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SHEBERGHAN GAS FIELD DEVELOPMENT PROJECT (SGFDP)

LEGAL AND REGULATORY ANALYSIS REPORT

March 31, 2011

Sheberghan Gas Field Development Project (SGFDP)
USAID Contractor



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ABBREVIATIONS AND ACRONYMS

ACD	Afghan Customs Department
AEAI	Advanced Engineering Associates International
AEIC	Afghanistan Energy Information Center
AERA	Afghanistan Electricity Regulatory Agency
AGE	Afghan Gas Enterprise
AIBA	Afghan Independent Bar Association
ANDS	Afghan National Development Strategy
ANSA	Afghanistan National Standards Authority
APPF	Afghan Personal Protection Force
ARTF	Afghanistan Reconstruction Trust Fund
ASYCUDA	Automated System for Customs Data
BRT	Business Receipts Tax
	Da Afghanistan Breshna Moasesa (replaced by DABS)
DABM	
DABS	Da Afghanistan Breshna Sherkat
EID Cluster	Economic and Infrastructure Development Cluster
EPSC	Exploration and Production Sharing Contract
GoIRA	Government of the Islamic Republic of Afghanistan
GSPA	Gas Supply and Purchase Agreement
	International Centre for Settlement of Investment Disputes
ICSID	
IPP	Independent Power Producer
ISAF	International Security Assistance Force
kW	Kilowatt
LRAR	Legal and Regulatory Analysis Report
MCM	Thousand Cubic Meters (Natural Gas)
MEW	Ministry of Energy and Water
MMCM	Million Cubic Meters (Natural Gas)
MoF	Ministry of Finance
MoM	Ministry of Mines
MoU	Memorandum of Understanding
MRRD	Ministry of Rural Rehabilitation and Development
MW	Megawatt
NATO	North Atlantic Treaty Organization
NEPA	National Environmental Protection Agency
NEPS	Northeast Power System
N-ESP	National Energy Supply Program
NHU	Northern Directorate of the Hydrocarbon Unit
PFEML	Public Finance and Expenditure Management Law
PPA	Power Purchase Agreement
PPU	Procurement Policy Unit
PSC	Private Security Company
SEPS	Southeast Power System

SGFDP	Sheberghan Gas Field Development Project
SPSC	Service and Production Sharing Contract
U.S.-NEPA	United States National Environmental Policy Act
UNCITRAL	United Nations Commission on International Trade Law
USAID	United States Agency for International Development

I. EXECUTIVE SUMMARY

The Sheberghan Gas Field Development Project (SGFDP) has been tasked by the United States Agency for International Development (USAID) under amended contract EPP-I-10-03-00004-00 with developing a roadmap for the feasibility of a 200 megawatt (MW) gas-fired power plant, based on an Independent Power Producer (IPP) model, near the City of Sheberghan in Jowzjan Province, Afghanistan. This document, the Legal and Regulatory Analysis Report (LRAR) is Deliverable No. 12 under the contract. The LRAR is prepared as an overview document of the existing laws and regulations, not in response to specific legal questions concerning any particular aspect of the IPP transaction.

The Legal and Regulatory Analysis Report (LRAR) was developed to introduce and analyze the existing legal framework in Afghanistan and to identify potential issues under the law that may affect the proposed IPP transaction. It was prepared using English translations of Afghan Laws, and should be used with some degree of caution based on that. Official Afghan laws are in Dari or Pashto, and those versions should be consulted for authoritative answers to specific legal questions.

The focus of the LRAR is the transaction between the private investors in the IPP gas-fired power plant and the Afghan Government. Under the current understanding of the transaction, the Sheberghan IPP would purchase or otherwise acquire natural gas from the Ministry of Mines through Afghan Gas Enterprise to fuel a 200 MW power plant under a to-be-negotiated Gas Supply and Purchase Agreement (GSPA). This gas is to be sourced from the Juma/Bashikurd gas fields near Sheberghan, but the gas contains high concentrations of carbon dioxide and hydrogen sulfide, as well as other contaminants, and must be processed prior to delivery to the power plant. Studies by AEAI and Gustavson Associates have demonstrated that sufficient reserves exist in the field to fuel the power plant for its anticipated 30 year operating life. The electricity produced by the IPP will be purchased by Da Afghanistan Breshna Sherkat (DABS) under a to-be-negotiated Power Purchase Agreement (PPA), containing a sovereign guarantee from the Government of the Islamic Republic of Afghanistan (GoIRA) to support payment by DABS. The electricity will then be transmitted through the North East Power System (NEPS) to Kabul and perhaps beyond to the South East Power System (SEPS).

Country & Governmental Analysis

Afghanistan is a Constitutional Republic with a President, a National Assembly made up of the House of People and the House of Elders, a Government comprised of Ministers and an independent Supreme Court. Afghanistan also has a provision in their Constitution for the *Loya Jirga*, a supra-national body made of influential decision-makers, tribal elders, and district and provincial representatives that holds a special place in Afghan governance. The court system appears functional on paper, but is replaced in many provinces by more informal tribal justice systems. The Afghan government, and particularly the court system, is rife with corruption, in some cases almost to the point of complete ineffectiveness. The justice system is not reliable and does not hold the trust of the people. Further, the laws of Afghanistan

are often poorly drafted and contain gaps that create ambiguity and uncertainty for investors. The lack of a credible justice system and the incomplete status of many of the laws require a strong dispute resolution clause in any contract that is concluded with Afghan government agencies or private enterprises. Investment in Afghanistan is accompanied by high risk, making risk management strategies paramount among business considerations.

Fuel Supply Issues

Afghanistan's Hydrocarbons Law and Hydrocarbon Regulations were written specifically with private investment in mind, so much so that only four types of contracts are recognized in the law. However, the laws are generally well written, and the emphasis on the production sharing aspects should be considered as a potential benefit to the IPP investor, as it suggests that once a stable market for natural gas is developed, private investment may flow into the gas fields as well. The Ministry of Mines and Afghan Gas Enterprise, the state-owned gas company, are anticipated to be the providers of natural gas to the IPP and the counter-party to the Gas Supply and Purchase Agreement. There were a few recommendations to address contracting issues, but overall there is nothing in the Hydrocarbons Law or Hydrocarbon Regulations that would create any difficulties in the fuel supply for the proposed IPP.

Construction, Land & Water Issues

The Customs Law in Afghanistan will be important during the construction and operations and maintenance phases of the IPP operations. The IPP will need to import equipment and goods in significant amounts and of significant value, and will benefit from the relatively low tariffs in Afghanistan. However, the IPP must be mindful of the problems described, be prepared and include the potential for customs delays in its planning, should use licensed brokers, and pay particular attention to the necessary paperwork to minimize delays.

The Procurement Law and Procurement Regulations become very important, particularly given that DABS is a state-owned electric company. The answer to the question of whether the purchase of electric power and capacity by DABS from the IPP falls within the Procurement Law and its procurement procedures is clearly answered yes, if the Regulations are considered. The issue is more problematic if only the Law is relied upon. No legislative or regulatory history has been accessible as a guide on the matter, however, if the IPP wishes to press the issue, they could request or try to persuade DABS or MEW to request an opinion from the Attorney General's office. The second prong of the primary question asks if the transaction between DABS and the IPP is within the law, what procurement methods may be used for the purchase. The answer appears to be: certainly all of them, if the investors are willing to go through a tender. However, given the constraints entailed in working in Afghanistan, the complexity of the project, the integration of the current infrastructure projects required, and the complicated financing arrangement involved, an argument can be made that the project qualifies for the single source financing method, if DABS agrees. Further, since the project would exceed the threshold value of the award authority, it would have to be approved by the Special Procurement Commission. Unless the investors can demonstrate that they are the only source

capable of providing the required service, primarily resulting from their possession of intellectual property, trade secrets or other exclusive rights, they will likely not qualify for a negotiated contract under the negotiated contract without competition or the non-solicited proposal provisions of Annex 6-1 of the Regulations. But if the investors are willing to submit a proposal and wait to see if the procurement process fails at an early stage, without likelihood of an award, a negotiated contract may be possible under the provisions of Annex 6-1. Even with a negotiated contract, if the entity must use one of the types of contracts set out in the Regulations, it may not fit the needs and its provisions limited in an unsatisfactory manner.

Proving land ownership in Afghanistan is very difficult, as the general literacy of the populations is very low, and 30 years of civil war and conflict have destroyed property records and land titles. The Sheberghan Gas Field Development Project and the Ministry of Mines have had direct correspondence regarding the status and ownership of the land for the proposed IPP. The SGFDP team received an official letter from the Deputy Minister of Mines which stated in relevant part: the area surrounding the Garquduq gas field, including your proposed site for the IPP, belongs to Afghan Gas Enterprise, and is accordingly considered property of the Government.¹ Since this information comes from the Deputy Minister of Mines, and after reviewing the project site during subsequent field visits, the SGFDP team is proceeding on the assumption that the proposed project site belongs to the Afghan Government and there are no further property ownership claims or issues that would adversely impact the IPP transaction.

Access to water is a small portion of the overall project, but will be an important consideration in whether to develop the IPP as a single cycle or a combined cycle configuration. The Afghan Water Law is vague and ambiguous on many points, including the issuing authority for the groundwater permits, which could either be the Ministry of Energy and Water or the Ministry of Mines. However, the Water Law appears to contain sufficient protections for large water users, such as a power plant, in the form of councils that enforce water usage to ensure that the interests and needs of the power plant are met. In terms of the amounts of water, there appears to be more than enough water in a nearby aquifer system to support the IPP, meaning that water conflicts are unlikely.

Corporate Issues

AISA and the Private Investment Law do seem to have made it easier to start a business in Afghanistan. According to the World Bank's "Doing Business in Afghanistan 2011"² Afghanistan ranked 25 out of 183 countries on ease of starting a business, involving only four steps and seven days on average. While this may be a reflection of the effects of the Law in the area of starting a business, it can be misleading. Afghanistan was also ranked 167 out of 183 economies in the ease of doing business and 183 out of 183 in the categories of protecting investors, trading across borders, and closing a business.

¹ Translated correspondence between the SGFDP and Deputy Minister of Mines, Dep. Engr. Akram "Ghyasy" dated March 31, 2010.

² "Doing Business in Afghanistan 2011," World Bank, Retrieved 2011-3-28.

Unless otherwise provided, the Private Investment Law expressly prohibits discrimination against foreign investors, and all natural or legal persons, foreign or domestic, may invest in all sectors of the economy with certain exceptions. Investments involving nuclear power, gambling, or production of narcotics or other intoxicants are prohibited. More importantly, investment in certain sectors is restricted. As to those sectors, the Commission must consult with the relevant ministries, and approve investments in such sectors on a case-by-case basis with the consent of such ministries. And the Commission may apply terms to such investments that are different than those commonly applied. Natural Resources and infrastructure, which includes power generation or transmission facilities, are among the restricted sectors, until special laws have been promulgated that are applicable to such investments, after which the special laws will govern. For this reason the draft Electricity Law includes provisions important to investors very similar to those in the Private Investment Law.

At this time, it is not anticipated that the corporation that will be responsible for building and constructing the IPP will be registered as an Afghan corporation, therefore this Law would not apply. The laws that would apply to the anticipated joint venture between the investors would be either the laws of the state or country where the joint venture is incorporated or another law as specified in the joint venture agreement. However, the corporation will still need to acquire a license from AISA. The procedures for acquiring an AISA license are attached as Appendix C.

