



Bosnia and Herzegovina

STATE ELECTRICITY REGULATORY COMMISSION

**REPORT ON ACTIVITIES
OF THE STATE ELECTRICITY REGULATORY COMMISSION
IN 2005**

Tuzla, December 2005

1. INTRODUCTION

1.1 Reform of the Electricity Sector in Bosnia and Herzegovina

The process of the reform of the electricity sector in Bosnia and Herzegovina (BIH) was initiated by the signing the Statements of the entity governments on the electricity policy (in 2000) and was continued by adoption of the Act on Transmission of Electric Power, Regulator and System Operator of Bosnia and Herzegovina and the Entity laws on electricity (in 2002). During 2004, adoption of the Law Establishing the Company for Transmission of Electric Power in BIH, and the Law Establishing an Independent System Operator for the Transmission System of BIH, Bosnia and Herzegovina commenced the reform of the electricity sector in practice.

The State Electricity Regulatory Commission (SERC) is an independent institution of Bosnia and Herzegovina, which acts in accordance with the principles of objectivity, transparency and equality, and has jurisdiction over and responsibility for transmission of electricity, transmission system operation and international trade in electricity.

SERC is a non-profit institution and is financed by the regulatory fees which are paid by the licensed entities.

The aforementioned laws identify the key entities for their implementation: The Ministry of Foreign Trade and Economic Relations of BIH, Entity Ministries in charge of energy, the State Electricity Regulatory Commission and the Entity Regulatory Commissions, and all of the power entities.

Laws adopted at the State and Entity levels provided for the establishment of the regulatory practice in the electricity sector of Bosnia and Herzegovina¹.

During the process of reform of the electricity sector, in July 2005, the Independent System Operator in Bosnia and Herzegovina (ISO BIH) started its operation, and the process of establishment of the Company for Transmission of Electricity in BIH (“Elektroprenos Bosne i Hercegovine”, JSC Banja Luka) is in its final stage, with the Company being expected to start its operations in February 2006.

In 2005, after entirely public, transparent and unbiased procedures, the State Electricity Regulatory Commission issued required rules and conducted proceedings, which enabled the issuance of decisions on tariffs and licensing of the activities of transmission, Independent System Operator and international trade in electricity.

The State Electricity Regulatory Commission cooperates and harmonizes its operation with the Regulatory Commission for Electricity in Federation of BIH and the Regulatory Commission for Electricity of Republika Srpska. The SERC also cooperates with other regulatory bodies established on the state level, namely with the Competition Council and the Communication Regulatory Agency in Bosnia and Herzegovina.

¹ The exception is Brčko District of Bosnia and Herzegovina in the activities of generation, distribution and the supply of electricity.

1.2 Energy Community

After the resynchronization of the two UCTE zones last year (UCTE-Union for Coordination of Transmission of Electricity) by which electricity systems of West and South East Europe was connected, the event of the year in regards to energy was the signing of the Treaty on Establishment of the Energy Community.

The Treaty, signed in Athens on October 25, 2005, provides for the creation of the biggest internal market in the world for electricity and gas, with effective participation of 34 parties: 25 members of the European Union and Croatia, Bosnia and Herzegovina, Serbia, Montenegro, Albania, Macedonia, Romania, Bulgaria, and UNMIK Kosovo. The negotiations with Turkey are in progress, and Moldova, Ukraine and Norway are in the process of joining; they currently have observer status.

The signing of the Treaty is a result of the Athens Process, during which in 2002 and 2003 the Memoranda on Understanding were signed to establish a regional market in electricity and natural gas in South East Europe, which would be gradually integrated in the energy market of EU.

The political will of the signatory countries expressed by signing the memoranda and the Treaty transforms into a legal obligation through ratification of the Treaty and its coming into effect.

Through participation in this process, Bosnia and Herzegovina confirmed its commitment to the reform of the energy sector, liberalization of the energy market and harmonization of its politics with those of the EU members.

2. ESTABLISHMENT AND OPERATION OF THE STATE REGULATORY COMMISSION

The SERC was established by the Parliament of BIH by adopting the Act on Transmission of Electric Power, Regulator and System Operator, and appointing Members of the Commission.

Members of the Commission from the Federation of Bosnia and Herzegovina are:

- Mirsad Salkić, with five- year term
- Željko Topić, with three- year term

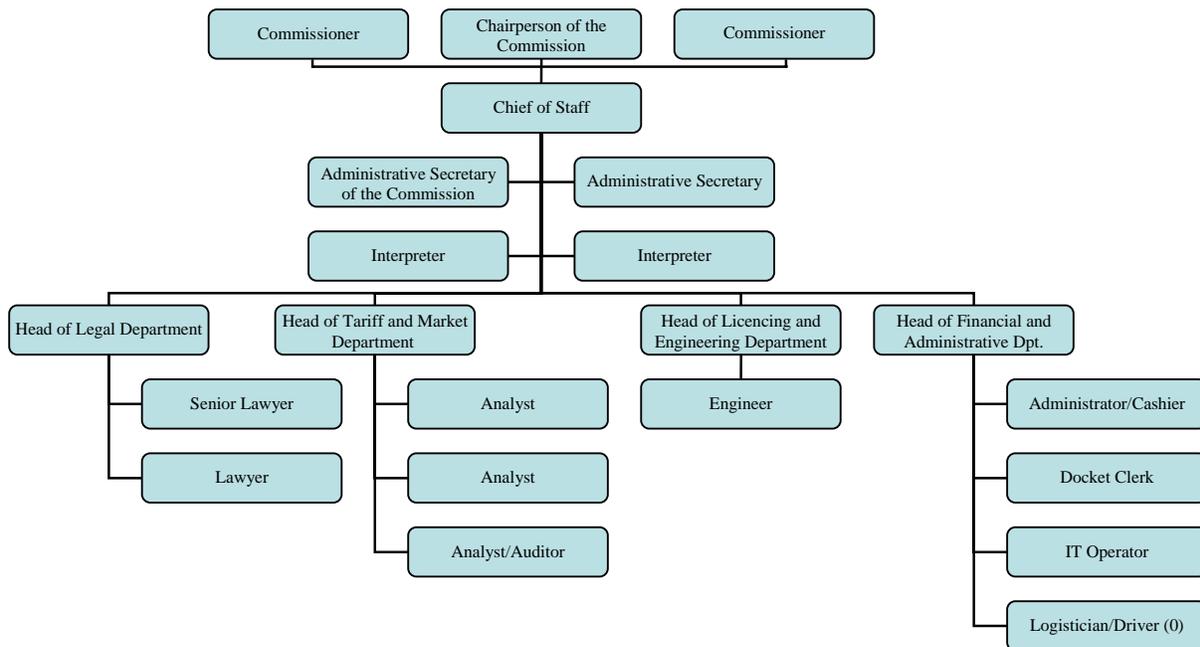
The Member of the Commission from Republika Srpska is:

- Vladimir Dokić, M.A. with four- year term.

