

**IPA Energy Consulting & Norton Rose**

**Energy Sector Technical Assistance Project II**

**Review of the Policy, Legal, Regulatory and Institutional  
Framework for Private Sector Participation in the Energy  
Sector in Kosovo**

**Final Report**

**to**

**Ministry of Energy and Mining  
&  
Central Regulatory Unit  
United Nations Mission in Kosovo**



**25 MARCH 2005**

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## IMPORTANT NOTICE

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# 1 INTRODUCTION

## 1.1 Scope and Purpose of the Report

- 1 This report forms the Final Report prepared pursuant to paragraphs 4.3 and 5.1 (Part III) of the Terms of Reference for the Kosovo Energy Sector Technical Assistance Project II. Regulation 2004/50 created the Ministry of Energy and Mining, and as a consequence the consultants' client – the Central Regulatory Unit of the UNMIK-EU Pillar (“CRU”) - no longer exists. This report is therefore issued both to Mr Zoran Morvay in his position as a representative of the former CRU and to Mr Ethem Ceku, Minister of Energy and Mining.
- 2 This report amends the Draft Final Report (amended) issued on 11 January 2005 taking into account comments received on the Draft Final Report and views expressed at the workshop held in Prishtina on 14<sup>th</sup> February to discuss the draft findings and recommendations. It also reflects certain important changes and developments affecting the power sector in Kosovo, namely:
  - the establishment of the Ministry of Energy and Mining and the consequent transfer of powers;
  - the promulgation of Regulation 2005/02 establishes the Independent Commission for Mines and Minerals and Regulation 2005/03 on Mines and Minerals;
  - recent developments in the tax regime
- 3 Consultees' comments on the Draft Final Report, together with the consultants' responses to those comments are now posted on the CRU website at <http://www.esp-kosovo.org/estap2/>.
- 4 As in the Draft Report, the updated matrix identifies, prioritises and makes recommendations for managing the key risks associated with different forms of private sector participation in Kosovo's energy sector. The matrix also identifies the changes and additions that are required in respect of specific policy, legal, regulatory and institutional issues relating to Kosovo's energy sector. This is followed by a set of proposals (including drafting instructions) intended to assist Kosovo to strengthen its legal, regulatory and institutional framework so as to improve the prospect of private sector participation in the energy sector.
- 5 To anchor the discussions arising from the analysis set out in the matrix we have used, for illustrative purposes only, UNMIK's plans for the construction of a new lignite mine mouth power plant in Kosovo within the next five years (the “proposed project”). We prepared a draft timeline and step plan at the request of the former deputy Special Representative of the Secretary General to the United Nations which meets the five year time frame for the proposed project, along with a list of the project documents, consents and other instruments that will be required for the proposed project. These are set out in Annexes D and E. It should be noted, however, that most of our recommendations are relevant to foreign investment in infrastructure in Kosovo generally. Unless otherwise indicated, where the term “transaction” is used in the matrix it applies equally to the proposed project and to any major investment transaction.
- 6 In preparing the matrix we have examined all legislation identified in Annex B(i) of the Inception Report dated 23 June 2004, which consists of:

- (i) investment-related Regulations and Administrative Directions promulgated by UNMIK and issued under the authority of the Special Representative of the Secretary-General in Kosovo; and
- (ii) investment-related Laws adopted by the Assembly of Kosovo, pursuant to authority given according to various sections of the Constitutional Framework on the Provisional Institutions of Self-Government (UNMIK Regulation 2001/9);

in each case as they appear in the English translation on the UNMIK Official Gazette website.

- 7 In addition we have reviewed other relevant Laws, Regulations and Administrative Directions adopted and/or promulgated as at 30th October, 2004. Finally, and as part of the task of finalising this report we have also examined Regulations 2005/02, 2005/03 which relate to Mines and Minerals together with Regulations 2001/19 and 2004/50 which relate to the executive powers of the Provisional Institutions of Self-Government.

## 1.2 Classification of the Legislation by Categorising the Risks it Creates

- 8 An important end-product of this project is that any substantive risks to foreign investment are identified and (wherever possible) removed, mitigated or allocated to the party/entity that is best able to meet the risk in question. In order to facilitate this, we have categorised the risks associated with each piece of legislation according to the materiality of the risk as follows:
- (i) a ‘high materiality’ categorisation indicates that the issue poses a risk which may jeopardise a transaction, if it is not addressed;
  - (ii) a ‘medium materiality’ categorisation indicates that the risk issue may be negotiated away, but potentially only through a reduction in value (i.e. in respect of an asset or share sale) or increase in price (i.e. under the power purchase arrangements for a green field IPP); and
  - (iii) a ‘low materiality’ categorisation indicates the risk is of relatively little impact, but consideration of the issue is desirable simply for consistency or clarity.
- 9 The matrix does not include those issues where we have identified the materiality of the risk as ‘not applicable’ (“N/A”), that is, where the legislation poses little relevance / no material risk to a transaction.
- 10 It is important to note that several of the issues – particularly relating to key legislative areas such as the environment, taxation and mining – may not be considered “deal-breakers” if they stood alone. However there is a significant cumulative effect when these issues are taken together.
- 11 For ease of reference, Section 2 of this report provides a summary of the recommendations. These are in two parts – firstly, recommendations which include an amendment to legislation; and secondly recommendations which do not impact on the legislation, but which we believe would strengthen the general investment environment of Kosovo.
- 12 The full detail of our analysis is contained in Annexes A to C. In Annex A we have first set out our analysis of the legislation which is likely to have the strongest influence and impact on any transaction in Kosovo’s energy sector (the “key legislation”). This analysis identifies each

piece of legislation or legal issue, and the risk it poses to a transaction. Each risk is then analysed and categorised in accordance with 5(i)-(iii) above.

- 13 This is followed by an analysis of the remaining legislation. In carrying out our analysis of this legislation we have arranged the various pieces of legislation or legal issues we have identified in a descending scale of the risks that they may pose to a transaction. Issues we have categorised as “medium” are analysed in Annex B and those categorised as “low” in Annex C.

### **1.3 Recommended Response, Actions Required and Drafting Instructions**

14 Having analysed and classified the risks and issues associated with each piece of legislation, we have set out the steps which we consider necessary to address/mitigate or reallocate the risk/issue in question (a “Recommended Response”) and the actions which we think are required in order to implant these steps (the “Actions Required”). Where relevant we have also set out the basic principles which will need to be reflected in any amendment to the legislation, or legal and regulatory framework (“Drafting Instructions”) although on some occasions these instructions are that the legislation should be drafted anew. Given that the primary purpose behind the Energy Sector Technical Assistant Project II is to make recommendations for the improvement of the legal and institutional framework for private sector participation in the energy sector in Kosovo over the long term the Recommended Responses, Actions Required and Drafting Instructions as a general rule, propose amendments to existing policy, institutional arrangements or draft legislation rather than:

- (i) transitional/interim arrangements; or
- (ii) “carve-out” arrangements;

under which certain provisions in the legislation or certain regulatory powers are disappplied from a transaction.

- 14 The consultants’ final task on this project has been to develop an Action Plan. This plan identifies the actions now agreed, and the relevant institution or ministry which is agreed to be the most appropriate entity to be responsible for implementing the Recommended Response and/or Drafting Instructions. At the 15<sup>th</sup> February 2005 workshop a draft Action Plan was reviewed and recommendations as to the institutions that should carry out the actions were discussed. We proposed initial institutions for the actions required, and those initial recommendations were accepted. As may be expected, the Ministry of Energy and Mining is a key focus for the actions. The Action Plan is now attached as Annex F.

### **1.4 Assumptions**

- 13 In analysing and assessing the risks and issues set out in the matrix we have made the following assumptions:
- (i) that the English translation of the legislation we have reviewed is both full and accurate and prevails over any legislation in force in Kosovo published in any other language;
  - (ii) that political/ diplomatic progress will be made in resolving Kosovo’s status prior to the letting of any concession agreement to a foreign investor, or that a prospective foreign investor will become comfortable enough to bid for / consider investing in Kosovo on the basis of its current status;

- (iii) that it is likely that prospective foreign investors will, at least initially, finance a significant proportion of any medium to large scale transaction “on balance sheet” with any debt finance for such transactions likely, at least initially, to be from multilateral financial institutions like the World Bank or the European Bank for Reconstruction and Development rather than the commercial sector;
- (iv) that prospective foreign investors will have (or will have access to) all the relevant expertise relating to the construction, operation and maintenance of lignite coal fuelled power stations in emerging economies/ economies in transition;
- (v) that the procurement procedures followed to encourage the necessary level of foreign investment in Kosovo’s energy sector will attract a sufficient number of foreign investors/ level of competition to allow the relevant organisations/Ministries of PISG to be able to benefit from its negotiations with the eventual preferred bidder;
- (vi) that the tender procedure for the proposed project will be structured on the basis that an investor, or a joint venture by a number of investors will bid both to develop, own, operate and maintain a new lignite mine and a new lignite-fired generation plant in Kosovo;
- (vii) that, in order to make the proposed project as attractive as possible to potential foreign investors, the Ministry of Energy and Mining and ERO and/or all other relevant institutions will, in so far as is reasonably possible, structure the tendering process for the project on as firm a basis possible, rather than waiting for potential investors to consider constructing an IPP and lignite mining business in Kosovo;
- (viii) that the project manager for the proposed project will have or have access to the necessary skills and expertise, along with the necessary time, to be able to negotiate the best terms possible for the power purchase arrangements and construction contracts;
- (ix) that relevant Ministries and regulators will have the necessary sustained long term capacity and funding required to carry out the functions and duties; and
- (x) that the Ministries, donors and agencies will co-operate with each other in seeking to secure investment in the proposed project/Kosovo’s energy sector generally.

## **1.5 Draft Timeline and Step Plan for the Proposed Project and the Action Plan**

- 14 The draft timeline and step plan for the proposed project is set out in Annex D of the matrix.
- 15 The draft list of project agreements documents, consents and other instruments required for the proposed project is set out in Annex E.
- 16 The Action Plan is set out in Annex F.

## 2 SUMMARY OF RECOMMENDATIONS

In the light of the analysis set out in the matrix our recommendations are summarised in this section.

### 2.1 Amendments to Legislation

It is clear that efforts have been made in the last six years to promulgate a general body of Kosovar law which is investor friendly. Some of this legislation is robust, clearly and accurately drafted and establishes a clear framework and parameters within which both the Provisional Institutions of Self-Government and foreign investors will be able to work. However, some of the law introduced over the last six years is, judging by the English translations, poorly drafted, provides no clear framework or mechanisms by which policy can be delivered, and on many occasions appears to be based (either entirely or in part) upon provisions of law copied wholesale and without any thought from other jurisdictions. There is therefore considerable scope for improvement. Such improvements are in some cases essential, and in others cases will serve to reinforce the investment environment and increase the ranking of Kosovo in investment terms compared with neighbouring countries. The following amendments to the existing body of legislation are recommended in order to mitigate the risks to investments in electricity-related infrastructure projects in Kosovo. The risks are classed as “high”, “medium” or “low” in line with the description in section 1.2 above, and there is a cross-reference to the relevant annex for the detailed analysis.

As noted under section 1.1 above, some of the risks and mitigations identified in our Draft report have been modified in this report. In addition, one important new risk area has arisen as a direct consequence of the legal and institutional changes that took place through Regulations 2004/50 (establishment of the Ministry of Energy and Mining et al), Regulation 2005/02 (establishment of the Independent Commission for Mines and Minerals) and Regulation 2005/03 (Law on Mines and Minerals). This risk is discussed in Annex A8(A) in the matrix, and in the table below.

| RISK | SOURCE      | NATURE OF RISK   | AMENDMENT REQUIRED          | MATRIX X-REF |
|------|-------------|--|-----------------------------|--------------|
| High | Energy Laws | Power Purchase Agreements must be no longer than 5 years’ duration. This is a deal breaker for a foreign investor interested in the proposed project, particularly, in the absence of an existing, tested and liquid spot market for electricity in Kosovo,; this is also not in line with recent European <i>practice</i> (see Ireland/Bulgaria). | Amend 2004/10 Article 21.5. | A1           |

**SECTION 2**  
**SUMMARY OF RECOMMENDATIONS**

| <b>RISK</b> | <b>SOURCE</b>      | <b>NATURE OF RISK</b>  | <b>AMENDMENT REQUIRED</b>   | <b>MATRIX X-REF</b> |
|-------------|--------------------|--|---|---------------------|
| High        | Energy Laws        | 2004/10 specifies that generators must enter into sale agreements on energy buy-back terms. This adds substantial uncertainty because these terms are not defined, and could be construed as allowing the Government to retain an option of future compulsory acquisition of electricity assets.   | Amend 2004/8 Article 15.3 by defining the term energy buy-back terms or by making a policy statement setting out what they are and publishing a set of energy buy back terms.   | A2                  |
| High        | Foreign Investment | An investor has recourse only to Kosovar courts in the event of expropriation of assets. While this is acceptable for the initial hearing, there must be recourse to independent international arbitration, enforceable in the Kosovar courts.   | Amend 2001/3 Article 17   | A6                  |
| High        | Concessions        | The law is so poorly drafted as to represent a major risk to the investor and to give an extremely negative signal about the integrity and robustness of the entire investment framework and the capacity of the new Kosovar institutions.   | Draft an entirely new law in line with good international precedents.   | A7                  |
| High        | Mines & Minerals   | There is ambiguity currently in Kosovo over the scope of responsibilities of the Ministry of Energy and Mining and over the boundary between its responsibilities and functions and those of the Independent Commission for Mines and Minerals, notably in terms of who will lead the process of securing inward investment in the lignite-to-power sector. The extent of transfer of powers from UNMIK to PISG is vague. An investor looking at the legislative framework today will be confused by Regulations 2005/2 (which does not recognise the Ministry of Energy and Mining) and 2005/3 (which has only minor reference to the Ministry of Energy and Mining) that were issued by UNMIK a month after the promulgation of Regulation 2004/50 transferring powers to the Ministry of Energy and Mining. | Approve a clear statement of the powers, duties and responsibilities of the Ministry of Energy and Mining in a policy document at least as detailed as those contained in the Annexes to 2001/19 and having equal legal status. If there remains, in UNMIK's view, a need for any powers to be retained, then UNMIK and PISG should agree clear criteria and a timetable for full transfer of the retained powers. In particular, the Ministry of Energy and Mining's role as the lead institution in securing an investor in the lignite / power sector should be clarified and confirmed. | A8(A)               |

**SECTION 2**  
**SUMMARY OF RECOMMENDATIONS**

| <b>RISK</b> | <b>SOURCE</b>    | <b>NATURE OF RISK</b>  | <b>AMENDMENT REQUIRED</b>   | <b>MATRIX X-REF</b> |
|-------------|------------------|--|---|---------------------|
| High        | Mines & Minerals | The extensive role, functions and duties of the Independent Commission for Mines and Minerals and lack of clarity as to boundary give rise to potential conflicts. In addition, the absence of any description of the role of the Mining Advisory Board and the lack of clarity over the extent to which the Board can delegate to the Director, create confusion and uncertainty for an investor. | Amend the draft legislation to clarify these points.  | A8                  |
| High        | Mines & Minerals | The apparent overlaps between the institutional and regulatory roles of the Independent Commission for Mines and Minerals and the Energy Regulator's Office, and the Ministry and other public authorities.  | Amend the draft law so that development and exploitation licences for energy minerals are placed under the energy regulator (amending 2004/10 also);<br>In section 61 replace the Minister's power to hold up plans for urban and spatial planning with a right to be consulted by/consult with public authorities. | A9                  |
| High        | Mines & Minerals | The "grandfathering" of existing licences on their existing terms immediately tilts the "playing field" and will be regarded as a major risk by the investor.  | Delete Section 63 from the legislation.   | A10                 |
| High        | Mines & Minerals | The fact that the period for consideration of licence applications has been fixed (between 6 and 12 months) in the law will be regarded as a potential high risk given that it represents a substantial portion of the development timetable for the proposed project / transaction.   | Remove the limitation and place a reasonable endeavours obligation on the Independent Commission for Mines and Minerals to process the application as quickly as possible once made.  | A11                 |
| High        | Mines & Minerals | There appears to be no process for bringing KEK's existing (apparently unlicensed) activities within the regulatory remit which will tilt the "playing field" and could be perceived by the private investor as posing a risk that it will be exposed to clean up or decommissioning costs for KEK.  | Amend the law to require existing operators to apply for a licence within a certain time period.  | A12                 |

**SECTION 2**  
**SUMMARY OF RECOMMENDATIONS**

| <b>RISK</b> | <b>SOURCE</b>            | <b>NATURE OF RISK</b>  | <b>AMENDMENT REQUIRED</b>   | <b>MATRIX X-REF</b> |
|-------------|--------------------------|--|---|---------------------|
| High        | Mines & Minerals         | A licensee or permit holder may not carry out its activities within certain distances of settlements, or agricultural land, but nothing in the legislation we have reviewed can be used to quickly and, if necessary, forcibly remove persons that have deliberately settled on concession land (in the hope of securing compensation) after it has become public knowledge what area of land will be covered by the proposed concession. If unchecked such behaviour will increase fraudulent claims for compensation and delay the development of a new mine/the proposed project. | Amend section 13 of the draft law.  | A13                 |
| High        | Mines & Minerals         | A Mine Development Agreement (MDA) is required in all cases and requires negotiation by the Independent Commission for Mines and Minerals and ratification by the SRSG. This represents a risk to the project as the SRSG's approval could be made conditional upon amendments being made to the draft MDA negotiated.   | Amend the law to require the MDA only when there are genuine commercial reasons for it. Remove the requirement that the MDA has to be approved following its negotiation. | A14                 |
| High        | Environmental Protection | The law is so poorly drafted as to represent a major risk to the investor and to give an extremely negative signal about the integrity and robustness of the entire investment framework and the capacity of the new Kosovar institutions.   | Replace 2003/09 with an entirely new law drafted in line with good international precedents.  | A18                 |
| High        | Environmental Protection | The law cuts across the jurisdiction / scope of other laws in terms of "research, exploration or exploitation of natural resources" and in the field of concessions (it is the third piece of legislation identified which the investor will need to comply in respect of concessions for the lignite)   | Ensure Article 18 of 2003/09 is not brought into the new environmental protection legislation.  | A21                 |
| High        | Air Protection           | It is not clear what purpose this law serves in addition to the law on Environmental Protection (2003/09). It does not deal clearly with emissions, and this is an important omission for the investor   | Develop a clear policy on emissions and ensure that this is incorporated into the new legislation on environmental protection   | A22                 |

**SECTION 2**  
**SUMMARY OF RECOMMENDATIONS**

| <b>RISK</b> | <b>SOURCE</b>       | <b>NATURE OF RISK</b>  | <b>AMENDMENT REQUIRED</b>  | <b>MATRIX X-REF</b> |
|-------------|---------------------|--|--|---------------------|
| High        | Tax Laws            | There has not hitherto been any system of binding tax clearances or rulings whereby a tax payer or potential taxpayer may approach the Kosovo tax administration for a ruling on the tax effect of a proposed transaction or series of transactions. Developed jurisdictions commonly offer such a service. In the absence of an advance clearance system, the tax effect of transaction(s) may remain in doubt. Uncertainty increases the risk underlying an investment and might cause an investor to decide to prefer a different tax jurisdiction and to decide not to invest in Kosovo. | Implement the proposed system of tax clearances through regulations  | A25                 |
| High        | Tax Laws            | The Tax regime is not especially attractive to investors considering projects of an infrastructure nature, such as energy sector investments. The period over which the investment attains tax relief for expenditures incurred can be long compared with other jurisdictions and in some cases relief may never be obtained.  | Amend the body of general tax legislation to provide the recommended (see matrix) tax advantages to all activities.<br><br>Specify the detail of the tax regime in greater detail.                                       | A26                 |
| High        | Foreign Investments | The law is so poorly drafted as to represent a major risk to the investor and to give an extremely negative signal about the integrity and robustness of the entire investment framework and the capacity of the new Kosovar institutions.   | Replace 2001/9 with a new law in entirety drafted in line with good international precedents   | A32                 |
| Medium      | Mines & Minerals    | The high administrative and compliance cost burdens imposed on all potential licensees will frustrate foreign investors generally, particularly if the Independent Commission for Mines and Minerals disapplies some of these requirements in relation to some applicants.   | Amend the draft law to reduce substantially the requirements for financial / other information and the eligibility criteria and delete Section 30.2  | A15                 |
| Medium      | Mines & Minerals    | The licensing procedure will be reviewed by the Mining Advisory Board but not subject to wider review. There is no general duty to consult, which will be viewed negatively by the prospective investor.   | Amend section 6 of the law to require the Commission to consult publicly on the licensing process and on other matters. Decide if the Mining Advisory Board, which is undefined/has no formal status is really required. | A16                 |

| <b>RISK</b> | <b>SOURCE</b>                      | <b>NATURE OF RISK</b>   | <b>AMENDMENT REQUIRED</b>   | <b>MATRIX X-REF</b> |
|-------------|------------------------------------|---|---|---------------------|
| Medium      | Mines & Minerals                   | A licence relating to energy minerals can only be awarded after the applicable law on the competitive award of concession has been complied with. This effectively means that the investor can only seek a licence if it has won a competitive tender. There is no benefit in being so restrictive.   | Amend clause 17 to make it an enabling clause rather than mandatory (“may” not “shall”) Simplify sections 9 and 10. | A17                 |
| Medium      | Compulsory powers / eminent domain | The current body of law in Kosovo contains no provisions for compulsory purchase and does not deal with eminent domain. Regulated entities in Kosovo’s energy sector occasionally need to be able to rely on compulsory purchase legislation in order to be able to compel (where necessary) third parties to grant them certain rights required in order to properly carry on their licensed business. | Draft a law on compulsory purchase eminent domain as a matter of urgency using good international precedents.       | A30                 |

