

**European Union – Opportunities and Challenges**  
**Hotel Excelsior, Dubrovnik**  
**3-5 June 2009**

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**Joint International Conference with**  
**the Croatian Bar Association and the Law Society of England and Wales**

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**OVERVIEW OF EC LAW IMPACT**  
**ON THE CROATIAN ENERGY SECTOR**  
**AND THE ROLE OF LAWYERS**

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**Abstract:** Energy availability is a precondition for economic activities and development, as well as life of individuals and human society as a whole. The energy sector is an economic sector that encompasses energy generation, transmission, storage, distribution and use. The energy sector reform is a transformation undertaken in order to establish market economy under legal, organisational, economic and financial, technical and technological and ownership conditions required for pursuing of energy-related activities and energy use. Europe initiated the energy sector reform in order to achieve its full liberalisation and integration. The energy sector reform in Croatia is an integral component of the transition processes. The new energy legislation is prepared using the EU legislation as a model, and the harmonisation with the *acquis communautaire* is almost finished. The energy market is formally open, but state-owned and semi-privatized state-owned enterprises still lack proper competition and the market competition process has actually not started. Institutional and structural changes have been made, but the effects of such changes, regarding their goals, are still in an initial stage. The legal profession plays an important role in reform implementation being an autonomous and independent Croatian legal aid service.

**Key words:** energy, energy sector, energy market, reform, *acquis communautaire*, Croatia, harmonisation of legislation, legal profession.

## 1. INTRODUCTION

The Constitution<sup>1</sup> enacted by the Parliament of the Republic of Croatia on 21 December 1990 states that the Republic of Croatia is established and shall develop as sovereign and democratic state in which equality, freedom and human and civil rights are guaranteed and secured, and economic and cultural advancement and social welfare are promoted.

The Croatian citizens and their NGOs, as well as foreigners and institutions of the countries they come from are inquiring into implementation of the above constitutional proclamation on a daily basis. This is particularly true of the EU Member States with which the Republic of Croatia signed the Stabilisation and Association Agreement and the European Community bodies which monitor and promote the ongoing association process.

This paper intends to give an overview of the EC law impact on the Croatian energy sector (nuclear power not included) and an insight into the implementation of the *acquis communautaire*, to which Croatia committed under the above Agreement. The phrase most frequently used to refer to these processes is “*the energy sector reform*”. It actually means establishment of market economy in energy sector accompanied by the regulation of public services in power transmission and distribution which are of general economic interest.

The reform has introduced a number of new concepts and contents into the life and work of the energy sector actors, from energy producers to consumers. These changes have primarily resulted in a complete change in energy legislation. Implementation of such changes in practice has required, and will require in the future, a lot of patient and professional engagement. This paper intends to additionally highlight the role, importance and capacities of the legal profession, established by the Constitution as autonomous and independent Croatian legal aid service, in implementation of the energy sector reform.

## 2. ENERGY SECTOR REFORM – GENERAL

The energy sector reform in Europe started with privatisation in the electricity and gas sector in Great Britain<sup>2</sup> in the eighties of the last century. The reasons for the reform were of economic nature. State

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<sup>1</sup> *Constitution of Republic of Croatia* from 1990 amended in 1997, 2000 and 2001 (Consolidated text, Official Gazette 41/2001 and 55/01-corr.)

<sup>2</sup> Metcalf R., “*Learning from the Experiences of Others: Development of Energy Regulation in UK and Greece*”, Proceedings, Problems with the Energy Service Market Regulation, Croatian Energy Association, 2002.

management has been found ineffective, and a strong political standing was that liberalisation of market relations and competition would result in lower prices and higher security of power supply.

The energy sector is an economic sector which includes energy generation, energy transmission, energy storage (where possible, e.g. gas storage), energy distribution and energy use.

Energy is extremely important for the contemporary way of life. This naturally ensues from the fact that energy availability is a significant precondition for economic activities and development as well as for life of individuals and human society as a whole. Energy demand increases on a daily basis, which causes increase in dependence on energy import (both in Europe and Croatia) and generates risks of interruption in energy supply. Additionally, energy generation from fossil fuels is the major source of global environmental pollution<sup>3</sup>, thus the energy development planning should comply with the sustainable development policy. These were the reasons for the energy sector reform aimed at full liberalisation and integration of the energy market in Europe.

The energy sector reform could be defined as an integrated and harmonised transformation of legal, organisational, economic and financial, technical and technological, as well as ownership conditions for pursuing of energy activities and for energy use.

The reform objectives are complex and multiple. The following could be indicated as reform goals:

- abolishing state monopoly in energy sector (particularly in energy generation),
- energy market development and competitive and/or reasonable energy pricing,
- ensuring quality and security of energy supply,
- ensuring free and efficient energy transmission and distribution from the producer to the consumer,
- regulation of natural (technical) monopolies (energy transmission and distribution),
- improvement in energy efficiency (in energy generation, transmission, distribution and use),
- harmonised development of energy sector aiming at sustainable development,
- encouraging use of renewable energy sources and cogeneration (for improvement in energy supply security and environmental protection).

The energy sector reform has different aspects and takes different forms, thus it could be conditionally referred to as legal, organisational, economic and financial, technical and technological and ownership reform.

The legal reform involves determining and meeting of legislative conditions for planning of energy development policy, restructuring of energy companies, energy market opening and interconnecting, changes in and harmonisation of responsibilities of the state authorities, establishing independent regulators and their work, increase in supply security and quality, protection of vulnerable segments of population and consumers.

