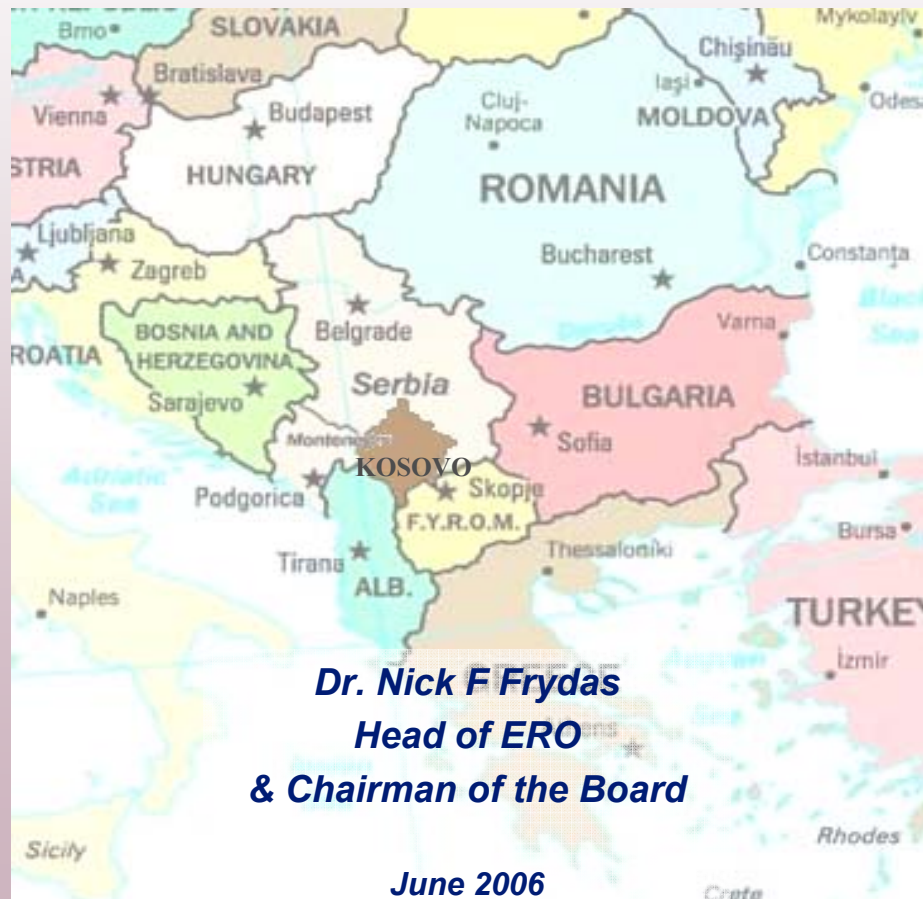


Energy Regulatory Office

The Roadmap to a single Regulatory space in ECSEE



Main themes of presentation

- Benefits of Energy Trade & Regional Markets
- The “Athens Process” leading to ECSEE Treaty
- Regulatory Challenges
- Main Obstacles & Mitigation Measures

Main themes of presentation

- Benefits of Energy Trade & Regional Markets



Benefits of Trade

- Sharing of Reserve Capacity
- Heterogeneous Resources / Diversity in Generation park
- Non-coincidental peak
- Improved security of supply
- Environmental enhancement & protection



Benefits of Markets

- Better economic efficiency through competition
- Shifting of Risk from Customers to the Investors
- Appropriate economic signals through competitive prices or regulated prices in networks
- “Commoditization” of Energy. Liquid Wholesale Markets and Suppliers/Traders bring important benefits to Customers



Pre-requisites for development of Competition

- Supply to exceed Demand, many Buyers/Sellers, lack of Market Power
- Liquid
- TPA
- Unbundling (networks), Industry fragmentation
- Cost-reflective Tariffs
- **Independent Regulation**
- Strong interconnectivity / harmonised framework

Common Characteristics of IEM Market Models

- An independent Regulatory Authority
- An independent Transmission System Operator (TSO)
- Competitive Markets in the wholesale Generation and in Supply
- Organized Financial Markets in Energy

Why Regional Markets?

