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Contributed by Morgan & Morgan ***Authors:*** Ramon Varela, Ana Carolina Castillo Solis

Law and Practice

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Morgan & Morgan's energy practice offers expertise in the full spectrum of projects from permits, development, financing and construction, to their operation. This allows them, when representing lenders, to have a more comprehensive perspective of the type of challenges faced by these projects. The lawyers advise both developers and lenders in all aspects related to the financing of energy projects, including the first post-privatisation hydroelectric project to be developed in Panama (2003) and the first wind farm (2014). Expertise also extends to M&A and joint ventures, power purchase agreements, dispute resolution, environmental permits, taxation and regulatory matters.

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1. General Structure and Ownership of the Power Industry

1.1 Principal Law Governing the Ownership and Structure of the Power Industry

Law 6 of 1997 regulates the electric power industry in the Republic of Panama and divides the industry into three different segments: (i) generation; (ii) transmission; and (iii) distribution and supply. All these activities are regulated by the National Authority of Public Services ("ASEP"). Moreover, the National Dispatch Centre ("CND") is entrusted – among others – with the responsibility of administering the national dispatch, as well as the contracts (PPAs) and spot markets.

At ASEP's website (www.asep.gob.pa), one may download or consult the laws and regulations that govern the electric power industry, as well as access other relevant information such as market tariffs, concessions, licences, and PPAs; all of the resolutions issued by ASEP are also published on its website.

The industry also recognises other market agents – although with a smaller participation – such as wholesale clients, who can purchase directly from the generators, and self-generators, who can generate the power required for their consumption and sell the excess in the market.

Public and Private Ownership

The only company currently authorised by law to provide the public service of transmission of electricity, is the Transmission Company (Empresa de Transmisión Eléctrica, S.A. or "ETESA") which is a 100% state-owned company.

Moreover, the distribution and supply services can only be provided by virtue of a concession agreement granted by ASEP. There are currently only three distribution concession areas and, henceforth, only three distribution concession agreements. The term of these concessions is 15 years, but it may be extended. It should be noted that the Government of Panama ("GOP") owns 48% of the shares in each of the distribution companies.

Generation services are subject to concessions and licences granted by ASEP. Concessions apply only for hydro and geothermal power, whereas licences apply to all other technologies. It is worth mentioning that investment in generation companies is currently open, and the GOP may create generation companies to operate and compete in the market, as well as own shares in generation companies. Currently, there are four generation companies in which the GOP is a shareholder: (i) AES Panama, S.R.L. (with 49% of its shares owned by GOP, and also a member of the AES Group); (ii) Enel Fortuna, S.A. (with 49% of its shares owned by the GOP and also a member of Enel Green Power); (iii) Bahia Las Minas Corp. (with 49% of its shares owned by GOP, and also a member of Grupo Argos); and (iv) Empresa de Generación Eléctrica, S.A. ("EGESA") a small generation company currently operating a small photovoltaic power plant.

As set forth under Law 6, the power public service activities cannot be vertically integrated. In other words, the services are segmented and divided in such a way that the same company (or economic group) cannot provide more than one public service.

1.2 Principal State-Owned or Investor-Owned Entities

ETESA (a 100% state-owned company) is the only company authorised to provide transmission services. Additionally, only three companies are authorised to provide distribution and supply services in Panama, namely: Elektra Noreste, S.A. (a member of Grupo EPM, a Colombian utility services company), Empresa de Distribución Eléctrica Chiriquí, S.A. and Empresa de Distribución Eléctrica Metro-Oeste, S.A. (both members of Gas Natural Fenosa, a Spanish natural gas and energy utility services company).

Furthermore, the main generation participants are (i) AES Panama, S.R.L. (a member of the AES Group), which through its subsidiaries owns hydro and thermo power plants, and is soon to begin commercial operations of the first LNG power plant in Central America with an installed capacity of approximately 300 MW; (ii) Enel Fortuna, S.A. (a member of Enel Green Power), with hydro and photovoltaic power plants, owning and operating the biggest PV power park in Panama with an installed capacity of 42 MW; and (iii) UEP Penonomé II, S.A. (a subsidiary of InterEnergy Holdings), which owns the biggest wind park in Central America with an installed capacity of 270 MW.

1.3 Foreign Investment Review Process

The electric power industry in Panama is open to foreign investment, allowing foreign investment as majority ownership in power companies operating in Panama, and even exclusively foreign ownership in generation companies.

There are no restrictions for foreign investment in the electric power industry. However, the Panamanian Constitution restricts ownership of land located within 10 km of the borders to Panamanian nationals. This is particularly relevant for generation projects located near the borders.

There are no specific foreign investment incentives or protections in the power industry, but there are certain incentives per technology and protections that can be enjoyed by nationals as well as by foreign investors. For example, the market regulations provide that the administration of the companies that provide electric public services shall not be subject to any precautionary measures, including injunctions.

Law 54 of 1998, which establishes a regime for the legal stability of investments, expressly acknowledges that foreign investors have the same rights and obligations as national investors. The said law also provides that investments in power generation can file for registry with the Ministry of Commerce and Industries for the purpose of benefiting from and enjoying, for a period of ten years, the following:

- legal stability, so that any changes in law do not affect the rights acquired by the company, unless it is a matter of public interest;
- tax stability, except for indirect taxes;
- municipal tax stability, providing that changes in the municipal tax regime can only affect the investment every five years;
- customs regime stability, provided the Cabinet Council may vary the tariff regime; and
- labour stability with regard to the provisions applicable to the moment of contracting.

1.4 Principal Law Governing the Sale of Power Industry Assets

Law 6 of 1997 is the law that regulates the electric power industry and is regulated by Executive Decree 22 of 1998.

ASEP is the regulator of the electric power industry and, as such, oversees the market agents' compliance with their licences and concessions. There are certain restrictions and requirements for the sale of power industry assets and businesses, depending on each industry segment. For example, Law 6 currently prohibits the sale of the GOP shares in

ETESA. Therefore, only ETESA may provide the transmission services and its shares may only be owned by the GOP.

Moreover, distribution activities are subject to concession and the GOP owns 48% of the shares of these companies. Also, the sale of shares owned by private investors in these companies is subject to the requirements of these concession agreements.

Furthermore, generation companies (or any of its affiliates) cannot own – whether directly or indirectly – distribution companies in Panama.

