ENERGY COMMUNITY
The Way Forward

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1. INTRODUCTION

After finalisation of the report 'An Energy Community of the Future' by the High Level Reflection Group of the Energy Community in May 2014 this article does not aim to start a new strategic discussion, but rather we would like to highlight some ideas and visions that were discussed along with it, but were only partially reflected in the report. The discussion so far of the report, it seems to us, wrongfully mixes up two separate questions: (1) whether to discuss the support to every single proposal from the HLRG right now (this is not the issue), and (2) the outcome of the so-called analytical paper based on the Procedural Act (the PHLG endorsed the Procedural Act No 2014/01/MC-EnC establishing a roadmap related to the report of the HLRG). The purpose of this article is to provide further input and motivation for question (2).

2. LEGAL SCOPE: CONCENTRATE ON ACTUALLY DELIVERING A TRUE SINGLE PAN-EUROPEAN MARKET

2.1. ENFORCEMENT

The presently ineffective enforcement mechanism must live up to the European standards of judicial protection of individuals and companies. Currently, the high level of harmonisation of legal rules (based on EU law) and the complete lack of judicial remedies stand in strong opposition. Among other issues, this deters investment. An idea for a compromise would be some flexible mechanism of enforcement. Strong enforcement is guaranteed for crucial issues like investments and legal disputes. One could be in favour of a weak enforcement on e.g. social issues and implementation timetables. In particular, any enforcement on social issues could create problems: acceptance of the

Energy Community will strongly depend on the benefits its individual citizens will feel both in their energy bill and from successful implementation of the *acquis*. If too strong an enforcement regime is created, then Contracting Parties might feel a lack of independence in their national political decision making. If a too weak enforcement is kept in place as of now, then we face the ambiguity of 'big' political targets on the one hand, but only low-key implementation on the other hand. So a solution could be a flexible mechanism of enforcement. We should suggest that a strong enforcement is guaranteed for crucial issues like investments and legal disputes. One could be in favour of a weak enforcement on e.g. social issues and implementation timetables. In any event, the enforcement mechanism must live up to the European standards of judicial protection of individuals and companies. An effective and independent judicial solution for enforcement should be developed, including effective penalties in case of non-compliance.

2.2. COOPERATION BETWEEN ACER AND ECRB

Although several activities of both the EU and the Energy Community aim to contribute to the establishment of the single pan-European market, cooperation between e.g. ACER and ECRB is currently limited to personal contacts (like the nomination of an ACER representative in the ECRB) or case-by-case handling by the Secretariat. The only real progress presented to the outside world so far has been the inclusion of the eighth region in ACER's quarterly ERI reporting exercise. Obligations to comply with the *acquis* are set by different mechanisms for Member States of the European Union (MS) and Contracting Parties (CP), which reflects the current status quo in terms of applicable legal mechanisms. In a few crucial areas, such as the definition of the term 'interconnector' in the transposition of the Third Energy Package into EnC law, the originally intended connection between MSs and their neighbouring CPs was not pursued. This unsatisfactory situation could lead to regulatory problems and should at all costs be avoided in the implementation of future legislation with the objective to achieve the single regulatory space envisaged in the EnC Treaty. As a result, obtaining for example a TPA exemption in a project where both CPs and MSs are involved is not a straightforward process. If the NRAs concerned agree on the exemption decision, MS are obliged to inform ACER; the fact that a CP does not have this obligation has a low impact on the final outcome. However, if agreement is not reached within six months, or the NRAs decide to send a joint request for ACER/ECRB decision, difficulties may arise (e.g. different decisions of ACER and ECRB). Membership of CP NRAs in ACER has been legally practically impossible so far although the legal basis of Article 31(2) Regulation (EC) No. 713/2009 (ACER Regulation) does not rule out observership as a short-term solution. The commitment for implementing the Third Energy Package stipulated by the related MC decision should provide

sufficient basis for enabling future participation (i.e. more than observership) of EnC NRAs in ACER without voting rights. In any event, the practical and continuous implementation of the Third Energy Package by CPs is monitored and enforced by the Secretariat. Some good examples of mutual (i.e. both EU and EnC) benefit are CP participation in ACER Working Groups on Network Codes, PCI/PECI overlaps, and improved case handling (e.g. TPA exemptions). Maybe ACER could grant official status of the Western Balkans as the 'Eighth Region'.