The organizational reform includes transformation of energy companies and introducing the new ones into the market, organisation in line with rules on unbundling of energy generation and supply from

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<sup>3</sup> Kropc, T., Goricanec, D., Pozeb, V.: *European internal market in energy and the importance of environmental protection*, Proceedings, 'Energy and the Environment, Vol II, Opatija, 2008.

energy transmission and distribution. The unbundling is carried out gradually and on different levels, from accounting and management level, to the legal status and ownership level, particularly in vertically integrated energy companies. The organisational reform encompasses application of means and methods for increase in organisational efficiency of energy companies, particularly in infrastructural activities related to rendering of the so called public services. The organisational reform framework may also include capacity building of energy companies for implementation of the strategic guidelines of the European energy policy, such as encouraging energy generation from renewable sources (wind, watercourse, solar, biofuel, geothermal energy, etc.) and cogeneration (combined heat and power production), and fostering of energy efficiency (not only in end use but also in energy generation, transmission and distribution). The organisational reform, as we see it, involves introduction of new institutions, independent energy regulators responsible for ensuring of legal order in the energy market, issuing licences to energy companies, and protection of energy consumers and power grid users against monopolistic prices of operators in the related sectors.

The economic and financial reform involves opening of the energy market to non-domestic consumers and the right of consumers to free choice of energy supplier. It includes liberalisation of energy prices and energy pricing in the market, based on the offer and supply conditions. The price regulation remains in force only exceptionally, in the business activities with natural or technical monopoly, such as energy transmission, storage and distribution. The price regulation would also remain in supply of vulnerable segments of population. As regards energy generation from renewable sources and cogeneration, the economic and financial reform introduces different forms and mechanisms of state incentives, from tax exemptions and releases to payment of regulated guaranteed energy purchase prices.

The technical and technological reform understands overall improvement in operation of technical and technological systems or parts thereof towards achieving of the following objectives:

- operational safety and reliability,
- energy efficiency,
- increase in energy transmission and distribution capacities,
- environmental protection,
- use of renewable sources and cogeneration.

The ownership reform is transformation of ownership relations by privatization of energy companies or parts thereto. The transformation could also involve the opposite process, i.e. establishing of public ownership of energy transmission, storage and distribution, in whole or in part, depending on specific conditions in individual countries.

Numerous participants take part in preparation and implementation of energy reform, particularly energy producers and energy transmission, storage and distribution operators, consumers, independent energy regulators, independent market protection and competition regulators, energy market operators, state authorities and NGOs. All participants play their roles, have their rights and obligations under the new energy laws, but their actual position depends on the reform implementation stage. Although the reform process starts from the same point in all the EU Member States, the results are not the same. Characteristically, the process evolves gradually, with exemption of some energy reform measures from implementation, but remaining firmly oriented towards complete implementation and creation of an integrated energy market.

## 4. CROATIAN ENERGY SECTOR REFORM

### 4.1. Basic Legislation

The energy sector reform and harmonisation of energy legislation with *acquis communautaire* had started much before Croatia became a candidate for the EU accession<sup>4</sup>, but it was an important boost to the process. Below is a chronological summary of legal documents based on which the reform has been carried out.

**Constitution of the Republic of Croatia** from 1990 and its amendments from 1997, 2000 and 2001 (consolidated text, Official Gazette 41/2001 and 55/01-corr.) constitutes, together with international treaties, the basic legal source and grounds for implementation of the legal reform in energy sector.

According to the Constitution, freedom, equal rights, national and gender equality, peace-making, social justice, respect for human rights, inviolability of ownership, conservation of nature and the environment, the rule of law and a democratic multiparty system are the highest values of the constitutional order of the Republic of Croatia (Article 3). The Constitution guarantees the right of ownership. Ownership shall imply obligations. Holders of the right of ownership and its users shall contribute to the general welfare. A foreign person may exercise the right of ownership under the conditions specified by law (Article 48). Free enterprise and free market shall form the foundation of the economic system of the Republic of Croatia. The state shall ensure all entrepreneurs equal legal status on the market. The abuse of monopolies, as defined by law, shall be forbidden. The state shall encourage the economic progress and social welfare of its citizens, and care for the economic development of all regions. The rights acquired through the investment of capital shall not be infringed by law or any other legal act. Foreign investors shall be guaranteed free transfer and repatriation of profits and invested capital. (Article 49). In the interest of the Republic of Croatia, ownership may be restricted or forfeited by law, subject to indemnification equal to the market value of the pertinent property. Free enterprise and property rights may be exceptionally restricted by law for the purposes of protecting the interests and security of the Republic of Croatia, nature and the human environment and public health (Article 50).

**United Nations Framework Convention on Climate Change**<sup>5</sup> (UNFCCC), ratified by the Republic of Croatia on 17 January 1996. The ultimate objective of this Convention is to achieve stabilisation of greenhouse gas concentrations in the atmosphere at a level that would prevent dangerous anthropogenic interference with the climate system. Such a level should be achieved within a time frame sufficient to allow ecosystems to adapt naturally to climate change, to ensure that food production is not threatened and to enable economic development to proceed in a sustainable manner (Article 2).

**The Energy Charter Treaty**<sup>6</sup> signed in December 1994 and ratified by the Republic of Croatia in September 1997. This international Treaty establishes a legal framework in order to promote long-term cooperation in the energy field, based on complementarities and mutual benefits, in accordance with the objectives and principles of the Charter, and the Republic of Croatia undertook to develop an open and competitive market for Energy Materials and Products (Articles 2 and 3).

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<sup>4</sup> Decision of the European Council of 17 and 18 June 2004 that Croatia is a candidate country for membership and that the accession process should be launched.