Although the sale of shares of power generation companies is not subject to any approvals or requirements, ASEP shall be informed of such sale, because of market participation restrictions. Law 6 provides a restriction that prohibits generation companies from requesting new concessions if, by doing so, the company would serve, directly or indirectly, more than 25% of the electricity consumption of the national market.

Finally, it should be noted that the assignment or sale of a generation licence or concession may be subject to prior approval from ASEP, whereas the merger of a generation company need only be informed to ASEP. It is also worth taking into account that, as per current legislation, even though a generator may be able to assign its concession agreement – even if ASEP has authorised such assignment – the water use concession required for the hydro power generation activities cannot be transferred.

1.5 Central Planning Authority

The National Dispatch Centre ("CND") is an entity ascribed to ETESA, and is entrusted with the powers to oversee and administer the operation of the electric power industry. ETESA, as the sole provider of the transmission services, is entrusted with planning and developing the expansion of the transmission grid to meet growth in demand

The CND is in charge of planning the dispatch of the generation companies providing for the optimal use of available resources meeting reliability, safety and quality of service standards. The power plants, transmission lines and substations in the power industry are operated in accordance with the CND's instructions.

ETESA is responsible for preparing the Expansion Plan, which shall be approved by ASEP. All the construction activities shall comply with the Transmission Regulations and the Operations Regulations.

Furthermore, ASEP, as the regulator, oversees compliance by the distribution companies of the reliability criteria and quality and safety of supply standards. ASEP is empowered to impose sanctions on electric power companies that do not comply with the reliability and safety of supply standards provided in the market regulations.

Before being able to energise any new facilities, these shall comply with the reliability and safety of supply requirements provided under the Transmission Regulations and the Operations Regulations, and be authorised by the CND.

Moreover, Law 37 of 2013 requires ETESA to include in the Expansion Plan – an annual report subject to the guidelines of the National Secretariat of Energy on the maximum capacity, per technology, that can be interconnected to the transmission grid in the short, medium and long terms, such as not to affect the reliability and safety of the system.

1.6 Material Changes in Law or Regulation

There have not been any recent changes in law or regulations that are materially relevant to the power industry.

1.7 Announcements Regarding New Policies

It should be noted that there are currently several bills before the National Assembly that propose significant changes to the industry, particularly with regard to hydroelectric power generation. These, however, were submitted a few legislative periods ago and there is no certainty that they will be passed by the Legislature or enacted as Laws of the Republic.

One of the bills under discussion provides certain amendments to Law 6, which could limit the market participation of generators, and also create a new market agent – the marketer (comercializador), subject to a licence granted by ASEP.

1.8 Unique Aspects of the Power Industry

The installed capacity of the electric power industry in Panama is highly dependent on hydroelectric power. ASEP publishes monthly reports on its website (www.asep.gob.pa) showing the installed capacity per technology. Also, the CND website (www.cnd.com.pa) displays the daily supply per technology. As of early June 2018, the consumption of the national market was supplied by approximately 80% hydroelectric power, 6% coal, 4.4% bunker, 1.63% wind, 1.26% PV, 0.15% biogas, and 6.56% other technologies and international exchanges.

Potential investors should take into consideration that there is currently a restriction in the transmission capacity that is affecting generation from the west of the country through Panama City. Power plants that are located in the west of the country may not be able to generate at full capacity, even if they have available resources, due ongoing effects of delays in the construction and operation of the third transmission line.

The National Energy Plan – prepared by the National Secretariat of Energy for the period covering 2015 through to 2050 – forecasts an increase in renewable energy, except hydro power (only one big hydro power plant is included in the pipeline, Chan II with an installed capacity of 223 MW), and it also contemplates a significant installed capacity of LNG and coal. The first LNG power plant in Central America, with an installed capacity of over 300 MW, is estimated to begin commercial operations in the third quarter of 2018. It is estimated that two more LNG power plants will be developed, one with an installed capacity of approximately 300 MW, and another with an installed capacity of over 600 MW.

2. Market Structure, Supply and Pricing

2.1 Structure of the Wholesale Electricity Market

The wholesale electricity market is regulated by Law 6 of 1997 and the Commercial Rules, approved by ASEP.

The wholesale electricity market is the venue for the sale of energy and/or power between producers ("*Participantes Productores*") and wholesale consumers ("*Participantes Consumidores*"). It has a contracts component and a spot market component, both of which are administered by the CND, based on the Commercial Rules, approved by ASEP. Thus, the CND manages all transactions carried out by the market agents, such as power compensations, auxiliary services, forced generation, transmission tolls, etc.

The contracts component of the wholesale market is a market of bilateral contracts, which includes mainly contracts between operators for the supply of capacity and/or energy at competitive prices resulting from public bidding processes, contracts between generators (*contratos de reserva*) and contracts between generators and wholesale clients (end users with a demand equal to or greater than 100 kW per month). Power purchase agreements are concluded mainly between the distribution companies and generation companies. The latter participate in a public bidding process, with contracts awarded to the winning bidders. The bidding process is proposed by the National Secretariat of Energy, approved by ASEP, and co-ordinated and awarded by ETESA.

On the other hand, the spot market component is a multi-segment market with prices changing by the hour, accounting for transfers involving power and energy not otherwise tied to a contract.

In accordance with the Commercial Rules, the producers are the generators, the self-generators and co-generators (who can sell surplus production as spot market sales).

The wholesale electricity market also comprises the national market (as described above) and the regional market, for the purchase and sale of energy and/or power through international interconnections.

2.2 Imports and Exports of Electricity

The wholesale electricity market also comprises the regional market, allowing the purchase and sale of energy and/or power through international interconnections.

Empresa Propietaria de la Red, S.A. (EPR), a public-private joint venture, was created to build and operate the Central American electrical interconnection system (SIEPAC), linking the power grids of Panama, Costa Rica, Honduras, Nicaragua, El Salvador, and Guatemala. Created in 1998 and headquartered in San José, Costa Rica. EPR's shareholders are the state-owned power entities from the countries covered by the system. The single-circuit 230 kV line extends for approximately 1,800 km and its final phases entered into operation within the past five years.

SIEPAC operates pursuant to a framework treaty entered into by all six countries, which established the creation of a regional regulator and operation guidelines for the regional grid.