## 2.2 Other institutional / commercial recommendations

The following actions are recommended in order to provide general improvements to the investment environment and to facilitate and smooth the transaction process.

| <b>RISK</b> | <b>SOURCE</b> | <b>NATURE OF RISK</b>   | <b>RECOMMENDED ACTION</b>   | <b>MATRIX X-REF</b> |
|-------------|---------------|---|---|---------------------|
| High        | Energy Laws   | Although direct sales on a merchant basis are allowed under the new laws, there are limited actual clients and the detail of the legal and regulatory framework is not yet in place to support such trades.   | Proceed with phased reforms of the market with a view to giving a robust framework for direct sales   | A3                  |
| High        | Energy Laws   | Although interconnector trades through to neighbouring markets are envisaged under the new laws, the markets are not yet sufficiently developed for an investor to be able to place reliance on them as a hedge against national sales (nor as a source of main revenues). The overall “market” for electricity output therefore remains risky. | Until such time as the regional market develops, this risk can be largely mitigated by giving the investor freedom to enter into long term PPAs, ensuring that the maximum flexibility attaches to sale contracts and promoting direct sales to major customers (that is, addressing A1, A2 and A3. | A4                  |

**SECTION 2**  
**SUMMARY OF RECOMMENDATIONS**

| <b>RISK</b> | <b>SOURCE</b>            | <b>NATURE OF RISK</b>   | <b>RECOMMENDED ACTION</b>   | <b>MATRIX X-REF</b> |
|-------------|--------------------------|---|---|---------------------|
| High        | Political Status         | The uncertain status of Kosovo creates a major political risk to an investor. The same problem gives uncertainty as to whether MIGA or any other multilateral agency would be prepared (or able) to provide a partial risk guarantee covering this risk. The same issue relates to foreign institutions providing export credit guarantees.   | Write to MIGA asking for a statement of their current policy on providing guarantees in Kosovo;<br>Encourage potential investors to hold exploratory discussions with their export credit agencies;<br>Explore whether any political risk insurance could be obtained on the commercial market (and at what price). | A5                  |
| High        | Environmental Protection | There are as many as ten consents / permits/ processes, and only one process out of these has a clear timetable. This imposes a substantial compliance burden which compounded with the negative signal given by very poor and confusing drafting will be seen as presenting a substantial risk to the investor.  | Develop a “one-stop-shop” to guide the investor through the requirements and to assist him in getting fully consented.  | A19                 |
| High        | Environmental Protection | The intention to conform to EU environmental standards raises the following questions that are not answered by either law or policy –<br><br>1. How Kosovo proposes to implement the Large Combustion Plant Directive;<br>2. What is the timetable for Kosovar compliance with EU standards;<br>3. What standards will the proposed project need to comply with on day one.                                 | Determine Kosovo’s policy response to these issues and issue clear policy statements.   | A20                 |
| High        | Tax Laws                 | Kosovo does not have a formal policy statement regarding the development of the minerals / energy sectors and in particular relating to the aggregate revenue sought from those sectors by PISG in terms of direct and indirect taxation and duties including mineral royalty. In parallel, the tax law does not provide for tax stability agreements to be concluded between PISG and potential investors. | PISG should develop a sector policy for the mining and energy sectors and should consult with the World Bank on this.<br>Provision for taxation stability agreements should be introduced into the legislation. OLA should respond to the proposal submitted by the Ministry of Finance and Economy in 2004.        | A23                 |

| <b>RISK</b> | <b>SOURCE</b>      | <b>NATURE OF RISK</b>  | <b>RECOMMENDED ACTION</b>   | <b>MATRIX X-REF</b> |
|-------------|--------------------|--|---|---------------------|
| High        | Tax Regime         | The principal regulations and laws are published on the UNMIK website. In addition to these materials, there is a substantial body of supplementary administrative instructions and tax rulings which are designed as clarifications / interpretations of the published laws. In some instances, these materials fill gaps that exist in the laws. These materials are available in hard copy from the Tax Administration but are not disseminated electronically. A foreign investor would not be aware of their existence and might thereby be misled as to the application of Kosovo tax to a potential investment. | Implement web publication. We note that the Ministry of Finance and Economy has indicated its intention to publish the materials in this way.   | A24                 |
| High        | Public Procurement | Although the legislation is fit for its purpose, the investors will need to know from the outset which procurement rules are to be applied to the given transaction, and, in the case of proposed project, will wish to be satisfied that the tendering of the proposed project on a “ready to go” basis is clearly within the legal and regulatory framework established by this legislation.   | The “project manager” for the proposed project should agree and put in place the necessary informal arrangements with the bodies that will be involved in the entire procurement process so that the project can be tendered “ready to go”. | A28                 |
| High        | Insolvency         | It is unclear from the relevant legislation (2003/7 and 2003/4) what actions the regulator(s) will take in the event of a licensee’s insolvency.   | Develop and issue clear statement of policy as to the appointment of an administrator, setting out relevant timetables.   | A29                 |
| High        | Project financing  | The foreign investor will therefore wish to satisfy themselves that as a matter of Kosovo law it is possible to grant security over its interest in the site and that there is an effective method of registering the Bank’s security/rights in respect of such assets.  | Obtain a legal memorandum from its Kosovar legal adviser advising on the legal and commercial steps necessary in order to grant various types of security under Kosovo law.   | A31                 |
| Medium      | Tax Regime         | Arrangements to mitigate the possible double taxation of business profits and employment income should be reviewed.  | Review the taxation treaties and consider whether the coverage is sufficient for the purposes of FDI in the energy sector.  | A27                 |

| <b>RISK</b> | <b>SOURCE</b>              | <b>NATURE OF RISK</b>   | <b>RECOMMENDED ACTION</b>  | <b>MATRIX X-REF</b> |
|-------------|----------------------------|---|--|---------------------|
| Medium      | Asset Ownership / Cadastre | There is a risk that the network maps (which identify just where the pipes and wires which comprise the network are located) are not always entirely accurate. A foreign investor will therefore have some concern as to how to rectify the Cadastral register in the event that there are assets which have been transferred to it which are not properly registered. In addition the foreign investor will also have concerns in respect of conflicting or competing interests being registered late over the same land on which the investor's assets are located. | KEK and any relevant public authorities should carry out appropriate due diligence in the event that there is a proposal to sell off all or part of the distribution transmission network. | A33                 |
| Medium      | Labour Law                 | It is not clear whether the Administrative Department of Labour and Employment has assumed its responsibilities and if so, whether it has actually developed any employment systems/ labour standards which would be applicable to the business being carried out by a foreign investor.  | The Administrative Department of Labour and Employment should develop and issue a policy statement regarding standards.  | B1                  |
| Medium      | Cadastre                   | Investors will wish to know precisely what obligation they are under in respect of registering their rights of the Kosovo Cadastral Agency. More importantly they will also wish to know what protection, if any, they will have if having registered their interest with this agency a third party subsequently applies to and succeeds in registering a competing/conflicting interest.   | Relevant public authority granting the concession to carry out appropriate investigations as to title prior to the tendering of any transaction.   | B2                  |
| Medium      | Export                     | The Law on External Trade Activity allows the Government of Kosovo to establish an "Export Control List" which will specify goods or classes of good the export of which may be controlled – it is possible for electricity to be placed on this list, and exports thus restricted.   | Nominate a "Project Manager" for each major investment transaction to ensure that this risk is addressed in the power purchase agreements.   | B3                  |

**SECTION 2**  
**SUMMARY OF RECOMMENDATIONS**

| <b>RISK</b> | <b>SOURCE</b>            | <b>NATURE OF RISK</b>   | <b>RECOMMENDED ACTION</b>  | <b>MATRIX X-REF</b> |
|-------------|--------------------------|---|--|---------------------|
| Low         | Money                    | There is a risk that a foreign investor might inadvertently breach its obligation under Regulation 2004/2 to file reports under this anti-money-laundering legislation. The legislation also imposes quite an administrative burden on a foreign investor given the relatively low threshold amounts.                   | The Financial Information Centre should review the arrangements and once the thresholds are fixed, the requirements should be publicised through a “one stop shop” established by the Ministry of Energy and Mining.   | C1                  |
| Low         | Petroleum licensing      | There is a risk that a foreign investor may not be granted a licence.   | The Ministry of Energy and Mining to promote this through a “one-stop-shop”.   | C2                  |
| Low         | Environmental Protection | A foreign investor may have concerns about:<br><br>(i) the uncertainty regarding the issuing of permits; and<br>(ii) the length of time/ procedures that have to be followed in order to obtain a permit.   | The Ministry of Energy and Mining to promote this through a “one-stop-shop”.   | C3                  |
| Low         | Payment transactions     | A foreign investor will wish to know how easily payments involving foreign currency can be made in Kosovo.  | The Ministry of Energy and Mining to promote this through a “one-stop-shop”.   | C4                  |
| Low         | Accounting Standards     | A foreign investor will wish to know what standards (accounting) the project will have to meet. If donor/ grant aid supports all or part of the project, the donor/ bank frequently requires their own accounting standards to be met. A foreign investor will, ideally, wish just to comply with one set of standards. | The Ministry of Energy and Mining to publicise the requirement for International Accounting and Financial Reporting Standards through the one-stop-shop and consider any special treatment as the issue arises.  | C5                  |
| Low         | Tax Laws                 | There is a risk that a foreign investor might not be granted a UNMIK Customs Service licence and that excise taxes may be onerous.  | The Ministry of Energy and Mining to highlight the requirement through the “one stop shop” as suggested in A19 and put in place arrangements to facilitate procurement of licence, including a policy statement from the Customs Service on circumstances on how they deal with licence applications and what the applicant must satisfy in order to be granted a licence. | C6                  |

| <b>RISK</b> | <b>SOURCE</b>    | <b>NATURE OF RISK</b>   | <b>RECOMMENDED ACTION</b>  | <b>MATRIX X-REF</b> |
|-------------|------------------|---|--|---------------------|
| Low         | Customs          | Border entries specified may not be the most economically efficient entry points into Kosovo for a foreign investor.  | The Ministry of Energy and Mining to advertise the requirement through the one stop shop and address any legitimate investor concerns if they are expressed on a one to one basis.   | C7                  |
| Low         | Tax Laws         | Regulation 1999/16 requires that any person must declare cash or equivalent if carrying more than €10,000 into Kosovo. Failure to do so will result in a fine of 25% of whatever value carried. A competent court may confirm, set aside or reduce a fine. There is a risk of inadvertent breach. | Publicise the legal requirement through the “one stop shop”.   | C8                  |
| Low         | Labour Law       | There is a risk of inadvertent breach by a foreign investor of some of the provisions of law 2001/27, particularly if the employment market in Kosovo is such that employees are prepared to ignore their rights.   | Publicise the legal requirements through the “one stop shop”.  | C9                  |
| Low         | Labour Law       | Risk of non-compliance with regulation 2003/33 by a foreign investor vicariously through its employees.   | Publicise the legal requirements through the “one stop shop”.  | C10                 |
| Low         | Sale of Property | Risk that certain rights in the concession/ project documentation granted to a foreign investor may be refused registration under Administrative Direction 2002/4.  | Publicise the requirement through the “one stop shop” and give policy guidelines on the circumstances in which registration would be refused, and any rights of appeal. Deal with any investor concerns on a one to one basis as they arise. | C11                 |

The following Annexes A to C contain a detailed description of all the above issues, and of our recommended response in the form of risk matrices.

## ANNEX A - ANALYSIS OF THE KEY LEGISLATION

In this Annex we examine a number of issues which arise from certain significant pieces of legislation –

- **Laws 2004/ 8 Energy, 2004/9 Regulation and 2004/10 Electricity**
- **UNMIK Regulation 2001/3 Foreign Investment in Kosovo**
- **The Law on Foreign Investments (pursuant to Regulations Nos. 2001/9 and 2001/19 Annex III (vii))**
- **UNMIK draft Law on Concessions**
- **Law 2003/9 on Environmental Protection**
- **Law 2004/2 on the Independent Commission for Mines and Minerals**
- **Llaw 2004/3 on Mines and Minerals**
- **Law 2004/30 on Air Protection**
- **Law 2003/17 on Public Procurement**
- **The body of current Tax Law**
- **Law 2003/4 on liquidation and reorganisation of legal persons**

In most cases, a number of serious issues are raised by the separate laws. These are dealt with one by one. We commence this analysis with issues relating to pricing and offtake in the electricity regime.

### **Power purchase offtake/price arrangements**

These issues will be of crucial importance to any foreign investor in Kosovo's generation assets or sector, since they will effectively represent the sole means by which the foreign investor can recover the cost of its investments along with any profit it may make.

As currently drafted the legislation and legal and regulatory framework would allow a foreign investor to enter into the following arrangements/contracts relating to the sale of its output:

- (i) power purchase agreement with the public supplier (presumably for all or part of the entire output of the station with a maximum term of 5 years);
- (ii) contracts for the sale of electricity on energy buy-back conditions;
- (iii) contracts for the sale of electricity (with an unregulated price) to contestable consumers; and
- (iv) sales of power across inter-connectors to consumers in the regional energy market.

We have considered each of these in the matrices below. This is followed by the analysis of some other issues relating to the arrangements for purchasing power in Kosovo.

**Issues Matrix Reference: Annex A1**

**Issue: Energy:** Power Purchase Agreements (Law No. 2004/10 (Article 21.5)) on Electricity

Article 21.5 specifies that any power purchase agreements entered into by producers of electricity with the public supplier shall have a minimum term of 1 year and a maximum term of 5 years. Given that there is not an established liquid traded market for electricity either in Kosovo or within the region, foreign investors will almost certainly view this restriction on the term of any power purchase agreement with the public supplier as a significant barrier to investment. We appreciate that: (i) the European Commission has issued guidelines in respect of the periods over which state owned entities, in their capacity of offtakers, can reasonably be expected to purchase electricity; and (ii) interest has already been expressed by a number of neighbouring utilities (from Albania, Macedonia, and Greece) in an export led generation project in Kosovo. However in our experience countries within the European Union which urgently required the construction of new generation capacity by the private sector (as opposed to incumbent state owned utilities), have approved and obtained the necessary EU state aid and approvals for the incumbent electricity utility to sign long term power purchase agreements. Two recent examples include a 12 year power purchase agreement (in the case of The Republic of Ireland) and a 15 year power purchase agreement (in the case of Bulgaria.)

There are strong policy arguments against long term power purchase agreement being entered into, but these should not interfere with the greater imperative of securing investment in the power generation sector. In addition, the fact that power purchase agreements with terms of 10 years are being entered into in EU Member States suggests that the European Commissions guidelines do not require the time constraints imposed by Article 21.5, and it would therefore be prudent to remove the 5 year limitation from the existing legislation. Flexibility in the legal, institutional and regulatory arrangements will have a major bearing on the price (and potentially the success) of the commercial transaction. The only reason to be restrictive in the primary legislation is that there is an absolute requirement to rule something out absolutely. This is not, in our view, the situation here (bearing in mind that these are only EU *guidelines*.)

**Materiality:** This risk is identified as “high”, and from both the perspective of the proposed project and of any other investment in generating capacity in Kosovo poses the greatest risk to such transactions. Even in politically stable and relatively mature energy sectors with the introduction of a new market investors and their lenders always seek to obtain a long term power purchase agreement with a creditworthy, reliable and stable counterparty<sup>1</sup>. If the foreign investor is not satisfied that a sufficient portion of the capacity of its generation facility will be sold on a medium-to-long term basis before it starts constructing the facility, then it will simply will not invest in Kosovo.

**Applies to:** Sales of shares/sale of assets, BOO-BOT, leases, concessions and the proposed project.

| <b>Possible Mitigation:</b>                                      | <b>Strengths</b>                                 | <b>Weaknesses</b>  |
|--|--|--|
| 1. Remove the 5 year restriction from the legislation and do not | This will at least give the foreign investor the | This may involve some degree of movement by the ERO away |

<sup>1</sup> See Issues Matrix Reference No. Annex A29 for analysis of how certain aspects of counterparty risk may be addressed.

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| <p>replace it with a further restriction.</p>   | <p>opportunity to negotiate on this issue, while allowing the public supplier / ERO sufficient flexibility to be able to decide, following negotiations, how long the term of any power purchase agreement need be in order to attract the necessary investment into Kosovo. Under Article 21.6 the terms of the PPA will have to be approved by the ERO.</p> | <p>from the European Commission's Policy in respect of the duration of power purchase agreement.</p> <p>However it is clear from the power purchase agreements signed in The Republic of Ireland and Bulgaria that the European Commission's policy on long term power purchase agreements is not carved in stone.</p> |
| <p><b>Recommended Response:</b> Amend Law No. 2004/10 Art 21.5</p>  |   |  |
| <p><b>Actions Required:</b> MEM or person originally responsible for drafting Law No. 2004/10 to amend this law.</p> <p><b>Drafting Instructions:</b> Remove the five year restriction from Article 20 1.5.</p> |   |  |

| <b>Issues Matrix Reference: Annex A2</b>   |  |   |
|--|--|---|
| <p><b>Issue: Energy:</b> Contracts for the sale of electricity on buy-back conditions. (Law 2004/No. 8)</p> <p>Article 15.3 of Law 2004/No. 8 specifies that new generators shall enter into arrangements for the sale of their electricity on energy buy-back conditions. These are not defined, but what will concern foreign investors is that (whatever these terms mean) they are, or the language of the Regulations suggests that they are, mandatory.</p> <p>If, by using the term “energy buy-back conditions” the drafter of the Energy Regulation contended that the foreign investor should construct the new generation plant, transfer title to the plant to a state-owned entity, once it had been commissioned, and then be paid a “monthly fee” in addition to an “operation and maintenance” fee for operating and maintaining the plant, then this would clearly have very strong implications for the way in which the ERO structure the tendering/procurement process for the project. There remains some uncertainty about this wording and its intention.</p> |  |   |
| <p><b>Materiality:</b> This risk is identified as “high”. Assuming we have understood the term energy buy-back conditions correctly, then this will significantly reduce the flexibility that ERO have in structuring the tender/procurement process in such a way as to attract foreign investors. We are not suggesting that it is unsuitable as a method by which to construct the new power station, but rather that this provision of the legislation should not be mandatory, and that it should be open to the ERO to consider using a structure, or a combination of structures, for a generation project which is most likely to attract foreign investment. It should also be noted that investors in infrastructure are always sensitive to anything which could signal future re-nationalisation of assets (at a price below their value) and unspecified energy buy-back conditions would almost certainly raise alarm.</p> <p><b>Applies to:</b> Sales of shares/sale of assets, BOO-BOT, leases, concessions and the proposed project.</p>                            |  |   |
| <b>Possible Mitigation:</b>  | <b>Strengths</b>   | <b>Weaknesses</b>   |
| <p>1. Remove the mandatory language from this clause, replacing “shall” with “may” and publish a policy statement and a draft set of energy buy-back conditions which make clear that these only apply to renewable generating capacity.</p>   | <p>This will remove the possibility of there being an argument that the only basis upon which there can be new investment in Kosovo’s generation sector is through prior purchase arrangements which are based on energy buy-back conditions. In these circumstances it can only serve to improve an interested foreign investor’s appetite in a transaction in this sector.</p> | <p>None.</p>  |
| <p>2. Remove the entire clause requiring new generating plant to sell its output on the basis of energy buy-back conditions.</p>   | <p>This will remove the possibility of there being an argument that the only basis upon which there can be new</p>   | <p>By remaining silent on the possible methods, the law gives no guidance to investors on the range of options that the ERO</p> |

|   |   |                        |
|---|---|------------------------|
|   | <p>investment in Kosovo's generation sector is through prior purchase arrangements which are based on energy buy-back conditions. In these circumstances it can only serve to improve an interested foreign investor's appetite in a transaction in this sector.</p> <p>Gives maximum flexibility to ERO.</p> | <p>would consider.</p> |
| <p>3. Remove the entire clause and replace with a clause to provide that the ERO may approve arrangements for the sale of generated output that are likely to be efficient, economic and give security of supply.</p> | <p>States the test that arrangements must pass to be approved, without indicating what form those arrangements may take, therefore allowing all parties to decide the terms or combination of terms upon which an investment in Kosovo's generation sector will be based.</p>                                 |                        |
| <p><b>Recommended Response:</b> Amend Article 15.3 in accordance with option 3 above.</p>   |   |                        |
| <p><b>Actions Required:</b> ERO or person originally responsible for drafting Law No. 2004/8 to amend this law.</p>   |   |                        |
| <p><b>Drafting Instructions:</b> Amend Article 15.3 in accordance with the principles set out in option 3 above.</p>  |   |                        |

**Issues Matrix Reference: Annex A3**

**Issue: Energy:** Proposed sale of energy on a merchant basis.

There are currently no large creditworthy consumers in Kosovo with whom a foreign investor would consider entering into a power purchase agreement with (KEK may have a large client base, but it will not be viewed as credit worthy). It is envisaged that this situation may slowly start to change in the very near future, with businesses like Ferronickeli likely to commence production at its mines early next year. It is hoped and envisaged that more large consumers will enter the Kosovo market or purchase assets/re-commence operations requiring large volumes of electricity. However, it is unlikely, in our view that at the time a foreign investor is required to legally commit to investing in the proposed project (which for the avoidance of doubt will have to be in 2005/2006, if the proposed project is to be commissioned by 1/1/2010) there will be a sufficient number of creditworthy consumers (be they traders, private consumers and/or KEK's non-eligible consumer base) for the foreign investor to be comfortable building a merchant plant.

