Hungary, there are a series of PPAs between the generators and the wholesale supplier who resells the power to privatized suppliers. See: SEETEC study, *supra* at 17.

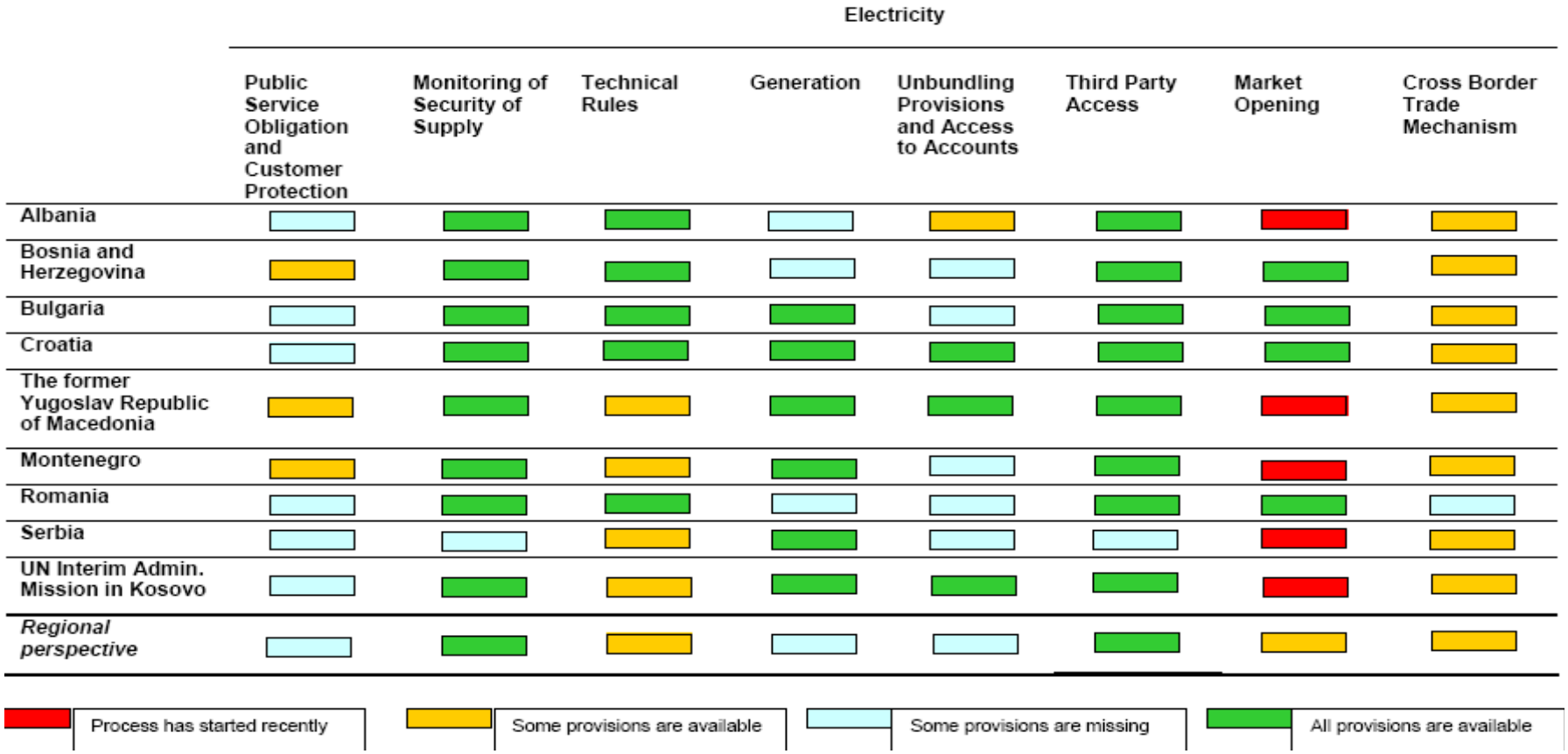
very few eligible customers (large industry mostly), and the eligibility thresholds differ around the region. Market rules even though are adopted by most of the regulators, they are not harmonised at regional level. Further harmonisation is needed also with regard to the implementation of the Regulated Fixed Tariff system, with identification of groups of consumers which shall participate in it, as well as timetable for its implementation and removal as the retail market opens at a later stage. With regard to the PSO, the SEE countries have introduced provisions in their legislation, but when it comes to the protection of the vulnerable consumers as well as to introduction of a supplier of last resort, the situation is not so positive and additional work is needed.