2.3 Supply Mix for the Entire Market

The specific distribution of the various energy supply sources varies depending on the period of the year, as hydroelectric power will be in shorter supply during the early months of the year, which correspond to the dry season in Panama. By the same token, wind and solar power will tend to peak around these months. Also, hydroelectric power, as a component of the overall electricity supply, tends to peak towards the end of the rainy season (typically October and November). As of early June, 2018, the approximate breakdown according to sources of energy supply was the following:

- hydroelectric power: 80%;
- coal: 6%;
- bunker: 4.4%;
- wind: 1.63%;
- solar: 1.26%;
- biogas: 0.15%;
- other (including international exchanges): 6.56%.

2.4 Principal Laws Governing Market Concentration Limits

Law 6 of 1997 is the law that regulates the electric power industry. Additionally, Law 26 of 1996, regulated by Executive Decree 279 of 1996, sets forth market concentration provisions.

Under Law 6, there are currently no restrictions as to how many generation licences a company may hold, or the installed capacity it may own. However, Article 58 of Law 6 establishes that generation companies cannot "request new

concessions [ie, for a hydroelectric or geothermal project] if, upon doing so, they serve, either directly or indirectly, through other generation companies or other means, over 25% of the electricity consumption of the national market." Furthermore, it establishes that the Executive Branch, prior to the opinion of ASEP, may increase the aforementioned percentage when it deems that the conditions for competition in the market justify such a measure. In other words, assuming a generator does not seek to develop any hydroelectric or geothermal projects, there should be no restriction as to developments of further projects. However, should it seek to file for any generation concession for hydroelectric or geothermal projects, then ASEP would have to review what percentage "of the electricity consumption of the national market" said company would serve in order to determine if such a concession may be granted.

In recent years, a few law-makers have introduced bills before the National Assembly seeking to broaden the scope of the 25% restriction to generation companies requesting concessions or licences. However, to date, all such legislative efforts have been unsuccessful.

2.5 Agency Conducting Surveillance to Detect Anti-Competitive Behaviour

Law 6 of 1997 is the law that regulates the electric power industry. Additionally, Law 26 of 1996, regulated by Executive Decree 279 of 1996, sets forth market concentration provisions.

Pursuant to Law 6 of 1997 and its regulatory decree (Executive Decree 22 of 1998), in addition to any provisions in the corresponding licence or concession to prevent anti-competitive behaviour by a generator, ASEP has the regulatory ability to intervene in cases in which any market agent is deemed to be abusing a dominant market position or is otherwise engaging in monopolistic practices.

Also, pursuant to Law 26 of 1996 – which is the framework law for ASEP – and its regulation (Executive Decree 279 of 1996), ASEP has the authority to enact additional measures in cases in which it deems that agents in the electricity market are engaging in monopolistic practices, including alerting the antitrust authority (ACODECO). When alerted of such practices, ACODECO is legally empowered to file civil claims for damages, as well as judicial precautionary measures, against agents that are deemed to be in breach of antitrust laws.

3. Climate Change Laws and Alternative Energy

3.1 Principal Climate Change Laws and/or Policies

Panama is a signatory of the Kyoto Protocol and the Doha Amendment, and recently the Paris Convention. Furthermore, as per the CND's installed capacity report, updated as of 14 March 2018, there is currently only one coal-fired power plant with n installed capacity of 120 MW operating in Panama, but there are over 300 MW of coal power being developed for the copper mine under development by Minera Panama.

3.2 Principal Law and/or Policies Relating to the Early Retirement of Carbon-Based Generation

There are no specific programmes or regulations to encourage the early retirement of coal-fired power plants. However, it should be noted that, currently, the only coal-fired power plant in operation is Bahía Las Minas, which has a coal-powered installed capacity of 120 MW out of a total 280 MW installed capacity. It should also be taken into consideration that the biggest infrastructure private investment in Panama, the copper mine being developed by Minera Panamá, includes a coal-fired power plant with an installed capacity in excess of 300 MW to cover the supply requirements of the mine, and any excess generation shall be sold to the electricity market.

3.3 Principal Law and/or Policies to Encourage the Development of Alternative Energy Sources

The principal laws that encourage the development of alternative and renewable energy sources are Law 45 of 2004, Law 44 of 2011, and Law 37 of 2013.

These laws encourage investment in sources such as hydro, geothermal, wind, and PV. It should be noted, however, that as of June 2018 there are no geothermal power plants in operation or under construction in Panama pursuant to a concession granted by ASEP.

All these technologies are subject to a generation licence, except hydro and geothermal power plants, which are subject to concessions. Current regulations provide that concessions shall be granted subject to a competitive process open to bidders, whereas licences are granted upon request by the interested party.

The first of these laws was Law 45 of 2004, still in force, which creates incentives for renewables in general, including hydro and geothermal power plants.

Law 45 provides that renewable energy power plants with an installed capacity of up to 10 MW shall not be subject to any distribution or transmission tariffs, and also that renewable energy power plants with an installed capacity of more than

10 MW and up to 20 MW shall be exempt from distribution and transmission tariffs for the first 10 MW of installed capacity during the first ten years of commercial operations.

Law 45 also creates other tax incentives, such as exemption from import taxes, tariffs, duties, fees, withholdings, machinery, materials, etc, necessary for the construction, operation and maintenance of renewable energy power plants.

Law 45 also provides that the developer of a renewable power plant of up to 10 MW of installed capacity may request a tax credit equivalent to 25% of the direct investment, based on the reduction of carbon dioxide emissions equivalent per year of the concession or license term, which may be used for payment of the income tax during the first ten years of commercial operations of the project. This benefit also applies to renewable power plants with an installed capacity of more than 10 MW, but in this case the tax credit can only be used to pay the amount equivalent to 50% of the income tax applicable to the company per fiscal period during the first ten years of commercial operations. This tax credit was created under the Kyoto Protocol, however, to this day, it has not been implemented in Panama.

Law 45 also provides a tax credit that may be applied for payment of the income tax, equivalent to 5% of the direct investment amount in public infrastructure works such as roads, streets, bridges, sewage systems, schools, health centres, and other works of a similar nature.