**Materiality:** This risk is identified as "high". However, as the issue is almost entirely a function of the status of Kosovo's current energy markets, any mitigation would be derived not from amendments made to individual pieces of legislation/regulations, but rather in the careful, well planned and phased reform of Kosovo's energy sector and with it the introduction of a right to supply retail electricity directly to major customers.

**Applies to:** Sales of shares/sale of assets, BOO-BOT, leases, concessions and the proposed project.

| <b>Possible Mitigation:</b>   | <b>Strengths</b>  | <b>Weaknesses</b>  |
|---|---|--|
| <p>1. Identify a creditworthy cash rich third party which is prepared to guarantee at least on some basis, KEK obligations as public supplier.</p> <p>Continued implementation of the reform of Kosovo's energy sector.</p> | <p>Prospective foreign investors would be more comfortable contracting with KEK if its payment and performance obligations are backed by a guarantee issued by a creditworthy and wealthy third party.</p> <p>Boosts investor confidence in the direction and intention of reforms</p>                    | <p>PISG will be reluctant to act as guarantor for KEK and it is unlikely that a party from the commercial sector will be prepared to act in this capacity.</p> |
| <p>2. Restructure KEK businesses, particularly its public supply business as a matter of priority.</p>  | <p>An investor will be marginally happier about contracting with a restructured KEK than the organisation that exists at the moment, although admittedly a restructured public supply business is very likely to be ring-fenced from KEK's transmission and distribution assets, so the restructuring</p> | <p>None.</p>   |

|   |   |  |
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|   | <p>may actually mean that<br/>KEK's public supply<br/>business is even less<br/>creditworthy.</p> |  |
| <p><b>Recommended Response:</b> Continued implementation of the reform of Kosovo's energy sector. Identify prospective parties to act as guarantor for KEK in its capacity as public supplier purchasing from the proposed project.</p>   |   |  |
| <p><b>Actions Required:</b> PISG, MEM, ERO, ICMM and other agencies/ministries to continue with the phased reform of Kosovo energy sector. Project manager for the proposed project to discuss informally with prospective foreign investors what sort of guarantees/credit support they would be looking to secure for their power purchase arrangements for the proposed project.</p> |   |  |
| <p><b>Drafting Instructions:</b> None.</p>  |   |  |

**Issues Matrix Reference: Annex A4**

**Issue: Energy:** Sales of power across interconnections to consumers in the regional electricity market.

Given that the regional energy market is as yet only at the planning stage and will not be operational when the investor would make his investment commitment, that investor is highly unlikely to place any weight on such a market coming into existence, when deciding whether to invest in Kosovo at this point in time. Significant progress has been/is being made in developing the Athens Memorandum into what will undoubtedly become a multi-lateral treaty. The treaty will impose obligations on its signatory states and on UNMIK to take the necessary steps to establish the regional energy market. However, a foreign investor is likely to be highly sceptical about the possibility of the regional energy market becoming significantly well established/bedded down, with a sufficient level of liquidity before the current target date for commissioning of the proposed prepared project. The foreign investor will take this view simply by reference to the time it has taken other jurisdictions to develop new/regional markets. There will be eight signatories to the treaty, all of whom, having signed the treaty, will have to (i) seek the necessary Parliamentary/Assembly approval before drafting and passing the necessary national legislation giving effect to the treaty, (ii) build out/rehabilitate the various inter-connectors over which the energy is to be traded; and (iii) agree the necessary trading rules will need to be developed for transactions involving inter-connector trades. From these factors it is possible to see why the foreign investor is highly unlikely, at least at this stage, to place much reliance upon the emergence of a regional energy market (at some point in the next 5-10 years) when its decision to invest is to be made in the next year or so.

**Materiality:** This risk is identified as “high”. If PISG, MEM or ERO insist that the emergence for a regional energy market must be factored into the foreign investor’s power purchase arrangements then this issue must be classified as “high”, because it is highly unlikely that a well established/liquid regional energy market will be in place by the time the foreign investor’s facility is fully commissioned. It should, however, be noted that by fixing the issues raised in Annex A1, A2 and A3 above, this risk is effectively removed.

**Applies to:** Sales of shares/sale of assets, BOO-BOT, leases, concessions and the proposed project.

| <b>Possible Mitigation:</b>  | <b>Strengths</b>  | <b>Weaknesses</b>  |
|--|---|--|
| 1. In relation to the proposed project it may be possible to include a re-opener in the terms of any Power Purchase Agreement which would allow the parties, following the meeting of certain objectively verifiable criteria relating to the establishment and bedding-down of the regional energy market, to re-negotiate the power purchase arrangement and for a proportion of the proposed project’s output to be | If this clause could be included then at least a proportion of the proposed project’s energy output could be sold into the regional electricity market, when such market is sufficiently well established. This would, at least theoretically, reduce the burden on the offtaker by gently easing its long take or pay obligations. | The difficulty with such an approach is that the foreign investor would probably wish to define the trigger mechanism by which the re-opener clause would be activated by reference to criteria which establish that the regional electricity market has become well established and well bedded-down. |

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| sold over the interconnector.   |   |       |
| 2. In relation to the proposed project, when approaching perspective foreign investors to informally request their views about power purchase arrangements providing them with the data available in relation to free/unused interconnector capacity between Kosovo and its neighbouring states as at this date.  | At least this would put the foreign investors in a position where they can accurately assess, on a here and now basis, what if any proportion of their output they might be willing to risk selling across interconnectors with countries that border Kosovo. | None. |
| 3. Undertake the actions recommended in respect of A1, A2 and A3 above to remove the materiality of this risk.  | Efficient resolution of the issue.  | None  |
| <p><b>Recommended Response:</b> Informally obtain perspective investor's views/commercial appetite for effectively taking this market risk in their power purchase arrangements.</p>  |   |       |
| <p><b>Actions Required:</b> Pursue option 3, but additionally the Project manager for the proposed project should informally approach investors with a view to ascertaining on what basis they would be prepared if any to take the risk of being able to sell output into the regional electricity market. This will be valuable in informing other policy decisions.</p> <p>MEM to seek this input when meeting potential investors.</p> <p><b>Drafting Instructions:</b> None.</p> |   |       |

| <b>Issues Matrix Reference: Annex A5</b>   |   |                   |
|--|---|-------------------|
| <p><b>Issue: Risk Guarantees:</b> The ability of the foreign investor to obtain political risk insurance from institutions such as the Multi-lateral Investment Guarantee Agency of the World Bank (MIGA).</p> <p>As Kosovo is not a sovereign state it does not fall within the conventional rules that institutions such as the Multi-lateral Investment Guarantee Agency (“MIGA”) apply when determining whether to provide political risk insurance for a project. We understand that there is precedent, at least as far as MIGA is concerned, which would allow for a level of political risk insurance to be provided by MIGA in respect of the proposed project in Kosovo provided that MIGA was satisfied both with respect to the status of the institution issuing the generation and mining licences and that these licences were valid.</p> <p>However it remains to be seen to what extent other foreign Government entities (for example those institutions that provide export credit guarantees) would be willing to provide such political risk insurance without the status of Kosovo being fully resolved.</p> |   |                   |
| <p><b>Materiality:</b> This risk is identified as “high”. The level of political risk insurance cover provided by MIGA is unlikely, in our opinion, to provide full relief for all parties potentially affected by an expropriation of the project.</p> <p><b>Applies to:</b> Sales of shares/sale of asset, BOO-BOT, leases, concessions and the proposed project.</p>  |   |                   |
| <b>Possible Mitigation:</b>  | <b>Strengths</b>  | <b>Weaknesses</b> |
| <p>1. MEM to write to the MIGA representative from the World Bank based in Kosovo requesting a letter stating precisely what MIGA’s policy is currently in respect of granting political risk insurance in Kosovo for an investment in Kosovo’s energy sector (probably best to use as example the proposed project). The letter should also request the fullest possible details, based on MIGA’s current policy, of the level of cover that such risk insurance would provide and the various losses it would extend to.</p>   | <p>This would allow both MEM and prospective foreign investors to establish on what terms, and with what cover MIGA would be willing to provide the risk insurance for the proposed project.</p> <p>Will give certainty at an early stage enabling the call for tenders to provide concrete guidance.</p> | <p>None</p>       |
| <p>2. Suggest to respective bidders (at an early stage in the tendering process) that, where relevant, they approach their respective export credit</p>  | <p>Similarly, this would at least allow prospective foreign investors to determine what if any further political risk insurance would be provided</p>   | <p>None</p>       |

|  |  |  |
|--|--|--|
| <p>guarantee departments to determine what additional level of cover, if any, the export credit guarantee departments would be provided for their investment.</p>  | <p>by relevant export credit guarantee departments of various states.</p> <p>Will ensure that bidders get an opportunity to evaluate their exposure sufficiently early to guide their bidding strategy.</p>                            |  |
| <p>3. Carry out some research to determine what level of political risk insurance, if any, and crucially at what price, could be obtained on the commercial market.</p>  | <p>Will provide general guidance to the relevant authorities in Kosovo on current thinking, and by initiating a debate on the issue may provide an opportunity to shape the level of insurance that insurers are prepared to offer</p> |  |
| <p><b>Recommended Response:</b> Write to MIGA requesting details set out in option 1 above.</p>  |  |  |
| <p><b>Actions Required:</b> (1) Project Manager for the proposed project (or any other forthcoming transaction proposal in Kosovo’s energy sector to write to MIGA;<br/>(2) Both Project Manager and MEM to raise 2 above with potential investors;<br/>(3) MEM to take on 3 above.</p> <p><b>Drafting Instructions:</b> None.</p> |  |  |

| <b>Issues Matrix Reference: Annex A6</b>   |  |   |
|--|--|---|
| <p><b>Issue: Arbitration:</b> The foreign investors will wish for international arbitration to apply to any dispute relating to the transaction including expropriation of the transaction by any government authority.</p>  |  |   |
| <p>This risk is addressed under <b>UNMIK Regulation 2001/3</b> on Foreign Investment in Kosovo for the purpose of creating certain legal guarantees necessary to make Kosovo more attractive to foreign investment.</p> <p>(Section 7) The authorities may expropriate a foreign investment only if such action is for an overriding public purpose or it is made on a non-discriminatory basis and in accordance with due process of law, and is accompanied by prompt, adequate and effective compensation to the foreign investor. A foreign investor who claims that his foreign investment has been expropriated shall be entitled to a prompt judicial or administrative hearing or a hearing before some other competent authority in accordance with due process of the law. If the claim is valid the authority shall assess the value of the claim and order the timely payment of compensation. Compensation shall be equivalent to the fair market value of the foreign investment. Compensation shall be in the form of a freely useable currency, including interest at the one-year LIBOR rate for the period between the date of the taking and the date of complete payment of compensation. Fair market value of the subject of the undertaking may be determined by other agreed means.</p> |  |   |
| <p><b>Materiality:</b> This risk is identified as “high”. We cannot stress highly enough the premium which foreign investors put upon being able to use international arbitration to resolve any dispute whatsoever relating to their investment in a transaction (particularly a mid to long term infrastructure project) in a jurisdiction such as Kosovo. Similarly a foreign investor will also put emphasis upon its ability to enforce any judgment or determination made by an international arbitration within the domestic courts of the jurisdiction in which it has invested. This legislation goes some way towards meeting these concerns in as far as it provides that although the Kosovo courts shall have jurisdiction over resolution of business disputes, the parties to a foreign investment may specify any arbitration procedure upon which they agree.</p> <p><b>Applies to:</b> Sale of shares/sale of assets/BOO-BOT/lease-concession. It is questionable whether it would apply to a management contract.</p>   |  |   |
| <b>Possible Mitigation:</b>  | <b>Strengths</b>   | <b>Weaknesses</b>   |
| <p>1. Amend Section 17 of this law so as to provide that (i) the Kosovo courts shall have jurisdiction over any dispute either relating to or arising from a foreign investment, (ii) but that such disputes shall, if the parties include an arbitration clause in their agreement, be determined using international arbitration; and that any board or determination made at</p>  | <p>It is well documented that the appetite of foreign investors is dramatically increased if they can have recourse to international arbitration to resolve any disputes that they may have arising in respect of their investment and any award or determination made as a result of international arbitration can be enforced in the jurisdiction in which the</p> | <p>Tends to/can be viewed as undermining status of domestic cuts.</p> |

|   |   |   |
|---|---|---|
| international arbitration will be enforceable by the courts of Kosovo in Kosovo in accordance with the New York Convention on Arbitral Awards.  | investment has been made.   |   |
| 2. just allow international arbitration for certain transactions (i.e. the proposed project).   | This would have the effect of weakening the level of comfort we have referred to under “Strengths” in option 1 above. | Potentially unfair on these investors in Kosovo’s energy sector that do not get this. |
| <p><b>Recommended Response:</b> Amend this legislation in accordance with 1 above.</p>  |   |   |
| <p><b>Actions Required:</b> Persons or entity which drafted this law to amend this law in accordance with the Drafting Instructions below.</p> <p><b>Drafting Instructions:</b> Amend this legislation in accordance with option 1 above.</p> |   |   |

| <b>Issues Matrix Reference: Annex A7</b>  |  |                   |
|---|--|-------------------|
| <p><b>Issue: Concessions:</b> UNMIK draft law on concessions.</p> <p>Although the prevailing language for this draft legislation is English, the standard of drafting, syntax and grammar is so poor that in some instances the document becomes incomprehensible. This coupled with the fact that there is no clear structure or hierarchy establishing and identifying the powers of either the PISG or the municipal assemblies to grant concession mean that a foreign investor carrying out its due diligence on its draft concession agreement will face a considerable burden in establishing that the grantor of its concession has the necessary jurisdiction, authority and powers to grant it the concession. Furthermore the foreign investor will be uncomfortable with the fact that its concession would appear to be subject not only to regulation by the grantor but also by the Agency, as some articles in the draft law grant the Agency executive decision-making powers which are superior to those of the grantor.</p> <p>The weakness of the drafting is likely to undermine a foreign investor’s confidence of the robustness and integrity of the whole body of Kosovar legislation.</p> |  |                   |
| <p><b>Materiality:</b> Assuming the draft law on concessions is to enter into legal effect and be used as the basis of awarding concession for the proposed project, this risk is classified as “high”.</p> <p><b>Applies to:</b> Sales of shares/sale of asset, BOO-BOT, leases, concessions and the proposed project.</p>   |  |                   |
| <b>Possible Mitigation:</b>   | <b>Strengths</b>   | <b>Weaknesses</b> |
| <p>1. Scrap the draft law concessions and draft a new law on concessions based on Part two of the UNCITRAL Model Legislative Provisions on Privately Financed Infrastructure Projects.</p>  | <p>Both the proposed payment and other transactions would benefit from a clear and concise piece of legislation establishing the legal and regulatory framework within which concession contracts are rewarded. If necessary concessions relating to other sectors other than the energy sector could be added to this legislation at a later stage.</p> | <p>None</p>       |

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| <p>2. Assuming the draft law on concession is to be brought into legal effect it would be possible to exclude the proposed project from the application of the draft law on concessions by inserting a brief opt-out article into the draft law.</p>  | <p>This should have the considerable advantage of allowing the relevant Government body to prepare a brief but clear tailor-made concession regime for the proposed project.</p> | <p>This would obviously only be a fix for the proposed project. The draft law on concessions will still need to be amended if it is to be used for granting concessions for future transactions.</p> |
| <p>3. Carry out the necessary significant and substantial amendments to the draft law on concessions before it is to enter into legal effect.</p>   | <p>This would mean that all concessionaires/future concessionaires are subject to the same legal and regulatory regime.</p>  | <p>This is likely to be very time-consuming and may therefore hold up progress in the development of the project.</p>  |
| <p>4. Structure the proposed project in such a way so that no concession agreement is required. This would require the opt-out article referred to in 1 above to be included in the draft law on concessions; coupled with a clear policy statement from the relevant authorities that the proposed project was being structured and awarded without the use of a concession agreement.</p>   | <p>The proposed project would be subject to the regime currently set out in the law on concessions.</p>  | <p>This would however establish an inconsistent approach with regard to the awarding of concession contracts.</p>  |
| <p><b>Recommended Response:</b> Do not promulgate this draft law. Draft a new law on concessions.</p>   |  |  |
| <p><b>Actions Required:</b> MEM should determine, in consultation with other relevant institutions, Kosovo’s policy for the use of concessions in relation to the exploitation of natural resources, and specifically in connection to the lignite-to-power sector. If MEM does wish the proposed project to be governed by and awarded in accordance with a law on concessions then we suggest that a new draft law is drafted. This need not be a particularly time consuming exercise as there are some excellent precedents available.</p> <p><b>Drafting Instructions:</b> We suggest that the new concession law be based on the model legislative provisions set out in Part two of the UNCITRAL Model Legislative Provisions on Privately Financed Infrastructure Projects.</p> |  |  |

**Legislation:** Regulation No. 2005/3 on Mines and Minerals in Kosovo and Regulation No. 2005/2 on the establishment of the Independent Commission for Mines and Minerals (ICMM).

Given the crucial importance that these laws will have on the development of both the lignite coal mine for the proposed project and other transactions in the Kosovo energy sector there are a number of key issues which we have identified while reviewing these laws.

These issues relate to:

- (i) the absence of any detailed long term mining policy for Kosovo (see Issue Matrix Reference A8);
- (ii) the extensive role, functions and duties of ICMM, absence of any description of the role of the Mining Advisory Board and apparent confusion over whether it is the Director or ICMM (ie the Board of the Commission) that is responsible for regulating the sector (for example the legislation refers on a number of occasions to ICMM as “him” or “he”);
- (iii) apparent institutional/regulatory overlaps between (i) ICMM (issuing licences for the exploitation for lignite coal) and ERO in its capacity as the energy regulator for Kosovo and (ii) ICMM and other public authorities with responsibilities relating to spatial planning and environmental protection;
- (iv) the “grandfathering” of existing licences granted prior to the entry into force of this draft legislation on the terms on which they were granted (Section 63);
- (v) the period of time it takes for an exploration licence to be issued (see Articles 31.1 and 31.2), 6 months with a possible extension to 12 months);
- (vi) the administrative/cost burdens created by the detailed financial information, commercial information, and other reporting requirements that the foreign investor will have to comply with (see Sections 5, 6, 30 and 32) and the very broad discretion that ICMM has (under Section 30.2) to disapply the requirements of Section 30.1;
- (vii) how it is envisaged KEK’s current mining operations will be brought within the regime of the draft mining law;
- (viii) the regime applicable to Restricted Activities (Section 12);
- (ix) the provisions governing Mining Development Agreements (Section 8);
- (x) procedures and standard forms for the application, recordation, processing and issuing of licences (Section 6); and
- (xi) Licences subject to competitive tender (Section 18), and are not freely transferable to third parties (Sections 9 and 10).

Apart from item (i) which is addressed at Issues Matrix References: A8 and A17, we have considered each of these in turn below.

**It is important to note that while some of these issues, taken alone, might not be considered “deal breakers” there is a significant cumulative effect when taken together.**

**Issues Matrix Reference: Annex A8(A)**

**Issue:** The transfer of powers to the Ministry of Energy and Mining appears hesitant and incomplete. No Annex has been issued by UNMIK specifying the duties and functions of the Ministry which is the normal precedent (see Regulations 2001/19 and 2002/5). The limited wording of the relevant regulation (2004/50) indicates that the Ministry is responsible for energy, but only for lignite in respect of mining, despite the name of the Ministry. The role of MEM in relation to Energy and ERO is adequately elaborated in the Regulations 2004/8 2004/9 and 2004/10. To compound an investor’s confusion, two laws relating to mining (including lignite) were promulgated one month *after* the establishment of the Ministry and the transfer of powers. The creation of ICMM and the unclear boundaries between it, the Ministry and the Energy Regulatory Office is discussed in Annex A8 below. ICMM is actively marketing the lignite opportunity itself in parallel to (and we understand without co-ordination with) the work now being undertaken by the Ministry. In addition, the development of yet another new law for mining by MEM (“MEM’s draft law”) may be viewed with alarm by an investor.

**Materiality:** This risk is identified as high. Indeed, confusion over the very powers, duties and functions of the responsible Ministry and the mixed signals being given to investors by ICMM and the Ministry may act as the single strongest deterrent to an investor identified on this project. The whole point of a one-stop-shop is to reduce confusion and ease bureaucratic processes. Here we appear to be developing two one-stop-shops.

**Applies to: Sales of shares/sale of assets, BOO-BOT, leases, concessions and the proposed project.**

**Possible Mitigation:**

1. Promulgate a clear statement of the duties, functions and responsibilities of the Ministry which should include policy formulation for both energy and mining (broadly) and the duty to secure appropriate new generation capacity and to facilitate foreign investment in the energy and mining sectors. The statement should also speak to the boundary between MEM, ICMM and ERO.

2. If MEM decides to proceed with drafting of a new law on mining, ensure that its reasons are explained clearly in the public domain together with a summary of the key provisions and changes from the current two regulations (2005/02 and 2005/03)

**Strengths**

Gives all institutions a clear brief (which means they can do their job) and also gives the investor a clear picture of who does what.

The MEM draft law is incomplete, but addresses many of the issues raised by the consultants in relation to Regulation 2005/2 and 2005/3. It is also based on a better precedent, and is more in keeping with other new laws produced in Kosovo (such as the Law on Energy).