After appointment of the first Chairman of the Commission, Vladimir Dokić, M.A. (on July 1, 2003) and expiration of the term of the next Chairman Mirsad Salkić (on June 30, 2005), following the principle of rotation of the Members of the Commission in this function, Željko Topić was appointed the new Chairman of the Commission (until June 30, 2006).

2005 was the first year that the State Electricity Regulatory Commission functioned in its full capacity, in accordance with the applicable organizational chart.

ORGANIZATION CHART OF THE SERC



Total number of employees: 21

In this period, besides the performance of regular duties and tasks, the employees of the SERC went through the process of specialized training on various issues in the area of regulation of the electricity sector. This training took place through different seminars and workshops with professionals from the field of energy participating, as well as through distance e-learning. In regard to this, this year as well, significant support was provided by the USAID (United States Agency for International Development) through various activity programs.

Besides training of its employees, the SERC appropriately participated in training on issues pertaining to regulatory practices, organized for the employees of the regulated entities, as well as judges and their associates.

During the aforementioned period, procurement of the necessary technical equipment required for the efficient operation of the State Electricity Regulatory Commission was continued.

3. KEY ACTIVITIES

During 2005, the State Electricity Regulatory Commission held 14 regular sessions, 25 internal meetings and 12 public hearings, out of which ten were general and two were technical hearings.

In the analyzed period, in a transparent manner, conducting adequate public hearings in which interested members of the public were able to give their comments, along with entities from the electricity sector, the Commission adopted several documents and achieved a number of activities. The most important ones are divided into the areas listed below.

3.1 General Rules

Rule on Hearing Procedures

(“Official Gazette of BIH”, number 38/05)

The public was asked to give its comments on the draft Rule on Hearing Procedures of the SERC. It could be done in various ways until February 4, 2005. Because of the few comments received, the SERC concluded that during the public hearing period, the content of this document did not initiate the interest of the representatives of the public, which was quite a surprise, nor the representatives of regulated entities whose application would be processed by the SERC in accordance with the Rule. Hence, the SERC noted the comments given on documents of the similar content offered to the public by the regulators of Republika Srpska and the Federation of Bosnia and Herzegovina.

Well-intended observations by the members of a competent public caused the SERC to additionally review the general concept and the individual rules of the proceedings which would be applied. The SERC had to carefully review the interest of the competent public: being an independent regulatory body, it is completely autonomous in determining rules and regulations that are to be followed by the parties in the proceeding and that will be followed by the Regulator in decision-making. Therefore, it was required to consult and determine the intent of the legislator expressed in multiple laws which established the institution of the Regulator and how precisely they determined the legal nature, status, role and jurisdiction of the Regulator.

The SERC conducted a detailed research of several state laws, and accordingly modified some provisions of the Rule on Hearing Procedures in its final version, in order to respect to a greater extent basic process principles in accordance to which it would conduct its proceedings, in order to clearly determine and protect the rights and obligations of the parties in the proceedings, and thus ensure the legal foundation of its actions and decisions.

Regulations and proceedings from the regulatory competencies are being reviewed and determined at regular sessions, in accordance with authorities prescribed by the law, and at internal meetings issues and documents of an organizational and administrative nature are reviewed and discussed.

With the view to soliciting comments of interested parties and members of the public on rules and regulations, or on any other document, the SERC organizes general hearings; technical hearings, which are organized with the view to resolve technical issues during the proceedings, e.g., the processing of procedural or essential issues; and formal hearings, which are organized with the view to establish decisive facts based on which the SERC might resolve certain applications or disputes.

Regular sessions and all types of public hearings are open to public.

The final content of the Rule, adopted at the session of the Commission held on May 24, 2005, is the result of the belief of the State Electricity Regulatory Commission that provided types of hearings before the SERC and established proceeding institutes, especially those represented by the formal type of hearing, that are consistent with the relevant laws. At the same time, the SERC is aware that the content of some parts of the Rule on Hearing Procedures is quite technical, complex and demanding. It initiates the interest and obligation to continuously follow the implementation of this document and to critically review and validate it. The SERC shall not refrain from revision of the Rule if its contents turn out to be theoretically disputable and unsustainable on a practical basis.

3.2 Licenses

Licensing Rule

(“Official Gazette of BIH”, number 38/05)

The Act on Transmission of Electric Power, Regulator and System Operator of BIH requires that relevant license issued by the SERC be obtained for performance of the activities of electricity transmission, independent system operator and international trade in electricity.

The Licensing Rule defines the procedures of license application, application review and issuance of the license, as well as deadlines for decision-making upon filing of the application, the essential criteria for the approval or rejection of the licensing application, and the content of the license and its conditions. This Rule also defines the method of modification, suspension and revocation of the license, as well as the procedures to be followed in sale, lease, or conveyance of the license, etc. Transitional and final provisions of this Rule define the deadlines for submitting an application for issuance of temporary licenses to existing entities performing licensed activities, as well as to newly-formed entities, such as the Independent System Operator in BIH and Elektroprenos BIH (Transmission Company BIH).

In order to provide as efficient conduct of the proceeding as possible and facilitate the implementation of the Licensing Rule, the SERC published on its internet page the form and the content requirements of the application for issuance of the license.