Law 44 of 2011, creates incentives for wind power plants, including:

- PPA bids exclusive for wind power;
- exemption from import taxes, duties, fees, tariffs, withholdings, as well as from the value added tax (ITBMS) caused by the importation of equipment, machinery, materials, etc., necessary for the construction, operation and maintenance of wind power plants;
- accelerated depreciation method, so that the net profits of the company are less affected; and
- tax incentives for manufacturing in Panama equipment and machinery used for wind power plants.

Additionally, Law 37 of 2013 creates incentives for PV power plants, such as:

- PPA bids exclusive for PV power with terms of up to 20 years;
- exemption from import taxes, duties, fees, tariffs, withholdings, as well as from the value added tax (ITBMS) caused by the importation and/or purchases in the national market, of equipment, machinery, materials, etc, (as listed in the law) necessary for the construction, operation and maintenance of PV power plants;
- a tax credit that may be applied for payment of the income tax, equivalent to 5% of the direct investment amount in public infrastructure works such as roads, streets, bridges, sewage systems, schools, health centres, etc; and
- accelerated depreciation method, so that the net profits of the company are less affected.

There is an excise tax applicable to the PV equipment that is imported, equivalent to 5% of the purchase price, which is not exempted.

Furthermore, Panama had enacted Law 42 of 2011 which created incentives for biomass power plants, but said incentives were repealed by Law 47 of 2015. Therefore, there are currently no incentives provided for this technology. As of now, there are no biomass power plants in operation or under construction in Panama.

4. Generation

4.1 Principal Laws Governing the Construction and Operation of Generation Facilities

Law 6 of 1997 is the principal law that governs the public service of electricity generation in the Republic of Panama, which may be provided by companies which request and obtain the appropriate generation licence or concession from ASEP. Law 6 also establishes the general rights, obligations and restrictions to which generation companies in Panama are subject.

The specific requirements for obtaining a generation licence or concession are established in ASEP resolutions AN 1021-Elec of 19 July 2007 and AN 5558-Elec of 31 August 2012, respectively.

4.2 Regulatory Process for Obtaining All Approvals to Construct and Operate Generation Facilities

In order to construct a generation facility (for any facility other than a hydroelectric or geothermal plant), a developer will need to obtain a generation licence from ASEP, in accordance with the provisions of Law 6 and follow the procedural guidelines established in Resolution AN No 1021-Elec of 2007. The licensing process usually involves two steps: procuring a provisional licence and procuring the definitive licence.

Provisional Licence

In order to obtain a provisional licence, the applicant must submit a completed Form E-170-A to ASEP and provide the following information and documents:

- a copy of the passport of the Legal Representative (most likely the President);

- a Public Registry Certificate;
- an affidavit by the Treasurer, listing the names and IDs of all the shareholders; if the direct shareholder is a legal entity, names and IDs must be submitted for the beneficial owners (who must be natural persons); if the shares of said legal entity are listed on a stock exchange or owned by an investment fund, then full IDs must be submitted for the company's governing body (eg, members of the board, management committee, etc);
- property deed or proof of rental of the land in which the project will be installed;
- document issued by an entity recognised by the Banking Superintendency of Panama certifying the applicant's financial and economic solvency and its capacity (or that of its shareholders) to fund no less than 30% of the project's cost;
- project description;
- letter of intent from the company that will operate the plant; the company must have at least two years' worth of experience operating generating plants of similar technology;
- letter of intent from the company in charge of engineering and design for the plant; the company must have no less than five years' worth of experience designing plants of similar technology;
- proposed design for connecting to the transmission or distribution grid;
- map in 1:50,000 scale and chart of the approximate location of the main project structures;
- licence bond in an amount equal to USD500 per MW of installed capacity for the proposed project (if it is a wind farm) or USD100 per MW of installed capacity (for all others), to be returned to the applicant once the definitive licence is issued;
- timeline of activities to procure the definitive licence, further to the annex included in form E-170-A (including wind measurement periods, if applicable); quarterly progress reports must be submitted.

If the applicant complies with all of the above requirements, ASEP should issue a provisional license. In practice such provisional licences are typically issued within 3-6 months after all requirements have been complied with. Once issued, the provisional licence will be valid for a term of 12 months, during which time the applicant shall have to obtain the remaining requirements in order for ASEP to issue the definitive licence. This provisional licence would not, however, entitle the applicant to begin construction on the project. Furthermore, please note that the provisional licence may not be assigned or transferred.

Definitive Licence

The remaining requirements for obtaining the definitive licence are:

- an authenticated copy of the resolution pursuant to which the Ministry of the Environment approves the environmental impact study for the project;
- an authenticated copy of the approved environmental impact study for the project;
- detailed information about the connection to the transmission or distribution grid;
- blueprint in at least 1:10,000 scale describing the required easements;
- if the project will access the transmission grid, a note from Empresa de Transmisión Eléctrica, S.A., (ETESA), the transmission company, authorising the connection; if the project will access the distribution grid, then the applicant must submit such authorisation notes issued both by ETESA and by the distribution company;
- if the application is for a wind farm, proof of wind measurements on site, at different altitudes, in order to determine both the size and characteristics of the wind turbines and their distribution;
- a construction bond in an amount equal to 10% of the project cost (the "Construction Bond"), to be returned to the applicant once construction of the project is finalised;
- a compliance bond, to guarantee the applicant's compliance with the terms of the licence, in an amount based on the installed capacity, as follows:
  - (a) for wind projects, USD500 per MW of installed capacity;
  - (b) for solar or LNG projects, USD2,000 per MW of installed capacity.

The time period for the issuing of the definitive licence is similar to the one provided for in the provisional licence (see above).

Generation Concession

In order to obtain a generation concession, the applicant shall have to submit a completed Form E-150 to ASEP and provide the following information and documents:

- a copy of the passport of the Legal Representative (most likely the President);
- a Public Registry Certificate;
- an affidavit by the Treasurer, listing the names and IDs of all the shareholders; if the direct shareholder is a legal entity, names and IDs must be submitted for the beneficial owners (who must be natural persons); if the shares of said legal entity are listed on a stock exchange or owned by an investment fund, then full IDs must be submitted for the company's governing body (eg, members of the board, management committee, etc);
- property deed or proof of rental of the land in which the project will be installed;
- document issued by an entity recognised by the Banking Superintendency of Panama certifying the applicant's financial and economic solvency and its capacity (or that of

its shareholders) to fund no less than 30% of the project's cost;
- letter of intent from the company that will operate the plant; the company must have at least two years' worth of experience operating generating plants of similar technology;
- letter of intent from the company in charge of engineering and design for the plant; the company must have no less than five years' worth of experience designing plants of similar technology;
- map in 1:50,000 scale and chart of the approximate location of the main project structures;
- a compatibility profile for the proposed water use;
- project description;
- timeline of activities to procure the concession;
- proposed design for connecting to the transmission or distribution grid;
- bond in an amount equal to USD1,000 per MW of installed capacity for the proposed project, to be returned to the applicant once the concession right is granted by ASEP.

