

Republic of Macedonia

OVERVIEW OF THE LEGAL AND REGULATORY FRAMEWORK

A. Electricity

A.1 Industry structure

Regulatory structure

The general sector law that regulates the energy industry and market in the Republic of Macedonia ("**Macedonia**") is the Law on Energy (the "**Energy Law**").¹ The Energy Law takes the form of an "umbrella" law, covering all significant areas such as electricity, renewable energy, oil and gas as well as regulation of the markets, transport and transmission of energy. The Energy Law introduces a new regulatory framework aimed at opening up the energy market by allowing fresh entries of competitors and full liberalization of the energy market by 1 January 2015.

The Energy Law envisages a range of bylaws for the electricity market but their enactment has not yet been finalised. Almost all subsectors are currently regulated by secondary legislation enacted under the old Law on Energy (the "**Old Energy Law**").² These existing bylaws adopted under the Old Energy Law are still effective and applicable and will stay in place until enactment of the new secondary legislation.

Regarding the country's compliance with the EU energy regulations, Macedonia was granted candidate status to join the EU in 2005, with a recommendation that accession negotiations begin in 2010; however, these negotiations have yet not commenced. The Old Energy Law was compliant with the Second Electricity Directive and the new Energy Law has been prepared following the New Electricity Directive concerning the common rules for the internal electricity market. Therefore, despite the fact that accession negotiations are yet to begin, Macedonia's energy legislation is largely compliant with the EU energy regulations.

¹ Published in the Official Gazette of the Republic of Macedonia nos. 16/2011, 136/2011.

² Published in the Official Gazette of the Republic of Macedonia nos. 63/2006, 36/2007, 106/2008 and 119/2010.

Finally, the Government of Macedonia ("**GoM**") has prepared a Strategy for Energy Development in the Republic of Macedonia until 2030, which lays down the main objectives in the field of energy development over the next 20 years.³

Participants in the electricity sector

The process of restructuring the former Electric Power Company of Macedonia ("**ESM**") commenced in 2004 and was finalised by 2006. As part of the GoM's programme to liberalise the electricity market, the restructuring resulted in unbundling of the vertically-integrated ESM into three legally separated enterprises:

- a) the Macedonian Electricity Transmission System Operator ("**MEPSO**") – which remained in 100% state ownership and is responsible for transmitting electricity and managing the high voltage transmission network, operating the electricity central dispatching system and implementing market operations, providing electricity supply for regulated wholesale customers and providing ancillary services;
- b) the 100% state owned joint stock company Electric Power Plants of Macedonia ("**ELEM**") responsible for the generation of electricity. ELEM controls the two major thermal power plants ("**TPPs**"), "TPP Bitola" and "TPP Oslomej", with a total capacity of 800MW and operates five major hydro power plants ("**HPPs**") with a total installed capacity of 530MW; and
- c) the private joint stock company EVN Macedonia – as part of the EVN Austria group, EVN Macedonia operates the distribution and supply of electricity in Macedonia. EVN Austria bought 90% of the ESM distribution company and today owns it jointly with the MEPSO (10%).

Energy regulatory bodies

The Ministry for Economy, headed by the Minister Mr. Valjon Sarakjini, and in particular its Department for Energy, is the most important state body responsible for energy policy and overall control of the energy sector in Macedonia.

The Energy Regulatory Commission (the "**ERC**") was established in 2002 as a regulatory body independent of the interests of the energy industry and governmental bodies. The ERC is composed of five Commissioners appointed by the Assembly of Macedonia. The most important function of

³ Published in the Official Gazette of the Republic of Macedonia no. 61/2010.

this body is the issuing, amending and revoking of energy licences and regulation of the prices and tariff systems for different types of energy.

Further responsibilities of the ERC include ensuring the safe, secure, continual and quality energy supply to final consumers, protection of the environment and nature, protection of competition and consumers in the energy sector, as well as other responsibilities envisaged in the respective regulations.⁴ The other relevant body in the electricity sector is the Energy Agency which was established in 2005 with the Law on Establishment of the Energy Agency of Macedonia.⁵

Licensing regime

The Energy Law states that legal entities must obtain a licence in order to perform energy activities in Macedonia. These licences are issued for a period of between 3 and 35 years, depending on the activity in question, the funds required, the duration of the right to use the respective energy resource and the submitted request of the activity performed. The procedure for obtaining a licence is regulated by a newly enacted Rulebook on licences for performance of energy activities (the “Rulebook”)⁶, which replaced the old Rulebook on the terms, manner and procedure for issuing, amending and revoking licences for performance of energy activities based on the Old Energy Law.