The SERC keeps a licensing register, with the basic data on licensed entities and the licensing conditions. The applicant and the public may follow all phases of the proceedings in progress on the internet page, as well as the time provided for their completion.

Procedures for License Issuance

Pursuant to the Licensing Rule and the Rule on Hearing Procedures, during 2005, procedures were conducted and decisions made on the issuance of a temporary license to the Independent System Operator in Bosnia and Herzegovina, Sarajevo, for the performance of the activity of Independent System Operator, and to “Elektroprenos Bosne i Hercegovine”, a.d. Banja Luka, for performance of the activity of electricity transmission. As the registration of the transmission company has not been completed yet, the registration date has been determined as the beginning of the validity period of the license.

Besides, temporary licenses for international trade were issued to:

- Public utility “Elektroprivreda Hrvatske zajednice Herceg Bosne” joint stock company Mostar,
- Public utility Elektroprivreda Bosne i Hercegovine, joint stock company Sarajevo,
- “Elektroprivreda” Republike Srpske, joint stock company Trebinje.

All proceedings were conducted as shortened procedures, which last up to 60 days, beginning with completion of the application. At the beginning of each proceeding, the SERC determined the schedule of each proceeding taking place. Although the procedures were shortened, all important elements of public participation and the conduct of prescribed procedures were included. During the proceeding, the public had an opportunity to give its comments on the application, as well as to request intervenor status in the proceeding. Also, the public was provided with an opportunity to give its comments during the general hearings on the drafts of documents. Prior to issuance of the final decision, the applicant and intervenor were provided with an opportunity to give their comments on the proposed decision. Although this is a rather new method of work in the sector, the public recognized it as a possibility to influence the quality of the document, as well as the content of decisions issued in the SERC.

Issuance of the licenses to the entities and regulated companies in the electricity market led to establishment of formal and legal conditions for implementing goals from the Act on Transmission of Electric Power, Regulator and System Operator of Bosnia and Herzegovina, i.e. creation of the conditions for the unlimited and free trade and continuous supply with electricity by defined quality standards for the benefit of BIH citizens, as well as the facilitation and expedition of the establishment of electricity market in Bosnia and Herzegovina and the regional electricity market. In this way, efficient measures in preventing antitrust activities and abuse of market power may be applied.

It is noted that the establishment of the Company for Transmission of Electricity in BIH (“Elektroprenos Bosne i Hercegovine” JSC Banja Luka) was accompanied by numerous and complex issues; thus this process did not progress by the required deadlines. Therefore, SERC addressed several times the Management Board of this company and the relevant state and entity institutions in order to stress the importance of unbundling the power activities, with the view to establish Elektroprenos BIH and take over of all of its functions in accordance with the foundation law. The registration of the Company is expected in February 2006; thus, the validity period of the temporary transmission licenses was extended for the existing companies performing the transmission of electricity, i.e. the existing power utilities performing the activity of electricity transmission within its organizational units.

Entity regulatory commissions (Regulatory Commission for Electricity of Republika Srpska and the Regulatory Commission for Electricity in Federation of Bosnia and Herzegovina) each, in their field, adopted the required secondary legislation and licensed activities over which they have jurisdiction (generation, distribution and supply) and conducted proceedings for the determination of tariffs in accordance with clear regulatory principles.

3.3 Tariffs

Rule on Tariff Proceedings *(“Official Gazette of BIH”, number 44/05)*

SERC issued the Rule on Tariff Proceedings in April 2005, in which it defined the basic procedures for the review of the application and all other submissions in regards to tariffs, tariff methodology and the standards for tariff issuance.

A tariff proceeding is a group of activities that are initiated by submitting an application for tariff approval by the regulated company or upon the initiative of the SERC. In accordance with this Rule, SERC shall only accept those applications containing enough information to make a decision, and shall approve applications if rates, deadlines and conditions for tariff application are non-discriminatory, reasonable for customers and based on objective costs for the provision of certain service. The obligation of the applicant is to prove that the proposed tariff fulfills the requirements from the law and the Rule.

Tariff Pricing Methodology for the Services of Electricity Transmission, Independent System Operator and Ancillary Services *(“Official Gazette of BIH”, number 46/05)*

Continuing its activities related to development of tariff rules in 2004, in June 2005 the SERC issued the Tariff Pricing Methodology for the Services of Electricity Transmission, Independent System Operator and Ancillary Services.

The Methodology provides for the structure of tariffs and the method of their calculation for the activities of electricity transmission, management of the transmission network and the provision of ancillary services.

The Methodology issued by SERC in June 2005, is based on the

methodology of traditional regulation (*'revenue requirement'*), in which the regulator approves the annual revenue requirement to the regulated company sufficient to cover the justified costs of the company.

The implementation of the Methodology ensures that the approved tariffs will be transparent, non-discriminatory, and based on justified operation and maintenance costs (*'cost reflective'*), to encourage energy efficiency, create stable relations in the electricity market, encourage development of regulated activity, respect environmental protection and reflect standards common in international practice.

The Methodology also provides for the form and the content of the application for submission of data in a tariff proceeding.

Decision on the Method of Determination of Interim Tariffs for the Electricity Transmission and the Operation of ISO
(*"Official Gazette in BIH", number 44/05*)

This decision specifies the right and obligation of Elektroprenos BIH and the ISO BIH to adequately submit applications for the approval of interim tariffs to SERC, in accordance with the Law Establishing the Company for the Transmission of Electricity in Bosnia and Herzegovina and the Law Establishing the Independent System Operator for the Transmission System in BIH, in their initial period of establishment and operation.

The Decision defines the method of determination of interim (initial) tariffs for the services of electricity transmission and the operation of Independent System Operator, which are intended to cover the operational costs of these regulated companies in the period until the issuance of tariffs involving the full implementation of the Methodology.

The Proceedings for Approval of Interim Tariffs for the Services of Electricity Transmission, Operation of the ISO and Ancillary Services

Pursuant to the Law and the Decision on the method of determination of interim tariffs, the management boards of the Independent System Operator in BIH and Elektroprenos BIH submitted applications for tariff approval. The applications were prepared in accordance with the appropriate forms, which were supported by comprehensive additional documentation.

