



Bosnia and Herzegovina

STATE ELECTRICITY REGULATORY COMMISSION

**REPORT ON ACTIVITIES
OF THE STATE ELECTRICITY REGULATORY COMMISSION
IN 2007**

Tuzla, December 2007

1. INTRODUCTION

The most important activities of the State Electricity Regulatory Commission, Bosnia and Herzegovina (SERC, BIH) in the fourth year of its existence include two concluded tariff proceedings. In the first round of proceedings, SERC reduced the total tariff for the services of the transmission company and the system operator by 5%, and by a further 5.8% in the second round, which had a positive impact on both the electricity prices paid by customers and the overall economic situation in Bosnia and Herzegovina.

In 2007, SERC also licensed many entities. Eight licenses were issued in total for the activities of transmission, system operator and international trade in electricity, of which five have a five-year term and the remainder being temporary licenses with a two-year term.

During the reporting period, the Office for Auditing of the Financial Operations of the Institutions of Bosnia and Herzegovina performed an audit of SERC financial reports for 2006, and after a positive audit, included the State Regulatory Commission among the five BIH institutions whose financial reports were assessed positively.

The field of international activities was dominated by activities related to the Energy Community, including a number of activities on the preparation and implementation of Road Maps. The European Union constantly recognizes energy as one of the most prioritized and most important issues. In this context, the relevance of the Third Liberalization Package is stressed, foreseeing the creation of competent energy markets in the true meaning of the word.

SERC emphasizes that the harmonization of secondary legislation and efficient coordination among the authorities that participate in its development and creation are in the interest of all key entities for implementing power sector reform in Bosnia and Herzegovina, the goal being the creation of a clear and reliable legislative framework based on the European directives and rules of the internal electricity market.

The State Electricity Regulatory Commission, the Regulatory Commission for Electricity in the Federation of BIH and the Regulatory Commission for Energy of the Republika Srpska cooperate and harmonize their activities. SERC also cooperates with other regulatory bodies established on the state level, primarily with the Competition Council of BIH.

The State Electricity Regulatory Commission 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 regulatory fees which are paid by the licensed entities.

2. COMPOSITION AND ORGANIZATION OF WORK OF THE STATE REGULATORY COMMISSION

The SERC was established by the Parliamentary Assembly of Bosnia and Herzegovina by adoption of the Act on Transmission of Electric Power, Regulator and System Operator of BIH, and appointing Members of the Commission.

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

- Mirsad Salkić, with a five-year term (from July 1, 2003 to June 30, 2008) and
- Nikola Pejić, with a five-year term (from September 25, 2007 to September 24, 2012).

The Member of the Commission from the Republika Srpska is:

- Vladimir Dokić, M.A. with four-year term (from July 1, 2003 to June 30, 2007).

After the decision of the Parliamentary Assembly of Bosnia and Herzegovina of September 2007, the former member, Mr. Željko Topić, upon the expiry of his three-year term, was replaced by Mr. Nikola Pejić. The four-year term of Mr. Vladimir Dokić, M.A., the Member of the Commission from the Republika Srpska, has also expired, but he will continue to perform this function until the appointment-re-appointment by the Parliamentary Assembly of BIH.¹

After the appointment of the first Chairman of the Commission, Vladimir Dokić, M.A. (who was the Chairman until June 30, 2004), following the principle of rotation of the Members of the Commission in this position, the Commission was chaired as follows: by Mr. Mirsad Salkić (until June 30, 2005), by Mr. Željko Topić (until June 30, 2006), again by Mr. Vladimir Dokić (until June 30, 2007), with the current Chairman being Mr. Mirsad Salkić until June 30, 2008.

The State Electricity Regulatory Commission has continued to operate in accordance with the organizational chart adopted at the beginning of its establishment, while SERC employees continue to acquire specialized knowledge and practices of relevance for the operation and regulation of the electricity sector in Bosnia and Herzegovina.

SERC has been using different ways to improve the internal knowledge and experience of its employees. The improvement of knowledge is achieved by participation in different professional consultations, conferences and topical seminars, in the country and abroad, and by distance e-learning. In this regard, special emphasis should be put on the educational

“We suggest that the Council of Ministers of BIH establish a single register of all mandates, which would include, inter alia, the dates of appointment and expiry of the mandates of officials in BIH institutions enabling a timely commencement of procedures for new appointments. In this manner, the practice of technical mandates, acting officers and other temporary solutions, which are not conducive to efficient operation of institutions, would be avoided.”

(from the Summary Report of the Office for Auditing of BIH Institutions on audit for 2006)

¹ At the time of the creation of this report, the procedure for appointment of the Member of the Commission is in process before the Government of the Republika Srpska. After the Government's proposal is confirmed by the National Assembly of the Republika Srpska, the nomination shall be submitted to the Council of Ministers of Bosnia and Herzegovina, which shall propose the appointment to the Parliamentary Assembly of Bosnia and Herzegovina.

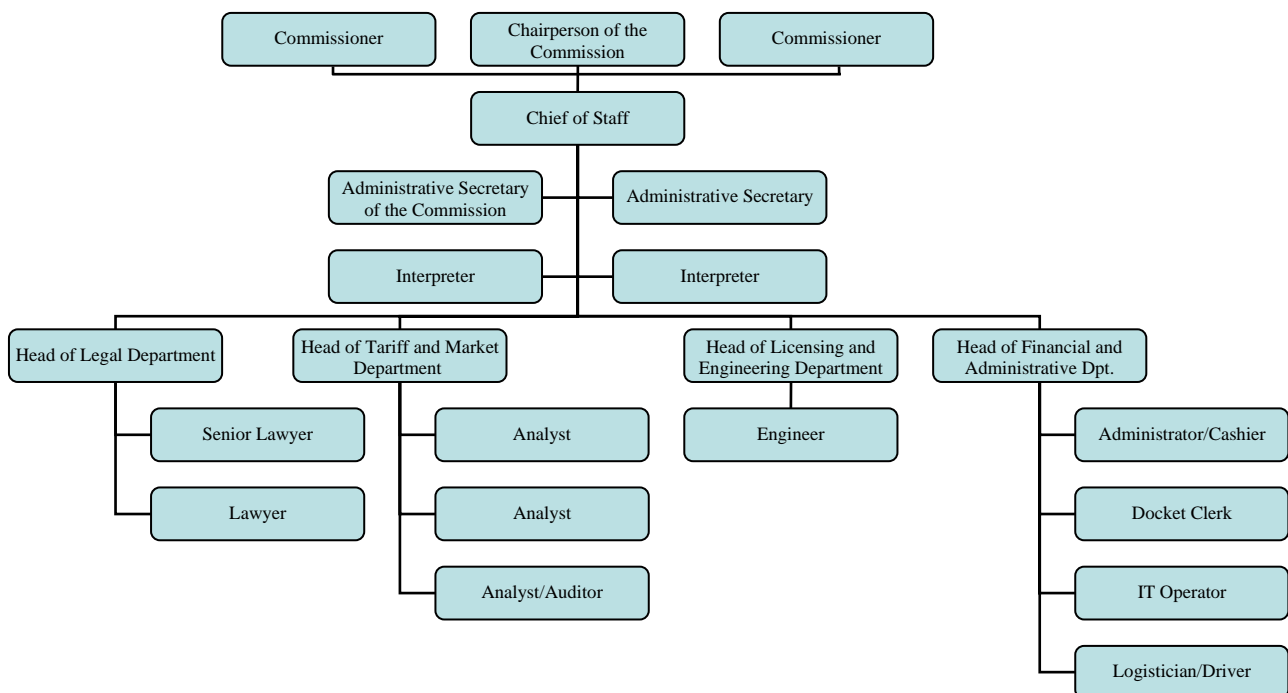


programs organized by the Energy Regulators Regional Association (ERRA) and the Florence School of Regulation (FSR) while significant support in this regard was also provided by the United States Agency for International Development (USAID). “The Energy Training Programme for South East Europe” should be mentioned here, which is organized by the Governments of the United Kingdom and Slovenia, aimed at assisting the countries in the region to transpose European legal regulations.

SERC will determine and support new training methods which are conducive to the faster development of human resources in accordance with its future needs and requirements. The competent performance of the regulatory role in the restructured electricity system and liberalized market increasingly implies also a high level of computer, communication and presentation skills of employees.

The technical equipment required for the efficient operation of the State Electricity Regulatory Commission was purchased to achieve this goal. The positive impact of this effort is supported by the fact that SERC employees were able to share their professional knowledge and experience from the regulatory practice achieved so far, with groups of employees of domestic regulatory companies and even with some regulatory authorities in the region.

ORGANIZATION CHART OF THE SERC



3. KEY ACTIVITIES

During 2007, the State Electricity Regulatory Commission held 11 regular sessions, 24 internal meetings and organized 14 public hearings, of which four hearings were formal 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 performed activities related to the adoption and approval of a range of documents and realized a number of activities of which the most important ones are divided into the areas listed below.

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

With the view to soliciting comments of interested parties and members of the public on rules and regulations, or on any other document, 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 SERC might resolve certain applications or disputes.

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

3.1 SERC Rules

Decision on Modifications and Amendments to the Tariff Pricing Methodology for Services of Electricity Transmission, Operation of the Independent System Operator and Ancillary Services

In 2005, the State Electricity Regulatory Commission set the structure and the manner of setting tariffs for the services of electricity transmission, independent system operator and ancillary services. SERC based the then-adopted tariff methodology on the traditional tariff regulation methodology ('cost of service'), in accordance with which the regulator approves a revenue requirement sufficient to cover justified costs of the regulated company's operation.

