

DISPUTE SETTLEMENT REPORT

1. Background

Title VII of the Treaty establishing the Energy Community envisages a dispute settlement mechanism to enforce the obligations assumed by the Parties by signing the Treaty. Articles 90 to 93 have been fully applicable from the entry into force of the Treaty, but dispute settlement only started in practical terms after the adoption of the Rules of Procedure for Dispute Settlement under the Energy Community Treaty in June 2008 by the Ministerial Council (Procedural Act No 2008/01/MC-EnC of 27 June 2008 on the Rules of Procedure for Dispute Settlement under the Treaty). The main features under these Rules are a two-step preliminary procedure to be carried out by the Secretariat on its own initiative or upon complaint by a private body, and the creation of an Advisory Committee to support the Ministerial Council in taking a Decision under Article 91 of the Treaty.

The report submitted to the Ministerial Council by the High Level Reflection Group as well as the Analytical Paper submitted by the European Commission and the Secretariat called into doubt the effectiveness and neutrality of the current enforcement system and made concrete proposals for its replacement or improvement.

The present dispute settlement report reflects the situation on 1 June 2015 and summarizes the open cases. Cases closed or not yet opened by this date are not reflected in this report. The present report is also without prejudice to bilateral discussions and negotiations currently taking place between the Secretariat and individual Contracting Parties (still) outside the scope of a dispute settlement procedure.

2. Open dispute settlement cases upon complaints

a) Case ECS-3/08 was initiated with an Opening Letter sent by the Secretariat to the Republic of Serbia on 17 September 2010. Following Serbia's reply, the Secretariat issued a Reasoned Opinion on 7 October 2011. The case was initiated by a complaint from the operator of the electricity transmission system located in Kosovo*, KOSTT. In the Secretariat's assessment, the lack of compensation to KOSTT for costs incurred as a result of electricity transit on the network operated by it violates Article 3 of Regulation (EC) 1228/2003 in cases where the electricity flow originates or ends on the system operated by the Serbian EMS. Moreover, revenues resulting from the allocation of interconnection on the interconnectors with countries adjacent to Kosovo* seem not to be used for one of the reasons stipulated by Article 6 of Regulation (EC) 1228/2003.

Since the end of 2013, the subject-matter of this case has been subject to intense negotiations between KOSTT and EMS mediated by the Secretariat. On 12 February 2014, a legally-binding Framework Agreement governing the operational and commercial relations between both transmission system operators has been signed. An operational Inter-TSO Agreement was signed in September 2014. Unfortunately, these agreements are not fully implemented. A Service Provision Agreement also signed in September 2014 has not been prolonged upon its expiry. Negotiations on an ITC and Interim Congestion Management Agreements have stopped. Under these conditions, Case ECS-3/08 will have to be submitted to the Ministerial Council.

b) On 26 February 2013, the Secretariat sent an Opening Letter in Case ECS-1/12 to Ukraine. The Secretariat, takes the preliminary view that the Auction Rules adopted for the allocation of capacity on the country's electricity interconnectors with its Western neighbours and Moldova, as well as their appliance in practice by the system operator, fails to respect relevant Energy Community

rules. The view that the Secretariat takes in the Opening Letter is that different treatment of electricity imports and exports by distinguishing between different directions of electricity flow and maintaining different procedures for the allocation of capacity in both directions is incompliant with the Energy Community law. In addition, the Secretariat found that the access to interconnectors for electricity exports is limited by maintaining requirements for participation to the auctions that are falling short of respecting the *acquis*. The Secretariat also took the preliminary view that the procedure for capacity allocation in case of non-congested interconnectors as well as the prohibition of secondary trading encroach upon several provisions and principles of the Energy Community law.

The Electricity Law in force since 1 January 2014 provides a legal basis for adoption of new Allocation Rules. However, the existing Allocation Rules adopted on the basis of the 2013 Electricity Law, are neither compliant nor followed in practice. The identified non-compliance is also closely linked to the prevailing market model in Ukraine. New Electricity Market Law, introducing a market model in compliance with the *acquis* is under preparation in close cooperation with the Secretariat. New Allocation Rules based on that Law are to be adopted in near future upon its adoption, alternatively the Secretariat will proceed with the case.

c) The Energy Community Secretariat, acting upon complaint, initiated a dispute settlement proceeding against Republic of Moldova by sending an Opening Letter in Case ECS-5/15 on 22 April 2015. In its preliminary assessment, the Secretariat took the view that by failing to adopt distribution tariffs applicable to all eligible customers (including suppliers), Moldova failed to comply with its obligations under Directive 2009/72/EC concerning common rules for the internal market in electricity. In its Opening Letter, the Secretariat concluded that the failure of ANRE, Moldova's regulatory authority, to adopt distribution tariffs for all distribution system operators prevents new suppliers established in or outside of Moldova from accessing the distribution network, as there is no tariff applicable to them. Moreover, customers are refused the right to access the distribution networks and thus also their right to freely choose their supplier.

