

Legal

The **Southeast Europe** Energy Handbook 2015

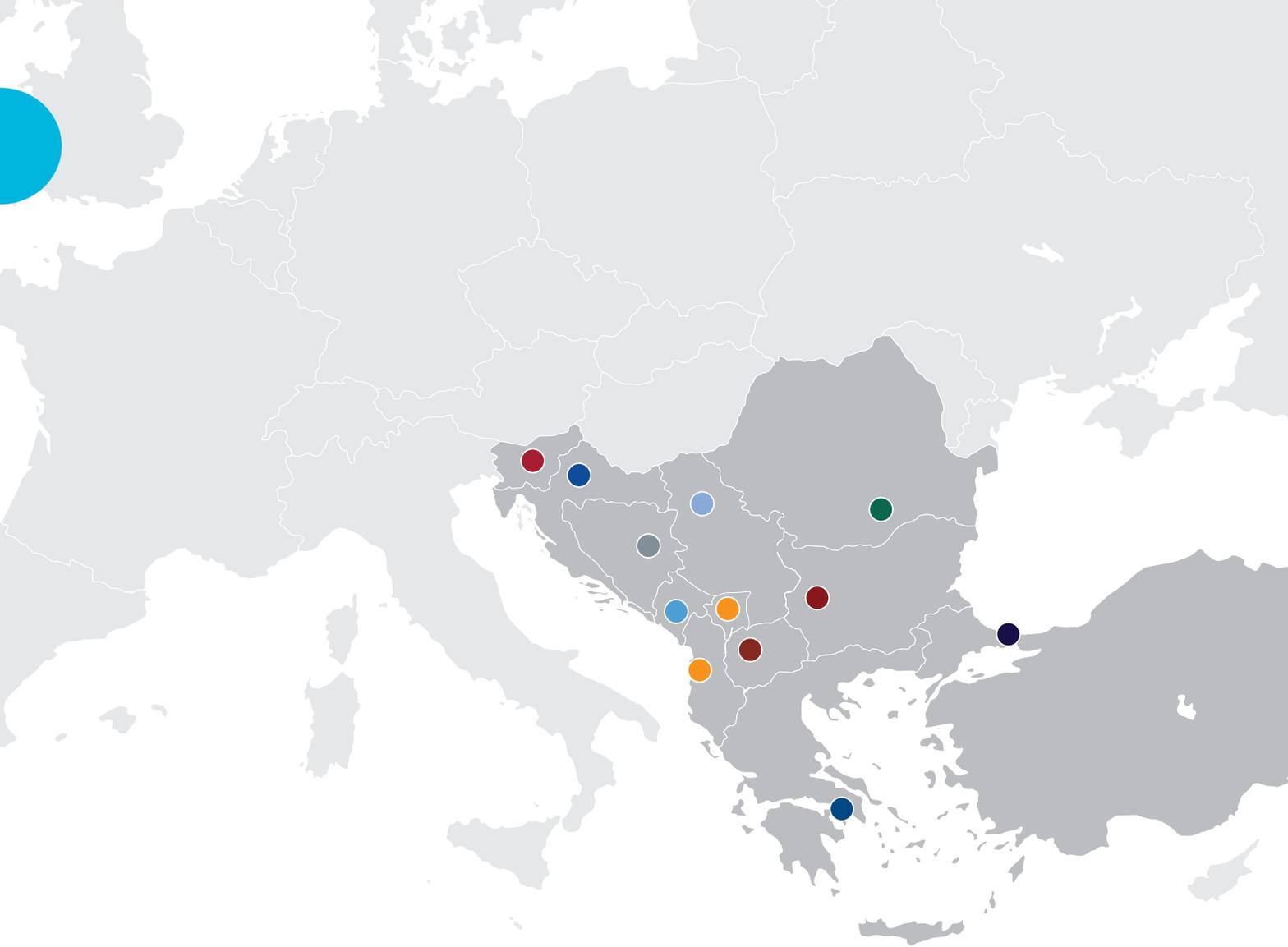


MONTENEGRO



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PREFACE

Dear Partners and Friends of SEE Legal,

This is the 3rd edition of the South East Europe Energy Handbook, a product of the Energy-Infrastructure Practice Group functioning within the South East Europe Legal Group ("SEE Legal"). The warm reception of the previous editions in several conferences, road shows and legal events from in-house counsels, industry professionals and energy law practitioners led to the release of the South East Europe Energy Handbook 2015.

Much like the previous editions, we have aimed to highlight the major aspects in the energy sector, such as market structures, licensing, price regulations, access to the grid, etc., and to provide all the legislative updates which took place over the past year in our region.

