GPARTNERS

CLIENT NOTE

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Regulation of Energy Sector in Armenia

Article 10 of the Constitution of Armenia provides that the State shall ensure the protection and reproduction of the environment and the reasonable utilisation of natural resources. Article 48 disposes that one of the basic tasks of the State is to pursue the environmental security policy for present and future generations.

LICENSING REQUIREMENTS

According to the Licensing Act the following energy-related activities require a license, which is granted by the Public Services Regulatory Commission (in the case of the power engineering sector), or the Government (in the case of the nuclear power sector):

Power engineering sector:

a) Production, import and export, transport, distribution and trade in/of natural gas;

b) Production, import, transmission, export, distribution and trade in/of electrical energy;

c) Production, import and export, transport, distribution and trade in/of thermal energy;

d) Rendering services on transmission and centralised dispatch of electrical energy; and

e) Construction of new capacities in the fields of electrical and thermal powers.

Nuclear power sector:

a)Works on selection, construction, putting into operation, operation, usage, maintenance and removing away from operation of nuclear and radioactive waste stations, sources and storages of ionization radiation;

b) Works with radioactive wastes of nuclear and radioactive materials, including transportation, usage, storage, reprocessing and burial of such materials;

c) Import and export of nuclear, radioactive and special materials, radioactive wastes, special equipment and technologies;

d) Design and preparation of materials, equipment and systems for projects using atomic energy;

The specifics of licensing in the field of power engineering are detailed in the Law on Energy. The Law on Licensing does not apply to permits (licenses) issued for use of natural resources, which are governed by the Law on Concessions of 5 November 2002.

LAW ON ENERGY

The regulation of the Armenian energy sector is carried out by the Public Services Regulatory Commission (hereinafter referred to as "Commission"), which is autonomous within its jurisdiction. It has a key role due to its authority and its distinct and independent legal operations.

The Commission has a number of responsibilities, in particular it:

1) sets the regulated tariffs for electrical and thermal energy and natural gas, transmission (transportation), distribution in the energy sector, system operator, services provided in the energy market, as well as maximum tariffs for electricity and natural gas import;

2) issues licenses for operations in the energy sector;

3) oversees compliance with the license conditions and apply penalties

4) establishes rules on supply and use of electrical and thermal energy and natural gas;

5) establishes model electricity and natural gas supply contracts1, or mandatory provisions thereof,

6) sets quality requirements for services provided to the consumers by the companies.

Licensing of the Activities of Economic Entities in the Energy Sector

The operation of the energy sector is based on the system of licenses, which are not transferable.

A license is required for the following activities:

- generation of electricity and thermal energy,
- transmission (transportation) and distribution of electricity,
- thermal energy, and natural gas,
- implementation of system operator services in the electric energy and natural gas sectors,
- construction or reconstruction of new generating capacities in addition to associated transmission and distribution networks in the electric/thermal energy or natural gas sectors,
- electricity and natural gas import and export activities,
- power market services provision, electric and thermal power and natural gas sale/purchase activities.

The Commission must consider an application for granting a license and adopt the relevant decision (decree) within the term set by the Commission; the term cannot exceed 60 days from the moment of submission by the applicant of all required documents. The license provisions may be modified based on the initiative of the Commission, only with consent of the licensee.

The Law restricts the possibility of holding multiple licenses in order to avoid monopolistic or oligopolistic practices.

Electrical and Thermal Power and Natural Gas Provision Contracts

Concluded contracts between licensees, as well as import and export contracts become effective from the moment of their registration with the Commission.

The supplier has the right to disconnect the supply of electricity, thermal energy or natural gas to a customer if the customer does not pay a bill. Such disconnection from energy and/or natural gas supply shall follow a warning procedure.

The Commission has the right to impose sanctions in instances of noncompliance or inadequate compliance or violation of the requirements of the Law, the legal acts of the Commission, or the license provisions by the licensees. In particular, the Commission may impose the following sanctions: a warning, reduction of the tariffs, suspension of the license, and revocation of the license. An appeal against legal acts issued by the Commission can be filed in court. However, the amount of tariffs established by the Commission is not subject to appeal and cannot be changed by court.

