

ANNUAL REPORT

ON THE ACTIVITIES OF THE ENERGY COMMUNITY TO THE PARLIAMENTS

This report, which covers the implementation period 2010, constitutes a summary of the Energy Community's activities. It has been prepared following the requirements of Article 52¹ of the Energy Community Treaty ("the Treaty"), according to which the Ministerial Council of the Energy Community is requested to present an annual report on the activities of the Energy Community to the European Parliament and the Parliaments of the Adhering Parties and of the Participants.

The report is based on several documents published by the Energy Community Secretariat, in particular its comprehensive monitoring and market development reports as well as the Work Programme (all available on www.energy-community.org).

1. THE IMPLEMENTATION OF THE LEGISLATION AND MARKET DEVELOPMENTS – MAJOR STEPS AND FINDINGS ON REGIONAL LEVEL

In the reporting period, further intensive activities took place within the Contracting Parties towards the implementation of the legal framework as outlined by the Treaty in all *acquis* areas (energy, environment, renewables, competition, security of supply and energy efficiency). In addition, concrete steps towards implementation of the *acquis* were undertaken by some Observers which have applied for full membership in the Energy Community².

All these steps have contributed and further support namely the establishment of a single energy market based on sustainability and enhancement of security of supply.

In view of the very different characteristics and requirements of the individual energy carriers falling within the scope of the Treaty – electricity, gas and oil – as well as the horizontal character of competition, environment, energy efficiency and social policies, the common conclusions need to be seen bearing in mind the complexity of developments both on national and regional level.

Furthermore, it should be recalled that the implementation process is not static - the Energy Community exists in an ever-changing global and European environment and changes as well. This affects not only the scope of *acquis* to be implemented, but also the situation in the Contracting Parties. In addition, the Energy Community currently experiences a process of expansion.

¹ Article 52 – The Ministerial Council shall submit an annual report on the activities of the Energy Community to the European Parliament and to the Parliaments of the Adhering Parties and of the Participants.

² This refers to Ukraine, which is a member of the Energy Community since 01.02.2011.

Nevertheless, some general findings and trends may be identified in 2010:

- In September 2010, the Secretariat published its Annual Implementation Report which was generally acknowledged as point of reference. The true and fair picture displayed there improved significantly in the subsequent months. With the assistance of the Secretariat, Montenegro and the relevant Kosovo³ institutions adopted legislation living up to high compliance standards. In an attempt to comply with the Secretariat's reasoned request in case ECS-2/08, the former Yugoslav Republic of Macedonia is about to adopt an energy law not far full transposition. Moldova and the Ukraine, which joined or are about to join the Energy Community in 2010, adopted state-of-the-art legislation in gas and partly also electricity.
- Generally speaking, the Contracting Parties in all sectors established legal frameworks based on the elements contained in the *acquis*. This finding is without prejudice to the lack of transposition of certain elements, or the lack of implementation and application of these elements in reality. Some degree of principle convergence of the market designs between Contracting Parties, as well as between Contracting Parties and EU Member States, however, exists and is to be attributed to the reform endeavours within the Contracting Parties following their Energy Community membership.
- The lack of proper wholesale market opening is certainly one of the key issues when it comes to the shortcomings in implementation of the Treaty. Another issue to be better addressed in the future relates to the creation of a regional market, one of the main tasks of the Treaty. In reality, the Contracting Parties still aim at creating or protecting energy autonomy and often seem ready to sacrifice key principles of the Energy Community *acquis* for that goal.
- In addition, the gap between the Contracting Parties in the implementation process is increasing. The Energy Community institutions and the European Commission are determined to use all possibilities in order to assist in, but also to push for an implementation close to the word and spirit of the *acquis*. Nevertheless, it should be underlined that the key tools as well as the responsibility for implementation in line with the requirements lies explicitly with the Contracting Parties.
- With regard to the regulatory framework, effective independence of regulatory and competition authorities, which is key for the practical implementation of market opening put into legislation, is still lacking. The lack of independence in practice provides another good example for the gap between implementation of the *acquis* by letter and by spirit. While competition and regulatory bodies are established in all Contracting Parties and are declared to be independent by law, the reality is often different. The Energy Community Secretariat notes continuing failure to address regulatory and structural shortcomings by the authorities. With respect to competition authorities, a certain recent trend towards emancipation may be observed in some Contracting Parties, but it remains to be seen to what extent the competition authorities can make significant contributions to market opening in the energy sectors.
- Beyond implementation of the existing *acquis*, concrete activities were undertaken to prepare gradually for implementation of new *acquis* in the field of the internal market, renewables, oil stocks and statistics. In order to follow the EU