<sup>5</sup> *Act on ratification of the United Nations Framework Convention on Climate Change* (Official Gazette–International Treaties 2/96).

<sup>6</sup> *Act on ratification of The Energy Charter Treaty* (Official Gazette – International Treaties 15/97)

**Energy Charter Protocol on Energy Efficiency and Related Environmental Aspects**<sup>7</sup> ratified in April 1998. The Protocol defines policy principles for the promotion of energy efficiency as a considerable source of energy and for consequently reducing adverse Environmental Impacts of energy systems. The Republic of Croatia undertook to participate in development and implementation of energy efficiency policy, laws and other regulations. It furthermore provides guidance on the development of energy efficiency programmes, indicates areas of cooperation and provides a framework for the development of co-operative and coordinated action. Such action may include the prospecting for, exploration, production, conversion, storage, transport, distribution, and consumption of energy, and may relate to any economic sector. The objectives of this Protocol are: the promotion of energy efficiency policies consistent with sustainable development; the creation of framework conditions which induce producers and consumers to use energy as economically, efficiently and environmentally soundly as possible, particularly through the organisation of efficient energy markets and a fuller reflection of environmental costs and benefits; and the fostering of co-operation in the field of energy efficiency (Article 1).

The EC legal instruments are those available to the Community institutions to perform their tasks according to the Treaty establishing the European Economic Community. These are: regulations, directives, decisions and recommendations. The directives are binding as to the results to be achieved; they have to be transposed into the national legal framework and thus leave a margin for manoeuvre as to the form and means of implementation<sup>8</sup>. The following EC laws were the most important for launching of energy reform.

**Directive 96/92/EC** of the European Parliament and of the Council of 19 December 1996 **concerning common rules for the internal market in electricity**<sup>9</sup>. This Directive establishes common rules for the generation, transmission, distribution and supply of electricity. It lays down the rules relating to the organisation and functioning of the electricity sector, access to the market, the criteria and procedures applicable to calls for tenders and the granting of authorisations and the operation of systems (Article 1).

**Directive 98/30/EC** of the European Parliament and of the Council of 22 June 1998 **concerning common rules for the internal market in natural gas**<sup>10</sup>. This Directive established common rules for the transmission, distribution, supply and storage of natural gas. It lays down the rules relating to the organisation and functioning of the natural gas sector, including liquefied natural gas (LNG), access to the market, the criteria and procedures applicable to the granting of authorisations for transmission, distribution, supply and storage of natural gas (Article 1).

**Council Regulation (EC) No 2666/2000** of 5 December 2000 **on assistance for Albania, Bosnia and Herzegovina, Croatia, the Federal Republic of Yugoslavia and the Former Yugoslav Republic of Macedonia, repealing Regulation (EC) No 1628/96 and amending Regulations (EEC) No 3906/89 and (EEC) No 1360/90 and Decisions 97/256/EC and 1999/311/EC**. The main purpose of the Community assistance is to support participation by the recipient countries in the stabilisation and association process. (Article 2).

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<sup>7</sup> *Regulation on ratification of the Energy Charter Protocol on Energy Efficiency and Related Environmental Aspects* (Official Gazette – International Treaties 7/98)

<sup>8</sup> Glossary: EU Institutions, Policies and Enlargement, EC Delegation in Croatia, May 2003

<sup>9</sup> Official Journal L 027, 30.1.1997 p. 0020-0029

<sup>10</sup> Official Journal L 204, 21.7.1998

In May 2001, the Republic of Croatia passed a number of laws integrally regulating the energy reform issues, and harmonised most of its energy legislations with the EC directives.

**Energy Act**<sup>11</sup> regulates: measures ensuring secure and reliable energy supply, efficient power generation and use; legislation that stipulates and which is the basis for implementation of energy policy and energy development planning; carrying out of energy-related activities on the market or as public service, and key issues related to pursuing energy activities (Article 1).

**Act on Regulation of Energy Activities**<sup>12</sup> The Energy Regulatory Council is established as an independent legal entity in charge of issuing licences for carrying out energy-related activities, activities aimed at ensuring transparent and non-discriminatory functioning of the energy market, activities aimed at ensuring transparent and non-discriminatory performance of energy activities as public service, carrying out activities related to regulation of energy prices to be set on the basis of tariff systems, and carrying out other activities within the scope of Energy Act and other laws regulating energy activities performed on free market principles or as public services (Article 1).

**Electricity Market Act**<sup>13</sup> regulates energy-related activities: electricity generation, transmission, distribution, supply, power grid control and organisation of electricity market (Article 1).

**Gas Market Act**<sup>14</sup> regulates energy-related activities, i.e. gas supply and distribution to be carried out on the basis of free market principles. It also regulates gas transmission as a public service (Article 1).

**Crude Oil and Petroleum Products Act**<sup>15</sup> regulates energy-related activities, i.e. production of petroleum products, transportation of oil by pipelines and other means of transportation, transportation of petroleum products by pipelines and other means of transportation, wholesale of petroleum products, retail of petroleum products, storage of crude oil and petroleum products, which are carried out as market activities (Article 1).

**Stabilisation and Association Agreement between the European Community and Member States of the one part and the Republic of Croatia of the other part**<sup>16</sup> signed in October 2001, which came into force in February 2005. An Association is established by this Agreement between the Community and its Member States of the one part and Croatia of the other part. The aims of this Association are: to provide an appropriate framework for political dialogue, allowing the development of close political relations between the Parties; to support the efforts of Croatia to develop its economic and international cooperation, also through the approximation of its legislation to that of the Community; to support the efforts of Croatia to complete the transition into a market economy, to promote harmonious economic relations and develop gradually a free trade area between the Community and Croatia; to foster regional co-operation in all the fields covered by this Agreement (Article 1).

