



IENE – 5th South East Europe Energy Dialogue
Electricity and Gas Infrastructure Priorities in South East Europe
- Towards a Regional Market
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ELECTRICITY MARKET LIBERALIZATION in the ENERGY COMMUNITY

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ENERGY COMMUNITY

- three pillars for development of the energy markets

LEGAL FRAMEWORK

- to enforce the basic principles for free trade of energy

REGULATORY STRUCTURE

- to compensate deficiencies from ideal market conditions

STRUCTURAL REFORMS

- to mold the environment and set the stage for competition

LIBERALIZATION

- wholesale market is a driving engine for investments

THE WAY FORWARD

- how could it work

PARTIES to the Energy Community (May 2011)

▪ 9 Contracting Parties

- Albania
- Bosnia and Herzegovina
- Croatia
- The former Yugoslav Republic of Macedonia
- Moldova
- Montenegro
- Serbia
- Ukraine
- UNMIK (pursuant to UNSCR 1244)

▪ 3 Observers

- Georgia
- Norway
- Turkey

▪ European Union

▪ 14 Participants

- Austria
- Bulgaria
- Cyprus
- Czech Republic
- France
- Germany
- Hellenic Republic
- Hungary
- Italy
- The Netherlands
- Romania
- Slovakia
- Slovenia
- United Kingdom

- **Moldova and Ukraine** acceded to the Treaty in 2010 - which almost tripled the potential energy market (**from 26 to 73 million inhabitants**)
- **Armenia** requested a status of **observer**

ENERGY POLICY in EU

▪ **Three main OBJECTIVES**

- sustainability
- security of supply
- competitiveness

▪ **The EU SOLUTION:**

ENERGY POLICY in SEE

▪ **The same Objectives in a more DEMANDING ENVIRONMENT**

- no common legal platform
- no regional legal enforcement
- deteriorating energy infrastructure
- limited investment potentials
- fragmented political environment
- economic and social disadvantages
- perception of political instability

▪ **Energy Community Treaty:**

A functioning common REGIONAL Energy Market

Binding Commitments – THREE PILLARS OF THE ENERGY COMMUNITY

Title II

Extension of the Acquis

Contracting Parties

ACQUIS on Energy Markets (Electricity, Gas)
ACQUIS on Access to Networks (Electricity, Gas)
ACQUIS on Security of Supply (Electricity, Gas)
ACQUIS on Competition Environment Renewable Energy Energy Efficiency
Generally Applicable Standards

Title III

Operation of Energy Markets

**Contracting Parties
+ A + BG + EL + HU + IT + RO + SL**

Single Mechanism for Cross-Border Transport of Energy
Statements on Security of Supply (Electricity, Gas)
Support for Provision of Energy to Citizens
Measures for Market Harmonization
Support for Renewable Energy Energy Efficiency
Safeguard Measures for sudden crisis

Title IV

Creation of a Single Energy Market

**Contracting Parties
+ 27 EU MS**

Alleviation of Barriers and Restrictions to Trade
Creation of a Single Energy Market without frontiers
Equivalent access for Import / Export with Third Countries
Mutual Assistance in case of disruption

Title VI – POWERS OF ENFORCEMENT in the ENERGY COMMUNITY

Title II

Extension of the Acquis

Contracting Parties

Proposal of
European Commission

MC Decision by
Simple Majority

Title III

Operation of Energy Markets

**Contracting Parties
+ A + BG + EL + HU + IT + RO + SL**

Proposal of
EU / CP / ECS

MC Decision by
**2/3 Majority
(EU Positive Vote)**

Title IV

Creation of a Single Energy Market

**Contracting Parties
+ 27 EU MS**

Proposal of
EU / CP

MC Decision by
Unanimity

Title VII of the Treaty establishes a *Regional Mechanism for DISPUTE SETTLEMENT* including possible Decision of the Ministerial Council in the case of a breach by a Party of its obligations under the Treaty

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Scope – *acquis* relevant for the electricity market

- Directive 2003/54/EC
- Regulation (EC) 1228/2003
- Directive 2005/89/EC

➤ **The III EU Energy Legislative Package** entered the Energy Community in September 2010 as a **Recommendation of the Ministerial Council**

