

Deploying the Energy Incentive: Reinforcing EU Integration in South-East Europe

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Key points

This Policy Brief urges the European Union to consider reinforcing the Energy Community by further Europeanising the Energy Community Treaty. It argues that the level of dysfunctionality with respect to the rule of law and corruption will make it very hard to establish a pathway for accession for most Balkan states. However, the demand across the region for a sustainable, competitive and stable energy sector creates an 'energy incentive' that the Union can leverage to improve the rule of law and adherence to European rules. Furthermore, a juridical strengthening of the Energy Community Treaty will also strengthen the hand of those parties supporting energy liberalisation rules across the region, such as independent businesses, consumers and NGOs. In addition, there is likely to be significant spill-over effects from decisions of a European Energy Community Court operating in the region on the rule of law in general and the accession process in particular.

The paper proposes juridical strengthening of the Energy Community Treaty, to include:

- An Energy Community Court with powers to hear direct actions from the Energy Secretariat, state parties, the EU institutions, EU member states and private parties with a direct and legitimate interest.
- A preliminary reference procedure from the courts of the state parties to the Energy Community Court.
- Elevating the role of the Energy Secretariat to that of a regional European Commission in the energy sector. It would include full powers on the European model to enforce the antitrust, state aid and merger rules within the sector.
- Extension of the *acquis* covered by the Energy Community Treaty to cover all environmental and free movement rules that affect the energy sector.

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1. Introduction

The Energy Community¹ seeks to provide a liberalised and open energy market in South-East Europe and the Black Sea region, where capital can be attracted to build a modern and sustainable energy sector. The difficulty with these objectives is that the Energy Community is ultimately dependent on the EU's energy *acquis* operating in the sub-optimal rule-of-law context of South-East Europe. The Union's enlargement programme aims to tackle the weaknesses with respect to the rule of law in the region.²

This paper argues that the current integration strategy can be significantly reinforced by recognising the overriding importance of the rule of law in the energy sector. Due to the weaknesses of capital formation in the energy sector in the region prior to 1989, the damage inflicted by war in the 1990s and the need for more sustainable energy sources to be developed, there is a hunger for capital in the regional energy market.³ Given the sheer scale of capital required in the energy sector, this need creates a major incentive that the EU can deploy to reinforce the rule of law, the effective application of the energy *acquis* and the progress of the Energy Community states towards full EU membership. There is a growing recognition among political elites, the business community, investors and consumers across the region of the need to expand and develop a sustainable energy system. For that investment to flow, however, strong rule of law mechanisms need to be put in place. This paper argues that the EU should consider taking steps to further Europeanise the Energy Community Treaty in order to strengthen the rule of law in the region.

A significant further Europeanisation of the Energy Community Treaty would include providing for an EFTA-style court, expanding the scope of the application of the Treaty to all four freedoms and creating a powerful antitrust enforcement competence within the Secretariat. It is contended that such a Europeanisation programme would significantly enhance the operation of the rule of law in the regional sector and create a much more open and reliable single energy market, which would attract investment on a large scale into the region. The programme would generate mutual reinforcing effects to improve governance and compliance on the ground with the whole EU energy *acquis* on the way to membership of the Union.

Section 2 of this paper examines the role and prospects for the Energy Community. Section 3 looks at the fragile context in which the Energy Community seeks to operate across South-Eastern Europe. Section 4 outlines the Europeanisation programme and its potential advantages for investment and the rule of law in the energy sector and section 5 offers a conclusion.

2. The Energy Community

The Energy Community Treaty grew out of the European Union's response to the Balkan wars in the 1990s. With the dissolution of Yugoslavia, the former interconnected energy

¹ The Energy Community, established in October 2005 under an international treaty that entered into force in July 2006, aims to extend EU energy policy into non-EU countries. Its secretariat is located in Vienna. Section 2 of this paper describes in more detail its origins, membership and structure.

² See *Energy Strategy of the Energy Community* (Energy Community, 2012).

