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Vienna, 25 January 2010
DIV/O/sne/15/25-01-2010

Subject: Annual report on the activities of the Energy Community

YOUR EXCELLENCY,

On behalf of the Ministerial Council of the Energy Community and pursuant to Article 52 of the Treaty establishing the Energy Community, please find herewith the Annual Report on the activities of the Energy Community for the year 2009, adopted by the Ministerial Council during its meeting on 18 December 2009.

The Report is also available on the website of the Energy Community under the following link:
<http://www.energy-community.org/pls/portal/docs/442180.PDF>.

Please accept, Excellency, the expressions of my highest consideration.

Sincerely yours,

Slavtcho Neykov
Director
Energy Community Secretariat

ANNUAL REPORT

ON THE ACTIVITIES OF THE ENERGY COMMUNITY TO THE PARLIAMENTS

Following the requirements of Article 52¹ of the Energy Community Treaty (the Treaty), 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.

This report, which covers 2009 as implementation period, represents summary of these activities. It is based on the set of documents published by the Energy Community, in particular the comprehensive monitoring and market development reports as well as the Work Programme (all available on www.energy-community.org).

1. IMPLEMENTATION OF THE EU LEGISLATION UNDER THE ENERGY COMMUNITY PROCESS

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

Aside the steps, registered towards effective opening of the electricity and gas markets, the active discussions and preparatory steps in relation to implementing concrete new *acquis* concerning energy efficiency, oil and renewables should be also explicitly noted.

1.1. The *acquis* on energy – major steps

The implementation of the *acquis* on electricity and gas³ has been substantially advanced.

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 Moldova and Ukraine.

³ Directive 2003/54/EC of the European Parliament and of the Council of 26 June 2003 concerning common rules for the internal market in electricity and repealing Directive 96/92/EC; Directive 2003/55/EC of the European Parliament and of the Council of 26 June 2003 concerning common rules for the internal market in natural gas and repealing Directive 98/30/EC and Regulation (EC) No 1228/2003 of the European Parliament and the Council of 26 June 2003 on conditions for access to the network for cross-border exchanges in electricity.

The Ministerial Council of the Energy Community, further to guiding the Contracting Parties in overcoming the remaining obstacles to full implementation, provided concrete political framework for speeding up the process of market development. Thus, in the electricity sector, the active process of establishment of the Coordinated Auction Office was launched and intensified in 2009 upon the signature of the relevant Memorandum among the Transmission System Operators from the region of SEE⁴. In addition, a Security of Supply Coordination Group was established, which discusses in concrete terms open issues of strategic nature – its first meeting in September 2009 focused on gas.

The Energy Community Secretariat continued with its intensified efforts to support the Contracting Parties in the practical process of improving their legislative framework along the lines of the acquis requirements. This resulted in additional amendments to the primary and secondary legislation.

However, major challenges are still ahead. In the electricity sector, while unbundling of networks and third-party access are generally well advanced in the transmission and to a lesser extent in the distribution, the facilitation of trans-border electricity flows still needs to be tackled. Effective market opening is still a process, often hindered by state intervention and artificially low prices. Thus, de facto the overall number of eligible customers is still not substantial.

In the gas sector, the crisis of January 2009 boosted more intensive discussions. The gas legislative framework on national level is quite developed, even despite the fact that still several Contracting Parties do not have access to gas. Thus, a key issue to be considered – in addition to improvement of the legislative framework – are practical steps towards the gasification of the region. Therefore, along the efforts related to gasification on national level, a common regional approach should continue to be in the focus of attention.

1.2. Work in the area of renewables

Although the Treaty requirements in relation to renewables have been formally fulfilled in the form of implementation plans submitted by the Contracting Parties, a decision was taken that the Contracting Parties and the candidate Observers⁵ shall be actively involved in analysis for implementation of the new Directive 2009/28/EC on the promotion of the use of energy from renewable sources.

The Ministerial Council of the Energy Community gave concrete guidance and impetus in this direction via establishing a special RES Task Force and via mandating the development of a concrete study. Both the Task Force and the study refer not only the Contracting Parties, but also to the candidate Observer countries. The key task of the study – further to specifying the concrete state of play in each Contracting Party and Observer country – is to provide precise information on the readiness of the Contracting Parties to implement the new RES EU Directive and to calculate binding targets in line with the methodology applied within the EU.

The RES Task Force is the operational body to lead the work in this aspect. It already adopted its Work Programme, which provides the frame for achieving the relevant results.

⁴ The Memorandum was signed in December 2008 by 11 TSOs/ISOs (only those from Bulgaria and Serbia have not joined yet).

⁵ These are Observer countries, which have applied for acceding to the Energy Community (Moldova, Turkey and Ukraine).