³ Under Resolution 1244 of UNSC

energy legislative developments, the Parties undertook measures for preparing the implementation of the 2009 RES Directive and the Third Internal Energy Market Package, which was reflected in two respective Recommendations⁴. Thus concrete steps towards the expansion of the areas of work of the Energy Community have been taken or are under development.

- Based on the Memorandum of Understanding on Social Issues, all Contracting Parties - with the exception of Moldova that only joined the Energy Community in May 2010 - have prepared Social Action Plans and have started to transpose some EU *acquis* on social aspects in their national legislation. Moldova will follow with the same approach.

The most beneficial result of the plans is the creation of a platform (plans and working groups) that would allow further and stronger cooperation of multiple stakeholders, including the social partners.

The treatment of vulnerable household customers remains a key topic for discussion throughout the region. Appropriate mechanisms are so far broadly missing in the Social Action Plans, with the exception of the Former Yugoslav Republic of Macedonia and (partly) also Moldova. Vulnerable customer groups exposed to potential energy poverty are to a large extent supported via regulated gas and electricity prices, which are questionable in the way applied by the Contracting Parties.

A more detailed analysis both of the regional and national developments in the form of the Secretariat's Annual Implementation Report is available on the Energy Community website.

<http://www.energy-community.org/pls/portal/docs/722178.PDF>

2. THE ENLARGEMENT OF THE ENERGY COMMUNITY

In 2010 the Energy Community underwent its first enlargement.

In December 2009, the Ministerial Council of the Energy Community agreed on the accession of the Republic of Moldova and Ukraine to the Energy Community Treaty as Contracting Parties, subject to specific conditions for accession related to their gas legislation. After reviewing the progress made, the relevant accession protocols were signed.

Based on these, Moldova – following ratification – became a member of the Energy Community as on 1st May 2010.

Ukraine has finalized its internal ratification procedures and is a member of the Energy Community since 1st February 2011.

In 2010 Armenia also filed officially its application for getting an Observer status.

Following invitation by the European Commission, the Energy Community Secretariat was also involved in the activities of the Eastern Partnership initiative on the topic of security of supply.

⁴ See the materials and the Ministerial Council Conclusions from 24.09.2010.

3. STRENGTHENING THE REGIONAL APPROACH

In addition to the developments on national level, 2010 marked a clearer and stronger trend towards cooperation among the Contracting Parties when targeting the development of South East Europe as a region in the Energy Community context.

In September 2010, the Ministerial Council of the Energy Community discussed a proposal, launched by Serbia, for a **regional energy strategy**, which was welcomed by the ministers. The Energy Community Secretariat was asked – in consultation with all Contracting Parties - to develop a more concrete proposal for consideration.

Further substantial steps forward were made in relation to the development of **energy projects of regional value**. In this relation, for the first time the Permanent High Level Group reached a common agreement on the list of priority projects both in the field of electricity and gas⁵ and outlined next steps. In addition, these projects have been intensively discussed in the context of the Donors' Community

As investments are one of the key priorities for the Energy Community, the Energy Community Secretariat paid explicit attention to strengthening the communication with the representatives of the business. Thus, the business representatives were organized in a **Business Advisory Panel** to discuss progress as well as barriers to investments in the energy sector in the Energy Community. The first Panel meeting was organized on 24 November 2010 in Vienna. It was attended by high level representatives of the main electricity and gas companies and business associations that are active investors in the Energy Community.