**Weaknesses**

None

Some continuing uncertainty is created until the new law is promulgated and the January 05 laws repealed.

**Recommended Response:** Pursue options 1 and 2 together.

**Actions Required:** MEM to finalise its proposed schedule of duties and functions and agree this with UNMIK as a matter of urgency. Place a clear statement of the drafting intention behind the new law on the MEM website, with an outline of what the main changes will be and their rationale and the estimated timetable for completion of drafting.

**Drafting Instructions:** None

| <b>Issues Matrix Reference: Annex A8</b>  |  |   |
|---|--|---|
| <p><b>Issue: Mines and Minerals:</b> the extensive role, functions and duties of ICMM, the absence of any description of the role of the Mining Advisory Board and the lack of clarity over the extent to which the Board can delegate to the Director.</p> <p>The role, function and duties of the Commission are too broad. An independent regulator should not, as matter of good practice be (i) drafting sectoral policy (see Section 61 of Regulation 2005/2); or (ii) responsible for encouraging commercial investment in the sector (see Section 21 of Regulation 2005/2). These functions which will play an important part in the delivery of the PISG’s long term policy for Kosovo’s mining sector should be the responsibility of the Ministry. In addition it is also important in defining the limits of the powers of ICMM establish precisely which of their power functions etc. are delegable to the Director. The wide powers and responsibilities in Section 2 of Regulation No. 2005/2 are not balanced or framed in any way. We would prefer to see the powers and responsibilities of ICMM framed or structured by a series of principles/duties applicable generally in the mining sector Art 2 of the Law on the Energy Regulator (No. 2004/9) should provide a useful starting point.</p> |  |   |
| <p><b>Materiality:</b> This risk is identified as “high”. A foreign investor needs to know precisely what powers a regulator has, along with how the responsibilities, duties and functions are divided up between the regulators various departments.</p> <p><b>Applies to:</b> Sales of shares/sale of assets, BOO-BOT, leases, concessions and the proposed project.</p>   |  |   |
| <b>Possible Mitigation:</b>   | <b>Strengths</b>   | <b>Weaknesses</b>                                   |
| <p>1. Amend Law 2005/2 so that (i) ICMM’s duties and functions effectively frame its powers and responsibilities; (ii) the role of the Director is accurately spelt out; and (iii) assuming it is still part of the sectoral policy, the creation of the Mining Advisory Board.</p>   | <p>This will meet the concerns of the investor mentioned above as well as providing a clearer framework through which the mining policy for Kosovo can be delivered.</p> | <p>May delay the promulgation of the draft law.</p> |
| <p><b>Recommended Response:</b> Amend the legislation in accordance with option 1 above.</p>  |  |   |
| <p><b>Actions Required:</b> MEM to draft amendments to this legislation (or draft new).</p>   |  |   |
| <p><b>Drafting Instructions:</b> Amend legislation in line with the recommendations set out in option 1 above.</p>  |  |   |

| <b>Issues Matrix Reference: Annex A9</b>   |   |  |
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| <p><b>Issue: Mines and Minerals:</b> The apparent overlaps between the institutional and regulatory roles of ICMM and the Energy Regulatory Office and MEM and other public authorities.</p> <p>As a matter of energy policy it is good practice (although not essential) for an energy regulator to regulate not only the electricity market but the market for the fuel which is most widely used in the energy sector to generate electricity. In addition foreign investors like, whenever possible, to keep the number of regulatory institutions that they have to deal with to a minimum. This is largely because by only having to deal with one regulator/institution the foreign investor can effectively insulate itself to a very large extent from the risk of, in this case the ERO and ICMM pursuing different regulatory policies, issuing licences within different time periods, and generally regulating the conduct of the foreign investor under the respective licences they have issued in ways which are inconsistent with each other.</p> <p>The problem is even more pronounced under Section 61.1, which establishes the ICMM right to prepare a Mineral Resources Management Plan stipulating that this “will take into account ... specific features and conditions of particular areas ...” (appearing to conflict with the provisions of the Environmental Protection Law). Sections 61.3 and 61.4 go even further providing that public authorities must “take full account of the Mineral Resource Management Plan” and may not approve or implement a spatial or urban plan without the consent of the Authorised Person. It is not clear why spatial and urban planning is made entirely subordinate to the decision of the Ministry.</p> |   |  |
| <p><b>Materiality:</b> This risk is identified as “high”. A foreign investor will not wish to have to deal with two regulators when there is a clear/obvious argument that one regulator can effectively regulate both the issuing of mining licence as well as generation licences. Investors will care far less about the Ministry’s jurisdiction over spatial and urban planning - although this clearly may have serious implications for the implementation of Kosovo’s policies on urban redevelopment and is not in line with best practice.</p> <p><b>Applies to:</b> Sales of shares/sale of assets, BOO-BOT, leases, concessions and the proposed project.</p>   |   |  |
| <b>Possible Mitigation:</b>  | <b>Strengths</b>  | <b>Weaknesses</b>  |
| 1. Amend the Law on Mines and Minerals so that licences for the development and exploitation of lignite coal mines are effectively removed from this legislation with a corresponding amendment being made to the energy legislation permitting the energy regulator’s office to issue licence for the development and exploitation of lignite coal mines.   | Having just one regulator for Kosovo’s energy sector would be consistent with best practice and would improve the chances of there being a better coordinated/coherent and clear energy policy in Kosovo both for the foreign investor itself and any future investors. | As with most institutions, in our experience, ICMM is unlikely to wish to see a weakening of its authority/jurisdiction in this way. |
| 2. Leave the Law on Mines and Minerals as it is, but establish a   | A memorandum of understanding, although   | There will nevertheless still be potential for disputes between  |

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| <p>memorandum of understanding between the ERO and the director of ICMM clearly setting out the basis upon which they will operate and work together in order to ensure, that as far as the energy sector is concerned, that Kosovo's lignite fired generators are regulated through their respective licences in a consistent, clear and coherent manner.</p>  | <p>usually not binding, may serve to meet some of the foreign investor's concerns about having to deal with two regulators.</p>  | <p>the ERO and the director of ICMM. This will be the inevitable result of having two regulators, with differing functions and duties pursuing and implementing different long term policies in respect of Kosovo's energy sector.</p> |
| <p>3 Amend the Law on Mines and Minerals so as to remove ICMM's/Ministry's powers to directly hold up plans relating to spatial and urban planning and replace it with a requirement in the legislation governing spatial planning that public authorities consult with the Ministry in relation to those plans which could have implications for the mining sector in Kosovo. Likewise the Ministry should be obliged to consult upon its draft Mineral Resources Management Plan.</p> | <p>This would remove the apparent legal priority given to the decisions of Authorised Person / the Mineral Resources Management Plan and replace it with an obligation for the Authorised Person and public authorities to ensure that their respective policies remain aligned.</p> | <p>None.</p>   |
| <p>4. Implement option 1 and 3 above in the new draft mining law.</p>   | <p>Allows the cleanest and most comprehensive correction.</p>  | <p>Leaves the uncertainty until the new law is promulgated.</p>  |
| <p><b>Recommended Response:</b> It is difficult to envisage how option 2 above could be made to work effectively. We therefore recommend option 4.</p>  |  |  |
| <p><b>Actions Required:</b> MEM to draft amendments to this legislation (or draft new)</p> <p><b>Drafting Instructions:</b> granting of licences for mining lignite to be taken out of the Law on Mines and Minerals and included in Law No. 2004110 Law on Electricity. Section 61 of the legislation to be amended in accordance with option 3 above.</p>   |  |  |

| <b>Issues Matrix Reference: Annex A10</b>  |  |  |
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| <p><b>Issue: Mines and Minerals:</b> The “grandfathering” of existing licences on their existing terms by Section 63.</p>  |  |  |
| <p><b>Materiality:</b> This risk is identified as “high” because foreign investor will naturally suspect that it will be subject to a stricter regime under the Law on Mines and Minerals than existing licence holders will be under the terms of their existing licences.</p> <p>Furthermore Section 63 conflicts directly with Section 3 of UNMIK Regulation 2001/3 on Foreign Investment in Kosovo, which provides that the principle by which foreign investors shall be regulated is that of national treatment. Section 14 of this regulation could also be relied on by foreign investors since it provides that foreign investors must meet the same licence, accounting, insurance and taxation requirements as domestic businesses.</p> <p>We understand, based on our discussions with the DMM in October 2004 that all licences relating to lignite mines in Kosovo have either expired, or are shortly to expire. Even if this is the case we would prefer to see a clear transfer/transitional regime under this legislation under which all holders of mining licences (whether in respect of lignite coal or other mining activities) are brought on to the same regime under the legislation which will apply in respect of new applications for mining licences.</p> <p><b>Applies to:</b> Sales of shares/sale of assets, BOO-BOT, leases, concessions and the proposed project.</p> |  |  |
| <b>Possible Mitigation:</b>  | <b>Strengths</b>   | <b>Weaknesses</b>  |
| <p>1. Delete Section 63 and add transitional provisions which specify that existing licence holders shall within 3 months of the Law on Mines and Minerals entering into legal effect apply for a new licence in accordance with the provisions of the Law on Mines and Minerals.</p>  | <p>This will eliminate any risk of a “tilted playing field” developing between existing licence holders and new licence holders. and will clearly establish that all licence holders both current and future are governed by the same legislation and regulatory regime.</p> | <p>The existing licence holders may assert that their rights, under their existing licences, have in some way been expropriated / weakened as a result of the transitional regime.</p> |
| <p><b>Recommended Response:</b> Delete Section 63 from this legislation</p>  |  |  |
| <p><b>Actions Required:</b> MEM to amend the legislation (or draft new).</p>   |  |  |
| <p><b>Drafting Instructions:</b> The Law on Mines and Minerals should be amended so that Section 63 is deleted, a regime similar to that used in Chapter 12 (Transitional Provisions of Law Number 2004/10) should be included setting out a clear timetable within which existing licence holders must apply for licences under the new regime set out in this legislation.</p>   |  |  |

| <b>Issues Matrix Reference: Annex A11</b>   |  |  |
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| <p><b>Issue: Mines and Minerals:</b> The fact that the period for the consideration of licence applications (between 6 and 12 months) has been fixed in Section 31.</p>   |  |  |
| <p><b>Materiality:</b> This risk is identified as “high”. This is particularly so given the amount of time that this period represents for any greenfield project in Kosovo’s energy sector, particularly within the 5 year period over which MEM/UNMIK wish to see the proposed project developed. Having to wait between 6 months and a year in order to discover whether it has been granted a licence is unlikely to wet any foreign investor’s appetite before investing in Kosovo. Given that some licence applications are by their very nature more complicated than others we suggest that it would be preferable, once an application for a mining licence has been “duly made” for ICMM to be under an obligation to use reasonable endeavours to process the application as soon as possible. These fixed periods may have been included in this legislation in order to minimise the potential for corruption and reduce lengthy processing time by largely eliminating any discretion in respect of the processing of licence application. However, provided there is a clear policy statement by ICMM setting out its timetable and the various steps it follows in processing licence applications, then the foreign investor will have a firm basis upon which to commence administrative proceedings if it believes that its licence application is either being ignored or duly delayed.</p> |  |  |
| <p><b>Applies to:</b> Sale of shares/sale of assets, BOO-BOT, leases, concessions and the proposed project.</p>   |  |  |
| <b>Possible Mitigation:</b>   | <b>Strengths</b>   | <b>Weaknesses</b>  |
| <p>1. Amend Section 31 (and other Sections containing similar timing requirements) by deleting the specific periods of time over which licences are to be issued. If Section 31 must remain part of the primary legislation then we would suggest that these time periods are replaced with a reasonable endeavours obligation upon ICMM to process the application for licence as soon as the application is duly made.</p>  | <p>This would incorporate a much needed element of flexibility into the licence application procedure and, coupled with a clear policy statement by ICMM, would establish the necessary legal and regulatory foundations to promote investor confidence in the processing of application for minor licences.</p> | <p>None.</p>   |
| <p>2. Amend Section 31 (and other Section containing periods relating to the issuing of mining licences) by reducing the period to one of between, say, one-three months.</p>   | <p>This would at least reduce the amount of time over which the foreign investor has to wait to find out if it will be issued its lignite mining licence.</p>  | <p>This amendment still would not provide the level of flexibility. Arguably, at some stage in the future, mining licence applications may be capable of being processed more quickly, and it is wrong in principle in our view to hard wire time periods into primary legislation unless there is very good cause</p> |

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|   |  | to do so. |
| <p><b>Recommended Response:</b> The fixed periods of 6/12 months for ICMM to process an application for the licence should be removed from this legislation.</p>  |  |           |
| <p><b>Actions Required:</b> MEM to amend section 31 (or draft new)</p> <p><b>Drafting Instructions:</b> The fixed periods of 6/12 months for ICMM to process an application for the licence should be removed from this legislation and replaced with wording which requires ICMM to use reasonable endeavours to process the application for a licence as quickly as possible once an application has been duly made. The procedures and rules governing applications for licences are usually set out in secondary legislation because, as a general rule, they tend to go into greater detail than is thought appropriate for primary legislation. We would therefore suggest that the amendments identified in option 1 above are included in the licence application procedures promulgated by ICMM. Precedents for both standard licence application regulations and policy statements by regulators explaining how such regulations are used on a day to day basis are wildly available on the internet.</p> |  |           |

| <b>Issues Matrix Reference: Annex A12</b>   |  |                   |
|---|--|-------------------|
| <b>Issue: Mines and Minerals:</b> KEK’s current mining activities and how they will be brought within the regime established by the Law on Mines and Minerals.  |  |                   |
| <p><b>Materiality:</b> This risk is identified as “high”. It has been suggested that some of KEK’s mining of lignite coal is unlicensed. If this is the case then (quite apart from any sanctions/criminal liability to which KEK may be exposed to under the current legislation in force in Kosovo) there is no mechanism by which to bring such unlicensed activities within the regime being established under the Law on Mines and Minerals.</p> <p>The foreign investors concerns with regard to this issue are likely to be two fold:</p> <ul style="list-style-type: none"> <li>(i) the potential liabilities to which a foreign investor will be exposed if, as part of the proposed project, the foreign investor will be required to take over control/clean up and decommission any of KEK’s lignite coal mines; and</li> <li>(ii) the possibility that KEK could argue that its existing mining activities, whether licensed or unlicensed, should be “grandfathered” on their existing terms and not subject to the regime under the new legislation.</li> </ul> <p><b>Applies to:</b> Sales of shares/sale of assets, BOO-BOT, leases, concessions and the proposed project.</p> |  |                   |
| <b>Possible Mitigation:</b>   | <b>Strengths</b>   | <b>Weaknesses</b> |
| 1. Include a new Section in Law on Mines and Minerals which establishes that any person carrying out unlicensed mining activities must apply for a licence within a certain period of time of the new legislation entering into effect.   | This would establish a clear mechanism by which to include any unlicensed mining activities that KEK is currently carrying out within the new regime established by the legislation. It would also establish a defence to any assertion by KEK that its existing rights should be grandfathered. | None.             |
| <b>Recommended Response:</b> Bring all/any unlicensed mining activities within the new regime.  |  |                   |
| <b>Actions Required:</b> MEM to amend legislation in accordance with option 1 above (or draft new)  |  |                   |
| <b>Drafting Instructions:</b> These could be based on the Transitional Provisions set out in Chapter 12 of Law Number 2004/10 Law on Electricity.   |  |                   |

| <b>Issues Matrix Reference: Annex A13</b>  |  |  |
|--|--|--|
| <p><b>Issue: Mines and Minerals:</b> Restricted activities (Section 12 of the Law on Mines and Minerals).</p> <p>Section 12.1 prohibits a Licensee or Permit Holder from conducting any one of a list of activities (a-m) upon any land. We presume that this includes land under which the Licensee or Permit Holder has been granted its licence or permit. Given that it is only reasonable to assume that ICMM would have taken into account such issues as for example, whether the proposed site mine is within 60 metres of the boundary of any village or settlement (a), or is within 45 metres of any land used for farming (c) or is a dedicated place of burial (i) when deciding actually to issue the licence or not, much of the mischief at which this Section is aimed should ideally be addressed at the time the licence is issued.</p> <p>More importantly, given the experience, to date with the large increase in the number of persons recently registering as inhabiting the village of Hade (following an announcement that compensation was to be paid to the inhabitants as the price of their resettlement) it would be prudent in our opinion to restrict, and if necessary prescribe, by making it a criminal offence for persons either to set up unlawful settlements or to squat on land which has been proposed as the concession area for a mine..</p> |  |  |
| <p><b>Materiality:</b> This risk is identified as “high” - particularly given the experience to date at the village of Hade. While the foreign investor will accept that in some cases a licence may well have been granted to it in circumstances in which the foreign investor is not required to obtain a waiver under Section 12.2, the risk of third party occupying and trying to assert rights over the site of the new mine after the license has been granted to the foreign investor remains very real.</p> <p><b>Applies to:</b> Sales of shares/sale of assets, BOO-BOT, leases, concessions and the proposed project.</p>   |  |  |
| <b>Possible Mitigation:</b>  | <b>Strengths</b>   | <b>Weaknesses</b>  |
| 1. Amend Section 12 so that it includes a further provision which restricts/imposes penalties upon third parties that carry out such activities.   | This will at least make the foreign investor more confident about the means in which it can assert its rights over the concession/licence. | None.  |
| 2. Instead of including such restrictions/penalties in the law on mines and minerals they can be set out in separate legislation (possibly the forthcoming legislation on the compulsory purchase of land).  |  | Defers correcting this problematic drafting until later legislation. |
| <p><b>Recommended Response:</b> Amend this legislation.</p>  |  |  |

**Actions Required:** MEM to amend legislation (or draft new)

**Drafting Instructions:** We suggest that provisions similar to those used in Article 30 of Law Number 2004/8 on Energy be used to address this risk.

**Issues Matrix Reference: Annex A14**

**Issue: Mines and Minerals:** The negotiation of the Mine Development Agreement (Section 16 of the Law on Mines and Minerals).

Under this section once ICMM has negotiated the terms of a Mine Development Agreement with a proposed Licensee the terms of the Mine Development Agreement cannot enter into effect unless approved by the SRSG.

It is unclear what purpose a Mining Development Agreement will serve given that a mining project will be subject to this legislation, the relevant licence issued under this legislation, and the terms of a concession agreement. In these circumstances, even for very large scale infrastructure mining projects, it is difficult to see what could usefully be obtained in yet another agreement. Assuming a case can be made for the use of a Mining Development Agreement, a foreign investor will completely fail to grasp why it is that having negotiated a Mine Development Agreement with ICMM, it will then have to risk the SRSG (or the Assembly - presumably when the relevant responsibilities are transferred) re-opening the negotiations and amending the terms.

In addition, we are assuming, given that ICMM is only given authority to negotiate the Mine Development Agreement that the parties to this agreement will be the relevant licensee and UNMIK/the PISG.

**Materiality:** This risk is identified as “high”. A foreign investor will (i) wish to know what issues will be addressed, regulated through its Mine Development Agreement; (ii) wish to be satisfied that any Mine Development Agreement it does negotiate is not liable to amendment by the SRSG/Assembly and be unhappy with the fact that the SRSG/Assembly of Kosovo (neither of whom will have the relevant expertise in the mining sector) will determine whether the Mine Development Agreement it has negotiated either with ICMM will be approved or not.

As a matter of best practice we would suggest that the Minister/the SRSG (or their representatives) should be responsible for negotiating a Mine Development Agreement with a respective licensee where the award of such license will involve the material promotion and development of the mining sector in Kosovo - effectively protecting/advancing Kosovo’s commercial interest in the mining sector. ICMM should have no role whatsoever in the negotiation of the Mine Development Agreement, save that it should review the execution draft of the agreement to ensure that its terms do not cut across any of the licensee’s obligations under the licence.

**Applies to:** Sales of shares/sale of assets/BOO-BOT/leases, concessions and the proposed project.

| <b>Possible Mitigation:</b>   | <b>Strengths</b>   | <b>Weaknesses</b> |
|---|--|-------------------|
| 1. Amend the Law on Mines and Minerals so that Mine Development Agreements are only required when there is a genuine commercial need for such an agreement, and the | This will create a far clearer division in the responsibilities in the mining sector - with the SRSG/the Minister safeguarding Kosovo’s commercial | None.             |

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| SRSG/the Minister (or their representatives) are solely responsible for the negotiation of Mine Development Agreements.               | interests and ICMM regulating the mining sector. |  |
| <b>Recommended Response:</b> Amend this legislation in accordance with option 1.  |  |  |
| <b>Actions Required:</b> MEM to amend this legislation (or draft new)   |  |  |
| <b>Drafting Instructions:</b> only relatively minor amendments are required in order to deliver the mitigation envisaged by option 1. |  |  |

**Issues Matrix Reference: Annex A15**

**Issue: Mines and Minerals:** The administrative and cost burdens imposed upon all potential licensees/licences, including foreign investor in complying with various requirements of the Law on Mines and Minerals.

**Materiality:** Given the well recognised deterrent effect that such provisions have on investors,<sup>1</sup> this risk is identified as “high” as the foreign investor is very likely to be irritated by legislation which contains provisions which appear to impose a standard of regulation and control which is out of proportion to the issue to which it relates. These impact on the investors costs of compliance and we would expect him to discount the value which he places on the investment opportunity. In addition the foreign investor will wish to be satisfied that other licensees/applicants are required to comply with the same Application criteria. Section 30.2 raises a real question over this issue. We have set out some examples below:

It is not immediately apparent why a prospective holder of a mining licence should demonstrate that it is a Business Organisation with “at least one senior technical manager responsible for day-to-day technical operations ..... who is physically present in Kosovo at least 270 days a year .....” (Section 5 Applicants Eligibility Criteria). It is also unclear why this requirement is not applicable to KEK and other publicly/socially owned enterprises.