SUBSOIL UTILISATION CODE

Subsoil is the exclusive property of the State, which may be granted on the basis of the right to use and shall not be privatized. Plots of subsoil shall not be subject to purchase/sale, pledge or otherwise alienated.

In some cases the use of subsoil may be limited. That could be in cases when human health, national security, and protection of the environment are endangered. Besides, subsoil use in residential areas, on the territory of suburban structures, industrial, and communication objects, etc. is limited or prohibited in order to prevent damage to important objects of economy.

Users of subsoil, acting with the aim of exploration, prospecting and development of radioactive resources, as well as disposal of radioactive or harmful chemical substances, shall be only legal entities established by the Government of Armenia and possessing a special permit.

CONCESSIONS FOR EXPLORATION AND MINING OPERATION

The Law on Allocation for Subsoil Exploration and Commercial Production for the Purposes of Mineral Resources Development (Concession) sets forth a procedure of subsoil allocation for the purposes of exploration and/or commercial production of mineral resources on the territory of the Republic of Armenia, as well as regulates the mining rights.

The Law distinguishes three types of licenses and their corresponding contracts with the Government:

1) license for mining operations which shall be issued for a period not exceeding 12 years;

2) license for exploration which shall be issued for a period not exceeding 3 years;

3) special license for mining operations which shall be issued for a period exceeding 12 years, but not more than 25 years.

The Ministry of Energy and Natural Resources competent for regulating this sector can also grant a permit to investigate an area which is not considered to be a mining object.

The decision to grant a license (or permit) and to conclude a license agreement should be taken in one month after the deposit of the application.

The special license for mining operations grants its owner an exclusive right to execute mining and exploration works in the area mentioned by the license.

The Concession Law regulates the termination of license (Article 31 and 32), thus protecting the rights of licensees.

There are corresponding taxes and annual payments for the licenses.

Mining rights may not be transferred or pledged without the consent of the Ministry of Energy of RA. Any mining rights transactions undertaken without such consent shall be null and void.

The Subsoil Utilisation Code and Concession for Investigation and Mining Operation of Subsoil Mineral Resources have two main weaknesses: the License for Exploration and the License for Production are not connected and the state taxes (royalties, supplementary payments, etc.) differ in the two laws.

ENERGY SAVING AND RENEWABLE ENERGY LAW

According to the Energy Saving and Renewable Energy Law the principles of Armenian policy in energy saving and renewable energy are:

1) Increasing the level of supply of indigenous renewable energy carriers to satisfy the energy demand of the economy,

2) Implementation of energy saving strategies, as well as development and enforcement of legal and economic mechanisms for the promotion of renewable energy,

3) Ensuring increasing usage of renewable energy resources as well as the application and development of renewable energy new technologies aimed its promotion,

4) Ensuring competitiveness of renewable energy resources and protection/enforcement of the rights of businesses engaged in the area of renewable energy,

5) Ensuring high priority of issues of environmental protection and efficient (economic) usage of natural resources while implementing measures/activities aimed at the development of energy saving and renewable energy; etc.

According to the Law, legal and physical persons using, producing and importing energy devices can submit those in the manner established by the Law on Certification of Compliance of Goods and Services with Normative Requirements for voluntary certification based on energy efficiency indicators. The costs are, however, carried by the mentioned legal (physical) persons. Further, all certified energy devices will be labeled.

The Law provides also for energy examination (audit) the purpose of which is to provide a conclusion on the real values of energy efficiency relative to values defined by national standards. This procedure is also voluntary.

INTERNATIONAL REGULATION OF ENERGY SECTOR: GENERAL DESCRIPTION

The Republic of Armenia has ratified the Energy Charter Treaty on 18 December 1997 and it entered into force in Armenia on 19 April 1998.