We are confident that this edition will once again prove to be a helpful desk-book resource when dealing with complex and highly regulated energy related matters in the twelve jurisdictions of South East Europe in which our member firms operate. This handbook is not meant to be a treatise on any particular country's energy legislation and is not exhaustive to the point of eliminating the need of professional advice, but we are confident that it serves its main purpose - to raise readers' attention as to the energy legislation of each jurisdiction covered by SEE Legal and assist in identifying the issues that might influence investment and business development decisions.

Established in 2003, SEE Legal continues as the only regional organization of 10 leading independent national law firms covering twelve jurisdictions of South East Europe with a legal force of more than 450 lawyers and an impressive client base of multinational corporations, financial institutions and governmental bodies. Our duty of care to our clients remains at the highest level and we are proud that our achievements in client service continue to distinguish SEE Legal as the leading group of law firms in South East Europe. Our member firms continue to be instructed to work on major energy – infrastructure related investment transactions and are associated with most of the important and high profile energy deals in our region. All member firms enjoy the highest recognition from their peers and are constantly ranked every year as market champions.

The South East Europe Energy Handbook 2015 is part of the various initiatives undertaken by the Energy-Infrastructure Practice Group to promote our members' capacity and profile in the region in order to continue our strong presence in the legal market and is a statement of our continuing commitment to further assist you in your legal and business matters.

Sincerely,

Gus J. Papamichalopoulos

Head of Energy - Infrastructure Practice Group of SEE Legal



Borislav Boyanov

Co-Chair of SEE Legal



Disclaimer

This publication is intended to provide a general guide to the law and regulation in the individual jurisdictions described and to be used for reference purposes only. The information contained herein is based on the respective legislation as of April 2015. (unless otherwise indicated) and is not intended to be a comprehensive study nor to provide legal advice. Specific legal advice should always be sought before taking any action based on the information provided herein.



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ME

MONTENEGRO

1. INTRODUCTION TO THE ENERGY MARKET

The Montenegrin energy market is still mainly synonymous with the electrical energy market. Other forms of energy such as gas and oil are not utilized, mainly because of a lack of appropriate infrastructure. However, the ongoing tender for offshore exploration and exploitation of oil as well as prospective development of the Ionian-Adriatic Pipeline, as a branch of the Trans-Adriatic Pipeline is set to change that. The construction of the underwater cable between Italy and Montenegro has still not commenced, mainly because of the altered route of the cable which requires approval from Croatia. If approved, it should additionally enhance the Montenegrin position in the regional energy market.

Montenegro, as part of the Energy Community, undertook the obligation to implement the third energy package by 1 January 2015. The Ministry of Economy is still working on the amendments to the Energy Law (Zakon o energetici, Official Gazette of Montenegro No. 28/2010, 40/2011, 42/2011, 06/13 and 10/2015) which are designed to align the local regulatory framework with the requirements of the Energy Community.

2. ELECTRICITY

2.1 Market overview

The bankruptcy of the "Kombinat aluminijuma Podgorica" ("KAP") aluminium smelter which accounted for 1/3 of the entire consumption of electricity in 2012 significantly reduced dependence of Montenegro on imported electric energy.

Plans for the construction of large hydro-power plants have been put on hold given the lack of interested investors and the inability of the state to participate in financing such investments. On the other hand, a revived plan for the construction of a second block of the thermal power plant in Pljevlja of around 240 MW is being implemented by the, "Elektroprivreda Crne Gore AD Nikšić"

("EPCG") national power utility. The realization of this plan is, however, dependent on resolving the relations between main shareholders of EPCG – the Government of Montenegro with 55 per cent of the shares and Italian utility A2A with 43.7 per cent in EPCG. The existing shareholders' agreement is about to expire at the end of 2014 and the construction of the second block of TPP Pljevlja is part of negotiations on the new shareholders' agreement.

The Montenegrin energy market is, at least on paper, liberalized. All consumers are entitled to choose their supplier, with the exception of households which will have that right as of 1st January, 2015. However, EPCG is practically the only retail supplier since the second licensed supplier, state-owned company "Montenegro Bonus", entered the electricity supply market, with the sole aim to supply KAP with electricity, following the termination of the EPCG supply agreement.

2.2 Regulatory overview

The most important piece of legislation in the electricity sector is the Energy Law. It regulates all the relevant energy sectors, i.e. the sectors of electricity, district heating, oil and gas. Within the electricity sector it regulates specifically: a) issuance of authorisations for the performance of energy activities; b) issuance of licences for the construction of energy facilities (energy licence – energetska dozvola); c) regulated prices, tariffs, fees; d) renewable energy; e) specific rules for various activities in the electricity sector; f) access to the electricity system, i.e. transmission and distribution systems; g) supply of energy; h) safeguard measures in the event of market disruption. The Ministry is preparing amendments to the existing law in order to adapt it to the third energy package by 1 January 2015.