1.3. Work in the area of environment

The focus of attention of the Energy Community with respect to the environmental acquis was on the implementation of the Large Combustions Plants and IPPC Directives as well as on the application of the Directive on Environmental Impact Assessment to projects in the energy sectors.

Generally speaking, Directive 85/337/EEC on Environmental Impact Assessment has been well transposed in almost all Contracting Parties. When it comes to the application to individual projects in the energy sectors, however, it becomes evident that full implementation has not yet been achieved. In this regard, the Secretariat, with the active participation of donors and the EC Commission, arranged for individual training of senior environmental officials in one Contracting Party. It is envisaged to intensify the Secretariat's involvement on a project basis in the future.

With respect to Directive 2001/80/EC on Large Combustion Plants, the Secretariat and the EC Commission took stock of the state of play of the Contracting Parties' factual and legal situation well ahead of the implementation deadline at the end of 2017. The Secretariat organized a workshop, highlighting the importance of early preparation for the implementation of this important piece of legislation.

1.4. The acquis on competition

The Treaty's chapter on competition requires the Contracting Parties to implement Articles 81, 82, 86 and 87 EC and apply them in the energy sector in accordance with EC practice. As of now, all Contracting Parties have adopted general competition legislation following the model of pre-2004 EC competition law. With the exception of one Contracting Party, formally independent competition authorities are in place. As regards State aid, however, legislation and institutions are still lacking in some Contracting Parties. Even in this area, however, concrete progress was noted during 2009.

Besides its regular monitoring activities, the Secretariat organised a workshop in early 2009 on the application of competition law to the energy sectors in the Energy Community. A study on the role of State aid in the electricity sector is also under consideration.

1.5. On Security of Supply

The Contracting Parties, following explicit decision of the Ministerial Council of the Energy Community, agreed to implement Council Directive 2004/67/EC of 26 April 2004 concerning measures to safeguard security of natural gas supply, Regulation (EC) No 1775/2005 of the European Parliament and the Council of 28 September 2005 on conditions for access to the natural gas transmission networks, and Directive 2005/89/EC of the European Parliament and of the Council of 18 January 2006 concerning measures to safeguard security of electricity supply and infrastructure investment by the end of 2009.

On the ground of the developed concrete Road Maps for implementation of the acquis, the work in all Contracting Parties in 2009 was very active with the support of the Secretariat. However, only few effective outcomes can be noted - a number of related aspects need further attention and increased efforts.

Common areas for possible progression are registered mainly in demand forecast, efficient use of the available infrastructure, administration of new capacities, the role

and the reliability of the markets, monitoring / reporting processes and mutual cooperation.

2. COOPERATION AMONG REGULATORY AUTHORITIES

Work of Energy Community Regulators is coordinated by the Energy Community Regulatory Board (ECRB). The ECRB is an Institution of the Energy Community established by Article 58 of the Energy Community Treaty and takes the role of a coordination body of the national regulators of the Energy Community for exchanging knowledge and developing common best practice solutions for implementing the Energy Community Treaty in a harmonized way. Streamlining of regulatory measures and providing a stable regulatory market framework remains a key promoter for a number of core objectives of the Treaty – such as market integration, facilitation of investments, competition and security of supply. Within the necessary range of national specificities linked to this, regulatory rules are required to be harmonized to the maximum extent possible on a cross-border basis, if not wanted to create barriers to trade across borders, to investments and consequently security of supply.

Within its objectives of facilitating the (development of) harmonized regulatory rules, the ECRB in 2009 concentrated its work on three areas: gas electricity and customer protection. More in detail work involved:

- **ELECTRICITY:** Congestion management and transmission capacity allocation – regional balancing – compatible market rules – wholesale market opening – harmonisation of trading licenses – cross border cooperation of regulators related to cross border investments;
- **GAS:** regulatory instruments for facilitation of regional gas investments in the Energy Community (“Gas Ring”)
- **CUSTOMERS:** Protection of vulnerable household customers – quality of supply and commercial services – tariffs/prices and transparency.

In addition, specific work is dedicated to supporting the setting up of a South East Europe Coordinated Auction Office (SEE CAO).

In performing its task the ECRB actively coordinates and cooperates with the other institutions set up by the Energy Community Treaty - such coordination remains of utmost importance given the legal fact that any regulatory activity, both on national and cross-border level, can only start from broader energy policy decisions and build on existing legal powers and framework rules.

3. TARGETING INVESTMENTS

Lacking substantial investments – particularly on regional level – is still an issue of concern. As to support the efforts of the Contracting Parties in this relation, the Energy Community Secretariat – together with the EBRD – organized in 2009

Investment Conference, which took place in Sarajevo in March 2009 and repeated the increasing and urgent need for energy infrastructure investments.

The IPA Investment Projects Facility, launched by the European Commission in March 2008, was used to the extent possible in 2009 to support the preparation of solid infrastructure developments. This activity outlined the necessity for active support to all Contracting Parties in preparing adequately their projects applications, which shall be targeted in the coming Work Programme period.

