

Assessment of the Application of Community Law in a Third Country

Review of the Republic of Serbia



For the purpose of participation of the Serbian energy regulatory authority, AERS, in Working Groups of the Agency for the Cooperation of Energy Regulators in accordance with Article 31 of Regulation (EC) 713/2009

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1. Introduction

1.1. Scope and context

The present review assesses the compliance of energy sector legislation in the Republic of Serbia with the criteria of Article 31 of Regulation (EC) 713/2009 ('ACER Regulation')¹ concerning participation of third countries² in the Agency for the Cooperation of Energy Regulators (ACER). More specifically, the review analyses whether the Republic of Serbia is on track to meet the requirements of Article 31 of Regulation (EC) 713/2009 within the next six to twelve months which should trigger the possibility for staff of the Serbian energy regulatory authority (AERS³; 'the regulator') to participate in the Working Groups of ACER (cf. chapter 1.2).

In the light of the requirement of Article 31(1) ACER Regulation for a third country to have "adopted and is applying" relevant EU law, the Secretariat's review looks into **transposition and implementation for both primary and secondary legislation**, including a forecasting perspective for the upcoming six to twelve months.

Further to the implementation of the Energy Community *acquis communautaire* ('acquis') on substance, the present analysis also assesses the organisational structure, competences and performance of AERS. The assessment thereby follows the requirements of Articles 39-42 of Gas Directive 2009/73/EC and Articles 35-38 of Electricity Directive 2009/72/EC, read in the light of the Secretariat's *Policy Guidelines on Independence of National Regulatory Authorities*⁴ that is setting essential pre-conditions for regulatory independence. An overview of the applied criteria is listed in the Annex to this report.

The review is performed by the Energy Community Secretariat ('Secretariat') following a request of AERS⁵.

The assessment is without prejudice to the competences of the European Commission ('Commission') to analyse compliance of Serbia with Article 31 of Regulation (EC) 713/2009.

1.2. Relevant legal framework

Articles 13 and 14 of the ACER Regulation limit membership to ACER's formal bodies, i.e. the Board of Regulators (BoR) and the Administrative Board (AB), to representatives from EU Member States. Article 31 however also opens the possibility for **participation of third countries in ACER, provided that:**

1. The third country has concluded an agreement with the Union (Article 31(1));
2. The third country has adopted and is applying Union law in the field of energy and, if relevant, in the fields of environment and competition (Article 31(1));
3. An institutional framework has been set up in the agreement referred to under (1) to specify, in particular, the nature, scope and procedural aspects of the involvement of the third country including provisions relating to financial contribution and to staff (Article 31(2)).

¹ OJ L 211 of 14.8.2009, p 14 et seq.

² i.e. non EU Member States.

³ Агенција за енергетику Републике Србије / Energy Agency of the Republic of Serbia (AERS); www.aers.rs.

⁴ PG 02/2015 of 28.1.2015.

⁵ Letter of 18 May 2016, ref.no. 269/2016-D-II.

The Commission by letter of 25 March 2015⁶ clarified that the Energy Community Treaty is to be considered an “agreement” as referred to in Article 31(1); and that the assessment of a third country’s compliance with the second requirement of Article 31(1) is to be carried out by the Commission with the support of the Secretariat.

The Commission, however, in the same communication also underlined that the above requirements are only pre-conditional for third country’s participation in the BoR and AB, whereas the criteria for and acceptance of their involvement in ACER Working Groups remain at the discretion of the Director of ACER. The Director of ACER, by letters of 26 November 2014⁷ and 24 July 2015⁸, expressed his intention to allow participation of National Regulatory Authorities (NRAs) from third countries “as long as their countries are assessed as being on track in meeting the requirements of Article 31 and there being an expectation that this will be achieved within a reasonable period of time (6 to 12 months)”. By letter of 24 July 2015 the Director of ACER invited the Secretariat to perform related assessments and inform ACER about its analysis.

1.3. Serbia under the Energy Community Treaty

The Republic of Serbia is Party to the Energy Community Treaty (‘Treaty’) that was signed in October 2005 in Athens and entered into force in July 2006. Articles 5 and 6 in conjunction with Article 11 of the Treaty commit the signatories to implement the *acquis* as listed in Annex 1 to the Treaty. The *acquis* relevant for the present assessment is listed in chapter 1.4; implementation and compliance by the Republic of Serbia is further discussed in chapter 2.