The Government, the Ministry of Economy, the Energy Regulatory Agency and other stakeholders have adopted a number of implementing regulations in the past two years aimed at creating the electric energy market, most important of them being: the Transmission Grid Code (Pravila za funkcionisanje prenosnog sistema električne energije, Official Gazette of Montenegro, No. 5/2012), the Distribution Grid Code (Pravila za funkcionisanje distributivnog sistema električne energije, Official Gazette of



Montenegro, No. 20/2012), the General Terms and Conditions for Supply of Electric Energy (Opšti uslovi za snabdijevanje električnom energijom, Official Gazette of Montenegro, No. 20/2012 and 22/2013), Market Rules (Tržišna pravila o načinu organizovanja i upravljanja tržištem električne energije u Crnoj Gori, Official Gazette of Montenegro, No. 44/2012), Rules on Third Party Access (Pravila o pristupu treće strane prenosnoj i distributivnoj mreži, Official Gazette of Montenegro, No. 13/2007).

The key stakeholders in the Montenegrin electricity market are:

- (a) Ministry of Economy - which is in charge, inter alia, of preparing the energy strategy and its implementation, preparation and the assessment of prospective investment projects, industrial production, energy policy, energy efficiency, determining the direction and dynamics of energy development, preparation of the energy balance of Montenegro, sales of petroleum products, concessions, competition, encouraging foreign investment and others;
- (b) Regulatory Energy Agency of Montenegro ("REA") - an independent, non-profit organisation, functionally independent of the state authorities and energy companies, exercising public authority in the field of energy, established pursuant to the Law on Energy. Its primary tasks are the development and enhancement of the electricity and gas market based on the principles of non-discrimination and effective competition by creating a stable regulatory framework;
- (c) Transmission system operator – Crnogorski elektroprenosni sistem – a majority state-owned company in charge of the development, safe and reliable functioning of the transmission system, enforcement of non-discriminatory and economical access to the transmission system;
- (d) Montenegrin electricity market operator - Operator tržišta električne energije ("Market Operator") - an entity in charge of the management of the electricity market established in August 2011.

2.3 Regulated electricity market activities

The Energy Law prescribes the following energy activities in the electricity sector:

- (a) The production of electricity;
- (b) The transmission of electricity;
- (c) The distribution of electricity;
- (d) Electricity supply;
- (e) The operation of the electricity market;

(f) Trading, brokerage and representation in the energy market. Energy-related activities may be performed only when the relevant licence has been obtained. The licence is issued at the request of the energy entity separately for each energy activity. The licence is issued for a period of 15 years and may be extended or shortened under certain conditions. The following energy activities may be performed without a licence:

- (i) The production of electricity for individual consumption;
- (ii) The production of electricity in buildings with installed capacity up to 1 MW;
- (iii) Electricity trading for the purpose of further sale, excluding the sale to the final customers, agency and representation on the energy market.

Energy activities of public interest in the electricity sector are:

- (a) The production of electricity;
- (b) The transmission of electricity;
- (c) The distribution of electricity;
- (d) The organization of the electricity market;
- (e) Trading with electricity for supply of electricity as a public service;
- (f) Any supply of electricity that represents a public service. Activities under (e) may be performed only by the public electricity supplier. EPCG has been designated by the Government of Montenegro as the public supplier. The following activities in the electricity sector are carried out as public services in order to ensure a regular, safe, reliable and quality energy supply at reasonable prices:
 - (i) The transmission of electricity;
 - (ii) The distribution of electricity;
 - (iii) The supply of electricity, in certain cases.

The provision of public services in the electricity sector must be on a non-discriminatory basis, transparent and under controlled prices.

Energy activities which are not performed as public services are carried out in accordance with market principles.

2.4 Generation

The development of generation capacities is subject to obtaining inter alia, an energy permit (energetska dozvola). The energy permit is issued at the very outset of the development process even before the acquisition of the requisite land on which the development will take place and prior to obtaining the act on urban technical conditions. Following the issuance of the energy permit, the investor may engage in procuring other permits and approvals prescribed by other sectoral laws. The request may be submitted by

a domestic or foreign entity and the permit is issued by the Ministry of Economy. The energy permit is not required in the event of the granting of a concession for the development of a generation facility. An energy permit may be issued for a generation facility which complies with the energy strategy and action plan for the implementation of the energy strategy. The following criteria are taken into account when deciding on the issuance of the energy permit: safe and unobstructed functioning of the energy system, conditions regarding the location and the usage of land, environmental conditions, health and safety of people and property, energy efficiency, usage of primary energy sources, conditions related to technical and financial capability of the applicant to realise the development of the energy facility, reduction of CO₂ emission. The energy permit is issued with a validity of two years and may be extended for one additional year.

