REFORMS FOR ECONOMIC GROWTH AND BUSINESS RESILIENCE 2024

ENERGY COMMITTEE

AMCHAM SERBIA
A LEADER IN CHANGE

ENERGY COMMITTEE

The Serbian economy faces issues that will have a decisive impact on its ability to sustain its pace of growth, such as **securing a stable and predictable energy supply, creating a business environment conducive for the rapid and effective development and construction of energy generation plants, infrastructure, and related facilities, improving the legal framework for green energy needed to accelerate the green transition based on best European practices, and enhancing energy efficiency**. The global energy crisis and developments in the Serbian energy sector seen in late 2021 have propelled these issues to the very top of the agenda, and as such it comes as no surprise to see **the green agenda and green energy transition ranked a high second on the list of AmCham members' priorities for improving the business environment.**

Serbia has recently launched an irreversible energy transition by enacting a special regulatory framework for delivering renewable energy projects, commencing investments into the transmission and distribution network, developing major infrastructure projects, and kickstarting reforms to how energy companies are managed and organised. Conversely, a major challenge for businesses, especially exporters and firms operating as part of large multinational corporations, is the fact that at least two-thirds of Serbia's electricity is generated from fossil fuels. This issue is exacerbated by the limited options for companies to secure renewable electricity, which has been directly affecting the ability of firms to meet sustainability requirements, which are quickly becoming part of their strategic orientations, as well as adversely affecting their global competitiveness.

Serbian businesses are ready to shift from being passive observers to active participants in the electricity market. A break with the current practice of complete reliance on supply by state-owned firms, as well as proactivity in finding and implementing alternative solutions to meet companies' green energy needs, will both have a decisive effect on business performance, export competitiveness, and environmental quality. In this context, **the government ought to continue enacting and pursuing policies that will incentivise large-scale renewable energy projects, enable self-supply of electricity and permit businesses to play an active part in the electricity market, and limit the potentially adverse impacts of the Carbon Border Adjustment Mechanism (CBAM) on the economy**.

OBJECTIVE 1: INCENTIVISE NEW ENTRANTS INTO THE ELECTRICITY MARKET

…BY CLEARLY DEFINING THE CONCEPTS, ROLES, AND RESPONSIBILITIES OF NEW MARKET ENTRANTS, SUCH AS SELF-CONSUMERS AND ACTIVE BUYERS

CHALLENGE: Amendments to the Renewable Energy Law have capped installed capacity for generation facilities using renewable sources operated by non-household self-consumers (i.e. commercial and industrial facilities) at 150 kW, whilst production facilities that apply for a connection during a transitional period ending on 1 July 2024 will be allowed a maximum installed capacity of 5 MW.

Although the transitional period was a major improvement on the previous unexpected restriction and provided some flexibility to businesses with ongoing or approved projects, the law as it currently stands is still fraught with a number of major challenges.

Firstly, starting on 1 July 2024, many companies that decide to invest in their own renewable generation facilities, either because they seek to comply with EU rules, follow ambitious corporate sustainability objectives in a bid to reduce their carbon footprint, or observe ESG principles, will face restrictions on their efforts. 'Active buyer' status, the alternative industry self-supply solution that would see businesses take on more responsibilities towards the electricity grid, has been announced but is yet to be legislated and its practical application remains uncertain. The same also holds true for the concepts of 'aggregator', 'storage facility', and 'citizen energy community', which will all have to be recognised by law before any 'active buyers' can be designated. **As such, once the transitional period has elapsed, industry self-consumers will be**

restricted to generation facilities with an installed capacity of under 150 kW, which is not enough to meet their green energy needs. This restriction will adversely affect continued industrial investment into medium-sized and large electricity self-supply capacity, act as a brake on Serbia's energy transition, and, in the medium term, have a negative effect on the competitiveness of Serbian exports into the EU (which is particularly significant in the context of CBAM).

Rules in effect ecross the EU and in neighbouring countries **generally do not limit total self-consumer generation capacity in zero-injection cases; rather, caps only operate when surplus power is fed back into the grid**. Experiences suggest that an excessively low cap may deter businesses from entering the energy market, as firms seek to ensure their investments pay off once they assume balance responsibility from the guaranteed supplier. As such, a proper definition of 'active buyer' is the key precondition for making certain this concept actually beds down.