³ *Ibid.*, p. 9.

networks were torn asunder by new borders and new state interests. Energy cooperation was initially developed via the South-East Europe Regional Energy Market, which was part of the Stability Pact for South-East Europe. Through what became known as the 'Athens Process' in 2003, negotiations commenced on transferring the EU's energy *acquis* into South-Eastern Europe.⁴ These negotiations culminated in the signing of the Energy Community Treaty between the European Union and Serbia, Montenegro, Croatia, Bosnia-Herzegovina, FYROM and Albania in June 2005. The Treaty came into force on 1 July 2006, for an initial period of ten years. Moldova and Ukraine subsequently joined in 2010 and 2011 respectively.⁵ The Energy Community may well grow in size in the coming years. Georgia is already a candidate state for membership, and other Caucasus states may join over time.⁶

The Energy Community aims to transfer the energy *acquis* of the European Union as it is developed into the laws of the Contracting States of the Community. There was a conscious modelling on the original European Coal and Steel Community (ECSC) as an instrument that aimed to provide "the basis for a broader and deeper community among peoples long divided by bloody conflicts"⁷ and provide a framework for cooperation between previously warring parties.⁸ The overall aim is to create a common regulatory framework for a liberalised regional energy market on the European model. This includes progressively taking up new iterations of the EU's liberalised energy regime together with flanking environmental, supply security and competition measures. As a consequence, capital should also be encouraged to invest in an energy sector regulated largely on the European model.

Institutionally the Community maintains a Ministerial Council, the highest policy-making level within the organisation consisting of ministerial representatives and representatives of the European Union. The standing Permanent High Level Group of senior officials of the states and the Union support the Ministerial Council. The Energy Community Regulatory Board, composed of regulators from each state and the European Commission and the Energy Secretariat are based in Vienna, which deals with the day-to-day work of the Community. There is no court system, but both the Energy Secretariat and the Energy Community Regulatory Board can initiate a dispute settlement procedure before the Ministerial Council, which has procedural affinity with the failure to comply with Union obligations provision of the EU Treaty. Ultimately a state's rights under the Community Treaty can be suspended for non-compliance via the dispute settlement procedure – in other words, via a quasi-judicial mechanism.⁹

⁴ For a discussion of the Athens Process and its development, see Karova (2009) and Renner (2009).

⁵ This paper focuses solely upon the initial signatory states of the Energy Community Treaty from South-East Europe.

⁶ Turkey and Armenia have observer status. It is also possible that if the twin impact of the shale revolution and a much slower growth rate of the Chinese economy over the next decade may motivate other states across Central Asia to consider Energy Community membership as a way to encourage capital investment.

⁷ Preamble to the European Coal and Steel Community, Paris, 1951.

⁸ See the European Commission's press release, "The EU and South-East Europe sign a historic treaty to boost energy integration", 25 October 2005 (http://europa.eu/rapid/press-release_IP-05-1346_en.htm European Commission).

⁹ For a discussion of how this model operates, see Buschle, 2011.

The core Union conception of the Energy Community Treaty is that like the ECSC Treaty, in that it can grow and develop over time into a source of cooperation and harmonious and positive development with numerous positive spill-over effects. The difficulty with this concept, however, is that contexts of the origins of the ECSC and the Energy Community are wholly different.

The ECSC was born in a context where the contracting states, despite their recent history of fascism, had a long rule of law tradition, reasonably sound public administration and strong civil society foundations. All those societies understood how a market economy functions and were populated by numerous actors who could participate in such an economy. In addition, the US provided significant additional support, by its physical presence, both civil and military, and technical support. Above all the US provided access to enormous amounts of cheap capital to rebuild European energy infrastructures.

By contrast, just over two years after its coming into being, the Energy Community experienced the greatest capital crisis in modern history. In addition, the Energy Community, while bringing the energy *acquis* (together with the other parts of the *acquis* relevant to the application of the energy *acquis*, such as core environmental, competition and public procurement rules) of the Union into South-Eastern Europe, was not granted the supranational infrastructure to ensure uniform application of the *acquis* that exists within the EU. Given that the domestic legal infrastructure is much weaker than that of the EU member states as well, the likelihood of effective application of the *acquis* is, needless to say, problematic. As argued below, the Ottoman, authoritarian and Communist heritage compounded by the impact of the Balkan Wars creates a context where the support systems that were available to the ECSC are much more limited and less effective in the context of the Energy Community.