**Energy Development Strategy of the Republic of Croatia**<sup>17</sup> of March 2002. The Strategy is a part of an overall strategy for the Croatian economic growth. Between 1995 and 1998, numerous researches

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<sup>11</sup> Official Gazette 68/01

<sup>12</sup> Official Gazette 68/01

<sup>13</sup> Official Gazette 68/01

<sup>14</sup> Official Gazette 68/01

<sup>15</sup> Official Gazette 68/01

<sup>16</sup> Official Gazette – International Treaties 7/05

<sup>17</sup> Official Gazette 38/02



were carried out as a background for a draft Energy Development Strategy of the Republic of Croatia prepared in July 1998. It encompasses all aspects of development and relations in the energy sector and presents a reform of the entire energy management system. The energy sector development strategy has its energy, economics, legal, organisational, institutional and educational aspects and is aimed at facilitating the Croatian energy sector in its integration into the European Union (Introduction).

**Resolution on the accession of the Republic of Croatia to the European Union**<sup>18</sup> adopted on 18 December 2002. The Croatian Parliament thereby decided to fully harmonise the legal system of the Republic of Croatia with the standards and the *acquis communautaire* of the European Union. Thus, a step forward was made in the accession process even before the Stabilisation and Association Agreement came into force.

**INA d.d. Industrija Nafta Privatization Act**<sup>19</sup> of 19 March 2002. This act regulates privatization of the INA – Industrija nafte d.d. (Oil Industry) (Article 1).

**Hrvatska Elektroprivreda d.d. Privatization Act**<sup>20</sup> of 19 March 2002. This act regulates privatization of the Hrvatska Elektroprivreda d.d. (National Power Company) (Article 1).

The EU energy legislation was supplemented with new directives and the old directives were improved.

**Directive 2001/77/EC** of the European Parliament and of the Council of 27 September 2001 **on the promotion of electricity produced from renewable energy sources in the internal electricity market**<sup>21</sup>. The purpose of this Directive is to promote an increase in the contribution of renewable energy sources to electricity production in the internal market for electricity and to create a basis for a future Community framework thereof (Article 1).

**Directive 2002/91/EC** of the European Parliament and of the Council of 16 December 2002 **on the energy performance of buildings**<sup>22</sup>. The objective of this Directive is to promote the improvement of the energy performance of buildings within the Community, taking into account outdoor climate and local conditions, as well as indoor climate requirements and cost-effectiveness. This Directive lays down requirements as regards: the general framework for a methodology of calculation of the integrated energy performance of buildings; the application of minimum requirements on the energy performance of new buildings; the application of minimum requirements on the energy performance of large existing buildings that are subject to major renovation; energy certification of buildings; and regular inspection of boilers and of air-conditioning systems in buildings and, in addition, an assessment of the heating installation in which the boilers are more than 15 years old (Article 1).

**Directive 2003/30/EC** of the European Parliament and of the Council of 8 May 2003 **on the promotion of the use of biofuels or other renewable fuels for transport**<sup>23</sup>. This Directive aims at promoting the use of biofuels or other renewable fuels to replace diesel or petrol for transport purposes in each Member State, with a view to contributing to objectives such as meeting climate change commitments, environmentally friendly security of supply and promoting renewable energy sources (Article 1).

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<sup>18</sup> Official Gazette 153/02

<sup>19</sup> Official Gazette 32/02

<sup>20</sup> Official Gazette 32/02

<sup>21</sup> Official Journal L , 27.10.2007

<sup>22</sup> Official Journal L 1, 4. 1. 2003

<sup>23</sup> Official Journal L , 123, 17. 5. 2003

**Directive 2003/54/EC** of the European Parliament and of the Council of 26 June 2003 **concerning common rules for the internal market in electricity and repealing Directive 96/92/EC**<sup>24</sup> The new directive establishes common rules for the generation, transmission, distribution and supply of electricity. It lays down the rules relating to the organisation and functioning of the electricity sector, access to the market, the criteria and procedures applicable to calls for tenders and the granting of authorisations and the operation of systems (Article 1).

**Directive 2003/55/EC of the European Parliament and of the Council of 26 June 2003 concerning common rules for the internal market in natural gas and repealing Directive 98/30/EC**<sup>25</sup>. The new directive establishes common rules for the transmission, distribution, supply and storage of natural gas. It lays down the rules relating to the organisation and functioning of the natural gas sector, including liquefied natural gas (LNG), access to the market, the criteria and procedures applicable to the granting of authorisations for transmission, distribution, supply and storage of natural gas and the operation of systems. The rules established by this Directive for natural gas, including liquefied natural gas (LNG), shall also apply to biogas and gas from biomass or other types of gas in so far as such gases can technically and safely be injected into, and transported through, the natural gas system (Article 1).

**Decision No 1229/2003/EC**<sup>26</sup> of the European Parliament and of the Council of 26 June 2003 **laying down series of guidelines for trans-European energy networks and repealing Decision No. 1254/96/EC (OJ L 176, 15. 7. 2003)** The new decision defines the nature and scope of Community action to establish guidelines for trans-European energy networks. It establishes a series of guidelines covering the objectives, priorities and broad lines of action by the Community in respect of trans-European energy networks. This Decision applies to electricity networks, i.e. to: all high voltage lines, excluding those of distribution networks, and to submarine links, provided that this infrastructure is used for inter regional or international transmission/connection; any equipment or installations essential for the system in question to operate properly, including protection, monitoring and control systems; to natural gas networks, i.e. to: high pressure gas pipelines, excluding those of distribution networks, making it possible to supply regions of the Community from internal or external sources; to underground storage facilities connected to the abovementioned high pressure gas pipelines; reception, storage and regasification facilities for liquefied natural gas (LNG) and also gas carriers according to the capacities to be supplied; to any equipment or installations essential for the system in question to operate properly, including protection, monitoring and control systems (Articles 1 and 2).