Transparent and non-discriminatory tariffs based on justified costs of operation and maintenance ('cost reflective'), reflecting regular standards of international practice, were meant to become an incentive to energy efficiency, stability of relations in the electricity market, development of regulated activities, and progress in the area of environment.

Taking into consideration the total progress in the electricity sector of Bosnia and Herzegovina (formation of a single transmission company, independent system operator, commencement of electricity market liberalization, regional activities etc.), SERC decided to subsequently change and adjust some elements with impact on tariffs for services of electricity transmission.

In order to accelerate the process of revival and development of the electricity market in Bosnia and Herzegovina, aiming to ensure priority of supply and a better position in this market to domestic customers, and intending to slow down further increases of electricity prices for end-customers, at its session held on February 22, 2007 SERC rendered the *Decision on Amendments to the Tariff Pricing Methodology for the Services*

of Electricity Transmission, Independent System Operator and Ancillary Services (“Official Gazette of BIH” No. 17/07).

3.2 Documents approved by SERC

The Rules of Connection

Having considered the current situation and the expressed need for the regulation of issues, SERC initiated the development of the *Rules of Connection*, which will regulate the connection of new users to the transmission network in a unified and clear manner. A public hearing on the draft of this document engendered much public interest and resulted in the offering of many comments and included many interesting but different views of the same matter. Having in mind that this document creates important contractual and financial obligations of some entities in the power sector, there remains a complex and responsible process of reaching clear, predictable and feasible solutions in the specifically structured sector in Bosnia and Herzegovina.

The Rules of Safety Zones

The draft of *the Rules of Safety Zones* (whose adoption is obligatory according to the Act on Transmission of Electric Power, Regulator and System Operator of Bosnia and Herzegovina) was prepared and considered by all relevant parties in the sector during a public hearing. The adoption of the Rules affects the protection of power facilities as well as the environment and population from the influence of the construction and utilization of power facilities.

The development of the Rules indicated some shortcomings, non-uniformity and nonconformity of the relevant technical regulations pertaining to the design and construction of overhead power lines on the territory of BIH. Namely, the regulations from 1998 are still applicable in practice which is a reason why an adequate contribution to the mentioned issue is expected from the national institutions competent for the issuance of technical standards.

SERC is planning to approve the Rules in the first quarter of 2008.

The Indicative Generation Development Plan and Long-Term Transmission Network Development Plan

The Indicative Generation Development Plan is developed for a ten-year period. It is updated on an annual basis and prepared

for following ten years. The goal of the plan is to inform the current and future users of the needs and existing projects for the construction of new generation capacities. At the same time, this plan is used as a basis for the development of *the Long-Term Transmission Network Development Plan* for a ten-year period.

Taking into consideration that these plans were developed for the first time in BIH, the experience gained during the preparation of the Indicative Generation Development Plan from 2007 to 2016 influenced the decision to approach the process for plan development for the period from 2008 to 2017 earlier and with far more qualitative input data, which would not only update the plan but also improve and expand the plan for one more year.

A better engagement in the plan development and especially in the provision of the necessary data by all players in the sector is of crucial importance for a better quality and applicability of the plans.

Having all this in mind, SERC also insisted on the public presentation of *the Indicative Generation Development Plan for the Period from 2008 to 2017*.

The Long-Term Transmission Network Development Plans for a Ten-Year Period are developed to actualize indicative plans and make them concrete, and they are used to further elaborate annual investment plans for “Elektroprijenos BIH” (the Company for Transmission of Electric Power). SERC approved such a plan for 2007.

The Rules of Allocation of the Right to Use Cross-Border Transmission Capacities

The opening of the electricity market in Bosnia and Herzegovina caused a need to create and develop rules which regulate the allocation of cross-border transmission capacities. International trade (export, import and transit of electricity) requires good knowledge of the points used for transactions of cross-border transmission lines by which they are performed. ISO BIH developed the rules of allocation of cross-border transmission capacities on an annual, monthly and daily basis, which precisely describe the procedure for allocation of cross-border transmission capacity to which only entities with SERC licenses to perform international trade in electricity are entitled. By its Decision No. 04-28-337-9/06 of December 13, 2007, SERC endorsed the following rules:

- *The Rules of Allocation of Cross-Border Transmission Capacities on an Annual Basis for 2007,*
- *The Temporary Rules of Allocation of Cross-Border Transmission Capacities on a Monthly Basis for the Period from 1.1.2007 to 30.6.2007.*

On June 28, 2007, SERC extended the term of temporary rules until the issuance of the new ones, which would be based on market principles (explicit auctions) and which would be consistent with European Union regulations.

Balancing Contract Standard Form

A balancing contract defines the inclusion of a market player by a balance-responsible party that must maintain a balance at any given moment between energy generation and consumption, which is important for reliable operation of the power system. The contract specifies the obligations of each individual entity, included by a balance-responsible party, from the aspect of technical and economic criteria.

SERC approved a standard form of this contract for unhindered transactions in the electricity market.

3.3 Procedures for License Issuance

During 2007, in several proceedings conducted mostly due to the expiration of the term of the previously issued *temporary* licenses, renewed, i.e., *new* licenses were issued with longer terms for the following activities and entities:

- For independent system operator activities
 - “Independent System Operator in Bosnia and Herzegovina” Sarajevo (June 2007),
- For electricity transmission activities
 - “Elektroprijenos Bosne i Hercegovine” Stock Company Banja Luka (June 2007),
- For international trade
 - Public Utility “Elektroprivreda Hrvatske zajednice Herceg Bosne” Stock Company Mostar (December 2007),
 - Public Utility Elektroprivreda Bosne i Hercegovine, Stock Company Sarajevo (December 2007),
 - Mixed Holding “Elektroprivreda Republike Srpske” – Parent Company, Stock Company Trebinje (December 2007).

In addition to the aforementioned, during the year proceedings for the issuance of *temporary* licenses to the entities that appeared for the first time in the electricity market as international electricity traders were also conducted (international trade licenses):

The entity regulatory commissions (Regulatory Commission for Energy of the Republika Srpska and the Regulatory Commission for Electricity in the 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).

- “Ezpada” Ltd. Čapljina (April 2007),
- “Birač” Stock Company Zvornik (December 2007),
- “B.S.I.” Ltd. Jajce – import of electricity for self-consumption (December 2007).

“Energy Financing Team” Ltd. Trebinje (EFT), and “Aluminij” Stock Company Mostar (import of electricity for self-consumption), were also registered as temporary licence holders for the activity of international trade in electricity as of June 2006 and November 2006 respectively.

Following an application filed by “Rudnap” Ltd. Banja Luka, the processing of the application for the issuance of temporary international trade license is in progress.

3.4 Monitoring of Activities of Licensed Entities

During the year, SERC monitored the licensed entities and compliance of their operations with the licensing conditions, especially for regulated activities performed by the ISO and Elektroprijenos BIH. Monitoring of activities is performed by analysis of regular and special reports as well as by announced or unannounced visits to license holders. License holders submit annual, semi-annual, monthly and daily reports on individual activities, of financial as well as technical and organizational character. Reports of license holders on contingency events in the system are also available.

Visits of SERC experts to regulated entities enable a direct insight in their documents and activities. On such occasions, besides monitoring the compliance of activities with licensing conditions, more demanding analysis of the operation and the financial position of the entity is carried out from the aspect of application of approved tariffs.

At its session of November 20, 2007, the State Electricity Regulatory Commission considered “The Report on Conducted Inspection of Activities and Documentation of Elektroprijenos Bosne i Hercegovine, Stock Company Banja Luka”, which had been prepared by an expert team of SERC.

The expert team report indicated an obvious division of the members of Elektroprijenos BIH management with regard to the development of the Long-Term Transmission Network Development Plan for the Period 2007-2016, but also on many other issues. The State Regulatory Commission expressed its concerns over this situation in November 2007 to the entity governments – owners, i.e., to the members of the Shareholders’ Assembly of Elektroprijenos BIH.

3.5 Tariff Proceedings for the Services of Electricity Transmission, ISO operation and Ancillary Services

On two occasions during 2007, SERC approved tariffs for the services of electricity transmission, ISO operation and ancillary services upon the requests of the regulated companies. On the first occasion, the tariffs were obliged to be applied as of May 1, 2007; on the second occasion, they were approved at the end of this year so that their application could commence as of January 1, 2008.

On both occasions, tariff proceedings were conducted in a fully transparent manner in accordance with SERC rules. Besides the regulated companies (Elektroprijenos BIH and the ISO BIH), the following companies participated in proceedings as intervenors: Public Utility Elektroprivreda BIH Stock Company Sarajevo, Public Utility "Elektroprivreda HZHB" Stock Company Mostar, Mixed Holding "Elektroprivreda RS" – Parent Company, Stock Company Trebinje and "Aluminij" Stock Company Mostar.

By SERC decision, tariffs for the services of electricity transmission (transmission fees) were determined as follows:

- The average transmission fee in the amount of 0.476 €/100 kWh (as of May 1, 2007), i.e., 0.445 €/100 kWh (as of January 1, 2008) – for declared export which shall be paid by owners of the license for international trade in electricity;
- Part of the transmission fee pertaining to energy in the amount of 0.309 €/100 kWh (i.e. 0.289 €/100 kWh) – for customers in BIH who take over electricity from the transmission network;
- Part of the transmission fee pertaining to capacity in the amount of 0.845 €/kW (i.e. 0.743 €/kW) – for customers in BIH who take over electricity from the transmission network.