The new Rulebook does not prescribe any significant novelties in the procedure for issuance of licences in the energy sector. The circle of potential applicants for licences for energy activities is widened because the new Rulebook envisages that every legal entity which is registered in the Central Registry of the Republic of Macedonia may apply for a licence, while the old bylaws also required that the legal entity has registered an energy activity as its prevalent activity. In order to achieve better efficiency, the procedure for issuance of the licence is simplified regarding the required documentation. The new Rulebook prescribes the issuance of a temporary licence for an energy object that enters into trial operation, which was not stipulated in the old secondary regulation. Such licence is issued in special situations prescribed by the Energy Law, upon an request by an investor for issuance of licence before obtaining approval for use of the energy facility (or before receiving the report of examination performed technical oversight by an authorized engineer for facilities that do not require the issuance of usage approval). However, upon the receipt of the usage approval or the report of the performed technical oversight of the facility, the ERC would issue a licence for performing an energy activity, following the temporary licence..

⁴ Source: ERC’s web site: www.erc.org.mk and the Energy Law.

⁵ Published in the Official Gazette of the Republic of Macedonia no. 62/2005.

⁶ Published in the Official Gazette of the Republic of Macedonia no. 143/2011.

Liberalisation of the energy market

Under the terms of the new Energy Law, the full liberalization of the energy market in Macedonia should be finalised by 1 January 2015. With the enactment of anticipated secondary legislation in accordance with the newly adopted Energy Law (ie the Rules for Supply of Electricity, the Rules for Supply of Electricity in Exceptional Cases, the Rulebook on Prices of Electricity for Suppliers in Exceptional Cases, the Energy Market Rules and Tariff Systems for Transmission and Distribution of Electricity and Services Provided by the Operator of the Electricity Market) all electricity consumers will acquire the status of eligible consumers with the exception of households, which will remain tariff consumers until 31 December 2014.

EVN Macedonia has reserved a monopolistic position regarding supply of electricity to households until 31 December 2014. However, the price of the supplied electricity is strictly regulated by the ERC. This monopoly is expected to change in future with the full liberalization of the energy market so that consumers can obtain electricity in line with its relevant value and market price.

Recently, there was a major disagreement between EVN Macedonia and the GoM regarding billing policy. In 2009 EVN Austria filed a request for initiation of arbitration proceedings against Macedonia to the Washington-based International Centre for Settlement of Investment Disputes and later to the International Court of Arbitration in London, regarding violation of Macedonian legislation. These arbitration procedures were closed in June 2011 following the enactment of the new Energy Law and the reaching of an understanding between the GoM and EVN Macedonia.

A.2 Electricity trading

The Energy Law categorises electricity trading as an unregulated energy activity. Such activities differ from regulated energy activities as they are not performed in the public interest. In order to undertake electricity trading, it is necessary to obtain a licence from the ERC.

The Energy Law stipulates that trade in electricity can be performed on a special exchange market set up for that purpose. However, such a market has not yet been established in Macedonia. The trade in electricity is financial in nature but the physical transfer of the traded electricity is through the MEPSO and the system it operates.

New electricity market codes are expected in the near future. The Energy Law states that such bylaws must be enacted within the nine months following the enactment of the new Energy Law; this period elapses in November 2011.

A.3 Third party access regime

According to the Energy Law, transmission system operators ("TSOs") and/or distribution system operators ("DSOs") are obliged, on the basis of the published tariffs, to allow access to the relevant system for eligible customers in a transparent and objective manner that prevents discrimination towards system users. The relevant TSO or DSO can deny access to the relevant grid only in cases of electricity distribution capacity shortage, in which case it is therefore obliged to inform the applicant in writing, providing a detailed and unambiguous explanation of the reasons for denial of access.