- Market Power/Dominant Positions of incumbent
- Trading over the energy networks
- Development of “Regional Markets”, a necessary interim stage



ERO

Harmonisation of Regulatory Framework

Harmonization is critical

If the intention is to create a regional energy market which will:

- decrease entry barriers & increase the number of market players
- alleviate concerns of market concentration
- enhance price convergence
- stimulate liquidity on the traded markets
- reinforce trust in price formation and markets abilities to deliver
- Need of **co-ordination** in important regional issues

Main themes of presentation

- Benefits of Energy Trade & Regional Markets
- The Athens Process leading to ECSEE Treaty



ECSEE Treaty - Objectives

- Optimization of energy usage & infrastructure to enhance the Security of Supply
- Attract private capital investments in Generation & Networks (\$ 20 bil – 2020)
- Improve the environmental situation & foster the use of RES
- develop competition on a broader geographic scale
- co-ordination & co-operation (in overcoming political issues, regulatory, investments, statistical & market etc.)
- Establishment of an “Energy Bridge” based on free market principles between the rich energy resources of the east and the “short” energy customers of the west
- Create a Regional Market (the 8th in Europe) that will be easier to be integrated with IEM

..... and the difficulties

- Small size of Energy Markets
- High political uncertainty & instability because of recent historical circumstances
- Big differences in the economic development between the countries of SEE:
 - *Low Income*
 - *Low and subsidised energy prices*
 - *Low quality, poorly maintained or even destroyed energy infrastructure*
 - *Uneven economic and legal frameworks*
 - *Emphatic difference between eastern and western Balkans*
- Existence of several interested parties (Donors, WB, EBRD, EU, private investors, etc...)
- Lack of co-ordination of the reconstruction efforts for the region (since 1996 it is estimated that donors have spent € 4 bil.)

How did we reach the Treaty

October 2005 – EC signed legally binding (ECSEE) treaty with Signatory parties (9) of Athens MoU

- First important political effort for co-operation in the region
- Establishment of “Athens Forum” – (8th will be in Athens on 22 June)
- Establishment of WGs for Regulators & TSOs
- It was clear from the onset that political binding of all participating countries was required in order to achieve progress in the creation of a regional market
- Treaty will formally start to be implemented after at least 6 signatory parties have ratified it. This is expected to happen by the 2nd half of 2006
- It could happen that the Treaty becomes the basis for future co-operation between the EU and third countries (Black Sea, Mediterranean, etc)

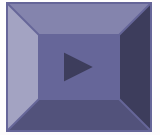
*EC – Donors: Nov 2002 (Dec 2003) 2 MoU were signed → Athens Process
Committing signatory parties of SEE region to implement parallel rules
for the creation of a real integrated energy market free of any barriers*