Operational Issues

One of the key issues for investors in and IPP transaction in Afghanistan is the existence, or lack thereof, of a legal regime for electricity regulation. There is nothing in Afghan law to prohibit the operation of IPPs, but that is mainly because there is no law that directly governs the sector. A draft Electricity Law is in preparation and still undergoing changes. The rules of the game, therefore, are uncertain. The electricity sector currently is largely self-regulated by the two main players in the electricity sector: MEW, the ministry with responsibility for the sector, and DABS, the wholly state-owned corporatized utility formed from DABM, the former utility arm of MEW. DABS is now to operate on a commercial basis. This is not an easy recalibration, since capacity in DABS is low, as are collections, and losses are high, although the situation is rapidly improving with USAID's help. Yet, as has been discussed, under the MOU of 30 September 2009, the MEW has retained responsibility for planning, designing, and constructing new generation and transmission infrastructure, which DABS is to manage and maintain. A non-commercial decision concerning construction of electricity infrastructure made by MEW can affect the ability of DABS to gain commercial status, which creates tension. To complicate matters, the MRRD is responsible for rural electrification, and has taken the lead in the development of renewable energy by virtue of its efforts in the area of non-grid sources of power. Accordingly, there are overlaps and gaps in assumed authority, and a need for significant realignment and clarification of responsibilities in the sector. But significant change predictably leads to significant resistance.

Given the legal vacuum and the limited access to power, particularly in rural areas, there are numerous small micro hydro facilities and diesel generators that generate and distribute electricity. Many are community-owned but some are privately-owned.

Private ownership of generation facilities is not a new concept. But with the proposed Sheberghan generation facility, everything else is, from the purchaser – DABS – which is still a monopoly, to the contracting, to the financing, to the scale on which the plant will operate. In the absence of law and regulations and lack of effective, predictable governance, investors in the IPP should attempt to build their own regulatory regime through their contractual arrangements.

The Income Tax Law is based on the income tax law of the United States and adapted to Afghanistan. It applies a flat tax rate to corporations and LLCs, while adopting a progressive tax on the income of natural persons, with tax rates that are reasonable by regional standards. Overall, it represents a modern and relatively simplified taxation system that should appeal to investors. The IPP investors should, and presumably will, work with the Ministry of Finance to pursue the opportunities for exemption from income taxes, as well as customs duties and taxes for a period of time.

The Environment Law in Afghanistan bears many similarities to the U.S.-NEPA process. An American corporation that is familiar and has experience with the U.S.-NEPA process should have little or no trouble operating in Afghanistan. Unfortunately, as with many of the laws in Afghanistan, what is written on paper for the law and what is actually enforced by the government agents do not always match. The overall condition of the environment in Afghanistan is poor and actual enforcement of the terms of the Environment Law is spotty and inconsistent at best. However, the presence of the supremacy clause in the Environment Law and the way it has attempted to integrate itself into the decision-making processes of the ministries creates a risk that not following the law could have major consequences for an individual and/or company should the Law be enforced to the letter.

Security Issues

The security situation in Afghanistan has been well documented by worldwide media reports. Recent reports regarding the security situation in Jowzjan Province, the proposed site of the IPP, suggest that it has been one of the most secure and relatively peaceful provinces in Afghanistan. However, the insurgency situation in Afghanistan is continually evolving and areas of relative peace cannot be automatically assumed to continue. As a key component of critical infrastructure, the power plant will certainly need some form of security for the installation and infrastructure associated with the plant.

On March 21, 2011, the United States Ambassador to Afghanistan, Karl Eikenberry, released the “Bridging Strategy for Implementation of Presidential Decree 62.”³ The Bridging Strategy outlines a one year plan for transitioning from private security companies to an “Afghan Public Protection Force” or APPF.⁴ Under this strategy, Afghan employees of existing private security companies will be incorporated into the APPF and all private security companies will be dissolved by March 20, 2012.⁵ With the implementation of Presidential Decree No. 62, a private company

³ The Bridging Strategy for Implementation of Presidential Decree 62 (Dissolution of Private Security Companies) Bridging Period March 22, 2011 to March 20, 2012.

⁴ Id.

⁵ Id.

developing a power plant will need to have an arrangement with the Afghan government or ISAF, or both, to provide security for the construction, and completed installation, as it will be impossible to rely on private security after March 20, 2012.

As the security situation in Afghanistan continues to evolve, and ISAF forces begin to scale down their involvement in counter-insurgency efforts, there is a risk that the costs of securing the power plant and related infrastructure will increase substantially. Such security costs could impact the ultimate profitability of the investment, particularly if other key pieces of infrastructure in the gas fields and power transmission systems are impacted by deteriorating security and insurgent activity. At the very least, the provision of security for the project will have to be studied more to reflect the changing circumstances and regulations in Afghanistan.

II. INTRODUCTION

The Sheberghan Gas Field Development Project (SGFDP) has been tasked by the United States Agency for International Development (USAID) under amended contract EPP-I-10-03-00004-00 with developing a roadmap for the feasibility of a 200 megawatt (MW) gas-fired power plant, based on an Independent Power Producer (IPP) model, near the City of Sheberghan in Jowzjan Province, Afghanistan. This document, the Legal and Regulatory Analysis Report (LRAR) is Deliverable No. 12 under the contract. The LRAR is prepared as an overview document of the existing laws and regulations, not in response to specific legal questions concerning any particular aspect of the IPP transaction.

The LRAR was developed to assess the legal and regulatory framework in Afghanistan that will affect the development of a 200MW gas fired power plant in the form of an IPP utilizing natural gas from the proven gas fields surrounding Sheberghan, Afghanistan. The LRAR is designed to:

- Provide information on the existing legal and regulatory framework
- Provide analysis of commercial considerations
- Analyze and review several key laws and regulations, including the Hydrocarbons Law, Hydrocarbon Regulations, the draft Electricity Law, the Law on Private Investment and the Environment Law.

The LRAR covers some commercial matters, including land acquisition, taxation, and some aspects of investment protection, but focuses primarily on the legal and regulatory aspects of the IPP transaction. Each section of the report contains both a summary and analysis of the laws and regulations, and how the laws and regulations will affect the IPP transaction. The report also contains recommendations, where necessary, regarding potential changes to the law or regulations in order to clarify or facilitate the IPP transaction.

The Legal and Regulatory Analysis Report – The IPP Transaction

The focus of the LRAR is the transaction between the private investors in the IPP gas-fired power plant and the Afghan Government. Under the current understanding of the transaction, the Sheberghan IPP would purchase or otherwise acquire natural gas from the Ministry of Mines through Afghan Gas Enterprise to fuel a 200 MW power plant under a to-be-negotiated Gas Supply and Purchase Agreement (GSPA). This gas is to be sourced from the Juma/Bashikurd gas fields near Sheberghan, but the gas contains high concentrations of carbon dioxide and hydrogen sulfide, as well as other contaminants, and must be processed prior to delivery to the power plant. Studies by AEAI and Gustavson Associates have demonstrated that sufficient reserves exist in the field to fuel the power plant for its anticipated 30 year operating life. The electricity produced by the IPP will be purchased by Da Afghanistan Breshna Sherkat (DABS) under a to-be-negotiated Power Purchase Agreement (PPA), containing a sovereign guarantee from the Government of the Islamic Republic of Afghanistan (GoIRA) to support payment by DABS. The electricity will

then be transmitted through the North East Power System (NEPS) to Kabul and perhaps beyond to the South East Power System (SEPS).

The LRAR is focused on the specific laws that will affect the construction and operation of the IPP. These include:

- The Hydrocarbons Law & Hydrocarbon Regulations
- The Customs Law & Customs Regulations
- The Procurement Law & Procurement Regulations
- The Corporation and Limited Liability Companies Law
- The Law on Private Investment
- The Draft Electricity Law
- The Income Tax Law
- The Environment Law
- The Constitution of the Islamic Republic of Afghanistan
- The Law on Organization and Jurisdiction of the Courts of the Islamic Republic of Afghanistan
- The Advocates' Law
- The Public Finance and Expenditure Management Law
- The Water Law

The LRAR also included discussions on land lease and acquisition and security, specifically the Bridging Strategy and the current situation regarding the use of private security companies.

Each of these laws is discussed to a greater or lesser extent, depending on its overall impact on the construction and operation of the IPP.

The Legal and Regulatory Analysis Report – Important Disclaimers

In preparing the LRAR, the authors relied on unofficial English translations of the laws and regulations, not the official versions of the laws and regulations. The official versions of the laws of Afghanistan are in either Dari or Pashto, the two national languages of Afghanistan. Every attempt has been made to ensure the accuracy of the translation of the documents. However, for the purposes of making legal conclusions and opinions based on the law, it will be necessary to refer to the Dari or Pashto versions of the law to ensure accuracy.

The authors reviewed the laws in an attempt to describe the existing legal framework and identify potential problems and issues in an IPP transaction in Afghanistan. This report should be viewed as background material and as a reference guide only. It is not a substitute for legal advice regarding an IPP transaction in Afghanistan. Anyone attempting to develop an IPP in Afghanistan should consult with an attorney licensed to practice in Afghanistan regarding the transaction.

III. COUNTRY & GOVERNMENTAL ANALYSIS

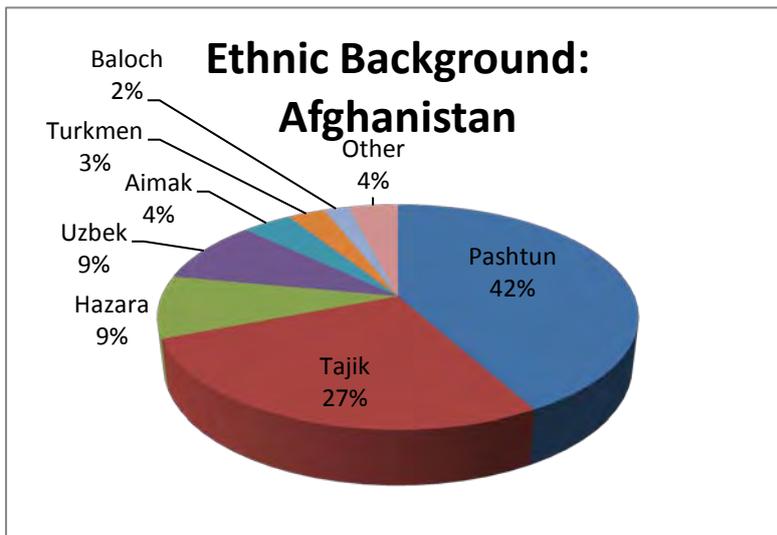
A. Afghanistan – Generally

Afghanistan is located in Central Asia and shares borders with Turkmenistan, Uzbekistan, Tajikistan, Pakistan, Iran, and a very small border with China in the east. The country is approximately 652,000 square kilometers, or slightly smaller than the American state of Texas.⁶ Afghanistan is composed of 34 provinces. The most recent population estimate is 29,835,392, though the number is likely to be revised once a formal census is complete sometime in 2011.⁷ The official languages are Dari (Afghan Persian) and Pashto, with several other languages and dialects from surrounding Central Asian neighbors.⁸ Afghanistan is comprised of many ethnic groups including Pashtuns, Tajiks, Hazaras, and Uzbeks.⁹ The ethnic breakdown is shown in Figure 1. The ethnic breakdown is shown in Figure 1. Afghan are roughly 80 percent Sunni Muslims and 20 percent Shi'a Muslims.¹⁰



1. Afghans are roughly 80

The literacy rate, based on persons above the age of 15 that can read and write is approximately 28.1 percent of the total population.¹¹ Of that number, the literacy rate for men is 43 percent, while the rate for women is 12.5 percent.¹² Life expectancy for Afghans is listed at 45, though the number may be slightly skewed by the high infant mortality rates in Afghanistan.¹³ The low literacy rate poses special challenges for advanced technology projects in Afghanistan. Following 30



years of foreign occupation and civil war, Afghans have had little experience with constructing and operating large scale power systems and natural resource development. These factors are important to take into account when developing a power or natural resource project in Afghanistan. However, with the proper training,

⁶ World Factbook: South Asia: Afghanistan. U.S. Central Intelligence Agency.

<https://www.cia.gov/library/publications/the-world-factbook/geos/af.html>. Last accessed: 21 March 2011.

⁷ Id.

⁸ Id.

⁹ Id.

¹⁰ Id.

¹¹ Id.

¹² Id.

¹³ Id.

Afghans are generally very quick to pick up information and are capable of constructing and operating advanced technology facilities.