The relevant TSO or DSO, pursuant to the relevant Grid Code, is obliged to specify the connection rules for the relevant grid and the connection charge-setting methodology.⁷ The entities applying for energy system connection or users applying for alteration to an existing connection will be obliged to submit a grid connection application to the relevant TSO or DSO. Furthermore, the MEPSO is obliged to provide third party access in an objective, transparent and non-discriminatory manner with fees and tariffs that have been previously approved by the ERC.

A.4 Market entry (*supply and generation*)

According to the Energy Law, there are regulated and unregulated energy activities within the Macedonian energy market.

The transfer of electricity, organisation and management of the electricity market, electricity distribution and supply of electricity to final consumers are determined as regulated energy activities in the electricity sector.

In order to obtain a licence for performance of an unregulated energy activity market entrants are obliged to establish a local subsidiary in the Macedonian Central Registry. However, if the market entrant wishes to obtain a licence for undertaking a regulated energy activity, it has to register a trade company according to Macedonian legislation. The ERC is the body authorised to grant energy licences, as detailed above. Regarding the length of the licences, a maximum term of up to 35 years is granted to entities that perform the following energy activities: (i) production, (ii) transfer, (iii) distribution, (iv) transit, and (v) operation of a system for the transfer and distribution of electricity. As a rule, licences are only issued for other energy activities for a period of ten years. Licences are given to entities that follow the procedure and fulfil the technical, financial and other criteria necessary in order to perform the energy activity.

⁷ Published in the Official Gazette of the Republic of Macedonia no. 95/2006.

According to the Energy Law, legal entities that perform one or more regulated energy activities cannot perform other energy activities or any other activities whatsoever. There is one specified exception for a legal entity performing the activity of electricity supply or natural gas supply, which can also perform the activity of electricity or natural gas supply of last resort.

A.5 Public service obligations and smart metering

Only the performers of regulated energy activities (as detailed above) are obliged to meet the requirements for performing a public service. The holder of a licence for undertaking a regulated energy activity must provide a public service in Macedonia in the manner provided by and in accordance with the prices and tariffs prescribed and/or approved by the ERC.

With regard to smart metering, the local supplier/distributor EVN Macedonia as part of its improvement of the network has taken a few steps towards voluntarily replacing the old electricity meters with new digital meters. Furthermore, the requirements and obligations for metering of electricity are prescribed by the Grid Code, where it is stipulated that metering units must comply with the relevant IEC or MKD standards.

A.6 Cross-border interconnectors

A new rulebook on granting cross-border interconnections has been in force since 1 August 2011. According to this Rulebook, the network operator MEPSO can organise joint auctions for the available cross-border transmission capacities. The subject of these auctions, organised by the MEPSO, are the following cross-border interconnectors between Macedonia and (i) Serbia (400kV lines), (ii) Bulgaria (400kV lines), and (iii) Greece (400kV lines).

B. Gas

B.1 Industry structure

Macedonia is a gas importing country. The system for transmission of natural gas in Macedonia consists of part of a Russian transit gas pipeline which passes through Ukraine, Romania and Bulgaria, and is designed for Turkey, Greece, Serbia and Montenegro. The connection with the system in Bulgaria is on the eastern border, in the area called Deve Bair, and reaches to Skopje, covering a total length of 98km. The small number of tariff consumers connected to the system for

transmission of natural gas during 2010 resulted in usage of approximately only 10-15% of the system's capacity.⁸

Regulatory structure

The Energy Law governs the gas sector of the energy market in Macedonia. The Energy Law is in compliance with the Second Gas Directive concerning common rules for the internal market in natural gas.

Gas energy activities as defined by the Energy Law consist of the following activities:

- natural gas transmission;
- natural gas transmission system operation;
- natural gas distribution;
- natural gas supply to final consumers;
- natural gas supply; and
- trade of natural gas.

Participants in the gas sector

As in the electricity sector, participants in the gas sector on behalf of the state are the Ministry of Economy, the ERC and the Energy Agency.