After the Opening Letter, on 18 July 2015, ANRE adopted a decision setting tariffs for access to electricity distribution networks applicable by all distribution companies to all system users in the country. Upon assessment, the Secretariat will consider closing the case.

d) On 23 July 2015, the Secretariat closed the Case ECS-7/13 initiated by sending an Opening Letter to Ukraine on 2 October 2014. The breach related to the so-called local content requirement for renewable energy installations. Ukrainian legislation required the producers of electricity from renewable sources to respect certain minimum thresholds for local content as a precondition for benefitting from the feed-in tariff, which amounted to discrimination. On 5 May 2015, the Parliament of Ukraine adopted amendments to the Electricity Law in which the local content requirement was replaced by a bonus system, thereby rectifying the breach of the Energy Community law.

3. Open dispute settlement cases on Secretariat's own motion

a) On 21 September 2010, the Secretariat sent an Opening Letter to Bosnia and Herzegovina in Case ECS-1/10. The Secretariat takes the preliminary view that Bosnia and Herzegovina failed to fulfill its obligations under the Energy Community Treaty by not adopting legislation prohibiting State aid and enforcing that prohibition, as required by Articles 6 and 18 of the Treaty. In February 2012, Bosnia and Herzegovina adopted the Law on System of State aid in Bosnia and Herzegovina which follows the principles of the *acquis* on State aid and transposes Article 18(c) of the Treaty. However, its effective implementation in practice is still pending and no application of State aid rules to energy sector has taken place yet.

b) On 20 January 2011, the Secretariat sent Opening Letters to Albania, Bosnia and Herzegovina, Croatia, former Yugoslav Republic of Macedonia, Montenegro and Serbia in accordance (Article 12 of the Rules of Procedure for Dispute Settlement) in Cases ECS-1-6/11. The Secretariat challenged that these six Contracting Parties have not yet adopted a common coordinated congestion management method and procedure for the allocation of capacity to the market, according to their obligation from a decision by the Ministerial Council of 2008. In March 2014, the TSO of Albania, Bosnia and Herzegovina, Croatia, Greece, Montenegro, Kosovo* and Turkey established a Coordinated Auction Office and started allocating capacities. Consequently, the cases against the Contracting Parties participating where closed.

The Secretariat entered into discussions with former Yugoslav Republic of Macedonia and Serbia for participation in the Coordinated Auction Office. While the negotiations with Serbia are still ongoing, former Yugoslav Republic of Macedonia refused to discuss the issue further. On 4 September 2014, the Secretariat sent a Reasoned Opinion to that Contracting Party.

It also transmitted the case on Bulgaria's failure to fulfill its obligations under the Energy Community Treaty to the European Commission for further handling.

c) On 8 February 2011, the Secretariat sent an Opening Letter to Kosovo* in Case ECS-7/11. It takes the preliminary view that Kosovo* failed to fulfil its obligations under the Energy Community Treaty by not adopting legislation prohibiting State aid and enforcing that prohibition, as required by Articles 6 and 18 of the Energy Community Treaty. Following the Opening Letter, Kosovo* adopted a State aid law in July 2011 that entered into force on 1 January 2012. The newly adopted State aid law transposes Article 18(c) of the Treaty to a large extent. However, State aid Commission and the Secretariat have not been fully established and have not become operational. Kosovo* started the work to amend the system of State aid control. If no concrete progress is achieved, the Secretariat will proceed with the case.

d) On 7 October 2011, the Secretariat initiated dispute settlement proceedings against Bosnia and Herzegovina for noncompliance with several provisions of Directive 2003/55/EC and Regulation (EC) No 1775/2005 by an Opening Letter in Case ECS-8/11. Having taken into account the reply of the Government to the Opening Letter the Secretariat sent a Reasoned Opinion on 24 January 2013, and submitted the case to the Ministerial Council for decision by way of a Reasoned Request on 21 May 2013. The Reasoned Request was broadly upheld by the Advisory Committee and in October 2013 the Ministerial Council, by unanimity, adopted a Decision establishing a breach of Energy Community Law and requiring Bosnia and Herzegovina to take all appropriate measures to rectify the breaches identified by June 2014. On 23 September 2014, the Ministerial Council decided that the breach was persistent and serious, but did not impose any sanctions under Article 92 of the Treaty. The infringement has still not been rectified to date.

e) On 11 February 2013, the Secretariat sent Opening Letters to Albania, Bosnia and Herzegovina, the former Yugoslav Republic of Macedonia, Serbia and Ukraine. In Cases ECS-1-5/13, the Secretariat comes to the preliminary conclusion that these five Contracting Parties have not yet transposed and implemented the requirements of Directive 1999/32/EC as required by Article 16 and Annex II of the Treaty. Directive 1999/32/EC aims to reduce emissions of SO₂ resulting from combustion of heavy fuel oils and gas oils. Having reviewed the replies in these cases, the Secretariat is currently preparing Reasoned Opinions against the Contracting Parties concerned.