Hence, by SERC's latest decisions, the transmission fee and part of the transmission fee pertaining to energy were reduced by 6.6%, while the transmission fee pertaining to capacity was reduced by 12%.

Tariffs for the operation of the Independent System Operator amounted to 0.0177 €/100 kWh as of May 1, 2007, i.e., 0.0204 €/100 kWh as of January 1, 2008 (15.3% higher than the previous tariffs).

As far as ancillary services are concerned, a dry run was in effect until December 31, 2007, during which financial settlement was not effective, but as of January 1, 2008, the following tariffs were set by *the Decision on Tariffs for Ancillary Services*: tariffs for secondary and tertiary regulation by generators, total tariff for secondary and tertiary regulation to be paid by customers and tariff for excessive take-on of reactive power from the transmission network to be paid by eligible customers.

Hence, in the first round of two tariff proceedings in 2007, SERC reduced the total tariff for the services of transmission network and the system operator by 5%, and in the second round by a further 5.8%.

In accordance with clear regulatory principles, the entity regulatory commissions (Regulatory Commission for Energy of the Republika Srpska and the Regulatory Commission for Electricity in the Federation of Bosnia and Herzegovina) conducted proceedings for tariff setting during 2007 as follows:

FERC for Elektroprivreda HZHB and Elektroprivreda BIH in April and December 2007 respectively,

REERS for Elektroprivreda RS in December 2007.

3.6 Electricity Market

Compared to the previous year, the electricity market in 2007 demonstrated some new trends. Aluminij Stock Company Mostar, whose consumption constitutes 20% of total consumption in Bosnia and Herzegovina, is the first customer that used the right to purchase some part of its required electricity in the market as an eligible customer. In the period from May to December 2007 it purchased 547.78 GWh in the market, which was around 45% of its needs during this period. Other customers did not use the option to purchase energy in the market as wholesale prices in the market of South East Europe experienced a considerable increase during this year.

Although the energy price at the largest European exchange in Leipzig (*EEX – European Energy Exchange*) fluctuated between 50-55 €/MWh, the prices in South East Europe reached the value between 75 and 80 €/MWh, due to unfavorable hydrologic conditions in 2007 and the closing down of two generating units at the Bulgarian nuclear power plant Kozloduy, which significantly reduced the offered quantities in the market, as well as due to congestion in cross-border lines at the borders to Serbia, and between Germany and Austria as well as Italy and Slovenia, congestion in the internal Romanian network, etc.

*Mr. Milorad Živković,
Chairman of the House of
Representatives of PA BIH:
"In the energy sector Bosnia
and Herzegovina is
developing a strategy which
is compatible with the global
process in the world,
especially in Europe, taking
into account its interests and
possibilities."*

*Mr. Slobodan Puhalic,
Minister of Foreign Trade
and Economic Relations of
BIH: "Our common need is
to create a stable regulatory
and market framework which
will attract investors to the
energy sector in order to
provide stable energy supply,
which is of crucial
importance for our economic
development and stability,
but also our opportunity."*

*(from the Conference on the
Electricity Market in BIH,
Neum, 13. and 14.9.2007)*

While considering the wider context of price trends in the market, it should be mentioned that there has not been almost any construction of new generation capacity in the past two decades in South East Europe, except in Greece, where a significant deficit has been mitigated by the accelerated construction of gas power plants. The cessation in construction of new generation capacities has been caused by a whole range of factors, the most important being spatial and environmental restrictions, but these problems occur with construction of transmission capacity as well.

During 2007, international trade in electricity (export and import) in Bosnia and Herzegovina is marked by a decrease compared to the previous year, which was mostly caused by low inflows and the reduction of generation by hydro power plants by almost 1800 GWh compared to the previous year.² The scope of international trade realized by the licensed entities is shown by data in the table below:

Licensed entity	2006		2007	
	Export	Import	Export	Import
EP BIH	1 143 973	1 440	1 321 022	600
ERS	1 838 594	71 618	965 714	129 254
EP HZHB	301 680	995 457	316 681	1 195 988
Aluminij				547 780
EZPADA			5 582	121 956
Total	3 284 247	1 068 515	2 608 999	1 995 578

² Basic power indicators are shown in Annex A.2

If the scope of trade in 2007 is considered at the borders with individual countries, the situation is as follows:

(MWh)

Country	Export	Import
Montenegro	861 533	27 418
Croatia	1 169 399	1 622 808
Serbia	578 067	345 352
Total	2 608 999	1 995 578

It should be observed that as of January 1, 2007, all end-use customers with annual electricity consumption higher than 10 GWh have the option of acquiring eligible customer status (the level of market opening is 33%). According to the following time schedule for market opening, this option must be available to:

- All customers, except households, as of January 1, 2008 (market opening of 57.5%),
- All customers as of January 1, 2015.

Pursuant to the relevant documents of the entity regulatory commissions, the transition period during which all customers are entitled to choose the manner of supply (as tariff or eligible customers) shall last until January 1, 2012.

The creation of a single market will be significantly supported by mutual standardization and compatibility of conditions and criteria that are to be implemented by the competent regulatory commissions as binding in the process of the market liberalization. Therefore, SERC will continue to monitor this process and analyze all its impacts.

“Taking into account that Bosnia and Herzegovina will have to harmonize its electricity prices with the countries in the region, it is suggested that the Council of Ministers of BIH, the Government of the Federation of BIH and the Government of BIH the Republika Srpska, in cooperation with the Regulatory Commission for Electricity in the Federation of BIH and the Regulatory Commission for Energy of the Republika Srpska, prepare a program for the protection of vulnerable categories in order to protect them.”

(from the Conclusions of the 5th session of the House of Representatives of the Parliamentary Assembly of BIH of March 15, 2007)

3.7 Customer Protection

Customer protection is an important issue of regulatory policy in all countries where the process of deregulation and liberalization of the power sector is in progress. To this end, regulatory authorities are even more responsible in the open electricity market to consider and achieve the main goals of customer protection, protection of power entities and the environment through a transparent and impartial solution to the issues occurring in the regulatory field.

As mentioned in the previous section, in the past few years electricity prices in Europe have been increasing steadily, which is caused by the supply and demand imbalance in the market. It is estimated that the trend of price increases will continue in the forthcoming period as well. *Attachment B* contains benchmarking data on electricity prices for households and industrial consumers in Europe, according to the Eurostat methodology, on typical days (July 1, 2006 and January 1, 2007).

The subsidizing of the most vulnerable energy consumers has become a widely accepted practice; consequently, it is expected

Eurostat 80/2007: “Between January 2006 and January 2007 electricity prices in the EU-27 increased by 9% for both households and industrial customers*.”*

Eurostat 18/2006: “Electricity prices in the European Union in July 2006 compared to July 2005 are 7% and 15% higher for households and industrial customers respectively.”

** In the Eurostat methodology a few categories of typical customers are defined, and benchmarking data are usually provided for the household category Dc, with annual consumption of 3500 kWh, of which 1300 kWh during night hours, and industrial customer Ie with annual consumption of 2 GWh and maximum capacity of 500 kW.*

in BIH as well. The main problems here are the identification of subsidy beneficiaries, the level of subsidization, funds and the manner of implementation. Lack of initiative and coordination has been the major shortcoming of up-to-date activities related to the provision of assistance to the most vulnerable categories of consumers of electricity and other energy sources. It seems logical that the main initiators of these activities would be the ministries competent for social protection with the support of other competent authorities, including the regulatory commissions.

SERC will actively participate in all activities related to the protection of vulnerable electricity customers and provide an adequate contribution within the authority vested in it by law.

In 2007, SERC continued to make efforts to protect electricity customers, especially vulnerable categories of the population, by active participation in all initiatives of the institutions at the state level and the preparation of Module 7 of the Energy Sector Study in BIH (*Support to Vulnerable Electricity Consumers*), as well as by following up and participating in regional activities, among which it is to be singled out the preparation of *the Best Practice Guidelines on the Protection of Vulnerable Household Customers* and the signing of *the Memorandum of Understanding on Social Issues with the Context of Energy Community* (see Chapter 4.1).

3.8 Other Issues

Energy Sector Study in BIH

Activities on the development of *the Energy Sector Study in BIH* commenced in November 2006. Based on historical and empirical indicators starting from 1990 and scientific findings, this Study will be a good basis for an energy balance projection to 2020. The Study will also comprise an analysis of all power sub-sectors, including an assessment of the investments required. Additionally, the Study is expected to define recommendations for an efficient integration of BIH into the EU power sector.

According to the Terms of Reference for the development of the Study and the Terms of Reference for TASED (Strengthening of the Energy Department at the Ministry of Foreign Trade and Economic Relations of BIH), the BIH Energy Strategy Project should be based on the Energy Sector Study in BIH. Furthermore, entity energy strategies will also be developed based on the Study in accordance with the agreement from October between the relevant state and entity energy ministries.

After the submission of the draft final report in January 2008, the Ministry of Foreign Trade and Economic Relations of BIH,



“It is necessary to complete the Energy Sector Study in BIH as soon as possible, consequently, it is suggested to the Council of Ministers of BIH, the Government of the Federation of BIH, and the Government of the Republika Srpska to draw up an energy sector development strategy based on the Study as well as development opportunities of Bosnia and Herzegovina.”

