

The Liberalisation of the Serbian Electricity and Gas Markets**

Taking the goals of energy market liberalisation as a starting point, namely security of supply, promotion of energy efficiency, use of renewable energy sources and increasing consumers' well-being by reducing electricity and gas prices, this article aims to research the process of liberalising the energy market and reach an answer on the question of what will benefit Serbia's electricity and gas sectors most, whether that be remaining in the arms of government or becoming fully liberalised, allowing state-owned energy incumbents to be privatised and private companies to become owners of the production, transmission, distribution and supply operations. On one hand, there are requirements from the European Union for opening the energy sector to competition and market principles, which need to be respected by Serbia, as a candidate country; on the other hand, energy incumbents owned by the state still provide electricity, gas and heat energy. This article will identify the positive and negative effects of a liberalisation policy in undeveloped countries and will outline the regulatory tools that increase competitiveness in the market.

The article comprises four chapters. The first chapter provides a general overview of the process of liberalising the energy markets, emphasising some crucial aspects of this process. The second chapter addresses how the European Union may influence the opening of energy markets, by continually developing European energy policy and through the rules of competition law. The third chapter explains how Serbia implements the European energy policy, highlighting its achievements in the production, supply and transmission operations in the electricity and gas markets, as well the level of applying competition law tools in the energy sector. It will also introduce the Energy Community, a regional organisation that facilitates the implementation of EU energy legislation in South-East Europe and the Black Sea countries. Finally, the fourth chapter provides a conclusion on the effects of liberalisation in undeveloped energy markets, such as Serbia, and on the legal mechanisms that need to be revisited in the Energy Community legal framework to bring about the desired effects of liberalising the energy market.

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I Introduction

Traditionally, electricity has been treated as a commodity that must be available to all consumers in adequate quantities, regardless of the price. A state was responsible for ensuring that consumers are supplied with electricity at a price lower than the cost of production.

Liberalising the electricity and gas sectors deregulates them and removes their monopoly status. Publicly owned incumbents enjoyed sole ownerships of all the production and supply facilities, as well as all transmission and distribution networks. Private investors were unable to enter the market and consumers were unable to choose their own suppliers. It can also be said that liberalisation policies intend to withdraw state influence over the energy incumbents.

From the start of the 1980s to the present, worldwide energy sectors have been subject to significant reforms, characterised by the following factors:

- 1) Restructuring monopoly companies that had operated all energy functions, into competitive companies, by separating the energy functions from each other,
- 2) Opening markets for production and supply and ensuring fair and equal third party access,
- 3) Privatising state property.

To privatise state-owned companies, transition countries must fulfil certain preconditions, such as to proceed with turning energy incumbents into corporations, to reform the legal systems, to restructure energy companies, to establish regulatory bodies that would monitor energy markets, and to develop wholesale markets. However, the privatisation of state-owned undertakings is a last resort action and not the usual means of reforming energy markets.

Production and supply are competitive functions and should be open to multiple competitors. In contrast, transmission networks are natural monopolies, usually performed by one or a small number of companies.¹ The Serbian Energy Law Act also envisioned transmission and distribution systems as activities of general interest regulated by law while viewing electricity generation and supply as needing to perform in accordance with market principles.²

Transmission and distribution operators need to provide open access to networks, which should be regulated to ensure equality, non-discrimination for all market participants and economic efficiencies. In the event that these networks become fully liberalised, meaning that multiple transmission operators are in place and that prices for access to the infrastructure are set by market principles, the largest companies would be able to offer the lowest prices for access to the network, thereby excluding competitors from the market. Also, in an unregulated market, a company with no competition can set monopolised prices and act to satisfy its own interest, giving little to no attention to public interests such as high quality, uninterrupted service and lower prices.

¹ For example, the German power system, which is one of the most complex and developed in Europe, has four big companies that perform transmission operation, while around 1000 companies generate and supply electricity.

² Energy Law Act ('Official Gazette of the Republic of Serbia' No. 145/14) (Energy Law Act 2014) art 16.

Unlike transmission systems, which usually remain under the state umbrella due to their strategic importance, the privatisation of distribution systems is not an uncommon feature. A benefit of privatising distribution systems is the reduction of technical and commercial losses. Private ownership can then influence the decrease of technical losses through investments while commercial losses may be reduced by increased motivation for better collection of debts.

The transmission networks of Southeast Europe (SEE) countries are still fully in direct or indirect state ownership to ensure non-discriminatory third-party access and security of supply. On the other hand, the distribution companies in some countries (Albania, Bulgaria, Romania, Macedonia and Montenegro) have been separated from dominant market players and have been sold to strategic investors.³

In the event of perfect competition, the interaction of many buyers and sellers theoretically creates a market price that is equal to the cost of the production of the last unit sold. This is an economically efficient solution. The goal of deregulation is the structuring of a competitive market with an adequate number of customers in order to eliminate the market power of companies to determine prices significantly higher than production costs.⁴

Developing and transitional countries, however, set prices for services of public interest, such as electricity, below the cost of generation in order to maintaining citizens' current standards of living, which are still at a low level. Deregulating electricity prices and their formation according to the market mechanisms of demand and supply would result in increased household bills. For example, electricity prices for household consumers across the EU increased by 25.9%, while industrial prices increased by 3.7% over the period from 2008 to 2017.⁵ Not only deregulation influences the rate of price increases, but the household expenditure may also reflect generators' costs of investing in renewable energy sources.

In addition, due to the higher prices that liberalisation can bring, large customers do not want the free market to remove their cheap energy. In such cases, factories would have to close or move to other countries due to increased expenses. States are also interested in retaining large companies in their territories by providing them with favourable conditions for doing business.