B. The Constitution of the Islamic Republic of Afghanistan

The Constitution of the Islamic Republic of Afghanistan was ratified on January 26, 2004. The Constitution establishes the State of Afghanistan and proclaims its respect for the human rights of its citizens, attainment of national unity, equality of peoples and tribes, and balanced development of the state.¹⁴ The Constitution establishes a governmental structure with an executive branch, a legislative branch, a judicial branch and special provisions for the Loya Jirga, a council unique to Afghanistan's ethnic Pashtuns, comprised of government officials, provincial representatives and tribal elders.¹⁵ Each of these elements is described in more detail below.

The Constitution establishes Dari and Pashto as the official languages of the state.¹⁶ All laws, decrees and regulations are published in Dari and Pashto. The English translations developed to assist aid workers and development organizations are not official and great care should be used when relying on translated texts of laws and regulations. Under the Constitution, no law can contravene the tenants and provisions of the holy religion of Islam in Afghanistan.¹⁷ This provision is extremely important, as it creates a superseding law above the laws of Afghanistan. Therefore, a law must be both within the bounds of the Constitution and must not violate any provisions of Islam in order to be held valid.

The President

The President of Afghanistan is the head of state of the Islamic Republic of Afghanistan.¹⁸ The President has a first vice president and second vice president.¹⁹ The President is elected by a majority vote in direct, national elections.²⁰ The most recent election was in 2009, when President Hamid Karzai was re-elected for his second five year term. President Karzai's second term will expire in 2014. The Presidential term is five years, and no person may serve more than two terms as either the President or one of the vice presidents.²¹ According to the Afghan Constitution, the following are qualifications for the President: 1) a citizen of Afghanistan, Muslim, born of Afghan parents and not a citizen of another country; 2) have attained the age of forty on the day of candidacy; and 3) must not be convicted of crimes against humanity, other criminal act or be deprived of civil rights by a court.²² The President is given broad power and authority under the Constitution, though many of the important decisions require "endorsement" by the House of

¹⁴ Chapter 1, Article 6, The Constitution of the Islamic Republic of Afghanistan.

¹⁵ See Generally Chapter 3, *The President*; Chapter 5, *The National Assembly*; Chapter 6, *The Loya Jirga*; Chapter 7, *The Judiciary*.

¹⁶ Chapter 1, Article 16.

¹⁷ Chapter 1, Article 3.

¹⁸ Chapter 3, Article 60.

¹⁹ *Id.*

²⁰ Chapter 3, Article 61.

²¹ Chapter 3, Article 61; Article 62.

²² Chapter 3, Article 62.

People.²³ These powers include serving as the Commander-in-Chief of the military, appointing ministers, endorsing laws and judicial decrees, signing treaties and agreements and supervising the implementation of the Constitution, among others.²⁴ The President can call a referendum on important national issues, as long as it is not contrary to the Constitution or require its amendment.²⁵

The National Assembly

The National Assembly of Afghanistan is a bicameral legislature comprised of the House of People and the House of Elders.²⁶ The National Assembly has traditional legislative powers, approval authority over development programs and the state budget, creation or modification of administrative units and ratification of international treaties or agreements, among others.²⁷ Laws proposed by the government originate in the House of People, including budgetary and financial affairs.²⁸ Once approved, the proposed law is sent to the House of Elders, which has fifteen days to accept or reject the proposed law.²⁹ Ten members of either of the two houses can sponsor a proposed law, and it is placed on the work agenda after approval of one fifth of the house where it originated.³⁰ A law must be approved by both houses of the National Assembly and signed by the President, unless stated otherwise in the Constitution.³¹ The National Assembly can override a Presidential veto by a two-thirds vote.³² The annual term of the National Assembly is nine months, and extraordinary sessions can be called by Presidential Order.³³

Members of the House of People are elected directly by the people to five year terms.³⁴ The most recent election was in September 2010 and the new House of People was inaugurated in February 2011. The House of People is proportionate to the population of each constituency and capped at two hundred and fifty individuals.³⁵ The qualifications for the House of People are as follows: 1) a citizen of Afghanistan for at least ten years; 2) no criminal history; and 3) be twenty five years old on the day of candidacy.³⁶ The House of People has three powers in addition to the general powers of the National Assembly: 1) no-confidence voting for ministers; 2) decide on development programs and the state budget; and 3) approve or reject appointments.³⁷

Members of the House of Elders are both elected and appointed as follows: 1) one individual from each of the provincial councils elected for a four year term; 2) one individual from each of the district councils of each province elected for a three year

²³ See Chapter 3, Article 64.

²⁴ *Id.*

²⁵ Chapter 3, Article 65.

²⁶ Chapter 5, Article 83.

²⁷ Chapter 5, Article 89.

²⁸ Chapter 5, Article 97.

²⁹ *Id.*

³⁰ *Id.*

³¹ Chapter 5, Article 94.

³² *Id.*

³³ Chapter 5, Article 107.

³⁴ Chapter 5, Article 83.

³⁵ *Id.*

³⁶ Chapter 5, Article 85.

³⁷ Chapter 5, Article 91.

term; and 3) the remaining third is appointed by the President for five year terms from experts and “experienced personalities,” and must include two nomads and two members from the impaired and handicapped.³⁸ Fifty percent of the presidential appointments must be women and no person can serve in the House of Elders and on the provincial or district council concurrently.³⁹ Members of the House of Elders must meet the same qualification requirements as the House of People, except that they should be thirty five years old on the day of candidacy.⁴⁰

The Judiciary

The judiciary is comprised of one Supreme Court, several Courts of Appeal and several Primary Courts whose jurisdiction is regulated by law.⁴¹ The Supreme Court is comprised of nine members, appointed by the President and approved by the House of People.⁴² The members of the Supreme Court are appointed for a single ten year term.⁴³ Supreme Court members must have the following qualifications: 1) forty years of age; 2) a citizen of Afghanistan; 3) higher education in legal studies or Islamic jurisprudence and expertise and experience in the judicial system of Afghanistan; 4) good character and reputation; 5) no criminal history; and 6) not affiliated with a political party during their term.⁴⁴

The Supreme Court has the power of judicial review, if requested by the government or courts, to determine their compliance with the Constitution and their interpretation.⁴⁵ The Court is obliged by the Constitution to state the reasons for its verdict and their final decisions shall be enforced, though capital punishment cases require Presidential approval.⁴⁶ The courts must apply the provisions of the Constitution and other laws.⁴⁷ If there is no provision on point, the court, “in pursuance of Hanafi jurisprudence⁴⁸,” rule in a way that does not violate the Constitution and attains justice in the best manner.⁴⁹ Interestingly, the Constitution also allows the courts to apply Shia jurisprudence in cases involving personal matters, or any other cases if not precluded by the Constitution or other laws, of a member of the Shia sect.⁵⁰ Lower court judges are appointed by the Supreme Court, subject to the approval of the President.⁵¹

³⁸ Chapter 5, Article 84.

³⁹ *Id.*

⁴⁰ Chapter 5, Article 85.

⁴¹ Chapter 7, Article 116.

⁴² Chapter 7, Article 117.

⁴³ *Id.*

⁴⁴ Chapter 7, Article 118.

⁴⁵ Chapter 7, Article 121.

⁴⁶ Chapter 7, Article 129.

⁴⁷ Chapter 7, Article 130.

⁴⁸ “Hanafi jurisprudence” refers to the Hanafi School of Law, one of the four main schools of interpretation of Islamic Law. The Hanafi School has the largest following among the Sunni Muslims, and is considered to be the most humanitarian regarding non-Muslims and its penal law is more lenient than the other three schools.

⁴⁹ Chapter 7, Article 130.

⁵⁰ Chapter 7, Article 131.

⁵¹ Chapter 7, Article 132.

The Loya Jirga

The “Loya Jirga” is a translation of “big council,” using the Pashto word for “big” and Dari word for “council.” It is a holdover of the tribal decision-making process and is a primarily Pashtun tradition, practiced in Afghanistan and some parts of Pakistan. According to the Constitution of Afghanistan: “[T]he Loya Jirga is the highest manifestation of the will of the people of Afghanistan.”⁵² The Loya Jirga consists of members of the National Assembly and presidents of the provincial and district assemblies.⁵³ Ministers, the Chief Justice and Members of the Supreme Court, and the attorney general participate in the Loya Jirga without voting rights.⁵⁴

The Loya Jirga can convene in only three circumstances: 1) to decide on issues related to independence, national sovereignty, territorial integrity and supreme national interests; 2) to amend the Constitution; and 3) to impeach the President.⁵⁵ The decisions of the Loya Jirga are adopted by a majority of members, except as stated otherwise by the Constitution.⁵⁶ While not explicitly mentioned in the Constitution, both traditionally and culturally decisions made by the Loya Jirga are considered final and binding on the government and the people of Afghanistan.

A Special Note on Islam

Foreign businesses doing work in Afghanistan should be mindful of the role of Islam in Afghan society. The Afghan Constitution explicitly states: “No law shall contravene the tenants and provisions of the holy religion of Islam in Afghanistan.”⁵⁷ Afghanistan follows the Hanafi school of Islamic jurisprudence, again according to its Constitution.⁵⁸ Afghanistan generally follows the civil law traditions of many of its northern neighbors, but includes the Shari’ah law where relevant. In addition, after the removal of the Taliban by NATO forces in 2001, foreign aid workers from traditionally civil law countries like Germany and France, and common law countries like the U.K. and U.S., began working with the Afghan Government officials on laws and regulations to facilitate Afghanistan’s entry into the global marketplace. Understandably, these individuals brought their respective legal influences with them and have created a state where some laws appear to be civil in nature, while others tend to be closer to the common law tradition. However, the influence of the Shari’ah can be seen and felt in many aspects of day to day life in Afghanistan.

Many women still wear the traditional burqa and calls to prayer can be heard from the mosques throughout the cities and items like alcohol are forbidden. The influence of Islam can also be keenly felt in business transactions. Islamic financing, that is financial operations compliant with the Shari’ah, is a fast growing business in the Middle East and Southeast Asia. For example, Islam prohibits the charging of interest on loans, though banks and financial institutions have been able to find ways around the prohibition. Investments should also be socially responsible and

⁵² Chapter 6, Article 110.

⁵³ Id.

⁵⁴ Id.

⁵⁵ Chapter 6, Article 111.

⁵⁶ Chapter 6, Article 113.

⁵⁷ Chapter 1, Article 3.

⁵⁸ See supra, note 44.

companies should not engage in the aggressive business practices more typical in the West. While Afghanistan generally does not follow the more fundamentalist interpretation of Islam practiced elsewhere, at least in the current social and political situation, foreign companies should be prepared for the differences in both the cultural and business practices that arise from Afghanistan's Islamic traditions.

C. Key Ministries Involved in the Sheberghan Gas Field Development Project

As stated earlier, the goal of USAID's Sheberghan Gas Field Development Project is to provide a roadmap for the development of the Sheberghan gas fields and a 200 MW gas-fired thermal power plant. There are several ministries that will play a substantial role in this transaction, including the Ministry of Mines (MoM), the Ministry of Energy and Water (MEW), the Ministry of Finance (MoF) and the National Environmental Protection Agency (NEPA). In addition to the Ministries, the Da Afghanistan Breshna Sherkat (DABS), the state-owned, corporatized, electric utility will play a large role in the power plant transaction as the purchaser, transmitter and distributor of the electric power. The relevant powers, authorities, structures and potential impacts of the entities on the gas development and IPP process are discussed below.

The Ministry of Mines

The Ministry of Mines receives its authority to regulate mining and hydrocarbon activities from three sources. The first is the Afghan Constitution, which states: "Mines and other subterranean resources shall be the property of the state. Protection, management and proper utilization of public properties as well as natural resources shall be regulated by law."⁵⁹ The second is the Minerals Law, which was enacted pursuant to the Constitutional provision. The third is the Hydrocarbon Law, also enacted pursuant to the Constitutional provision. The Afghan Constitution establishes the authority for the state to regulate the hydrocarbons and minerals in Afghanistan, and the related laws outline the specific duties and powers of the Ministry of Mines to regulate minerals and hydrocarbons in Afghanistan.