2.5 Trading and supply of electricity

According to the Energy Law, electricity trading for the purpose of further sale, with the exception of sale to final customers, agency and representation on the energy market does not require an energy licence. According to the Energy Law, all consumers are entitled to choose their supplier, with the exception of households which will have that right as of 1st January, 2015. REA is in charge of approving the regulated tariffs for supply of electricity to qualified consumers and end-consumers supplied by the public supplier. The activity of distribution of electricity and public supplier activity is currently handled by separate functional units within the EPCG. A plan for division of these activities into separate companies was due to have been implemented by mid-2011 but the division has not been yet effectuated. There is no indication as to when the actual division might take place.

According to the Energy Law, the right to participate in the electricity market is granted to producers, suppliers, public supplier, trader and qualified purchasers. The electricity market is operated by the market operator Operator tržišta električne energije d.o.o. Podgorica, formed in August 2011. The participants in the electricity market have balance responsibility and are obliged to participate in the settlement process and make payments determined on the basis of the settlement calculations. The functioning of the electricity market and the balancing mechanism is further regulated by the Market Rules.

Cross-border capacities are allocated pursuant to the Rules for Award of Available Transmission Capacities on Montenegrin Interconnections with Adjacent Areas enacted in 2011 by the Montenegrin TSO. According to this regulation, the available cross-

border transmission capacities are awarded at annual and monthly auctions, with the possibility of allocating the remaining transmission amounts in the daily auctions or by applying the „first come - first served” principle. Prior registration with TSO is a prerequisite for participation in the auctions for the allocation of cross-border transmission capacities. The allocated capacities may be further transferred.

All participants in the allocation procedure are treated either as suppliers (entities licensed for supply of electric energy in Montenegro) or as transporters (entities which are transporting electric energy through the Montenegrin transmission system). The most important criteria for the allocation of the available cross-border transmission capacity is the category of the participant (supplier or transporter), where the supplier always has priority over the transporter. The second criteria is congestion price (price per MWh of transported electric energy in case demand exceeds cross-border capacities) and the third criteria is the time of bid submission (the earlier bid has priority). The Energy Law provides for the possibility of forming an entity for coordinated auctions of cross-border capacities at a regional level outside the scope of REA's supervision.

According to the decision of the Ministerial Council of the Energy Community from December 2008, the headquarters of the regional coordinated auction house should be in Montenegro. The Project Team Company, as a seed of the future regional auction house, has been established with the support of the international donors and is currently working on setting up the regional auction house.

2.6 Transmission and grid access

Access to the transmission / distribution system may be granted only to a participant licensed for performing electrical energy activity in the Montenegrin electricity market. Pursuant to Article 99 of the Law on Energy, TSO is obliged to enable third party access to the transmission system on a non-discriminatory basis, within its transmission capacities and in accordance with technical rules. The access may be denied only on technical grounds in the event of lack of capacity or danger to public services in the electricity sector. The dissatisfied party has the right to appeal to REA.

Pursuant to the previous Energy Law, REA has adopted the Rules on Third Party Access to the Transmission and Distribution Network (Pravila o pristupu treće strane prenosnoj i distributivnoj mreži, Official Gazette of Montenegro, No. 13/07) ("Rules on Third Party Access"), which further elaborate the principles and procedure for third party access. The Rules on Third Party Access remain applicable

only in as far as they are not in contravention of the new Energy Law which also has comprehensive provisions on this issue. The interested party first submits a request for access to the transmission/ distribution network. TSO and the interested party are required to enter into an agreement on access to the transmission system which details special conditions related to calculation of access fees, the point of access, approved power, place and manner of measuring the electricity, termination grounds etc. The Energy Law also regulates the connection of production and consumer facilities to the transmission system. The right to connect to the transmission system may be denied only in the event of technical impediments and/or if the equipment and installations do not fulfil the technical and other requirements. The deadline for the issuance of the connection approval is 30 days and, in case of more complicated connections - the deadline is 120 days. The dissatisfied party may appeal to REA within 15 days. The decision of REA is final in the administrative proceedings but may be challenged before the Administrative Court in the administrative accountancy proceedings.

The connection approval determines, inter alia, the conditions for connection, costs of connection, connection point, the manner, costs, technical conditions and deadline for connection, place and manner of measurement of delivered electricity. Based on connection approval the TSO and the interested party enter into a connection agreement. The costs of connection and preparation of the connection elaborate are borne by the interested party; TSO bears the costs of internal analysis of the transmission system.

3. RENEWABLE ENERGY

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3.1 Market overview

At the end of 2014, Montenegro has adopted the National Renewable Energy Action Plan and has set the goal for gross final energy consumption from renewable sources by 2020 at 33 per cent, in accordance with the decision of the 10th Ministerial Council of the Energy Community.