**Act on Environmental Protection and Energy Efficiency Fund**<sup>27</sup> of 24 June 2003. It establishes the Croatian Environmental Protection and Energy Efficiency Fund, regulates its organisation, activities, funding sources and method of spending of funds, and other issues related to the performance of the Fund activities (Article 1).

The EU energy legislation has been amended with new and improved versions of old directives.

**Council Directive 2003/96/EC** of 27 October 2003 **restructuring the community framework for the taxation of energy products and electricity**<sup>28</sup>. This Directive makes up for the absence of Community provisions imposing a minimum rate of taxation on electricity and energy products other than mineral oils which may adversely affect the proper functioning of the internal market and the achievement of the

<sup>24</sup> Official Journal L 176, 15. 7. 2003

<sup>25</sup> Official Journal L , 176, 15. 7. 2003

<sup>26</sup> Official Journal L 176, 15.7.2003

<sup>27</sup> Official Gazette 107/03

<sup>28</sup> Official Journal L 176, 15. 7. 2003

objectives of other Community policies which require minimum levels of taxation to be laid down at Community level for most energy products, including electricity, natural gas and coal (Introduction).

**Directive 2004/8/EC** of the European Parliament and of the Council of 11 February 2004 **on the promotion of cogeneration based on a useful heat demand in the internal energy market and amending Directive 92/42/EEC**<sup>29</sup>. The purpose of this Directive is to increase energy efficiency and improve security of supply by creating a framework for promotion and development of high efficiency cogeneration of heat and power based on useful heat demand and primary energy savings in the internal energy market, taking into account the specific national circumstances especially concerning climate and economic conditions (Article 1).

**Council Directive 2004/67/EC** of 26 April 2004 **concerning measures to safeguard security of natural gas supply**<sup>30</sup>. This Directive establishes measures to safeguard an adequate level for the security of gas supply. These measures also contribute to the proper functioning of the internal gas market. It establishes a common framework within which Member States shall define general, transparent and non-discriminatory security of supply policies compatible with the requirements of a competitive internal gas market; clarify the general roles and responsibilities of the different market players and implement specific non-discriminatory procedures to safeguard security of gas supply (Article 1).

After the EU had adopted a number of new directives improving the legal framework for the energy sector, in December 2004 Croatia passed the new laws in order to harmonise with the EU legislation, including the following laws.

#### **Act amending the Energy Act**<sup>31</sup>

New **Act on the Regulation of Energy Activities**<sup>32</sup> which improves the establishment and implementation of the regulation system for the energy-related activities, regulates the procedure for establishment of the energy regulatory bodies, and other matters of importance for the regulation of energy-related activities.

New **Electricity Market Act**<sup>33</sup> improves the performance of the following energy-related activities: electricity generation, transmission, distribution, supply, and organisation of electricity market (Article 1).

**Heat Production, Distribution and Supply Act**<sup>34</sup> of 18 March 2005. This law regulates heat production, distribution and supply as the energy-related activity (Article 1).

The new EC legislation has also been adopted.

**Directive 2005/32/EC** of the European Parliament and of the Council of 6 July 2005 **establishing a framework for the setting of eco-design requirements for energy-using products and amending Council Directive 92/42/EEC and Directives 96/57/EC and 2000/55/EC of the European Parliament and of the Council**<sup>35</sup>. This Directive establishes a framework<sup>35</sup> for the setting of Community eco-design

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<sup>29</sup> Official Journal L 52, 21. 2. 2004

<sup>30</sup> Official Journal L 127, 29. 4. 2004

<sup>31</sup> Official Gazette 177/04

<sup>32</sup> Official Gazette 177/04

<sup>33</sup> Official Gazette 177/04

<sup>34</sup> Official Gazette 42/05

<sup>35</sup> Official Journal L 191, 22. 7. 2005

requirements for energy-using products with the aim of ensuring the free movement of those products within the internal market. This Directive provides for the setting of eco-design requirements by implementing measures. The Directive does not apply to means of transport for persons or goods. The Directive objective is setting up of an integrated framework for the overall environmental impact assessment of energy-using products including, in addition to the energy efficiency, use and possible recycling of materials, emissions to air and water, and other impacts (Article 1).

**Regulation (EC) No 1775/2005** of the European Parliament and of the Council of 28 September 2005 **on conditions for access to the natural gas transmission networks**<sup>36</sup>. This Regulation aims at setting non-discriminatory rules for access conditions to natural gas transmission systems taking into account the specificities of national and regional markets with a view to ensuring the proper functioning of the internal gas market. This objective shall include the setting of harmonised principles for tariffs, or the methodologies underlying their calculation, for access to the network, the establishment of third party access services and harmonised principles for capacity allocation and congestion management, the determination of transparency requirements, balancing rules and imbalance charges and facilitating capacity trading (Article 1).

The Energy Community was established in order to improve the EU accession process of the countries of the Western Balkans and regional cooperation.