1.4. Relevant Energy Community *acquis communautaire*

Article 31(1) of the ACER Regulation requires third countries to have adopted and apply Union law “in the field of energy and, if relevant, in the fields of environment and competition” as pre-condition for their participation in ACER.

ACER currently has established four Working Groups⁹:

- Implementation, Monitoring and Procedures Working Group;
- Monitoring, Integrity and Transparency Working Group ;
- Electricity Working Group;
- Gas Working Group.

As regards **electricity and gas market legislation**, relevant EU law in the form of the so-called Third Energy Package – namely Electricity Directive 2009/72/EC, Gas Directive 2009/73/EC, Electricity Regulation

⁶ Ref. ENER.B2/SZ/el/ener.b2(2015)1198324.

⁷ Ref. ACER-AP-FG-ss-2014-647.

⁸ Ref. ACER-AP-FG-ss-2015-390.

⁹ http://www.acer.europa.eu/en/The_agency/Organisation/Working_groups/Pages/default.aspx. Both the Commission and ACER in their related correspondences (cf chapter 1.2) expressed that participation of Energy Community Contracting Parties’ NRAs should not be open to Working Groups dealing with the implementation of Regulation 1227/2011 (REMIT), OJ L 326 of 8.12.2011,p 1 et seqq.

(EC) 714/2009 and Gas Regulation (EC) 715/2009 – has been included in the Energy Community acquis by Ministerial Council Decision 2001/02/MC-EnC of 5 October 2011¹⁰.

Besides, compliance with the acquis in the fields of competition and environment are relevant for the present assessment as well, having in mind that competition and state aid control form the very basis for effective implementation of the gas and electricity acquis. At the same time, compliance with the standards established by the Energy Community acquis on environment, in particular with regard to the reduction of emissions may be relevant as well, as it prevents third countries' energy sectors from gaining unfair competitive advantage over those in the EU.

As regards **competition law**, the acquis rests on three pillars:

- the prohibition of anti-competitive agreements established by Article 101 of the Treaty on the Functioning of the European Union ("TFEU");
- the prohibition of abuse of a dominant position provided for in Article 102 TFEU; and
- the prohibition of State aid granted in violation of Article 107 TFEU and the principles of the Treaty.

As regards **environmental legislation**, the following pieces of EU law have been included in the Energy Community acquis: Directive 85/337/EEC on environmental impact assessment, Directive 1999/32/EC on the sulphur content of liquid fuels, Directive 2001/80/EC on the emissions of large combustion plants, Chapter III and Annex V of Directive 2010/75/EU on industrial emissions¹¹ and Article 4(2) of Directive 79/409/EEC on wild birds.

2. State of implementation

Serbia transposed the majority of the Third Energy Package's electricity and gas acquis requirements by adopting the Energy Law ('the Energy Law') in December 2014¹².

2.1. Electricity

In line with the deadlines stipulated in the Energy Law, the majority of by-laws were adopted or amended in 2015. This includes a set of rules on energy permits, licensing and certification, vulnerable customers, switching supplier, organised electricity market operation, transmission and distribution Grid Codes, pricing methodologies for transmission and distribution network use, pricing methodologies for guaranteed supply and pricing methodologies for connection to the transmission and distribution system. The decree on conditions of electricity delivery and supply still remains to be aligned with the Energy Law. The market rules that define market-based procedures for procurement of balancing energy and non-discriminatory and cost-reflective imbalance settlement are applied as of 1 January 2013. The transmission system operator is currently in the process of adapting the rules to the Energy Law and market requirements. Development and adoption of the rules on publication of the key market data is still pending.

¹⁰ The ACER Regulation is not part of the Energy Community acquis.

¹¹ Included by Decision 2013/05/MC-EnC of the Ministerial Council, as amended by Decisions 2015/06/MC-EnC and 2015/07/MC-EnC.

¹² Official Gazette of Serbia No. 145/2014.

- a. The provisions of Directive 2009/72/EC concerning (ownership) **unbundling** of the transmission system operator are transposed in the Energy Law and apply as of 1 June 2016. However, the transmission system operator Elektromreža Srbije (EMS) has not been unbundled in compliance with this deadline. Certification is by law envisaged to be finalised until 30 December 2016. Given the state of preparations, keeping this deadline is equally non-realistic. Necessary unbundling measures, including amendments of the Law on Government, the Law on Ministries and the Law on Public Companies are yet to be taken in order to ensure separation of control over the transmission system operator EMS and generation company Elektroprivrede Srbije (EPS), both fully state-owned companies, supervised by the Ministry of Economy, Ministry of Finance and Ministry of Mining and Energy in accordance with their specific competences.

