

EUROPEAN ENERGY LAW AND ITS IMPACT ON SERBIA PROGRESS, PERSPECTIVES AND POSSIBILITIES

by

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The European Energy Law will have great impact on Serbia and its renewable energy sector.

The Energy Community is extending the European Union internal energy market to Southeast Europe and beyond on the ground of legally binding treaty. Thus, Serbia, as a member of the Energy Community, has been committed to implement the relevant EU regulations concerning the energy sector step-by-step.

Furthermore, the ability of Serbia to assume the obligations of membership is evaluated on the basis of the implementation of the EU Acquis. The energy sector has been outlined by the European Commission as one of the fields where Serbia will have to undertake additional efforts to align with the acquis in the medium term. As the European Council granted Serbia the candidate status in March 2012, the EU will monitor the adoption of the EU Energy Acquis closely.

Key words: *energy law, energy efficiency, renewable energy*

Legal basis

The European Energy policy aims to secure affordable and greener energy. In accordance with the Article 194 of the Treaty on Functioning of the European Union, the EU will:

- (a) Ensure functioning of energy market;
- (b) Ensure security of energy supply in the Union;
- (c) Promote energy efficiency and energy saving and the development of new and renewable forms of energy; and
- (d) Promote interconnection of energy networks.

The EU Energy *Acquis* consists of rules and policies covering competition and state aid, internal energy market (opening electricity and gas markets in particular), promoting renewable energy sources, energy efficiency, crisis management and oil stock security obligations, nuclear energy, nuclear safety and radiation protection.

Energy forms the part of shared competences between the EU and Member States and it is therefore the subject of the principle of subsidiarity. As a consequence, the EU may only intervene if it is capable of acting more effectively than Member States. Nevertheless, as the energy sector is one of the EU major policies, the scope of action of the national legislator is strongly influenced by Brussels politics through the new Regulations.

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Furthermore, Serbia is a contracting party of the Treaty Establishing the Energy Community which was signed on 25th October 2005 in Athens by the European Community and subsequently by nine Contracting Parties from Southeast Europe. Following ratification, the Treaty entered into force on 1st July 2006.

The Treaty strives to balance commercial, political and social interests of all parties. In guaranteeing stable and continuous energy supply, the process of Energy Community will ultimately result in enhanced economic development and social stability.

According to the Article 2, the task of the Energy Community is to organize relations between parties and create legal and economic framework in relation to the Energy Network in order to:

- (a) Create stable regulatory and market framework capable of attracting investments in gas networks, power generation, and transmission and distribution networks.
- (b) Create single regulatory space for trade in the Energy Network that is necessary to match geographic extent of concerned product markets.
- (c) Enhance security of supply in the single regulatory space.
- (d) Improve environmental situation in relation to the Energy Network and related energy efficiency, foster the use of renewable energy and set out the conditions for energy trade in the single regulatory space.
- (e) Develop the Energy Network market competition on broader geographic scale and exploit economies of scale.

Thus, Serbia has agreed to implement the core parts of the EC *Acquis Communautaire* by adopting the plan to bring its energy sector in line with generally applicable standards of the Community.

Current energy policy in Serbia

Progress

Serbia's overall energy balance comprises coal, oil, gas, firewood, hydroelectricity and other renewable energy sources. There is currently no nuclear energy production. In 2008, three major energy sources for covering gross inland consumption were coal (51%), oil (27%) and natural gas (13%). Domestic production covers 60% of the total primary energy consumption. Serbia's energy sector accounts for more than 10% of its GDP. Moreover, as a transit hub in Southeast Europe, Serbia's interconnections with neighboring countries are very often congested.

Serbia's energy strategy is outlined in the Energy Sector Development Strategy from 2005. The Implementation Plan was adopted in 2007 and subsequently updated, most recently in 2010. The development of a new energy strategy for the period of at least fifteen years is foreseen under the new Energy Law adopted in July 2011.

The new Energy Law provides a new market model and the unbundling of distribution and supply functions for gas and electricity. It also foresees stronger powers for the Energy Agency of the Republic of Serbia (AERS), notably as regards the definition of tariffs, oversight of the unbundling process, market rules, allocation rules and network development plans.

Under the new Energy Law, the tasks and powers of the AERS are principally in line with the 'second package' of the EU Energy *Acquis*. However, they are resource-intensive and the implementation of the new law will require the increase of the AERS's staff and its independence. The reinforcement of the administrative capacity is essential in order to ensure effective implementation and enforcement of its legal obligations in the energy sector.

Perspectives

The European Commission, on its Opinion on Serbia's Application for Membership of the European Union, identifies some points where Serbia needs to "do additional efforts in order to align its legal framework with the EU *acquis* on Energy [1]". They can be resumed as follows.

Security of supply

Serbia's production is dominated by coal and it relies on imports for cleaner energy sources. For instance, Serbia's dependence on natural gas imported from Russia and Ukraine exceeds 80%.

In the gas sector, storage projects and new interconnections are planned in the Energy Sector Development Strategy and this will help to diversify the supply.