The idea for establishing a SEE REM should be achieved through introducing wholesale competition market model with bilateral contracts, as well as DAM at a later stage. Also a short-term wholesale market for balancing should be established. But in the SEETEC's study it was found that in the transitional phase at the moment, the retail electricity market for large industrial consumers is more opened then the wholesale market itself, because the eligible customers can import electricity directly or buy electricity from traders, whereas there is a wholesale supplier at wholesale level acting as a single buyer. Therefore, there is also very low wholesale activity on the free market. However, after the presentation of the SMD for SEE by CEER and its endorsement by the Commission, all countries started to develop their own national electricity markets which differ among each other. Bilateral contracts are the most usual model for trading electricity implemented so far, with regulated balancing market.

Nevertheless, having in mind the short period of implementation of the EnCT and liberalisation of the electricity markets in the countries of SEE, compared to the period that was necessary for the Member States of the EU, it could be concluded that the reforms brought some important improvements at national and regional level. They include development of legislation, unbundling, PSO provisions, TPA and overall wholesale market organization. However, attention should be brought to the fact that there are still areas where progress shall be done such as adoption of technical rules, unbundling of distribution and supply, unbundling of generation, development of a retail market, tariff reform and protection of vulnerable consumers and appointment of a supplier of last resort.

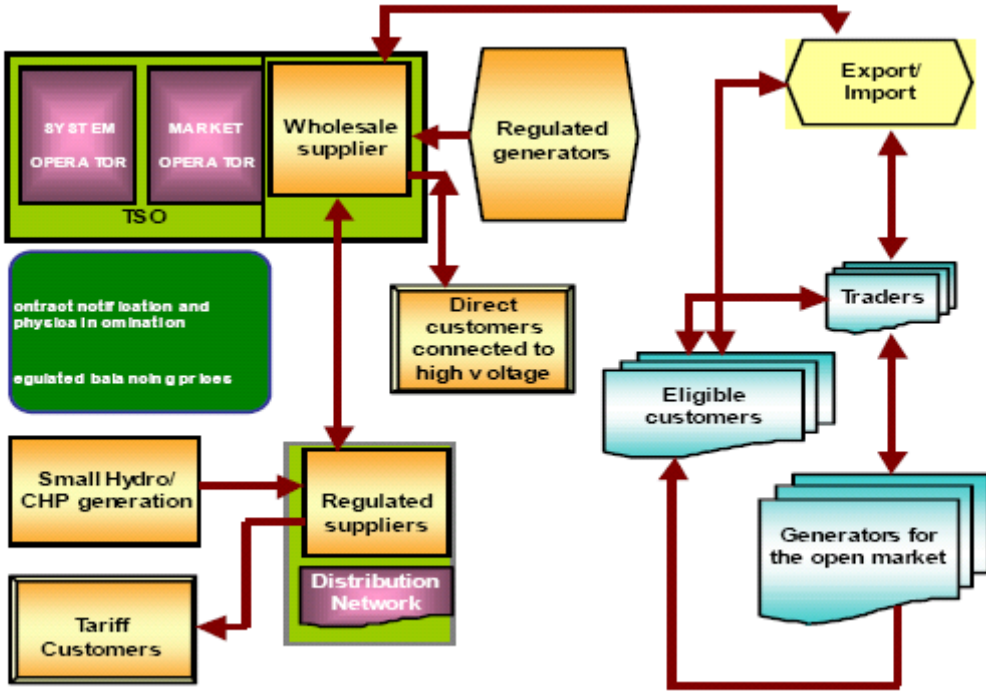
Therefore, having in mind the existing obstacles on the way to establishing a real liberalised REM in SEE, there are still some open questions which deserve further studying and monitoring of their development, having in mind the importance of the Energy Community and the firm commitment of its participants for establishment of REM. Some of these questions and remaining problems could be: the definition of the geographical scope of the region itself and the harmonisation of market rules and national market designs. Licensing regime and its harmonisation at regional level is another interesting and open issue. In addition, the regulators' activity with regard to tariff reforms, which depend very much on the market designs and gradual opening of the markets, are very important question because of their impact on the final consumers, having in mind the economic situation and the specific characteristics of these developing countries.