Under the Minerals Law, the Ministry of Mines is responsible for the formulation and implementation of policies relating to minerals development in Afghanistan, the issuance of licenses and establishment of rights and obligations under those licenses, the announcement and arrangements for bidding processes, and determination of the royalty rate of minerals and ensuring its proper collection, among others.⁶⁰ The Minerals Law defines a mineral as: "[Mineral] means any chemical element forming a naturally-occurring substance, simple or complex, inorganic or organic, in solid or gaseous states; or as solution in water."⁶¹ According to the Minerals Law, mineral operations shall be conducted by the State, or by a person who receives a license or authorization from the Ministry of Mines.⁶² The Minerals Law also creates an Inter-Ministerial Commission for the following four purposes: 1) to monitor bidding of small and medium scale mining contracts; 2)

⁵⁹ Chapter 1, Article 9. Constitution of the Islamic Republic of Afghanistan.

⁶⁰ See Chapter 2, Article 6. The Minerals Law of Afghanistan. 2010.

⁶¹ Chapter 1, Article 3: Definitions. The Minerals Law of Afghanistan. 2010.

⁶² Chapter 1, Article 4: Ownership of Minerals.

approve medium scale mining contracts; 3) grant exemptions from surface rentals; and 4) approve the royalty rate as established under the Minerals Law.⁶³ The Inter-Ministerial Commission is composed of: 1) the Minister of Mines (Chair); 2) the Minister of Finance (vice-chair); 3) the Minister of Economy; 4) the Minister of Commerce; 5) the Minister of Foreign Affairs; 6) the President of the National Environmental Protection Agency.⁶⁴ Within the Ministry of Mines, the Mining Cadastre is responsible for the issuance of Mineral Certificates as evidence of Mineral Rights, the collection of fees and rentals, collection of maps showing Mineral Rights and registration of security interests on Mineral Rights and mining assets.⁶⁵ The Minerals Law is not directly related to the transaction involving the IPP or even gas field development as described above. However, the Minerals Law is important to understanding the role and sources of authority for the Ministry of Mines.

In addition to the Minerals Law, the Ministry of Mines also derives its authority from the Afghan Hydrocarbon Law. Under the Afghan Hydrocarbon Law, the Ministry of Mines is responsible for the formulation of policies, including the promotion of private investment, relating to hydrocarbon operations, monitoring of hydrocarbon operations, to stipulate surface rentals and initial royalties for hydrocarbon operations, and to propose areas of operation to the Inter-Ministerial Commission for hydrocarbon development, among others.⁶⁶ The composition of the Inter-Ministerial Commission is the same in the Hydrocarbon Law as it is for the Minerals Law.⁶⁷ The Inter-Ministerial Commission has the authority to: 1) monitor the bid process and award of contracts; 2) evaluate draft contracts prepared by the Ministry of Mines; 3) make decisions on signing contracts by the Minister of Mines; and 4) endorse other related issues which need approval by the Inter-Ministerial Commission.⁶⁸ All hydrocarbons located on or under the ground in Afghanistan are the property of the state, and the Ministry of Mines is responsible for granting licenses for hydrocarbon operations under the Hydrocarbon Law.⁶⁹ The Hydrocarbon Law was primarily written with private development of hydrocarbon resources in mind, and contains no mention of an organization like the Mining Cadastre, nor does it contain any mention of Afghan Gas Enterprise, the branch of the Ministry of Mines responsible for natural gas development. The Ministry of Mines does have a Hydrocarbon Department that is responsible for coordination and implementation of the Hydrocarbon Law and Hydrocarbon Regulations, though the latter remain in draft form awaiting the signature of the Minister of Mines.

Below is the organizational chart showing the structure of the Ministry of Mines.

⁶³ Chapter 2, Article 7: Inter-Ministerial Commission, subpoint (1). The Minerals Law of Afghanistan. 2010.

⁶⁴ Id. at subpoint (2).

⁶⁵ Chapter 2, Article 8: Mining Cadastre. Minerals Law of Afghanistan. 2010.

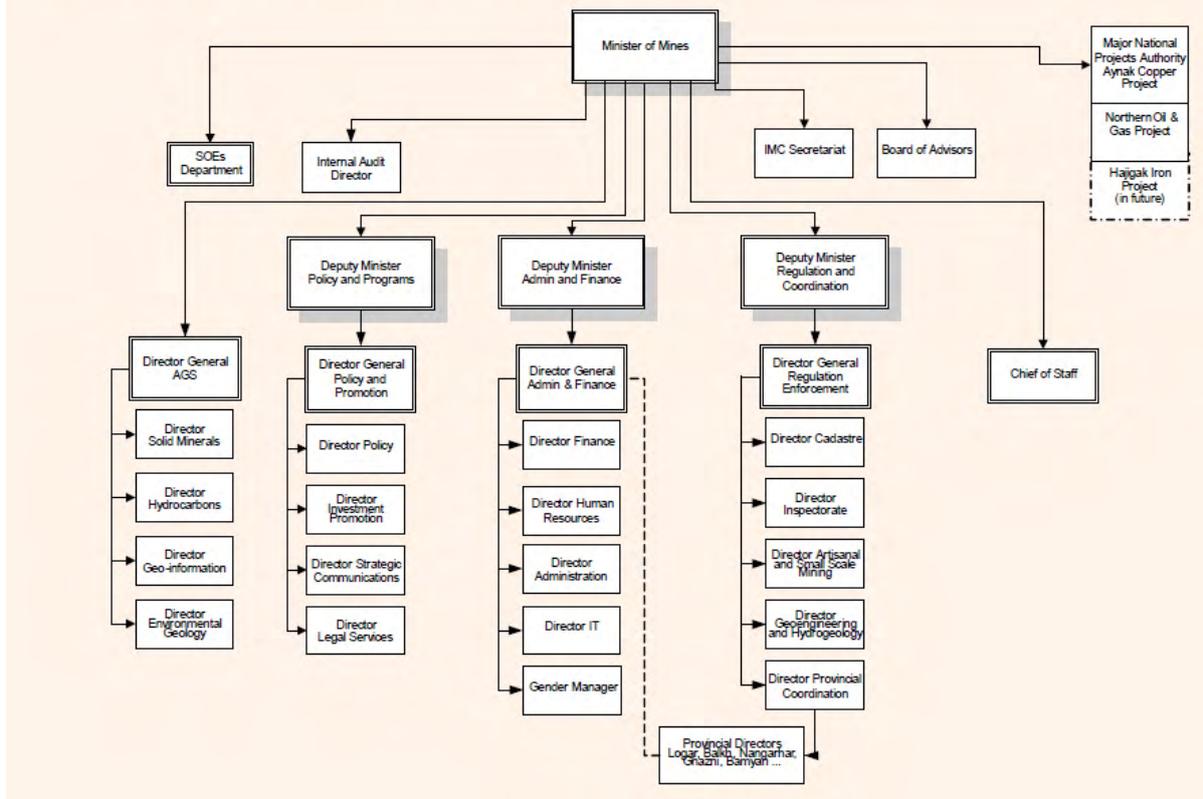
⁶⁶ Chapter 2, Article 5: Duties and Authorities. The Hydrocarbon Law.

⁶⁷ Chapter 1, Article 4: Inter-Ministerial Commission. The Hydrocarbon Law.

⁶⁸ Id.

⁶⁹ Chapter 1, Article 3: Ownership to Hydrocarbons: The Hydrocarbon Law; also Chapter 2, Article 5: Duties and Authorities. The Hydrocarbon Law.

Below: The new organisational structure of the Ministry of Mines



Afghan Gas Enterprise and the Northern Directorate of the Hydrocarbon Unit

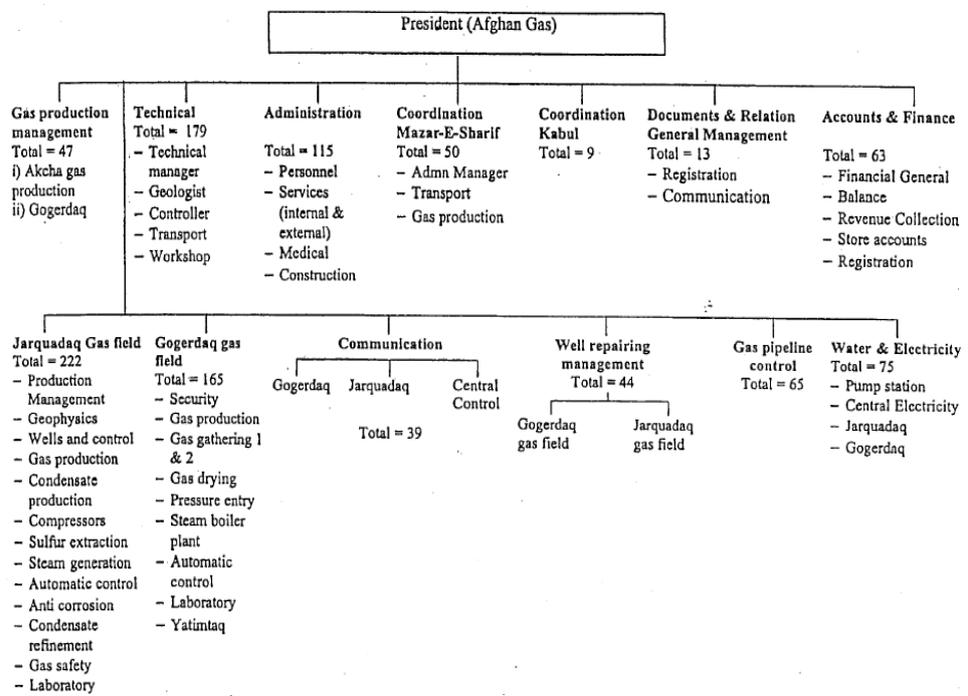
Afghan Gas Enterprise (Afghan Gas) and the Northern Directorate of the Hydrocarbon Unit (NHU) are both entities of the Ministry of Mines. Generally, the NHU has had the responsibility of exploration and development work for the gas fields around the City of Sheberghan. Once they had completed the exploration and development work, the completed wells were turned over to Afghan Gas for production, processing and transportation of the gas. This distinction no longer holds true, as Afghan Gas and the NHU have been working to jointly develop and rehabilitate wells in the Sheberghan area. There is a possibility that these entities will be integrated into a single state-owned corporation, but no firm decisions have been made as yet.

Afghan Gas Enterprise was established as the second branch of the Ministry of Mines in 1967 (1346) to explore for and develop natural gas in Afghanistan. It was legally transformed into a governmental enterprise in 1984 (1363). At that time, Afghan Gas had 14.374 billion Afghanis in capital (13.344 billion in fixed property assets and 1.031 billion in operating capital). Afghan Gas was established with 72 officials, 421 hired workers and 119 foreign experts. Afghan Gas is currently producing approximately 450,000 m³ per day or about 12.5 million m³ per month. Roughly 80% of this production goes to the Kude Barq fertilizer plant. The remaining 20% is distributed to domestic users in the City of Sheberghan and the immediate area, including the villages of Aqcha and Khoja Dokoh. Currently, Afghan Gas lacks modern equipment at all levels of its operations and substantial investment will be required in equipment and capacity building activities.