Nor is it clear why the criminal convictions, over the past 10 years, of the respective applicant’s executives, managers, directors or significant owners should in any way impinge upon whether the applicant is successful or not.

Many of the criteria are overlapping. For example the criteria set out in Section 5(b)(i) - (vii) could effectively be reduced to one criterion: that the Authorised Person is satisfied that the applicant is capable of financing the activities which it is to carry out under the licence.

Furthermore Section 30 sets out the further information that the foreign investor will have to provide whilst applying for its mining licence for lignite coal. Examples taken from section 30 followed by a brief commentary are set out below. Section 30 requires among other things, that:

- (i) the foreign investor provide completed applications for any approvals required from other public authorities as may be required under the applicable law (Section 30.1(g)) - we can see no reason why the granting of a mining licence should in any way turn upon whether the foreign investor has completed application forms for approvals which it is filing with third parties;
- (ii) proposals for carrying out the planning Development - these will almost certainly be confidential in nature, and having demonstrated in the criteria under Section 5 that it is capable of financing its business operations, quite frankly a foreign investor will take the view that this is tantamount to “micro management” of its business (see Section 30.1(i)(iii));
- (iii) the foreign investor provide a discounted cash flow estimate over the term of licence

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<sup>1</sup> See characteristics of successful mining, legal and investment regimes in Latin America and the Caribbean region ([http://www.wellbank.org/html/ftd/mining/m3\\_files/ienim/remyla2.htm](http://www.wellbank.org/html/ftd/mining/m3_files/ienim/remyla2.htm))

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| (iv) | <p>of projected capital and operating costs and revenues that establishes the financial and economic viability of the Mining Programme (see Section 30.1i(iv)) - again having demonstrated that it is capable of financing its activities under the licence it is nothing short of micro management and a foreign investor will be very loathed to provide such highly confidential information to anybody other than its financiers;</p> <p>an environmental impact assessment and all documentation required under the environmental law in relation to the Mining Programme (see Section 30.1j) - this is a clear overlap with the responsibilities of the Environmental Agency which is charged with the task of obtaining and assessing environmental impact assessments. The Environmental Agency and all other agencies in Kosovo must be trusted to do their jobs properly, without, as in this case, ICMM looking over their shoulder.</p> <p>Finally, if these provisions are to apply equally to KEK as they are to foreign investors, then there have to be some considerable doubts as to whether KEK would be willing, let alone capable of complying with the various criteria and provisions we have mentioned above using Section 30.2 and disapplying one or all of these requirements from any application for a licence for KEK may make in future would not only be unfair on any investor that is required to comply with them in full but would also be in breach of Sections 3 and 14 of UNMIK Regulation 2001/3 on Foreign Investment in Kosovo.</p> <p><b>Applies to:</b> Sales of shares/sale of assets, BOO-BOT, leases, concessions and the proposed project.</p> |  |                   |
|      | <b>Possible Mitigation:</b>  | <b>Strengths</b>   | <b>Weaknesses</b> |
|      | <p>1. We suggest that the financial/information and eligibility criteria required to be submitted/met by an applicant for a mining licence be substantially reduced and thinned out and that Section 30.2 be deleted.</p>  | <p>This will reduce what we see as an unnecessary and expensive regulatory and administrative burden upon any applicant applying for a licence under the new regime.</p> | <p>None.</p>      |
|      | <p><b>Recommended Response:</b> A simpler set of criteria should be included in this legislation both for the eligibility criteria and the financial information and other data of that respective licensees and licensees are required to provide to ICMM. In addition Section 30.2 should be deleted.</p>  |  |                   |
|      | <p><b>Actions Required:</b> MEM to amend this legislation (or draft new)</p>   |  |                   |
|      | <p><b>Drafting Instructions:</b> Some good examples of precedent mining law which cover these issues in the correct level of detail can be obtained over the internet.</p>   |  |                   |

| <b>Issues Matrix Reference: Annex A16</b>  |   |                   |
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| <p><b>Issue: Mines and Minerals:</b> Procedures and standard forms for the application, recordation, processing and issuing of licenses (Section 6 of the Law on Mines and Minerals).</p> <p>Section 6.1 specifies “that ICMM shall issue procedures and standard forms for the application, recordation, processing and issuance of licenses”, which shall be subject, prior to their publication to a period of 30 days’ review by the Mining Advisory Board. It is still not clear to us whether the Mining Advisory Board exists. However, given that it is existing and prospective licence holders that will be affected most directly by these procedures and standard forms, and to obviate the risk of the Mining Advisory Board passing on the drafts of these procedures and standard forms to some licence holders but not others, we suggest that it will be more prudent to have a general obligation for ICMM to consult generally (either through posting the draft document on its website or otherwise) on such procedures and standard forms before they are published. This is after all what regulators do, as a matter of good practice, within other jurisdictions.</p> |   |                   |
| <p><b>Materiality:</b> This risk is identified as “medium”. If a foreign investor has a genuine grievance with any procedures and standard forms published by ICMM then, we are assuming, it will be able to attempt to persuade ICMM to amend or modify the procedures or standards.</p> <p><b>Applies to:</b> BOO-BOT leaves concessions and the proposed project.</p>   |   |                   |
| <b>Possible Mitigation:</b>  | <b>Strengths</b>  | <b>Weaknesses</b> |
| <p>1. Amend Section 6 to give ICMM a duty to consult more general - for example encompassing all interested parties.</p>   | <p>This will encourage not only the foreign investor but other licensees/prospective licensees to take more of an interest/become involved in helping to shape the procedures and standard forms which will be used to regulate them.</p> |                   |
| <p><b>Recommended Response:</b> MEM should be required to consult with all the interested parties in the sector on the licence procedures.</p>   |   |                   |

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| <p><b>Actions Required:</b> MEM to amend this legislation (or draft new).</p>   |
| <p><b>Drafting Instructions:</b> Amend Section 6 of this legislation to require ICMM to go to public consultation on its licence procedures. It will also be prudent to include a specific provision relating to consultation identifying those issues upon which ICMM must consult as well as providing a more general provision whereby ICMM can, in its discretion, go to public consultation.</p> |

| <b>Issues Matrix Reference: Annex A17</b>  |   |                   |
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| <p><b>Issue: Mines and Minerals:</b> Licences subject to competitive tender (Section 17 of the Law on Mines and Minerals) and the regime that applies to the transfer of a licence to a third party (Sections 9 and 10.)</p> <p>Section 17.1 specifically provides that a licence relating to Energy Minerals can only be awarded after the applicable law on the competitive award of concession has been complied with.</p> <p>It is wrong, in principle in our view, to “hard wire” this requirement into the primary legislation. It effectively means that any foreign investor considering constructing a lignite fired power station in Kosovo can only do so if it is the successful bidder following a competitive tender. Even if they wished to do so, foreign investors will not be able to apply for a lignite mining licence on their own merits and take the entire risk in its capacity as a prospective independent power producer.</p>   |   |                   |
| <p><b>Materiality:</b> This risk is identified as “medium” for the requirement for a competitive tender and “high” in relation to the regime applicable to transfer of a licence / Mining Development Agreement.</p> <p><i>Competitive tender:</i> In our view, the proposed project is only likely to proceed, given the current political/commercial climate in Kosovo, if a very carefully and well structured competitive tender is carried out. However, it is far from clear that in the mid-long term the only basis upon which lignite fired power stations will be an attractive commercial opportunity is if they are awarded on a competitive tender.</p> <p><i>Transfer of licence / Mining Development Agreement to a third party:</i> this will be regarded as absolutely fundamental by investors who will not only wish to be able to assign their interests by way of security (if an investment is to be debt financed) but also to be able to sell the investment outright to a third party.</p> <p><b>Applies to:</b> Sales of shares/sale of assets, BOO-BOT, leases, concessions and the proposed project.</p> |   |                   |
| <b>Possible Mitigation:</b>  | <b>Strengths</b>  | <b>Weaknesses</b> |
| <p>1. A minor amendment could be made to clause 17.1 specifying that certain licences “may” rather than “shall only” be awarded on the basis of a competitive tender. In this way if enough interest is shown by IPPs then ICMM won’t have to carry out a competitive tender when granting mining exploration licences relating to Energy Minerals but he will be able to do so if such genuine interest isn’t shown by IPPs.</p>  | <p>This will broaden the basis upon which foreign investors can chose to invest in Kosovo’s energy sector, and bring the regime into line with the regime applicable under the Energy Laws.</p> | <p>None.</p>      |

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|---|---|-------|
| 2 Amend Sections 9 and 10 simplify the process by which a licence and Mining Development Agreement can be transferred.  | This will mitigate a serious concern for all potential investors. | None. |
| <b>Recommended Response:</b> Remove the mandatory language from Section 17 which requires all licences relating to Energy Minerals to be awarded by way of competitive tender and simplify the provisions of Sections 9 and 10. |   |       |
| <b>Actions Required:</b> MEM to amend this legislation (or draft new).  |   |       |
| <b>Drafting Instructions:</b> Amend this legislation as indicated in options 1 and 2 above.   |   |       |

**Regulation No. 2003/9 The Law on Environmental Protection**

This law will have a significant influence on the foreign investors' decision to invest particularly given the damage that has been done to certain parts of Kosovo's natural resources over the last 10 years; the increasing importance that donors, banks and investors themselves place upon transactions complying with minimum Environmental Standards; and perhaps most importantly, Kosovo's commitment to meet the Environmental Standards of European Union.

In reviewing this law we have identified the following key issues:

- (i) the need to clarify and amend the architectural framework of this law (as well as certain concepts, definitions and provisions);
- (ii) a tentative list of the possible consents that the foreign investor may need to obtain for the proposed project;
- (iii) provisions which clearly cut across the jurisdiction/scope of other legislation;
- (iv) how certain EU Environmental Standards/mechanisms are to be met (even if gradually) by Kosovo.

Each of these is considered in turn below.

**As with the Mining Law, some issues take on a higher significance than they would if each was an isolated problem and, taken together, would be likely to act as deterrents to investment.**

**Issues Matrix Reference: Annex A18**

**Issue: Environmental Protection:** Clarification/amendments required to the architectural framework of this law as well as certain concepts, definitions and provisions.

This law is very poorly drafted. There is little accuracy in the way responsibilities for the environment are assigned and those responsibilities which are clearly assigned are poorly defined and therefore capable of being construed as providing a very wide jurisdiction. In addition this law confusing, and potentially misleading, because of the large number of typographical errors it contains and because the convention of using capitalised letters for defined terms have been so poorly applied. Article 3 for example specifies the public’s authorities “shall or may... engage in Environmental Protection,” but does not define Environmental Protection. Article 4 lists the objectives of Environmental Protection and Article 5 sets out some guiding party principles for Environmental Protection. It remains unclear however what engaging in “Environmental Protection” actually is. Similarly, given the importance of the terms “Natural Resources” (although sometimes the term “natural resources” is used) it is somewhat surprising that this term is not defined. Other terms such as “Discharge” and “Emission (of pollution) Waste,” “Environmental Strains” and “Environmental Licence” are all undefined.

These are just illustrative examples. It is clear from this analysis that as currently drafted, this legislation contains numerous gaps, ambiguities and inconsistencies not only in the activities it seeks to regulate but also in relation to the institutional arrangements through which the legislation is to be delivered.

**Materiality:** This risk is identified as “high”. As drafted this law is so unclear that, in our view, any investor would have to spend a lengthy time (whether by suggesting amendments, or by trying to obtain statements of clarification from the relevant authorities) before it became comfortable enough to invest.

**Applies to:** Sales of shares/sale of assets/BOO-BOT leases, concessions and the proposed project.

| <b>Possible Mitigation:</b>   | <b>Strengths</b>  | <b>Weaknesses</b>   |
|---|---|---|
| 1. Amend this law. We strongly recommend that experts (in the preparation of Environmental Legislation) are used to draft the necessary amendments.   | Provided the amended law on Environmental Protection was sufficiently certain this would greatly improve the prospect of foreign investment in proposed projects. | There is a considerable amount of work to be done in amending this legislation, which will require further time and effort.   |
| 2. Clarify the uncertainties in this legislation by encouraging those authorities/entities with regulatory powers to issue clear policy statements about how they construe their respective roles under this legislation. | This may go some way towards mitigating a foreign investor’s concerns relating to this legislation, as far as they relate solely to the proposed project.         | While this could be made to work for the proposed project, it is not in line with best practice. Where, as in this case, there are so many issues to be clarified attempting to do so through more effectively drafted/non-binding policy statements is |

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|  |  | likely merely to compound the problem rather than solve it. |
| <b>Recommended Response:</b> We recommend that option 1 is implemented as a matter of priority.  |  |   |
| <b>Actions Required:</b> Expert Environmental Lawyer/Draftsman to be instructed to redraft the law and environmental protection on behalf of MESP and to consult with MEM and ERO (as well as other relevant ministries and agencies) on the final draft). |  |   |
| <b>Drafting Instructions:</b> The experts referred to above will undoubtedly use their best practice and precedent legislation of the appropriate vintage and jurisdiction.  |  |   |

**Issues Matrix Reference: Annex A19**

**Issue: Environmental Protection:** List of consents likely to be required by a foreign investor for the proposed project

As a minimum the foreign investor will require the following consents/permits and to comply with certain regulations under this legislation:

- (i) for the Discharge and Emission of pollutants (which include amongst other items which are non-exhaustively listed in Article 10) - liquid, gas pollutants and hazardous substances into the air. (Please see our comments on the need for the Law on Air Protection at Issues Matrix Reference Annex A22. While Article 10 doesn't actually specify that a permit will be required, given the nature of this activity, and the Government's right to "establish acceptable levels" for the Discharge and Emission of such pollutants, a foreign investor will at minimum have to establish that it is complying with such levels;
- (ii) for the regulation of the foreign investor's business of "managing, storing, transporting or administering" Waste. Although this term is undefined, we assume it is likely to include the ash/slag produced once the lignite coal has been burnt. Even if the foreign investor doesn't require a permit or a licence for this activity it is highly likely that a transaction will have to establish the necessary monitoring schemes to establish that it is complying with the rules that the Government set down under Article 12;
- (iii) if part of the foreign investor's obligations are to monitor/manage the "clean up" of the existing mines for the plants at Kosovo A and Kosovo B then the necessary measures will have to be adopted in order to comply with the requirement of Article 19;
- (iv) we assume that the proposed project will have "significant potential for causing Environmental Damage" and will therefore be required to conduct an Environmental Impact Assessment in accordance with Article 20;
- (v) an Environmental Consent, being a permit issued by the Ministry which is required before any application for a construction permit can be processed; and
- (vi) an Environmental Permit, required before a facility commences operations, and which will only be in effect for a five year period;
- (vii) complying with the "established prescribed permissible maximum levels for the discharge and emission of pollutants into the air" (Article 28);
- (viii) complying with the "prescribed permissible maximum levels for the discharge and emission of pollutants into water" (Article 29);
- (ix) complying with the "permissible maximum levels for the discharge and emission of pollutants into soil" (Article 30); and
- (x) complying with the "permitted noise limit levels in the living Environment (whatever that is) (Article 31).

**Materiality:** This risk is identified as “high”. Obtaining the necessary consents and permits for any power station even in jurisdictions with well established legal frameworks with stable and reliable political systems, can be immensely time consuming. The fact that there are potentially as many as 10 consents/permits/ processes which the foreign investor will either have to obtain or demonstrate compliance with is likely to make the foreign investor concerned about the amount of time it may take to obtain such consents and permits. Only one of the ten examples we have identified (of the Environmental Impact Assessment) sets out a clear time table under which such investments are to be scrutinised. Once it has been submitted KEPA have 60 days within which to advise the Ministry on whether to grant an Environmental Consent, with a further 15-30 days for the Ministry to carry out a public consultation.

In addition, given the fact that this legislation merely sets out the framework to be used to protect Kosovo’s environment, one of the first questions a foreign investor is likely to ask will be for copies of the “subsidiary normative acts establishing the acceptable limits” for the various types of polluting activities/restricted activities that the proposed project is likely to carry out.

**Applies to:** Sales of shares/sale of assets/BOO - BOT, leases, concessions and the proposed project.

| <b>Possible Mitigation:</b>   | <b>Strengths</b>  | <b>Weaknesses</b>   |
|---|---|---|
| <p>1. The setting up of a “one-stop shop” (in the case of the proposed project probably co-ordinated and operated by MEM) which will assist the foreign investor, where necessary, in its discussions with those institutions/ministries which are responsible for issuing any consent or permit relating to the proposed project, not just those permits and consents required under this legislation.</p> | <p>This does not necessarily require an amendment to the legislation. We believe that a policy statement by the minister that, in respect of the proposed project a one-stop shop is to be established, coupled with a clear statement about how the ministry expects all public authorities and other interested persons to carry out their legal and regulatory duties, should provide a sufficient level of comfort to the foreign investor provided of course that it can be implemented effectively.</p> | <p>We do not envisage any weaknesses with this proposed mitigation, save that the ministry may lack direct sanctions against a public authority that refuses to comply.</p> |
| <p>2. As part of the redrafting of the law on environmental protection the experts instructed to carry out the drafting should be instructed to streamline, and wherever possible reduce the number of permits and consents required generally under this legislation.</p>  | <p>This will make investors more comfortable in their belief that their transaction will not become tied in the red tape so frequently associated with permitting procedures.</p>   | <p>None.</p>  |

**Recommended Response:** Implement option 1 and 2 (with option 1 being implemented as a matter of priority).

**Actions Required:** MEM to develop, in conjunction with the relevant ministries a methodology for a “one stop shop” for the proposed project, as well as a list of all of the consents licences and permits that the proposed project will require.

**Drafting Instructions:** MEM and other relevant ministries to draft a memorandum of understanding formalising the “one stop shop” arrangements; and experts instructed to amend the law and environmental protection will, following consultation and having taking instructions from the relevant ministries reduce and simplify the consents and permitting procedures for this legislation.

| <b>Issues Matrix Reference: Annex A20</b>   |  |                   |
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| <p><b>Issue: Environmental Protection: How and when</b> Kosovo’s compliance with the standard foreign environmental protection set by the European Union will be implemented.</p> <p>Article 1 paragraph 1 of this legislation specifies that it is a “fundamental purpose” of the present law to establish a basic legal framework that will promote an increasingly healthy environment for the people of Kosovo through the gradual introduction of the Environmental Standards of the European Union. This commitment is even more strongly expressed in the Draft Energy Community in South East Europe Treaty Version 1 (see recital 4 and paragraphs 2 and 3(d) of Title I Principles). Furthermore, European or international standards are frequently cited as the appropriate standard/threshold for other legislation in Kosovo (for example health and safety at work and employment).</p> <p>A foreign investor will not be dismayed at a requirement to comply with EU environmental standards, but what he will wish to see, as a bare minimum, when reviewing the Environmental standards and requirements with which the proposed project will have to comply, is a clearly expressed set out body of rules and standards (ideally fixed for the period over which the proposed project will be operational) which the proposed project will have to meet.</p> <p>Looked at from this perspective, the foreign investor is likely to raise the following issues:</p> <ul style="list-style-type: none"> <li>• How Kosovo (without being a member of the European Union) proposes to (even if gradually) introduce policies which deliver the objectives of the Large Combustion Plant Directive (“LCPD”) and the directive establishing the EU wide emissions trading scheme for greenhouse gasses (“EU ETS”);</li> <li>• A clear timetable setting out exactly when Kosovo asserts it will be in compliance with all the various EU standards (relating to the proposed project);</li> <li>• Exactly what standards the proposed project will have to meet on day 1 of its operations.</li> </ul> |  |                   |
| <p><b>Materiality:</b> This risk is identified as “high”.</p> <p><b>Applies to:</b> Sales of shares/sale of assets/BOO - BOT, leases, concessions and the proposed project.</p>   |  |                   |
| <b>Possible Mitigation:</b>   | <b>Strengths</b>   | <b>Weaknesses</b> |
| <p>1. The relevant ministries should make clear policy statements indicating exactly what is meant by either adopting or meeting the environmental standards of the European Union in the context of specific EU regulations and directives (such as the LCPD and the EU ETS). Wherever possible, this should also set out a clear timetable</p>  | <p>This would at least allow the foreign investor to know exactly what environmental regime and standards it will have to comply with at the time it decides whether to invest in Kosovo or not.</p> | <p>None.</p>      |