Annex 1: Electricity benchmarking



Source: CARDS Project 2005, Facilitating and Implementing the Energy Community in South East Europe: *Report on the Implementation of the Treaty Establishing the Energy Community*, May 2007, at 14.

ANNEX 2: Most Common Market Design in SEE



Source: SEETEC Balkans[282]

[282] SEETEC Balkans: *"Study of the Obstacles to Trade and Compatibility of Market Rules"*, Southeastern Europe Electrical System Technical Support Project, Regional Activity REM-1202: Final Draft Report 014551-REM-1202-47RA-I-0001-01, June 2006, presented at the 9th Athens Forum, 23-25 October 2006, Athens at 30.

List of Abbreviations

AAC – Already Allocated Capacity
AD ESM - Electric Power Company of Macedonia
AD ELEM - Electric Power Generators of Macedonia
ATC – Available Transmission Capacity
CAO - Co-ordinated Explicit Flow-based Auctions for transmission capacity allocation
CBT – Cross-border Transmission
CEE – Central East Europe
CEER - Council of European Energy Regulators
CHP – Heat and Power Plant
CMG - Guidelines on congestion management
DAM – Day-Ahead Market
DG TREN - Directorate General for Transport and Energy
DSO – Distribution System Operator
EBRD – European Bank for Reconstruction and Development
EC – European Communities
ECJ – European Court of Justice
ECRB – Energy Community Regulatory Board
EnCT - Treaty establishing the Energy Community for South East Europe (Energy Community Treaty)
ENP – European Neighbourhood Policy
ERC – Energy Regulatory Commission
ERGEG - European Regulators Group for Electricity and Gas
ERI - Electricity Regional Initiative
ERRA - Energy Regulators Regional Association
ETSO – European Transmission System Operators
EU – European Union
GIS – Generation Investment Study
GRI - Gas Regional Initiative
HPP – Hydro Power Plant
ISO – Independent System Operator
IPP – Independent Power Plant
ITC – Inter-TSO Compensation
LNG - Liquefied Natural Gas
MEPSO – Macedonian Transmission System Operator
MO – Market Operator
NRA – National Regulatory Authority
PHLG - Permanent High Level Group
PPA - Power Purchase Agreements
PSO – Public Service Obligation
REM – Regional Electricity Market
SAP – Stabilization and Association Process
SECI - South Eastern Cooperative Initiative
SEE – South East Europe
SEE REM – South East European Regional Electricity Market
SEETEC – South Eastern Europe Electrical System Technical Support Project
SEETSO – South East European Transmission System Operators
SFRY – Socialist Federal Republic of Yugoslavia
SMD – Standard market Design
TAP – Trans-Adriatic Pipeline
TEN-E Guidelines – Trans-European Energy Guidelines

TEU – Treaty of the European Union
TPA – Third Party Access
TSO – Transmission System Operator
UCTE - Union for Co-operation of Transmission of Electricity
UNMIK – United Nations Mission in Kosovo

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