(from the Conclusions of the 5th session of the House of Representatives of the Parliamentary Assembly of BIH of March 15, 2007)

which coordinates the activities related to the Study, plans to have three two-day topical seminars as follows:

- Natural gas, central heating, oil and issues related to investment programs related to these sectors (Sarajevo),
- Electricity, coal, renewables and issues related to investment programs (Banja Luka),
- Energy safety, environmental feasibility and implications for the investment programs (Mostar).

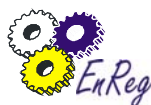
The completion of the activities related to the Study is expected in the first quarter of 2008.

USAID Project: Regulatory and Energy Assistance Project – REAP



The key areas of support within this project, which will last from 2007 to 2011, are as follows: (i) continuous support to the Independent System Operator in BIH, including further development of the Grid Code and the Market Rules with further integration of BIH market into the regional and internal EU markets pursuant to the obligations from the Treaty Establishing the Energy Community, (ii) Monitoring of and assistance with the implementation of action plans, and (iii) Further assistance with the unification of regulations, including the completion of all activities pertaining to the development of a new gas law and necessary modifications of the state and entity electricity laws.

European Commission Project: Technical Assistance to the Energy Regulation System of BIH – EnReg



The project aim is to strengthen the institutional and professional capacity of the three regulatory commissions, to improve the effectiveness of the existing regulatory system performance and to facilitate BIH compliance with the obligations from the Treaty Establishing the Energy Community.

Key areas of support from the project are connected to the quality of supply, connection issues, market monitoring and opening, as well as incentive regulation. Furthermore, the project will assist the Commissions in establishing a regulatory system for the gas sector, adequate treatment of renewable energy as well as enhancement of the staff performance in accounting and financial issues.

4. INTERNATIONAL ACTIVITIES

4.1 Energy Community



The Treaty Establishing the Energy Community, which was signed in Athens on October 25, 2005, and came into effect on July 1, 2006, provides for the creation of the biggest internal market in the world for electricity and gas, with effective participation of 34 parties: 27 members of the European Union and Albania, Bosnia and Herzegovina, Croatia, Macedonia, Montenegro, Serbia and UNMIK Kosovo.

The main goals of the Treaty are the creation of a stable and single regulatory framework and market space that ensures reliable energy supply and attracts investments in the electricity and gas sectors. In addition, it assumes the development of alternative sources of gas supply and improvement of the condition of the environment, with the implementation of energy efficiency and the utilization of renewable sources.

By signing 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 the EU energy market with which it will integrate. It is to be achieved by gradual transposition of the EU *Acquis Communautaire* pertaining to energy, environment and competition, which means the implementation of the relevant EU directives and regulations pertaining to energy and environment.

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

It is important to note that the following countries are in the process of joining the Energy Community: Georgia, Moldova, Norway, Turkey and Ukraine, which, at the time of the creation of this report, have observer status.

In accordance with the interest expressed, the following countries participate in the work of the Energy Community bodies: Austria, Bulgaria, Czech Republic, Cyprus, France, Germany, Greece, Hungary, Italy, the Netherlands, Romania, Slovakia, Slovenia and the United Kingdom. These fourteen countries, the so-called Participants from the European Union, directly participate in the work of the Energy Community bodies, and in the voting procedure their positions are expressed by votes of the European Commission.

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 (Maribor Forum) and the Secretariat.

The Presidency of Bosnia and Herzegovina adopted the Decision on Ratification of the Treaty Establishing the Energy Community on July 27, 2006 ("Official Gazette of BIH – International contracts" No. 9/06).

Acquis communautaire taken over by signing of 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 July 1, 2007, 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. By the decision of the Energy Community Ministerial Council of December 2007, acquis on energy (Articles 10 and 11 of the Treaty) has been expanded by:

- Directive 2005/89/EC of the European Parliament and of the Council of 18 January 2006 concerning measures to safeguard security of electricity supply and infrastructure investment; implementation - December 31, 2009
- Council Directive 2004/67/EC of 26 April 2004 concerning measures to safeguard security of natural gas supply; implementation - December 31, 2009
- Regulation 1775/2005/EC of the European Parliament and of the Council of 28 September 2005 on conditions for access to the natural gas transmission networks; implementation - December 31, 2008

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 ($\geq 50\text{MW}$); 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 the *acquis* on renewable energy sources by July 1, 2007.



The Ministerial Council, as the highest body of the Energy Community, ensures the achievement of goals that are determined by the Treaty Establishing the Energy Community. The Ministerial Council consists of one representative of each Contracting Party and two representatives of the European Union.

At its meeting held in December 2007, the Ministerial Council stressed that the implementation of the *acquis* taken over by the Treaty was the priority in the Energy Community work. In this context, significant progress in the past period had been stressed, as well as the need to accelerate the implementation of the measures required to meet the remaining obligations, in accordance with the Road Maps of individual countries for the energy market reform.³

After the first Conference on the Social Aspect of the Energy Community had been held on October 18, 2007 and the *Memorandum of Understanding on Social Issues within the Context of Social Community* signed, the Work Program of the Ministerial Council for the forthcoming two years put a special emphasis on further development of the social dimension.

Rational and reliable electricity and gas supplies are a basis of modern economic and social life. The establishment of a single energy market, which is the final goal of the Energy Community process, will generally improve working conditions and the living standard. As a result of the liberalization and de-regulation process, the legal and institutional framework, the tariff and pricing policy undergoes substantial changes. If concomitant measures are not undertaken, the reform process can have a negative impact on everyday life.

Discussions on the social dimension have accompanied the Energy Community process from the outset. The Treaty establishing the Energy Community centres among others on the implementation of the EU energy Directives 2003/54 and 2003/55. According to Article 3 of the two Directives, the Contracting Parties must protect final customers and “*in particular ensure that there are adequate safeguards to protect vulnerable customers.*”

³ With a view to meet all remaining obligations by July 1, 2008, a detailed Road Map of Bosnia and Herzegovina will be made at the beginning of 2008. Unlike the electricity sector which is in compliance with the EU *acquis* to a great extent, the gas sector of BIH is only starting the process of reform.

The Social Conference brought together high level energy and social policy officials, union representatives, energy and gas companies and other stakeholders from the Contracting Parties and Observers to the Treaty.

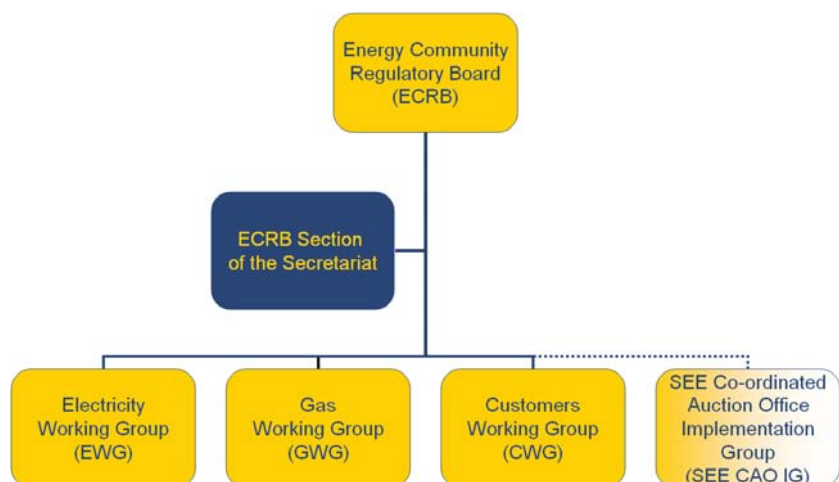
Recognising the pressing need of a regular platform for dialogue, it was proposed that the Conference on Social Issues should be organised on an annual basis. In view of this, the Ministerial Council supported the establishment of the Social Forum as a special annual event.

The work of the State Electricity Regulatory Commission in this field was carried out with the 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 different groups which include energy regulators from the region and the European Union.



The Energy Community Regulatory Board (ECRB), seated in Athens, is comprised of representatives of the regional state regulatory bodies, and the European Union is represented by the European Commission, with the assistance of one regulator of the EU participants and one representative of the European Energy Regulators Group for Electricity and Gas (ERGEG). ECRB considers the issues of regulatory cooperation and may become a body issuing regional regulatory decisions and serving as a dispute resolution institution. The Regulatory Board has a key role in the expanded market operation. According to the opinion of the European Commission, this supranational body may become a role model for other parts of the world.

The formal establishment of the Regulatory Board of the Energy Community, in which Bosnia and Herzegovina was represented by the State Electricity Regulatory Commission, took place on December 11, 2006 in Athens. During 2007, the Regulatory Board held three meetings.



From the structure of the Regulatory Board provided in the previous organigram, it is obvious that some ECRB activities are organized through several working groups with the support of the relevant Energy Community Secretariat Section. The State Electricity Regulatory Commission continuously participates in the work of the Regulatory Board and working groups, while the Customers Working Group is chaired by a SERC representative.

During 2007, **the Electricity Working Group (EWG)** was focused on the monitoring and integration of ICT mechanism of European Union countries and countries of South East Europe (see Chapter 4.7), monitoring of the congestion management mechanism – simulation of coordinated auctions based on real time flows, establishment of the regional balancing mechanism in reference to the harmonization of national legal frameworks, issues of regional market design taking into account the development of national electricity markets, support mechanisms for generation capacities, proposals to harmonize market rules and the opening of wholesale markets, regional planning of transmission network development and creation of a market monitoring mechanism.