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| <p>over which such standards are to be introduced. In addition the foreign investor may request that any new (tighter) environmental standards should not, as far as is possible be applied to the proposed project.</p> |  |  |
| <p><b>Recommended Response:</b> Clear policy statements to be issued as soon as possible in accordance with option 1 above.</p>  |  |  |
| <p><b>Actions Required:</b> Once the law on environmental protection has been amended it should be possible to identify which ministries and agencies should be responsible for issuing these policy statements.</p>     |  |  |
| <p><b>Drafting Instructions:</b> MESP and MEM jointly to develop, approve and issue policy statements in accordance with option1 above following consultation with MTI and other relevant institutions.</p>              |  |  |

| <b>Issues Matrix Reference: Annex A21</b>  |  |                   |
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| <p><b>Issue: Environmental Protection:</b> The fact that this legislation cuts across the jurisdiction/scope of other legislation.</p> <p>The neatest example of this can be found in Article 18 which purports to govern the use of natural resources. This Article provides that persons may “engage in research, exploration of exploitation of Natural Resources” (which we have already noted is undefined) if they meet a series of criteria which include, submitting an Environmental Impact Assessment, respecting all laws and rules relating to their activity, and, among other things, if the Natural Resource is public property (again public property is undefined) to have a Concession or other adequate right to use and exploit the Natural Resource in accordance with the law.</p> |  |                   |
| <p><b>Materiality:</b>       <b>When taken together with other issues identified in the environmental laws,</b> this risk is identified as “high”. Based on our review to date this is the third piece of legislation/draft legislation which sets out requirements relating to concessions (the other legislation being the draft law on concessions and the law on mines and minerals).</p> <p><b>Applies to:</b> Sales of shares/sale of assets/BOO – BOT, leases, concessions and the proposed project.</p>  |  |                   |
| <b>Possible Mitigation:</b>  | <b>Strengths</b>   | <b>Weaknesses</b> |
| 1.Delete Article 18 from this legislation.   | This will remove the duplication. It will also mean that this law does not trespass into areas and issues which are simply not part of environmental protection. | None.             |
| <b>Recommended Response:</b> Delete Article 18 from this legislation.  |  |                   |
| <b>Actions Required:</b> Experts amending this legislation to delete Article 18.   |  |                   |
| <b>Drafting Instructions:</b> Amendment to be made as part of the redrafting of the Law on Environmental Protection.   |  |                   |

| <b>Issues Matrix Reference: Annex A22</b>  |
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| <p><b>Law No. 2004/30: The Law on Air Protection</b></p>   |
| <p><b>Issue:</b> Clarification /amendments to certain concepts, definitions and provisions in this law.</p> <p>Regulation No 2003/9 The Law on Environmental Protection covers the subject of emissions into the air. There is however no explicit recognition of this fact in this legislation.</p> <p>It is unclear whether there is even a need for the Law on Air Protection since its purpose (to provide the basic legal framework to “provide an increasingly healthy environment”) is already covered under The Law on Environmental Protection.</p> <p>The Law on Air Protection gives significant responsibilities to the MESP, without stating what this entity or defining the MESP’s relationship with the other institutions with responsibilities for the environment (identified in the Law on Environmental Protection). This clearly creates an overlap in responsibilities and will only cause uncertainty in the investor community. The Law on Air Protection also suffers from much of the poor drafting and inconsistencies found in the Law on Environmental Protection</p> <p>In addition to these serious architectural defects the investors will also be uncomfortable with the way in which the following issues are currently addressed:</p> <ul style="list-style-type: none"> <li>(i) emission levels/ standards: these are described as being harmonised with the EU’s standards but later reference is made to the standards of the World Health Organization. Given that these standards merely set a general bench mark and have to be implemented foreign investors will require much greater and clearer detail as to precisely what these standards will be.</li> <li>(ii) consents: the Law on Air Protection identifies 9 instances where a permit is required and includes all stages of the development and operation of a project. This coupled with the 13 consents already required under the Environmental Protection Law create the appearance of a level of red tape that is enough to put off any investor.</li> <li>(iii) Monitoring, enforcement and sanctions: the monitoring of air quality will be the responsibility of MESP through the Environmental Protection Agency, the KEPA and other competent authorities. The Law does not specify the attributions and competence of each agency or party involved. This will leave foreign investors (not to mention these agencies themselves) unsure as to who is responsible to monitor their activities and who to address if they have an issue. Sanctions (for failures to comply including for failure to obtain an environmental permit) range from a fine to the suspension of work pending the application for the permit. This will be an issue for foreign investors as they may face a suspension for failing to obtain a permit even if they have not caused pollution. In addition the Law on Air Protection does not specify sanctions procedures or whether sanctions can be appealed, or indeed if there are time limits.</li> </ul> |
| <p><b>Materiality:</b> This risk is identified as “high” for all the reasons set out above.</p>  |
| <p><b>Applies to:</b> Sales of shares/sale of assets/BOO-BOT leases, concessions and the proposed project.</p>   |

| <b>Possible Mitigation:</b>   | <b>Strength</b>   | <b>Weaknesses</b> |
|---|---|-------------------|
| 1. Prepare a clear policy statement setting out the precise emission levels and standards that will be applied to existing and new generating units in Kosovo.  | Even without the legislation required to deliver these standards in place an investor will at least know what standards/levels will be applied to their projects. | None.             |
| 2. Revoke the Law on Air Protection and allow the legal experts redrafting the Environmental Protection Law to address to the issue of drafting appropriate regulations for emissions at a later date.  | Once this is in place investors will have even greater confidence.  |                   |
| <p><b>Recommended Response:</b> Follow and implement options 1 and 2 above. Option 1 to be given high priority.</p>   |   |                   |
| <p><b>Actions Required:</b> MESP and MEM jointly, in consultation with EPA and ERO, to prepare and approve a clear policy statement on the extent to which emissions standards will be met by new generating units in Kosovo, following which EPA and ERO should consult and agree on the precise emission levels and standards that will be applied to existing and new generating units in Kosovo, in line with the approved policy.</p> <p><b>Drafting Instructions:</b> Revoke the Law on Air Protection and instruct the legal experts redrafting the Environmental Protection Law to address the issue of drafting appropriate regulations for emissions at a later date.</p> |   |                   |

| <b>Issues Matrix Reference: Annex A23</b>  |   |   |
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| <p><b>Issue: Tax Law:</b> Kosovo does not have a formal policy statement regarding the development of the minerals and / or energy sectors and in particular to the aggregate revenue sought from those sectors by PISG, in terms of direct and indirect taxation and duties, including mineral royalty. In parallel, the tax law does not provide for tax stability agreements to be concluded between PISG and potential investors. These two factors produce a sense of uncertainty as to the taxation to which a long term project in these sectors might be subject. In the light of the current trend to increase rates of taxation, investors might consider the risk of future increases as an important disincentive to investment.</p> |   |   |
| <p><b>Materiality:</b> This risk is identified as “high”</p> <p><b>Applies to:</b> Sales of shares / sale of assets / BOO – BOT leases, concessions and the proposed project.</p>  |   |   |
| <b>Possible Mitigation:</b>  | <b>Strengths</b>  | <b>Weaknesses</b>   |
| <p>1. PISG should develop a policy statement that would be approved by the Assembly; the statement would set out the PISG’s policy on the encouragement of investment in the respective sectors and (inter alia) specify maximum levels of revenue sought by PISG.</p>   | <p>A clear policy statement will provide an element of comfort to investors.</p> <p>A policy statement would also help ensure a co-ordinated approach to the sectors by all PISG organs (viz.: MEM, MFE, ERO, ICMM, Tax administration, other Ministries)</p> | <p>Policies may be changed.</p>   |
| <p>2. Legislate for the availability of stability agreements between Kosovo and the investor</p>   | <p>A bilateral agreement can specify the full range of taxes and other Government take from the project and provide binding assurance to the investor</p>   | <p>Disparities may arise between stability agreements entered into with different investors at different times.</p> <p>The validity of such agreements might be questioned in relation to the resolution of final status.</p> |
| <p><b>Recommended Response:</b><br/>Both proposals set out above should be implemented.</p>  |   |   |

**Actions required:**

PISG should initiate the development of a sector policy for the energy and mining sectors. The consultants recommend PISG to consult the World Bank. Taxation stability agreements should be provided for in the tax legislation.

**Drafting Instructions:** Provide in the Law on Profit Tax (or its successor) that the Government of Kosovo may enter into an agreement with an investor in a qualifying project whereby the taxation liabilities (and other forms of Government Take) of the investor / project shall be determined in accordance with the provisions of the agreement which shall take precedence over other generally applicable legislation.

| <b>Issues Matrix Reference: Annex A24</b>   |   |   |
|---|---|---|
| <p><b>Issue: Tax Law:</b> Methods of dissemination of tax regime</p> <p>The principal regulations and laws are published on the UNMIK website. In addition to these materials, there is a substantial body of supplementary administrative instructions and tax rulings which are designed as clarifications / interpretations of the published laws. In some instances, these materials fill gaps that exist in the laws. These materials are available in hard copy from the Tax Administration but have not been disseminated electronically. A foreign investor would not be aware of their existence and might thereby be misled as to the application of Kosovo tax to a potential investment. The Ministry of Finance and Economy has stated that such materials will shortly be made available on the internet.</p> |   |   |
| <p><b>Materiality:</b> The Risk is identified as “high”. As a matter of principle, the operation and administration of tax law should be transparent and insufficient or inconvenient publication of tax laws detracts from that principle.</p> <p><b>Applies to:</b> Sales of shares / sale of assets / BOO – BO, leases, concessions and the proposed project.</p>  |   |   |
| <b>Possible Mitigation:</b>   | <b>Strengths</b>                        | <b>Weaknesses</b>                       |
| 1. Publish all tax administrative documents on a website without delay and provide a comprehensive web-based search facility  | Full transparency of taxation regime    | None                                    |
| 2. Publish on the UNMIK website a list of documents that may be obtained in hard copy form, citing the name and co-ordinates of the official to whom application should be made.  | Full disclosure of extant tax documents | Poor accessibility to foreign investors |
| <p><b>Recommended Response:</b> See Option 1, above.</p> <p><b>Actions required / Drafting recommendations:</b> MFE to implement web publication.</p>   |   |   |

| <b>Issues Matrix Reference: Annex A25</b>   |  |  |
|---|--|--|
| <p><b>Issue:</b> There has not hitherto been any system of binding tax clearances of rulings whereby a tax payer or potential taxpayer may approach the Kosovo tax administration for a ruling on the tax effect of a proposed transaction or series of transactions. Developed jurisdictions commonly offer such a service. In the absence of an advance clearance system, the tax effect of transaction(s) may remain in doubt. Uncertainty increases the risk underlying an investment and might cause an investor to decide to prefer a different tax jurisdiction and to decide not to invest in Kosovo.</p> <p>A proposal for binding tax rulings has been submitted by MFE to the OLA in 2004 and a response is still awaited.</p> |  |  |
| <p><b>Materiality:</b> This risk is assessed as “high” in view of the potential deterrent effect on investment in Kosovo.</p> <p><b>Applies to:</b> Sales of shares / sale of assets / BOO - BOT, leases, concessions and the proposed project.</p>   |  |  |
| <b>Possible Mitigation:</b>   | <b>Strengths</b>   | <b>Weaknesses</b>  |
| <p>1. Develop a system of advance tax clearances, enabling potential taxpayers to obtain a binding ruling on a transaction. The consultants are informed that the tax administration is in the process of developing such a procedure.</p>  | <p>The procedure may provide clarity and certainty as to the application of tax law.</p> | <p>Unless expertly implemented, may bind the Tax administration in unforeseen ways</p> |
| <p><b>Recommended Response:</b> Option 1</p> <p><b>Actions required / Drafting recommendations:</b> Implement the proposed system of tax clearances. MFE should follow up this issue with OLA and urge for a ruling as soon as practicable.</p>   |  |  |

| <b>Issues Matrix Reference: Annex A26</b>  |   |   |
|--|---|---|
| <p><b>Issue: Tax Law:</b> The Tax regime is not especially attractive to investors considering projects of an infrastructure nature, such as energy sector investments. The period over which the investment attains tax relief for expenditures incurred can be long compared with other jurisdictions and in some cases relief may never be obtained. The aspects of tax law causing concern in this respect are:</p> <ul style="list-style-type: none"> <li>▪ Limitation of loss carry forward to 5 years</li> <li>▪ Unattractive rates of capital allowance</li> <li>▪ Inadequate definition of boundaries between classes of assets for depreciation purposes</li> <li>▪ Lack of provision for relief for unsuccessful exploration costs</li> <li>▪ Requirement for segregation of exploration costs and inadmissibility of pooling</li> <li>▪ Tax Administration acknowledges that the current classification regime is too simplified for larger taxpayers and would support further work on this.</li> </ul> |   |   |
| <p><b>Materiality:</b> The risk is identified as “high”. Investors undertaking analysis of the international competitiveness of the Kosovo tax regime for long term projects would conclude that the regime is not competitive.</p> <p><b>Applies to:</b> Sales of shares / sale of assets / BOO - BOT, leases, concessions and the proposed project.</p>  |   |   |
| <b>Possible Mitigation:</b>  | <b>Strengths</b>  | <b>Weaknesses</b>   |
| 1. Develop a special taxation regime for long term projects for activities regulated by the Energy Regulatory Office.  | Appropriate targeting of tax policy   | Difficulty of distinguishing activities to which the special regime should relate; the consultants recommend that the criterion should be whether the activity is regulated by the Energy Regulatory Office.<br>Possible discriminatory economic effects that might distort markets |
| 2. Amend the general taxation law to provide the proposed tax advantages to all activities.  | Clarity of application<br>No economic discriminatory effects  | Perhaps offers tax incentives to activities that do not require them, resulting in loss of tax revenue.   |
| 3. Develop the sophistication of the tax system.   | Improved specification of the tax regime would increase certainty and reduce risk perceptions of investors. |   |

**Recommended Response:**

Option 2 is recommended on the basis of ease of administration and the advantage of the lack of potential discriminatory effects. It is doubtful whether the loss of revenue would be significant but this should be appraised by the Tax Administration. A policy decision is required by MFE on this.

Mitigation 3 above should be undertaken additionally.

**Actions required / Drafting recommendations:** Draft the proposed changes into the tax law.

| <b>Issues Matrix Reference: Annex A27</b>  |                                   |   |
|--|-----------------------------------|---|
| <p><b>Issue: Tax Law:</b> Arrangements to mitigate the possible double taxation of business profits and employment income should be reviewed. The UNMIK view on the applicability of pre-1999 Double Taxation Treaties has recently changed and it is now considered that these international treaties are applicable to Kosovo. It is appropriate at this time to review the coverage of the treaty network and the scope of the treaties themselves. The content of treaties should be updated to reflect current Kosovo domestic legislation and the evolution of best international tax practices.</p> |                                   |   |
| <p><b>Materiality:</b> The risk of double taxation is assessed as “medium”. For many investing jurisdictions, there are provisions for unilateral relief that mitigate the worst effects of double taxation. For high value long term projects, such as energy and mining investments, however, the specific nature of the projects may entail transactions that require careful taxation planning. The currency of the tax treaty provisions can therefore be important.</p>  |                                   |   |
| <p><b>Applies to:</b> Sales of shares / sale of assets / BOO - BOT leases, concessions and the proposed project.</p>   |                                   |   |
| <b>Possible Mitigation:</b>  | <b>Strengths</b>                  | <b>Weaknesses</b>   |
| <p>1. Review taxation treaties in force and appraise the relevance and completeness of their coverage of situations that are likely to arise in the energy and mining sectors</p>  | <p>Suitably targeted approach</p> | <p>It is difficult to anticipate every eventuality. PISG should therefore be aware that potential investors might request specific amendment of international treaty obligations as part of the investment negotiations</p> |
| <p>2. Consider whether the treaty coverage is sufficient for the purposes of likely investors in the energy and mining sectors; negotiate further treaties to improve coverage</p>   | <p>Suitably targeted approach</p> | <p>The source of investment into the sectors is a matter of conjecture</p>  |
| <p><b>Recommended Response:</b><br/>Both actions should be implemented. The analysis and review of treaties must however be regarded as a medium term and on-going task. Implementation is likely to be hindered by lack of suitably experienced personnel.</p>  |                                   |   |
| <p><b>Actions required / Drafting recommendations:</b><br/>The Ministry of Finance and Economy should initiate the process. At the same time, the Ministry should be ready to respond appropriately to specific requests from potential investors for urgent review of single relevant treaties.</p>   |                                   |   |

**Issues Matrix Reference: Annex A28**

**Law on Public Procurement - Law No. 2003/17**

**Issue:** Prospective investors in Kosovo’s energy sector will place a very high premium on the bidding process that is founded upon clear, transparent, robust and workable set of procurement rules. Having reviewed the rules set out in this legislation we are satisfied that that they are fit for their purpose and, on their face, should provide the necessary legal and regulatory framework in which to carry out the procurement/tender process for opportunities in Kosovo’s energy sector.

Given the scope of the proposed project there is little doubt that the procurement activities in respect of it will involve contracting authorities and concessionaires (see section 2.1) and therefore the requirements and procedures of the Law on Public Procurement will need to be met.

Significantly, section 3.2 provides an exemption to the compliance requirement where “the procurement activities leading to the award of a public contract falling within the scope of an agreement providing for the application of other procurement rules and/or procedures where (i) such agreement makes the availability of financing for the concerned contract conditional on the application of such other rules and/or procedures, and (ii) such agreement has been entered into between UNMIK or the Government and an intergovernmental, bilateral, multilateral or international financing institution.”

This means that this Law need not apply if, for example, the proposed project is partly financed through a loan granted by an EBRD loan, where such loan is subject to the EBRD’s procurement rules.

This will be favourably looked upon by investors as, by providing that only one set of procurement rules apply, conflicts between rules will be avoided and it will avoid further costs and delays.

In reviewing this legislation we have assumed that in order to make the proposed project as attractive as possible to potential foreign investors, MEM and/or all other relevant institutions will, insofar as is reasonably possible, structure the tendering process for the proposed project on as firm a basis as possible. For example, much of the administrative burden faced by an investor could be removed through a procurement process which involved the incorporation of an “off the shelf company” (with the shares being held by the relevant ministry). This company, once the appropriate site had been identified and obtained by the project company, would be able to apply for in principle consents and permits from all the relevant public authorities. To the extent that a permit consent or licence was conditional upon the meeting of certain criteria which the project company was unable to meet at that particular point in time then these conditions could be imposed and set out in the terms of the in principle consent. Similarly, advanced drafts of all the key project documents (examples of which are listed in Annex E) could be negotiated by the project company with its relevant counterparties.

A procurement process for the proposed project implemented in this way would therefore mean that the investor would be able to make its decision to invest based upon advanced drafts of key project documents clearly allocating the risks that the investors and other parties would be expected to take, and would probably complete its investment by purchasing the entire share capital of the project company from the ministry. In addition it might be possible, since the proposed project would be tendered on a “ready to go” basis, to extract some form of guarantee from the investor about the

date by which the proposed project will start commissioning of the generation turbines.<sup>1</sup>

If, as we have assumed, the proposed project is to be put out to tender on this basis then it will be necessary firstly to determine which procurement rules are to be applied to the tendering process for the proposed project. Secondly, assuming that this legislation is to be used, it will be necessary to establish the informal arrangements required between the project company and all the relevant government, ministries, agencies and regulators in order to ensure that the way in which the tender process for the proposed project is structured remains strictly within the framework of rules set by this law while at the same time ensuring that the carrying out of the procurement process mitigates the inefficiencies that investors so frequently experience and associate with procurement procedures in countries in transition.

**Materiality:** This risk is identified as “high”, because, although the legislation is fit for its purpose, the investors will need to know from the outset which procurement rules are to be applied to the given transaction, and, in the case of proposed project, will wish to be satisfied that the tendering of the proposed project on a “ready to go basis” is clearly within the legal and regulatory framework established by this legislation. This Law should be complied with as it provides a clear, robust and workable set of procurement rules and will be favourably received by investors.