Unbundling of the distribution system operator was due under the Energy Community Treaty by 1 January 2015. The requirements were transposed and implemented in line with the acquis. Legal unbundling was finalised in July 2013. Functional unbundling was accomplished in June 2016. The regulator approved a compliance programme of the distribution system operator and the distribution system operator's decision on the appointment of the compliance officer. An exemption from unbundling for distribution systems with less than 100.000 customers exists, however there are no distribution system operators to which this provision would apply.

- b. Provisions on **third party access** to transmission and distribution systems are transposed in compliance with the Third Package and further defined by the Transmission and Distribution Grid Codes. Network fees for the transmission and distribution systems are determined and published based on methodologies adopted by AERS.

The procedures for exemption of new direct current interconnectors from third party access, including the role of the Secretariat, are defined in line with Regulation (EC) 714/2009.

Cross-border transmission capacities are allocated by EMS through joint auctions with neighbouring system operators of Bulgaria (ESO), Croatia (HOPS), Hungary (MAVIR), Romania (Transelectrica) and Bosnia-Herzegovina (NOS BiH), split auctions with Montenegro (CGES), FYR of Macedonia (MEPSO) and Albania (OST). The allocation process is conducted based on the rules approved by AERS. However, EMS is still not participating in a **regional coordinated capacity allocation** platform. This is subject to an ongoing infringement procedure¹³ and a key condition ("soft measure") under the so-called Western Balkan 6 process¹⁴.

A second pending infringement case in the electricity sector¹⁵ relates to the **usage of revenues** from the allocation of electricity interconnection transmission capacities by EMS that goes beyond the list of exclusive usage cases supported by Article 6(6) of the Electricity Regulation and therefore is not in line with the Energy Community law.

The rules on **balancing** and imbalance settlement, which are further elaborated by the market rules, are transposed and implemented in line with the Electricity Directive's requirement for a market-based and

¹³ Case ECS-6/11; www.energy-community.org – areas of work – enforcement.

¹⁴ www.energy-community.org – areas of work – Energy Community Western Balkan six.

¹⁵ Case ECS-3/08.

non-discriminatory approach. A functional national balancing market exists since 2013. EMS and the transmission system operator of Montenegro (CGES) started a cross-border balancing cooperation for exchange of balancing energy from a manually activated frequency restoration reserve. Prices of reserve capacity needed for secondary and tertiary regulation are still regulated. Deregulation of these prices depends on the assessment of AERS on the need for full or partial regulation (see below).

- c. In terms of market opening, the Energy Law defines eligibility in line with the acquis. All customers are eligible to choose their supplier as of 1 January 2015, including households and small customers. Switching rules were adopted by AERS in 2015.
- d. All final customers except households and small customers are obliged to choose their electricity supplier at unregulated prices as of 1 January 2015. Due to the market power enjoyed by the incumbent, EPS, only a very limited number of eligible customers chose alternative suppliers¹⁶. As a consequence, the market remains foreclosed.

Households and small customers retain the right to be supplied under regulated prices. Due to non-competitive regulated electricity prices, there are almost no households and small customers that have switched supplier. Deregulation of these prices depends on an assessment of AERS who is obliged to publish the first report on the need for further regulation of these prices until 1 May 2017. The report is to be based on the level of competition, development of the regional market and cross-border capacities. AERS, in cooperation with the Ministry of Mining and Energy has developed an action plan for phasing out remaining price regulation. Should AERS assess that the need for price regulation ceases to exist, the Ministry will have to select a guaranteed supplier for supply of customers at non-regulated prices.

In February 2016, the Serbian day-ahead electricity market operated by the joint-stock company South East European Power Exchange (SEEPEX) was launched. SEEPEX, together with the regulatory authority and the transmission system operator expressed interest to couple with the markets of Hungary, Czech Republic, Slovakia and Romania (known as 4MMC). New licensing rules and amendments to the Value Added Tax law that entered into force in October 2015 allow foreign companies to participate in the Serbian electricity market without restrictions. In praxis however, the number of participants in and liquidity of the day-ahead market remains rather low as the national state-owned supplier EPS only marginally participates. Increasing liquidity and reducing EPS' dominance will require further measures. AERS should play a more pro-active role in this process.