Current legislation and operating rules provide sufficient safeguards for system stability, which cannot be jeopardised by self-consumers operating 400 kW generation facilities. The Distribution System Operating Rules require that any application by a small-scale generating facility for connection to the system includes a technical check to ascertain whether the facility is liable to interfere with the distribution system; the distribution system operator has the power to assess connection criteria on a case by case basis. In addition, self-consumers with a generating capacity of more than 160 kW are required to fund the construction of a switchgear facility with a remote station to enable the operator a real-time view of both generation and consumption levels and, if needed, ultimately take the generation facility off the grid. Lastly, self-consumers must provide yearly facility generation plans by month, including at the time of filing their initial application for connection to the grid.

Interpretation of the Renewable Energy Law is also affected by the 2022 amendments to the Government Order on criteria, conditions, and manner of calculating mutual financial claims between self-consumers and suppliers **(Self-Consumer Order)**, which introduce prosumers as a separate category of market actors which generate electricity 'exclusively for their own consumption and store any electricity so generated exclusively for their own needs without feeding electricity into the transmission system, distribution system, or closed distribution system'. **It remains unclear whether the statutory 150 kW cap on installed capacity also applies to this group of self-consumers that do not feed any excess electricity back into the grid** and as such cannot adversely affect the electricity system in any way. From the standpoint of network stability, self-consumers are variable consumers, just as they always have been, and are limited by the maximum approved capacity of their connection, in common with all other customers. The responsibility of these stakeholders for feeding any electricity back into the grid and any damage caused by doing so is very clearly set out in the Self-Consumer Order. To ensure they are able to track the behaviour of self-consumer generation facilities, transmission system, distribution system, and closed distribution system operators have internal procedures that stipulate the equipment necessary for exercising this control. However, the lack of mutual alignment between these provisions hinders investment into predictable self-supply capacity.

Lastly, the market in ancillary services, congestion management market, capacity leasing market, and the like are currently not open but could be attractive to active buyers and other new entrants.

RECOMMENDATIONS:

- Amend stand-alone Article 23(2) of the Law Amending the Renewable Energy Law to extend the transitional period during which installed capacity of 5 MW is allowed until such time as the notion of active buyer is introduced by means of amendments to the Energy Law and the statutory instruments required for its implementation have been enacted.

- Amend Article 58 of the Renewable Energy Law to permit an appropriate increase in the installed capacity cap for generation facilities operated by self-consumers.

- Explicitly exempt any zero-injection self-consumers from any restrictions. This could be done by amending Article 6a of the Government Order on criteria, conditions, and manner of calculating mutual financial claims between self-consumers and suppliers to exempt from these restrictions self-consumers that generate electricity exclusively for their own consumption and/or store electricity exclusively for their own purposes without feeding electricity into the transmission system, distribution system, or closed distribution system.

- Transpose adapted EU directives and regulations into national law, including legal regulation of the concepts of 'active buyer', 'aggregator', 'storage facility', and 'citizen energy community'.

- The market in ancillary services, congestion management market, capacity leasing market, and the like are currently not open but could be attractive to active buyers and other new entrants.

…BY STRENGTHENING CAPACITY OF THE DISTRIBUTION AND TRANSMISSION NETWORK AND OPTIMISING ADMINISTRATIVE PROCEDURES FOR CONNECTION TO THE GRID

CHALLENGE: Limited capacity has been an increasingly important issue for South-Eastern Europe, causing grid overload and constituting an obstacle to new entrants into the electricity market. In Serbia, the capacity needed to respond to the large number of applications for connection significantly exceeds the available regulatory reserve that guarantees stable operation of the power grid. Moreover, not all connections may actually be granted, especially as the procedure for issuing design and connection approvals does not discourage frivolous applications.

According to the draft Serbia Transmission System Development Plan, 2023-2032, the maximum renewable energy capacity that the transmission system is able to effectively balance amounts to 5.8 GW. Balance reserves are sized for balancing 1 GW of solar and 4.8 GW of wind capacity, accounting for some 52 percent of all current applications for connection to the transmission grid (at 11.1 GW). Latest figures released by transmission system operator Elektromreža Srbije suggest generation capacity has fallen significantly, from 21.5 GW in November 2023 to just 11.1 GW in February 2024. This sudden decline has been driven by new regulations that mandate additional guarantees from investors and seek to address the ballooning number of applications. Publicly available figures indicate the distribution system is currently processing more than 2,500 applications with a total installed power capacity of 1.9 GW, also substantially in excess of available balance capacity.