2.3. COOPERATION BETWEEN TSOs

The objective of establishing a single pan-European market including the CP was not considered sufficiently at TSO level. As a consequence, different approaches of ENTSO-E and ENTSOG related to CP participation have been developed (full membership possible in ENTSO-E, observer status possible in ENTSOG). As a result, participating in the development of an important top-down instrument, the TYDNP, targeted to support transmission adequacy as a prerequisite for a single pan-European market, is precluded for the CP. In practice, electricity transmission projects of the CP TSOs are included in the ENTSO-E TYNDP, but excluded from ENTSOG's. This also explains the different methodologies for agreeing PCI and PECI projects.

2.4. INSTITUTIONAL SCOPE: STRENGTHENING THE IDEA OF 'STICK AND CARROT'

In our institutional view, one should start asking why the Energy Community is needed by both its Contracting Parties, the EU and the companies and customers. As far as we know, there is still a demonstrated lack of concrete benefits of being a Contracting Party of the Energy Community. By such a future analysis, it could also evolve that Contracting Parties should not be in the role of being mere recipients of past EU legislation without being involved in the preparations before. So far only one thing is clear: the EnC is the only effective instrument to create energy regions which include both Member States and Contracting Parties. There is currently a lack of proper governance instruments and structure to address this.

2.5. REALISTIC POLICY MAKING

Development of realistic and achievable institutional goals for implementing the EU energy *acquis* would be essential. As an example, a strong push for tabling the EU Network Codes (once legally binding at EU level) without delay to the

PHLG for adoption having in mind the need to ensure smooth functioning of interconnected systems, trading oversight along with REMIT, funding for future PECIs, interim implementation steps of Network Codes (regional balancing markets, market models and designs) and more regional flexibility are issues where no one can seriously object.

Another very simple but efficient example would be an obligation to implement amendments to the *acquis* (in line with evolution of EU law) with binding deadlines for the discussion in EnC institutions.

Another 'old' problem coming out of the Third Energy Package is interconnector definitions. The term 'interconnector' should be corrected to also apply to connections between CP and MS. The Energy Community's Ministerial Council Decision 2014/1/MC-ENC (September 2014) does not solve this problem.

2.6. INSTITUTIONAL STRENGTHENING

The Secretariat of the Energy Community could be enriched with additional tasks in some areas similar to those of the European Commission, including of executive nature (state aid and competition enforcement), but also as regards capacity building (like management of energy-related programmes like Twinning, Taiex and technical assistance within its geographical scope). Further soft measures (like more resources, targeted expertise) should be explored as a short-term measure.

We are in favour of strengthening the Secretariat with executive powers with a court and a board of appeal for judicial review. Connecting this to the different categories of membership, this would only apply to those countries that have agreed to implement the full set of *acquis*, including the entire Third Energy Package. The Secretariat would do the technical work, while a court/board (a separate institution) would take the decision on the sanctions.

The idea of cooperation between ACER and ECRB-members has already been eluded in the report 'An Energy Community of the Future' by the High Level Reflection Group. But just to recall some cases where such cooperation might already be useful in coordinating the actions of the NRAs involved in the case of cross-border issues: the process for TAP, a gas interconnector between Hungary and Serbia, and in the future an Italy–Montenegro electricity interconnector. In the case of flows from Hungary to Serbia, exit capacities are prices six times higher than for other Hungarian exit points; the case is of particular relevance since 80% of gas imports to Serbia flow from Hungary. The problem so far is that flows from Hungary to Serbia are not considered as gas transit and thereby assumed to be not subject to the relevant provisions of the Second/Third Energy Package.

On the other hand, concerning an institutional strengthening and increased ownership of the EnC development, one should not give in to the political desires of setting up any new body with blocking rights inside the EnC.

2.7. STICK AND CARROT

Under the idea of stick and carrot, the EU principle of conditionality for receiving EU funds and facilities would be linked to an implementation of *acquis*. European Union's funds and facilities for Contracting Parties should be focused on the needs of the Energy Community. This should include an *ex ante* conditioning of disbursement as an incentive for implementing the *acquis* or as a sanction for breach of Treaty provisions. This could be linked to the creation of a court.

2.8. GEOGRAPHIC SCOPE: ENLARGING THE BORDERS OF THE ENERGY COMMUNITY AND MAKING IT A BROADER FOREIGN POLICY INSTRUMENT

The Energy Community should not only be promoted as a preparatory tool for countries willing and able to implement the relevant EU *acquis*. We would like to repeat the case for a more flexible structure of membership of the Energy Community. On the one hand an enlarged geographic scope for new members should be possible. On the other hand there should also be some form of membership 'light' for those countries who want to actively participate just in the political process without full-scale implementation.