2.2. Gas

Serbia continued to align its secondary legislation with the Energy Law, with some shortcomings however. AERS adopted all necessary secondary legal acts stipulated by the law. The Ministry of Mining and Energy adopted licensing and certification rules.

¹⁶ In 2015 out of 3,617,781 total electricity customers, roughly 11% (396,248) were obliged to choose their supplier at unregulated prices. Out of this group 23% switched their supplier, which adds up to 2,5% of customer switches out of the total number of electricity customers (values rounded). The related percentages roughly doubled compared to 2014 data; cf. Secretariat, Annual Implementation Report 2016, market data Serbia.

A number of secondary legal acts were neither aligned nor adopted in line with the December 2015 deadline set by the law. This includes general conditions for gas supply, security of supply rules and all acts that should have been developed by the transmission system operator - *inter alia* the Grid Code, the programme for non-discriminatory conduct and the Ten-Year Network Development Plan.

- a. As regards **unbundling**, Serbia properly transposed the unbundling and certification provisions of the Third Energy Package. The Energy Law sets a deadline for unbundling of transmission system operators until 1 June 2016 and certification foreseen until 30 December 2016. All three models for transmission operator system unbundling were transposed. Some transitory provisions related to management cooling off periods under the Independent Transmission Operator (ITO) model could potentially lead to non-compliance with the Gas Directive. Moreover, the Law on Government, the Law on Ministries, the Law on Public Companies, Company Law and other regulations still need to be amended according to the Energy Law to allow for full implementation of unbundling.

Most importantly, however, the state-owned vertically integrated gas company of the country, Srbijagas, has been refusing to unbundle in line even with the Second Package for almost a decade now, which makes compliance with the Third Package unbundling requirements illusory.

Srbijagas holds licenses for and performs the activities of transmission system operation and supply of natural gas in Serbia, which means that it is not even unbundled in line with the Second Package gas acquis. Srbijagas has neither adopted nor applies compliance programmes as required by the Energy Law and the Gas Directive. In this context, the 2014 Energy Community Ministerial¹⁷ Council decided that Serbia breaches the Treaty and obligated Serbia to undertake necessary actions to fully unbundle Srbijagas. Following this Decision, the European Commission imposed rectify of the Treaty breach as pre-condition for opening the accession negotiations with Serbia on the energy chapter (chapter 15). Despite the Serbian government's approval of several restructuring plans of Srbijagas since 2014, the unbundling process of Srbijagas *realiter* did not progress. As a consequence of this serious and persistent breach, the Secretariat requests sanctions under Article 92 of the Treaty against Serbia; the case is to be heard and decided in October 2016.

Yugorosgaz Transport has applied for certification under Article 11 of the Gas Directive, being a TSO controlled by a person or persons from a third country or third countries but then revoked its application before AERS adopted a preliminary decision.

As none of the TSOs has been unbundled by 1 June 2016 it is to be expected that the certification procedure will not be finalised within the deadline of 30 December 2016 set by legislation.

In practical terms, the Network Codes are not implemented, thus foreclosing the gas market in Serbia.

The Energy Law requires the unbundling of storage and distribution operators from activities not related to storage and distribution, if they are part of a vertically integrated undertaking.

- b. The Energy Law transposes non-discriminatory **third party access** to transmission and distributions system and storage facilities as well as to upstream pipelines. Detailed rules on access to the transmission network have been included in the Network Codes of Srbijagas and Yugorosgaz Transport

¹⁷ D/2014/03-MC-EnC.

and Distribution Codes of distribution system operators. Banatski Dvor, the storage operator, did not adopt a Storage Code which represents a breach of the Energy Law.

The procedures for exemption of new gas infrastructure from third party access, including the role of the Secretariat, are defined in line with Directive 2009/73/EC.