EWG prepares overviews of the regulatory environment, identifies legal and financial obstacles and proposes solutions at regional and national levels for the implementation and functioning of new mechanisms within the regional market of South East Europe. The area of activities of the Working Group requires a wide range of skills including technical, legal and financial issues.

During 2007, **the Gas Working Group (GWG)** prepared a Study on the regional gas market and regulatory practices, worked on the development of draft guidelines for new gas infrastructure and investments and contributed to the development of the comprehensive Gasification Study of South East Europe, which was financed by the World Bank and KfW Development Bank (on behalf of the German Government).

It should be noted that the gas market in South East Europe is less developed than the electricity market. Only a few countries have developed their gas markets, while the others use gas within a limited scope or not at all. Currently there is a large number of projects aimed at regional gas market development.

The 1st Gas Forum (Maribor Forum) held in November 2007, welcomed the results achieved by the Group so far and supported its further work.

In the forthcoming period, GWG plans, *inter alia*, to prepare non-discriminatory and transparent methodologies for tariff setting, capacity allocation and procedures for congestion management, rules of access, continue activities on the preparation of common regulatory guidelines for new gas infrastructure, and elaborate proposals for mutual recognition of licenses.

In 2007, the **Customers Working Group (CWG)** identified as its key activity the development of the *Best Practice Guidelines on the Protection of Vulnerable Household Customers*. In order to present them to the Ministerial Council, ECRB submitted the Guidelines to the Permanent High Level Group which accepted them as useful reference material.

The development of the Guidelines was preceded by an extensive regional analysis of the current situation in transitional markets (electricity, gas and heating) as well as different aspects of customers' protection and assistance to vulnerable categories of the population.

A non-tariff based solution is set forth by the Guidelines as an optimal solution, taking into consideration that this approach would not distort the market, but assuming the existence of functional social welfare systems. As an option for a short transitory period, the Guidelines elaborated on solutions based on the introduction of a special regulated tariff for an identified customer group.

The Customers Working Group will continue its activities in 2008 aimed at the implementation of the Guidelines alongside the quality of supply analysis, tariff methodologies and transparency of prices, taking into account the issues of energy efficiency from the regulatory domain.

The South East Europe Co-ordinated Auction Office Implementation Group (SEE CAO IG) is comprised of representatives of regulatory authorities and transmission system operators, with regulators having a leading role. This composition takes into account the fact that continuous and close cooperation between regional system operators and regulators is required to deal with the issues of coordinated auctions.

During 2006 and 2007, monthly simulations of a uniform *coordinated explicit capacity auction mechanism* in South East Europe were conducted in order to overcome congestion problems at interconnectors. The joining of electricity traders during the dry-run in 2007 improved auctions considerably and made the test results more relevant.

The establishment of the Coordination Auction Office is of major significance for further expansion of opportunities in international trade, since the current allocation method has become a limitation factor to further market development. According to the Action Plan, the establishment of the Office is expected by February 2009, by which time several pending issues need to be resolved, including the method of revenue allocation and timely definition of participant countries and the regional borders that will be covered by the Office.

4.2 ERRA



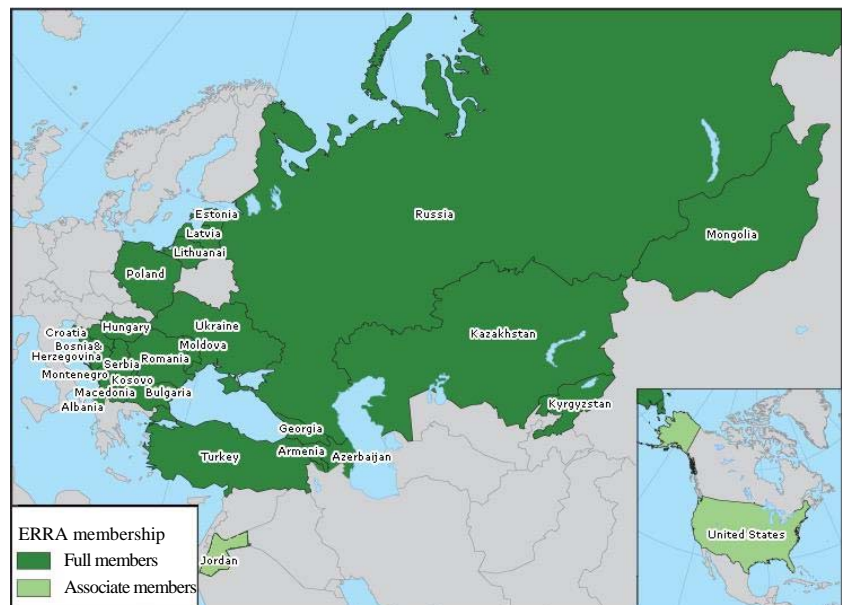
The goals of ERRA are improvement of energy regulation in the member countries, development of independent and stable energy regulators, improvement of cooperation among regulators, exchange of information, research and experience among the members, better access to energy regulatory information and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

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 23 full and 3 associate members, all established at the national level. In addition, 3 affiliate members are engaged in ERRA activities, including the National Association of Regulatory Utility Commissioners (NARUC).

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.

The most important topics elaborated in 2007 include the simplification of wholesale licensing, analysis of options for mutual licensee recognition, international cooperation of regulators in projects for cross-border transmission capacity development and the setting of connection fees for distribution and transmission network.

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.





4.3 CEER

The Council of European Energy Regulators (CEER) was established in March 2000, when ten national EU regulatory authorities signed the Memorandum of Understanding on the CEER Establishment. Today CEER comprises 29 national regulators (27 from the European Union and two from the European economic space – Iceland and Norway).

A strategic goal of CEER is the creation of single competitive efficient and sustainable gas and electricity market in Europe, in which mutual cooperation of regulatory authorities and cooperation with EU institutions present the main mode of operation. Besides coordinated activities with ERGEG, CEER cooperates with a similar association in America (NARUC) and Central and Eastern Europe (ERRA). CEER has an important role in the development of efficient and competitive electricity and gas market in South East Europe.

4.4 ERGEG



Membership in the European Energy Regulators Group for Electricity and Gas (ERGEG) is open to EU regulators, and observer status may be acquired by regulatory authorities from the member countries of the European economic space.

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 cooperation of regulatory authorities with the European Commission.

The work of ERGEG, a body established at the end of 2003 by the European Commission's decision, is open to all market participants, in particular to end-customers.

4.5 International Energy Regulation Network - IERN



International Energy Regulation Network – (IERN) is a web platform (www.iern.net) that aims to facilitate information exchange on electricity and natural gas market regulation, to the benefit of regulators, but also of other interested users. Through IERN, regulators and other energy market stakeholders exchange information about themselves, the sectors they are involved in and the way these sectors are regulated.

IERN is also a place where regulators can exchange information about training courses, conferences and online resources on energy regulation. Longer term, IERN aims to become not only

a vector for exchanging existing information, but also a producer of in-house working papers on best practices.

In order to guarantee the quality of the data to be found in the website, IERN is supported by the main regional associations of regulators worldwide, individual energy regulators and by some international institutions. SERC directly participated in the creation of the Network, which made the data on the power sector and regulatory practice in BIH accessible in this manner as well.

4.6 MEDREG



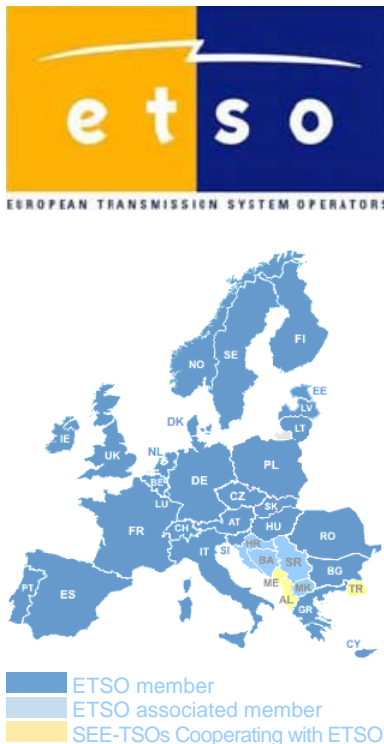
The Mediterranean Working Group on Electricity and Natural Gas Regulation-MEDREG is a working group created in Rome in May 2006. MEDREG is supported by the European Commission, the Italian Energy Regulator and the ministry competent for energy, and it comprises 23 regulatory authorities coming from Albania, Algeria, Bosnia and Herzegovina, Croatia, Cyprus, Egypt, France, Greece, Italy, Israel, Jordan, Lebanon, Libya, Malta, Montenegro, Morocco, the Palestinian Authority, Portugal, Slovenia, Spain, Syria, Tunisia and Turkey.

The main objective of MEDREG is to promote a stable, harmonized regulatory framework in the Euro-Mediterranean energy market, providing the maximum benefits to energy consumers in both regions.

Moreover, MEDREG fosters co-operation, information exchange and assistance among members providing a framework for discussion.

On November 15, 2007, the authorized SERC representative together with representatives of the Mediterranean regulators signed the Constitutional Act of MEDREG in Rome, which marked the commencement of the operational work of the Association. MEDREG will closely cooperate with the Rome Euro-Mediterranean Energy Platform (REMEP), enhancing the consolidation of permanent institutional relationship between the two Associations with a positive impact on electricity and gas markets in the region.

4.7 Inter-TSO Compensation Mechanism (ITC Mechanism)



The mechanism of inter-TSO compensation (ITC mechanism) has been implemented in Western Europe since 2002, and in South East Europe since 2004, under 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 the implementation of the mechanism, which involves the implementation of 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.