A fully liberalised sector is one with tariffs that reflect the costs of production and that provide adequate incentives for efficiency improvements, the involve the private sector, provide well-regulated third parties with access to networks and have developed a competitive energy generation industry. Energy sectors with such characteristics should anticipate improvements in quality of service, a reduction in price differences between countries and the option for each customer to choose a supplier.

³ Nela Vlahinić, 'The Effects of Privatization in Electricity Sector: The Case of Southeast European Countries' in G. G. Sander, L. Tichy (eds), *Öffentliche Daseinsvorsorge in Deutschland und Ostmitteleuropa zwischen Daseinsvorsorge und Wettbewerb* (Verlag Dr Kovac 2011, Stuttgart, 121–137) 132.

⁴ Ivan Tominov, 'Liberalization of electricity market, is it meeting expectations' (2008) 57 *Energija* 256–299, 265.

⁵ Agency for the cooperation of Energy Regulators, *Annual Report on the Results of Monitoring the Internal Electricity and Natural Gas Markets in 2017 – Electricity and Gas Retail Markets Volume* para 17.

II How EU Policy Influences the Liberalization of the Energy Market

The main avenue of the European Commission (Commission) for opening energy markets to competition and market mechanisms consists of enhancing energy sector policies. The Commission has been upgrading its regulatory policies towards the internal energy market for 20 years and counting.

To achieve the goals established in Article 194 of the Treaty on Functioning of the European Union (TFEU), designed to ensure the functions of internal energy markets and the security of energy supply in the Union and to promote energy efficiency, energy savings, the development of new and renewable sources of energy and promotion of interconnectivity between energy networks, the EU has developed a detailed energy policy encompassing the First, Second and Third Energy Packages.⁶ The latest output of the EU is the Clean Energy for All Europeans package, which will partially repeal the Third Energy Package, mostly in the field of electricity.⁷

For creating an efficient internal energy market in electricity and gas sectors within the territories of Member States, the following measures have been established by energy legislation:

- 1) Opening the production of electricity to new generation capacity,
- 2) Securing free access to transmission networks by third parties, under equal, non-discriminatory conditions,

⁶ The First and Second Energy Package consist of Directive 96/92/EC of the European Parliament and of the Council of 19 December 1996 concerning common rules for the internal market in electricity [1997] OJ L 27/20; Directive 98/30/EC of the European Parliament and of the Council of 22 June 1998 concerning common rules for the internal market in natural gas [1998] OJ L 204/1; 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 [2003] OJ L 176/37; Directive 2003/55/EC concerning common rules for the internal market in natural gas and repealing Directive 98/30/EC [2003] OJ L 176/57; Regulation (EC) No 1228/2003 of the European Parliament and of the Council of 26 June 2003 on conditions for access to the network for cross-border exchanges in electricity [2003] OJ L 176/1. Third Energy Package consists of Regulation (EC) No 713/2009 of the European Parliament and of the Council of 13 July 2009 establishing an Agency for the Cooperation of Energy Regulators [2009] OJ L 211/1; Regulation (EC) No 714/2009 of the European Parliament and of the Council of 13 July 2009 on conditions for access to the network for cross-border exchanges in electricity and repealing Regulation (EC) No 1228/2003 [2009] OJ L 211/15 (Electricity Regulation); Regulation (EC) No 715/2009 of the European Parliament and of the Council of 13 July 2009 on conditions for access to the natural gas transmission networks and repealing Regulation (EC) No 1775/2005 [2009] OJ L 211/36 (Gas Regulation); Directive 2009/72/EC of the European Parliament and of the Council of 13 July 2009 concerning common rules for the internal market in electricity and repealing Directive 2003/54/EC [2009] OJ L 211/55 (Electricity Directive); Directive 2009/73/EC of the European Parliament and of the Council of 13 July 2009 concerning common rules for the internal market in natural gas and repealing Directive 2003/55/EC [2009] OJ L 211/94 (Gas Directive).

⁷ 'Clean Energy for all European package' <<https://ec.europa.eu/energy/en/topics/energy-strategy-and-energy-union/clean-energy-all-europeans>> accessed 28 December 2018.

- 3) Unbundling the operations of transmission and distribution from production and supply within existing, vertically integrated undertakings,
- 4) Forming an independent regulatory body, empowered to monitor energy markets;
- 5) Providing a secure energy supply, environmental protection and consumer protection, and
- 6) Providing cross-border integration.

The Third Energy Package prescribes three unbundling models for electricity and gas transmission system operators (TSOs) which are designed to prevent any conflict of interest among the management of companies that provide energy services. These models are Ownership Unbundling (OU) as the primary model and the Independent Transmission Operator (ITO) and Independent System Operator (ISO) as alternative models.

The alternative models may be considered as less disruptive unbundling approaches, by which companies retain ownership of all corporate assets while needing to create or designate a separate legal entity for managing the transmission assets autonomously. Ownership unbundling is a more aggressive approach, forcing companies to sell their transmission or generation assets. Thus, ownership unbundling may be perceived as a form of pressuring energy sector companies to demerge their assets.⁸

Electricity and Gas Regulations prescribe that third-party access services shall be offered on a non-discriminatory basis to all network users, shall be firm and interruptible, and shall be available on both a long and short-term basis.⁹ This concept of third-party access to essential facilities is one of the main instruments for opening an internal energy market to competition. Owners of energy infrastructure have to contract with suppliers to allow network usage and energy flow. The Commission classifies disputes arising from the breach of third-party access rights in the context of possible abuse of dominant position.¹⁰

Thus, it should be emphasised that, in addition to development of the regulatory framework, the Commission, by the application of competition law, fosters the liberalisation of internal energy markets by prohibiting mergers between energy incumbents with great market power and by investigating the anti-monopolistic behaviours of dominant energy companies. For example, the Commission forced energy companies to sell their generation capacities, and by that means it achieved its unbundling aims, preventing strong market concentration. In addition, it prohibited mergers between energy incumbents, which prevented the strengthening of companies with dominant positions in the market.¹¹

⁸ Stefan Bogner, Stephan M. Gasser, Margarethe Rammerstorfer, 'Mergers and acquisitions in European and North American energy markets: empirical analysis of legal and ownership unbundling' (2015) 11 *Journal of Competition Law & Economics* 935–954, 936.