2010 marked also the start of **concrete relations with the newly established regional institutions ACER, ENTSO-E and ENTSO-G**, institutions established under the Third Internal Energy Market Package.

As regards the **environmental challenges** awaiting the Contracting Parties, most notably the timely implementation of the Sulphur in Fuels and Large Combustion Plants Directives, the Ministerial Council established an Environmental Task Force⁶. The implementation of these directives will be difficult and have manifold implications on the Contracting Parties' energy sectors. With the establishment of the Task Force, the Energy Community is well prepared.

4. DISPUTE SETTLEMENT

In 2010, the Secretariat intensified its efforts in enforcing the Treaty by using the dispute settlement mechanism made operational in 2008. It initiated formal procedures both upon complaint and on its own motion. The example of the former Yugoslav Republic of Macedonia shows that the dispute settlement mechanism, when coupled with intensive technical assistance by the Secretariat in amending non-compliant rules, can lead to very concrete and satisfactory results.

⁵ See Conclusions of 16th PHLG meeting (17.03.2010).

⁶ See Conclusions of the Ministerial Council meeting on 24.09.2010.

5. CONCLUSIONS

The reporting period of activities of the Energy Community is characterized by variety of actions towards the implementation of the Treaty and by substantial positive changes in the Energy Community environment. Thus, the efforts by its Contracting Parties and institutions outline stable development and have resulted in concrete results in all areas. However further steps towards practical development of the energy markets are further required.

In addition, the work in all areas covered by concrete acquis, and in those where new acquis is about to be incorporated (RES, oil, statistics, third internal energy market package) shall actively continue.

In this relation, there is no doubt that further concrete results in all outlined areas shall follow.

ANNEX: ABOUT THE ENERGY COMMUNITY

- The Energy Community Treaty entered into force on 1st July 2006. Albania, Bosnia-Herzegovina, Croatia, the Former Yugoslav Republic of Macedonia, Moldova, Montenegro, Serbia, Ukraine, the United Nations Interim Administration Mission in Kosovo pursuant to the United Nations Security Council Resolution 1244, and the European Union are Parties to the Treaty.
- Georgia, Norway and Turkey have status of Observers. The negotiations with Turkey are ongoing.
- The general objective of the Energy Community is to create a stable regulatory and market framework in the energy sector in order to:
 - Attract investment in power generation and networks as to ensure stable and continuous energy supply that is essential for economic development and social stability;
 - Create an integrated energy market allowing for cross-border energy trade and linked to the EU market ;
 - Enhance the security of supply;
 - Improve the environmental situation in the region.
- In order to pursue these objectives, the main instrument of the Energy Community Treaty is the implementation of parts of the EU acquis:
 - Key electricity and gas directives and regulations;
 - Key environment directives;
 - Key directives on renewables and biofuels;
 - The main principles of the EU competition policy;
 - Key directives, related to energy efficiency;
 - Major acquis in relation to security of supply.
 - Concrete list of acquis in relation to oil stocks and the new EU RES directive, as well as the legislation under the Third Internal Energy Market Package, are at different stages of current consideration for being implemented.
- The Contracting Parties have the obligation to implement these instruments within specific timeframes.
- Compliance may be enforced through a specific dispute settlement system.

- The Institutions of the Energy Community are the Ministerial Council, the Permanent High Level Group, the Regulatory Board, the Fora (Electricity, Gas, Social, Oil), and the Energy Community Secretariat in Vienna. The donors are organized in a Donors' Community, chaired by EC.
- All documents related to the activities of the Energy Community are available on www.energy-community.org.