

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 non-compliant 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 currently existing Allocation Rules are neither compliant nor followed in practice. The identified non-compliance is also closely linked to the prevailing market model in Ukraine. The Secretariat will proceed with the case and in parallel works with the Ukrainian authorities on replacing the current Electricity Market Law which proved to be non-applicable.

c) On 2 October 2014, the Secretariat opened Case ECS-7/13 against Ukraine related to the so-called local content requirement for renewable energy installations. Ukrainian legislation makes it obligatory on producers of electricity from renewable sources to respect certain minimum thresholds for local content as a precondition for benefitting from the feed-in tariff. In the Secretariat's view, as expressed in the Opening Letter, this requirement is discriminatory and violates the Treaty. The Secretariat subsequently entered into negotiations with the Ukrainian counterparts. 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. The Secretariat is currently analyzing the amendments to verify whether the case can be closed.

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. The Secretariat is still not convinced that the State aid Council and the Secretariat to the Council work properly.

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 challenges 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. The Secretariat is currently preparing a Reasoned Opinion in this 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. If this will not happen, the Secretariat will have to ask the Ministerial Council to take a decision under Article 92 of the Treaty.

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. The Secretariat is currently preparing a Reasoned Opinion.

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. Bosnia and Herzegovina has not yet rectified the breach. The Secretariat is currently preparing a Reasoned Opinion.

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.

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 send a Reasoned Opinion in Case ECS-2/15.

m) On 22 May 2015, the Secretariat sent an Opening Letter in Case ECS-5/15 against the Republic of Moldova. The Secretariat concludes that by failing to adopt distribution tariffs applicable to all eligible customers (including suppliers), Moldova fails to comply with its obligations under Directive 2009/72/EC.

*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.