In accordance with the Decision, SERC conducted both procedures using a transparent process identical to the regular procedure. All interested parties were provided with an opportunity to have direct access to complete applications at the premises of SERC and on the internet page, and the public was accordingly informed as to that availability in the written media.

Results of a study of the European Bank for Reconstruction and Development (EBRD): “Can the poor pay for energy? - Affordability of Electricity in South East Europe” (November 2003) shows that 20% of population of Bosnia and Herzegovina has an annual income of under 2200 BAM (1 € ≈ 1.96 BAM) and results in a socially vulnerable population, which allocates 15-20% of their income to electricity consumption.

A previous study of EBRD (from 1999), also known as the Fichtner Study, in regards to costs considers as justified the electricity cost increase of 40-60% average. That is why this Study introduces the obligation of establishment of social safety net for the population with low income.

During the proceedings, SERC granted intervenor status to all parties that showed an interest in the proceedings (in all cases the three power utility companies and “Aluminij” JSC Mostar), and organized general public hearings in order to solicit comments and opinions on these applications. The comments of the public and intervenors in the tariff proceedings, and additional explanations of the applicants were included in the reports of the Presiding Officers. Final reports on the concluded tariff proceedings demonstrated detailed economic analysis of the revenue requirement, i.e. of all justified costs of the applicant. All parties in the proceedings were given an opportunity to make final comments. In 2005, the SERC approved the revenue requirement and the tariff for the operation of the Independent System Operator in BIH.

3.4 Consumer Protection

Consumer protection becomes one of the key issues of the regulatory policy in all countries in which processes of deregulation and liberalization are ongoing. For that purpose, regulatory bodies are increasingly obligated to review and achieve the basic goals of consumer protection in an open electricity market, protection of power entities and the environment through transparent and impartial regulation.

At the end of 2005, the proceedings of tariff approval for delivered electricity and the services of the companies in the electricity sector were commenced before the State Electricity Regulatory Commission and the entity regulatory commissions. These activities initiated planned resolution of the issue of socially vulnerable categories protection. The resolution of this issue would enable these categories to regularly pay for the consumed electricity.

The Directives 2003/54/EC of the European Parliament and Council on the common rules for internal electricity market introduce an obligation to the countries to undertake relevant measures of end-user protection, especially the socially vulnerable population, with the goal to eliminate disconnection of those customers from the power network due to inability to pay their bills.

According to statements, taken from the “Framework for development of the electricity market in Southeast Europe” (World Bank, 2005), all countries of the region, except BIH, Montenegro and Turkey have a system of protection for socially vulnerable customers.

Uniting forecasts, recommendations, and observations from available studies and documents, the conclusion arises that in the years to come in Bosnia and Herzegovina could be an additional burden on the socially vulnerable customers. That is

Level of Market Opening

<i>EU-25</i>	<i>66%</i>
<i>EU-15</i>	<i>88%</i>
<i>Austria</i>	<i>100%</i>
<i>Belgium</i>	<i>90%</i>
<i>BIH*</i>	<i>31,9%</i>
<i>Bulgaria</i>	<i>25%</i>
<i>Montenegro</i>	<i>15%</i>
<i>Check Republic</i>	<i>47%</i>
<i>Denmark</i>	<i>100%</i>
<i>Estonia</i>	<i>10%</i>
<i>Finland</i>	<i>100%</i>
<i>France</i>	<i>70%</i>
<i>Greece</i>	<i>62%</i>
<i>Croatia</i>	<i>15%</i>
<i>Ireland</i>	<i>56%</i>
<i>Italy</i>	<i>79%</i>
<i>Cyprus</i>	<i>35%</i>
<i>Latvia</i>	<i>76%</i>
<i>Luxemburg</i>	<i>57%</i>
<i>Hungary</i>	<i>67%</i>
<i>Macedonia</i>	<i>28%</i>
<i>Malta</i>	<i>0%</i>
<i>Netherlands</i>	<i>100%</i>
<i>Norway</i>	<i>100%</i>
<i>Germany</i>	<i>100%</i>
<i>Poland</i>	<i>52%</i>
<i>Portugal</i>	<i>100%</i>
<i>Romania</i>	<i>84%</i>
<i>Slovakia</i>	<i>66%</i>
<i>Slovenia</i>	<i>75%</i>
<i>Spain</i>	<i>100%</i>
<i>Sweden</i>	<i>100%</i>
<i>Turkey</i>	<i>10%</i>
<i>Great Britain</i>	<i>100%</i>

*Sources: Eurostat 07, 2005 (EU and Norway),
ETSO (Athens Forum 11, 2005),
BIH draft of Decision on market opening

why he SERC at the end of November 2005, in its initiative to the Council of Ministers of BIH, indicated some of the possible activities in the field of protection of electricity customers as transition solutions towards creating a concept of the overall model of social protection in Bosnia and Herzegovina. SERC will actively cooperate and give its appropriate contribution to all activities which are directed towards the protection of socially vulnerable electricity customers, within its jurisdiction vested in it by law.

3.5 Market Opening

Draft of Decision on Scope, Conditions and Time Schedule of Electricity Market Opening in Bosnia and Herzegovina

The Act on Transmission of Electric Power, Regulator, and System Operator in Bosnia and Herzegovina emphasizes its intention to “enable and expedite the creation of the electricity market in Bosnia and Herzegovina and the regional electricity market”. Introduction of competition in the energy market and the liberalization of the same market require the undertaking of major structural and regulatory reforms and preparation of adequate regulation. In November 2005, the SERC developed the draft of the Decision, which represents a part of that regulation and a beginning of the approach towards realization of the overall obligations of Bosnia and Herzegovina after the signing of the Treaty on Establishment of the Energy Community.