South-East Europe: A fragile context for the development of the EU energy *acquis*

The energy *acquis* within the European Union is supported by strong rule of law culture,¹⁰ on the whole sound and capable public administration and backed by EU-level surveillance and enforcement. These support factors are necessary if the sophisticated energy liberalisation framework of the Union is to be constructed and then put into operation. These support factors are also key to ensuring that investors are willing to make major investments into Europe's energy sector.

The difficulty in South-East Europe is that the EU's energy *acquis* is transmitted via the Energy Community into a region with limited support factors. For a host of historical and current reasons, the rule of law and the quality of public administration are very weak. It is difficult to see how the energy *acquis* can easily prosper in such a fragile environment.

A number of factors have created this situation. The negative historical context of the region for most of the period since the fall of Constantinople arose from either having been part of the Ottoman Empire, under the control of the Austrian Empire, or having been run as independent authoritarian states. None of these regimes developed a strong rule of law culture, nor a culture of sound and efficient public administration.

¹⁰ In his seminal work *The Rule of Law*, Lord Bingham (2011) makes a compelling modern case for the importance and value of the rule of law.

This historical reality was then compounded by the creation of a Communist state where all the organs of the state were 'harnessed by the party'.¹¹ The executive, legislature and judiciary were under the control of the Communist Party undermining any true notion of the application of the rule of law.¹² Law was merely a means of ensuring the will of the Party.

The collapse of Communism in the region also triggered a major conflict. That conflict exacerbated the already significant problems of creating a strong rule of law culture. It also led to the rise of illiberal political parties who became a major block to the development of European norms in relation to both law and public administration.¹³

These illiberal parties sought to concentrate power in their hands, violating the principle of separation of powers, which in turn encouraged arbitrary rule. The political power of the illiberal governing parties was converted into economic power by corrupt privatisations.

Even after the turbulent 1990s and the end of conflict, the adoption of formal democratic structures within the region did not do much to push the region in the direction of European norms. As Dolenc (2011) has argued, the region has undergone a 'process of refeudalisation' in which informal networks of legality became the structuring principle of governance. The rhetoric of liberal democracy may be presented and European rules may be formally adopted, yet insider networks control access to all the levers of power and continue to profit from their insider status.

Clearly the prospect of European Union membership can act as a major pressure to adopt real reform. However, with the notable exception of Croatia, there appears to be very significant resistance across the region from amongst the elites who have now benefited for 20 years from the current structures to undertake such reform. It is very much an uphill struggle for the European Commission and the member states to bring the countries of the region to accept the value of European norms. This reality is illustrated below with some examples drawn from recent OECD and EU reports as well as media commentary.

For example in its 2011 Assessment Report on Serbia, the OECD was quite blunt: "The state appears largely captured by vested interests."¹⁴ The European Commission 2012 Progress Report was also quite frank. Little progress was found to have been made on judicial reform.¹⁵ It noted that the legal framework still leaves room for undue influence over the judiciary.¹⁶ The views of the OECD and the EU are underlined by a recent poll in June 2012 by TNS Medium Gallup which found 87% took the view that the judicial system has a role to play (in dealing with corruption), but it is too corrupt to deal with corruption.¹⁷

The OECD in its 2011 Assessment Report on Albania is equally blunt: "Compliance with the law by the government is not ensured".¹⁸ The report went on to say that "there is general disrespect for decisions of the courts, including the constitutional court".¹⁹

¹¹ See Stojin (2009).

¹² Ibid.

¹³ See Dolenc (2011).

¹⁴ See OECD (2011, p. 3).

¹⁵ See European Commission (2012, p. 9).

¹⁶ Ibid., p. 49.

¹⁷ TNS Medium Gallup, June 2012.

¹⁸ See OECD (2011b, p. 3).