2.8.1. Enlarging the Borders

The key question of the geographical scope is whether to limit EnC membership to those who have the potential to become EU Member States or also use the EnC to develop and improve external energy relations and attract members that will probably never join the EU. In the latter case, the EnC could become a single instrument for organising EU external relations with third countries. The question would then also be what can be offered to these countries not (immediately) eligible for EU accession.

Turkey is surely a special case, as it was one of the founding members, but decided not to join as a CP only very shortly before signature of the Treaty. The situation now is that Turkey is neither an accession country nor an Eastern Partnership country. One could maybe grant a 'special' status to Turkey (more than just an observer, e.g. an 'Associated Member'). Maybe the permanent synchronous operation of the Turkish electricity transmission system with the system of continental Europe in 2014 can be a justification for this.

We would like to make a case for expanding the EnC to deal with different categories of members. This would also necessitate different obligations and rights depending on the category of membership and imply different enforcement mechanisms and institutional setup. It would be useful to have two or three categories to allow flexibility. Some categories would commit to only part of the *acquis* or allow for a significant delay in implementation. Still, those that would join the EU should be subject to stricter enforcement.

A visible benefit for those with no direct EU accession prospects could be technical assistance, which could be more directly handled by the Secretariat. Financial support (i.e. for PECIs) beyond what exists now should also be considered. Looking at the European reality, even EU Member States are having problems implementing the Third Energy Package in full and some flexibility in scope and timing would be beneficial.

2.8.2. Energy and Foreign Policy

What the EU can offer to its (in a wider sense) neighbours is a working legal framework needed for energy sector reform and an efficient investment system. It is in the EU's interest to make sure that there is a larger sphere where energy markets work in a predictable way and good investor conditions are in place. A multilateral scheme such as the Energy Community, complemented by more efficient enforcement, works better than bilateral relations with the EU. Its benefits should be better communicated.

There is agreement among experts that the EnC could offer more to its members, like the possibility of partial participation in EU institutions if accepting the EU *acquis*, full access to EU market, legal certainty (predictable rules and effective enforcement), technical assistance and funding.

We think that the EnC should be made attractive to energy producer countries. For those with a more distant future of EU accession, the EnC could offer a quality of service in the energy field (legal rules, enforcement, security of supply) and the energy *acquis* to those that are willing to accept it gradually. The result should be that the EnC also offers an energy market and is thus attractive to energy producers. This could include the MENA region (like Algeria), Russia and the Caspian area. So in order to make it very clear: if the EnC is extended to producer countries, they should not only be offered rules, but also effective export access (e.g. via Network Codes) to the EU market; the regulation of retail or DSOs might be less relevant for them.

It is worth recalling the strength of the EnC compared to other, much weaker external energy instruments. So there is a good reason why one is in favour of making the EnC deal with countries that have no inclination to join the EU in the foreseeable future and transforming the EnC for serving as EU's general foreign policy tool. There is a need to find a way to work with countries like Turkey and MENA on issues of common energy interest.

On the other hand, one should avoid policy overlaps (like the Energy Charter Treaty or the EU Eastern Partnership).

2.9. INVESTMENT CHALLENGE: IS A SINGLE PAN-EUROPEAN MARKET GUARANTEED?

We would like to recall that the main challenge in the EU's internal energy market today is the incompatibility between national energy systems. The Third Energy Package eliminated this problem in the EU by transferring the responsibility for cross-border issues and many technical aspects from national government decision-making to the EU level. In the EnC, some problems with Contracting Parties (e.g. lack of progress on CAO) had to do with the fact that these decisions are still taken by the national government. Investments are expected to go up if the rules are fully and properly implemented and markets are integrated.

The European side should also enable more flexible instruments like a regional participation in Projects of Common Interest (PCI). By that, Energy Community projects should also be regarded as projects of European interest. Ultimately, it would also be in the European interest to consider special financial instruments for Energy Community projects to grant to these projects more money than would have been possible inside the EU (e.g. more than for a normal PCI).

Once more, it is worth recalling the need to harmonise permitting and licensing procedures and criteria. In this respect, we would like refer to the EU PCI example of the one-stop shop in the EU and a maximum time for granting permits.

The (false) argument that many implementation steps might be delayed since parliamentary procedures require qualified majorities or constitutional changes needs a reality check if confronted with the difficulties Austria for example regularly has with certain electricity legislation, which basically includes changes to the constitution every time a new package of legislation is introduced. So Contracting Parties' problems are related to the fact that they are still 'stuck' with the Second Energy Package and afraid of changes in their legal/constitutional system.

