



MEMORANDUM

TO: Jane Wilson

FROM: Ognjen Markovic

DATE: August 19, 2010

RE: Annual Report on the implementation of the Acquis under the Treaty Establishing the Energy Community, prepared by Energy Community Secretariat

The Energy Community Secretariat prepared the Annual Report on the implementation of the Acquis under the Treaty Establishing the Energy Community. The Report that covers the period mid 2009 and mid 2010 will be presented at the next Energy Community Ministerial Council that will take place on September 24, 2010. The Report is interesting for at least two reasons: (i), the first reason is that the Report gives general comments with regard to the implementation of the Acquis in the South East Europe (SEE) region and (ii) the second reason is that the Report addresses the implementation of the Acquis in each Contracting Party particularly addressing the following issues: (i) Implementation of the respective acquis; (ii) Progress made within the reporting period and (iii) State of compliance. Though the Secretariat does not have deep insight into each electric power sector, it is of great interest to see the Secretariat's view on the achievements of each party and items that contracting parties should deal with in the future. A particular issue that is important for BiH in this Report is Secretariat's comments on the OHR decision on the supply of District Brcko. They consider the amendments imposed by OHR to the State and entity laws as contrary to EU Directive 2002/54 and Energy Community Treaty.

These are some of the most important items from the report:

The SEE Region: The following are the most interested findings with regard to the Region:

- (i) Generally speaking all Contracting Parties established a legal frameworks based on the acquis;
- (ii) All Contracting Parties transposed the acquis in the regulated sectors. Domestic legislation that deals with authorization/tender procedures, competition, state aid, customs and taxes, and social issues are still missing;

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- (iii) The market opening section shows that most of the Contracting Parties comply with the Treaty in granting eligibility to non-household customers, however, due to keeping regulated tariffs below costs and market price, regulators incentivize customers to stay as tariff customers. This is the impediment for successful market functioning. At the same time, this approach distracts investors from investing in the electric power sector of the Contracting Parties;
- (iv) Instead of developing and implementing a vulnerable customer programs, the countries in the region very often use subsidization;
- (v) The Contracting Parties apply some measures that disturb successful wholesale market functioning in the region. Such measures are export fees, statutory priority to domestic electricity; a method of capacity allocation, etc.
- (vi) The Report, in the general observations, mentions Bosnia and Herzegovina as the most critical case with regard to regulatory independence, regulatory tasks and responsibilities on the state level.
- (vii) Unbundling TSO was finalized in all Contracting Parties but unbundling of distribution, supply and generation is still pending;
- (viii) The network tariff is still not cost reflective so this has negative effect on investments in the networks;
- (ix) The rate of voluntary supplier switching is almost zero;
- (x) Security of supply concerns reporters due to lack of the investments in new generations in the region;
- (xi) Coordinated Auction Office project implementation has been blocked due to an evident gap between the political support and adequate follow-up on the operative levels.

Bosnia and Herzegovina:

Progress made in the reporting period:

- (i) No progress regarding the functioning of the Transco. The Transco Working Group has not advanced in solving the problem;
- (ii) SERC adopted a new standard contract on responsibility on balancing;
- (iii) “Congestion management on interconnections has been substantially changed by mid 2010 when SERC approved the auction rules base on market principles”. *(This is the only real progress made in the observation period).*

State of compliance:

As the Report reads the legislation transposes the main part of acquis: Market opening; Public service obligation; Tasks of TSO and DSO; Unbundling requirements; Regulatory competences; Customer protection; Operational security; Third party access; Congestion management and confidentiality protection;

The Report addresses the following issues that are still not adequately transposed:

- (i) Universal service not adequately defined;
- (ii) Labeling information is still not required;



- (iii) Tendering procedures are not adequately transposed;
- (iv) Responsibility related to reporting on security of supply and measures to maintaining long-term energy balance are not consistently assigned
- (v) Regulatory competence related to the methodologies for the provision of balancing services is not explicitly assigned;
- (vi) Competence over District Brcko supply tariffs is still pending issue;

The Report comments on the amendments to the Law on the Transmission of Electric Power, Regulator and System Operator in BiH and the FBiH Electricity Law. They consider provisions that oblige the two utilities to supply all customers in the FBiH contrary to Art 32 of the Treaty and Art. 3.1. of the EU Directive 2003/54. The Report has same conclusions with regard to the provisions on the supply of District Brcko.

The Energy Community Secretariat, who prepared the Report, considers SERC's decision to establish a fee for declared export contrary to Article 41 of the Treaty and 4(4) of Regulation 1228/2003.

The Report expects the ISO to coordinate its congestion management method and procedures with neighboring TSO's.

Particular attention in the Report was paid to an adequate network tariff that would enable investors to finance a building of networks.

REAP's opinion: While the chapter that deals with Bosnia and Herzegovina particularly, does not address market opening and other important issues, it is obvious that general comments, made on the regional level, could be applied to Bosnia and Herzegovina too. This is case particularly with items (iii), (iv) and (v) related to the Region.

Generally the Report says the following:

1. Barriers for investment: There are barriers for investments in BiH. The report addresses the following: (i) Authorization/Tendering procedures are not defined; (ii) Tariffs are below market prices and are not cost based; (iii) Transco does not function properly;
2. Impediments for successful market functioning: (i) Unbundling has not been accomplished yet; (ii) Tariffs are below market prices; (iii) Supplier of Last resort and Default Supplier are not determined; (iv) Balancing issue unsolved; (v) Transco does not function properly;

REAP will take into account this Report when updating the Internal Action Plan for Bosnia and Herzegovina.