The latest OECD report for Bosnia-Herzegovina also makes disappointing reading in respect of the whole gamut of capture by vested interest, fidelity to the rule of law and corruption.²⁰

The 2011 OECD Assessment Report for FYROM is also far from positive. As in Serbia and Albania, the OECD notes the centralisation of power in the executive branch. It also expresses “serious concern” at the limited extent to which the rule of law is put into practice.²¹

The OECD Report also refers obliquely to the Ivanovski case where a lustration law was deployed to remove the President of the Constitutional Court. Mr Ivanovski has now filed a case against FYROM with the European Court of Human Rights alleging violation of Articles 6 and 8, breach of a right to a fair trial and his right to privacy.²² The ECHR Statement of Facts and Questions to the Parties in the case reinforces the concerns raised by the OECD. These include inadequate opportunities to respond to the allegations made, violation of the presumption of innocence (the President of the Supreme Court speaking to the media on the conclusion of an appeal several days before judgment was handed down) and allegations that judges who had been involved in the case were subsequently promoted, including to Mr Ivanovski’s own position on the Constitutional Court.²³

The OECD Assessment Report for Kosovo observes that Kosovo is “a paradise for corruption”²⁴ and notes that the absence of visible results of fighting corruption also has a negative effect on the image of Kosovo. This darkening view is reinforced by the most recent European Commission Progress Report: “The limited independence and impartiality of the judiciary in practice is a serious impediment to strengthening the rule of law.”²⁵

The OECD Montenegro Report notes that ‘one major reason for the shortcomings in public governance is the lack of respect for the rule of law and democratic institutions by major actors’.²⁶

As one would expect, Croatia demonstrates a more substantial attempt to adhere to European rule of law standards. The latest OECD Assessment Report and European Commission Progress Report are more positive on Croatia than for the other states of South-East Europe. However, the OECD does note that respect for the rule of law remains a source of concern and needs to be continuously monitored.²⁷

Furthermore although there has been significant corruption in Croatia, since 2009 there has been an upward swing in anti-corruption investigations by the state. Several high-profile cases have been launched, most notably the prosecution and conviction of former Prime Minister Sanader in November 2012.²⁸ This conviction demonstrates the commitment of

¹⁹ Ibid., p. 5.

²⁰ OECD (2011c).

²¹ See OECD (2011d).

²² *Ivanovski v. FYROM*, Application No. 29908/11, lodged 9 May 2011.

²³ Ibid., *Statement of Facts*.

²⁴ See OECD (2011e, p. 6).

²⁵ European Commission (2012.b).

²⁶ OECD (2012, pp. 2-3).

²⁷ OECD (2011f, p. 4).

²⁸ “Croatia Gets Boost from Graft Conviction Ahead of EU Report”, Bloomberg, 21 November 2012.

Croatia to tackle corruption even at the highest level of the state. This positive anti-corruption signal is likely to be reinforced by the fact that there are a number of further outstanding corruption charges to be brought against the former Prime Minister.²⁹ Any further convictions will underline that Croatia is moving heavily against corruption and is willing to uphold democratic integrity and the rule of law.

Sanader's initial oral statement³⁰ in November 2012, however, does raise some questions as to the quality of judgments handed down in corruption cases and the risk of first-instance decisions being overturned on appeal. The language used in the Sanader case adopted a non-judicial and nationalist tone in respect of the Croatian energy company INA. The focus of the judge for a significant part of the ruling appeared to be based on condemning Sanader for transferring INA to a foreign management, highlighting more a lack of patriotism than financial greed.³¹ This sort of language together with a lack of focus on the evidence does raise serious concerns even in Croatia.³²

Looking across all the OECD and European Commission Progress Reports for the region is a dispiriting task. There are a number of alarming features through all these reports. The centralisation of executive power and the reduction in the influence of Parliament, are compounded in several states by the use of exceptional emergency procedures to adopt legislative programmes wholesale. There is a willingness to bend the judiciary to political ends and a preparedness on the part of public institutions to simply ignore court rulings and to side-step the rights of constitutional courts. The scale and extent of corruption across public life in the region are worrying as is the weakness of official response. One comes away with the sense that a substantial part of the 'reform' movement in the region is entirely generated from Brussels and Washington and would collapse if it were not for external actors.

Developing the energy incentive: Energy and the rule of law

Given the discussion above, it is clearly open to question how the EU's energy *acquis* contained in the Energy Community Treaty can actually function in South-East Europe. It is of course correct to note that all the states of the region are progressively on their way to European Union membership and that in order to obtain membership they will have to significantly improve their adherence to the rule of law. However, it is clear from the scale of judicial dysfunctionality and elite preference for maintaining the current opacity and sub-optimal effectiveness of their domestic institutions that the Union is on a very long and hard road to bring these states in the direction of greater adherence to the rule of law and membership of the Union.