-security of supply, private investment-

-TPA & competitive conditions-



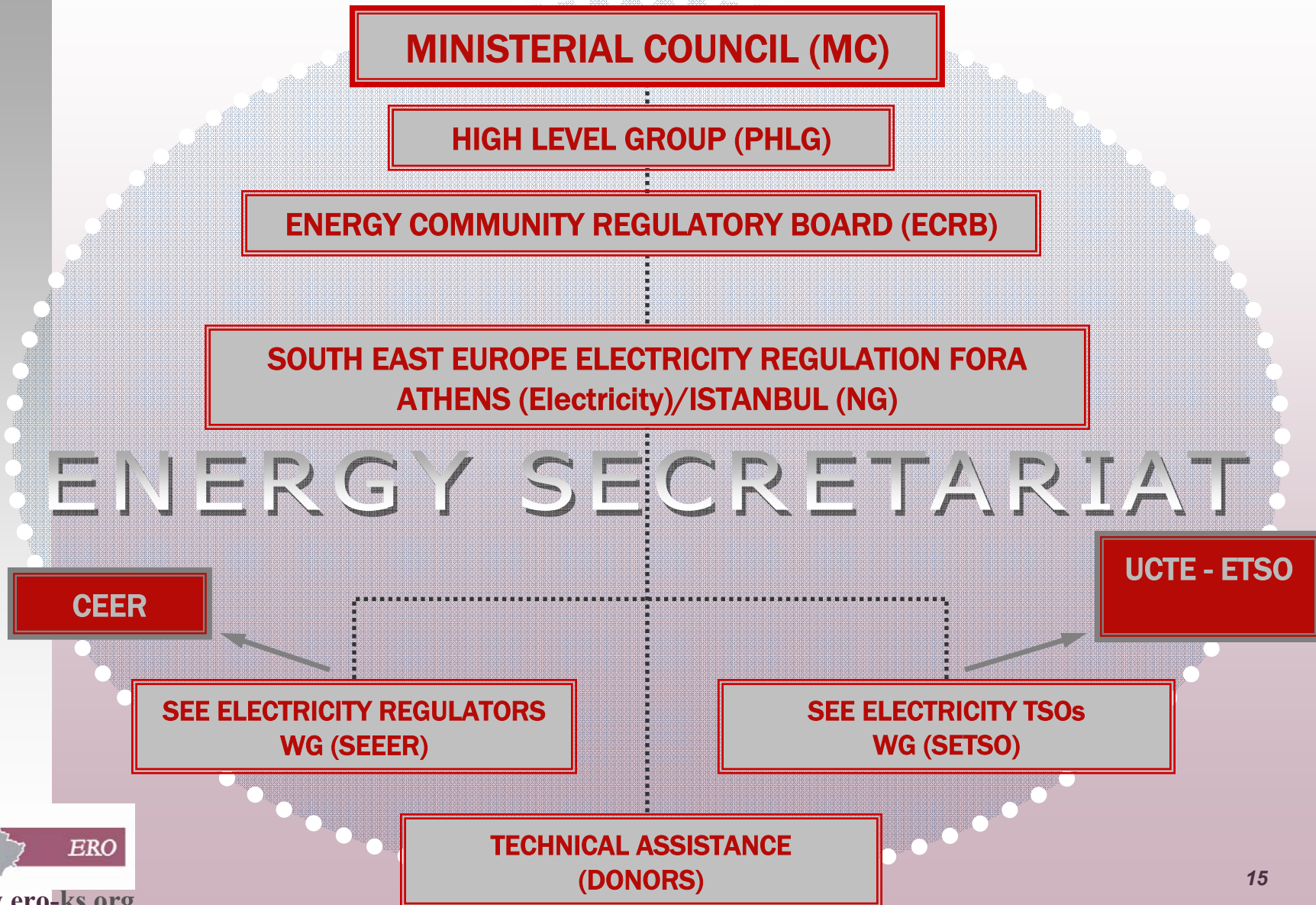
What is it provisioned by the Treaty



Acquis

- The implementation of the "*Acquis Communautaire*" in energy, environment, competition and renewables, by all signatory parties
- The power to implement measures & legally binding decisions, particularly in the areas of:
 - *Cross-Border Trading*
 - *Security of Supply, "uniform right of supply" of all energy customers*
 - *the harmonisation and compliance of the regional market rules*
 - *the mutual recognition of Licenses*
 - *Renewable Energy Sources*
- No VAT or other form of Taxes on energy exchanges between EU and SEE
- Harmonisation of imports/exports to and from third countries which are not participants in the Treaty
- Mutual Assistance in case of Power Outages

Governance structure & Institutions



National Obligations imposed by Treaty

National Institutions

- Independent Institution for:
- Independent DSOs

a) policy

b) regulation

c) system operation (TSOs)

National Markets

- Unbundling utilities & market opening – phased approach

1st January 2008
for all
non-household customers

Market opening

1st January 2015
for all
customers

- Adoption of competition legislation for energy sector
- Regulated TPA and development of transparent and unbundled transmission & distribution tariffs
- Development & Monitoring of licenses for facilities and Market Participants
- Elimination of cross subsidies in Tariffs

Regional & other commitments of the Signatory Parties

Regional Markets

- Harmonisation of Market Rules - ECRB
- Transmission Access Framework (CBT/ITC & CM) - SETSO
- Publication of Market Information / Transparency
- Dispute Resolution mechanisms at regional level
- Transparent Authorization Procedures for the new infrastructure
- Establishment of common rules for the transmission, distribution, supply and storage of natural gas