Once an application for a generation concession has been submitted, ASEP will issue a public notice in two national newspapers for two consecutive days, in order that any company interested in the same project may come forward and participate in a public bidding process. If other applicants come forward, they must submit the same documentation as the original applicant. All applicants must also submit an economic bid pursuant to a reference price that will be determined by ASEP.

After all documents have been submitted pursuant to the timeline that ASEP will establish, ASEP will then evaluate both the technical and economic bids submitted and will ultimately assign the concession to the winning bidder.

Concession Agreement
Once the concession right is granted, the applicant to which such right is granted must submit the following to ASEP in order for the concession agreement to be executed:

- an authenticated copy of the resolution pursuant to which the Ministry of the Environment approves the environmental impact study for the project;
- an authenticated copy of the approved environmental impact study for the project;
- an authenticated copy of the water use concession agreement, duly countersigned by the Comptroller General of the Republic;
- if the project will access the transmission grid, a note from ETESA (the transmission company) authorising the connection; if the project will access the distribution grid, then the applicant must submit such authorisation notes issued both by ETESA and by the distribution company, along with detailed information about the connection to the transmission or distribution grid;
- written records of meetings held with the local authorities and neighbouring communities in order to properly inform them about the project; these records must be signed by the relevant authorities and community members.

After the aforementioned documents have been submitted before ASEP, the latter should award the concession within 30 days after submission; once the concession agreement is executed, it must be sent to the Office of the Comptroller General for countersignature.

4.3 Terms and Conditions Imposed in Approvals to Construct and Operate Generation Facilities

One of the key components within the generation licence and the concession agreement (other than particular details about project location, installed capacity, etc) is the milestone schedule, which is submitted by the developer for approval by ASEP. The schedule will include all the major development milestones (eg, construction start date, major phase milestones, testing, commercial operation, etc), as well as deadlines for financial closing. ASEP tends to be proactive in following up on developers' compliance with these milestones.

That being said, developers of greenfield projects find that ASEP tends to be accommodating with regards to extensions, provided that such developers can show that they have the means and the intent to develop the project. If, however, the developers engage in behaviour that leads ASEP to believe the contrary, extensions will be more difficult to obtain.

Timeliness in filing requests for necessary environmental approvals, beginning negotiations with landowners/holders for land rights, etc, are some of the actions that, in case of a delay, can serve to convince ASEP that such delays are not attributable to the developer and will help to bolster the case for extensions. In any case, developers are best advised to show concrete evidence of trying to move forward with the project before requesting any extensions from ASEP.

Another key component required in any licence or concession agreement is the owner's ability to encumber the concession/licence, a key factor to which lenders looking to provide financing for the project will look.

Finally, generation licences and concession agreements contain termination provisions which typically contemplate the following:

- Termination could occur following the licensee/concessionaire's failure to comply with its specific obligations under the corresponding licence/concession (for instance, failure to begin or complete construction within the man-

dated period in the corresponding licence and/or concession). This termination right would be typically subject to a cure period. There is, however, no automatic cure right and this remains subject to the regulatory authority and discretion of ASEP.
- Termination could also occur following breaches of regulatory duties. If during an administrative proceeding it is found that the generating company failed to comply with its regulatory duties, such as engaging in regulated activities without the corresponding licence or concession, interconnecting to the transmission and/or distribution grid without appropriate authorisation, causing damage to the grid, failing to comply with established service quality guidelines or generally failing to comply with existing regulations regarding the electricity sector, ASEP has the right to terminate the generation licence or concession, in addition to imposing fines. Generally, however, termination of a generation licence/concession issued to an operational facility due to a breach of a regulatory duty is rare. There are, however, precedents in which ASEP has fined companies for: (i) taking generation units offline for regular maintenance without first having either alerted ASEP or obtained the appropriate approval from the CND; (ii) failing to make timely payments of spot market purchases assigned to them; or (iii) unwarranted refusal to abide by CND dispatch instructions.
- Finally, generation licences and concessions may be terminated by ASEP due to bankruptcy, dissolution or suspension of payments by the generation company.

4.4 Proponent's Eminent Domain, Condemnation or Expropriation Rights

Pursuant to Law 6 of 1997, land which is required for the construction of generation facilities is deemed to be "of public interest." Developers are required to conduct direct negotiations with landowners/holders in order to secure any and all necessary land rights for construction or operation of the project. However, to the extent such negotiations are unsuccessful and the developer is not able to secure an agreement with the landholder, then the developer can request ASEP to intervene. In such case, the developer needs to petition ASEP to declare a "forceful easement" over the portion of land that is required. This is an administrative process through which ASEP essentially forces the landholder to grant an easement in favour of the project and establishes the compensation to be paid by the developer.

Law 6, as amended by Law 18 of 2013, also contemplates an expedited process that, under matters of urgency, empowers ASEP to authorise generation companies to enter the land and begin construction before the adjudication of the forceful easement process.

The owner of the land shall be entitled to receive (i) a compensation for the use of its land, and (ii) an indemnification for the damages or detriment to its property rights that may result from the construction and installation of facilities in the easement. Law 6 also provides that if upon the imposition of the easement there remains unused areas of land, the indemnification shall also cover such unusable lands.

The quantum of such compensation and indemnification is determined based on appraisals made by independent experts that are appointed by each party. If the value in each of these appraisals is significantly different from the other, the final quantum shall be determined by an independent expert appointed by ASEP. The appraisals shall be subject to the parameters that are approved by ASEP by virtue of Resolution No. JD-2287 dated 8 August 2000, which sets forth the scale of values applicable to the restriction coefficient used by experts in determining the compensation of easements.