The Treaty's provisions focus on four broad areas:

- the protection of foreign investments, based on the extension of national treatment, or most-favoured nation treatment (whichever is more favourable) and protection against key non-commercial risks,
- non-discriminatory conditions for trade in energy materials, products and energy-related equipment based on WTO rules, and provisions to ensure reliable cross-border energy transit flows through pipelines, grids and other means of transportation,
- the resolution of disputes between participating states, and - in the case of investments - between investors and host states,
- the promotion of energy efficiency, and attempts to minimise the environmental impact of energy production and use.

In particular, the Treaty provides the obligation to combat anti-competitive conduct in tre energy sector (art. 6), to allow transit of energy materials through State territory (art. 7), to promote access to and transfer energy technology on a commercial and non-discriminatory basis to assist effective trade and investment in energy materials (art. 8), to ensure the access to capital (art. 9), etc.

PROTECTION OF INVESTMENTS

As regards the protection of investment in energy sector, the Treaty provides that every contracting State (including the State-owned enterprises (Article 22) and sub-national authorities (Article 23)) shall encourage and create stable, equitable, favourable and transparent conditions for investors of other contracting States to make investments in its territory. Such conditions shall include a commitment to accord at all times to investments of investors of other Contracting States fair and equitable treatment (art. 10). This provision implies that no State is under no legal obligation to let investors of other States make investments in its territory.

Any State shall accord to Investors of other contracting States a treatment which is no less favourable than that which it accords to its own investors or to investors of any other contracting State or any third state, whichever is the most favourable.

The Treaty provides a number of other guarantees for protecting the nationals of other contracting States making investments in its territory (art. 11-17). The Treaty also provides that laws, regulations, decisions, administrative rulings and treaties of the Contracting State should be transparent and accessible to the public (Article 20)

Notwithstanding all mentioned guarantees, the State conserves his sovereign rights over energy resources (art. 18), by reserving the rights to decide the geographical areas within its territory to be made available for exploration and development of its energy resources, the optimization of their recovery and the rate at which they may be depleted or otherwise exploited.

The Treaty provides that each Contracting State shall strive to minimize in an economically efficient manner harmful environmental impacts occurring either within or outside its territory from all operations within the energy cycle.

The Treaty also provides for a number of exceptions which, however, do not concern trade-related measures (Article 29), compensation for losses (Article 12) and the issues of expropriation (Article 13). The Treaty lists a number of exceptions to the provision of the Treaty which permit the Contracting State to adopt measures:

1. necessary to protect human, animal or plant life or health,
2. essential to the acquisition or distribution of energy materials and products in conditions of short supply arising from causes outside the control of that Contracting Party,
3. designed to benefit investors who are aboriginal people or socially or economically disadvantaged individuals or groups or their investments,
4. necessary to protect its essential security interests.
5. necessary to maintain its public order, etc.

DISPUTE SETTLEMENT

Lastly, the Treaty regulates the dispute settlement mechanism. Only one matter covered by the Treaty cannot be resolved via its dispute settlement mechanism: the trade-related matters which are to be solved via the dispute settlement rules of the GATT/WTO system.

It provides for two dispute settlements: one State-State disputes (to be resolved by an *ad hoc* tribunal(Article 27)) and the other disputes between the investor and the Contracting State.

As regards the latter, the Treaty stipulates that in the case the negotiations for settling any disputes between State and investors, arising under the Treaty do not succeed during three month period (so called "cool-off period"), the investors will have the right to chose any of the following forums for settling disputes:

- the courts or administrative tribunals of the Contracting State party to the dispute,
- international arbitration or conciliation, including arbitration under the auspices of the International Centre for Settlement of Investment Disputes (ICSID) or in accordance with the Arbitration Rules of the United Nations Commission on International Trade Law (UNCITRAL), or under the Arbitration Institute of the Stockholm Chamber of Commerce,
- in accordance with any other previously agreed dispute settlement mechanism.

A tribunal constituted in accordance with the preceding shall apply the Treaty and applicable rules and principles of international law. The awards rendered in accordance with the mentioned procedure are binding and final and shall be recognized and executed in States party to the ICSID Convention and (or) the New York Convention on recognition and enforcement of foreign arbitral awards.

If you would like further or more detailed information, please contact:

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