In the hydropower sector the Ministry of Economy has finished the second round of tenders for the award of a concession for development of small HPPs. However, not a single project for development of small HPPs has so far been completed. In the large hydro sector, two promising projects: 4 HPPs on Moraca with envisaged installed power of 230 MW and HPP Komarnica with installed power of 168 MW have been put on hold. In the wind

sector, the Ministry of Economy has entered into two land-lease agreements for the development of wind farms of an estimated installed power of approximately 120 MW. None of these two projects has yet achieved the financial closing. Biomass, geothermal and solar energy sources are currently not used for power generation although there is a potential for all of them.

3.2 Support schemes

(a) General

The Montenegrin Energy Law generally prescribes that production from renewable resources may be increased, inter alia, by determining the minimum mandatory percentage of production from renewable resources, by reducing the investment costs and by prescribing feed-in tariffs.

A privileged producer is defined as a producer who uses renewable energy resources or waste or is involved in cogeneration, in an economically suitable manner and in compliance with environmental protection requirements. The status of privileged producer is acquired by a decision of REA subject to the fulfilment of the following requirements: the production facility a) is connected to the transmission or distribution system; b) is producing energy from renewable resources or highly effective cogeneration; c) has its own measuring point; d) does not endanger the stability of the system. The status of a privileged producer is acquired for a period of 12 years. During that period, the privileged producer is entitled to freeze the feed-in PPA and sell the electricity directly on the market for periods not shorter than 12 months. Those periods are, however, accounted within the total 12 years of the privileged status.

Privileged producers are part of one balancing group which is not charged by the Market Operator for deviations; however, if the producer sells the electricity on the market it is not exempt from bearing the balancing services. Privileged producers have priority in dispatching generated electricity subject to the technical conditions of the system. Each supplier of electricity is obliged to purchase electricity from privileged producers in the percentage equal to the percentage in which the renewable electricity participates in the total amount of electricity produced in Montenegro.

(b) Feed-in tariff

Pursuant to the Decree on the Tariff System for the Calculation of the Privileged Purchase Price for Electricity Produced in Renewable Energy Sources and Highly Efficient

Cogeneration (Uredba o tarifnom sistemu za utvrđivanje podsticajne cijene električne energije iz obnovljivih izvora energije i visokoeфикаsne kogeneracije, Official Gazette of Montenegro, No. 52/2011 and 28/2014) ("Methodology") a feed-in tariff regime has been instituted for small HPPs, wind generators, biomass power plants, on-roof solar plants, solid waste incineration plants, landfill gas plants and biogas plants. The right to receive feed-in tariff may be realized if the following conditions are fulfilled:

- a) the power plant uses renewable energy source thereby contributing to the fulfilment of the national renewable energy target in accordance with the national renewable energy action plan,
- b) the highly efficient cogeneration facility is within the capacity envisaged by the programme for the development and usage of highly efficient cogeneration and c) the power plant has acquired the status of privileged producer from the REA in accordance with the procedure set forth in the Decree on the Manner of Acquiring Status and Realization of the Rights of Privileged Producer of Electricity (Uredbu o načinu sticanja statusa i ostvarivanja prava povlašćenog proizvođača električne energije, Official Gazette of Montenegro, No. 37/2011).

The power plant for which the status of privileged producer is being acquired may not be older than 3 years, except in case of refurbishment of an old plant. The status of privileged producer is acquired at the very end of the development process, i.e. after completion of construction and obtaining the operational permit for the power plant. The guaranteed tariffs applicable to renewable energy produced by privileged producers are as follows:

- 5.04 to 10.44 cEUR/kWh for small HPPs;
- 12.31 to 13.71 cEUR/kWh for biomass plants;
- 15.00 cEUR/kWh for biogas plants;
- 9.60 cEUR/kWh for wind farms;
- 8.00 cEUR/kWh for landfill gas power plants;
- 8.00 to 10.00 cEUR for combined cycle power plants;
- 9.00 cEUR/kWh for waste-fired power plants;
- 15.00 cEUR/kWh for on-roof solar energy power plants.

(c) Certificates of origin

The Energy Law also stipulates the possibility of issuing certificates of origin by REA. The Government of Montenegro adopted the Decree on the Manner of Issuing,

Transfer and Withdrawal of Guarantees of Origin for the Energy Produced from Renewable Sources and High-efficiency Cogeneration (Uredba o načinu izdavanja, prenošenja i povlačenja garancija porijekla energije proizvedene iz obnovljivih izvora energije i visokoeфикаsne kogeneracije, Official Gazette of Montenegro, No. 37/2011).