⁹ Electricity Directive and Gas Directive (n 6), art 32.

¹⁰ Consolidated version of the Treaty on the Functioning of the European Union [2012] OJ C 326/1, art 102.

¹¹ For example, E.ON, German electricity incumbent had opposed to the Commission's proposal on introducing an ownership unbundling regime in Third legislative package, but however soon after, in November 2008 the Commission accepted the commitments offered by E.ON on divestiture on generation capacities. For example, in 2004 the Commission prohibited the acquisition of GDP, Portugal's gas incumbent by EDP, Portugal's electricity incumbent through its wholly owned subsidiary, ENI.

The liberalised market can bring a reduction of prices only if enough participants compete among themselves, by delivering better quality services at competitive prices.

III Serbia

The energy sector reform in Serbia started in 2004, much later than it did in Member States, with the adoption of the first Energy Law,¹² which incorporated the requirements of the first two energy packages and began the process of liberalising the Serbian electricity and gas markets. The Energy Law 2014 currently in force has implemented liberalisation rules in the electricity and gas sectors as envisioned by the Third Energy Package.

For both the electricity and gas markets, the two responsible bodies are the Ministry of Mining and Energy of the Republic of Serbia (the policy-making body) and the Energy Agency of the Republic of Serbia (AERS). AERS is an independent, regulatory body established in 2005, with the main task of supervising the Serbian energy market.¹³

The Republic of Serbia has assumed the obligation of implementing the EU energy acquis through two paths:

- 1) The process of stabilisation and association as defined in the Agreement on Stabilization and Association (ASA), and
- 2) The Energy Community legal framework, such as being one of the Contracting Parties to the Treaty to establish an Energy Community (EnCT).¹⁴

1 The Stabilization and Association Agreement

The EU established the process of stabilisation and association for the countries of the Western Balkans, aiming to stabilise the entire region by creating stronger political and economic relationships between countries that share the same perspective on EU membership.

Serbia received the status of a candidate for EU membership in 2013 and began negotiations about membership on 21 January 2014. These negotiations represent a process in which future Member States adjust their current systems to the legal, economic and social frameworks of the EU, aiming to adopt European values and standards.

The accession negotiations are divided into 35 Negotiating Chapters. Each Chapter represents a model of *acquis communautaire*, which must be adopted in different fields. An energy field is regulated in Chapter 15. The energy acquis consists of rules and policies, most notably regarding competition and State aid (including in the coal sector), the internal energy market (opening up the electricity and gas markets and promoting renewable energy sources), energy efficiency, nuclear energy, nuclear safety, and radiation protection.

¹² Energy Law Act ('Official Gazette of the Republic of Serbia' No. 84/04) (Energy Law Act 2004).

¹³ *Ibid*, art 10–15.

¹⁴ *Treaty establishing Energy Community* [2006] OJ L 198/18 (Energy Community Treaty).

The Serbian energy sector was the subject of bilateral and explanatory screening processes, which were completed in June 2014. The results of these screening processes showed that Serbia, at that time, was insufficiently prepared for negotiations on this Chapter.¹⁵ So far, the negotiation process for Chapter 15 has not commenced.

2 The Energy Community

The second road for implementing the EU energy rules in Serbia is the Energy Community, a regional organisation established in October 2005 in Athens, Greece, when the EnCT was signed by nine countries¹⁶ on the one hand and the EU, on the other hand.¹⁷ The Contracting Parties committed to developing adequate regulatory frameworks in line with the EnCT's *acquis communautaire*, with the aim to reforming and enhancing their energy sectors.

The idea underpinning the EnCT is the creation of the Regional Energy Market (REM) for SEE countries, which would later be integrated into the EU internal energy market. By implementing the EnCT, the SEE countries are set to become part of the EU internal energy market, even before accession to the EU. So far, only three founding members (Bulgaria, Croatia and Romania) have joined the EU, while the extension of the Energy Community went beyond the Balkan countries and made the Energy Community a powerful international policy instrument. Currently, the Contracting Parties of the Energy Community are Albania, Bosnia and Herzegovina, Kosovo,¹⁸ the Former Yugoslav Republic of Macedonia, Georgia, Moldova, Montenegro, Serbia and Ukraine. In addition, fourteen EU Member States, which surround the Contracting Parties, enjoy the status of Participants, and three enjoy the status of Observers.¹⁹ However, there are ongoing discussions that are contrary to the initial idea. They entertain the possibility that the new Contracting Parties might not consider joining the Energy Community as the first step towards EU accession, but may make this decision a permanent means of cooperating with the EU, without ever becoming full-fledged members.²⁰

The institutional setting of the Energy Community supports the process of implementing EU energy policies within the Contracting Parties' national legal systems. The Ministerial Council is the highest decision making body in the Energy Community, composed of ministers

¹⁵ European Commission, *Screening Report Serbia, Chapter 15 – Energy* (2014) 27 (Screening Report Serbia).