4.5 Requirements for Decommissioning

Any owner of a generation facility with an installed capacity greater than 10 MW, seeking to reduce the available capacity of this facility or to decommission it, must provide advance notice of not less than six months for plants with an installed capacity up to 30 MW, or one year in advance if the installed capacity is greater. Furthermore, decommissioning will not, in and of itself, release the owner from any contractual obligations it may have vis-à-vis other market agents. To the extent that decommissioning coincides with, and is undertaken as a result of, the expiration of a generation licence, such licence would only generate ongoing regulatory responsibilities for the owner to the extent that relevant provisions to that effect are expressly included in the licence. If the owner has other facilities still in operation, however, then such owner will logically continue to be subject to the requirements and obligations contained therein (including contractual obligations vis-à-vis its off-takers).

To the extent the decommissioning process involves dismantling facilities and could cause adverse environmental effects, such measures will have to be co-ordinated with the Ministry of the Environment and in accordance with the environmental impact study of the project. If any damages occur, the statute of limitations for civil claims arising out of environmental damages is ten years.

5. Transmission

5.1 Regulation of Construction and Operation of Transmission Lines and Associated Facilities

5.1.1 Principal Laws Governing the Construction and Operation

The principal laws and regulations that govern the construction and operation of transmission lines and associated facil-

ities are Law 6 of 1997, which regulates the electricity public services, Executive Decree 22 of 1998, which regulates Law 6, the Transmission Regulations and the Operations Regulations, both approved by ASEP. All these laws and regulations may be accessed at ASEP's website (www.asep.gob.pa).

Law 6 provides that only ETESA may provide the public service of transmission of electricity in the Republic of Panama. However, it should be noted that generators may build and operate transmission lines required to interconnect their power plants to the transmission grid.

Therefore, transmission facilities may only be built under the transmission concession of ETESA, or under a generation licence or concession granted by ASEP. As part of the requirements for obtaining the generation licence or concession, the petitioner must submit to ASEP the interconnection viability issued by ETESA. Thus, ETESA shall be required to review and approve the proposed interconnection of the project before commencing any construction works, taking due regard of the standards and criteria set forth in the Transmission Regulations. Also, an interconnection agreement will be required to be executed between the generator and ETESA.

Furthermore, before energising any transmission facilities and all power plants connected to the national grid, the CND shall verify and authorise commercial operations, provided these pass the reliability and safety tests and comply with the standards set forth in the Transmission Regulations and the Operations Regulations.

5.1.2 Regulatory Process for Obtaining All Approvals to Construct and Operate Transmission Facilities

ETESA (a 100% state-owned company) is the only market agent authorised to provide transmission services. As such, ETESA is obligated to perform the works and expansions to the transmission grid that are necessary to meet the growth in demand that is included in the Expansion Plan approved by ASEP.

The construction of such transmission facilities shall comply with the Transmission Regulations and Operations Regulations approved by ASEP. ETESA shall also obtain all the necessary permits required for infrastructure construction in the Republic of Panama, including obtaining the approval of the environmental impact study by the Ministry of Environment, and procuring and obtaining all the easements necessary for the transmission line. The easements required shall be subject to negotiation with the owners of the land, but if no agreement is reached, ETESA may petition ASEP to order a forceful easement in favour of ETESA.

It should be further noted that generators may build and operate transmission lines required to interconnect their power plants to the transmission grid. The construction of said facilities shall also be subject to the interconnection viability and interconnection agreement entered into with ETESA, and these facilities may only be energised upon approval by the CND, who shall certify that the facilities meet the reliability and safety standards provided in the Transmission Regulations and the Operations Regulations. If the facilities are required by two or more market agents to interconnect to the national transmission system, ETESA shall have the obligation to acquire such facilities and operate these under its concession agreement.

5.1.3 Terms and Conditions Imposed in Approvals to Construct and Operate Transmission Facilities

Transmission facilities built by ETESA must comply with both the Transmission Regulations and the Operations Regulations, as well as being included in the Expansion Plan approved by ASEP. Moreover, transmission facilities built and operated by a generation company must not only comply with the Transmission Regulations and the Operations Regulations, but also with the interconnection agreement required to be entered into with ETESA.

These interconnection agreements are a standard agreement provided by ETESA and approved by ASEP, and set forth the terms and conditions for such interconnection. The Transmission Regulations provide the minimum terms that these agreements shall contain, which include:

- the general information of the contracting parties;
- the location of the facilities and the interconnection points;
- the quality and safety of supply regulations that shall govern the service, which at a minimum shall be those approved by ASEP;
- the specification of the services that shall be provided;
- the obligations and rights of the parties;
- the inspections required to be performed and the requirements that shall meet such inspections;
- the measurement of the electricity that shall be transmitted and the points where such measurements shall be made;
- the charges that shall be paid, subject to the tariffs approved by ASEP;
- the responsibility for maintenance of the facilities and the agreements for carrying such maintenance;
- the responsibility for damages to the facilities;
- the term of the agreement;
- the payment guarantees that shall be furnished;
- provisions regarding breach of the agreement and situations involving force majeure as provided under Law No 6;
- resolution of disputes subject to arbitration before ASEP;
- laws and regulations governing the contract, which shall give priority to the market regulations; and
- provisions governing the amendment or expansion of the interconnection facilities.

5.1.4 Proponent's Eminent Domain, Condemnation or Expropriation Rights

By virtue of Law 6 and ETESA's concession agreement, ETESA is authorised to use the land where transmission facilities are required to be built, as provided in the Expansion Plan approved by ASEP, in order to meet the demand growth. Such lands are deemed under Law 6 to be of "public interest".

The easements required shall be subject to negotiation with the owners of the land, but if no agreement is reached, ETESA may petition ASEP to order a forceful easement in favour of ETESA. Law 6, as amended by Law 18 of 2013, also contemplates an expedited process that, under matters of urgency, empowers ASEP to authorise ETESA enter the land and to begin construction before the adjudication of the forceful easement process.

The owner of the land shall be entitled to receive (i) a compensation for the use of its land, and (ii) an indemnification for the damages or detriment to its property rights that may result from the construction and installation of facilities in the easement. Law 6 also provides that, if upon the imposition of the easement there remains unused areas of land, the indemnification shall also cover such unused lands.