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- Regulatory Challenges

Challenges in implementation of REM

- increase tariffs to cost-reflective levels for each category of consumers (affordability)
- identify regional investment priorities
- develop a harmonised capacity support mechanism
- improve payments discipline
- costs associated with EU environmental standards
- develop social programs for coal industry labor restructuring
- develop an independent regulatory framework

Key elements of a Credible Regulatory System

Independence

- *Decision making independence - no government entity other than a court or pre-designated arbitrator can overrule the regulator's decision*
- *Financial independence - earmarked, secure and adequate source of funding*
- *Management independence - autonomy over internal administration as well as protection from political interference (dismissals without due cause)*

Accountability – *Accountable for its decisions (Parliament – Auditing)*

Transparency & Predictability – *"Ex-ante" definition of the rules, clearly explained and in transparent manner (Public Consultation) – "Ex-post" intervention in market abuse cases*

AUTHORITY
AUTHORITY
ACCOUNTABILITY



ERO

Challenges & Risks in ERO

- Political interference which represents risks for private investors
- Achieve full financial independence of ERO for effective and efficient operation in order to fulfil its mandate
- Low level of salaries / retain experienced professional staff
- Training required (2004-2006) >€ 3.5 mil. (Donors)
- Poor financial conditions of energy utilities
- Mitigation of risks for investors = transparent and stable regulatory framework

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- Main Obstacles & Mitigation Measures

Main obstacles & mitigation measures (i)

- Limited availability of interconnection capacity
 - full TSO unbundling / methodology for utilization of auction revenue
 - Abolition of import/export monopoly / no new AAC / AAC holders must pay average auction price / Flow-based Coordinated auctions
- TSOs conflict of interest with ITC fund. Lack of methodology for market participants
 - Merging of 2 funds (ETSO-SETSO) / methodology for payments by participants / ensure TSO neutrality to fund
- TSOs unbundled but no development of new (market related processes)
 - new business processes (PN/CN, BM, Market rules/GC, planning, coordination)

Main obstacles & mitigation measures (ii)

- Concentration of Generation / non existence of Supply Function
 - issue SEE guidelines regarding market structure: Promotion of the supply function / role of Wholesale Supplier; Measures to kick start competition (initial contracts; virtual capacity auctions, etc); Phased (gradual) approach
- Market rules not implemented (or only partially) in many jurisdictions. Many constraints and lack of harmonization in existing market rules
 - jointly CEER/SETSO to create a group for Market Harmonization and issue guidelines regarding minimum requirements for market rules (e.g.):
 - all participants subject to market rules (imbalances)
 - harmonize gate closure (afternoon ahead)
 - minimum constraints to contracts
 - publishing of information
 - improved tendering rules for import-export
 - procurement of AS and balancing energy only through TSO (eliminate bilateral settlement)

Main obstacles & mitigation measures (iii)

- Cross subsidies and lack of tariff rationalization creates distortions to trade (need to protect vulnerable consumers)
 - Implementation of new tariff structures
- Need to define role of regional market institutions and processes
 - Role of Power Exchanges
 - Coordinated Auctions
 - ITC
 - Regional Balancing Market
- Cumbersome licensing procedures for national / regional trade
 - Harmonization of trading/supplier concepts
 - No need for trading license-need to be linked to BRPs
 - Mutual recognition of Trade Licenses