2.10. A FAST-TRACK MODE FOR INVESTMENTS

All the issues so far propose improvements to the Energy Community, which should also benefit the EU. It is natural in any political debate that proposals like that of the High Level Reflection Group are very likely to be amended and 'downgraded' in future. The part on investment promotion, however, deserves special attention and could be taken out and decided in fast-track mode, since no one should have objections to overcoming the investment obstacles.

The implementation and application of EU legal acts cannot be ensured by the framework of the EnC Treaty, lacking effective dispute settlement and infringement procedures. From an investment perspective homogenous implementation and application of EU energy legislation is essential.

2.11. ENFORCEMENT, AGAIN AND AGAIN

Enforcement possibilities for legal shortcomings should be solved by redesigning the dispute settlement procedure of the EnC Treaty. An effective judicial solution for enforcement should be developed, including effective penalties in case of non-compliance. Additionally, the invocation of EnC rights at CP courts is not as dramatic as it sounds; similar solutions found in the European Common Aviation Agreement (ECAA) and/or the Agreement on the European Economic Area (AEEA) should be studied and evaluated in terms of their applicability within the EnC framework.

Solutions found in the ECAA and/or AEEA as regards conformity in interpretation of EU law in a single regulatory space and dispute settlement conformity in interpretation of EU law should be studied and evaluated in terms of their applicability within the EnC framework.

2.12. RISK MITIGATION

We support the creation of a risk guarantee facility with a 'big bank', e.g. the World Bank or EIB, co-investing as a way to reduce investment risk typical for the EnC area. Funding is always important, through grants or a guarantee facility. However, it would be rather complex for the EnC to manage its own fund. A number of international financial institutions are already in place. The EnC should facilitate the process but not directly manage the funds.

We would like to highlight the importance of risk mitigation by the creation of a court-like institution which provides quick results. Lengthy permitting procedures are another problem which could be resolved by giving certain projects preferential treatment under which if a permit was not issued by a certain date (two to three years) it would be issued automatically.

3. CONCLUSIONS AND OUTLOOK

Based on European Council conclusions from June 2014, the Energy Community has the potential to become the key instrument of a pan-European external energy policy. To fully tap this potential, the process of energy sector reforms

in the Contracting Parties and their integration in the internal market needs to be accelerated and reinforced. The report by the High Level Reflection Group on an 'Energy Community for the Future' should serve as a basis for concrete proposals to be developed jointly by the Commission and the Secretariat of the Energy Community, with a view to the Energy Community Ministerial Council amending the Treaty in 2015. The proposals should prioritise strengthening the effectiveness and independence of the enforcement mechanism as well as increased funding for investments, primarily for Projects of Energy Community Interest, and conditional upon compliance with the Treaty.

The Energy Community has been described by many as a success story. As an agreement of nine EU neighbour countries with a legally binding commitment to market reform and market integration both on a regional and pan-European level, it is a unique vehicle to make energy sectors attractive to investors and ultimately competitive. Simultaneously, there is growing concern as to whether the potential of the Energy Community is being fully tapped. The list of commitments not honoured is long: the wholesale markets are still foreclosed, crucial infrastructure is still missing and the institutions have not attained the level of independence and capacity needed.

The Energy Community is also expected to deliver in the future. From the perspective of politicians on any reform, they will ask what the short-term benefit is and what will it cost. From the perspective of stakeholders any reform should show the lessons learned from both an EU and EnC perspective. For potential investors it will be fundamental to have assurance that there is a recourse path credible enough for private investors to pursue in case of breach of contract. The low credibility of the judicial system and/or its compensation by stronger EC enforcement procedures need to be addressed urgently.

The Energy Community gains importance since it is the only existing and well-functioning energy treaty between EU and Balkan and Caspian region countries and especially Ukraine. There is urgency for increased integration of the Energy Community region and regulatory authorities in these countries in the EU regulatory process.

Contracting Parties' implementation of the *acquis* remains a significant challenge. Difficulties existing on the energy markets stem from the fact that many of these countries still have not resolved the basic problem of energy market reform even under the Second Energy Package, i.e. opening of markets and launch of cross-border cooperation.

Private companies are still not confident enough to invest in the Contracting Parties to the extent needed. As we see that many EU members are experiencing big difficulties in fully implementing the Third Energy Package, we should expect even bigger problems in some of the CPs.

A multilateral scheme such as the Energy Community, complemented by more efficient enforcement, works better than bilateral relations with the EU.