The guarantees of origin are issued on a monthly basis and a request for their issuance must be submitted by the 15th day of the month for energy produced in the previous month. The request should contain information on the producer, production facility, type of primary energy being produced, data on the support schemes applicable to the facility and, in case of high efficiency generation, additional data on the minimum calorific value of the fuel, its consumption and savings of primary energy.

The first request is accompanied by a connection agreement, main design of the energy facility and a schematic overview of the measuring points. The guarantees of origin are transferrable, both within Montenegro and abroad, and may be used by the supplier to prove the percentage of renewable energy in the overall quantity of the energy it sold.

4. NATURAL GAS

4.1 Market overview

The natural gas market in Montenegro has a marginal influence on the overall energy market. Montenegro does not have any natural gas infrastructure and thus there is no access to any international gas transportation system. On the other hand, there is no domestic natural gas generation. Certain exploration projects reveal indications of natural gas reserves in the coastal area.

However, certain steps are expected to be taken, as Montenegro has formed partnerships with Croatia, Albania and Bosnia and Herzegovina on a project to develop a 400 km (of which 100 km will be through Montenegro) Ionic-Adriatic pipeline, which is intended to be a separate arm of a larger Trans-Adriatic gas pipeline. The value of the gas infrastructure to be developed in Montenegro as part of the project is estimated at EUR 60 million. Montenegro would then have a constant supply of natural gas and would be able to utilise more adequately its own underwater natural gas capacities.



4.2 Regulatory overview

Legal framework

The natural gas sector in Montenegro is mainly covered by the Energy Law. The following important laws are also applicable to the natural gas sector:

- (a) Law on Mining (Zakon o rudarstvu, Official Gazette of Montenegro, No. 65/2008, 74/2010 and 40/2011);
- (b) Law on Hydrocarbon Exploration and Exploitation (Zakon o istraživanju i proizvodnji ugljovodonika, Official Gazette of Montenegro, No. 41/10, 40/2011 and 62/2013);
- (c) Law on Spatial Planning and Construction of Buildings (Zakon o uredjenju prostora i izgradnji objekata, Official Gazette of Montenegro, No. 51/2008, 40/2010, 34/2011, 40/2011, 47/2011, 35/2013, 39/2013 and 33/2014).

4.3 Regulated natural gas market activities

The Energy Law regulates the following licensed activities: (i) the purchase of natural gas, (ii) storage, (iii) transportation, (iv) distribution and (v) supply. Any entity wishing to perform any of the natural gas activities must be a local entity registered with the Montenegrin Commercial Register and must apply for a licence to be issued by REA as the main regulatory body in the gas sector. The licences are issued for a period of up to 15 years with the possibility of renewal. The Energy Law provides for the possibility of suspending a licence, upon request of the interested entity. REA is also entitled to cancel the licence: (i) upon the request of an energy undertaking, (ii) in the event that an energy undertaking is not fulfilling the conditions imposed by the licence, (iii) non-compliance with the material conditions for carrying out the energy activity, (iv) non-compliance with orders from the energy inspectorate. REA may also temporarily cancel a licence if the energy undertaking does not fulfil specific conditions for a particular gas activity, does not maintain gas facilities properly, and does not determine prices against methodologies adopted by REA, etc. REA shall leave an additional remedy period, no longer than 60 days, for compliance and shall cancel the licence permanently should the energy undertaking fail to remedy the breach.

4.4 Exploration and production

The exploration and production of natural gas and other hydrocarbons in Montenegro is regulated by the Law on Hydrocarbon Exploration and Exploitation (Zakon o istraživanju i proizvodnji ugljovodonika, Official Gazette of Montenegro, No. 41/10, 40/2011 and 62/2013) ("Hydrocarbons Law").

According to that piece of legislation, natural gas may be explored and produced only on the basis of concessions awarded by the Government through concluding a concession agreement on gas exploration or a concession agreement on gas exploitation and exploration.

This law lays down the conditions, manner and procedure for research and production of hydrocarbons and regulates a number of other related issues. The Law excludes the application of other laws potentially applicable to exploration and production of carbons, such as the general Concessions Law, the Law on Mining and the Law on Geological Exploration. The activities of research and production of hydrocarbons may be performed only with a concession awarded by the Government of Montenegro (for research) or the Parliament (for production) in accordance with the Hydrocarbons Law.

The Ministry of Economy ("Ministry") is in charge of all legal, administrative and technical issues related to the application of the Hydrocarbons Law.

The Hydrocarbons Law foresees two types of concession: for exploration and for production of hydrocarbons. However, the production concession may also cover an exploration phase.

The procedure for the award of concession is almost identical for both concession types. The public invitation by which the procedure is initiated contains, inter alia, the following elements:

- (a) subject-matter of the concession;
- (b) existing technical information;
- (c) conditions to be fulfilled by the prospective concessionaire and the operator (technical, financial, organizational, etc.);
- (d) bidding criteria;
- (e) deadlines for submission and withdrawal of bids;
- (f) bid bond details.