The regulator approves tariffs for access to and usage of gas grids based on its methodologies defined and published in advance. The transmission tariff methodology is based on entry-exit principles in the case of Srbijagas but transmission fees of Yugostransgaz are still based on a post-stamp model which - in principle¹⁸ - contradicts the Energy Community law; the regulator though announced to rectify the breach by 31 December 2016¹⁹. Also, the Srbijagas transmission tariff includes commodity (trading) related costs components and thereby is not in compliance with the acquis: it has to be acknowledged that the regulator pinpointed to the incompliance with both national legislation and the acquis in writing in the course of the underlying negotiations between the International Monetary Fund and the Republic of Serbia. However, it is at the same time paramount to stress that AERS at the end gave in to political pressure. AERS has adopted a tariff methodology for access to storage. Nevertheless, Banatski Dvor does not perform storage activity based on the adopted tariff methodology although the law explicitly foresees only regulated access.

Provisions from Regulation (EC) 715/2009 have been transposed in detail in the Network Codes of Srbijagas of 2013 and Yugostransgaz Transport of 2015 which also include capacity allocation, congestion management and balancing. Secondary trading and interruptible capacity are offered as a means of congestion management. The balancing rules applied in the Srbijagas Network Code are defined in compliance with Regulation (EC) 715/2009.

The Network Codes of Srbijagas and Yugostransgaz Transport do not allow for transfer of capacity rights on a monthly or daily basis, which runs counter to the acquis' requirement for the transmission system operators facilitate such trade. Furthermore, both Grid Codes do not transpose the obligation to offer unused capacity on the primary market at least on a day-ahead and interruptible basis properly, thus breaching the congestion management procedures.

- c. In terms of **market opening**, the eligibility right to freely choose a supplier is guaranteed to all customers as of 1 January 2015, which is in line with the gas acquis. Supplier switching rules were adopted in 2012 and aligned with the new Energy Law and are compliant with the gas acquis. The majority of gas volumes traded – however not the majority of customers – are now supplied under market conditions. The percentage of customers which have supply contracts under non-regulated prices adds up to 85,3%. This does not translate, however, in a significant reduction of Srbijagas' market share which is monopolizing the non-regulated segment of the gas market in Serbia²⁰.

¹⁸ Article 14(1) of Regulation 715/2009, as applicable in the Energy Community according to Ministerial Council Decision 2001/02/MC-EnC, requires a separately bookable entry-exit system. A post-stamp model would in general not comply with this requirement. However, the draft Tariff Network Code currently discussed in the EU allows post-stamp tariffs under certain conditions. The document is not finalised yet.

¹⁹ Letter of 19 July 2016, ref.no. 447/2016-D02/1.

²⁰ In 2014 the number of companies selling at least 5% of available gas (i.e. gross inland consumption composed of production plus net imports plus storage variations) added up to two, out of which Srbijagas held 75%. In terms of market concentration this translates in a Herfindahl-Hirschmann Index (HHI) value of 10.000; according to economic theory a HHI value above 2.000 indicates high market concentration. Cf. ECRB, Market Monitoring Report 2015, tables 4 and 5.

Only two traders – NIS and Srbijagas – are active on the wholesale market. Serbia's gas market is based on bilateral purchase contracts between suppliers and customers. In total, 802 customers purchased gas on the market. The rest of the market (household customers and some small consumers) is supplied under regulated prices by 33 public suppliers. These categories of customers are also free to opt for supply under market conditions but the switching rate is low and adds up to only 5,5% of the total gas quantities sold to customers in Serbia; the switching rate for customers connected to the transmission system is higher and stands at 19,8% of sold gas quantities.

- e. Serbia is compliant with the provisions on **security of gas supply and customer protection** provisions required by Directive 2009/73/EC, and with Directive 2004/67/EC concerning measures to safeguard security of natural gas supply. Regulation (EC) 994/2010 on security of gas supply²¹ is not part of Energy Community acquis.

2.3. The regulatory authority

AERS is the single authority for regulating the energy sector of Serbia. The regulator is by law set up as an institution legally distinct and functionally independent from any other public entity. AERS is headed by a Council consisting of a President and four members with a term of five to seven years, all renewable once. A rotation scheme is in place: namely, Article 43 of the Energy Law stipulates that the President of the Council²² is elected for a period of seven years; two members of the Council are elected for a period of six years and two members for a period of five years. The current Council members and its President have been elected by the Serbian Parliament on 28 July 2011²³ and are completing their current term.