¹⁶ The Energy Community was founded by Albania, Bulgaria, Bosnia and Herzegovina, Croatia, Macedonia, Montenegro, Romania, Serbia and The United Nations Interim Administration Mission in Kosovo pursuant to the United Nations Security Council Resolution 1244.

¹⁷ Council Decision 2006/500/EC of 29 May 2006 on the conclusion by the European Community of the Energy Community Treaty [2006] OJ L 198/15.

¹⁸ This designation is without prejudice to positions on status and is in line with UNSC1244 and the ICJ Opinion on the Kosovo Declaration on Independence.

¹⁹ Participants: Austria, Bulgaria, Cyprus, the Czech Republic, France, Germany, Greece, Hungary, Italy, the Netherlands, Romania, Slovakia, Slovenia, and the UK; Observers: Georgia, Norway and Turkey.

²⁰ Leigh Hancher, Adrien de Hauteclouque, Małgorzata Sadowska, 'Report on Vienna Forum on European Energy Law' (2015) 6 Renewable Energy Law and Policy Review III–IX, IV.

responsible for the energy sectors of the Contracting Parties and two representatives of the EU.²¹ The Permanent High Level Group (PHLG) prepares the meetings of the Ministerial Council.²² The Energy Community Regulatory Board (ECRB) is the independent regional body of energy regulators in the Energy Community and beyond.²³ The Fora embody the broadest discussion platforms within the Energy Community, where discussions on ongoing and future legal, regulatory and practical developments occur. There are Electricity, Gas and Oil Fora.²⁴ The Energy Community Secretariat (the Secretariat) serves as the only permanently acting institution of the Energy Community, with the main task of supporting the day-to-day activities of the Energy Community and monitoring the implementation of the EnCT.²⁵ Moreover, it may initiate a case of non-compliance by a Party with EnCT in line with procedural rules for dispute settlement (DSR).²⁶

The dispute settlement rules of the Energy Community resemble the EU infringement procedural rules that Article 258 TFEU prescribes. The procedure has three stages. The first is a preliminary procedure, beginning with an Opening Letter, sent by the Secretariat to a Party who failed to comply with the EnCT's obligations or with the decision addressed to it within the required period. The Secretariat is the counterpart of the Commission, empowered to safeguard the application of the EnCT. The first phase resembles the informal dialogue that the Commission, through the EU pilot, conducts with Member States on non-compliance with EU law and it aims to resolve a problem without moving on to further corrective steps. If the Secretariat is not satisfied with the answer it receives or receives no answer, it may then send a Reasoned Opinion to a Party, which represents the initiation of a formal infringement procedure. The final step of the Secretariat is to submit a Reasoned Request to the Ministerial Council, seeking to bring a decision on the breach of obligations under EnCT.²⁷ Most cases opened by an Opening Letter are closed in a preliminary procedure before they are referred to the Ministerial Council.²⁸

Even though the dispute settlement procedure was developed based on infringement procedure rules, the major difference between Article 90 of the EnCT and Article 258 of the TFEU is that the infringement procedure in the Energy Community does not result in a decision by a court. Instead, the deciding authority in disputes about the compliance of a Party with the Energy Community law is the Ministerial Council, a body consisting of the politicians'

²¹ Energy Community Treaty (n 14) art 47–52, 89–93.

²² Energy Community Treaty (n 14) art 53.

²³ Energy Community Treaty (n 14) art 58.

²⁴ Energy Community Treaty (n 14) art 63.

²⁵ Energy Community Treaty (n 14) art 67.

²⁶ Procedural Act 2015/04/MC-EnC of the Ministerial Council of the Energy Community of 16 October 2015 on Rules of Procedure for dispute settlement under the Treaty, art 11–19 (Procedural Act).

²⁷ *Ibid*, art 13–14.

²⁸ Rozeta Karova 'The disputes settlement system of the Energy Community, Testing its effectiveness in The Energy Community. A new energy governance system' in Dirk Buschle, Kim Talus (eds), *The Energy Community, A New Energy Governance System* (Intersentia 2015, Cambridge 32–42).

government ministers responsible for energy from each Party and of two EU representatives, usually being the European Commissioner for Energy and a high-level representative of the Presidency of the Council of the European Union.²⁹ The Ministerial Council may determine that a Party violated its obligations under the EnCT. In cases of serious and persistent breaches, the Ministerial Council may suspend certain rights of the Party concerned. In particular, it may suspend voting rights and the right to participate in meetings, but it may not impose monetary sanctions, which would be a more effective method for enforcement.³⁰

Some authors³¹ find that the decision-making phase of this procedure corresponds with Article 7 of the Treaty of the European Union, by which the European Council may determine the existence of a serious and persistent breach by a Member State and may decide to suspend certain rights deriving from the application of the Treaties to the Member State. Moreover, critics are directed to the fact that those who can become a subject of the dispute, being Contracting Parties themselves, are actually empowered to decide on the breach and the sanction, since the decision making body, the Ministerial Council, consists of ministers from each Contracting Party charged with managing energy.

Experts recommend that dispute procedural rules need to be revised, in order to remove the negotiating nature of this process and to provide an appropriate decision-making body and mechanism for pressing the Parties to comply with their obligation. To this end, they have proposed creating a court that resembles the court of the European Economic Area (EFTA Court).³²

3 Electricity Market in Serbia

The state-owned public enterprise *Elektroprivreda Srbije* (Electric Power Industry of Serbia, or EPS) has dominated the Serbian electricity market, performing all electricity activities until 2005, including generation, transmission, distribution and supply. In 2005, EPS reorganised and formed a new public enterprise, called '*Elektromreža Srbije*' (Electric Networks of Serbia, EMS), tasked with managing the electricity transmission system. In 2016, the legal identity of EMS transitioned from a public enterprise to a joint stock company with one shareholder, the Republic of Serbia. EPS continues to generate, distribute and supply electricity today.