A proposal for corresponding **Decision** is under preparation

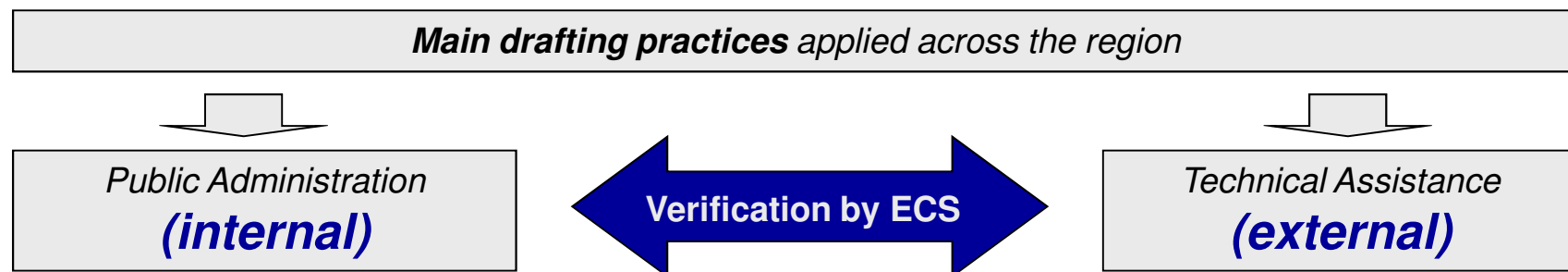
Related *acquis* under the Treaty encompass a set of acts, including

- **Provisions from EU Treaty on Antitrust rules and State Aid**
- **Directives referring Environmental aspects** (LCP Emissions, EIA, Sulphur in fuels)
- **Directives referring Renewable energy** (MC recommendations for the new Directive)
- **Directives referring Energy Efficiency** (Performance of buildings, Labelling, End-use Efficiency)

Implementation – current state of transposition

- **Advanced state of compliance**
 - Croatia (III package compliant draft)
 - The Former Yugoslav Republic of Macedonia (recently adopted)
 - Montenegro (recently adopted)
 - UNMIK (recently adopted)

- **Under review or development of new acts**
 - Albania (drafting)
 - Bosnia and Herzegovina (review / drafting)
 - Serbia (drafting)
 - Moldova (review)
 - Ukraine (drafting)



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Implementation – (regulatory) state of compliance

- Advanced level of development:
 - Croatia (adjustment for the III package)

- Intensive ongoing activities on the secondary legislation
 - The Former Yugoslav Republic of Macedonia
 - Montenegro
 - Moldova
 - UNMIK

- Frameworks which shall need further attention
 - Albania
 - Bosnia and Herzegovina
 - Serbia
 - Ukraine

Growing gap exists between **TRANSPOSITION** (formal adoption) of the Acquis and its practical **IMPLEMENTATION** (enforcement through corresponding Rules and Instruments)

All Contracting Parties have established Regulatory Authorities and developed comprehensive regulatory frameworks - however still **missing substantial elements** for liberalization of the market and support for investments

Implementation – Regulatory power deficiencies

▫ WELL BALANCED FUNCTIONS and COMPETENCES

*Regulatory functions mostly stick to **regulation** (of rights, prices, licences) – not so much to **monitoring** of MARKET CONCENTRATION (in generation, supply, cross-border capacity rights), cases of TRADE BARRIERS, SUBSIDIES and STATE AID*

▫ COMPREHENSIVE MONITORING OBLIGATIONS

*- need to extend over **all IMPOSITIONS** (including Public Service, Transparency, availability of Information, Conflicts of Interest, etc.) and include **practices**.*

▫ APPLICABLE INSTRUMENTS FOR PENALTY and APPEAL

*Powers of imposing **penalties** for non-performance / non-compliance are rather inefficient (absent or administrative) – could be integrated with those of the **Competition Authority***

▫ INDEPENDENCE FROM THE POLICY AUTHORITIES

***Policy authorities** (ministries, state government, local government) bear inherent **conflict of interest** with respect to entry of competition in the area of operation of the STATE-OWNED COMPANIES and supply of electricity under PUBLIC SERVICE OBLIGATION*

Implementation – regional regulatory coordination

- ECRB (Energy Community Regulatory Board)
- Bilateral coordination
- Main areas requiring coordinated legal enforcement:
 - RECIPROCITY – MUTUAL RECOGNITION OF LICENCES

*The aspects of standardization, cross-border recognition or elimination of licences are almost entirely **absent from the legal frameworks** expecting a coordinated decision on EU and Regional level – this problem is indicated by traders and their associations among those **requiring most urgent solution***
 - REGIONAL MARKET STRUCTURES

*Regulation of possible bilaterally or regionally organized forms of trading (Cross-border capacity allocation / congestion management, balancing market, ancillary services, various forms of spot market, power exchanges etc.) is addressed only **partially and/or without a view for participation in a fully regionally coordinated platform***

ECRB activities nevertheless represent a **single continuously progressive framework** for cooperation on the regional integration of the local electricity markets

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Implementation – general references (1)

- Pretending to have implemented more advanced structural reforms
 - Croatia (pending adjustments for the III package)
 - The Former Yugoslav Republic of Macedonia
- Some aspects of restructuring have been taken seriously
 - Albania
 - Serbia
 - Ukraine
- Progress achieved so far still requires further attention
 - Bosnia and Herzegovina
 - Moldova
 - Montenegro
 - UNMIK