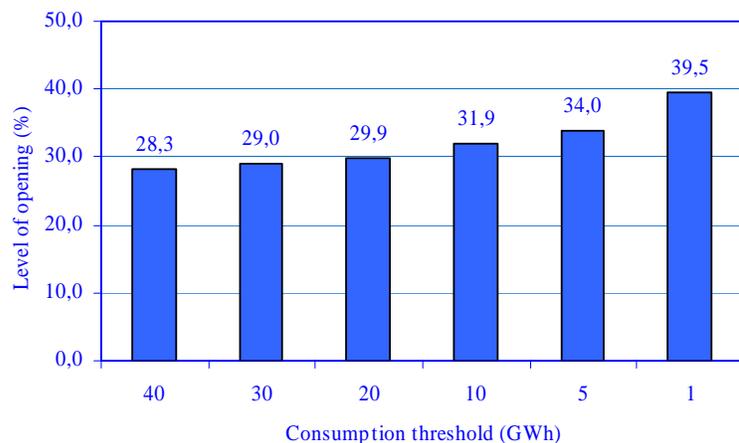
Establishment of the mechanism of an open electricity market in Bosnia and Herzegovina requires fulfillment of a few basic conditions that should enable customers to actively exercise their legal right to a free choice of supplier, and for the suppliers to have their right to freely provide services to their customers. It is necessary to choose and create an efficient model of an effective and competitive internal market, market rules, grid code, metering rules, set and publish network fees, determine all functions of the Independent System Operator and Market Operator. Some of the conditions are realized or are about to be realized.

To be able to gain eligible customer status it is required that the requirements stipulated in this Decision be met in regard to the annual electricity consumption, as well as other conditions determined by the relevant regulatory commission in separate documents. Thus, the SERC notices that significant mutual harmonization and compatibility of the criteria and conditions, prescribed as obligatory by the competent regulatory commissions will significantly contribute to the unification of the market. Also, under the same conditions, the commissions

would have to implement the eventual right of the eligible customer to change its status.

The Decision includes the gradual electricity market opening, changing in each phase the level of annual consumption of eligible customers necessary to have the right to freely choose a supplier. In the draft of the Decision, SERC chose to introduce an initial threshold of 10 GWh, which had already been defined by the legislature of Republika Srpska. This threshold would result in 31.9% electricity market opening in Bosnia and Herzegovina. This relatively high percentage of opening is the result of existence of dominant customer (“Aluminij” JSC Mostar) whose consumption amounts to around 20% of the total consumption in Bosnia and Herzegovina.

Level of BIH market opening in relation to consumption threshold



In accordance with the adopted laws and international obligations, Bosnia and Herzegovina is joining the other countries in the region, which have already opened their electricity markets.

The commencement of competitive market operation is envisaged to be January 1, 2007, when it will be possible to implement the first bilateral arrangements for the sale of electricity among market participants.

With regard to consumption, in the beginning the electricity market would be divided into tariff customer and eligible customer markets. Subsequently, smaller commercial customers, and eventually households, would acquire the right to choose suppliers.

On December 7, 2005, the SERC held a general public hearing during the decision-making process to obtain comments of the public and interested parties. Rendering of the final decision is planned for the first quarter of 2006, after processing of obtained comments and adequate analysis.

3.6 Grid Code and Market Rules

Pursuant to the law, at the end of 2005, the ISO BIH initiated activities related to creation of the key documents for operation of the power system and electricity market – the Grid Code and Market Rules.

SERC follows the developments and progress of the activities with regard to creation of these documents, taking into account its competencies concerning their approval.

As expected in the first half of 2006, the finalization of these activities will create conditions for the qualitative defining of relationships in the sector itself and will introduce both technical and commercial rules for all electricity market participants in BIH. Namely, the Grid Code will define the manner of planning and development of the transmission system, conditions for connection (procedures, contracts, criteria), the manner of operational planning (consumption forecast, balance responsible parties, grid congestion management), and operational activities (dispatching, procedures, communications), measures in extraordinary situations (consumption control, restart of the system after black-out), the manner of billing metering in the power system and other necessary technical measures for qualitative and reliable operation of the transmission system. Such a document has not existed in the power practice in BIH so far; therefore, it will define the relationships and increase the quality of services provided by individual market participants.

On the other hand, the Market Rules define the relationships between the ISO BIH and licensed participants in the electricity market by defining the participants themselves, the scope of their activities and commercial relationships in the electricity market. They also define how the ISO BIH will fulfill its obligations related to management and operation of the balancing mechanism, management of contracts for purchase of ancillary services, provision of data for power transaction settlements (commercial metering), congestion management, allocation of fees for unplanned deviations with neighboring control zones, invoicing for ancillary services and balancing etc. Considering the current situation in Bosnia and Herzegovina, the Market Rules should enable transition of the current processes and technical equipment of all market participants towards a more developed market design, in accordance with technical possibilities.



Mr. José Manuel Barroso, Chairman of the European Commission, welcomed the Treaty as an “important achievement for peace and stability in Europe.”

Mr. Andris Piebalgs, EU Commissioner for energy issues, who signed the Treaty on behalf of the European Union: “The Energy Community Treaty is going to increase security of supply and provide support to the sector of strategic importance”.

Athens, October 25, 2005

The Treaty comes into force on the first day of the month following the date on which the European Community and six contracting parties notify the Secretary General of the EU Council of finalization of the approval procedure in accordance with their internal procedures.

4. INTERNATIONAL ACTIVITIES

4.1 Energy Community

The Treaty, signed in Athens on October 25, 2005, provides for the creation of the biggest internal market in the world for electricity and gas, with effective participation of 34 parties: 25 members of the European Union and Croatia, Bosnia and Herzegovina, Serbia, Monte Negro, Albania, Macedonia, Romania, Bulgaria, and UNMIK Kosovo. The negotiations with Turkey are in progress, and Moldova, Ukraine and Norway are in the process of joining, and have observer status.

Signing of the Treaty is a result of the Athens Process, within which in 2002 and 2003 the Memoranda on Understanding were signed to establish the regional market in electricity and natural gas in South East Europe which would be gradually integrated in the energy market of the EU.

The political will of the signatory countries expressed by signing the memoranda and Treaty becomes a legal obligation through ratification of the Treaty and its coming into effect, which is expected to happen in the second part of 2006.