Excessive connection applications have proven a problem for both the distribution and the transmission system, with particular challenges posed by applications incomplete in terms of both project design and finance. Long waiting lists for connection to the distribution system are caused in part by the fact that **applications need not be accompanied by any collateral and by the absence of any explicit time limits for commencing and completing projects**. Purely by submitting their requests at little cost to themselves, applicants reserve grid capacity, generating projects that are either yet to begin or are only at an early stage, often intended solely to be resold before any tangible development takes place. Here, applicants who lack either the capacity or the intent to build generation facilities have the same rights as serious investors. This may mean serious investors face years of permitting delays, as applications are handled in the order in which they are received, with capacity reservations exhausting distribution grids and leading to paralysis of projects designed to promote self-supply of green energy. The recommendations outlined below seek to incentivise responsibility in project planning by investors and help avoid overloading the distribution system operator with connection applications that are incomplete in terms of both project designs and finance.

RECOMMENDATIONS:

- Amend the procedure for connecting to the distribution grid to introduce stricter criteria and anti-abuse mechanisms, such as, for instance, requiring applications above a certain capacity threshold to be accompanied by collateral proving their seriousness, provided that the collateral amounts do not pose undue barriers to new entrants. Stipulate clear time limits for project delivery and release reserved capacity if projects fail to make progress.

- Regularly publish information about opportunities for connecting to the transmission and distribution grid, including estimated capacity available at particular connection points, divided by category and based on the total number of active applications.

- Plan and hire new staff in a timely fashion to avoid bottlenecks due to understaffing.

- Introduce a public online system for filing applications and tracking their progress; allow decisions to be made simultaneously on all applications filed within a particular period that is clearly regulated by statute; and enable flexibility in decision-making, including allowing stakeholders to participate in the process before a final disposition is made.

- Ensure the Government of Serbia continues to improve capacity of the distribution and transmission grid. In this context, continued digitalisation of the grid ought to be a priority, including the installation of smart meters and smart networks, especially for the distribution grid.

OBJECTIVE 2: CONTINUE DEVELOPING AND DELIVERING RENEWABLE ENERGY PROJECTS

…BY CREATING A REGULATORY ENVIRONMENT CONDUCIVE TO THE DEVELOPMENT OF RENEWABLE ENERGY PROJECTS

CHALLENGE: Serbia has proven able to kickstart its energy transition by finalising the regulatory framework needed for attracting investment into the renewable energy sector. Amendments to the Renewable Energy Law adopted in 2023 have improved legislation for the energy transition, aligning it with the highest European standards. These steps have sent a positive message to investors in renewable energy, guaranteeing effective and transparent reforms and decarbonisation of the country's energy sector. These developments have led to the first successful auctions being held in 2023.

Apart from serving as the foundation for a robust investment climate, the current legal framework ought to produce large-scale benefits for consumers and businesses alike by minimising the need for energy imports and boosting market liquidity. No less importantly, an increased share of renewables in the overall energy balance would significantly improve air quality and the environment. Nevertheless, continuing green energy transition still faces obstacles, including the issue of **balancing electricity generation and the attendant challenge of constructing additional storage capacity**, together with the underdeveloped high-voltage grid and the large volume of connection applications, both of which are discussed at length in the foregoing section.

Amendments to the Renewable Energy Law enacted in 2023 have introduced the requirement for investors into renewable generation facility to provide **secondary reserve services** as a precondition for being allowed to connect to the grid. This has proven disproportionately onerous for investors, increasing investment into new wind farms and solar generation capacity by between 20 and 30 percent (by way of an illustration, 0.4 MWh/MW battery capacity can increase investment by up to 70 percent compared to 0.2 MWh/MW for the same installed active power). These large capacity requirements and the high attendant costs may cause investors to move to countries with less demanding criteria. Overall, Europe boasts only some 500 MW in battery capacity integrated with renewable energy generation facilities (with 270 MW of these located in the

UK, which has a well-developed system services market), although such facilities totalling 40 GW were constructed during last year alone.

The global energy crisis has proven the necessity of accelerating the Bistrica and Đerdap 3 pumped-storage hydroelectric power plants, projects that are now nearly half a century old. **These hydropower plants are crucial to the stability of the electricity grid**, not only as they will generate additional electricity but also because they offer the ability to balance wind and solar generation, in particular given the high cost of battery storage.

RECOMMENDATIONS:

- AmCham believes that setting the threshold for storage capacity in last year's amendments of the Renewable Energy Law was premature. Any such more ought to be preceded by an assessment of the adequacy of the system to strike the right equilibrium between balancing needs and the necessity of sustaining an environment conducive to the creation of new green energy generation capacity. Since current requirements for installed generation capacity and battery storage greatly increase the cost of these investments, consider amending the statute to envisage that **the regulation range for providing ancillary services should amount to at least 10 percent of the installed active power of the facility using variable renewable energy sources, or, alternatively, reducing the required battery capacity to at least 0.2 MWh/MW of the installed power of the facility**, which should meet the requirement for secondary reserve services. Moreover, **this article of the law ought to be construed strictly in the sense that the batteries will only be available for use in the free market for ancillary services and balance energy, pursuant to the Energy Law and the Energy Market Operating Rules**.