However, EPS is not the only company that generates and supplies electricity. The opening of the production and supply market began 1 January 2014, the day the Energy Law

²⁹ Composition of the Ministerial Council <<https://www.energy-community.org/aboutus/institutions/MC.html>> accessed 20 May 2018.

³⁰ Energy Community Treaty (n 14), art 90–93.

³¹ Dirk Buschle, 'The enforcement of European energy law outside the European Union Does the Energy Community live up the expectations?' (2016) 6 (1) European Energy Journal <https://www.energy-community.org/dam/jcr:c9f03062-7963-4f6e-8179-2f4f6ff1656a/%20EEJ_Buschle_enforcement_EU_energy_la.pdf> accessed 13 May 2018.

³² The High Level Reflection Group of the Energy Community, 'Report An Energy Community for the Future' <https://www.ceas-serbia.org/images/2015-i-pre/Energy_Community_HLRG_Report.pdf> accessed 20 May 2018.

went into force. Since then, more than four thousand medium-to high-voltage consumers (comprising 43% of total consumption) lost their automatic right to public supply and had to find a supplier on the market. Twenty-two companies currently hold licences for generating electricity and sixty-four companies hold licences to supply electricity.³³

Since 1 January 2015, households and small consumers now have the choice (and not an obligation) not only to choose an electricity supplier from the open market,³⁴ but also to return to a regulated, guaranteed supply in the event that the supplier they have chosen fails to satisfy their expectations.³⁵ All other final customers must choose a supply contract within the parameters of market conditions, with the available option of switching to another supplier free of charge. In 2016 the non-regulated market in Serbia accounted for 43.3% of total end-user electricity consumption,³⁶ while one-hundred percent of households are subject to regulated prices.

The guaranteed supply of electricity to households and small consumers is provided under regulated tariffs, which are set below market price levels. Removing this ‘social component’ from the electricity price, however, which protects citizens’ living standards, would yield significantly more funds, which could then be invested into technological developments and ‘green energy’. To achieve an appropriate level of economic balance, it is necessary to plan for a constant increase, in real terms, of the regulated electricity price so that these investment goals could be reached in a relatively short period of time (such as two to three years).³⁷

Eliminating state influence over electricity price regulations will result initially in an increase in production costs, especially in those industry areas most dependent on electricity. Nevertheless, this should motivate the increased application of energy efficiency measures and a more efficient consumption management approach, using other energy sources as a replacement and even constructing new electricity generation facilities of their own.

In relation to the new sources for generation of electricity, foreign capital has entered the Serbian electricity market through companies that produce electricity from RES: biomass, wood, wind, solar and hydro energy, etc. Serbia has set mandatory national goals for sharing renewable energy in gross final consumption, being 27% by 2020, starting from a level of 21.2% in 2009.³⁸ To develop an electricity generation market and to achieve ‘clean energy’ goals, the

³³ License Register of Agency of Energy of the Republic of Serbia, <https://www.aers.rs/Index.asp?l=2&a=535.3&ted=&ed=&id_ed=&tp=Zanpra&id=&idag=&tvid=&lid=&sid=1> accessed 18 July 2018.

³⁴ Energy Law Act 2014 (n 2), art 402.

³⁵ Energy Law Act 2014 (n 2), art 197.

³⁶ Commission, ‘Staff working document’ Serbia 2018 Report Accompanying the document Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions 2018 Communication on EU Enlargement Policy, COM(2018) 450 final, p 67 (Commission Report Serbia 2018).

³⁷ Ministry of Mining and Energy of the Republic of Serbia, Energy Sector Development Strategy of the Republic of Serbia for the period by 2025 with projections by 2030, (‘Official Gazette of the Republic of Serbia’ No. 101/15), 44.

³⁸ Screening Report Serbia (n 15), 10.

Serbian legislator included in the Energy Law Act of 2014 obligations for EPS to buy electricity from companies that produce electricity from renewable sources.³⁹ In this way, Serbia decentralised the electricity generation field; there is no longer one central source of electricity production, but many more. Prior to 2014, only one company in Serbia produced electricity, doing so primarily from coal and water. Today, a total of twenty-two companies produce electricity, mostly from renewable sources. The increased use of renewable sources positively influences decarbonisation and moves the country closer to fulfilling the obligation to produce 27% of electricity from renewable sources. Decentralising electricity production decreases the loss of energy which occurs in transmission through distribution systems because energy travels to consumers on a shorter pathway. On the other hand, the purchase prices for this electricity are prescribed as feed-in tariffs, which function as incentives for production of electricity from renewable sources. Those are partially transferred to end users by EPS, resulting in increased household bills. Evidently, measures for achieving one liberalisation goal influence another liberalisation goal. As such, proper energy planning and balancing is important.

If we recall the EU Commission's achievements in applying the principle of competition to energy market, as mentioned in Chapter II, we may conclude that using the tools of competition law can also foster competitiveness in the Serbian energy market.