Interested bidders are provided with tender documents comprising the instructions for the preparation of bids, including on the content of bids and the manner of bid submission as well as other information of relevance for the award of concession. The Hydrocarbons Law specifies that one of the mandatory elements of the bid is a proposal of a working programme.

The Tender commission, formed by the Ministry, prepares the ranking list which is delivered to the Ministry and then published on the Ministry's website. The bidders are allowed to review the documents in the period of 8 days and submit an appeal within an additional 8 days deadline. The Ministry is required to reach a decision on the appeal within 8 days as of submission of the appeal. The Ministry then submits to the Government a detailed report, the ranking list and the proposal of the concession contract (predlog ugovora o koncesiji).

The decision on the award of concession for exploration is issued by the Government, whereas in the event of a concession for production - the decision is issued by the Parliament upon the Government's proposal. A concession for exploration assumes the right of the concessionaire to perform geological, geophysical or other detailed analysis, in order to determine tectonic and structural features of the land or seabed and evaluate existence of hydrocarbons.

The exploration concession is awarded by the Government of Montenegro for a period of up to 2 years. Within 6 months following the end of the research works, envisaged by the working programme, the concessionaire is obliged to deliver a report containing research results. The mandatory content of this report is supposed to be prescribed by the Ministry.

A production concession allows the concessionaire to produce hydrocarbons in accordance with the law. A production concession consists of the following phases:

- (i) Exploration phase and verification of reserves - the maximum duration is 6 years and can be extended for up to 2 additional years upon a decision of the Government;
- (ii) Development phase - based on the development and production plan submitted by the concessionaire to the grantor in accordance with the concession contract;
- (iii) Production phase - starts on the day of first extraction of the hydrocarbons from the well, and may last up to 20 years with the possibility of extension for half of the initial period of the concession.

The main features of the concession arrangement:

- (a) The surface area of the production field is determined by the concession contract and the maximum surface area is 150km²; exceptionally, it may be increased to 300km². Any surplus surface area should be returned to the grantor once the production phase starts;
- (b) The Law prescribes two types of fees: (i) area fee, payable on the annual level based on the surface area covered by the concession and amounts to EUR 300 per km² (increased tenfold in the case of extension of the exploration phase) and (ii) royalty fee, determined as a percentage of the quantity of gas produced by the concessionaire and amounting to 2 per cent of the produced quantity of gas at the point of extraction. The amounts, manner of calculation and payment of these fees is further regulated by the Decree on the Manner of Calculation and Payment of the Fee for Production of Oil and Gas (Uredba o načinu obračuna i plaćanja naknade za proizvodnju nafte i gasa, Official Gazette of Montenegro, No. 13/14);

- (c) A special corporate income tax will be payable by the concession company. The Law which envisages the introduction of this tax has still not been adopted but, according to the draft version, the tax rate is set at 59 per cent of the tax base.
- (d) The concessionaire is obliged to incorporate a Montenegrin company to pursue the concession project;
- (e) The concessionaire is obliged to allow third party access to the facilities and the upstream network for joint use provided that it does not interfere with the regular operations of the concessionaire and other entities who already acquired the access right. The manner and conditions of access are supposed to be regulated in detail by implementing bylaws to be adopted by the Ministry;
- (f) If a well is located on territory belonging to two concessionaires, the grantor may request the concessionaires to propose a programme of joint development and production;
- (g) The Law prescribes detailed obligations of the concessionaire regarding the protection of the environment, safety of production, revitalization of the affected environment and the plan for conservation of the well and removal of the equipment following the completion of production phase;
- (h) The concessionaire is obliged to procure insurance for the duration of the concession contract in accordance with the best international practice in this industry and provide evidence thereof to the grantor. The Law prescribes for the obligation of the concessionaire to indemnify the grantor and third parties for all the damages incurred as a result of concessionaire's actions during the concession agreement. The concessionaire is specifically obliged to compensate all environmental damages caused in the course of execution of the concession contract for production;
- (i) Engagement of the contractor and subcontractors is subject to the Ministry's approval;
- (j) The Law specifically prescribes for the grantor's right to impose the mandatory purchase of part or all of the oil and gas produced, at a price equal to the international market price for that quantity and quality;
- (k) If the concessionaire is a consortium, each member is jointly and severally liable for all the obligations arising from or in connection with the concession agreement;
- (l) A pledge or mortgage over the assets obtained under the concession contract or over production facilities is possible only with the grantor's approval;

- (m) Disposal of stakes or other ownership interest in the project company as well as disposal of ownership or other rights of the concessionaire may be performed only with the grantor's approval.