On the books, AERS' organisation complies with all independence criteria stipulated by Directive 2009/72/EC and Directive 2009/73/EC except for two – but very crucial – aspects: first, management does not have full autonomy in designing the authority's internal management. Rather, its statutes require the approval by the Parliament. A more serious threat to regulatory independence, however, lies in constant budgetary uncertainty and sufficient human resources: at the date of finalizing the present report AERS' financial plan for 2016 has not been approved by the Parliament yet; similar delays have been monitored in previous years. Also, according to the Law on the Maximal Number of Employees in the Public Sector, the employment of additional staff is subject to a Decision of the National Assembly Committee for Administrative and Budgetary Affairs. The number of new employees is indirectly subject to approval by the Parliament in the context of approving of the regulator's annual budget. Staff salaries have been originally comparable to the private industry and higher than those of the public sector. Due to a conservative policy of salary increase in comparison to the (regulated) industry as well as introduction of certain salary limits applicable to civil servants, the competitiveness of the regulator's salaries has decreased.

On the regional level, AERS is one of the most active participants in the Energy Community Regulatory Board (ECRB), including co-chairmanship of the Electricity Working Group and previous Presidency.

²¹ OJ L 295 of 12.11.2010, p 1 et seq.

²² AERS' management (Board) is referred to in the Energy Law as "the Council".

²³ <http://www.aers.rs/Index.asp?l=2&a=14>.

AERS has also proven both expertise and commitment to develop secondary legislation in line with required deadlines. AERS' performance and independence thus seems well established with regard to technical aspects of market regulation and tariff setting.

By contrast, the regulatory authority still is to establish its full independence in practice, in particular when it comes to rectifying or even addressing the major issues of non-compliance of Serbia's energy markets with the European rules applicable through the Energy Community. Indeed, the regulator failed for several years to object political pressure and enforce compliance of regulated companies with the Serbian and Energy Community law and abolish the shortcomings described in chapters 2.1 and 2.2. The Secretariat is firmly convinced that one must expect from a truly independent regulator active enforcement of legal obligations including imposition of measures in case of in-compliances, even if involving politically sensitive aspects and/or state-owned companies. It is, according to Article 57(3) of the Energy Law indeed the obligation of AERS to ensure fulfilment of legal obligations by regulated companies.

2.4. Competition and State aid

Serbia has adopted the Law on Competition in 2009. Its provisions are largely in line with the *acquis* on competition. The authority in charge for enforcement is the Commission for Protection of Competition. However, since its establishment it has neither undertaken any investigation of the gas or electricity markets (only repeatedly of the oil and oil derivatives market) nor identified any infringements of competition law in the energy sectors.

In the area of State aid, the Law on State Aid, adopted in 2009, is generally compliant with the *acquis*. The Commission for State Aid Control is in charge of the enforcement of the State Aid Law and is assisted by a Department of State Aid established within the Ministry of Finance. This close link to the ministry puts the authority's independence into question. The Commission has only become active in the energy sector upon a request for information by the Secretariat following complaints regarding potential aid measures.

Despite having adopted provisions in line with the EU *acquis* on competition and State aid, there is currently a lack of active application of those rules by the enforcement authorities in charge.

2.5. Environment

Environmental impact assessment in Serbia is governed by the Law on Environmental Impact Assessment of 2004, as amended in 2009. The list of activities requiring an environmental impact assessment is transposed by the Decree on the Lists of Projects Subject to an Environmental Impact Assessment, adopted in 2011. Overall, Serbia has reached a high level of transposition and environmental impact assessments are carried out in accordance with the provisions of the Directive.

As regards the Sulphur in Fuels Directive, Serbia fails to comply with the provisions of the directive on the maximum sulphur content of heavy fuel oil. The Secretariat launched an infringement case in 2013 which has been referred to the Ministerial Council by a Reasoned Request in May 2016.

Serbia has adopted new legislation regulating the emissions of large combustion plants, namely the Regulation on Emission Limit Values of Pollutants into the Air from Combustion Plants and the Regulation on the Measurements of Emissions of Pollutants into Air from Stationary Sources of Pollution. These regulations transpose the requirements of the Large Combustion Plants Directive (for existing plants) and the Industrial Emissions Directive (for new plants) and will enable Serbia to implement the provisions of these directives by the deadline set by the Treaty, i.e. 31 December 2017. Furthermore, Serbia prepared and submitted to the Secretariat a National Emission Reduction Plan in December 2015. It is therefore expected that compliance with the Large Combustion Plants and Industrial Emissions Directives will be ensured the within the next six to twelve months following the implementation deadline.