*Applies to: Sales of shares/sale of assets/BOO-BOT leases, concessions and the proposed project.*

| Possible Mitigation:  | Strengths   | Weaknesses |
|---|---|------------|
| 1. MEM’s Project Manager for each transaction should identify sources of funding for the transaction and if these are firm then find out the extent to which the Bank is proposing to lend to the transaction, insist on adherent to their own procurement rules. Once in this position the Project Manager and the relevant government ministries can make a decision as to what extent, if any, this legislation (Law No. 2003/17) can be disapplied. | Investors prefer to keep their costs associated with procurement to a minimum, and since complying with one set of rules normally achieves this objective better than complying with two sets, they will probably wish to see one set of rules applied to the procurement process in respect of the transaction in which they are interested, | None.      |
| 2. The Project Manager for the proposed project (taking appropriate advice on Kosovo law where necessary) should agree and put in place the necessary semi-formal arrangements  | An expedited procurement process, carried out properly within the constraints of the governing procurement rules, will ensure that the investor’s interest in the proposed project is retained. It should   | None.      |

<sup>1</sup> This structure has most recently been used in the tendering process carried out for a new gas fired IPP in the Republic of Ireland.

|   |   |  |
|---|---|--|
| <p>with the host of government ministries, agencies and regulators which will be involved in the procurement process for the proposed project. Required to allow for this project to be put out to tender on a “ready to go” basis.</p>   | <p>also ensure that the procurement process is completely quickly and that the commissioning of the proposed project will therefore have a better prospect of being met within the 5 year time frame envisaged.</p> |  |
| <p><b>Recommended Response:</b></p> <p>Identify procurement rules that will be applied by major lenders thinking of investing in the proposed project and the extent to which these rules must be complied with by the proposed project. Draft the necessary informal arrangements relating to putting out the project out to tender on the most efficient basis possible.</p>  |   |  |
| <p><b>Actions Required:</b></p> <p>MEM’s Project Manager (for the proposed project) and other government ministries, UNMIK, agencies and regulators to agree the arrangements required to implement Option 2. Project Manager to approach various international finance institutions which may be interested in investing in the proposed project.</p> <p><b>Drafting Instructions:</b></p> <p>These can only be drafted once it is clearly established what procurement rules are to be applied to the proposed project and the precise structure the Project Manager wishes to follow in the procurement process.</p> |   |  |

| <b>Issues Matrix Reference: Annex A29</b>  |   |                   |
|--|---|-------------------|
| <p><b>Issue: Insolvency:</b> The relationship between the insolvency of a licence holder in Kosovo's energy sector and the steps that the regulator(s) will take in these circumstances.</p>   |   |                   |
| <p><b>UNMIK Regulation 2003/7</b> on the promulgation of the Law adopted by the Assembly of Kosovo on liquidation and reorganisation of legal persons in bankruptcy.</p> <p><b>Law 2003/4</b> on liquidation and reorganisation of legal persons in bankruptcy applies to legal persons, which includes general partnerships, limited partnerships, joint stock companies and limited liability companies.</p> <p>The liberalisation and introduction of competition into any market, including Kosovo's energy market will mean that the risks within that market (including the risk of insolvency/administration) become much more exposed.</p> <p>The insolvency/appointment of an administrator in respect of a licence holder will almost certainly be grounds upon which the licence may be terminated by the relevant regulator. Given as a matter of general commercial law businesses that have been put into administration may, in certain circumstances make proposals which will allow them to "work out" of their precarious financial position, a foreign investor would be looking, at the very least for a policy statement from the authorities issuing their licences that in the circumstances the regulator would at least allow the licence holder a reasonable period of time to make arrangements for such a work out before revoking the company's licence.</p> <p><b>Materiality:</b> This risk is identified as 'high' when taken together with the issue on creditworthiness issue raised at A3 above, particularly given that KEK is very likely to be the offtaker for any new generation project and the investor will wish to know precisely what will happen in the event of KEK's administration. The significance of this issue will reduce substantially as the general creditworthiness issue is reduced.</p> <p><b>Applies to:</b> Sale of shares/ sale of assets, BOO - BOT, lease, concession/ management contract.</p> |   |                   |
| <b>Possible Mitigation:</b>  | <b>Strengths</b>  | <b>Weaknesses</b> |
| 1. The ERO (and ICMM as appropriate) to make clear statements to the effect that they will, in the event that the licensee becomes insolvent, appoint an administrator giving that licensee an appropriate amount of time to attempt a work out before revoking its licence.   | This will help to reduce the investor's concern about counterparty's inability to perform its contractual obligations in the event that it becomes goes into administration and is put at risk of losing its licence. | None.             |
| 2. Amend the energy legislation and Law on Mines and Minerals to formalise the arrangements  | This will help to reduce the investor's concern about counterparty's inability to   | None.             |

|  |  |  |
|--|--|--|
| that the regulators will follow in the event of an insolvency or administration of a licensee.   | perform its contractual obligations in the event that it becomes insolvent and is put at risk of losing its licence. |  |
| <b>Recommended Response:</b> We recommend implementation of option 1 as a matter of priority. Option 2 can be implemented if investors insist on seeing such a structure spelled out in the legislation. |  |  |
| <b>Actions Required:</b> ERO and ICMM to draft appropriate statement of regulatory practice in consultation with MEM.  |  |  |
| <b>Drafting Instructions:</b> Examples of such practice statements are widely available from a number of regulator's websites.   |  |  |

**Issues Matrix Reference: Annex A30**

**Issue: Compulsory Powers:** The absence of any **compulsory purchase** legislation/nor on **eminent domain**.

Investors developing an IPP, as well as other regulated entities in Kosovo’s energy sector occasionally need to be able to rely on compulsory purchase legislation in order to be able to compel (where necessary) third parties to grant them certain rights required in order to properly carry on their licensed business. From the foreign investor’s perspective these may include rights of access over lands surrounding site and permission to construct overhead cables from the power station to the connection to the transmission system. These are typically set out in what is referred to as either compulsory purchase legislation or legislation relating to rights of eminent domain. No such legislation exists in Kosovo at this point in time, although we understand that there are proposals for such legislation to be drafted.

There are of course provisions in the Energy Law which allow licence holders, in certain circumstances, to compel third parties to provide them with easements or rights of way for the purpose of discharging their licence obligations. However, no such equivalent provisions are set out in the Law on Mines and Minerals. Instead, parties are expected to negotiate service rights agreements covering such issues. It is unclear however what an investor would do if its counterparty refuses to enter into a service right agreement.

The constitution clearly states that any such procedure should be subject to a fair and due process with reasonable compensation being awarded to the land owner, and given that such a process is envisaged by the constitution there is clearly an argument that there is an implied power to one or more of the institutions of Government pursuant to which they could implement the compulsory purchase process.

**Materiality:** This risk is identified as “medium” for transactions in the generation sector. Provided that a foreign investor can establish (i) a title which has been granted to the project site as a result of any compulsory purchase process has been done so fairly and in accordance with the necessary procedures; or (ii) where necessary the foreign investor may be able to invoke such compulsory purchase procedures in order to acquire a right or title over any land needed to properly fully develop the facility, then the foreign investor should be able to get comfortable with this risk.

**Applies to:** Sale of shares/ sale of assets, BOO - BOT, lease, concession/ management contract.

| <b>Possible Mitigation:</b>  | <b>Strengths</b>   | <b>Weaknesses</b>  |
|--|--|--|
| 1. Draft law on compulsory purchase/rights of eminent domain. With the necessary provisions allowing for compensation to be made in appropriate circumstances. | The investor will be most comfortable with this option because it would leave the formalised regime in which the investor can have recourse to its right to carry out a compulsory purchase. | None.  |
| 2. The relevant provisional Government institution (which  | None.  | This would effectively leave foreign investors with a non- |

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| <p>has the right to compulsorily purchase land for a perspective generator/owner of a lignite coal mine, could make a policy statement indicating the circumstances, in respect of certain specific transactions, including the proposed project, relating to the steps and procedures proposed to follow.</p> |  | <p>binding policy statement in respect of this issue.</p> |
| <p><b>Recommended Response:</b> Draft as a matter of priority a law on compulsory purchase/rights of owner/eminent domain.</p>   |  |   |
| <p><b>Actions Required:</b> Relevant Government Authority/Ministry to draft this legislation.</p>  |  |   |
| <p><b>Drafting Instructions:</b> None.</p>   |  |   |

| <b>Issues Matrix Reference: Annex A31</b>  |   |                   |
|--|---|-------------------|
| <p><b>Issue: Project Financing:</b> The ability of the foreign investor to grant security over its assets/licences in Kosovo as part of its strategy to be able to finance the project on a non-recourse basis.</p> <p>We have assumed that the foreign investor will be unlikely to debt finance/project finance the proposed project during the construction stage and early stages of operation facility. However, it is possible that some time in the short to medium term the foreign investor may wish to have the flexibility to take the project off its balance sheet by using debt finance. In these circumstances lenders typically request security over all the project assets, contracts and where possible, the licences. Given that security over Kosovo assets can only be governed by Kosovo law any security that the foreign investor wishes to grant to its Lenders must be governed by Kosovo law.</p> <p>The foreign investor (and its lenders, if at some stage in the future the foreign investor chooses to debt finance a project) will therefore wish to satisfy themselves that as a matter of Kosovo law it is possible:</p> <ul style="list-style-type: none"> <li>(i) for the foreign investor to grant security (by way of charge or mortgage or other relevant instrument) over its interest both in the site on which the generation facilities are constructed along with any legal interest that it has in the lignite mine; and</li> <li>(ii) that there is an effective method of registering the Bank’s security/rights in respect of such assets.</li> </ul> |   |                   |
| <p><b>Materiality:</b> This risk is identified as “high”. We have given this issue this rating because as of yet we have yet to see any law which clearly sets out the basis upon which security can be granted in Kosovo. We are aware from our discussions with the World Bank that prior to [1990] businesses were able to secure loans against their assets. However, we have yet to come across working examples of such mortgage arrangements UNMIK.</p> <p><b>Applies to:</b> Sale of shares/sale of assets, BOO-BOT, leases, concessions and the proposed project.</p>   |   |                   |
| <b>Possible Mitigation:</b>  | <b>Strengths</b>  | <b>Weaknesses</b> |
| <p>1. A foreign investor that envisages using debt finance for its project (whether initially or at some stage during the life of the project may enquire, whether in principle, the following arrangements could be made part of its future/prospective lenders “security package”:</p> <ul style="list-style-type: none"> <li>(i) Direct Agreements: the relevant counterparty to certain key project agreements (such as the Connection Agreement,</li> </ul>   | <p>These are standard documents in many project financings around the world both in civil and common law jurisdictions. Investors would therefore take a level of comfort from the fact that, were they to decide, for example, at some stage in the future to debt finance their investment they would have their counterparty’s agreement in principle that a direct agreement could be entered into.</p> | <p>None.</p>      |

|  |  |  |
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| <p>the Concession Agreement, the power purchase agreement) entering into direct agreements with the project company and its prospective lenders;</p> <p>(ii) Comfort Letters: the regulators write letters of comfort stating what their present policy is in the event that a licensee went into liquidation or bankruptcy (i.e. in the case of the foreign investor itself the regulator would approach the Lenders and give them the opportunity to make proposals to restructure/rescue the business before revoking the licence).</p> |  |  |
| <p><b>Recommended Response:</b> It would be prudent for the project manager of any transaction to obtain a legal memorandum from its Kosovar legal adviser, advising on the legal and commercial steps necessary in order to grant various types of security under Kosovo law as well as an opinion about whether, under Kosovo law, the types of security suggested in (i) and (ii) above would work in Kosovo law.</p>   |  |  |
| <p><b>Actions Required:</b> MEM's Project manager for the proposed project to obtain the legal opinion referred to our recommended response above.</p>   |  |  |
| <p><b>Drafting Instructions:</b> None at present, but changes may be required if the inability in law to give security becomes an impediment to the project.</p>   |  |  |

**Issues Matrix Reference: Annex A32**

**Issue:** The Law on Foreign Investments. Pursuant to Regulation No. 2001/9 and Regulation No. 2001/19 Annex III (vii).

This draft law states as its aim the promotion of foreign investment by legal and physical persons in Kosovo. It is extremely poorly drafted, with many of its key concepts and components described in very poor or pidgin English. Crucially, it is not immediately clear how this law interacts with UNMIK Regulation 2001/3 on Foreign Investment in Kosovo, or exactly what constitutes a foreign investor. This is then followed by a series of articles which states that a foreign investor’s investment shall be carried out in accordance with the relevant legislation relating to leasing contracts, franchising contracts, concessions, etc. It is not apparent however why such provisions are needed because if this legislation applies to all parties carrying on business in Kosovo then it will apply to a foreign investor’s investment regardless to whether these articles are included in this law or not. The same argument applies in respect of Article 8 (Profit, Transfer and Reimbursement), Article 10 (Intellectual Property Rights) and Article 11 (Environment Protection).

More importantly, the procedures that the foreign investor has to follow under this draft law in establishing a foreign investment are far from clear. For example, Article 17 stipulates that a foreign investor’s engagement is “regulated by the investment contract and/or establishment contract which are prepared in writing, attached to the foundation decision”. The draft does not define “investment contract” or “establishment contract” or “foundation decision”.

Finally, Article 21 makes quite clear that any disputes relating to foreign investments must either be solved “by competent court authority of Kosovo” unless the “establishment decision” specifies that arbitration can be used in which case it is mandatory for whichever arbitrator hears the case to apply the “complimentary rules of convention of international centre thoughtfully for investment discussions”.

**Materiality:** This risk is identified as “high”. A poorly drafted and unclear law on foreign investments is, in our view, worse than having no law on foreign investments. If this draft law is to give any level of cover to a foreign investor considering tendering for the proposed project, then it requires significant and substantial amendment.

**Applies to:** Sale of shares/sale of assets, BOO-BOT leases, concessions and the proposed project.

| <b>Possible Mitigation:</b>           | <b>Strengths</b>                                | <b>Weaknesses</b> |
|---------------------------------------|---|-------------------|
| 1. Amend this law as suggested above. | Arguably this will improve investor confidence. | None              |

**Recommended Response:** Remove this legislation from the body of laws applying in Kosovo. Instruct legal experts with the necessary skills to prepare a Foreign Investment Law tailored to meet Kosovo’s needs.

**Actions Required:** Relevant ministry to identify project and instruct experts to draft a new law for foreign investment.

**Drafting Instructions:** Expert legal draftsman to draft new law on foreign investments having consulted with ERO, ICMM and any other relevant Government agency.

| <b>Issues Matrix Reference: Annex A33</b>  |   |                                  |
|--|---|----------------------------------|
| <p><b>Issue: Asset ownership:</b> Investors in a distribution or transmission network will wish to know exactly which assets they have acquired and what their obligations are in respect of registering those assets.</p>   |   |                                  |
| <p><b>UNMIK Law on Cadastre 2003/25</b> for the purpose of regulating the cadastre field according to modern standards. To be overseen by the Kosovo Cadastral Agency (the “KCA”). Municipal Cadastral Offices (the “MCO”) and licensed surveying companies to act under the authority of the KCA. The KCA shall licence surveyors until there is a competent professional body to do so. Requests for registration of changes to be made to the MCO with supporting documents. The Law includes provisions for registration of land parcels, buildings, parts of buildings and utilities (pipelines, sewers etc).</p> <p><b>Materiality:</b> This risk is identified as “medium” for transactions involving an investment in the distribution or transmission networks. This is because there is a risk that the network maps (which identify just where the pipes and wires which comprise the network are located) are not always entirely accurate. A foreign investor will therefore have some concern as to how to rectify the register in the event that there are assets which have been transferred to it which are not properly registered. In addition the foreign investor will also have the same concerns in respect of conflicting or competing interests being registered late over the same land on which the investor’s assets are located.</p> <p><i>Applies to: Sale of shares/ sale of assets/ BOO-BOT/ lease-concession.</i></p> |   |                                  |
| <b>Possible Mitigation:</b>  | <b>Strengths</b>  | <b>Weaknesses</b>                |
| 1. Provisions in the Energy Laws set out the circumstances in which a licensee is entitled to have a public easement or property right over land for the purposes of fulfilling its functions as a utility.  | These provisions should go some way to mitigating the investor’s concerns about competing or conflicting interests, even if they are registered late. | None.                            |
| 2. KEK, the relevant public authority and the investor will have carried out the necessary due diligence prior to completion of the transaction and this process, coupled with any indemnities which the foreign investor can extract as part of the negotiation process should also serve to mitigate these risks.  | These steps will mitigate the risks along commercial lines in which the foreign investor is familiar.   | None.                            |
| 3. Government could give a   | Would give immediate  | Investors may be sceptical about |

|   |          |  |
|---|----------|--|
| warranty to the investor underwriting the asset register with a promise to compensate if any of the assets turn out to be not validly transferred.  | comfort. | compensation actually materialising, as assessment of compensation is problematic and may attract dispute. |
| <b>Recommended Response:</b> KEK and public authority to carry out due diligence at relevant time.  |          |  |
| <b>Actions Required:</b> KEK and relevant public authority to carry out appropriate due diligence in the event that there is a proposal to sell off all or part of the distributional transmission network. |          |  |
| <b>Drafting Instructions:</b> None.   |          |  |

## ANNEX B – ISSUES CATEGORISED AS MEDIUM RISK

**In this Annex we address issues that are classified as “medium” risk as likely to affect value, but which arise from other relevant legislation.**

| <b>Issues Matrix Reference: Annex B1</b>  |   |  |
|---|---|--|
| <p><b>Issue: Labour Law:</b> Whether the Administrative Department of Labour and Employment has assumed its responsibilities and if so, whether it has actually developed any employment systems/ labour standards which would be applicable to the business being carried out by our foreign investor.</p>   |   |  |
| <p><b>UNMIK Regulation 2002/24</b> establishes the Administrative Department of Labour and Employment as being responsible for the overall management of matters relating to labour and employment, including the development of an employment system based on applicable international labour standards, and to co-ordinate activities of international and governmental/ non-governmental organisations in order to promote the coherent development of labour/employment policies.</p> <p><b>Materiality:</b> This risk is identified as “medium” if the Administrative Department of Labour and Employment has yet to publish rules relating to an employment system and/or labour standards which would be applicable to the foreign investor’s business. In order to accurately price the cost (including the day to day running costs) of a transaction in Kosovo’s energy sector an investor will need to know what the cost implications are of the employment system labour standards issued by the Administrative Department of Labour and Employment.</p> <p><b>Applies to:</b> Sale of shares/sale of assets, BOO-BOT, leases, concessions and the proposed project.</p> |   |  |
| <b>Possible Mitigation:</b>   | <b>Strengths</b>  | <b>Weaknesses</b>  |
| <p>1. The administrative department of Labour and Employment should, if it has not already done so, publish these rules and make a policy statement about the changes that it envisages making to such rules over the medium to long term.</p>  | <p>This should go some way to starting to mitigate the foreign investor’s concerns on this issue.</p> | <p>Since policy statements are not, as a general rule legally binding, the foreign investor may argue that the employment system and standards currently faced should be grandfathered for the term of the transaction. We do not support such an argument as this will almost certainly not be a position in the jurisdiction in which the foreign investor has incorporated and the foreign investor is best placed to deal with such risks.</p> |
| <p><b>Recommended Response:</b> Administrative Department of Labour and Employment to publish, if it has not already done so, the rules relating to the employment system and labour standards which will be applicable in respect of the proposed project.</p>   |   |  |
| <p><b>Actions Required:</b> Administrative Department of Labour and Employment to develop and approve policy statement.</p>   |   |  |
| <p><b>Drafting Instructions:</b> None.</p>  |   |  |

| <b>Issues Matrix Reference: Annex B2</b>   |   |                   |
|--|---|-------------------|
| <p><b>Issue: Cadastre:</b> Investors will wish to know precisely what obligation they are under in respect of registering their rights of the Kosovo Cadastral Agency. More importantly they will also wish to know what protection, if any, they will have if having excessively registered their interest with this agency a third party subsequently applies to and succeeds in registering a competing/conflicting interest. In addition investors will wish to know what arrangements and steps need to be taken (in addition to registration) in order to create valid and enforceable security in Kosovo.</p>   |   |                   |
| <p><b>UNMIK Regulation 2002/22</b> promulgates the Law on the Establishment of an Immoveable Rights Register (Law 2002/5) adopted by the Assembly of Kosovo, subject to the condition that it becomes effective once supplementary legislation providing the protection of persons whose rights may be affected by the registration is adopted by the Assembly.</p> <p><b>UNMIK Law 2002/05</b> gives the Kosovo Cadastral Agency (the “KCA”) overall authority for administration of the register. Municipal registers to be maintained by Municipal Cadastral Offices (“MCO”). Immoveable property rights include: ownership, mortgages, servitudes and rights of use of socially owned property and state owned property. The MCO may reject registration if a document submitted in support of application for registration is not sufficient to prove applicant is holder of claimed property right. Applicant can ask for reconsideration of rejected applications. Claims that a registered right is incorrect and adversely affects another’s rights will be adjudicated by a competent court. Once the register is established, there may be no transfer of rights without registration. Registered rights enjoy the presumption of legality.</p> <p><b>Materiality:</b> This risk is identified as “medium” but it is a risk that should properly be addressed in the first instance by due diligence.</p> <p><b>Applies to:</b> Sale of shares/sale of assets, BOO-BOT, leases, concessions and the proposed project.</p> |   |                   |
| <b>Possible Mitigation:</b>  | <b>Strengths</b>  | <b>Weaknesses</b> |
| <p>1. The risk of a third party that has not registered its rights over an investor’s land is perennial to any infrastructure project in any country’s energy sector. It is very likely that the appropriate due diligence will have flushed out any such interests during the tendering process and if the investor has any residual concerns then they will ask the public authority which grants them the concession over the land in respect of which a conflicting or competing interest subsequently arises to provide them with an indemnity in respect of any additional costs they incur as a result of that competing/conflicting interest.</p>  | <p>This is a commercial solution which should be acceptable to foreign investors and does not involve the signing away of the unregistered interests that any citizens may have over a respective project site in Kosovo.</p> | <p>None.</p>      |

|   |  |  |
|---|--|--|
|   |  |  |
| <b>Recommended Response:</b> Adopt option 1 above.  |  |  |
| <b>Actions Required:</b> Relevant public authority granting the concession to carry out appropriate investigations into title, prior to the tendering of any transaction. |  |  |
| <b>Drafting Instructions:</b> None.   |  |  |

| <b>Issues Matrix Reference: Annex B3</b>   |   |                   |
|--|---|-------------------|
| <p><b>Issue: Export controls:</b> Government control over exports and specifically over exhaustible natural resources.</p>   |   |                   |
| <p><b>UNMIK Regulation 2003/15</b> of External Trade Activity allows the Government of Kosovo to establish an “Export Control List” which will specify goods or classes of good the export of which may be controlled for purposes listed, including “(f) to implement temporary measures imposed for the purpose of ensuring a minimally adequate supply on the domestic market of basic and essential foodstuffs or other vital goods....”</p> <p>Whilst this legislation establishes a clear set of rules in conformity with international best practices, the Government still retains control over exports and specifically over exhaustible natural resources.</p> <p>The government might use these powers where, due to failure of other generation plants in Kosovo, insufficient power is being supplied to meet domestic demand. It could thus seek to direct an IPP to divert energy destined for export to meet the shortfall arising in domestic demand. This risk would otherwise need to be addressed in a foreign investor’s export sale agreement, which would reduce the value of those contracts to the investor.</p> <p><b>Materiality:</b> This risk is identified as “medium” as there is some risk that this legislation could be applied in certain circumstances to the export of electricity across interconnectors into the regional electricity market.</p> <p><b>Applies to:</b> Sale of shares/sale of assets, BOO-BOT, leases, concessions and the proposed project.</p> |   |                   |
| <b>Possible Mitigation:</b>  | <b>Strengths</b>  | <b>Weaknesses</b> |
| <p>1. If this legislation could be applied to the export of electricity across interconnectors to the countries around Kosovo then the foreign investor would be likely to seek some sort of assurance in its power purchase agreement that it would not be applied to the proposed project save in the circumstances set out in the power purchase agreements. Alternatively, the foreign investor would seek an indemnity from PISG covering its costs and loss of profits resulting from the application of this legislation.</p>   | <p>This will mitigate the risk of the power purchase arrangements being eroded by this legislation.</p> | <p>None.</p>      |
| <p><b>Recommended Response:</b> Ensure that this issue is addressed in the power purchase arrangements.</p>  |   |                   |

**Actions Required:** Identify and nominate a project manager for each major investment transaction to ensure that this risk is addressed in the power purchase arrangements.