*All Contracting Parties have effectively **unbundled the Transmission operator** which still remains in state ownership*

*All Contracting Parties have preserved **dominant incumbent generator** (one or more) which still remains in a (majority) state ownership*

*All Contracting Parties are still short of **unbundling of any Distribution operator** at least from the supply of customers under public service obligation*

Implementation – state of compliance (2)

▫ UNBUNDLING OF ACCOUNTS

*Formally almost accomplished – accounts must be also unbundled between **regulated generation / supply** activities and those performed **under market conditions**.*

▫ UNBUNDLING OF COSTS

*Unbundled accounting is needed (and missing) in a (regulated) generation facility for the sake of **transparency** of costs between **different production units** and between **different electricity products** (as applicable) in order to ensure cost-reflectivity*

▫ UNBUNDLING OF VERTICALLY INTEGRATED UTILITIES

*Enforcement rules against **conflicts of interest** are mostly provisional (if any) – few serious cases of applied **Compliance programming** – applied regulatory powers and **transparency** in such cases are also mainly provisional.*

▫ LOCAL MARKET MODEL

*In most cases a **SINGLE BUYER MODEL** is still enforced and/or applied (a regulated wholesale umbrella for public supply) applied through typically **annual contracts** (including imports) along with incumbent **balancing mechanisms** – any short-term trading is mainly **seasonal** but **gradually growing** on some borders – no liquid and reliable day-ahead or other kind of spot market is implemented*

Implementation – state of compliance (3)

▫ TPA TO TRANSMISSION AND DISTRIBUTION NETWORKS

- *formally transposed and legally enforced – **transparency** is generally deficient and/or not monitored, cases of **capacity reservation** or **priority of access** still persist – **exemptions** (merchant lines) are not always sufficiently addressed*

▫ TECHNICAL RULES

*In most cases **network code** is applied (driven by ENTSO-e) for TRANSMISSION and in not so comprehensive way for DISTRIBUTION networks, **market rules** are provisional and interpret mainly obsolete models, **rules for supply** of electricity to end-customers remain the most regularly applied technical rule - usually short of significant elements of compliance, supplier **switching rules** are very rare (Croatia) and not substantial, **cross-border capacity allocation rules** are recently brought to common attention and quickly progressing although still on bilateral basis*

▫ ELIGIBILITY OF CUSTOMERS

- ***all customers** who comply with specified criteria – must not be made short of their legal rights to exercise eligibility (to switch their supply) – **some classes of customers** (households and S.M.E.) may be given **exceptional rights** to be supplied under regulated conditions for a limited period of time – such benefits can not be made **available at large** (any such measures must be treated as a form of state aid)*

- ***eligibility** is vastly implemented through **conservative criteria** – either with lack of compliance or of implementation or both*

Implementation – state of compliance (4)

▫ PUBLIC SERVICE

*Imposed to (public) utilities as obligation for supply of end-customers under regulated tariffs, generally applied as **default supply** or justified by provisional interpretation of the right for **universal service** – to be treated as exemption rather than a rule*

▫ CUSTOMER PROTECTION

*- transposition done in a relatively moderate way although usually short of compliance – improvement of **scope** and **transparency** is needed along with adequate monitoring*

*- implementation reflects a **HISTORICAL MISSINTERPRETATION** of the electricity supply -*

- confused with the Public Service and justified through broad **public interest***
- reduced to **universal service** and/or **commercial criteria** of the supply*
- applied to broad **scope of customers** in a non-critical manner*
- socialized via **implicit subsidies** with no transparency and often including **state aid***
- adverse influence on **cost-reflectivity** and entry of **competition** in the supply*

*- protection of socially **VULNERABLE CUSTOMERS** is not sufficiently implemented including lack of*

- effective identification of **beneficiary customers***
- sustainable **source of funds** and transparent reimbursement*
- demand-side measures and **energy efficiency***

Implementation – state of compliance (5)

▫ SECURITY OF SUPPLY

- Imposed mainly through enforcement of annual **Energy Balance** and administrative competences for **strategic planning documents** (energy policy, development plan investment program etc) – short of substantial compliance with **monitoring obligations** and reporting, applied measures dominantly relate to forms of **state aid** or **curtailment** of supply (load-shedding)
- Planning aspects such as **generation adequacy** and sufficiency, demand forecast, long-term **investment planning** for generation and transmission capacities etc. **slowly progress** and remain short of realistic approach to **sources** for the required funding and the **role of market** on the future supply

▫ AUTHORIZATION AND TENDERING PROCEDURES

- **formally addressed** (often insufficiently) less often implemented in a sufficiently transparent and sustainable manner – **predictability** and sustained tendering criteria still need to be applied
- several cases of appointment of **authority responsible** for tendering new capacity, tendering rules often not appropriate (public procurement Law or concession Law)