The main goals of the Treaty are creation of a stable and single regulatory framework and market space which ensure reliable energy supply and may attract investments in the electricity and gas sectors. In addition, it assumes the development of alternative sources of gas supply (Caspian basin, North Africa, Middle East) and improvement of the condition of the living environment, with the implementation of energy efficiency and utilization of renewable sources.

By signing of the Treaty, the contracting parties from the region are obligated to establish a common electricity and gas market which will operate in accordance with the standards of EU energy market with which it will integrate. It is to be achieved by gradual implementation of the EU *Acquis Communautaire* pertaining to energy, environment and competition. In the field of energy and environment, this consists of the implementation of the relevant EU directives and regulations in accordance with an established time schedule.

By participation in this process Bosnia and Herzegovina confirms its determination to reform of the energy sector, liberalization of the energy market and harmonization of its policy with EU members.

It bears repeating that establishment of a single electricity and natural gas market and its inclusion in the international market is one of the priorities of the Mid-term Development Strategy of Bosnia and Herzegovina in the energy sector.

Acquis Communautaire from the Treaty

Acquis on Energy

- Directive 2003/54/EC of the European Parliament and of the Council of June 26, 2003 concerning common rules for the internal electricity market
- Directive 2003/55/EC of the European Parliament and of the Council of June 26, 2003 concerning common rules for the internal natural gas market
- Regulation 1228/2003/EC of the European Parliament and of the Council of June 26, 2005 on conditions for access to the network for cross-border electricity trade

The deadline for implementation of these directives is 12 months after the entry into force of this Treaty, ensuring that all customers but households have the eligible customer status by January 1, 2008 at the latest, and as of January 1, 2015 all customers.

Acquis on Environment

- European Community Council Directive 85/337/EEC of June 27, 1985 on assessment of the effects of certain public and private projects on environment, with subsequent amendments of March 3, 1997 (Directive 97/11/EC) and Directive 2003/35/EC of the European Parliament and the Council of May 26, 2003; implementation after entry into force of the Treaty
- Directive 2005/53 of the European Parliament and of the Council of July 6, 2005, amending Directive 199/32 of April 26, 1999 relating to the reduction of sulfur content of certain liquid fuels; implementation by December 31, 2011.
- Directive 2001/80/EC of the European Parliament and of the Council of October 23, 2001 on limitation of emissions of certain air pollutants by large combustion plants (≥ 50 MW); implementation by December 31, 2017.
- Article 4(2) of the European Community Council Directive 79/409/EEC of April 2, 1979 on conservation of wild birds; implementation after entry into force of the Treaty
- Endeavour to accede to the Kyoto Protocol and implementation of the Directive 96/61/EC of September 24, 1996 on pollution prevention and control

Acquis on Competition

The following activities are not allowed and shall be assessed pursuant to Article 81, 82 and 87 of the Treaty Establishing the Energy Community:

- Prevention, restriction or distortion of competition,
- Abuse of dominant position,
- Any public aid which distorts or threatens to distort competition.

In particular, with regard to public undertakings and undertakings to which special rights have been granted, six months following the date of entry into force of the Treaty, provisions of the Treaty Establishing the Energy Community, in particular Article 86, shall be upheld.

Acquis on Renewable Energy Sources

- Directive 2001/77/EC of the European Parliament and of the Council of September 27, 2001, on promotion of electricity generated by using renewable sources in the internal market
- Directive 2003/30/EC of the European Parliament and of the Council of May 8, 2003 on promotion of use of bio-fuels or other renewable fuels in transportation

The Energy Community members shall prepare a plan for implementation of *acquis* on renewable energy sources within one year after the entry into force of the Treaty.

The work of the State Electricity Regulatory Commission in this field was carried out with good cooperation of the Ministry of Foreign Affairs and Economic Relations of Bosnia and Herzegovina, then, through participation in the achievement of different projects supporting the establishment of the Energy Community, and in particular, through work in the different groups which include energy regulators from the region and the European Union.

To ensure an adequate process of establishing and functioning of the Energy Community, the Treaty establishes the Ministerial Council, the Permanent High Level Group, the Regulatory Board, the Electricity Forum (Athens Forum), the Gas Forum and the Secretariat.



The Energy Community Regulatory Board (ECRB) seated in Athens is comprised of representatives of the state regulatory authorities from the countries in the region, while the European Union is represented by the European Commission with assistance of one regulator from the bordering countries of the region, and one representative of the European Energy Regulators Group for Electricity and Gas (EREGG). ECRB will consider issues of regulatory cooperation and it may become a body issuing regional regulatory decisions and may serve as a dispute resolution institution. The Regulatory Board has a main role in the operation of the expanded market. According to the opinion of the European Commission, this supranational regulatory body may become a model for other parts of the world.

As the Chairmanship of the European Community is held in accordance with the English alphabet, after the position of the Chairman was held by Bosnia and Herzegovina in the first half of 2005, and Bulgaria in the second half, the position of the Chairman shall be taken over by Croatia in the first half of 2006, and subsequently by Macedonia.

Priorities of the Energy Community in 2006 include, among other things, ratification of the Treaty and implementation of the *acquis communautaire*, signing of a Memorandum on social aspects resulting from changes in the market, continuation of negotiations with Turkey and other observers, further work with donors to create a simplified infrastructure fund, development and adoption of a gas strategy, adoption and implementation of an Action plan for market design, a regional plan for demand management and energy efficiency, and work on oil sector issues.

4.2 ERRA



The Energy Regulators Regional Association (ERRA) is an organization composed of independent energy regulatory bodies in Central and East Europe and newly independent states in the region. ERRA has 21 full and 5 associated members, all established at the state level.

The State Electricity Regulatory Commission is a full ERRA member as of May 19, 2004, since SERC actively participates in the work of the General Assembly and Investment Conference, as well as in the work of standing committees and working groups with particular emphasis on the Standing Licensing/Competition Committee, Standing Tariff/Pricing Committee, Legal Regulation Working Group and EU Integration Working Group.