The Nis-Dimitrovgrad project linking Serbia to Bulgaria is the most advanced with a feasibility study underway.

Concerning electricity, Serbia has given priority to the new interconnection with the FYR of Macedonia. The construction of substations for Montenegro, Bosnia and Herzegovina and the area along the transmission corridor towards Italy are at the prefeasibility study stage.

The level of emergency oil stock reserves is classified as a state secret according to the Serbian Law on Commodity Reserves. A new law is currently drafted and it will classify mandatory oil rather than commodity reserves. Hence, the level of these stocks will no longer be the state secret.

Competitiveness of internal energy market

To achieve common purposes, the EU focused on antitrust-issues in the energy sector. The existing competition problems have been followed with groundbreaking decisions. These cases have led to the third internal market package for electricity and gas. As a major issue, the EU obligates member states to implement rules concerning the separation of energy production and distribution in large integrated energy companies (legal and functional unbundling).

By separating energy production and network operation, they expect to solve any conflict of interest between producers, suppliers and transmission system operators. These regulations create incentives for necessary investments and guarantee access for new market entrants under transparent regulatory regime. The deadline for implementing these directives in national law expired on 3rd March 2011. Serbia still needs to align its legal framework with this regulation.

Electricity: Since 2005, the operation of the transmission system and the electricity market has been under the responsibility of the public enterprise EMS (Elektromreža Srbije – Serbian Transmission System and Market Operator). The remaining functions (generation, distribution and supply) are performed by the vertically integrated public company EPS (Elektroprivreda Srbije – Electricity Industry of Serbia).

In accordance with the new Energy Law, the EPS needs to complete legal unbundling of distribution and supply as they, due to the persistence of regulated prices which are set at levels below the market price, hold a *de facto* monopoly.

In this field, the choice of a market model, with the reform of the tariff system is crucial. Parallel with this reform, Serbia needs to implement the Regulation on Cross Border Allocation Capacity. The Energy Community Secretariat has already blamed Serbia for not fulfilling its obligations in this sense¹.

¹ The complaint concerned the absence of compensation for electricity transit to the Kosovo Electricity Transmission System and Market Operator (KOSTT) and the allocation of cross border. Furthermore, the Serbian Electricity Utility is maintaining the unlicensed branch in the north of Kosovo.

Gas: The State owned “Srbijagas” is a fully integrated company and the only wholesale supplier at the market. It has not been unbundled. “Srbijagas” purchases gas from “Gazprom” via the intermediary “Yugorosgaz”. The difficult financial situation of “Srbijagas” needs to be addressed as a matter of priority.

On the other hand, market opening in the energy sector can cause problems to current and former monopolists. They are bound by long-term supply contracts with their customers who do not have any other choice then to purchase from them. Now, their demand will decrease because clients can obtain gas or electricity from other sources.

Renewable energy

Regarding the Renewable Energy Sources Directive, it can be said that the Energy Law is partly in line with it. As the regulation will be further developed by subsequent laws, it should be closely monitored in order to ensure compliance with the EU *Acquis*.

Serbia has significant potential for renewable energy, which still remains largely untapped. The share of renewable energy sources in total primary energy production in Serbia was only 8% in 2008.

In the context of the Strategy until 2020, Serbia is preparing a binding target for the percentage of renewable energy consumption in the total energy mix. The National Renewable Energy Action Plan may provide a roadmap for this purpose and foster the use of renewable energy in all sectors, in particular in transport and heating/cooling.

There are “renewable market” feed-in tariffs at present. However, the administrative procedures for authorization, licensing and network connections are still the biggest barrier for the uptake of renewable energies.

The European Energy Policy aims at opening markets to small-size and mid-cap companies which are highly dependant on having access to local grids (usually controlled by large corporations). For boosting renewable energies, the EU has created an initiative for competitiveness which is faced with strong opposition within national interests.

Energy efficiency

Serbia’s economy is highly energy-intensive, consuming 2.7 times more energy per unit of output than the OECD average. The Law on Energy Efficiency has been drafted and it anticipates performance in buildings, labeling of domestic appliances and energy services, as well as the creation of the Energy Efficiency Fund. Ensuring sufficient administrative capacity for the implementation of new legislation will be essential.

Nuclear safety and radiation protection

The Serbian Agency for Ionizing Radiation Protection and Nuclear Safety (SRPNA), established in 2009, implements international conventions which Serbia has signed. The transfer of inspection functions from the variety of ministries to the Agency has not yet been achieved according to the best regulatory practice. The Commission has also proposed to envisage the Quality Management System and the National Strategy for Nuclear Waste Management and to seek for the solution regarding the radiological situation at Vinča.

Possibilities

The Europe’s economic future requires smart, sustainable and fully interconnected transport, energy and digital networks. These are necessary conditions for the completion of

the European single market and will help to achieve the EU's sustainable growth objectives outlined in the Europe 2020 Strategy and the EU's ambitious "20-20-20" objectives¹ in the area of energy and climate policy.

Furthermore, the EU established a new "Energy Roadmap 2050" in December 2011 where the EU commits to reduce gas emissions by 80-95% compared to 1990 and to address the problem of security of energy supply and competitiveness. In this context, Serbia will also need to establish the objective in compliance with the Europe 2020 Strategy.