So far, the Serbian competition authority has adopted only one decision regarding the electricity sector, finding the abuse of the dominant position by *EPS Distribucija* (EPS Distribution) to be a significant operator on the market for electricity distribution, applying dissimilar business conditions to equivalent transactions with differing undertakings. This disparity resulted in some undertakings being placed in a less favourable position than the position of their competitors.⁴⁰ The decision imposed a fine, amounting to about three hundred million dinar (about 3 million euro), but also determined nine measures for the removal of competition infringements and for any other future acts that might restrict, distort or prevent competition by abusing a dominant position.⁴¹

Along with the national competition authorities, The Secretariat has powers to monitor Energy Community Parties' compliance with the EnCT rules. The Secretariat found that Serbia did not successfully implement an ownership unbundling model concerning the condition of preventing any conflict of interest, since the Government of Serbia directly manages both the transmission operator EMS and the generation, supply and distribution undertaking, EPS⁴². In particular, according to the OU model, a TSO will be deemed independent if an undertaking which acts as a TSO is first the owner of the transmission assets; second, the person or persons who control the TSO must not have direct or indirect

³⁹ Energy Law Act 2014 (n 2), art 70–78.

⁴⁰ Commission for protection of competition of the Republic of Serbia, Decision Number: 5/0-02-563/2016-60 of 23/12/2016, 1–2 (Decision Number: 5/0-02-563/2016-60).

⁴¹ *Ibid*, 22–26.

⁴² Law on Public Enterprises ('Official Gazette of the Republic of Serbia' No. 15/2016), art 2.

control over energy subjects that perform other electricity functions, nor should they appoint the members of supervisory boards or serve as board members. Nevertheless, it is permissible that, in the event that a Member State is an owner of both a TSO and energy generation or supply companies, two separate public bodies may control a TSO on the one hand and a generation or supply energy companies on the other hand.⁴³ Regarding this condition, it is necessary to designate two public entities that will control these energy subjects separately.⁴⁴ The formal separation of competences between public bodies constitutes a *sine qua non* for unbundling a state-owned TSO.

The importance of the enforcement methods will be specially outlined in the next subdivision, which examines the openness and state of play of the Serbian gas sector.

4 The Gas Market in Serbia

Two aspects that characterised the Serbian gas market are dependence on gas imported from Russia and the non-alignment of TSOs with the rules on unbundling, which aspects lead to the foreclosure of it.

Serbia imports gas from the Russian Federation via a long-term agreement with the transmission system operator, Public Undertaking 'Srbijagas', which accounted for 82% of the total demand in 2018. The remainder is produced by the only domestic producer, the oil and gas company called *Naftna industrija Srbije JSC* (Oil Industry of Serbia, or NIS). NIS is the only Serbian state-owned energy company that was privatised, in 2008, by selling 49% of its capital to the Russian oil company Gazprom Neft.

Consumers of natural gas may choose their supplier freely, choosing from sixty-six licenced suppliers. Likewise, on the electricity market, households may opt for guaranteed supply via tariffs set below market levels and approved by AERS.

Two companies, Srbijagas and Yugorosgaz-Transport LLC, operate the gas transmission system in Serbia.⁴⁵ Srbijagas functions as a vertically integrated company owned by the Government, which holds licences for the transmission, distribution and supply of gas. The Serbian government's action plan from 2016 envisaged the separation of the Srbijagas transmission system from supply by implementing the Independent Transmission Operator (ITO) model as one of the alternative models set in the Gas Directive.

Choosing alternative models for unbundling the transmission system remains a part of this vertically integrated company. However, to safeguard independence, the Gas Directive has imposed a set of detailed obligations, which a competent authority must verify before certification.⁴⁶

⁴³ Electricity Directive and Gas Directive (n 6), art 9(6).

⁴⁴ For example, in the Czech Republic, the Ministry of Industry and Trade is in charge of exercising controlling rights over national TSO (ČEPS), but not over other electricity functions.

⁴⁵ Decision on Energy Balance of the Republic of Serbia for 2018 (Official Gazette of the Republic of Serbia No. 119/2017).

⁴⁶ Gas Directive (n 6), art 13.

An ITO model raises the possibility of founding a subsidiary that will manage the transmission system independently, while Srbijagas will hold ownership over the network. In 2015, Srbijagas established a new company, Transportgas Srbija, aiming to carry out the activities of an ITO. However, the Secretariat is of the opinion that Transportgas Srbija is only a shell company, incapable of performing any of the functions stipulated in the Energy Law.⁴⁷ Due to non-compliance with the unbundling rules, the Ministerial Council, acting on a Reasoned Request of the Secretariat, adopted a decision in case ECS-9/13, October 2016, identifying a serious and persistent breach of EnCT by Serbia.⁴⁸

The second transmission operator is Yugorosgaz-Transport, LLC, a company founded in 2012 by joint stock company Yugorosgaz, which was established by the agreement between Russia and Serbia in 1996 for the development, construction and operation of gas transmission systems in southern Serbia.⁴⁹ AERS certified Yugorosgaz-Transport, LLC as an Independent System Operator (ISO) in June 2017. However, the Secretariat did not give a positive opinion on this matter, finding that Yugorosgaz-Transport, LLC failed to establish full independence from production and supply interests in vertically integrated owner Yugorosgaz. In particular, Yugorosgaz, as the owner of the transportation system directly and Gazprom Neft indirectly (through its control over its subsidiary Yugorosgaz), exercises control over Yugorosgaz-Transport and is also active in producing and supplying natural gas.⁵⁰

Most recent news on the gas market in Serbia reports that the construction of the new gas infrastructure, as part of the ‘Turk Stream’ project, is in preparation.