Issues specific to SEE

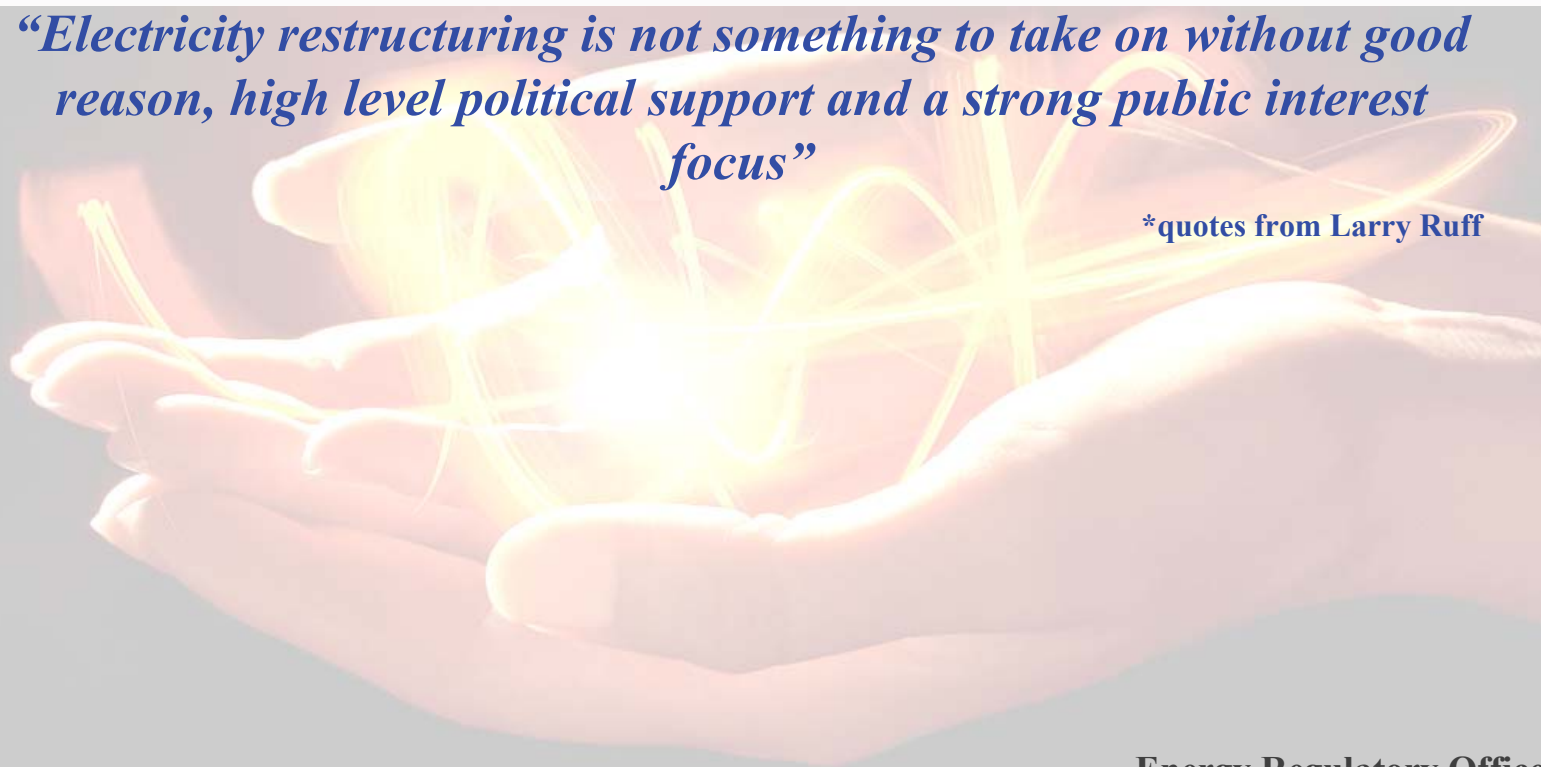
Large number of small countries/many TSOs make the regional aspects and the need for harmonization very important:

- Develop more liquid regional DA market
- Regional balancing market
- ITC
- Coordinated Auctions

Energy Regulatory Office

“Electricity restructuring is not something to take on without good reason, high level political support and a strong public interest focus”

**quotes from Larry Ruff*

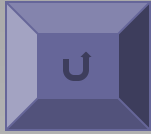


**Thank
You**

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Acquis Communautaire



Acquis

- *EC Electricity Directive 2003/54/EC*
- *EC Natural Gas Directive 2003/55/EC*
- *EC Regulation on conditions for access to the network for cross-border exchanges in electricity 1228/2003/EC*
- *EC Council Directive 85/377/EEC - environment*
- *EC Council Directive 199/32/EC - environment*
- *EC Council Directive 2001/80/EC - environment*
- *EC Council Directive 79/409/EEC - environment*
- *EC Council Directive 79/409/EEC - renewables*
- *EC Council Directive 79/409/EEC - renewables*