The quantum of such compensation and indemnification is determined based on appraisals made by independent experts that are appointed by each party. If the value of each of these appraisals is significantly different from the other, the final quantum shall be determined by an independent expert appointed by ASEP. The appraisals shall be subject to the parameters that are approved by ASEP by virtue of Resolution No JD-2287 dated 8 August 2000, which sets forth the scale of values applicable to the restriction coefficient used by experts in determining the compensation of easements.

5.1.5 Transmission Service Monopoly Rights

As provided under Law 6 of 1997, ETESA (a 100% state-owned company) has the exclusive right to construct and operate transmission facilities in the Republic of Panama. The transmission tariffs charged by ETESA, however, are subject to review and approval by ASEP.

It should be further noted that Empresa Propietaria de la Red, S.A. ("EPR") is the owner and operator of the regional transmission line SIEPAC that interconnects Central America and allows exchanges under the regional electricity market. Although generators may interconnect to the national transmission grid through SIEPAC – in which case they will require an interconnection agreement with SIEPAC – EPR does not compete with ETESA, because EPR does not provide transmission services in the national market, only in the regional (ie, Central American) market.

EPR and its transmission line, SIEPAC, are subject to oversight by the regional market regulator, the Electric Interconnection Regional Commission (Comisión Regional de Interconexión Eléctrica or "CRIE").

5.2 Regulation of Transmission Service, Charges and Terms of Service

5.2.1 Principal Laws Governing the Provision of Transmission Service, Regulation of Transmission Charges and Terms of Service

Law 6 of 1997 is the principal law that governs the public service of electricity transmission in the Republic of Panama, which may only be provided by ETESA. Law 6 sets forth the general framework for determining the tariffs that ETESA shall charge for such transmission services, which are further developed and regulated in the Transmission Regulations.

It should be noted that the transmission tariffs that may be charged by ETESA shall be subject to approval by ASEP and shall be revised every four years.

5.2.2 Establishment of Transmission Charges and Terms of Service

Law 6 of 1997 provides that the tariffs associated to the interconnection and use of transmission facilities shall cover the costs of investment, administration, operation and maintenance of the national transmission grid required to meet the growth in the demand, under adequate conditions that meet the standards of quality of service, reliability and sustainability. Also, the costs shall be calculated based on the assumption of economic efficiency.

Regulatory Principles Applied in Setting Rates, etc
Law 6 further provides that the costs used for the calculation of the tariffs shall allow ETESA to have a reasonable rate of return before applying the income tax over the net fixed asset at its original cost. The reasonableness is determined as such rate that does not differ more than two points from the sum of the annual interest rate of the 30-year treasury bonds of the USA, plus a seven-point premium for the transmission risk in the country.

The transmission tariffs for the access and use of the national transmission grid are divided into charges associated to (i) the interconnection of the market agents to the transmission grid, and (ii) the transmission services provided through the grid.

The transmission tariffs are determined per each four-year tariff period. Thus, every four years, ASEP revises the transmission tariffs and makes adjustments in accordance with the provisions set forth in the Transmission Regulations.

Furthermore, transmission facilities built, owned and operated by a given generation company or distribution company required for interconnecting other power plants – provided there is available capacity and that such interconnection will not affect the reliability and safety and quality of service standards provided in the Transmission Regulations – shall be subject to remuneration to the owner of such facility. The Transmission Regulations provides the maximum income allowed for the use of transmission facilities owned by generation companies and distribution companies, which shall be approved by ASEP. Such charges shall be based on the same methodology applied to ETESA, taking due regard of the value of the assets to be remunerated, based on:

- the construction costs, if construction of the assets was subject to a competitive process, in which case the same tariff formulas used for determining the maximum income allowed to ETESA shall be applied, taking into consideration the efficiency parameters and profitability comparisons used for ETESA;
- the present value of the annual payment agreed with the supplier of the equipment, if it was obtained through a competitive process for the construction, financing, operation and maintenance, discounting the rate of return applied to ETESA in the respective tariff period; or
- the value of replacement, as new, used in the tariff calculation, or the best budget that may be calculated by ETESA and approved by ASEP, when the user has built the equipment at its own expense or bought it on its behalf. ASEP shall approve the calculation of the maximum income allowed for the owner of the transmission facilities upon each interconnection request basis.

The quadrennial rate review and approval by ASEP must take due consideration of the matters indicated above.

5.2.3 Open Access Transmission Service

Law 6 of 1997 provides that market agents shall enjoy open access to the transmission grid on a non-discriminatory basis, subject only to complying with the reliability and safety and quality of supply standards set forth in the Transmission Regulations and Operations Regulations, and subject to payment of the transmission tariffs approved by ASEP.

Access to the transmission grid is regulated under the Transmission Regulations, and shall be authorised by ETESA, the transmission company. If there is a conflict between the user of the transmission services and ETESA, such conflict shall be resolved by ASEP.

6. Distribution

6.1 Regulation of Construction and Operation of Electric Distribution Facilities

6.1.1 Principal Laws Governing the Construction and Operation of Electric Distribution Facilities

Law 6 of 1997 is the principal law that governs the public service of electricity distribution in the Republic of Panama. There are three concession areas in Panama and, within each, one company has a monopoly over the service, via a distribution concession. Law 6 sets forth the general framework for determining the tariffs that the concession holders shall charge for such services, which are further developed and regulated in the Distribution and Commercialisation Regulations. The Republic of Panama is a minority shareholder (approximately 48%) in each of the three distribution companies.

6.1.2 Regulatory Process for Obtaining All Approvals to Construct and Operate Distribution Facilities

Distribution concessions are subject to 15-year terms; once this term comes to an end, the private investor that owns 51% of the shares may participate in the public bid that is then carried out. If the price offered by the current owner is lower than such offered by a potential new bidder, the 51% share block of the distribution company would be granted to the new offeror at the price paid by the original owner. If the price offered by the original owner of 51% of the shares is higher than the price offered by any other bidder, the original owner shall retain its share block without needing to make payments in addition to said offered price.

The existing distribution concessions were all granted in 1998, for a period of 15 years. Before this period ended, the concessions were renewed for an additional 15-year period. Therefore, barring a change in law, no new distribution concessions will be granted until 2028 at the earliest.