In 2008 Russia commenced the ‘South Stream project’, which consisted of constructing a gas pipeline to enable the flow of natural gas from Russia, through the Black Sea, into Bulgaria, then through Serbia, Hungary and Slovenia, then further to Austria. In December 2014, Russia announced the cancellation of this project. Not long afterwards, in October 2016, Russia and Turkey agreed to a new gas pipeline project called ‘Turk Stream’. The primary aim of this new project is building a gas transport route to Turkey and further onward to South-East and Central Europe, bypassing Ukrainian territory. This Russian-Turkey gas pipeline, which will run through Black Sea, was completed in November 2018. The second stage should be constructed, linking the Bulgarian, Serbian and Hungarian transmission systems.

Gastrans LLC of Serbia is a company established for constructing and transmitting the Serbian element of the Turk Stream project. This entity has recently received an exemption from AERS regarding the rules for unbundling and third-party access. It especially relates to Article 288 of the Energy Law of 2014, which extends Article 36 of Gas Directive, making it possible for national regulatory authorities to grant exemptions for new, major gas infrastructures, upon request, and for a defined period of time, if certain conditions are met.

⁴⁷ Implementation: Serbia <<https://www.energy-community.org/implementation/Serbia/GAS.html>> accessed 18 May 2018.

⁴⁸ Decision of the Ministerial Council of the Energy Community, D/2016/17/MC-EnC on imposing measures on the Republic of Serbia pursuant to Article 92(1) of the Treaty of 14 October 2016.

⁴⁹ Yugorosgaz Transport, Development plan for 2017-2026 of 01/06/2017.

⁵⁰ The Secretariat of the Energy Community, Opinion ECS-No.2/17, 9.

These are exemptions from the provisions related to unbundling, third-party access, access to storage and access to upstream pipeline networks.⁵¹

This rule exempts the obligation of transmission operators to allow third parties access to the network, with the result that opening gas market to competition is lawfully restricted. It is created to encourage investments and to provide investors with a shield against potential risks. European regulators were motivated to strike a balance between free competition and much-needed investments. Indeed, building new gas infrastructure will foster competition, by diversifying sources through eventual import of Romanian and Azeri gas, along with gas from LNG storage in Greece and Turkey, as justified by arguments elaborated in a feasibility study attached to the request for Gastrans exemption.

However, it seems that the Bulgarian-Serbian gas interconnection with Turk Stream will position the Russian gas market to become stronger in Serbia, since the rules of the Gas Directive to liberalise the market (granting access to networking, unbundling, etc.) will be excluded and the largest infrastructure capacity will be reserved for Srbijagas and Gazprom Export LLC (up to 88% according to long-term projections), for 20 years.⁵² This exemption is lawful and follows normal practice for new international infrastructure projects.⁵³ Even so, other infrastructure projects, such as Trans Adriatic Pipeline and Nabucco, have aimed primarily at making gas available from other sources, such as Azeri gas, for delivery to Europe.

The Secretariat will soon issue an opinion on AERS's exemption decision. The opinion will be non-binding, but the decision-making body should respond to this opinion in a serious manner, nonetheless.

In relation to the foreclosure of gas markets, significant progress has been made by the Secretariat's actions towards eliminating the destination clause from the gas supply agreement between Russia and Serbia. The case deals with Gazprom's abuse of its dominant position by including a destination clause, to mandate where gas can be delivered and limiting buyers from reselling excess gas, in the agreement on gas supply established with Serbia. This agreement has resulted in the territorial isolation of Serbia's gas market.

For nearly twenty years, the European Commission has been struggling with Gazprom's anti-competitive behaviour within the EU territory, by concluding agreements that restrict competition and affect trade between Member States.

From 2000 to 2007, the Commission investigated the practices of the three largest suppliers of natural gas to the European market, Russia, Algeria and Nigeria, or Gazprom, Sonatrach and NLNG. These investigations were concluded with settlement decisions.

⁵¹ Energy Agency of Republic of Serbia, 'Gastrans submitted third party access exemption application to the energy agency' <https://www.aers.rs/Index.asp?l=2&a=541&ted=&ed=&id_ed=&tp=&id=211&idag=&tvid=1&lid=&sid=1> accessed 31 May 2018.

⁵² Secretariat invites interested parties to send observations on the exemption decision for the Gastrans natural gas pipeline project <<https://www.energy-community.org/news/Energy-Community-News/2018/10/24.html>> accessed 15 November 2018.

⁵³ The Commission has granted the exemption from the requirements on third party access, tariff regulation and ownership unbundling rules for the Trans Adriatic Pipeline, OPAL and Nabucco projects.

Gazprom, for instance, committed to excluding destination clauses from existing contracts and to refrain from inserting such clauses in future contracts.⁵⁴ However, the Commission has recently adopted a new commitment decision that addresses the same Gazprom's monopolistic behaviour in the territory of Central and Eastern Europe.⁵⁵

Since Serbia is not Member State of the EU, the Commission has no competences to investigate the lawfulness of gas supply in Serbia. However, in case ECS 18/16, the Secretariat determined the 2012 agreement between the government of the Republic of Serbia and the government of the Russian Federation for the supply of natural gas from Russia to Serbia to be anti-competitive, since it asserts that the natural gas is intended for use only in the Serbian market. In response, the Serbian parliament approved the removal of the destination clause and thereby rectified the breach identified. As a result, the Secretariat decided to discontinue Case ECS-18/16.⁵⁶

IV Conclusion

Adapting transitional nations to the new energy market conditions has proven to be far more difficult than for countries with developed markets. The legislative and regulatory models adopted in developed countries do not transfer well to transitional nations without considering the idiosyncrasies of their individual power systems. In relation to that, the Energy Community recognised the importance of taking into account the specific situation of each Contracting Party when adopting measures concerning the adaptation of the *acquis communautaire*.⁵⁷

There is no guarantee that the free market will automatically bring about efficiency. The social problems that could arise from full liberalisation include a reduction in the number of employees for companies slated for privatisation. To change the legal identity of EPS from a public enterprise to a joint stock company, five thousand employees will need to be released.⁵⁸ Moreover, eliminating the guaranteed prices for households while introducing market pricing instead will increase household expenditure and will greatly impact the social stability of a country. The primary goal of continued regulation of some electricity and gas sectors is thus preserving social stability by keeping electricity and gas prices for households at a rate below market prices.