In addition, the work with the Donors' Community is strongly intensified as to streamline the needed focus of attention, concerning investments with maximum effect on regional level. Otherwise, the Ministerial Council of the Energy Community is updated on regular basis on the developments via updating the information on the priority list of infrastructure projects, which is also publicly available. .

4. ENERGY EFFICIENCY

The work of the Energy Efficiency Task Force, established in 2007, continued actively in 2009 on the ground of its extended mandate. The key focus of its work within the period was related to analyzing the possibility of implementing new acquis, concerning energy efficiency. The concrete outcome is that a proposal has been made that three concrete directives might be adopted for mandatory implementation by the end of 2011. These are:

- Directive 2006/32/EC of the European Parliament and of the Council on energy end-use efficiency and energy services and repealing Council Directive 93/76/EEC;
- Directive 2002/91/EC of the European Parliament and of the Council on the energy performance of buildings;
- Council Directive 92/75/EEC on the indication by labeling and standard product information of the consumption of energy and other resources by household appliances, as amended by Regulation (EC) No 1882/2003 of the European Parliament and of the Council and Regulation (EC) No 1137/2008 of the European Parliament and of the Council ("Directive 92/75/EEC") as well as the following Implementing Directives.

The concrete decision on this is expected at the Ministerial Council meeting in December 2009.

5. SOCIAL DIMENSION

The Social Dimension of the Energy Community has been introduced in concrete terms via the Memorandum of Understanding on Social Issues in the Context of the Energy Community, signed in October 2007 by all Parties to the Treaty.

Following the decision of the Ministerial Council meeting in December 2007, the second annual Social Forum was organized in October 2009. The outstanding necessity for more active cooperation among the social partners was underlined again. Still, the communication among the social partners on national level is considered insufficient. Therefore, there is no doubt that this cooperation needs to be strengthened. In addition, the focus on vulnerability was clearly requested. Thus, further to the work in this aspect, provided by the Energy Community Regulatory Board, the Secretariat shall continue its support to the governments and the other

social partners for adequate, timely and concrete discussions along the adopted national Social Action Plans.

6. OIL DIMENSION

As a follow up of the Ministerial Council decision from December 2008 on developing the Energy Community Oil Dimension, the first Oil Forum was organized in September 2009 in Belgrade. A major focus of attention of the work along the Oil Dimension is linked to analysis of the status quo and eventual inclusion of the acquis to be implemented of the relevant EU Oil Stocks Directive, which shall be concretely considered by the Ministerial Council in 2010.

The discussions so far clearly outlined the importance of the oil stocks in the context of the overall security of supply, which was proved in concrete terms during the gas crisis in January 2009. Two concrete issues were agreed to be of utmost importance - institution building and the cooperation between the governmental institutions and the private business.

7. DISPUTE SETTLEMENT

Following the adoption of the Rules of Procedure for Dispute Settlement in the Energy Community in 2008, the Secretariat already has gained practical experience on the ground of the five cases, of which one was resolved already during 2008 following mediation by the Secretariat. In one other case, the Secretariat opened the formal procedure and issued a reasoned opinion in summer 2009. The Government concerned has been encouraged to amend its legislative framework, including the regulatory approach to tariff-setting. In another case, the two TSO involved have been invited to negotiate a bilateral agreement following mediation with the Secretariat's involvement.

The dispute settlement mechanism proved to be a concrete asset in the work towards efficient implementation of the Energy Community Treaty.

III. CONCLUSIONS

The revised period of activities of the Energy Community is characterized by variety of actions towards the implementation of the Treaty and the efforts brought concrete results in all areas. However further steps towards practical development of the energy markets remains an overwhelming priority. Strengthened efforts in the area of security of supply are also needed.

In parallel, the work in all other areas, covered by concrete acquis on one side, and in those, which are being considered for inclusion in the mandatory implementation list (energy efficiency, oil) shall actively continue. In this relation, it should be also noted that despite the challenges, the growing Energy Community has clear outline for its coming steps – this was concretely specified within its new two years detailed Work Programme (2010-2011), backed up by concrete budget frame. Therefore, under the guiding role of the European Community as specified in the Treaty, 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, Montenegro, Serbia, the United Nations Interim Administration Mission in Kosovo and the European Community are Parties to the Treaty.
- Georgia, Moldova, Norway, Turkey and Ukraine have status of Observers. The negotiations with Moldova and Ukraine on accession to the Energy Community have been finalized; those with Turkey are at the initial phase.
- 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, in particular the environmental impact assessment directive;
 - Key directives on renewables and biofuels;
 - The main principles of the EU competition policy;
 - Major acquis in relation to security of supply.
 - Concrete list of acquis in relation to energy efficiency, oil stocks and the new EU RES directive 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 .