**Treaty establishing the Energy Community**<sup>37</sup> signed on 25 October 2005 between European Community of the one part and the Republic of Albania, the Republic of Bulgaria, Bosnia and Herzegovina, the Republic of Croatia, the former Yugoslav Republic of Macedonia, the Republic of Montenegro, Romania, Republic of Serbia of the other part. By this Treaty, the Parties establish among themselves an Energy Community. The task of the Energy Community shall be to organise the relations between the Parties and create a legal and economic framework in relation to Network Energy, in order to:

(a) create a stable regulatory and market framework capable of attracting investment in gas networks, power generation, and transmission and distribution networks, so that all Parties have access to the stable and continuous energy supply that is essential for economic development and social stability, (b) create a single regulatory space for trade in Network Energy that is necessary to match the geographic extent of the concerned product markets, (c) enhance the security of supply of the single regulatory space by providing a stable investment climate in which connections to Caspian, North African and Middle East gas reserves can be developed, and indigenous sources of energy such as natural gas, coal and hydropower can be exploited, (d) improve the environmental situation in relation to Network Energy and related energy efficiency, foster the use of renewable energy, and set out the conditions for energy trade in the single regulatory space, (e) develop Network Energy market competition on a broader geographic scale and exploit economies of scale. "Network Energy" includes the electricity and gas sectors falling within the scope of the European Community Directives 2003/54/EC and 2003/55/EC (Articles 1 and 2).

The activities of the Energy Community include:

(a) the implementation by the Contracting Parties of the *acquis communautaire* on energy, environment, competition and renewables, as described in Title II, adapted to both the institutional framework of the

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<sup>36</sup> Official Journal L 289, 3.11.2005

<sup>37</sup> Official Gazette – International Treaties 6/06

Energy Community and the specific situation of each of the Contracting Parties (hereinafter referred to as “the extension of the *acquis communautaire*”);

(b) the setting up of a specific regulatory framework permitting the efficient operation of Network Energy markets across the territories of the Contracting Parties and part of the territory of the European Community, and including the creation of a single mechanism for the cross-border transmission and/or transportation of Network Energy, and the supervision of unilateral safeguard measures (hereinafter referred to as “the mechanism for operation of Network Energy markets”), as further described in Title III;

(c) the creation for the Parties of a market in Network Energy without internal frontiers, including the coordination of mutual assistance in case of serious disturbance to the energy networks or external disruptions, and which may include the achievement of a common external energy trade policy (Article 3).

The EU energy legislation and policy have been supplemented with the following legislation.

**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**<sup>38</sup>. This Directive establishes measures aimed at safeguarding security of electricity supply so as to ensure the proper functioning of the internal market for electricity and to ensure: an adequate level of generation capacity, an adequate balance between supply and demand and an appropriate level of interconnection between Member States for the development of the internal market. It establishes a framework within which Member States are to define transparent, stable and non-discriminatory policies on security of electricity supply compatible with the requirements of a competitive internal market for electricity (Article 1).

**Directive 2006/32/EC** of the European Parliament and of Council of 5 April 2006 **on energy end-use efficiency and energy services and repealing Council Directive 93/76/EEC**<sup>39</sup>. The purpose of this Directive is to enhance the energy efficiency and energy services by creating the conditions for the development of a market for energy services and thus contribute to the environmental protection and secure energy supply. The directive aims at providing the indicative targets as well as mechanisms, incentives and institutional, financial and legal frameworks to remove existing market barriers and imperfections that impede the efficient end use of energy (Article 1);

**Green paper: A European Strategy for Sustainable, Competitive and Secure Energy**<sup>40</sup> of 8 March 2006 determines that developing a European energy policy will be a long term challenge. This needs a clear but flexible framework: clear in that it represents a common approach endorsed at the highest level, flexible in that it needs periodic updating. Europe’s energy policy should have three main objectives:

- Sustainability: (i) developing competitive renewable sources of energy and other low carbon energy sources and carriers, particularly alternative transport fuels, (ii) curbing energy demand within Europe, and (iii) leading global efforts to halt climate change and improve local air quality.
- Competitiveness: (i) ensuring that energy market opening brings benefits to consumers and to the economy as a whole, while stimulating investment in clean energy production and energy efficiency, (ii) mitigating the impact of higher international energy prices on the EU economy and its citizens and (iii) keeping Europe at the cutting edge of energy technologies.

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<sup>38</sup> Official Journal L 33, 4. 2. 2006

<sup>39</sup> Official Journal L 114, 27. 4. 2006

<sup>40</sup> COM (2006)205 final, 8.3.2006

- Security of supply: tackling the EU's rising dependence on imported energy through (i) an integrated approach – reducing demand, diversifying the EU's energy mix with greater use of competitive indigenous and renewable energy, and diversifying sources and routes of supply of imported energy, (ii) creating the framework which will stimulate adequate investments to meet growing energy demand, (iii) better equipping the EU to cope with emergencies, (iv) improving the conditions for European companies seeking access to global resources, and (v) making sure that all citizens and business have access to energy (Item 3 and Conclusions).

Following the EU energy legal framework improvement, Croatia passed the following new laws to harmonise with the EU legislation.

**New Crude Oil and Petroleum Products Market Act<sup>41</sup>** of 12 May 2006. This act regulates the following activities: production of petroleum products, transportation of oil by pipelines and other means of transportation, transportation of petroleum products by pipelines and other means of transportation, wholesale of petroleum products, retail of petroleum products, storage of and trading in crude oil and petroleum products, agency and representation in the crude oil and petroleum product markets. Under this Act, the Croatian Compulsory Oil Stocks Agency HANDA was established and the measures for crude oil and petroleum product supply security and reliability determined (Article 1).

**New Gas Market Act<sup>42</sup>** of 30 March 2007 regulates rules and measures for performance of energy-related activities in the natural gas sector, including the LNG, rights and obligations of the natural gas market participants, unbundling of the system operator activity, third-party access to the natural gas system and opening of the natural gas market (Article 1).