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Development of organized regional market

- MEASURES UNDER THE TREATY REQUIRED FOR DEVELOPMENT OF A REGIONAL MARKET

Based on the legal commitments under the Treaty

- AGREEMENT ON A REGIONAL **MARKET STRUCTURE** and **ACTION PLAN**
- AGREEMENT ON THE ESTABLISHMENT OF A **REGIONAL MARKET OPERATOR**
- ESTABLISHMENT OF **IMPLEMENTATION PROJECT**

*Based on the draft proposals from the **WB – Wholesale Market Opening Study of 2010**, related **conclusions of ECRB and PHLG** and corresponding support from national Transmission operators and regulatory authorities*

- DEVELOPMENT OF MARKET FRAMEWORK, MARKET RULES AND DETAILED DESIGN
- IMPLEMENTATION OF THE PROJECT ACTIVITIES INCLUDING **FUNDING**
- **DRY RUN** OF THE REGIONAL MARKET (PHASE-OUT)

*Based on the provisions and timeframe of the established **Implementation Project***

- FOLLOW-UP AND OPERATION OF THE **ELECTRICITY MARKET**

The proposed structure illustrates current initiative of the WB and results from common endeavours of the Energy Community task forces and Contracting Parties

Regional aspects of market liberalization

- ESTABLISHMENT OF A COMMON REGIONALLY COORDINATED **CB CAPACITY ALLOCATION** (CONGESTION MANAGEMENT) MECHANISM
*Based on the **CAO Project** and in coordination with corresponding initiatives*

- AGREEMENT AND IMPLEMENTATION OF COMMON RULES FOR AUTHORIZATION OF **TRADING ACTIVITIES** (RECOGNITION OF LICENCES)
*Based on the ongoing **ECRB initiative** and in compliance with corresponding EU practices*

- ESTABLISHMENT OF COMMITMENT AND TIMELY IMPLEMENTATION OF THE **THIRD ENERGY LEGISLATIVE PACKAGE** BY ALL CONTRACTING PARTIES
*Based on the provisions and timeframe of the established **Implementation Project***

- ACTIVE ENGAGEMENT ON COMPLIANCE, COOPERATION AND ASSOCIATION WITH **ENTSO-e** AND **ACER**

- EFFECTIVE PLANNING AND IMPLEMENTATION OF **INVESTMENT PRIORITIES** FOR DEVELOPMENT OF THE TRANSMISSION AND GENERATION INFRASTRUCTURE

Local aspects of market liberalization (outstanding)

- **UNBUNDLING OF SUPPLY** FROM INCUMBENT GENERATION (FOR ALL CLASSES OF CUSTOMERS) – UNBUNDLING OF GENERATION CAPACITY

Development of supply function for eligible customers on applicable level for new market participants

- **ADEQUATE TREATMENT OF ELIGIBILITY**

- if necessary with transitional support from the state authorities in a transparent and non-tariff-based manner

- **ADOPTION AND IMPLEMENTATION OF MARKET RULES** WHICH ADEQUATELY ADDRESS BALANCE RESPONSIBILITY AND BALANCING MECHANISMS

Based on commercial principles (market-based if applicable)

- **ADJUSTMENT THE REGULATORY POWERS** IN ORDER TO EFFECTIVELY COPE WITH MONITORING OF MARKET CONCENTRATION AND CB CAPACITY ALLOCATION

- **INCREASE OF ALL ASPECTS OF TRANSPARENCY** TO THE REQUIRED LEVEL (IN SCOPE AND IN TYPE)

- **DEVELOPMENT AND IMPLEMENTATION OF SCHEMES AND RELIABLE MECHANISMS** FOR PROTECTION OF **SOCIALLY VULNERABLE CUSTOMERS** (HOUSEHOLDS)

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Internal tradeoffs relevant for the process of market liberalization:

- SECURITY OF SUPPLY versus COST OF SUPPLY
- ADMINISTRATIVE DECISION versus EFFECTS OF COMPETITION
- MARKET VOLATILITY versus PERCEPTION OF RISK
- LOCAL SOLUTIONS versus EXTERNAL DEPENDENCE
- STATE-OWNERSHIP versus PRIVATE OWNERSHIP
- TECHNOLOGY versus ECONOMY

- Coherent **LEGAL FRAMEWORK** is required – transposed and enforced
- Comprehensive **RULES** and **MEASURES** to be developed / applied
- **TRANSPARENCY** to be applied as a basic principle in all aspects
- **SUSTAINABLE SOLUTIONS** based on long-term priorities
- Sufficient **ADMINISTRATIVE CAPACITY** and **political focus** as well

I APPRECIATE YOUR ATTENTION

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