- **Consider whether the integrated storage facility system is appropriate or whether storage could be regulated otherwise, for instance on the Greek model.** If integrated storage facilities are retained, clearly spell out the rules of the game so that the source of income for the facilities is known.

- **Consider letting a tender for stand-alone battery electricity storage systems similar to those operated by countries in the region** (such as Greece, Romania, and Bulgaria). Create a regulatory framework for large-scale electricity generation facilities (batteries, hydrogen, and the like) that will allow rapid permitting for these units, especially in terms of their connection to the grid.

…BY STREAMLINING ADMINISTRATIVE PROCEDURES TO REIGNITE THE GREEN TRANSITION

CHALLENGE: Complicated procedures and excessive administrative requirements often hold back the development of renewable energy projects.

RECOMMENDATIONS:

- Eliminate the undue administrative burden on renewable energy projects (such as, for instance, the outdated Cultural Heritage Law, which requires approval for solar power projects even though these investments require no earth-moving).
- Ensure compliance with time limits in the construction permitting procedure, including fines and other penalties for permitting officials who fail to adhere to the prescribed timeframes.

OBJECTIVE 3: SAFEGUARD COMPETITIVENESS OF THE SERBIAN ECONOMY IN THE FACE OF CBAM

…BY ASSESSING THE IMPACT OF CBAM IN DETAIL AND ENSURING CONTINUED DECARBONISATION OF THE ECONOMY

CHALLENGE: A major challenge for businesses, especially exporters and firms operating as part of large multinational corporations, is the fact that at least two-thirds of Serbia's electricity is generated from fossil fuels. Companies have long faced efforts to limit their carbon footprint, even where doing so directly affects their competitiveness and profitability. These attempts reached a peak in December 2022, when the European Council and the European Parliament agreed on the introduction of the Cross-Border Adjustment Mechanism (CBAM). The CBAM seeks to promote decarbonisation in non-EU countries, so overcoming the issue of carbon shifting and helping the European economy remain competitive by ensuring the cost of carbon dioxide (CO2) emissions is the same for products made in the EU and imported ones. In practice, the CBAM will constitute an additional tariff on imports into the EU of products whose manufacture in third countries generates significant carbon emissions. Currently, the list of goods subject to the CBAM includes electricity, cement, aluminium, steel, and fertiliser, and is only expected to grow. Electricity is subject to the CBAM as it accounts for a large part of GHG emissions if generated in thermal power plants using coal or other fossil fuels.

Regulation (EU) 2023/956 establishing the CBAM was adopted on 10 May 2023 by the European Parliament at the proposal of the European Commission. The Regulation took effect on 1 October 2023, when an initial monitoring phase began, whilst the actual fees are first expected to be levied in 2026.

Importers were originally required to file their first CBAM reports by 31 January 2024, but technical issues have now pushed this date back. At any rate, these declarants will face no penalties for failing to file reports before an amendment procedure is launched in which they will be able to provide justification and rectify any inaccuracies in their CBAM reports. Lastly, declarants will be able to amend their first three CBAM reports by 31 July 2024.

Given their high export dependence on the EU and low decarbonisation levels, countries of the Western Balkans will be among the hardest hit by the CBAM. Full-fledged CBAM implementation can lead to large-scale job losses if companies in the affected sectors become price uncompetitive in the EU due to the high cost of their exports.

The ways in which businesses can decarbonise further remain limited, and addressing some regulatory obstacles could help reduce carbon footprints across CBAM-affected industries, cut production costs, and boost competitiveness in goods markets.

RECOMMENDATIONS:

- Produce economic, legal, technical, and financial analyses of how the CBAM will affect electricity generation and other industries in Serbia.
- Include businesses in consultations about alternative arrangements that would allow alignment with the CBAM and allow companies sufficient time to adjust.
- Ensure the free exercise of options for direct supply of renewable electricity, such as the corporate power purchase agreements envisaged by the Renewable Energy Law.
- Remove regulatory barriers that hinder stability of supply whilst focusing on alternative sources of energy: for instance, amend the Waste Management Law to reverse the current ban on imports of non-hazardous waste for use as fuel.