By the end of May 2007, the Organization of the South East Transmission System Operators (SETSO), in which Bosnia and Herzegovina was represented by the Independent System Operator in BIH, implemented the ITC mechanism for the countries in the region of South East Europe. In June 2007, the planned merger of ITC mechanisms, i.e., the ITC funds, of SETSO and ETSO countries took place, which brought together 29 countries within a single ITC mechanism. The “Independent System Operator in BIH,” as a representative of Bosnia and Herzegovina, is an associated member of the Organization of European Transmission System Operators (ETSO) since November 2006.

Due to its geographic position as a transit country in the region and the structure of the transmission network, Bosnia and Herzegovina realizes regular revenue based on the ITC mechanism implementation. In the first five months of 2007, through the SETSO mechanism the revenue amounted to €56 533, and following the merger of ITC mechanism in Europe, only in June 2007 the revenue amounted to €1 112 326. Expecting this trend to continue, ISO BIH estimated total revenue of Bosnia and Herzegovina in 2007 to be €5.47 million and in 2008 the amount of €5.83 million.

In October 2007, following SERC approval, the “Independent System Operator in BIH” signed the Agreement on the ITC Mechanism for 2008 and 2009, which defines the continuation of functioning of a single ITC mechanism of the European countries.

Close and continuous cooperation between the regional system operators and regulators is required in order to treat the issues of ITC mechanism in an appropriate manner.

4.8 UCTE



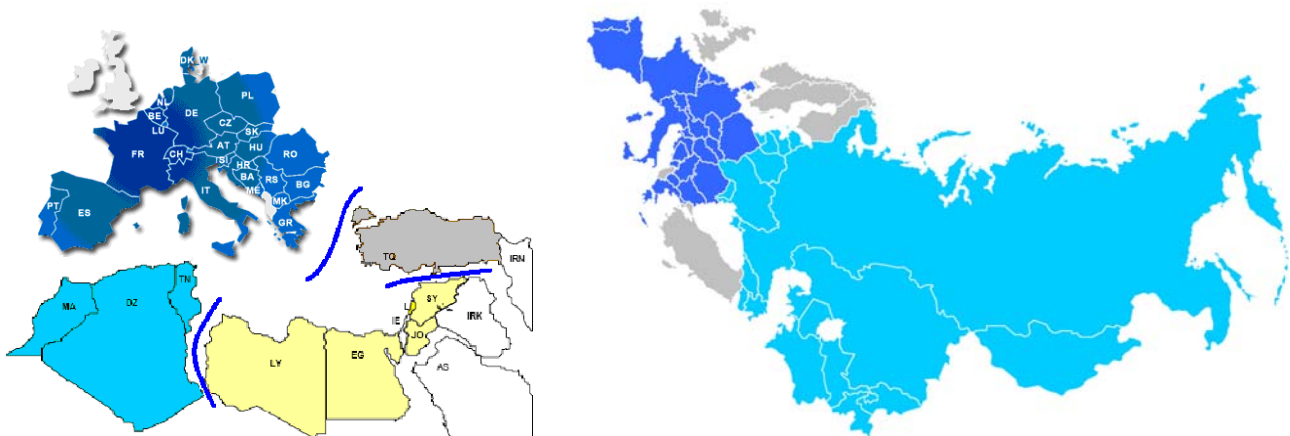
The UCTE member from our country is the Independent System Operator in BIH.

The Union for the Coordination of Transmission of Electricity (UCTE) coordinates the operation and development of the electricity transmission network from Portugal to Poland and from the Netherlands to Romania and Greece. UCTE, an association of transmission system operators in 24 European countries provides a reliable market platform for all participants in the internal electricity market and beyond, i.e., provides security of electricity supply for more than 450 million people in one of the biggest electricity synchronous interconnections world-wide.

After the European electricity market liberalization, which significantly increased cross-border flows and unbundling of activities in the sector, there is a need for European standards of security and reliability to become applicable for all interconnected system operators, and at a later stage, for all network users.

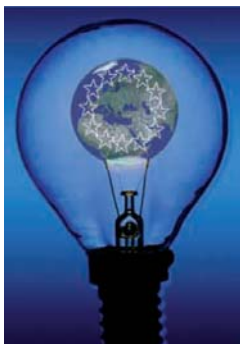
As pointed out in previous annual reports, on October 10, 2004, reconnection of the former first and the second UCTE synchronous zones was completed. Reconnection has had important technical and commercial effects, contributing to increased operational safety, frequency stability and reliability, improvement of the 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 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, in the first place, refers to the area of Turkey, then to interconnection of Maghreb countries (that are already in the synchronous operation with UCTE), with Libya and the East Mediterranean, and to the IPS/UPS system, which includes the Baltic countries (Latvia, Lithuania, Estonia) and Armenia, Azerbaijan, Belorussia, Georgia, Kazakhstan, Kirgizstan, Moldova, Russia, Tajikistan, Ukraine and Uzbekistan.



UCTE, expansion plans: Turkey and the Mediterranean ring (left) and integration with IPS/UPS (right)

4.9 The 3rd Package for Energy Market Liberalization



Mr. José Manuel Barroso, President of the European Commission: “Energy is a driving force of economy... If a company owns the transmission system and sells electricity and gas, then it can ensure that its competition does not have equal access to the network.”

Mr. Andris Piebalgs, European Commissioner for Energy: “To ensure success of the 3rd energy market liberalization package it is necessary to ensure independence of energy regulators from their governments and to enhance their competences.”

From the statements on the announcement of the 3rd package, Brussels, September 19, 2007

Some ten years after the European Union decided to open its electricity market, following the January proposal for new European energy policy measures, in September 2007, the European Commission published the 3rd energy package proposals for market liberalization.

The result of major shortcomings of the applicable legislation and regulatory framework (difficult entrance of new companies, disharmonized competencies of national regulators, difficult compliance of a large number of operators and regulators on issues of common interest, lack of adequate rules on transparency and access to information...) is the fact that vertically-integrated companies have dominant roles in national markets, which increases price regulation and prevents competition. Maintaining the practice of price regulation distorts the market and discourages investment in new sources as well in other infrastructure, and endangers long-term security of supply.

The 3rd package of measures has been designed to remove these structural shortcomings. This comprehensive and detailed set of documents elaborates the following areas:

- Unbundling,
- Competences and independence of national regulators,
- Cooperation between national regulators and transmission system operators
- Security of supply and customers protection.

The first item caused most discussions in the EU. The January proposal identified ownership unbundling as an optimal solution, which was supported by the EU Parliament and ERGEG. In the 3rd package, the European Commission kept this solution as preferred, but reflecting the initiative of the EU Council, an alternative to this proposal was introduced, according to which the vertically-integrated entity keeps the ownership, but the network management is given to a fully separated independent company – to the so-called ‘deep’ independent system operator.

The goal of the package is not to establish an ideal organization of national energy markets, but to develop supranational regional markets, and subsequently the European energy market. Hence, in addition to the strengthening of competences and independence of national regulators, the need of institutional enhancement of their cooperation is identified through the establishment of an EU Agency for the Cooperation of Energy Regulators.

Institutional enhancement is also stipulated in the part pertaining to the formal establishment of transmission operators’ organization, with a clear mandate and responsibility for

proposing ten-year investment plans and the development of technical rules required for the internal market which are approved by the European Agency. It should be stressed that this Agency is neither a substitute for national regulators nor a European regulator.

The 3rd liberalization package also includes a range of measures pertaining to security of supply, the development of new technologies, improvement of energy efficiency, environment protection, transparency, strengthening the customers' role at the energy market and their adequate protection.

According to some optimistic assessments, the 3rd liberalization package, i.e., the drafts of new directives would be presented to the European Parliament, and if accepted, they would become a part of *EU acquis* at the end of 2008, during the French Presidency of the European Union.

5. AUDITING REPORT



“The financial reports of the Commission for 2006 realistically and objectively show its financial standing on December 31, 2006 in all relevant material aspects.”

(the Office for Auditing of the Institutions of Bosnia and Herzegovina, May 17, 2007)

Pursuant to the Act on Transmission of Electric Power, Regulator and System Operator of BIH, the State Electricity Regulatory Commission is obligated to prepare accounting reports in accordance with international accounting standards, audit them, and publish the report of an independent auditor on the auditing performed, with a view to provide information to interested persons and a wider public. The Auditing, Accounting and Consulting Company “REVIK” Ltd. Sarajevo has audited the reports so far, in accordance with the International Accounting Standards (IAS) applicable to the auditing of financial reports.

In 2006, the auditing of SERC financial reports was performed for the first time by the Office for Auditing of the Financial Operations of the Institutions of Bosnia and Herzegovina in accordance with auditing standards of the International Organization of Supreme Audit Institutions (*INTOSAI*).

Having found no relevant material mistakes, the Office for Auditing of the Institutions of Bosnia and Herzegovina affirmatively appraised the compliance of performance of all controlled activities with laws and regulations, and satisfactory functioning of the established system of internal control.

These auditing results of the Office for Auditing of the Institutions of Bosnia and Herzegovina put the State Electricity Regulatory Commission among the five institutions of Bosnia and Herzegovina whose financial results were positively assessed.

“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, 2006, business results and cash flows for the period of time concluded at that point, in accordance with the International Financial Reporting Standards (“IFRS”).