One negative factor however, could well be turned into a means to enhance the rule of law and underpin the operation of the Energy Community Treaty *acquis*. There is a very

²⁹ "Former Croatian Premier Faces New Charges", Bloomberg, 13 December 2012.

³⁰ Even after seven months, no formal judgment has been handed down in this case.

³¹ A rough English language translation can be found on the link below. It does appear to raise a number of concerns in terms of language, legal argument and reason. See <http://www.globalsecurity.org/military/library/report/2012/2012-11-20-sanader-verdict.htm>

³² Ibid. Experts reports from a major international accounting firm appear to be dismissed for no compelling reason and reports from foreign state prosecutors ignored.

substantial demand for sustainable and deliverable energy across the region.³³ This is due to the ageing Communist-era infrastructure, which regularly cannot keep up with demand³⁴ and results in distribution losses as high as 22%.³⁵ The very high levels of energy intensity are approximately 2.5 times higher than the European average.³⁶ This is exacerbated by the lack of market integration across the region, which dissolved along with the dissolution of Yugoslavia.³⁷ In the case of Bosnia-Herzegovina, there is not even energy market integration within the state.³⁸ There is a substantial import dependency of over 90% for the region and save for some hydropower, an almost total dependence on fossil fuels.³⁹

As the Energy Community points out in its *Energy Strategy* paper adopted in October 2012:

A common feature (across the region) is that the main elements of the energy infrastructure (e.g. power plants) were built in the 1960s and 1970s, using standard East European technology. Their age and type of technology, and their inadequate maintenance raise serious policy challenges at present. There is an urgent need for large scale rehabilitation and replacement of infrastructure to avoid a situation in which considerable generation and transmission capacities are not available.⁴⁰

The Energy Strategy paper underlines the scale of the task by pointing out that the state parties to the Treaty in the Balkans region estimate they need to provide 13GW of new capacity at a cost of €28 billion by 2020. However, as the Strategy paper points out, since 1990 the region has only seen 0.94GW of new utility scale plant put in place.⁴¹ This is indeed a heavy task:

to ensure adequate power supply, the region will have to develop its generation plant fleet at a rate more than 10 times that seen over the past two decades.⁴²

This paper argues that these realities create an opportunity for the Union to create leverage amongst the power elites of the region. The demand for stable energy from consumers and industry,⁴³ in combination with the scale of pollution in the cities across the region,⁴⁴ creates

³³ The most detailed recent discussion can be found in the IEA paper *Energy in the Western Balkans: The Path to Reform and Reconstruction*, Paris, 2008, pp. 17 ff. The paper provides an extensive discussion of the weaknesses of the regional energy infrastructure and the need for capital investment,

³⁴ Boromisa (2010) and Ralchev (2012).

³⁵ See the CSIS-EKIM Policy Report, *Delinking the Western Balkans: The Energy Dimension*, CSIS, Washington, D.C., 2012.

³⁶ *Ibid.*, p. 4.

³⁷ The CSIS-EKIM (2012, p. 5) report makes the point that market integration in the energy sector had begun unravelling in the region even before the dissolution of the Yugoslav state.

³⁸ Rachev (2012, p. 4).

³⁹ *Ibid.*, p. 2.

⁴⁰ Energy Community (2012, p. 9).

⁴¹ *Ibid.*, p. 12.

⁴² *Ibid.*

⁴³ One of the major issues for consumers and industry is the inability of current power systems to maintain stable supply. Hence, there is no backup when drier summers reduce the amount of hydropower generation available; failures in the power systems from failing antique power plants and infrastructure or gas supply shortages. See OSW (2012).

⁴⁴ As reported in DW (2013). According to the WHO, Sarajevo has the worst air pollution of any European city. Tetovo and Skopje in Macedonia are not far behind. There are also specific air

domestic and industrial constituencies in support of investment in energy infrastructure. New energy investment, particularly with respect to renewables and gas generation, can cut pollution plaguing cities across the region, and greater and more stable power supplies will themselves make it easier to attract further foreign investment.