The Commission Proposal for the Next Multiannual Financial Framework considers the next financial period of the transition to low carbon economy as the priority:

"In the energy sector, public and private entities in the Member States will need to spend around € 400 billion on distribution networks and smart grids, another € 200 billion on transmission networks and storage as well as € 500 billion to upgrade and build new generation capacity between now and 2020".

This investment seems to be unfeasible at national levels, as Member States' public budgets are struggling with the necessary fiscal consolidation. Thus, the mobilization of investment needs is to be done from the national to the European level. The use of innovative financial instruments, including EU project bonds, in order to attract private and equity capital, will enable pooling of assets to improve the risk profile and to lower costs of financing for future infrastructure portfolios. The Commission is also studying the possibility to create the new "Connecting Europe Facility" covering energy, transport and broadband investments.

Serbia will need to adopt its administrative structure for the implementation of projects and managing of funds which can be shared among EU and at the national level. The capacity of absorption needs to be deployed, as well as the sound financial management. According to the principle of conditionality, the Commission will provide economic assistance under the condition of efficiency and effectiveness in the implementation of the Energy Community Treaty.

Due to the harmonization of funding, southern countries are more interested in foreign investments in Serbia. In this respect, renewable energies require extension of existing energy grids to transport wind energy from the north to the south and solar energy from the south to the north. Serbia will play the major role in transit ways due to its geographic position.

In the current period, members states have benefited from the following programs [2]:

- **TEN-E:** Created in 1990, it is the energy sector specific tool for supporting initiatives aimed at the creation of single energy market, reduction of secluded less favored and island regions, securing and diversifying the EU's energy supplies, also through cooperation with third countries, and the contribution to sustainable development.
- **Intelligent Energy Europe:** The main areas covered by this program are energy efficiency, new and renewable resources and energy in transport, as well as integrated initiatives which combine several of these or address more than one economic sector at the same time. The initiative includes the following programs: Energy Efficiency and Rational Energy Use (SAVE), New and Renewable Resources (ALTENER) and Energy in Transport (STEER).
- **European Energy Program for Recovery (EC 663/2009):** Within the framework of the EU response to the economic crisis, a new *ad hoc* instrument was adopted in 2009 to grant targeted financial assistance to projects in the field of energy. Eligible areas are gas and electricity interconnection, gas reverse flows and storage, offshore wind energy and carbon capture and storage. Its main objectives are to speed up and secure investments in infrastructure and technology projects in the energy sector, to improve security of supply and to help

¹ Improving the EU's energy efficiency by 20% by 2020; - increasing the share of renewable energy to 20% by 2020 - reducing greenhouse gas emissions by 20% compared to 1990 level

in the implementation of 2020 objectives. This initiative serves as the framework for the following programs: CO₂ Capture and Storage (CSS), Offshore Wind Energy (OWE), Gas and Electricity Infrastructure Projects, European Energy Efficiency Fund (EEF) which allocates around EUR 146 million from the EEPR (3.7% of the total EEPR envelope) towards new financial facility dedicated to projects in energy efficiency and renewable energies.

- **European Energy Efficiency Facility** has also been set up to support energy efficiency and renewable energy.

Under specific conditions, energy projects can be sponsored by Pre-Accession Funds. These funds are intended to support future member states to adjust their living conditions.

As an example of financial assistance in Serbia, the SuDES Project (Sustainable Development in the Energy Sector) financed by the EU and managed by the Delegation of the European Union to the Republic of Serbia should be emphasized. It assists Serbia in energy activities with the main goal to contribute in the sustainable development of Serbia by enhancing capacities in the energy sector in order to efficiently use resources in compliance with the EU Energy and Climate *Acquis*. The objectives of the program are: implementation of the Energy Policy and Kyoto Protocol by, increasing the quality of conventional fuels and raising public awareness on sustainable development.

At the same time, the European Bank for Reconstruction and Development (EBRD) has launched the Western Balkans Sustainable Energy Direct Financing Facility to provide financing for renewable energy and industrial energy efficiency projects to small and medium size enterprises in the West Balkans.

Therefore, the European Bank for Reconstruction and Development is actively promoting sustainable energy investments, providing credit lines for € 60 million to local partner banks for local business.

Conclusions

Serbia is on the right green energy track but needs to consider the following:

- The adoption process of the EU Energy Law has to be in advance in order to receive full EU membership.
- Effective use and expansion of existing energy grids, for example, by using high temperature conductors or underground cables.
- Security of supply, competitiveness of internal market, renewable energies, efficiency and nuclear energy are the sectors where Serbia needs to focus its attention. The energy industries have to amend existing contracts in the light of open market.
- The national legislator has to increase programs of government aid for new energies to meet their objectives regarding Europe 2020.
- Energy projects might be co-financed by the EU in the future.

References

- [1] SEC(2011) 1208 Final Commission Opinion on Serbia's Application for Membership of the EU
- [2] http://ec.europa.eu/energy/grants/index_en.htm