(“REVIK”, March 29, 2007)

In accordance with the previously concluded contract, the financial reports were also audited by the “REVIK” Company Ltd. Sarajevo.

Through the conducted audit, this independent auditor, evaluating the overall presentation of the financial reports, recognizing and measuring transactions and business occurrences, also determined that the SERC financial reports for 2006 objectively and authentically present the state of play of assets, liabilities, capital and financial results of performance.

The Auditing Reports of the Office for Auditing of the Institutions of Bosnia and Herzegovina and the “REVIK” Company Ltd. Sarajevo were published in the “Official Gazette of BIH” as well as on the web-sites of the Office for Auditing and SERC.

6. MAIN ACTIVITIES IN 2008

The State Electricity Regulatory Commission will continue its activities on the 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 and the rules of the internal electricity market.

Through its activities SERC will be focused on:

- Setting of tariffs,
- Issuance of licenses,
- Monitoring of licensed entities,
- Analysis of regulatory rules and practice,
- Creation of regulatory rules
- Design of a single electricity market,
- Developing the social aspect within the field of regulatory practice,
- Monitoring the implementation of the ITC mechanism and establishment of the mechanism for coordinated explicit capacity auctions,
- Sharing information on regulatory practice with the regulated entities and the public.

SERC will also focus on the activities of international bodies pertaining to the regulation of the electricity market, primarily those in whose activities SERC participates: the Energy Community Regulatory Board, ERRA, MEDREG and IERN.

Furthermore, SERC will continue to follow the work of CEER and ERGEG, as well as the analysis of the content and activities related to the adoption of the 3rd Package for Energy Market Liberalization, taking into account the fact that the new energy directive will be a part of the *EU acquis* and as such will become mandatory for Bosnia and Herzegovina through the Treaty Establishing the Energy Community.

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.

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

(data used provided by ISO BIH, public power utilities and the Company for Transmission of Electric Power of BIH)

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 (BIH+Hr.)	2×108	216
Čapljina	2×210	420
Rama	2×80	160
Jablanica	1×25+5×30	175
Grabovica	2×57	114
Salakovac	3×70	210
Mostar	3×24	72
Jajce I	2×30	60
Jajce II	3×10	30
Bočac	2×55	110
Višegrad	3×105	315
Peć-Mlini	2×15	30

Thermal power plants	Installed capacity (MW)	Available capacity (MW)
TUZLA	715	635
G3	100	85
G4	200	182
G5	200	180
G6	215	188
KAKANJ	450	398
G5	110	100
G6	110	90
G7	230	208
GACKO	300	276
UGLJEVIK	280	250

Basic data on the transmission system

transmission lines

No.	Nominal voltage of transmission lines	Length (km)
1	400 kV	864.73
2	220 kV	1525.50
3	110 kV	3888.82
4	110 kV - kablovski vod	31.35

interconnectors

No.	Nominal voltage of transmission lines	No. of interconnections
1	400 kV	4
2	220 kV	10
3	110 kV	22
	Ukupno	36

transmission sub-stations

No.	Type of sub-station	No. of substations	Installed capacity (MVA)
1	TS 400/x kV	9	5924.5
2	TS 220/x kV	7	1427.0
3	TS 110/x kV	119	4693.5

transformers

No.	Transmission ratio of transformers	No. of transformers	Installed capacity (MVA)
1	TR 400/x kV	14	4900
2	TR 220/x kV	14	2100
3	TR 110/x kV	219	5045

ATTACHMENT A.2: Basic Power Indicators in Bosnia and Herzegovina

(GWh)

Estimate for 2007	EP BIH	ERS	EP HZHB	Brčko District BIH	BIH
Generation	6605.00	4430.00	1220.00		12255.00
Gen. in hydro power plants	1120.00	1780.00	1220.00		4120.00
Gen. in thermal power plants	5395.00	2605.00			8000.00
Gen. in small and industrial PPs	90.00	45.00			135.00
Consumption	4410.00	3286.00	3341.00	290.00	11657.00
Distribution consumption	3840.00	3040.00	1275.00	290.00	8445.00
Transmission losses					330.00
Large consumers	570.00	195.00	2055.00*		2820.00
Pumping and mines consumption		51.00	11.00		62.00

* Including the amount of 547.78 GWh which the "Aluminij" Company purchased as an eligible customer.

Realization in 2006	EP BIH	ERS	EP HZHB	Brčko District BIH	BIH
Generation	6401.13	5390.49	1883.55		13675.17
Gen. in hydro power plants	1488.03	2528.13	1883.55		5899.71
Gen. in thermal power plants	4811.56	2802.50			7614.06
Gen. in small and industrial PPs	101.54	59.86			161.40
Consumption	4265.62	3309.89	3352.60	252.60	11491.81
Distribution consumption	3722.72	3061.31	1279.49	252.60	8316.12
Transmission losses					311.10
Large consumers	542.90	199.50	2053.79		2796.19
Pumping and mines consumption		49.08	19.32		68.40

Realization in 2005	EP BIH	ERS	EP HZHB	Brčko District BIH	BIH
Generation	5778.53	5200.64	1768.69		12747.86
Gen. in hydro power plants	1477.69	2747.10	1768.69		5993.47
Gen. in thermal power plants	4218.88	2384.44			6603.32
Gen. in small and industrial PPs	81.97	69.10			151.07
Consumption	4190.57	3458.33	3469.83	252.47	11371.20
Distribution consumption	3641.86	3254.65	1232.47	252.47	8128.98
Transmission losses	163.78	136.47	83.72		383.97
Large consumers	384.93	20.77	2133.31		2539.01
Pumping and mines consumption		46.43	20.33		66.76

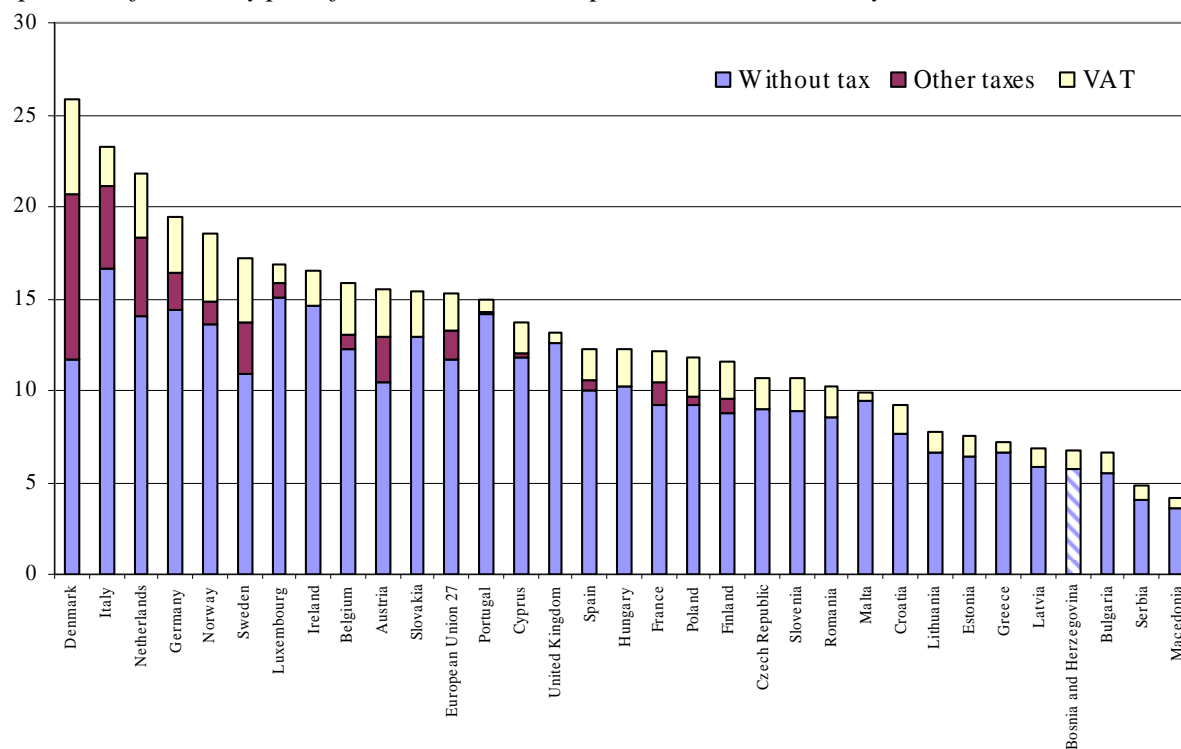
Realization in 2005	EP BIH	ERS	EP HZHB	Brčko District BIH	BIH
Generation	6113.02	4960.19	1669.49		12742.70
Gen. in hydro power plants	1610.52	2699.14	1669.49		5979.15
Gen. in thermal power plants	4435.17	2189.87			6625.04
Gen. in small and industrial PPs	67.33	71.18			138.51
Consumption	3847.00	3291.60	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

ATTACHMENT A.3: Map of the Power System of Bosnia and Herzegovina with Operational Areas of “Elektroprijenos BIH” (the Company for Transmission of Electric Power in BIH) and Areas of Public Utilities (December 2007)