3. Forecast – probability to reach full de iure and de facto compliance within the next six to twelve months

At this moment, based on the evidence available as well as resistance experienced in the past, and taking into account the lead time as well as the political complexities, the Secretariat does **not** deem realistic the closure of the following breaches of the acquis and market shortcomings within the upcoming six to twelve months:

Electricity

- Case ECS-3/08 related to EMS' usage of revenues resulting from the allocation of electricity interconnection transmission capacities by EMS;
- Case ECS-6/11 related to participation of EMS in a regionally coordinated electricity cross-border transmission capacity allocation;
- Unbundling and certification of EMS in line with the Third Energy Package;
- De-regulation of electricity prices for households and small customers;
- Unconditional support of EMS for participation of KOSTT in ENTSO-E.

Gas

- Case ECS-9/13 related to the unbundling of Srbijagas and Yugostransgaz in line with the Second Energy Package;
- Unbundling and certification of Srbijagas and Yugostransgaz in line with the Third Energy Package;
- De-regulation of electricity prices for households and small customers;

Competition and State aid: effective implementation of competition and State aid law in the energy sector.

Environment: compliance with the Sulphur in Fuels Directive.

4. Conclusions

The gas and electricity legislation in the Republic of Serbia ranks among the most enhanced in the Energy Community Contracting Parties, at least in terms of transposition. Serbia was the first Contracting Party of the Energy Community to transpose the Third Energy Package and has achieved a high degree of compliance in that respect. The degree of real term implementation, however, is not on the same level.

In the electricity sector, the picture is mixed. While notable progress was achieved in wholesale market opening, further efforts are needed to develop competition in the retail market. The country is in the vanguard in regional spot market development. At the same time, it is the only country in the Western Balkans where the transmission system operator does not participate in regional capacity allocation as required by the acquis. Its transmission system operator also continues to obstruct the unconditional integration of Kosovo's KOSTT in ENTSO-E, with negative knock-on effects on regional integration. Lacking unbundling of EMS and persistence of regulated electricity prices for households and small customers remain obstacles to effective market opening. It remains to be seen whether the regulator will be able to translate into real term success the progress made on wholesale level with the establishment of SEEPEX by setting measures to boost liquidity.

The gas sector remains foreclosed. To a large extent it is due to the refusal of the state-owned incumbent Srbijagas to unbundle in line with the Energy Community acquis. This constitutes a serious and persistent breach of the Energy Community rules as a result of which Serbia may face sanctions under Article 92 of the Treaty.

On institutional level both the energy regulator and Commission for State Aid Control have to develop a more active and independent profile to design and shape the energy market of Serbia. While performing well on a technical level, the energy regulatory authority has to become more active and facilitate the further opening of the market and tackle major issues of European and national rules not complied with, in particular by the state-owned incumbents. This inertia also calls into question its independence from political influence and/or the interests of the state-owned energy incumbents.

Having said this, it is noted that the present review applies strictest standards in terms of *de iure* transposition and *de facto* implementation that, most probably, are not met by all of EU energy markets and / or regulators either.

While it remains for ACER to consider which level of compliance with the acquis it deems sufficient for participation of a third country's regulatory authority in its Working Groups, the Secretariat, based on the assessment above, respectfully suggests that

- AERS would benefit from and has the necessary capacities for participation in the Implementation, Monitoring and Procedures Working Group (AIMP WG) and should be invited to that WG. This includes participation in the process of developing Framework Guidelines and reviewing Network Codes;

- Given the absence of REMIT in the Energy Community, the Secretariat abstains from the proposal related to the invitation to the Monitoring, Integrity and Transparency Working Group (AMIT WG);
- An invitation of AERS to the Electricity Working Group and the Gas Working Group should be made conditional on unbundling and certification (taking into account the Opinion of the Secretariat) of the respective transmission system operators in line with the Third Energy Package.