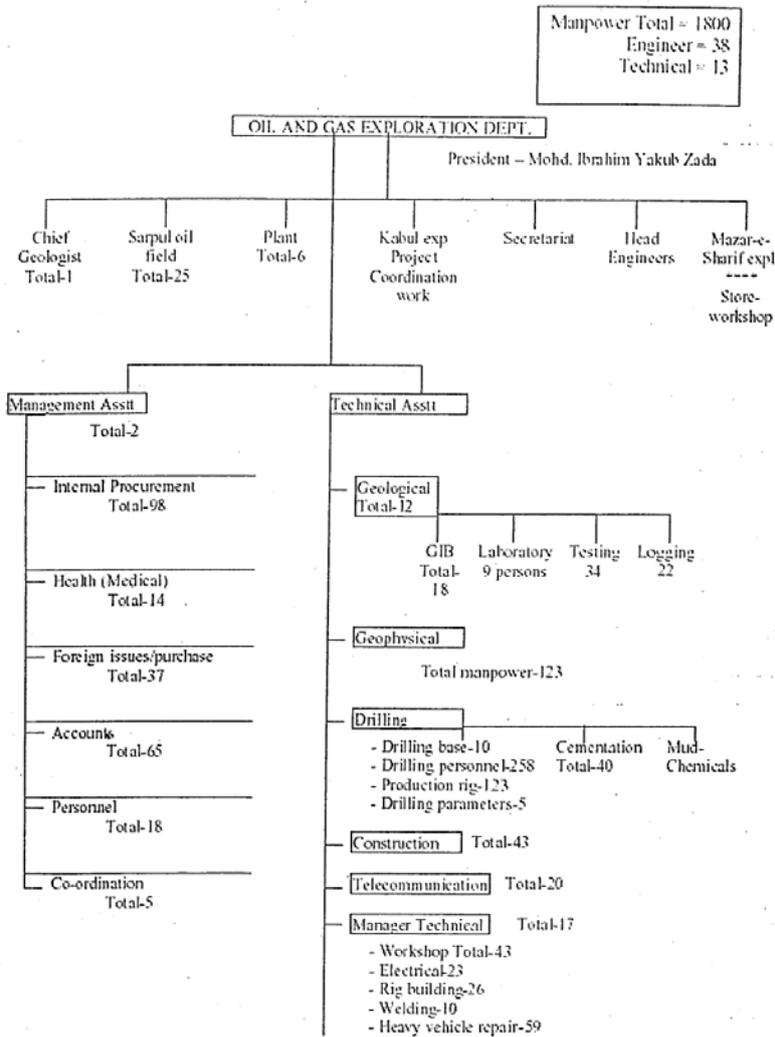
The Ministry of Mines has discussed the possibility of corporatizing Afghan Gas, as they are looking to Afghan Gas to represent Afghanistan in the negotiations and implementation of the proposed Turkmenistan-Afghanistan-Pakistan-India (TAPI) pipeline. The Ministry of Mines has also discussed utilizing a management contract, where the company would be put under management of an outside entity with experience in operating a gas company to quickly build capacity of the organization to make it more effective in handling its affairs. No concrete steps have been taken towards this objective yet, but the potential corporatization of the natural gas supplier in the IPP transaction is something that the investors should be aware of.

The Afghan Gas Enterprise organizational chart is below.

Organogram of Afghan Gas



The Northern Directorate of the Hydrocarbon Unit has traditionally been responsible for the exploration and development of the gas fields. However, the NHU is suffering from the same lack of investment in modern equipment and training as Afghan Gas. While the Ministry of Mines has been discussing a more expanded role for Afghan Gas in the future, little or no discussions have taken place with stakeholders regarding the future of the NHU. Vertically integrating the NHU with Afghan Gas appears to be the most likely option, though no decision has been made to that effect by the Ministry of Mines. The organizational chart for the Northern Hydrocarbon Unit (also called the Oil and Gas Exploration Department) is below:

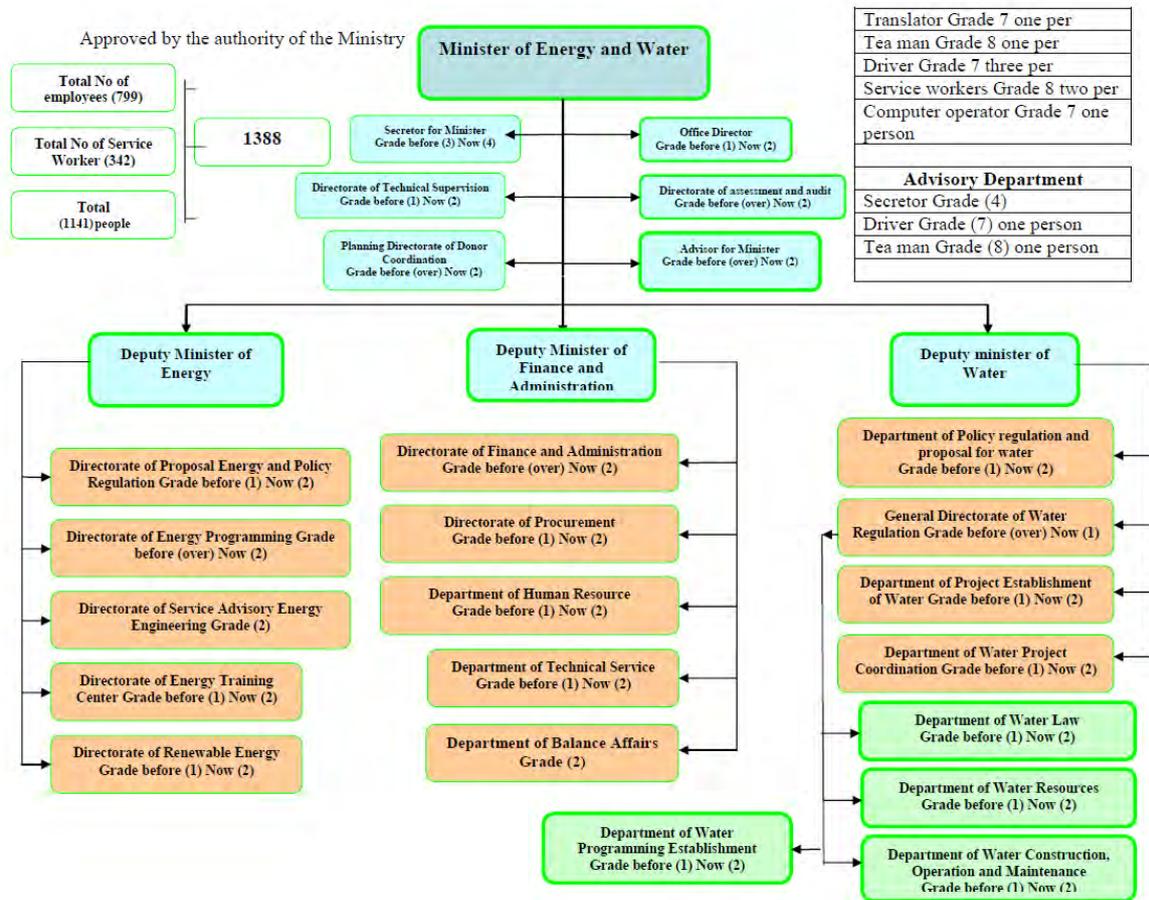


The Ministry of Mines will play a major role in the proposed transaction described above. Afghan Gas Enterprise, as an entity of the Ministry of Mines, will be responsible for providing natural gas fuel to the power plant. Afghan Gas also owns the land that will be leased to the investors for construction and operation of the power plant. Afghan Gas, and necessarily the Ministry of Mines will be signatories to the Gas Supply and Purchase Agreement (GSPA) that will regulate the terms of the sale and purchase of natural gas from the Government of Afghanistan to the investor group operating the proposed power plant.

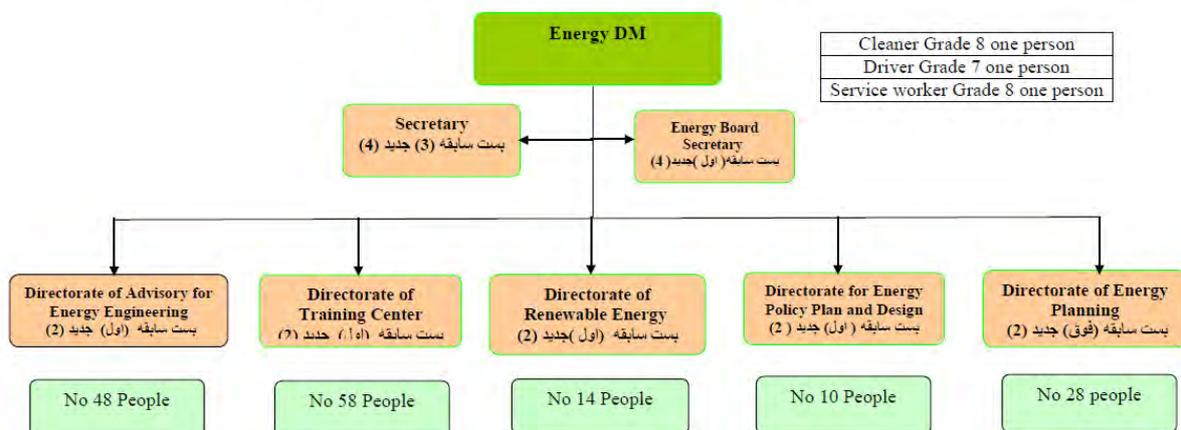
The Ministry of Energy and Water

The Ministry of Energy and Water (MEW) does not have a specific constitutional provision that authorizes its activities, though some of its functions are addressed in later sections of this report (such as the Water Law). Generally speaking, MEW has authority over electricity imports, hydroelectric facilities, and some other electrical generation and transmission issues, as well as some authority regarding water, specifically surface water resources. The areas of responsibility and division are not clearly articulated under the laws, because Afghanistan lacks an electricity law and

the water law is vague and poorly drafted.⁷⁰ Two representative organizational charts for the Ministry of Energy and Water are below:



General Organization Chart of DM of Energy for 1388



⁷⁰ For more information on the specific responsibilities of the Ministry of Energy and Water, see the specific sections addressing the draft Electricity Law and Water Law.

The most relevant document for the purposes of the IPP transaction is the Memorandum of Understanding that was signed between MEW, DABS and MoF on September 30, 2009.

The 2009 MoU delegated responsibility for the following to MEW:

- Preparation and management of national policies and laws of the energy sector;
- Guiding and planning development of the energy sector;
- Determining and evaluating needs in the energy sector (such as coal, gas, renewable energy, energy sufficiency, financial issues, human resource capacity) so that the work frame of the [Islamic Republic of Afghanistan] is supported and socio-economic growth further accelerated;
- Establishment of standards for better management and issuance of licenses.⁷¹

MEW retained the responsibility for surveying, planning and designing new generation and transmission infrastructure, as well as engineering, supplies, construction and assembly of new projects.⁷² The retention of these duties has created an issue as to whether DABS, as the corporatized, state owned electric utility, or MEW, as the ministry responsible for the administration of the electricity sector, should be responsible for new generation projects. The full text of the 2009 MoU has been included in this document as Appendix A.

MEW will play a major role in the IPP transaction based on its role in managing national policies and laws of the energy sector, planning development of the energy sector, and the establishment of standards and licenses. However, the authority for MEW and its role in the IPP transaction is not clearly defined and the overall status of the power sector and power sector regulation in Afghanistan is still developing. Efforts to pass an electricity law that would provide certainty and clarity for the sector have, so far, been unsuccessful. Therefore, close consultation with MEW is strongly recommended to avoid potential pitfalls due to ambiguities in roles and responsibilities regarding the IPP transaction.

Da Afghanistan Breshna Sherkat

DABS began operations as Da Afghanistan Breshna Moasesa (DABM), a state enterprise that reported to MEW. DABS is anticipated to have perhaps the largest role of any institution in Afghanistan for the IPP transaction, as DABS will be the counter-party to the PPA with the IPP. The MoU described in MEW section above was drafted to define roles and responsibilities as DABM was corporatized and became DABS. The corporatization of DABS was intended to create a commercial entity in a matter of years that could operate without being subsidized by the Afghan Government. That process remains ongoing and donors have been aggressively working to build capacity and reduce both technical and financial losses that are

⁷¹ Memorandum of Understanding (MoU) between the Ministry of Energy and Water (MEW), Da Afghanistan Breshna Sherkat (DABS) and the Ministry of Finance (MoF), dated September 30, 2009; also see Appendix A.

⁷² Id.

making DABS unprofitable as a corporation. Under the MoU, DABS is responsible for:

- Management and operation of the electricity sector, including power production from existing facilities;
- Transmission, dispatch, distribution and supply of electricity throughout Afghanistan.⁷³

DABS is also responsible for management, maintenance and commercial affairs related to the operation or activity of infrastructure, sale and transmission of electricity, as well as strengthening the existing distribution networks.⁷⁴ Under the MoU, then, the division of responsibility seems to be that DABS owns and operates the national electricity infrastructure, but that MEW remains in control of planning and constructing new generation and supply facilities for the electricity sector.