The key market player in the Macedonian gas market is Makpetrol AD Skopje, which is the major importer and exporter as well as supplier of natural gas in the country. In 2006 the GoM and Makpetrol AD Skopje jointly established the public company "GA MA", which is the current natural gas market operator in Macedonia. GA MA is bound to provide an operational management system for natural gas transmission and third party access to the system on a transparent and non-discriminatory basis, in accordance with national legislation harmonized with EU directives. GA MA is licensed to perform the energy activities of managing the system for transmission of natural gas and transmission of natural gas, the licences having been issued by the ERC.

⁸ Annual report on the work of ERC for 2010.

B.2 Gas trading

The Energy Law stipulates that the natural gas trader must purchase natural gas for the purpose of selling it to other traders, suppliers, electricity and/or heating energy generators, natural gas TSOs and DSOs, as well as customers abroad. In order to trade in natural gas, the interested legal entity must obtain a licence for that energy activity, which is granted by the ERC. When undertaking natural gas export or transit, the natural gas trader is obliged to secure sufficient transmission capacity, pursuant to the applicable tariffs and the Transmission Grid Code. Similar to trade in electricity, the Energy Law envisages the enactment of Rules for the natural gas market that should be prepared within nine months of the Energy Law coming into force. Only one licence for transmission of gas and system operation can be granted in Macedonia (granted to GA MA).

B.3 Third party access regime to gas transportation networks

Access to the system for the transfer of natural gas requires a procedure involving construction of a connectivity installation. In the same way as for access to the electricity system, a request has to be filed and technical requirements have to be met. After receipt of the application, the formal procedure is initiated and proceeds in accordance with the Network rules on transmission of natural gas.⁹

GA MA as the network operator is obliged to provide equal, transparent and non-discriminatory conditions for access of the gas pipeline network to all system users. Access is agreed by means of a contract following a formal decision by GA MA for acceptance of the request for access when all technical conditions are met. Arrangements for access and transmission of natural gas can be made separately for transmission capacity of input and output stations of the system.

B.4 LNG and gas storage

There are no LNG terminals in Macedonia.

B.5 Market entry

Licences in the gas sector can only be awarded to companies (regulated energy activity) or subsidiaries (unregulated energy activity) that are established in Macedonia. In order to be supplied with the appropriate licence, the applicant must fulfil numerous requirements in relation to technical characteristics of the facilities, qualification of staff engaged and financial position. Entry

⁹ Published in the Official Gazette of the Republic of Macedonia no. 45/2009.

into the gas market is also subject to requirements imposed by laws and regulations governing other sectors (concessions, environmental protection, etc.).

B.6 Public service obligations

According to the Energy Law, licensed entities performing regulated gas related energy activities (transmission of natural gas, management of the system of natural gas, distribution of natural gas) have an obligation to perform them as a public service. The Energy Law imposes an obligation on the operator of the distributive system to measure the quantities of gas with devices that are adequate under the Energy Law and the Grid Code for distribution of natural gas.¹⁰ Furthermore, the new Rulebook on the manner and conditions on regulation the tariffs for transmission, management with the transmission system and distribution of natural gas¹¹ imposes an obligation for the legal entities that perform the regulated gas related energy activities to create their tariffs following the methodology set in the bylaw.

B.7 Cross-border interconnectors

The cross-border interconnection, through which from which all of the gas supplies for Macedonia arrive, is on the border between Macedonia and Bulgaria, in the area called Deve Bair.

C. Climate change and sustainability

C.1 Climate change initiatives

Macedonia is not yet an EU Member State and is a non-Annex I country of the United Nations Framework Convention on Climate Change. Therefore, Macedonia is not obliged to implement the EU Climate Change Package and is not subject to greenhouse gas ("GHG") emissions reduction commitments under the United Nations Framework Convention on Climate Change.

However, Macedonia has enacted several pieces of legislation that directly or indirectly impact climate change and/or climate change sustainability, including:

- the Law on the Ambient Air, one of the main objectives of which is preventing and reducing pollution that causes climate change;¹²

¹⁰ Published in the Official Gazette of the Republic of Macedonia no. 45/2009.

¹¹ Published in the Official Gazette of the Republic of Macedonia no. 160/2011.

¹² Published in the Official Gazette of the Republic of Macedonia nos. 67/2004, 92/2007, 35/2010 and 47/2011.