6.1.3 Terms and Conditions Imposed in Approvals to Construct and Operate

The contractual obligations provided for in a distribution concession agreement typically include:

- to provide the service within the concession area in accordance with quality standards determined by ASEP;
- to maintain supply to the existing customers in the concession area;
- to supply energy and install and maintain equipment for public lighting;
- to take the necessary measures in the wholesale electricity market to ensure adequacy of supply;

- to allow third party access to its distribution lines and transformer capacity in accordance with applicable laws;
- to monitor the quality of the supply;
- to promote energy efficiency and a rational use thereof;
- to comply with all applicable standards, including those covering public lighting, metering, quality of technical and customer service, use of public service infrastructure and the operations of the interconnected system;
- to comply with all applicable legislation and regulations, including those of ASEP;
- to achieve 24-hour service in specific isolated (ie, off-the-grid) systems;
- to complete certain defined rural electrification projects; and
- to include and maintain in the company's by-laws the necessary covenants that oblige the relevant purchase of the shareholding of the majority shareholder to: (i) maintain the indivisibility of the shareholding of the majority shareholder for as long as the concession remains valid in accordance with Section 46 of the Electricity Law; and (ii) keep the proportionality of the shareholding of the majority shareholder when new shares of the company are issued.

6.1.4 Proponent's Eminent Domain, Condemnation or Expropriation Rights

Pursuant to Law 6 of 1997, land which is required for the construction of electric distribution facilities is deemed to be "of public interest." Developers are required to conduct direct negotiations with landowners/holders in order to secure any and all necessary land rights for construction or operation of the project. However, to the extent such negotiations are unsuccessful and the developer is not able to secure an agreement with the landholder, then the developer can request ASEP to intervene. In such case, the developer needs to petition ASEP to declare a "forceful easement" over the portion of land that is required. This is an administrative process through which ASEP essentially forces the landholder to grant an easement in favour of the project and establishes the compensation to be paid by the developer.

Law 6, as amended by Law 18 of 2013, also contemplates an expedited process that, under matters of urgency, empowers ASEP to authorise distribution companies to enter the land and begin construction before the adjudication of the forceful easement process.

The owner of the land shall be entitled to receive (i) a compensation for the use of its land, and (ii) an indemnification for the damages or detriment to its property rights that may result from the construction and installation of facilities in the easement. Law 6 also provides that if, upon the imposition of the easement there remains unused areas of land, the indemnification shall also cover such unusable lands.

The quantum of such compensation and indemnification is determined based on appraisals made by independent experts that are appointed by each party. If the value in each of these appraisals is significantly different from the other, the final quantum shall be determined by an independent expert appointed by ASEP. The appraisals shall be subject to the parameters that are approved by ASEP by virtue of Resolution No JD-2287, dated 8 August 2000, which sets forth the scale of values applicable to the restriction coefficient used by experts in determining the compensation of easements.6.1.5 Distribution Service Monopoly Rights

The distribution of electric energy is an activity that is designed as a monopoly within the corresponding concession area. The Republic of Panama is divided into three concession areas and each is assigned to a different company (although two of the concessions are currently assigned to entities that are affiliates of each other).

6.2 Regulation of Distribution Service, Charges and Terms of Service

6.2.1 Principal Laws Governing the Provision of Distribution Service, Regulation of Distribution Charges and Terms of Service

Law 6 of 1997 is the principal law that governs the public service of electricity distribution in the Republic of Panama. Law 6 sets forth the general framework for determining the tariffs that the concession holders shall charge for such services, which are further developed and regulated in the Distribution and Commercialisation Regulations.

Pursuant to Law 6, distribution companies are mandated to grant the supply of energy required by their clients. Therefore, it is the contractual obligation of each of the distribution companies to have sufficient supply of energy to cover its area of concession. In principle, any deficiency in contracting energy supply renders the distribution company liable and subject to fines and penalties.

In order to acquire the required energy, distributors establish a bidding process for the purchase of energy and capacity. Usually the distributors establish a reference price approved by ASEP as part of its participation process in securing balanced tariffs to consumers.

Additionally, pursuant to Law 6 of 1997, ASEP must periodically define methodologies for establishing rates for distribution services, including minimum and maximum rates and the formulas for calculating them. These rates are established every four years (unless new rates are not established for the following four-year period before the current one expires, in which case the existing rates will continue in force until new rates are established). The distribution companies must

submit their rate schedule proposals to ASEP for the approval thereof, along with proposals for the maximum permitted income (IMP) that, pursuant to applicable law, they are allowed to receive. The latter proposal is subject to public comment and input, prior to ASEP issuing a decision on said proposal. The current rate schedule entered into force in 2014, and thus expires later this year.

6.2.2 Establishment of Distribution Charges and Terms of Service

Costs incurred by distribution companies in purchasing energy from generation companies, as well as in paying transmission tariffs to ETESA, will all be factored into the cost structure of the respective distribution company and, thus, will be key components in setting the distribution fees to be charged to the end user. In other words, such costs are passed on to the end user.

Each rate schedule will establish general rate parameters for end users, depending on whether they are connected at low tension, medium tension or high tension. Generally speaking, the cost of each kWh of energy consumed may fall into different rates depending on the overall consumption of the end user. For instance, if two end users are connected at low tension, but one is consuming 15 kWh per month and the other is consuming 100 kWh per month, the latter will pay a higher cost per kWh than the former. Also, end users with a maximum monthly demand in excess of 15 kW will be subject to a different fee structure.

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In addition to actual energy consumption, the end user will usually pay a fixed commercialisation charge for the first 10 kWh of energy consumed, distribution fees (including for energy losses in distribution) and a public lighting charge.

Regulatory Principles
As set forth above, Law 6 of 1997 provides the general framework for establishing distribution rates.

Usually the distributors establish a reference price approved by ASEP as part of its participation process in securing balanced tariffs to consumers.

Additionally, pursuant to Law 6 of 1997, ASEP must periodically define methodologies for establishing rates for distribution services, including minimum and maximum rates and the formulas for calculating them. These rates are established every four years (unless new rates are not established for the following four-year period before the current one expires, in which case the existing rates will continue in force until new rates are established). The distribution companies must submit their rate schedule proposals to ASEP for the approval thereof, along with proposals for the maximum permitted income (IMP) that, pursuant to applicable law, they are allowed to receive. The latter proposal is subject to public comment and input, prior to ASEP issuing a decision on said proposal. The current rate schedule entered into force in 2014, and thus expires later this year.