⁵⁴ 'Commission reaches breakthrough with Gazprom and ENI on territorial restriction clauses' <http://europa.eu/rapid/press-release_IP-03-1345_en.htm?locale=en> accessed 20 May 2018.

⁵⁵ 'Antitrust: Commission sends Statement of Objections to Gazprom for alleged abuse of dominance on Central and Eastern European gas supply markets' <http://europa.eu/rapid/press-release_IP-15-4828_en.htm> accessed 20 May 2018.

⁵⁶ Case ECS-18/16: Serbia / competition <<https://www.energy-community.org/legal/cases/2016/case1816RS.html>> accessed 16 October 2018.

⁵⁷ Energy Community Treaty (n 14), art 24.

⁵⁸ 'Serbia intends to transform EPS into joint stock company in 2020' <<https://seenews.com/news/serbia-intends-to-transform-eps-into-joint-stock-company-in-2020-621173>> accessed 26 July 2018.

On the flip side, proponents of full liberalisation emphasise that a higher price provides an incentive for reducing energy costs and for investing in the development of new methods of electricity generation. Low electricity prices for household consumers made it difficult for electric companies to make any strategic investments. Hence, the only way to develop the power industry has been through various types of state interventions, such as budget subsidies, state-funded capital investments and state guarantees for loans. Moreover, the demanding goals of the EU concerning clean sustainable energy has forced states to apply measures that, though they are not welcomed by citizens, may provide the funds necessary for modernising infrastructure and technology.

Privatisation can yield improved performance for industries operating in competitive markets, but this advantage is not certain for natural monopolies operating in non-competitive markets. In many developing and transitional countries, privatisation has yielded benefits for their owners only. History demonstrates that transitional countries with high budget deficits and public debt that decided to sell loss-making electricity enterprises suffered from disbenefits such as increased unemployment and higher economic and social costs.⁵⁹

In 2016, representatives of EPS emphasised that EPS privatisation was out of question. For privatisation to occur, EPS must become a joint stock company, requiring it to identify its assets. This is the first step towards posting on a stock exchange. The chairman of the EPS supervisory board also emphasised his belief that profitable state-owned enterprises should not be privatised.⁶⁰ Time will tell whether Serbia will find justifiable and profitable reasons to privatise EPS.

At this moment, Serbia has not yet achieved the level of economic development necessary to achieve the full liberalisation of electricity markets in terms of privatisation, leading to efficiencies for all stakeholders. In light of this, it appears that competitiveness and market strengths remains insufficiently developed when the number of effectively unregulated customers and the quantity of the total electricity consumed outside regulated tariffs remains high.⁶¹ That (1) Serbia has preserved an option for households and small consumers to purchase electricity under regulated tariffs and that (2) one-hundred percent of households and small consumers choose this option indicates that the electricity market is not yet capable of delivering benefits to all stakeholders.

Moreover, the 2018 Report of the Commission on Serbia outlines, in a summary of Chapter 15 of the *acquis*, that Serbia is only moderately prepared in the energy sector. Against this backdrop, it is emphasised that a primary task for the coming year is to fully unbundle vertically integrated monopolies while simultaneously developing a competitive gas market.⁶²

The goals of the EU energy policy cannot be achieved if the enforcement of this policy remains ineffective. Contrary to the experience within EU electricity and gas markets,

⁵⁹ Vlahinić (n 3) 16.

⁶⁰ 'Serbia is not selling EPS' <<https://balkangreenenergynews.com/antic-serbia-is-not-selling-eps/>> accessed 2 August 2018.

⁶¹ Tominov (n 4) 270.

⁶² Commission Report Serbia 2018 (n 36) 67.

competition law tools have not been used in sufficient volume to support the opening of the electricity and gas markets in Serbia. The very first aim of market competition is to reduce the prices of energy products, along with improving the quality of service. This effect will not occur if there are no market participants that can compete with their products and services, in terms of quality and price. As elaborated here, the Serbian electricity and gas sectors are still dominated by state-owned companies. Moreover, the rules of the Energy Community's dispute settlement procedure do not provide a mechanism that can force parties to align their performance with the EnCT, especially when the breach is persistent and there is no willingness to adhere to the obligations established by the EnCT. As concluded by the High Level Reflection Group, the sanctions mechanism should be reviewed, because it fails to satisfy the standards of an Energy Community in correspondence with the rule of law.⁶³ The mechanism for sanctions in an Energy Community, modelled by Article 7 of TEU, is unable to resolve individual breaches and is therefore unsustainable.

In sum, liberalising the energy market represents a complex set of concepts, rules and procedures, which has the aim of bringing welfare for states, industry and consumers. Introducing measures for reaching the goals of clean energy and infrastructure development at the beginning of implementation may have an adverse effect on another liberalisation goal, namely the wellbeing of consumers, in terms of lower prices for electricity and gas. Much work remains for the Serbian economy to achieve a respectable degree of economic stability and social development, enabling the implementation of market principles and making effective competition in the energy market possible. Moreover, adhering to the obligations established by the EU energy policy and creating a proper enforcement mechanism should lead to an efficient and prosperous energy market.

⁶³ The High Level Reflection Group of the Energy Community (n 32).