By providing the relevant information on the power sector of Bosnia and Herzegovina, in particular on the applicable regulatory practice, the State Electricity Regulatory Commission fulfills its role acquired by full ERRA membership.

The goals of ERRA are improvement of energy regulation in the member countries, development of stable energy regulators, improvement of cooperation among regulators, exchange of information, research and experience among the members, better access to energy regulatory information and sharing of experience around the world.

4.3 CEER



During 2005, the Council of European Energy Regulators (CEER), led by South East Europe Energy Regulators Working Group (SEEER) in whose work the SERC continuously participates, and with the practical assistance of Pierce Atwood and support of USAID, issued the third Regulatory Benchmarking Report.

It covers all aspects of regulatory work of signatory counties of the Treaty Establishing the Energy Community, Italy, Austria, Hungary and Greece as the EU bordering countries with the region, as well as Turkey and Moldova. This Benchmarking Report provides an excellent guide and the possibility to observe the fields of regulatory activities that require further improvement. The document confirms that Bosnia and Herzegovina is going in a good direction for establishment and development of the regulatory practice, with its specific situation of having entity regulatory commissions (Regulatory Electricity Commission of Republika Srpska and the Regulatory Electricity Commission of the Federation of Bosnia and Herzegovina).

The Benchmarking Report was presented at the 7th Athens Forum (October, 2005).

4.4 ERGEG



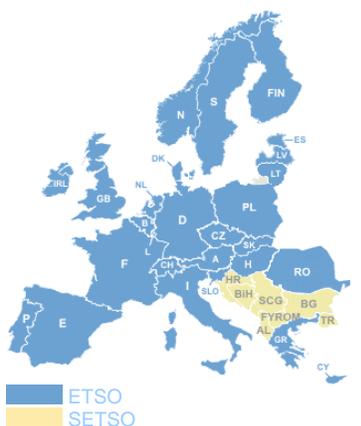
The State Electricity Regulatory Commission follows the work of the European Energy Regulators Group for Electricity and Gas (ERGEG).

The membership in ERGEG is open to the EU regulators, and observer status may be acquired by regulatory authorities from the member countries of the European economic area.

ERGEG assists in consistent implementation of the relevant European directives and rules on cross-border trade and enables a transparent platform for mutual cooperation of national energy regulators, as well as for cooperation of the regulatory authorities with the European Commission.

The work of ERGEG, a body established on December 17, 2003, is open to all market participants, in particular to consumers and end-customers.

4.5 Inter-TSO Compensation Mechanism (ITC Mechanism)



The ITC mechanism is implemented by most of the countries of South East Europe through their system operators: Romania (Transelectrica), Bulgaria (NEK), Serbia (EMS), Montenegro (EPCG), Macedonia (ESM) and Albania (KËSH).

The mechanism of inter-TSO compensation (ITC mechanism) has been implemented in Western Europe since 2002, and in South East Europe since 2004, with the previously used term CBT mechanism (cross-border trade mechanism). The ITC mechanism is a method of compensation for costs on the national transmission network caused by electricity flows due to cross-border trade. In this manner an important platform has been created that enables electricity trade in the region of South East Europe, as well as between the region and the European Union.

It is in the jurisdiction of the regulator to approve implementation of the mechanism, which in the first place includes implementation of the Regulation EC 1228/2003 of the European Parliament and of the Council of June 26, 2003 on conditions for access to the network for cross-border electricity trade, and to determine the manner of providing funds for covering costs of the network which is used for electricity transit.

The organization of the South East Transmission System Operators (SETSO), in which Bosnia and Herzegovina is represented by the Independent System Operator in BIH, continued to implement the ITC mechanism during 2005. Due to its geographic position as a transit country in the region and the structure of the transmission network, Bosnia and Herzegovina, after the revenue of approximately 1.2 million EUR in 2004, realized *ex ante* revenue of 4.4 million EUR in 2005 based on implementation of the ITC mechanism.

Continuation of a gradual accession of the system operators of the countries from the region to the integrated Organization of European Transmission System Operators (ETSO) is planned for the next year, as well as preparatory activities on merging of ITC mechanisms of SETSO and ETSO countries in 2007, i.e. their associated ITC compensation funds.

In addition, during 2006, establishment of a single mechanism of coordinated explicit capacity auctions in South East Europe is expected with the view to overcome the problem of congestion at interconnections. For adequate handling of this issue, it is necessary to have close cooperation between the system operators and the regulators in the region.

4.6 UCTE Reconnection and Its Effects

As pointed out in the SERC Report on Activities for 2004, on October 10, 2004 reconnection of the former first and second UCTE synchronous zones (UCTE – the Union for the Coordination of Transmission of Electricity) was completed. Reconnection has had important technical and commercial effects, contributing to increased operation safety, frequency stability and reliability, improvement of voltage profile and quality of electricity supply as well as to the scope of electricity trade. The UCTE continues to carefully monitor the system stability of the reconnected network, since experience from the reconnection process in the South East Europe will be useful for further development of the UCTE synchronous area.

UCTE is working on studies on the possible extension of its synchronous area, which, first, refers to the area of Turkey, then to closing of the Mediterranean ring through Morocco, Algeria and Tunisia, and expansion to the Baltic countries, Russia and other countries of the Union of Independent States (former Soviet Union).

The UCTE member from our country is the Independent System Operator in Bosnia and Herzegovina.



UCTE, December 2005



UCTE, expansion plan

5. AUDITING REPORT

Pursuant to the Act on Transmission, the State Electricity Regulatory Commission has established obligations to prepare accounting reports in accordance with international accounting standards (meaning an obligation to make a fair and true presentation of report), auditing performed by an independent auditor, and publication of the report to provide information to interested persons and a wider public.

“In our opinion, the financial reports realistically and objectively show the financial standing of the State Electricity Regulatory Commission (SERC) in all relevant aspects on December 31, 2004, business results and cash flows for the period of time concluded at that point, in accordance with the International Financial Reporting Standards (“IFRS”).”