**Kyoto Protocol to the United Nations Framework Convention on Climate Change<sup>43</sup>** was signed by Croatia in 1999 and ratified in May 2007. Croatia undertook to ensure that its aggregate anthropogenic carbon dioxide equivalent emissions of the greenhouse gases do not exceed their assigned amounts, calculated pursuant to its quantified emission limitation and reduction commitments, with a view to reducing its overall emissions of such gases by at least 5 per cent below 1990 levels in the commitment period 2008 to 2012 (Article 3). Each Party shall have in place, no later than one year prior to the start of the first commitment period, a national system for the estimation of anthropogenic emissions by sources and removals by sinks of all greenhouse gases not controlled by the Montreal Protocol (Article 5).

**New Physical Planning and Construction Act<sup>44</sup>** of 13 July 2007 regulates the system of urban planning and construction, and energy efficiency in building construction. Each building, depending on its type and purpose, shall be designed, built and maintained so that it retains its stipulated energy properties during its use. Before the occupancy licence is issued and/or before title is changed or building or a part thereof is leased, a certificate has to be obtained on energy properties of a building issued by a licensed person. The energy properties and method of calculation of building thermal properties, energy requirements on new and existing buildings with exceptions from the requirements, conditions, contents and method of issuing the certificates (certification process), buildings obliged to public display of their energy property certificates and conditions for authorized certifiers are regulated by a by-law (Articles 1 and 15).

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<sup>41</sup> Official Gazette 57/06

<sup>42</sup> Official Gazette 40/07

<sup>43</sup> *Act on ratification of Kyoto Protocol to the United Nations Framework Convention on Climate Change* (Official Gazette – International Treaties 5/07)

<sup>44</sup> Official Gazette 76/07 and 38/09

**Energy End-Use Efficiency Act**<sup>45</sup> of 18 December 2008 regulates efficient end-use of energy, adopting of plans and programmes for improvement of energy efficiency and their implementation, energy efficiency measures, and particularly energy services and energy audits, obligations of public sector, energy company and large consumer, and rights of consumers with regard to implementation of energy efficiency measures. The purpose of the Act is to achieve sustainable energy development objectives: mitigate environmental impacts from energy sector, improve energy supply security, satisfy energy consumer needs and meet international commitments of the Republic of Croatia with regard to reduction of greenhouse emission by stimulating implementation of energy efficiency measures in the energy end-use sectors (Article 1).

**Act on Biofuels for Transport**<sup>46</sup> is currently in the parliamentary procedure. This act regulates production, trade, storage and use of biofuels and other renewable fuels in transport, adoption of plans and programmes for the promotion of production and use of biofuels in transport, powers and responsibilities for establishment and implementation of the policy aimed at promotion of the production and use of biofuels for transport, as well as the measures to support production and use of biofuels in transport. The purpose of this Act is to achieve the targets of sustainable development in the transport sector: mitigation of the environmental impacts, improvement of environmentally friendly security of supply, meeting the consumers' needs for fuel and fulfilment of international commitments of the Republic of Croatia regarding greenhouse gas emission saving by promoting the production and use of biofuels for transport to replace diesel or petrol (Articles 1 and 2).

**Amendments to the Energy Strategy of the Republic of Croatia - Draft Green Paper** of October 2008<sup>47</sup> aiming at defining of the Croatian energy sector by 2020. The purpose of the Strategy is to build, under the conditions of uncertainty in the global energy market and scarce local energy resources, a sustainable energy system, a system that makes a balanced contribution to security of energy supply, competitiveness and environmental protection and provides for security and availability of energy supply to the Croatian citizens and business sector.

In December 2008, the most recent updates of the Croatian energy legislation were made, and the new laws are:

**Act amending the Energy Act**<sup>48</sup>

**Act amending the Electricity Market Act**<sup>49</sup>

**Act amending the Gas Market Act**<sup>50</sup> .

### 3.2. Energy Reform Status

#### General

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<sup>45</sup> Official Gazette 152/08

<sup>46</sup> Final biofuel for transport bill

<sup>47</sup> Draft Green Paper

<sup>48</sup> Official Gazette 152/08

<sup>49</sup> Official Gazette 152/08

<sup>50</sup> Official Gazette 152/08

The energy sector reform is one of the transition process component, and is therefore faced with weaknesses characteristic for the transition to market economy. This means that the energy sector, despite the declared goals, is to a certain degree exposed to liberal market relations which do not depend on the administrative authorities. The energy pricing, particularly pricing of electricity and natural gas, is politically controlled and liberalisation of prices is a limited prices, mostly because of the general economic and social situation in the country.

The reform is typically carried out consecutively with the EU energy sector reforms, thus it has previously evolved in phases and required subsequent and multiple changes in legislation and other aspect of reform, that had not been fully completed.

Institutional and structural changes have been implemented but, compared to the objectives, the effects that have been achieved are only initial. Reorganisation of energy companies has not resulted in increase in efficiency in the sector, and role of regulatory bodies is focused on completing of the energy legislation and adopting tariff system methodologies, without tariff schedules, for the energy transmission, distribution, and supply of the so called tariff consumers who have not selected their supplier. The Croatian Energy Regulatory Agency (HERA) is an autonomous, independent and non-profit agency which regulates energy activities in the entire energy sector but for nuclear energy. The Croatian Energy Market Operator (HROTE) is owned by the Republic of Croatia, and it acts as the electricity and natural gas market operator.

The energy market has been open formally, but in energy supply, state-owned and semi-privatized companies are still not faced with real competition and the actual market competition has not started yet.