- the Law on the Environment, which implements the Clean Development Mechanism from the Kyoto Protocol;¹³
- the Strategy for Energy Development in the Republic of Macedonia until 2030, which lays down the main objectives in the field of energy development until 2030;¹⁴
- the Strategy for Promoting Energy Efficiency in Macedonia until 2020;¹⁵
- the Strategy for Utilization of Renewable Sources of Energy in the Republic of Macedonia until 2020;¹⁶
- the Regulation on Indicative Targets for Saving Energy in Macedonia, which determines indicative targets for saving energy in Macedonia until 2018;¹⁷
- the Rules on Renewable Energy Sources Macedonia (the "**RES Rules**"), which regulate in more detail the types of renewable energy sources ("**RES**") and the functioning thereof;¹⁸
- the Rules on Highly Efficient Combined Facilities, which regulate in more detail the types of efficient combined facilities and the functioning thereof;¹⁹
- the Second National Environmental Action Plan, prepared by the Macedonian Ministry of Environment and Physical Planning, which focuses on the mitigation of climate change in Macedonia; and
- the Energy Law, which is the main legislative act with regard to the realization of energy efficiency and promoting the use of RES.²⁰

However, as mentioned above, most bylaws arising from the Energy Law are based on the Old Energy Law and new bylaws (based on the new Energy Law) are expected to be enacted in the near future.

C.2 Emission trading

Macedonia is not part of the EU Emission Trading Scheme. Furthermore, Macedonia does not currently have the concept of emission trading incorporated into its legislation.

¹³ Published in the Official Gazette of the Republic of Macedonia nos. 53/2005, 81/2005, 24/2007, 159/2008, 83/2009, 48/2010, 124/2010 and 51/2011.

¹⁴ Published in the Official Gazette of the Republic of Macedonia no. 61/2010.

¹⁵ Published in the Official Gazette of the Republic of Macedonia no. 143/2010.

¹⁶ Published in the Official Gazette of the Republic of Macedonia no.125/2010.

¹⁷ Published in the Official Gazette of the Republic of Macedonia no. 112/2011.

¹⁸ Published in the Official Gazette of the Republic of Macedonia no. 113/2011.

¹⁹ Published in the Official Gazette of the Republic of Macedonia no. 128/2011.

²⁰ Published in the Official Gazette of the Republic of Macedonia no. 16/2011.

C.3 Carbon capture and storage

Macedonia does not currently have the concept of carbon capture and storage incorporated into its legislation.

C.4 Renewable energy

Macedonian energy authorities and the respective regulations try to promote energy produced using RES as much as possible, in line with the current international and EU drive in this area. The Energy Law classifies facilities that produce electricity from RES as facilities of public interest. The ERC plays a major role in the promotion of RES on the Macedonian energy market. As mentioned above, this independent regulatory body is authorised to make decisions with regard to the preferential tariffs for the purchase and sale of electricity produced and delivered from RES. Pursuant to the Energy Law, in order to stimulate construction of new RES power plants, these production facilities can acquire the status of preferential producer of energy and through this the right to sell the generated electricity at preferential tariffs. The status of preferential producer is provided for each RES production plant of electricity separately.

A power plant can acquire the status of preferential producer if the following general conditions are fulfilled:

- it produces electricity from RES or in highly efficient cogeneration plants;
- it meets the prescribed upper limit of installed capacity; and
- the sum of the installed power plant and the total installed capacity of power plants of the same type recorded in the register of preferential producers does not exceed the total installed capacity of preferential manufacturers of this type set out by a decision of the GoM.

In addition to the aforementioned requirements, in order to gain the status of preferential producer one of the following requirements must also be fulfilled:

- an authorisation for construction of energy facilities (for particular production facilities) has to be obtained; or
- approval for construction (for energy facilities that do not require authorization) has to be secured; or
- a concession agreement for use of natural gas for the production of electricity has to be signed; or

- the right for construction of an energy production facility must have been acquired by way of a public call procedure.

The RES Rules establish a guarantee of origin system for energy generated from RES; guarantees of origin can be obtained by producers of electricity that produce electricity from RES. Each guarantee of origin is issued for electricity of 1MWh and as a general rule these guarantees are valid for 12 months. Guarantees of origin can be transferred from the holder of the guarantee to another licence holder for trade or supply of electricity in Macedonia.