**Drafting Instructions:** None.

## ANNEX C – ISSUES CATEGORISED AS LOW RISK

In this Annex we address issues that are classified as “low” risk which it may be beneficial to tidy up, but which arise from other relevant legislation.

| <b>Issues Matrix Reference: Annex C1</b>   |   |                   |
|--|---|-------------------|
| <p><b>Issue: Movement of money:</b> Risk that a foreign investor inadvertently breach its obligation to file reports under this legislation. The legislation also imposes quite an administrative burden on a foreign investor given the relatively low threshold amounts.</p>   |   |                   |
| <p><b>UNMIK Regulation 2004/2</b> on the deterrence of money laundering and related criminal offences. The Financial Information Centre (the “FIC”) is to be established in order to monitor business transactions. Any business organisation which receives more than €10,000 in a transaction, or in related transactions, shall file a report with the FIC within 15 days of the transaction. This enters in force on 1 July 2004. The Municipal Cadastral Office may not register a transfer of immoveable property rights without a declaration as to the financial account number from which payment is debited and to which it will be transferred, and the names in which the accounts are held. The movement of monetary instruments of value greater than €10,000 into and out of Kosovo must be declared. This declaration is to be made in writing to a customs officer, and to include the source of monetary instruments. Failure to comply is a minor offence punishable by a fine of 25% of the sum of undeclared monetary instruments. ‘Monetary Instruments’ means currency, traveller’s cheques, personal and bank cheques, money orders, cashier’s cheques of any description and/or investment securities or negotiable instruments in bearer form or otherwise in such form that title thereto passes upon delivery. Provisions as to the criminal offence of money laundering are included.</p> <p><b>Materiality:</b> This risk is identified as ‘low’ on the basis that a foreign investor should be capable of putting in place the necessary practices and procedures to ensure compliance.</p> <p><b>Applies to:</b> Sale of shares/ sale of assets/ BOO-BOT/ lease-concession/ management contract.</p> |   |                   |
| <b>Possible Mitigation:</b>  | <b>Strengths</b>  | <b>Weaknesses</b> |
| <p>1. Review the operation of this law and consider whether changes to the threshold amounts or to the broad scope would be appropriate.</p>   | <p>Getting the balance right between the administrative burden and the benefit to Government is eminently sensible.</p> | <p>None</p>       |
| <p><b>Recommended Response:</b><br/>Review the rational for the current regulation and consider change.</p>  |   |                   |
| <p><b>Actions Required:</b> The FIC should undertake a review.</p>   |   |                   |
| <p><b>Drafting Instructions:</b> None</p>  |   |                   |

| <b>Issues Matrix Reference: Annex C2</b>   |  |                   |
|--|--|-------------------|
| <p><b>Issue: Petroleum Licensing:</b> Risk that a foreign investor may not be granted a licence.</p>   |  |                   |
| <p><b>UNMIK Regulation 1999/9</b> on the importation, transportation, distribution and sale of petroleum products (POL) for and in Kosovo. This piece of legislation sets out the licensing requirements and provides for the establishment of a Fuel Supervisory Board.</p>   |  |                   |
| <p><b>Materiality:</b> This risk is identified as ‘low’.</p>   |  |                   |
| <p><b>Applies to:</b> Sale of shares/ sale of assets/ BOO - BOT/ lease - concession/ management contract.</p>  |  |                   |
| <b>Possible Mitigation:</b>  | <b>Strengths</b>   | <b>Weaknesses</b> |
| <p>1. Highlight the requirement through the “one stop shop” as suggested in A19 and put in place arrangements to facilitate procurement of licence, including a policy statement from the Fuel Supervisory Board on circumstances on how they deal with licence applications and what the applicant must satisfy in order to be granted a licence.</p> | <p>Bringing the requirements to the investors’ notice and assisting him in compliance will give comfort that the bureaucracy will not be unduly onerous.</p> |                   |
| <p><b>Recommended Response:</b> Promote this through the one stop shop.</p>  |  |                   |
| <p><b>Actions Required:</b> Ministry of Energy and Mining to take on and work with the FSB to prepare an investor-friendly policy statement</p>  |  |                   |
| <p><b>Drafting Instructions:</b> None</p>  |  |                   |

| <b>Issues Matrix Reference: Annex C3</b>   |                                      |                   |
|--|--------------------------------------|-------------------|
| <p><b>Issue: Environmental Protection:</b> A foreign investor may have concerns about:</p> <p>(i) the uncertainty regarding the issuing of permits; and<br/>                     (ii) the length of time/ procedures that have to be followed in order to obtain a permit.</p>   |                                      |                   |
| <p><b>UNMIK Regulation 2003/9</b> on the promulgation of the Law adopted by the Assembly of Kosovo on Environmental Protection.</p> <p><b>Law 2002/8</b> provides that any person who wishes to undertake construction or modification of an industrial facility will require an Environmental Impact Assessment (“EIA”), and must receive an EIA permit from the ministry responsible for environmental affairs.</p> <p><b>Materiality:</b> This risk is identified as ‘low’. A foreign investor should be able to get comfortable with the regime for consents and permits in Kosovo.</p> <p><b>Applies to:</b> Sale of shares/ sale of assets/ BOO-BOT/ lease-concessions/ management contract.</p> |                                      |                   |
| <b>Possible Mitigation:</b>  | <b>Strengths</b>                     | <b>Weaknesses</b> |
| 1. Advertise the requirements and the process through the one stop shop.   | Gives comfort from the transparency. | None              |
| <p><b>Recommended Response:</b> Address through the one stop shop</p> <p><b>Actions Required:</b> Ministry of Energy and Mining to promote.</p> <p><b>Drafting Instructions:</b> None</p>  |                                      |                   |

| <b>Issues Matrix Reference: Annex C4</b>  |                                 |                   |
|---|---------------------------------|-------------------|
| <b>Issue: Payment transactions:</b> A foreign investor will wish to know how easily payments involving foreign currency can be made in Kosovo.  |                                 |                   |
| <p><b>UNMIK Regulation 2001/26</b> on payment transactions, for the purpose of regulating the rights and obligations of participants in payment transactions in any foreign currency in Kosovo. Legal entities may open an unlimited number of bank accounts in any foreign currency and conduct payment transactions through these accounts in accordance with applicable law. A bank may act for a customer/ correspondent bank outside Kosovo on payment transactions. A receiving bank shall comply with international banking standards. Provisions for payment transactions procedures are included, and intra-bank liabilities are designated.</p> <p><b>Materiality:</b> This risk is identified as ‘low’.</p> <p><b>Applies to:</b> Any aspect of a foreign investor’s business that requires payments to be made in foreign currency.</p> |                                 |                   |
| <b>Possible Mitigation:</b>   | <b>Strengths</b>                | <b>Weaknesses</b> |
| 1. Bring to the investor’s attention through the one stop shop.   | The transparency gives comfort. | None.             |
| <b>Recommended Response:</b> Promote through the one stop shop.   |                                 |                   |
| <b>Actions Required:</b> Ministry of Energy and Mining to promote   |                                 |                   |
| <b>Drafting Instructions:</b> None.   |                                 |                   |

| <b>Issues Matrix Reference: Annex C5</b>   |   |   |
|--|---|---|
| <p><b>Issue: Accounting Standards:</b> A foreign investor will wish to know what accounting and financial standards the project will have to meet. If donor/ grant aid supports all or part of the project, the donor/ bank frequently requires their own accounting standards to be met. A foreign investor will, ideally, wish just to comply with one set of standards.</p>   |   |   |
| <p><b>UNMIK Regulation 2001/30</b> on the establishment of the Kosovo Board on Standards for Financial Reporting (the “Board”) and a Regime for Financial Reporting of Business Organisations. The Board to be appointed by the Special Representative of the Secretary-General. The Board is to issue accounting standards in compliance with International Accounting Standards (“IAS”). Business organisations with an annual turnover greater than €100,000 or operating with publicly-owned or socially-owned assets are to prepare general purpose financial statements. Business organisations with an annual turn-over/ total assets in excess of €250,000 to have general purpose accounts audited by licensed auditors. Within 6 months of the financial year end, such corporations shall submit audited financial statements to the business registry and/or Central Fiscal Agency. Provisions for qualifications and licensing of accountants/auditors listed. Sanctions and penalties imposed for non-compliance with requirements in this regulation to be set out in an administrative direction. If a decision is made to impose sanctions the decision and reasons must be given to affected parties. Parties may seek judicial review of decisions.</p> <p><b>Materiality:</b> This risk is identified as ‘low’.</p> <p><b>Applies to:</b> Sale of shares/ sale of assets/ BOO-BOT/ lease-concessions/ management contract.</p> |   |   |
| <b>Possible Mitigation:</b>  | <b>Strengths</b>                            | <b>Weaknesses</b>   |
| 1. Publicise the requirement to use International Accounting and Financial Reporting Standards through the one stop shop and consider any special treatment as the issue arises  | Avoids pre-empting what may not be an issue | Leaves mitigation until further down the process (but this is offset by advertising the requirement to an extent) |
| <b>Recommended Response:</b> Advertise requirement through the one stop shop   |   |   |
| <b>Actions Required:</b> Ministry of Energy and Mining to promote and deal with investor concerns as they arise  |   |   |
| <b>Drafting Instructions:</b> None   |   |   |

| <b>Issues Matrix Reference: Annex C6</b>   |  |                   |
|--|--|-------------------|
| <p><b>Issue: Tax Law:</b> Risk that a foreign investor might not be granted a UNMIK Customs Service licence and that excise taxes may be onerous.</p>  |  |                   |
| <p><b>UNMIK Administrative Direction 2000/1</b>, implementing Regulation 2000/2 on Excise Taxes in Kosovo. Pursuant to the provisions of this piece of legislation, raw and auxiliary materials imported into Kosovo to be used in the manufacture of goods for export by persons holding a license issued by the UNMIK Customs Service shall be exempt from excise tax. Excise taxes are not payable by contractors to UNMIK when importing goods to be used exclusively in connection with the performance of contracts for UNMIK, registered non-governmental organisations with public benefit status (defined in Regulation 1999/22) on the following goods used by organisation to fulfil its public benefit purpose: gasoline, kerosene, diesel, ethanol, or such other organisations the SRSG specifies as exempt.</p> |  |                   |
| <p><b>Materiality:</b> This risk is identified as ‘low’.</p>   |  |                   |
| <p><b>Applies to:</b> Sale of shares/ sale of assets/ BOO-BOT/ lease-concession/ management contract.</p>  |  |                   |
| <b>Possible Mitigation:</b>  | <b>Strengths</b>   | <b>Weaknesses</b> |
| <p>1. Highlight the requirement through the “one stop shop” as suggested in A19 and put in place arrangements to facilitate procurement of licence, including a policy statement from the Customs Service on circumstances on how they deal with licence applications and what the applicant must satisfy in order to be granted a licence.</p>  | <p>Bringing the requirements to the investors’ notice and assisting him in compliance will give comfort that the bureaucracy will not be unduly onerous.</p> | <p>None</p>       |
| <p><b>Recommended Response:</b> Promote this through the one stop shop</p>   |  |                   |
| <p><b>Actions Required:</b> The Customs Service to develop a policy in consultation with the Ministry of Energy and Mining and to prepare an investor-friendly policy statement that MEM can post on its website.</p>  |  |                   |
| <p><b>Drafting Instructions:</b> None</p>  |  |                   |

| <b>Issues Matrix Reference: Annex C7</b>  |                                      |   |
|---|--------------------------------------|---|
| <p><b>Issue: Customs:</b> Border entries specified may not be the most economically efficient entry points into Kosovo for a foreign investor.</p>  |                                      |   |
| <p><b>UNMIK Administrative Direction 2001/8</b>, for the purpose of controlling the conveyance of commercial traffic and commercial goods into and out of Kosovo, and the assessment of taxes and customs duties on commercial goods. This Administrative Direction implements Regulation 1999/16, as amended, on the establishment of the Central Fiscal Authority and other related matters and sets out the authorised boundary crossing points for commercial goods by commercial means of transport and the approved routes for the transport of commercial goods by commercial means of transport entering/exiting Kosovo through authorised boundary crossing points.</p> <p><b>Materiality:</b> This risk is identified as ‘low’.</p> <p><b>Applies to:</b> Sale of shares/ sale of assets/ BOO - BOT/ lease - concession/ management contract.</p> |                                      |   |
| <b>Possible Mitigation:</b>   | <b>Strengths</b>                     | <b>Weaknesses</b>   |
| <p>1. Advertise the requirement through the one stop shop and address any legitimate investor concerns if they are expressed on a one to one basis.</p>   | <p>Avoids pre-empting the issue.</p> | <p>May leave mitigation until further into the process, but by raising awareness through the one stop shop this is not significant.</p> |
| <p><b>Recommended Response: Advertise through the one stop shop.</b></p>  |                                      |   |
| <p><b>Actions Required: Ministry of Energy and Mining to take forward</b></p>   |                                      |   |
| <p><b>Drafting Instructions: None</b></p>   |                                      |   |

| <b>Issues Matrix Reference: Annex C8</b>   |                                       |                   |
|--|---------------------------------------|-------------------|
| <b>Issue: Tax Laws:</b> Risk of an inadvertent breach by a foreign investor.   |                                       |                   |
| <p><b>UNMIK Administrative Direction 2002/3</b>, implementing Regulation 1999/16 on the establishment of the Central Fiscal Authority and other related matters, for the purpose of enhancing control over the movement of cash, securities and negotiable instruments into Kosovo. Any person must declare cash or equivalent if carrying more than €10,000 into Kosovo. Failure to do so will result in a fine of 25% of whatever value carried. A competent court may confirm, set aside or reduce a fine.</p> <p><b>Materiality:</b> This risk is identified as ‘low’.</p> <p><b>Applies to:</b> Sale of shares/ sale of assets/ BOO-BOT/ lease - concession/ management contract.</p> |                                       |                   |
| <b>Possible Mitigation:</b>  | <b>Strengths</b>                      | <b>Weaknesses</b> |
| 1. Publicise the requirement through the one stop shop   | Reduces chance of inadvertent breach. | None              |
| <b>Recommended Response:</b> Publicise through the one stop shop   |                                       |                   |
| <b>Actions Required:</b> Ministry of Energy and Mining to take forward.  |                                       |                   |
| <b>Drafting Instructions:</b>  |                                       |                   |

| <b>Issues Matrix Reference: C9</b>  |                                     |                   |
|---|-------------------------------------|-------------------|
| <p><b>Issue: Labour Law:</b> Risk of inadvertent breach by a foreign investor of some of the provisions of this law, particularly if the employment market in Kosovo is such that employees are prepared to ignore their rights.</p>  |                                     |                   |
| <p><b>UNMIK Regulation 2001/27</b> for the purpose of setting out the essential labour law in Kosovo. Those less than 18 years of age are not permitted to work if it might affect health/development or school attendance. Employees and employers have the right to form unions. Collective agreements to survive for a maximum period of 3 years, and may not include provisions limiting employees rights or resulting in less favourable working conditions than those set out in this regulation. Collective agreements must be registered with the Department. Provisions to be incorporated into a Labour Contract listed; general grounds and circumstances when a labour contract may be terminated. If a large-scale layoff (min. 50 employees discharged within a 6 month period it's considered a 'large-scale layoff'), 3 months written notice to employees required, employer to take steps to limit number of employees to be discharged. Severance pay scale listed. Wages to be paid in DM, and there is a minimum wage provision. In the mining sector the working day underground may not exceed 8 hours, and the working day for drivers not to exceed 9 hours. Labour Inspections to be conducted without prior warning and possible penalty fines (max. 20,000 DM) if a determination that an employer is in violation of a provision of this Regulation. Employer has right of appeal to determination through competent Kosovo courts.</p> <p><b>Materiality:</b> The risk is identified as "low".</p> <p><b>Applies to:</b> Sale of shares/ sale of assets/ BOO-BOT/ lease-concession. It is questionable whether it would apply to a management contract.</p> |                                     |                   |
| <b>Possible Mitigation:</b>   | <b>Strengths</b>                    | <b>Weaknesses</b> |
| 1. Publicise through the one stop shop  | Reduces risk of inadvertent breach. | None              |
| <b>Recommended Response:</b> Publicise through the one stop shop  |                                     |                   |
| <b>Actions Required:</b> Ministry of Energy and Mining to take forward  |                                     |                   |
| <b>Drafting Instructions:</b> None  |                                     |                   |

| <b>Issues Matrix Reference: Annex C10</b>   |                                |                   |
|---|--------------------------------|-------------------|
| <p><b>Issue: Labour Law:</b> Risk of non-compliance by a foreign investor vicariously through its employees.</p>  |                                |                   |
| <p><b>UNMIK Regulation 2003/33</b> in order to create conditions of occupational safety in Kosovo. Employer obliged to create conditions of occupational safety and health, and employer liable for payment of expenses associated with treatment of work-related accidents/illnesses. Full-time safety officer if 250+ employees (part-time if 50+).</p> <p><b>Materiality:</b> This risk is identified as “low”.</p> <p><b>Applies to:</b> Sale of shares/ sale of assets/ BOO-BOT/ lease-concession. It is questionable whether it would apply to a management contract.</p> |                                |                   |
| <b>Possible Mitigation:</b>   | <b>Strengths</b>               | <b>Weaknesses</b> |
| 1. Publicise through the one stop shop  | Reduces risk of non-compliance | None              |
| <p><b>Recommended Response:</b> Publicise through the one stop shop</p>   |                                |                   |
| <p><b>Actions Required:</b> Ministry of Energy and Mining to take forward</p>   |                                |                   |
| <p><b>Drafting Instructions:</b> None</p>   |                                |                   |

| <b>Issues Matrix Reference: Annex C11</b>  |                                    |  |
|--|------------------------------------|--|
| <p><b>Issue: Sale of Property:</b> Risk that certain rights in the concession/ project documentation granted to a foreign investor may be refused registration.</p>  |                                    |  |
| <p><b>UNMIK Administrative Direction 2002/4</b> implementing Regulation 2001/17 on the registration of contracts for the sale of real property in specific geographical areas in Kosovo. Annex A sets out specific geographical areas within the meaning of sections 1.1 and 1.2 of UNMIK Regulation 2001/17. Municipal Administrators are to make available to the public a copy of this Administrative Direction and a map or detailed geographical description identifying the designated areas within the municipality.</p> <p><b>Materiality:</b> This risk has been identified as ‘low’. Whilst this legislation in itself does not give rise to any material risk relating to the form of foreign investment envisaged by our Terms of Reference, the foreign investor will wish to know exactly what procedure needs to be followed in order to register any of its purchases or sales of real property.</p> <p><b>Applies to:</b> Any form of foreign investment which involves the purchase of real property by the foreign investor</p> |                                    |  |
| <b>Possible Mitigation:</b>  | <b>Strengths</b>                   | <b>Weaknesses</b>  |
| 1. Relevant Government institution(s) to set down the basis on which registration decisions are made, and grounds for refusal and grounds for appeal and advise MEM.   |                                    |  |
| 2. MEM to publicise guidance received from 1. above through the one stop shop. Deal with any investor concerns on a one to one basis as they arise   | Makes the requirement transparent. | Leaves it up to the investor to seek comfort that registration would not be refused. |
| <p><b>Recommended Response:</b> Pursue options 1 and 2.</p>  |                                    |  |
| <p><b>Actions Required:</b> MESP to take forward with support from MEM and in consultation with the relevant Government institution(s)</p>   |                                    |  |
| <p><b>Drafting Instructions:</b> None</p>  |                                    |  |

## ANNEX D – DRAFT TIME LINE AND STEP PLAN FOR THE PROPOSED PROJECT

*Please note the following assumptions for this timeline –*

- 1. the new power station will burn lignite to be extracted from a new lignite mine and will be ready to generate by 1 January 2010*
- 2. the development of a new power station and a new lignite mine will be offered as a single package to private investors*
- 3. based on current data, the breaking of the ground of the new lignite mine will need to occur no later than 1 January 2007*

*Please also note that for the electronic version of this document, Annex D is found on a separate file “Annex D – Tender Timetable.pdf”.*

## ANNEX E – DRAFT LIST OF PROJECT AGREEMENTS, DOCUMENTS, CONSENTS AND OTHER INSTRUMENTS REQUIRED FOR THE PROPOSED PROJECT

1. Form of Concession Agreement
2. Form of Generation Licence
3. Form of Mining Licence
4. Form of Draft Connection Agreement
5. Form of Use of System Agreement
6. Market Rules
7. Grid Code
8. Power Purchase Arrangements/Agreements
9. Energy Buy-Back Conditions
10. Form of Mining Development Agreement
11. Form of Surface Rights Agreement
12. Letters of Comfort from MIGA (re political risk insurance)
13. Form of Environmental Impact Assessment
14. Environmental Consent
15. Environmental Permit
16. Construction Permit

## ANNEX F – ACTION PLAN