Annex

	Criteria	Reference	
		Gas	Electricity
Legal set up and impartiality	NRA is established as single regulatory authority with nation-wide competences in gas and electricity	Directive 2009/73/EC, Art 39.1	Directive 2009/72/EC, Art 35.1
	NRA is established by law, i.e. not by decision of another public institution	not a 3rd Package requirement but as general principle an institution needs to be established by law to ensure independence	
	Legal and functional independence from public and private interest is stipulated by law	Directive 2009/73/EC, Art 39.4(a)	Directive 2009/72/EC, Art 35.4(a)
	Management and staff are prohibited to hold political positions or have interest in regulated companies	Directive 2009/732/EC, Art 39.4(b)	Directive 2009/72/EC, Art 35.4(b)
	Sanction for violation of the prohibition to hold political positions or have interest in regulated companies exist (dismissal or other)	Directive 2009/72/EC, Art 35.4(b) and Directive 2009/732/EC, Art 39.4(b) require that management and staff are prohibited to hold political positions or have interest in regulated companies - a sanction mechanism in case of violation of this rule additionally supports compliance (ECS, Policy Guideline on NRA Independence)	
	Staff has to act independently from market interest / not seeking or taking instructions	Directive 2009/73/EC Art 39 (4b (ii)) and ECS, Policy Guideline on NRA independence	Directive 2009/72/EC Art 35 (4b (ii)) and ECS, Policy Guideline on NRA independence
	Decision making is by law defined as autonomous and independent	Directive 2009/73/EC, Art 39.5(a)	Directive 2009/72/EC, Art 35.5(a)
	Decisions are immediately legally binding	Directive 2009/73/EC, Art 41(4a)	Directive 2009/72/EC, Art 37(4a)
	Decisions are required to be duly substantiated and justified to allow for juridical review	Directive 2009/73/EC, Art 41(16)	Directive 2009/72/EC, Art 37(16)
	Appointment of Board members	Vacancies are announced publically	ECS, Policy Guideline on NRA independence
Selection process is defined by law and includes a selection committee		ECS, Policy Guideline on NRA independence	
Selection criteria for Board member are defined by law and are limited to education, experience, neutrality		ECS, Policy Guideline on NRA independence	
Top management terms are limited to a fix term of 5-7 years		Directive 2009/73/EC, Art 39(5b)	Directive 2009/72/EC, Art 35(5b)
Top management terms are renewable only once		Directive 2009/73/EC, Art 39(5b)	Directive 2009/72/EC, Art 35(5b)
A rotation scheme in the sense of the 3rd package is in place		Directive 2009/73/EC, Art 39(5b)	Directive 2009/72/EC, Art 35(5b)

	Criteria	Reference	
		Gas	Electricity
Operation	NRA has sufficient human resources	Directive 2009/73/EC, Art 39(5a)	Directive 2009/72/EC, Art 35(5a)
	Management has autonomy on internal organisation (work program, statutes) including staff appointment	Directive 2009/73/EC, Art 39(4a); ECS, Policy Guideline	Directive 2009/72/EC, Art 35(4a); ECS, Policy Guideline
Financial independence	NRA has a separate annual budget	Directive 2009/73/EC, Art 39(5a)	Directive 2009/72/EC, Art 35(5a)
	The budget is financed from levies	ECS, Policy Guideline on NRA independence	ECS, Policy Guideline on NRA independence
	NRA's budget does not require approval by another public body	ECS, Policy Guideline on NRA independence	ECS, Policy Guideline on NRA independence
	NRA has certainty on financial resources	ECS, Policy Guideline on NRA independence	ECS, Policy Guideline on NRA independence
	Staff salaries orientate on regulated industry	ECS, Policy Guideline on NRA independence	ECS, Policy Guideline on NRA independence
	NRA has autonomy in using its annual budget	Directive 2009/73/EC, Art 39(5a)	Directive 2009/72/EC, Art 35(5a)
Dismissal	Dismissal reasons are limited to cases of criminal offence or in compliance with independence	Directive 2009/73/EC, Art 39(5b subparagraph 2)	Directive 2009/72/EC, Art 35(5b subparagraph 2)
Competences	NRA is equipped with all 3rd package competences	Directive 2009/73/EC	Directive 2009/72/EC
Accountability	NRA provides an annual activity report	Directive 2009/73/EC, Art 41 (1e)	Directive 2009/72/EC, Art 37 (1e)
Transparency	Decisions are published	Directive 2009/73/EC, Art 39(4a)	Directive 2009/72/EC, Art 35(4a)
	Information about the NRA structure and governance is published	Directive 2009/73/EC, Art 39(4a)	Directive 2009/72/EC, Art 35(4a)
	Board meetings are (in general) open to public	adds to transparency (Directive 2009/73/EC, Art 39(4a))	adds to transparency (Directive 2009/72/EC Art 35(4a))