At present, the predominant types of energy from RES used in Macedonia consist of hydropower, biomass, geothermal energy, as well as a modest amount of solar and biofuel energy. The use of wind and solar energy, as well as biogas, is planned to be intensified in future. Several projects have been proposed which would help Macedonia to start using RES. In accordance with the Decision Adoption of the Energy Balance of the Republic of Macedonia for 2011, the percentage of energy consumption in Macedonia which stemmed from RES in 2010 was approximately 20%.²¹ The calculations for 2011 indicate that this number will fall to around 15.5%, due to the fact that HEPPs have seen a significantly reduced production of energy during 2011 in comparison to 2010. Macedonia is a country with relatively high utilisation of this type of energy source and that the target of 21% energy from RES out of the total energy consumption as a target for 2020 (as prescribed in the Strategy for Utilisation of Renewable Sources of Energy in Macedonia until 2020) is well within reach.

Aside from this, it is interesting to mention that in 2007 Macedonia actually successfully implemented a clean development mechanism project. The project was named "Rehabilitation of six HEPPs in the Republic of Macedonia". The following six HEPPs were rehabilitated with the help of Japan: (1) Vrutok, (2) Raven, (3) Vrben, (4) Shpilje, (5) Globochica, and (6) Tikvesh. It is estimated that this project reduced CO₂ emissions by 200,334 metric tonnes per annum.²²

C.5 Biofuel

In accordance with the Energy Law, production, storage and trade of biofuel are all regulated energy activities. Therefore, entities which undertake such activities must obtain a licence and must also fulfil certain conditions and requirements in respect of their premises, equipment and facilities for performing such energy activities.

²¹ Published in the Official Gazette of the Republic of Macedonia no. 172/2010.

²² Source: the UN official web site - <http://cdm.unfccc.int/Projects/DB/KEMCO1194421187.96/Review/>.

According to the Strategy for Energy Development in the Republic of Macedonia until 2030, it is expected that the percentage share of biofuels will increase to at least 10% of the consumption of diesel and petrol fuels by 2020.

However, the relevant legislation regarding the contents and quality of fuel does not contain obligations for fuel suppliers to reduce the life cycle GHG emissions of their fuels by at least 6% by 2020 (as prescribed by the Biofuel Directive). In addition, the Macedonian legal system does not implement the Biofuel Directive's rules regarding the permissible content of ethanol in petrol.

C.6 Energy efficiency

As stipulated in the Energy Law, the policy of energy efficiency is due to be achieved through measures and activities for efficient use of energy, adoption of programs and plans for improving and promoting energy efficiency and their implementation, providing services for energy efficiency and energy controls, and meeting obligations in terms of energy efficiency and energy savings in the public sector. According to the same law, energy suppliers are obliged to submit annual data containing a view and structure of consumption by their consumers, a geographical grouping of consumers, a grouping of consumers according to their consumption characteristics, an assessment of energy efficiency, and proposed measures to improve energy efficiency.

The Strategy for Promoting Energy Efficiency in Macedonia until 2020 envisages that the expected energy savings in 2020 will amount to 14.5% compared with the average consumption in the period 2002-2006 or the total of 237.31ktoe. This plan is based on planned savings in the residential sector, the commercial and service sectors, the industrial sector and the transport sector.

D. Nuclear energy

At present, no nuclear energy is generated in Macedonia. There have been a couple of proposed projects to build a nuclear power plant ("NPP") in Macedonia as well as proposed projects for Macedonia to participate in building NPPs in neighbouring countries. However, to date, none of these projects have been completed.

The Law on Banning the Construction of Nuclear Power Plants in the Socialist Federal Republic of Yugoslavia from 1989 became a law of Macedonia with the Constitutional Law on Implementation of the Constitution of the Republic of Macedonia.²³ According to this law, the construction of NPPs

²³ Published in the Official Gazette of the Republic of Macedonia nos. 52/1991 and 4/1992.

on ex-Yugoslavian territory is banned. As this law is contained within the Macedonian legislature, this restriction is still in force and can only be lifted through enactment of a new law.