In addition to the September 2009 MoU, a “comprehensive agreement” between DABS and the Ministry of Finance outlined the overall goals and operational structure for DABS. Under the “comprehensive agreement,” DABS is to “operate and manage electric power generation, transmission, and distribution throughout Afghanistan.”⁷⁵ DABS was established to be an independent and autonomous 100% State-owned corporation, incorporated May 4, 2008, and was designed to operate on a commercial basis, guided by policies and regulations developed by MEW.⁷⁶ The “comprehensive agreement” included the phasing out of subsidies to DABS by the GoIRA through the Ministry of Finance by Afghan year 1393 (March 21, 2014).⁷⁷

Despite the existence of the MoU and “comprehensive agreement,” there is no clearly defined legal structure for the operation and regulation of the electricity sector in Afghanistan. As stated previously, attempts to pass an electricity law have been unsuccessful. Therefore, many of the rules and regulations governing the relationships between DABS, MEW and the private investors in the IPP will have to be developed and memorialized in contracts and MoUs.

Ministry of Finance

The Ministry of Finance (MoF) derives its authority from Article 75 of the Constitution of Afghanistan, which gives the Government the duty to prepare the budget, regulate financial affairs and protect public wealth.⁷⁸ MoF is the implementing agency for the Public Finance and Expenditure Management Law. Under that Law, MoF has the following duties: 1) to set the financial and public expenditure policy of Afghanistan; 2) to report to the Government and National Assembly on the implementation of the Law; 3) to propose regulations to the Government; and 4) to adopt procedures and rules to facilitate implementation of the Law.⁷⁹ MoF will be involved in the sovereign

⁷³ Id.

⁷⁴ Id.

⁷⁵ “Comprehensive Agreement” between DABS and Ministry of Finance, dated February 22, 2009.

⁷⁶ Id.

⁷⁷ Id.

⁷⁸ Chapter 4, Article 75. The Constitution of the Islamic Republic of Afghanistan.

⁷⁹ Chapter 1, Article 4: Ministry of Finance Responsibilities and Authorities. The Public Finance and Expenditure Management Law.

guarantee aspect of the transaction, as well as any other circumstances where the Government of Afghanistan is contributing financial support the transaction. MoF also contains the Customs and Revenue Department, which will be responsible for the assessment of customs duties on imported equipment for the power plant.

National Environmental Protection Agency

The National Environmental Protection Agency (NEPA) derives its authority from the Afghan Constitution and the Environment Law. According to the Afghan Constitution: “The state shall be obligated to adopt necessary measures to protect and improve forests as well as the living environment.”⁸⁰ The Environment Law designates NEPA, as an independent institutional entity, as the implementing agency for the Environment Law.⁸¹ NEPA has the power to maintain environmental integrity, promote sustainable use of natural resources and conservation and rehabilitation of the environment, and provide environmental management services in the areas of impact assessment, air and water quality management, pollution control, and permitting of activities, among many other duties.⁸²

In the 200 MW power plant transaction described above, NEPA will have a significant role in issuing permits and evaluating the environmental impacts, including those on air and water quality, of the proposed power plant. The relevant legal provisions of the Environment Law and the necessary permits and evaluations are described in more detail in the Environment Law section of this report. For now, it is sufficient to say that NEPA will have a major role in any private transaction on the scale of the one contemplated by the private investors in the 200 MW power plant.

D. Legal Systems Analysis

The Legal System - Generally

In Afghanistan, the court system is arranged according to the Law on Organization and Jurisdiction of the Courts of the Islamic Republic of Afghanistan, enacted on May 21, 2005.⁸³ The Law was enacted pursuant to the Afghan Constitution, specifically Articles 116 and 123, to organize the judiciary branch.⁸⁴ The Law establishes a legal framework consisting of the Supreme Court, Courts of Appeal, and Primary Courts, with different *dewans* (Dari for “bureaus”) within each court.⁸⁵ Attorneys in Afghanistan are licensed by the Afghanistan Independent Bar Association (AIBA),⁸⁶ pursuant to the Advocates Law.⁸⁷ The Advocates’ Law also establishes a series of requirements for practicing advocates that must be satisfied prior to receiving a license to practice law in Afghanistan.⁸⁸

⁸⁰ Chapter 1, Article 15. The Constitution of the Islamic Republic of Afghanistan.

⁸¹ Chapter 1, Article 3. The Environment Law. 2007.

⁸² See generally, Chapter 2, Article 9. The Environment Law. 2007.

⁸³ Law on Organization and Jurisdiction of Courts of the Islamic Republic of Afghanistan. May 21, 2005.

⁸⁴ Id. at Chapter 1, Article 1.

⁸⁵ See Id. at Chapters 1-4.

⁸⁶ See Afghanistan Independent Bar Association Website: <http://www.aiba.af/>. Last accessed: 24 March 2011.

⁸⁷ See generally Article 1, The Advocates’ Law. December 17, 2007.

⁸⁸ Chapter 6, Article 2. The Advocates’ Law. December 17, 2007.

The judiciary is granted the authority to resolve disputes between and among individuals and legal entities, including the state of Afghanistan.⁸⁹ According to the law, courts must resolve cases in accordance with the Constitution and laws of Afghanistan, except when there is no clear legal provision for the case, in which circumstance it will be handled in accordance with Articles 130 and 131 of the Constitution.⁹⁰ The Constitutional Articles refer to the use of Shari'ah Law to decide cases fairly according to the merits and to use Shi'a law when applicable.⁹¹ Courts are also duty bound to establish reasons, grounds and legal provisions when issuing a decision.⁹²

The Supreme Court

The Afghan Supreme Court is composed of nine individuals, appointed by the President with concurrence of the House of People, for a term of ten years.⁹³ The Supreme Court is divided into four *dewans*: 1) general criminal division; 2) public security; 3) civil and public rights; and 4) commercial.⁹⁴ The head of the *dewan* is responsible for: 1) leading the relevant *dewan's* activities; 2) holding and presiding over relevant *dewan's* sessions; and 3) arranging affairs, coordinating and submitting of reports to the Supreme Court.⁹⁵ The Supreme Court has the power of judicial review, if requested by the government or courts, to determine their compliance with the Constitution and their interpretation.⁹⁶ The Supreme Court also has the authority under the Law on Organization and Jurisdiction of Courts to assess the "conformity of laws, decrees, legal documents, international contracts, and conventions with the Constitution and their interpretation based on the government or courts demand in accordance with law."⁹⁷ The Supreme Court also has the power to revise rulings of lower courts based on challenge by the Attorney General's Office or a party to a claim and resolve conflicts of jurisdiction, among others.⁹⁸ The Afghan Supreme Court is also responsible for the administration of the lower courts, including budgeting, facility procurement, approval of rules and regulations and disciplinary actions, among others.⁹⁹

⁸⁹ Chapter 1, Article 3. Law on Organization and Jurisdiction of Courts of the Islamic Republic of Afghanistan. May 21, 2005.

⁹⁰ Id. at Chapter 1, Article 7.

⁹¹ See supra notes 42-45; discussion on page 9.

⁹² Chapter 1, Article 9. Law on Organization and Jurisdiction of Courts of the Islamic Republic of Afghanistan. May 21, 2005.

⁹³ Chapter 2, Article 17. Law on Organization and Jurisdiction of Courts of the Islamic Republic of Afghanistan. May 21, 2005. Also Articles 117, 118, Constitution of the Islamic Republic of Afghanistan.

⁹⁴ Chapter 2, Article 18. Law on Organization and Jurisdiction of Courts of the Islamic Republic of Afghanistan. May 21, 2005.

⁹⁵ Chapter 2, Article 19: Powers of Heads of *Dewans*. Law on Organization and Jurisdiction of Courts of the Islamic Republic of Afghanistan. May 21, 2005.

⁹⁶ Chapter 7, Article 121.

⁹⁷ Chapter 2, Article 24. Judicial Powers and Duties of the Supreme Court. Subpoint 1. Law on Organization and Jurisdiction of Courts of the Islamic Republic of Afghanistan. May 21, 2005.

⁹⁸ Id.

⁹⁹ Chapter 2, Article 29: Administrative Duties and Jurisdictions of the Supreme Court. Law on Organization and Jurisdiction of Courts of the Islamic Republic of Afghanistan. May 21, 2005.

Courts of Appeals

The Courts of Appeals are established in all 34 provinces in accordance with the law.¹⁰⁰ The Courts of Appeals are composed of the chief of the court, heads of *dewans* and other judicial members, with the head of the Courts of Appeals selected from the judges based on qualifications, experience and competency.¹⁰¹ The Courts of Appeals have six *dewans*: 1) general criminal; 2) public security; 3) civil and family; 4) public rights; 5) commercial; and 6) juveniles.¹⁰² Each *dewan* of the Courts of Appeals is limited to six judges, and the Supreme Court may establish additional *dewans* as needed with the approval of the President.¹⁰³ The Courts of Appeals have the power to oversee the rulings and decisions of the lower courts, and may overturn, amend, confirm or repeal the rulings and decisions of the lower courts.¹⁰⁴ Heads of the Courts of Appeal and individual *dewans*, as well as the judges themselves, are responsible for deciding cases in a timely manner according to the law, correct application of the law, and proper explanation of the grounds for their decision.¹⁰⁵

Primary Courts

The Primary Courts are established within the jurisdiction of each Court of Appeals, with the following divisions: 1) central provisional primary court; 2) juveniles court; 3) commercial primary court; 4) district primary court; and 5) family issues primary court.¹⁰⁶ The central provisional primary court is further divided into the following *dewans*: 1) general criminal; 2) civil; 3) public rights; 4) public security; and 5) traffic criminal, with each *dewan* having one head and no more than four members.¹⁰⁷ Cases are resolved on a primary level by the relevant *dewan* of the central provincial primary courts according to the following: 1) general criminal cases are resolved by the general criminal *dewan*; 2) civil disputes between natural persons are resolved by the civil *dewan*; 3) civil disputes between natural and legal individuals/entities or among legal entities are resolved by the public rights *dewan*; 4) criminal cases of public security and interest, drug trafficking, and other crimes are resolved by the public security *dewan*; and 5) traffic criminal cases are resolved by the traffic criminal *dewan*.¹⁰⁸ Commercial courts are to be established in the center of each province,¹⁰⁹ though not all provinces have established them. In such a situation, the duties of the

¹⁰⁰ Chapter 3, Article 31: Organization of the Courts of Appeals. Law on Organization and Jurisdiction of Courts of the Islamic Republic of Afghanistan. May 21, 2005.

¹⁰¹ Id.

¹⁰² Chapter 3, Article 32: Structure of *Dewans* of Courts of Appeals. Law on Organization and Jurisdiction of Courts of the Islamic Republic of Afghanistan. May 21, 2005.

¹⁰³ Id.

¹⁰⁴ Chapter 3, Article 33: Follow-up on Decisions and Rulings (*Qarar*). Law on Organization and Jurisdiction of Courts of the Islamic Republic of Afghanistan. May 21, 2005.

¹⁰⁵ Chapter 3, Article 38: Responsibility. Law on Organization and Jurisdiction of Courts of the Islamic Republic of Afghanistan. May 21, 2005.

¹⁰⁶ Chapter 4, Article 40: Organization. Law on Organization and Jurisdiction of Courts of the Islamic Republic of Afghanistan. May 21, 2005.

¹⁰⁷ Chapter 4, Article 41: Primary Court Structure. Law on Organization and Jurisdiction of Courts of the Islamic Republic of Afghanistan. May 21, 2005.

¹⁰⁸ Chapter 4, Article 42: Resolving Cases by *Dewans* of Primary Courts. Law on Organization and Jurisdiction of Courts of the Islamic Republic of Afghanistan. May 21, 2005.