f) On 24 October 2013, the Secretariat sent an Opening Letter in Case ECS-9/13 to Serbia in which it took the view that Serbia failed to comply with its obligations under the Energy Community Treaty related to the unbundling of two vertically integrated gas undertakings. The Secretariat believes that the two transmission system operators licensed in the country, Srbijagas and Yugorosgaz, do not comply with this requirement. Having taken into account the reply of the

Government to the Opening Letter, the Secretariat sent a Reasoned Opinion to Serbia on 24 February 2014 reiterating its view expressed in the Opening Letter. Due to lack of reply to the Reasoned Opinion and continued failure to rectify the identified issues of non-compliance within a time limit of two months, on 23 April 2014, the Secretariat submitted a Reasoned Request to the Ministerial Council. On 23 September 2015, the Ministerial Council decided that Serbia failed to comply with the gas unbundling rules of the Second Energy Package. Serbia was given until 30 June 2015 to rectify the breach. In June 2015 the Supervisory Board decided, and the Government approved the Decisions of the Supervisory Board for establishing two different companies, transmission system operator "Transportgas Srbija" and the distribution system operator "Distribucijagas Srbija". The Adoption of these documents is a basis for registration and licensing of the new companies. However, the companies have still not been established and they have not been licensed by AERS yet.

g) In Case ECS-10/13, initiated on 25 November 2013, the Secretariat identified the lack of transposition of the Directive 2006/32/EC on energy end-use efficiency and energy services in Albania. Albania has not yet rectified the breach for which the adoption of an Energy Efficiency would be necessary. New draft legislation is pending adoption. If progress is not achieved, the Secretariat will proceed with the case.

h) On 3 March 2014, the Secretariat opened dispute settlement proceedings in Case ECS-1/14 against Bosnia and Herzegovina for incomplete transposition of Directive 2006/32/EC on energy end-use efficiency and energy services. While Republika Srpska adopted the Law on Energy Efficiency and the EEAP, these documents are still awaiting adoption in the Federation of Bosnia and Herzegovina. The draft EE Law in FBiH was adopted by the House of Representatives in September 2014, but the final adoption by the House of People was delayed due to elections. This Law is now put again into procedure for adoption and the Secretariat will follow the process.

i) On 11 February 2014, the Secretariat sent Opening Letters to Albania, Bosnia and Herzegovina, former Yugoslav Republic of Macedonia, Montenegro and Ukraine for failure to comply with Energy Community law related to renewable energy. In the Opening Letters in Cases ECS-3-7/14, the Secretariat addresses the failure of these Contracting Parties to adopt and submit to the Secretariat a National Renewable Energy Action Plan, since the deadline for adoption and notification to the Secretariat of those Plans expired on 30 June 2013. While the cases against Montenegro and Ukraine were closed, Reasoned Opinions were sent on 24 February 2015 to Albania, Bosnia and Herzegovina, and former Yugoslav Republic of Macedonia. On 12 May 2015, the three cases were referred to the Ministerial Council by Reasoned Requests.

j) On 22 April 2014, the Secretariat sent an Opening Letter to Ukraine and initiated infringement proceedings in Case ECS-8/14. In the Opening Letter, the Secretariat takes the preliminary view that Ukraine failed to fulfill its obligations under the Energy Community Treaty by not adopting legislation prohibiting State aid and enforcing that prohibition as required by Article 1(2) of the Accession Protocol of Ukraine to the Energy Community. On 1 July 2014, a Law on State Aid has been adopted, but the Law will enter into force in three years after its publication. The Secretariat will monitor the implementation of the Law before closing the case.

k) On 18 July 2014, the Secretariat initiated infringement action against Kosovo* in Case ECS-12/14. In the Opening Letter, the Secretariat takes the preliminary view that Kosovo* failed to fulfill its obligations under Article 41 of the Energy Community Treaty by levying customs duties on imports of certain petroleum products from EU Member States to Kosovo*. As the breach has not been rectified in the meantime, the Secretariat will soon send a Reasoned Opinion in that case.

l) On 30 January 2015, the Secretariat sent an Opening Letter to the former Yugoslav Republic of Macedonia for its failure to comply with the Energy Community's eligibility rules by postponing full

opening of the electricity market until beyond 2020. The Energy Community Treaty sets 1 January 2008 as the implementation deadline for market opening for non-household customers and 1 January 2015 for all customers including households. The new rules in Macedonian energy legislation effectively deprive small businesses and all household customers of their right to purchase electricity directly from the supplier of their choice. On 27 April 2015, the Secretariat sent a Reasoned Opinion in Case ECS-2/15. The breach has not been rectified yet.

*This designation is without prejudice to positions on status, and is in line with UNSCR 1244 and ICJ Advisory opinion on the Kosovo declaration of independence.