Despite their control of most local institutions, the elites are not all-powerful. They need to be able to command the support of sufficient numbers of voters to limit challenges to their power; they need to keep some business support on their side as well as demonstrate some commitment to the European Union if they are to progress towards membership. Delivering real change in local and regional energy markets will allow the elites to deliver on these goals.

The weakness of the rule of law discussed above, however, will make it very difficult for the local elites to attract capital at a scale necessary to deliver such energy projects. It is notable that there has been no major oil or gas investment in the region for the last 30 years and as pointed out above, only 0.94GW of capacity has been added since 1990. The only significant development was the Hungarian pipeline project into Croatia, which was a European project connected with improving the Union's own energy security and not with developing the regional energy market.⁴⁵

The argument of this paper is that the Union can leverage regional energy needs and the interests of the local elites into strengthening the Energy Community Treaty.⁴⁶ By strengthening the Energy Community, the Union will also be reinforcing the processes of integration and the pathway to membership.

One contrary view, however, holds that the Contracting Parties should 'learn to fish' themselves. In other words, the states that are Contracting Parties to the Energy Community have to come to grips with the rules of the energy *acquis* and flanking measures from the *acquis*, operating in support of the EU's energy rules and case law. They will be supported by the accession programme but otherwise they have to develop the means themselves to support the energy *acquis* as part of the process of preparation for membership. This 'learning to fish' idea approach has a lot to recommend it. Candidate member states should be encouraged to develop the means to function with the *acquis* themselves.

However, the difficulty with this approach is that it does not recognise the reality of the Balkans. Notwithstanding the interests of some reformists and those who see a means to deliver to particular constituencies a significant part of the local elites and the state bureaucracies do not in fact want to learn to fish. They are happy with the current systems and structures.

The key insight of this paper is that despite the dysfunctional governance described above the demands for a larger and more sustainable energy market create an opportunity for the

pollution problems from individual energy installations across the region. See, for instance, Webpublicapress, "Air Pollution in Balkans Worst", 27 December 2012, which describes the impact of pollutants from the oil refinery in Bosnia-Herzegovina at Bosanski Brod on the nearby Croatian town of Slavonoski Brod.

⁴⁵ CSIS & EKIM (2010, p. 5).

⁴⁶ This is not a region where energy can be a source of corruption itself as there is very little domestic oil or gas production. The elites who want to deliver energy goods need to encourage the inflow of private capital to the region. Hence they have some incentive to comply with the rule of law to attract that capital.

Union to generate support within the region. However, that support is only likely to be generated if the Energy Community Treaty rules are reinforced. In other words, the 'learning to fish' approach only works if the Union provides EU legal hooks that businesses, NGOs and consumers can themselves deploy. In addition, the Energy Secretariat would be left with the weak quasi-judicial enforcement mechanisms under the Treaty.

The question therefore is what sort of EU legal hooks work best. One approach would be to adopt the approach of the comprehensive air services agreement for South-East Europe under the European Common Aviation Area (ECAA), which provides for the extension of the *acquis* in respect of air transport to non-EU states in the region. The ECAA in the region provides for access to the European Court of Justice's preliminary reference procedure to ensure uniform application of the air transport rules for the EU and the Balkan ECAA.

It is clear that a reference procedure would provide some positive attributes. It would assist the uniform interpretation of the energy *acquis* in the region. It would provide some 'backup' to local judges seeking to comply with the rule of law. However, it is far from clear that a preliminary reference procedure provides sufficient reinforcement to the energy *acquis*. The ECAA only deals with air transport where states have a direct vested interest to comply with the rules to obtain route access to other states. By contrast, there are very substantial vested interests within the region that are likely to see energy liberalisation as a threat to their ability to obtain monopoly rents. Those interested parties would perceive liberalisation as a zero-sum game. That would be unlikely to be the case with respect to air transport liberalization. Most states and local economic interests would want to promote access to the rest of Europe and therefore would be much more willing to accept European air transport obligations. In addition, the introduction of the energy *acquis* via the Energy Community Treaty involves a considerable number of flanking measures from competition law, public procurement and environmental law.