¹⁰⁹ Chapter 4, Article 45: Commercial Primary Court. Law on Organization and Jurisdiction of Courts of the Islamic Republic of Afghanistan. May 21, 2005.

commercial courts are assumed by the civil *dewan* of the provincial central primary court.¹¹⁰ District Primary Courts are responsible for dealing with all ordinary criminal, civil, and family cases which are legally presented.¹¹¹ The decisions of the Primary Courts are absolute and final in the following situations: 1) when both parties agree upon the issued decision of the court; 2) when the time for appeal has lapsed; 3) when the disputed property is worth up to 100,000 Afghani; 4) when the order for a cash fine of 50,000 Afghani is issued; and 5) other situations set forth in law.¹¹²

The Legal System – Special Notes and Dispute Resolution

The above sections describe the legal framework of the judiciary in Afghanistan. While the written legal structure appears reasonable on paper, the legal system in Afghanistan is still in its infancy and the functionality and impartiality of the legal system has been significantly undermined by corruption, bribery, and developing views of the role of the courts in Afghan society. Many areas of Afghanistan continue to use more traditional means of justice and dispute resolution, relying on councils of tribal elders called Jirgas, to resolve civil disputes.¹¹³ Afghans see the formalized, government system as highly corrupt.¹¹⁴ However, the traditional system does not rely on *stare decisis* and the lack of publication (compounded by the low literacy rates in the provinces) lead to inconsistent application of justice and unpredictable

Enforcing Contracts in Afghanistan	
Nature of Procedure	Indicator
Procedures (number)	47
Time (days)	1642
Filing and service	40
Trial and judgment	1,420
Enforcement of judgment	182
Cost (% of claim)*	25
Attorney cost (% of claim)	24
Court cost (% of claim)	1
Enforcement Cost (% of claim)	0

results.¹¹⁵ The NATO report suggests that reliance on the formalized court system, with the dual system of informal justice prevalent in the provinces would be highly problematic, especially for foreign companies and businesses operating in Afghanistan.

Further, the table to the left illustrates the challenges associated with the enforcement of contracts in Afghanistan. According to the information provided by the Kabul Commercial Court, enforcing a contract in Afghanistan requires 47 different procedures and takes 1642 days, or four years, six months and two days.¹¹⁶ In the table, the claims were estimated at 200% of per capita

income. Under these circumstances, a foreign company would be well advised to rely on a carefully drafted international arbitration provision to protect its financial and legal rights when operating in Afghanistan.

¹¹⁰ Id.

¹¹¹ Chapter 4, Article 48: District Primary Court Jurisdiction. Law on Organization and Jurisdiction of Courts of the Islamic Republic of Afghanistan. May 21, 2005.

¹¹² Chapter 4, Article 53: Finality of Decisions. Law on Organization and Jurisdiction of Courts of the Islamic Republic of Afghanistan. May 21, 2005.

¹¹³ Captain Nauta, David R.D. (LL.M.) NATO Review: Law, order and the elections in Afghanistan. Website: <http://www.nato.int/docu/review/2009/Afghanistan-law-order-elections/Judicial-Reform-Process/EN/index.htm>.

Last accessed: 26 March 2011.

¹¹⁴ Id.

¹¹⁵ See Id.

¹¹⁶ Source: Kabul Commercial Court.

Afghanistan is a signatory of the 1958 Convention on the Recognition and Enforcement of Foreign Arbitral Awards, also referred to as the “New York Convention.” The New York Convention entered into force in Afghanistan on February 28, 2005.¹¹⁷ Afghanistan has made the following reservations regarding its ratification of the New York Convention: 1) Afghanistan will only recognize and enforce awards made in another contracting state; and 2) the convention will only apply to differences arising out of legal relationships that are considered commercial under the national law.¹¹⁸ Afghanistan’s participation in the New York Convention provides additional assurances and enforcement mechanisms for foreign companies operating in Afghanistan. Rather than try to enforce a contract or settle a dispute in either the formalized Afghan court system or, for the more daring, attempting to settle a dispute in the informal system of Jirgas, an arbitration mechanism provides the benefit of certainty and neutrality in dispute resolution. Given the problems with the Afghan judicial system listed above, the use of a well drafted and thoughtfully considered international arbitration provision would help to protect the interests of the foreign company.

Afghanistan’s Law on Private Investment in Afghanistan also contains some important provisions regarding dispute resolution procedures. Under the Law, if a foreign investor or registered enterprise is involved in a dispute with the State, or an instrumentality thereof, the parties can specify the method of dispute resolution, or submit the dispute to either the International Centre for Settlement of Investment Disputes (ICSID) for resolution under the Convention on the Settlement of Investment Disputes between States and Nationals of Other States of March 18, 1965, or, if ICSID is precluded, according to arbitration in accordance with United Nations Commission on International Trade Law (UNCITRAL) rules.¹¹⁹ The Afghan Government, in the Law, provides its consent to the submission of a dispute to ICSID for settlement by arbitration.¹²⁰ The choice of whether to use the default rules, which defer to ICSID, or whether to specify another method of dispute resolution will depend on the needs of both the foreign investor (in this case the IPP) and the Afghan Government, and the willingness of one or both of the parties to negotiate on an alternative to the default dispute resolution procedures under the Law on Private Investment in Afghanistan.

E. Corruption and Governance Issues

Regrettably, no discussion of the legal and country framework of Afghanistan would be complete without a discussion of the problem of corruption. As of 2009, Transparency International, the global coalition against corruption, ranks Afghanistan 179th out of 180 governments in terms of corrupt practices, second only to Somalia.¹²¹ The Risk Analysis Report for the Sheberghan Gas Field Development Project attributed corruption in Afghanistan to:

¹¹⁷ United Nations Commission on International Trade Law (UNCITRAL). Website: http://www.uncitral.org/uncitral/en/uncitral_texts/arbitration/NYConvention_status.html. Last accessed: 26 March 2011.

¹¹⁸ Id.

¹¹⁹ Chapter 8, Article 30: Dispute Resolution, subsection (e), points (i) and (ii). Law on Private Investment in Afghanistan.

¹²⁰ Id. at point (ii); also Article 30: Dispute Resolution, subsection (a) and subsection (f).

¹²¹ Transparency International. Website: http://www.transparency.org/publications/annual_report. Last accessed: 26 March 2011.

- Collusion between the GoIRA and the business elite for access to capital and commercial opportunities;
- Lack of transparency in government processes, including title to real property;
- Role of former warlords in the GoIRA;
- Poorly paid police and civil servants who supplement their incomes through bribery; and
- A weak judicial system

The problem of corruption in Afghanistan is well recognized and well documented among aid agencies, international donor organizations and other humanitarian organizations. There are a multitude of reports that calculate and quantify the devastating effect of corruption in Afghanistan.¹²²

In addition to the reports described above, there have also been several recent scandals involving corrupt officials that have undermined the commitment professed by President Hamid Karzai and the Afghan Government to reduce corruption in the country. Two of these scandals are worth mentioning as representative of the type of atmosphere that has been created in Afghanistan since the fall of the Taliban in 2002. Further, these scandals have both taken place in the last year, just one year into Karzai's second five year term and after almost ten years of international development assistance and international monitoring.

The most recent, high profile example of the problem of corruption involves the Kabul Bank. In the fall of 2010, Kabul Bank, which was the largest privately owned bank in Afghanistan, disclosed a series of transactions that showed bank executives, shareholders and well connected individuals borrowing money from the bank to invest in high risk ventures. One of the shareholders, Mahmoud Karzai, brother of Afghan President Hamid Karzai, was provided with a seafront mansion in Dubai at no cost by Kabul Bank. Further, the series of loans to shareholders and politically connected Afghans were backed by no collateral, had little or no interest, and no repayment date. Overall, Kabul Bank is estimated to have provided some \$900 million in loans to bank executives and shareholders.¹²³

In recent days, officials of Afghanistan's Central Bank agreed to start dissolving Kabul Bank, after pressure from the United States and the International Monetary Fund. The International Monetary Fund suspended its program in Afghanistan after the disclosure of the suspect transactions by Kabul Bank officials, which risked millions of dollars in foreign aid from countries that do not invest without an IMF presence.¹²⁴ The failure of Kabul Bank based on hundreds of millions of dollars in bad loans to politically connected Afghans is an extreme example, but illustrative of

¹²² See generally e.g., July 2010 National Corruption Survey. Integrity Watch Afghanistan [need web address]; Afghanistan in 2009: A Survey of the Afghan People", The Asia Foundation, October 2009 [need web address]; "Assessment of Corruption in Afghanistan", USAID 2009 [need web address].

¹²³ See generally e.g. Rubin, Alissa J. and Rod Nordland. *Afghan Elite Borrowed Freely From Kabul Bank*. New York Times, March 28, 2011; Londono, Ernesto. *Afghan officials agree to dissolve Kabul Bank, under pressure from U.S. and IMF*. Washington Post, March 26, 2011.

¹²⁴ Id.

the atmosphere of corruption and lack of respect for the rule of law that is pervasive in Afghanistan.

There are certainly no shortage of stories and examples of corrupt practices in Afghan government and society. In a country like Afghanistan, where the rule of law has yet to take hold and government officials are given broad latitude to make decisions, every point of discretion in decision-making is an opportunity for a corrupt act. While the Foreign Corrupt Practices Act¹²⁵ and European anti-corruption legislation offer some guidance for foreign companies operating in Afghanistan, private companies must be especially vigilant and cautious in business dealings and dealing with government agencies.

With respect to the IPP transaction described above, there are many areas where a strong anti-corruption regime will be required. The importation of the construction materials and capital equipment must obtain customs clearances, operating and environmental permits must be obtained, visas must be obtained for workers, land must be acquired under lease, security must be provided, and taxes must be paid. Each of these points contains some discretion by government actors, and is an opportunity for a corrupt action. In sum, the issue of corruption is a major one in Afghanistan and any foreign entity looking to do business in the country should be prepared to deal with the problems and challenges posed by corrupt practices.

¹²⁵ See 15 USC §§78dd-1, et seq.

III. FUEL SUPPLY ISSUES

Fuel Supply – Generally

The proposed 200 MW gas-fired thermal power plant will be supplied with natural gas from the Juma and Bashikurd gas fields located to the southeast of the City of Sheberghan in Jowzjan Province, Afghanistan. AEAI has calculated that a 200 MW power plant will require 1.2 million cubic meters (MMCM) per day of pipeline quality natural gas. Providing this amount of gas per day for the 30 year anticipated operational life of the power plant will require reserves in the amount of 13.1 billion cubic meters (BCM). At P50 distribution, the Juma/Bashikurd gas field is estimated to have 25.18 BCM of sweetened gas, that is to say the amount of gas remaining after removal of the hydrogen sulfide and carbon dioxide contaminants.¹²⁶ At the time of publication, it is anticipated by the Ministry of Mines that Afghan Gas Enterprise will have the responsibility of providing gas to the IPP. Presumably, gas will be developed and sold to the IPP under the Hydrocarbons Law and the Hydrocarbons Regulations (which remain in draft form). The primary legal authority for the Hydrocarbon regime is the Afghan Constitution, which vests ownership of natural resources in the State.¹²⁷

The current proposal is for USAID to fund a rehabilitation and drilling contract limited to a total of four wells in the Juma/Bashikurd gas field. USAID is anticipated to provide funds to the Ministry of Mines through an on-budget funding mechanism that the Ministry can then use to engage a contractor to do the rehabilitation and drilling work. The proposal does not include a production sharing component, which is significant for the application of the Hydrocarbons Law and Hydrocarbons Regulations. The details of this transaction as they relate to the Hydrocarbons Law and Hydrocarbons Regulations are discussed in more detail below.

A. The Hydrocarbons Law

The Hydrocarbons Law is the primary source of law that governs hydrocarbon operations in Afghanistan. The Law contains six chapters and 71 articles that contain the types of contracts that the Ministry of Mines may enter into for hydrocarbon operations, as well as legal, environmental and safety requirements that Contractors must follow in carrying out their contractual duties. There was a recent attempt to amend the Hydrocarbons Law, but the changes proposed by the Ministry of Mines were rejected by the Ministry of Justice, presumably on the basis that the Hydrocarbons law was relatively new and should not need amendment so quickly.