Acting in accordance with the provision of the Law on Public Procurement, the SERC concluded a Contract on performing auditing services with the Auditing, Accounting and Consulting Company “REVIK” Ltd. Sarajevo, which conducted the audit in accordance with international auditing standards applicable to auditing of financial reports and submitted a Report on the completed audit.

Through the conducted audit, the independent auditor, evaluated the overall presentation of the financial reports, recognized and measured transactions and business occurrences, and determined that there was no false presentation of the facts or false presentation of SERC’s financial standing.

Pursuant to the Act on Transmission of Electric Power, Regulator and System Operator of Bosnia and Herzegovina and international accounting standards, the Report was published in the “Official Gazette of BIH”, number 21/05.

At the beginning of 2005, copies of accounting reports and the Report on Realization of the Financial Plan of the State Electricity Regulatory Commission for 2004 were submitted to the Office for auditing of financial operation of BIH institutions, in order to inform the Office on the SERC financial operation.

Additional information on the operation and procedures conducted by the State Electricity Regulatory Commission may be obtained on the internet at www.derk.ba, or by phone on 035 302060 and 302070, fax 035 302077, e-mail info@derk.ba or at the seat of the SERC in Tuzla, M. Jovanovića Street 4/II.

The State Electricity Regulatory Commission expresses gratitude to USAID and the law firm Pierce Atwood.

6. MAIN ACTIVITIES IN 2006.

The State Electricity Regulatory Commission will continue its activities on creation of conditions for free trade and unhindered electricity supply in accordance with the previously defined quality standard to the benefit of the citizens of Bosnia and Herzegovina, and in compliance with the relevant European directives.

6.1 Completion of Activities Initiated During 2005

In this section, the following are identified as the most important:

- Monitoring of the establishment of the Company for Transmission of Electricity in BIH,
- Market opening, approval of the Grid Code and Market Rules,
- In accordance with clear regulatory principles and in cooperation with the entity regulators, harmonized determination of all tariffs in the power sector in BIH, thus ensuring the existence of an overall tariff regulatory regime.
- By completing the aforementioned activity, the SERC will be in a position to note that there are conditions for the High Representative in the capacity of the enactor of the Law on Implementation of the Tariff System for Electricity (“Official Gazette of the Federation of BIH”, number 6/04) to decide on cessation of its validity.

6.2 Permanent SERC activities

Through its activities the SERC is focused on:

- Licensing activities within its jurisdiction,
- Monitoring licensed entities, in particular analysis of the state of play with regard to measuring energy values,
- Design of a single electricity market,
- Issuance of tariffs in its jurisdiction,
- Social aspect within the field of the regulatory practice,
- Monitoring the implementation of the ITC mechanism and establishment of the mechanism for coordinated explicit capacity auctions,
- International activities pertaining to regulation of the electricity market,
- Further training of the regulated entities and the public on regulatory practice.

ATTACHMENT 1: Basic Data on the Power System of Bosnia and Herzegovina

Major generation facilities

Hydro power plants	Capacity of power unit (MW)	Total installed capacity (MW)
Trebinje I	3×60	180
Trebinje II	8	8
Dubrovnik (BandH+Cro.)	2×105	210
Čapljina	2×210	420
Rama	2×80	160
Jablanica	2×25+4×30	170
Grabovica	2×58,5	117
Salakovac	3×70	210
Mostar	3×25	75
Jajce I	2×30	60
Jajce II	3×10	30
Bočac	2×55	110
Višegrad	3×105	315
Peć-Mlini	2×15	30

(used ISO BIH data)

Thermal power plants	Installed capacity (MW)	Available capacity (MW)
TUZLA	779	709
G1	32	29
G2	32	29
G3	100	91
G4	200	182
G5	200	180
G6	215	198
KAKANJ	578	514
G1, G2, G3 i G4	4×32	4×29
G5	110	100
G6	110	90
G7	230	208
GACKO	300	276
UGLJEVIK	300	279

Basic data on the transmission system *transmission lines*

No.	Nominal voltage of transmission lines	Length (km)
1	400 kV	992
2	220 kV	1691
3	110 kV	3649
4	110 kV – cable line	31

interconnectors

No.	Nominal voltage of transmission lines	No. of interconnections
1	400 kV	3
2	220 kV	8
3	110 kV	17

transmission sub-stations

No.	Type of sub-station	No. of sub-stations	Installed capacity (MVA)
1	TS 400/x kV	8	5861.5
2	TS 220/x kV	7	1277.0
3	TS 110/x kV	119	4873.5

transmission transformers

No.	Transmission ratio of transformers	No. of transformers	Installed capacity (MVA)
1	TR 400/x kV	14	4900
2	TR 220/x kV	12	1800
3	TR 110/x kV	205	5196

Basic power indicators

(GWh)

Realization in 2004	EP BIH	ERS	EP HZHB	Brčko District	BIH
Generation	6113.02	4960.19	1669.49		12742.70
Generation in hydro power plants	1610.52	2699.14	1669.49		5979.15
Generation in thermal power plants	4435.17	2189.87			6625.04
Generation in small and industrial power plants	67.33	71.18			138.51
Consumption	3847.00	3291.60	3351.78	229.58	10719.96
Distribution consumption	3529.50	3117.7	1463.17	229.58	8339.95
Transmission losses	143.33	119.17	59.17		321.67
Large consumers	174.17		1829.44		2003.61
Self-consumption of mines and thermal power plants		54.73			54.73
Estimate for 2005	EP BIH	ERS	EP HZHB	Brčko District	BIH
Generation	5770.00	5164.00	1747.00		12681.00
Generation in hydro power plants	1484.00	2702.00	1747.00		5933.00
Generation in thermal power plants	4218.00	2390.00			6608.00
Generation in small and industrial power plants	68.00	72.00			140.00
Consumption	4189.00	3567.00	3459.00	253.00	11468.00
Distribution consumption	3643.00	3381.00	1497.00	253.00	8774.00
Transmission losses	161.00	127.00	62.00		350.00
Large consumers	385.00		1900.00		2285.00
Self-consumption of mines and thermal power plants		59.00			59.00

ATTACHMENT 2: Map of the Power System of Bosnia and Herzegovina