Given the vested and captured state interests discussed above and the attractiveness of monopoly rents from the energy sector, a stronger judicial underpinning of the Energy Community Treaty would provide a means of challenging those interests. Both interests in favour of liberalisation, such as private businesses seeking to develop the market and consumer groups, could deploy stronger legal hooks. Equally, the Energy Secretariat would be able to play a greater role to ensure effective application of the rule of law in the sector.

A juridical strengthening of the Energy Community would also encourage investment into the region as investors would have greater security as to the application of the rule of law and open markets. Such a strengthened Community would also provide advantages to those parts of the local elites who seek political advantage in delivering stable and sustainable energy supplies.

This Europeanisation approach supported by this author would develop the Energy Community further along the European model. As outlined above, the weakness of the rule of law in the region makes it very difficult to rely on domestic courts and ensure effective application of legal rules. There is therefore a compelling argument that the Energy Community at the very least needs to develop its own legal order with its own court system, modelled on the EFTA court based in Luxembourg. The Energy Community Court (ECCT) would receive direct actions brought by the Secretariat, the Contracting Parties and private parties with a legitimate interest. The ECCT would also be able to receive preliminary references from national courts. This would reinforce the energy *acquis* across the region and create legal precedents which individuals and companies could rely upon, and the prospect

of an adverse ruling in the ECCT would reduce the prospect of domestic court systems being gamed or unduly influenced.

The ECCT would have a direct impact on the application of the energy *acquis* and the EU flanking measures under the Energy Community Treaty. It would reinforce the rule of law in the region and support a besieged judiciary. It would also introduce a degree of transparency into energy disputes and create a significant number of legal precedents which those seeking to enforce the rule of law can deploy. The ECCT would also be likely to have significant spill-over effects. One such effect would be one where ECCT precedents and practices simply encourage stronger adherence to the rule of law in the region. The second type of spill-over effect is where the ECCT precedents are used to reinforce the accession process itself as the precedents in relation to flanking measures under the *acquis* as well as the core energy *acquis* are applied broadly by courts in the region. This secondary spill-over effect can be reinforced by extending the scope of the *acquis* to cover all environmental fields that could impact on the energy sector and the application of all the free movement competences not just goods, but also services, establishment and capital in the energy sector.

Under this more European model, the Energy Secretariat would be the regional European Commission in the energy sector. It would clearly need an equivalent of Regulation 1/2003 to enforce the competition rules in respect of the energy sector. It would also require an equivalent of the merger regulation. As is evidenced by the success of the 2005 Sectoral Enquiry on EU energy liberalisation, antitrust law is one of the principal means to ensure full compliance with the Union's liberalisation objectives.⁴⁷

The impact of further Europeanisation of the Energy Community would be to significantly enhance the investment prospects for the region's energy sector. Greater liberalisation operating under clear and stable legal rules will encourage investment. There would also be as discussed above a significant spill-over effect as the judgments of the ECCT and the decisions of the Secretariat began to be recognised and felt across the region. The precedential value and model of such rulings would reinforce the application of the rule of law and make it more difficult for judicial dysfunction to maintain its hold on the region's courts.

Although only focused on energy, the likelihood is that this sectoral programme would generate significant additional spill-over effects. The establishment of stronger rule-of-law norms in the energy sector and the driving out of corruption would also make it more difficult to maintain lower standards in the rest of the economy. A broad constituency would be likely to demand that the same standards be applied across the country. In essence, one of the concerns that appears again and again in OECD and EU reports, namely that the pro-rule of law and anti-corruption agenda is only being pushed externally, would have been answered. By targeting the energy sector, the Union could trigger internal pressures supporting adherence to European norms.

Conclusions: Improving the context for the Energy Community

If the Union continues with the existing strategy of relying on potential membership of the Union combined with horizontal measures to encourage adherence to the rule of law, the energy *acquis* is likely to become a fossilised regime of formalistic rules and little practical utility. Equally the path to membership of the Union for the states of South-East Europe will

⁴⁷ See Riley (2008).

continue to be a difficult uphill journey. The Union needs to consider new measures to accelerate the pace of compliance with European norms in the region. Creating a sectoral programme for the regional energy market is one place to start.

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