The public tender was launched in August 2013 and bid submission deadline was set for 15 May 2014. The tender attracted the world's largest oil and gas companies, since recent geological explorations have revealed the possible presence of nearly 425 billion m³ of natural gas in the coastal area of Montenegro.

4.5 Transmission and access to the system

(a) General

Since gas infrastructure is rather undeveloped, there is no gas transportation system in Montenegro for the time being. Nevertheless, the Energy Law sets out rules for the potential future gas transmission systems.

(b) Access to the gas transmission system

A gas transmission system operator ("GTSO") is obliged to provide access to the gas transmission system ("GTS") to all customers based on non-discriminatory principles. The Government appointed state-owned "Montenegro Bonus" to act as the operator of the gas transmission system.

GTSO is entitled to reject access to the system in the event of: (i) a lack of transportation capacity, (ii) if access would endanger performance of public services, (iii) GTS technical incompatibility, (iv) severe economic and financial problems caused due to the take or pay obligations (upon the request of the supplier that has entered into the take or pay gas supply agreement). Major new gas infrastructure such as interconnectors, transportation gas lines, LNG and LPG facilities and storage facilities, may, upon request, be exempted, from the obligation to provide access or to apply regulated tariffs and conditions under certain conditions.

4.6 Storage

Since Montenegro still does not have any gas storage facilities, the storage sector appears under-regulated. However, the public gas supplier and GTSO, storage facility operator shall be appointed by the Government in 2013, but no later than 90 days after the acquisition of the construction permit for the development of a gas transmission system in Montenegro. Operating and storing shall be subject to a licence issued by the REA. The rules applicable to the GTSO access shall be mutatis mutandis applied to gas storage and access to gas storage.

4.7 Liquefied natural gas and liquefied petroleum gas

The Energy Law regulates the following activities related to liquefied natural gas ("LNG") and liquefied petroleum gas ("LPG"): (i) transportation and storage of LNG, (ii) operation of LNG system, (iii) operation of LPG system, (iv) wholesale and supply of LNG and (v) wholesale and supply of LPG. Performance of any of the above activities is subject to obtaining a licence from the REA.

Under the previous energy law, the energy companies mostly held licences for the commercial transport, storage and supply of LPG, while under the new Energy Law, 20 licences for supply of LPG, 10 licences for storage of LPG and 11 licences for the wholesale trade of LPG have been issued by the REA.

5. UPSTREAM OIL MARKET

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5.1 Market overview

Currently there are no oil exploitation capacities in Montenegro. However, years of undersea exploration have indicated that there are significant reserves of oil and gas on the seabed near the Montenegrin coast. The Government of Montenegro has launched a tender for the award of concession for further exploration and exploitation of hydrocarbons (oil and gas).

5.2 Regulatory overview

Similarly to the natural gas sector, the oil sector is governed by the Energy Law as well as the Law on Mining, the Law on Hydrocarbon Exploration and Exploitation and the Law on Spatial Planning and the Construction of Buildings.

5.3 Regulated oil market activities

The Energy Law regulates the following licensed activities: (i) oil transportation; (ii) transport of oil derivatives; (iii) wholesale trading; (iv) retail trading and (v) storage of oil and oil derivatives. Any entity wishing to perform any of the natural gas activities must be a local entity registered with the Montenegrin Commercial Register and must apply for a licence to be issued by REA as the main regulatory body in the gas sector. The licences are issued for a period of up to 15 years with a possibility of renewal.

The Energy Law provides for the possibility of suspending a licence, upon request of the interested entity. The REA is also entitled to cancel the licence: (i) upon the request of an energy undertaking,

(ii) in the event that an energy undertaking is not fulfilling the conditions imposed by the licence, (iii) non-compliance with the material conditions for carrying out the energy activity, (iv) non-compliance with orders from the energy inspectorate. The REA may also temporarily cancel a licence if the energy undertaking does not fulfil specific conditions for a particular gas activity, does not maintain gas facilities properly and does not determine prices against methodologies adopted by REA, etc. The REA shall leave an additional remedy period, not longer than 60 days, for compliance and shall cancel the licence permanently should the energy undertaking fail to remedy the breach.

5.4 Exploration and production

The Law on Hydrocarbon Exploration and Exploitation governs the exploration and exploitation of oil and all the abovementioned with regards to the exploration and exploitation of natural gas also applies to the exploration and exploitation of oil.

However, the royalty fee is determined and paid on the basis of the quantity of oil/gas extracted and the prevailing market price and the percentage rate is progressive: 5 per cent for amounts up to 10,000 Barrels per day, 7 per cent for amounts above 10,000 and less than 20,000 Barrels per day, 10 per cent for amounts above 20,000 and less than 30,000 Barrels per day and 12 per cent for amounts above 30,000 Barrels per day.



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