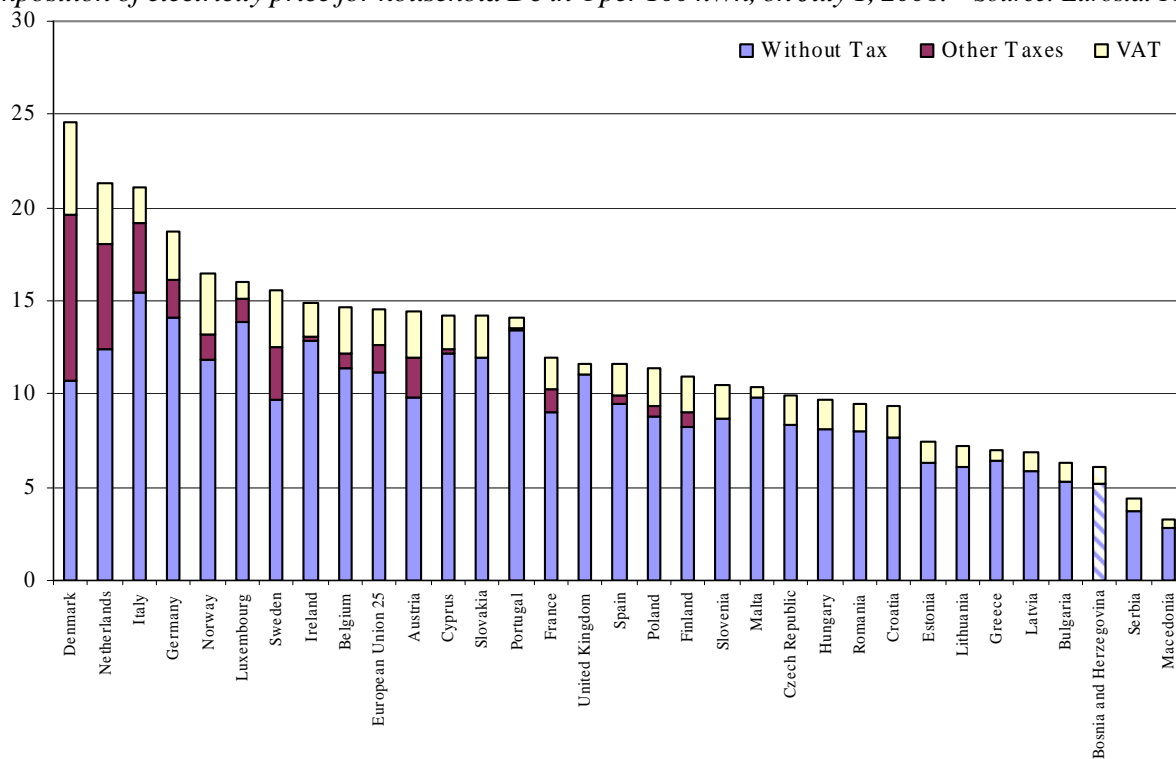


ATTACHMENT B: Benchmarking Data on Electricity Prices for Households and Industrial Consumers⁴

Composition of electricity price for household Dc in € per 100 kWh, on January 1, 2007 Source: Eurostat 80/2007



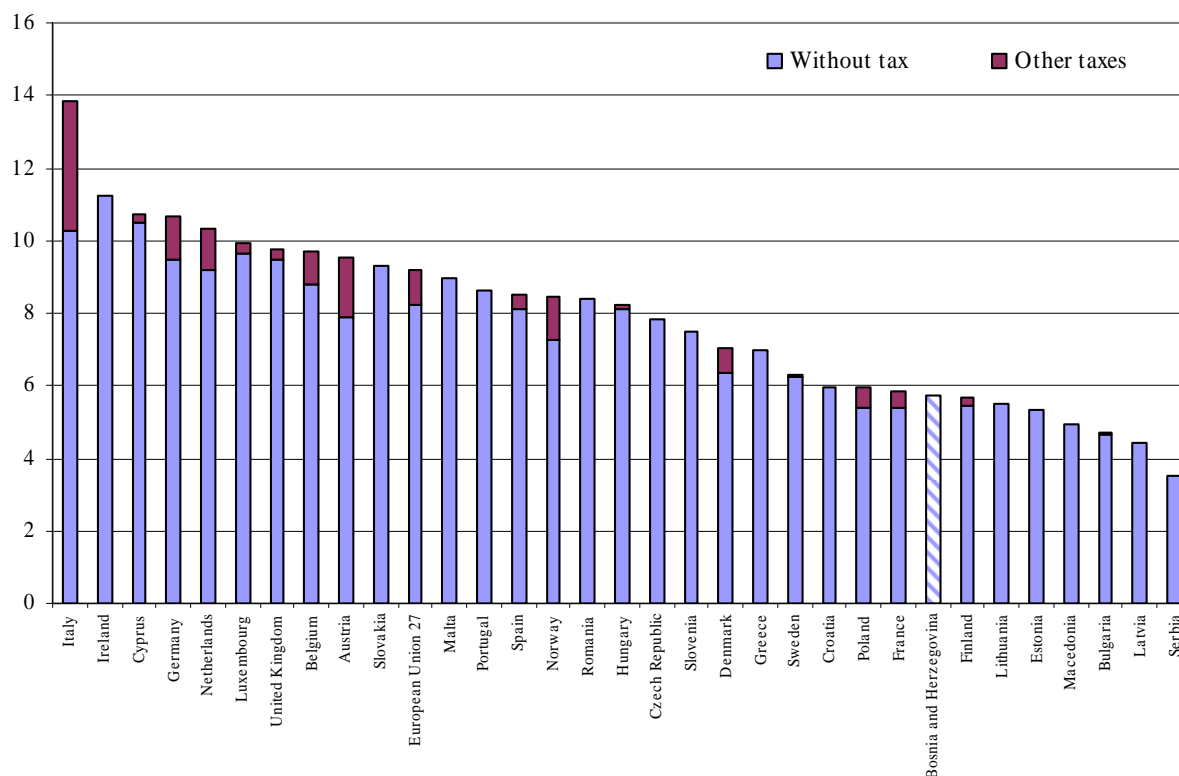
Composition of electricity price for household Dc in € per 100 kWh, on July 1, 2006. Source: Eurostat 18/2006



⁴ According to the Eurostat methodology – In the Eurostat methodology a few categories of typical customers are defined, and benchmarking data are usually provided for the household category Dc, with annual consumption of 3500 kWh, of which 1300 kWh during night hours, and industrial customer Ie with annual consumption of 2 GWh and maximum capacity of 500 kW.

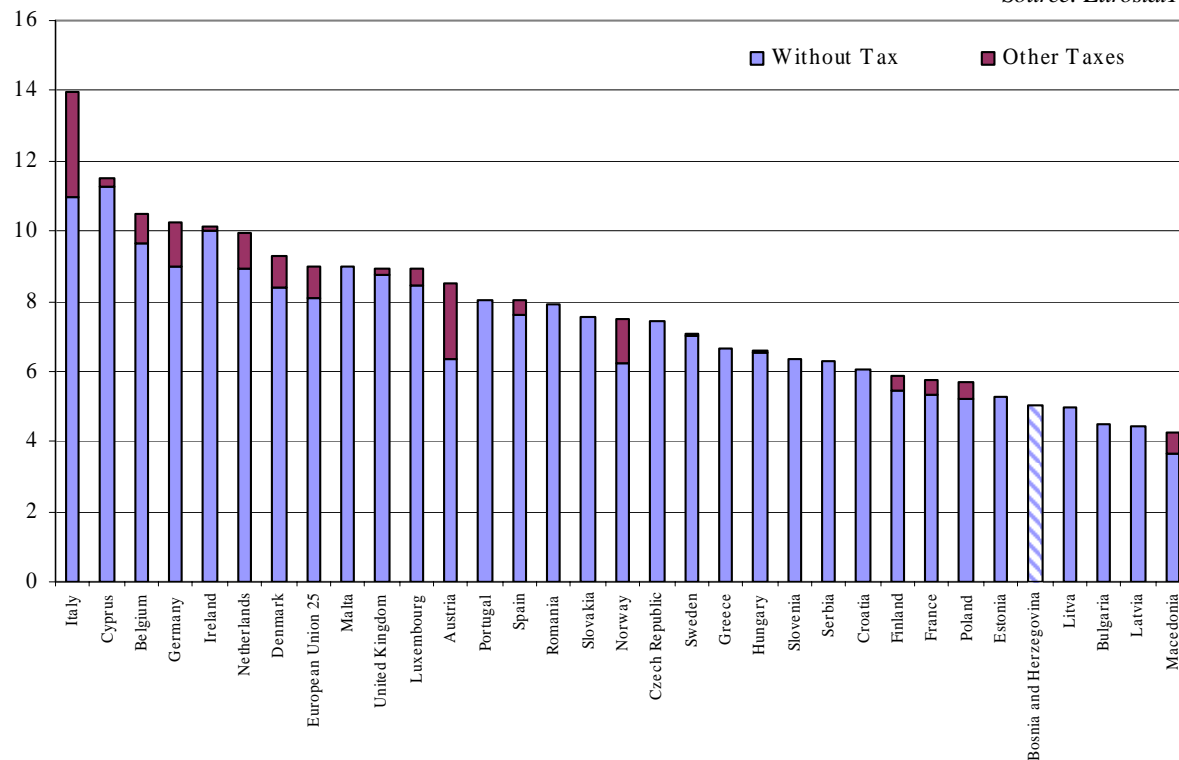
Composition of electricity price⁵ for industrial customer Ie in € per 100 kWh, on January 1, 2007

Source: Eurostat80/2007



Composition of electricity price for industrial customer Ie in € per 100 kWh, on July 1, 2006

Source: Eurostat18/2006



⁵ The charts for industrial consumers do not include VAT as it may be deductible.