The national plan for energy end-use efficiency is still in the governmental procedure, and the National Action Plan for Renewable Energy Sources is in preparation. The updating and upgrading of the energy strategy for Croatia has been prepared (Draft Green Paper) and has entered the final stages of the governmental procedure.

### Electricity

Statutory regulations in the electricity sector have been almost completely harmonised with the EU directives. There is no secondary legislation on licensing procedure for the construction of power plants. The secondary legislation has been promulgated to encourage electricity generation from the renewable sources. This has resulted in a large interest in preparation of implementation of construction projects for electricity generation from renewable sources.

Hrvatska Elektroprivreda d.d. (HEP) is the national electricity company organized as a holding company including: transmission system operator, distribution system operator, electricity supply company, and electricity generation company which is a separate entity. The property used for business operations of these companies is owned by the holding company. The Hrvatska Elektroprivreda d.d. Privatization Act was adopted but no political decision has been made on its privatization. Electricity price is not regulated on the market but controlled by the Government, which causes problems related to profitability of the HEP business operations.

The electricity market is open to all the consumers, but HEP has no real competition in the market. Private investments have started recently with construction of two wind parks, while a number of private facilities is still in administrative procedure. The capacity of the transmission and distribution network to accommodate new sources imposes major limitation.



## Natural Gas

Statutory regulations and secondary legislation in the natural gas sector have been almost completely harmonised with the EU directives.

Transmission system operator is Plinacro d.d., a state-owned company which also manages the natural gas storage system. The only Croatian natural gas producer and importer is INA d.d. Oil Company and the Republic of Croatia is no more majority owner of this company. Problems with the gas supply security ensue from the fact that the Croatian gas resources are insufficient and the supply line from Russia is the only supply source. Natural gas distribution and supply (separate accounting) is carried out by a number of small businesses (municipal utilities or public-private ownerships),

Formally, the market is open and the consumers have a right to choose their supplier, but the gas price is not based on market principles but controlled by the Government which causes problems with profitability of the INA business operations.

The gas mains towards Dalmatia is currently under construction. Preparations for construction the first international LNG terminal construction project in the Adriatic are underway, with 25% participation of the Croatian companies.

## Heat

Statutory regulations in heat sector have been almost completely harmonised with EU directives. There is no secondary legislation encouraging heat production from renewable sources.

The market is still not completely open. The majority of district heating systems are within the HEP d.d.

The heat price is not regulated at the market but controlled by the Government which causes problems with profitability of the HEP and small heat suppliers business operations.

## Crude Oil and Petroleum Products

Statutory regulations in the crude oil and petroleum products sector have been almost completely harmonised with the EU directives.

Crude oil and petroleum product stocks are managed by the Croatian Compulsory Oil Stocks Agency (HANDA), an autonomous, independent and non-profit agency which regulates crude oil and petroleum product stocks. The stocks have still not reached the required 90-day reserve,

The market is open for all consumers. The only producer of crude oil and petroleum products is INA d.d. In addition to INA d.d., a number of small businesses is involved in import and supply. Pricing is market-based and under administrative control of the Government.

## **5. ENERGY SECTOR PROSPECTS AND ROLE OF LAWYERS**

### **5.1. Energy Sector Prospects**

Croatia will continue to adhere to the EU energy policy, regardless of the date of its formal accession to the EU. Croatia signed and ratified numerous international treaties, and its relation with the EU is necessary not only in the energy but also in the overall economic sector. Such approach is confirmed by the Draft Green Paper – Update/Upgrade of the Energy Strategy and of the Implementation Programme for the Republic of Croatia focusing on defining the Croatian energy sector development by 2020.

The Croatian energy legislation will be completed with secondary legislation and will reflect the changes in the EU legislation, particularly with regard to the renewable energy sources, but it might lag behind the changes in the EU.

Croatia requires private investment into new energy sources. Privatization of HEP should be expected as well as private-public partnerships in new energy sources, where suitable to the future partners in the market, because Croatia has reached an excessive debt level and because of the energy sector privatization policy.

The energy sector privatization shall free the prices from state influence, but the protective prices to protect the vulnerable consumers will become a problem.

Numerous changes in organisation and ownership structure of the energy companies will be necessary to achieve new energy policy objectives. Intersectoral coordination of state authorities should be improved, licensing and approval procedures for new power facilities need to be simplified, particularly with regard to the renewable sources, and current changes in the EU legislation need to be regularly observed.

### **5.2. Role of Lawyers**

Lawyers have already contributed and might contribute considerably to the future implementation of the energy sector reform because:

- they are independent and autonomous in their work,
- they have the ability to identify with the needs and interests of their clients,
- they are qualified to offer all sorts of legal aid,
- they are capable of responding to new challenges and conditions under which they render their services.

Conditions for increase in contribution of the lawyers:

- intensive familiarization with the EU legislation and case law (supported by theory),
- extensive collaboration with experts and colleagues (in Croatia, region and EU),
- presentation and analysis of experience and searching for solutions for improvement in legislation and practice.

Expected lawyers' contribution includes:

- elaboration and studying of legal problems encountered in reform implementation (as needed by the administrative authorities),
- direct involvement in preparation of primary and secondary legislation (in collaboration with the civil servants and other experts),

- public consultations and publishing of professional standings on issues related to the reform (in Croatia, region and EU),
- representing client interests in proceedings before the national authorities and courts,
- consultations on legal aspects of the energy sector reform and conditions necessary for the sector business operations.

We hope that the energy sector participants will recognize options for additional improvement of the collaboration in the field, and it is the lawyers' duty to offer their support in that.

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