The Afghan Hydrocarbons Law was written specifically to encourage private investment in the hydrocarbon sector. The primary types of oil and gas contracts contemplated by the law are exploration and production sharing contracts (EPSC) and service and production sharing contracts (SPSC).¹²⁸ The production sharing contract is a good match for the situation in Afghanistan, as it does not require an outlay of capital by the host government for hydrocarbon operations and provides some risk mitigation by allowing the contractor to take their share of produced

¹²⁶ Gustavson Associates, Ranking of Potential Wells for Twinning and Cost Estimates, page 7. March 19, 2011.

¹²⁷ Chapter 1, Article 9. Constitution of the Islamic Republic of Afghanistan.

¹²⁸ See generally Chapter 4. The Hydrocarbons Law.

petroleum for sale on the market. The Ministry of Mines has attempted one tender for hydrocarbon operations, but the tender was unsuccessful when all but one of the contractors were disqualified and the remaining bid was rejected by the Afghan Government.¹²⁹

Hydrocarbons are defined in the law as “liquid hydrocarbons and natural gas.”¹³⁰ Hydrocarbon Operations are defined as “any operations related to prospecting, exploration, extraction, production, field separation, storage, transportation, or sale of hydrocarbons, but not transportation beyond the exit-point for exports or after delivery into a refinery or a processing plant.”¹³¹ Natural gas is defined as “any hydrocarbon which at specified atmospheric conditions of temperature and pressure, is found in a gaseous state and includes dry gas, including coal-based methane, wet gas and residue gas remaining after the extraction, processing or separation of liquid hydrocarbons from wet gas, as well as non-hydrocarbon gas or gases produced in association with liquid or gaseous hydrocarbons, and the residue gas remaining after the condensation of liquid hydrocarbons, excluding condensed or extracted liquid hydrocarbons.”¹³²

As stated above, all hydrocarbons located on or under the ground belong to the State of Afghanistan.¹³³ A contractor under an exploration and production sharing contract or service and production sharing contract acquires title to a share of the extracted hydrocarbons pursuant to the terms of the contract.¹³⁴ The remaining share of extracted hydrocarbons are the property of the State and may be disposed of as appropriate.¹³⁵ The ability of the State to dispose of its share of extracted hydrocarbons “as appropriate” is significant because it allows the State to determine the most beneficial use of the produced hydrocarbons.

There are four types of contracts specifically listed in the Hydrocarbons Law: 1) exploration and production sharing contract; 2) service and production sharing contract; 3) contracts for geological/geophysical/geochemical services; and 4) contracts for pipeline operations.¹³⁶ The Law states that “[T]he Contracts for hydrocarbon operations shall be concluded as one of the following:” and then lists the four types of contracts.¹³⁷ The exploration and production sharing contract grants the contractor the exclusive right to explore for and to develop and produce hydrocarbons upon making a commercial discovery, and to receive a share of the hydrocarbons.¹³⁸ The service and production sharing contact grants the contractor the exclusive right to operate and upgrade/rehabilitate hydrocarbon production facilities and receive a share of the produced hydrocarbons.¹³⁹ The contracts for geological/geophysical/geochemical services grant the right to conduct those services in an identified area, as long as it is not within the area covered by the first

¹²⁹ See <http://afghanistanpetroleum.com/>

¹³⁰ Chapter 1, Article 2: Definitions, subpoint 1. The Hydrocarbons Law.

¹³¹ Id. at subpoint 2.

¹³² Id. at subpoint 4.

¹³³ Supra note 64.

¹³⁴ Chapter 1, Article 3: Ownership to Hydrocarbons, subpoint 2. The Hydrocarbons Law.

¹³⁵ Id.

¹³⁶ Chapter 4, Article 22: Types of Contract. The Hydrocarbons Law.

¹³⁷ Id.

¹³⁸ Id. at Article 23: Exploration and Production Sharing Contracts.

¹³⁹ Id. at Article 24: Service and Production Sharing Contracts.

two contracts.¹⁴⁰ The contracts for pipeline operations grant the right to construct pipelines and associated facilities to store and transport hydrocarbons.¹⁴¹ Under the Hydrocarbons Law, all hydrocarbon operation contracts shall be awarded through public tenders.¹⁴²

The language used in the unofficial English translation is significant when referring to the four types of contracts, because the words “shall be concluded as one of the following” appears to be a limiting factor on the types of contracts that the Ministry of Mines may enter into regarding hydrocarbon operations. The present type of contract, a contract for exploration and services with no provision for production sharing, does not fit under one of the four types of contracts specifically listed and could be interpreted as a limitation on the ability of the Ministry of Mines to enter into such a contract when the object of the contract is hydrocarbon regulations. In order to enhance the clarity and ensure that there is no question as to the ability of the Ministry of Mines to engage contractors for any necessary purpose, the Hydrocarbons Law should be amended to include various types of additional contracts, including those without a production sharing component, to facilitate hydrocarbon development and production. In the alternative, it would be possible to sign a modified service and production sharing contract, with the production sharing provisions for the company set at zero to reflect the type of transaction that is contemplated.

The Hydrocarbons Law contains sufficient provisions to ensure the supply of gas from the Afghan Government, through the Ministry of Mines and Afghan Gas Enterprise, for the 200 MW IPP. Under both the EPSC and the SPSC, the State is able to dispose of its share of hydrocarbons “as appropriate.”¹⁴³ Presumably, this ability would extend to the type of contract that will be used in the current transaction. Further, under the current proposed development plan, title to the hydrocarbons would never transfer to any entity besides the State of Afghanistan, until the gas is sold to the IPP. The Hydrocarbons Law also allows the State to purchase the contractor’s share of hydrocarbons under an EPSC or SPSC in order to meet internal consumption requirements.¹⁴⁴ These two provisions suggest that the Government of Afghanistan is the owner of the gas until sale, and there is no restriction on the sale or disposal of those resources to a third party for any purpose, including for use in a privately owned power plant.

Finally, under the Hydrocarbons Law, two articles relating to domestic employment and procurement should be noted for a contractor. The first is a mandate in the Hydrocarbons law that the contractor employs and trains Afghan nationals for the operations of the project and only use foreign labor on a temporary basis and in exceptional circumstances.¹⁴⁵ The second is a requirement that the contractor purchase goods and services, as long as they meet quality, quantity and price standards, from local sources.¹⁴⁶ These benefits are significant because one of the

¹⁴⁰ Id. at Article 25: Contracts for Geological/Geophysical/Geochemical Services.

¹⁴¹ Id. at Article 26: Contracts for Pipeline Operations.

¹⁴² Id. at Article 28: Contract Bidding.

¹⁴³ Supra, note 116.

¹⁴⁴ Chapter 4, Article 47: Supply of Oil and Gas to the State. The Hydrocarbons Law.

¹⁴⁵ Chapter 4, Article 44: Employment of Labour. The Hydrocarbons Law.

¹⁴⁶ Chapter 4, Article 45: Procurement of Domestic Goods and Services. The Hydrocarbons Law.

goals of the development program is to build the capacity of Afghans to allow them to take responsibility for the operations and maintenance of the gas fields. Oil and gas operations are able to provide local residents with good paying jobs and high-skilled employment opportunities. These two provisions should apply to any contract, whether the production sharing component is included or not, involving hydrocarbon operations in Afghanistan.

B. The Hydrocarbon Regulations

The Afghan Hydrocarbon Regulations are still technically in draft form, meaning they have not been officially signed and approved by the Minister of Mines and have no operational legal effect. The Hydrocarbon Regulations were written pursuant to Article 5, paragraph 13 of the Hydrocarbons Law and contain many of the same biases and issues as the Hydrocarbons Law relating to the preference for a private corporation to enter into some form of production sharing agreement for hydrocarbon operations. The Hydrocarbon Regulations contain detailed information on bid requirements and the bid process for tendering out hydrocarbon operations.¹⁴⁷ The Hydrocarbon Regulations also contain information on contract terms, rights over public and private land, work practices of the contractor, and reporting and recordkeeping requirements.¹⁴⁸ Further sections include accounting records and financial reports and royalties and surface use fees.¹⁴⁹ When contracts for hydrocarbon operations are concluded by the Ministry of Mines, they must be endorsed by both the Inter-ministerial Commission and the Cabinet.¹⁵⁰

The Afghan Hydrocarbon Regulations will need to be amended to reflect the same issues as the Hydrocarbons Law regarding the limited number of contractual mechanisms available for the Ministry of Mines to accomplish well rehabilitation and new drilling programs. The Hydrocarbon Regulations remain in draft form and are capable of amendment without amending the Hydrocarbons Law. To address the specific problem of the necessary contract not being grounded in the Hydrocarbons Law, simply adding a new contract under the existing regulations would not necessarily make that type of contract valid, particularly when the Hydrocarbons Law is specific to the types of contracts that can be concluded by the Ministry of Mines regarding hydrocarbons operations. Therefore, both the Hydrocarbons Law and Hydrocarbon Regulations would have to be amended to include the type of contract contemplated for this project.

It is also the prevailing view at the Ministry of Mines that the existence of the Hydrocarbon Regulations and Hydrocarbons Law exempts the hydrocarbon bidding process from the Afghan Procurement Law. Under more traditional natural resource contracting methods like a production sharing agreement, there is little or no capital outlay by the Ministry of Mines, meaning that the engagement of a contractor to conduct hydrocarbon operations would not trigger the application of the Procurement

¹⁴⁷ See generally Chapter 2: Bids for Contracts for Hydrocarbon Operations. The Hydrocarbon Regulations.

¹⁴⁸ See generally Chapter 4: Contract Terms; Chapter 5: Rights over Public and Private Land; Chapter 6: Work Practices; Chapter 7: Reports and Records on Hydrocarbon Operations. The Hydrocarbon Regulations.

¹⁴⁹ See generally Chapter 8: Accounting Records and Financial Reports; Chapter 9: Royalties, Surface Fees and Other Fees and Compensation. The Hydrocarbon Regulations.

¹⁵⁰ Chapter 4, Article 21: Conclusion of Contract for Hydrocarbon Operations and issue of the Licence. The Hydrocarbon Regulations.

Law. This argument is based on the premise that under either the EPSC or SPSC, there is no expenditure being made by an entity funded under the government budget and therefore no procurement being made. Further, because the Hydrocarbons Law and Hydrocarbon Regulations contain specific bidding procedures, the argument could also be made that the specific provisions in the Hydrocarbons Law control the process over the more general provisions in the Procurement Law.

These views appear to be unsupported by the Afghan Procurement Law, which requires that entities funded under the government budget procure goods, works and services in accordance with the Procurement Law, except under the following three circumstances: 1) where procurement requires confidentiality; 2) where the procurement rules of an international institution conflict; and 3) where the Afghan entity conducting the procurement is located abroad.¹⁵¹ The preference of USAID that the drilling and rehabilitation contract be done through an on-budget contracting mechanism ensures that the rules and requirements of the Procurement Law probably apply in the specific transaction described above.

C. The Role of Afghan Gas Enterprise and the Northern Directorate of the Hydrocarbon Unit

In the gas development transaction, Afghan Gas Enterprise will take control of the wells once the rehabilitation and drilling work has been completed by the private contractor. Afghan Gas will also be responsible for transportation and processing of the natural gas before it is provided to the IPP. Finally, both Afghan Gas Enterprise and the Ministry of Mines will be signatories to the Gas Supply and Purchase Agreement with the Independent Power Producer. In this role, there is nothing in the Hydrocarbons Law or Hydrocarbon Regulations that will interfere with the performance of these duties. There are significant institutional and capacity building challenges that must be overcome before Afghan Gas is in a position to provide a reliable supply of gas to the power plant, not to mention substantial capital investments, but according to the Hydrocarbons Law and Hydrocarbon Regulations, there is no language that suggests they would not be legally capable of this role.

D. Impacts Analysis on the IPP

The Hydrocarbons Law and Hydrocarbon Regulations will not have a significant effect on the Independent Power Producer transaction. Afghan Gas Enterprise and the Ministry of Mines will be responsible for signing the Gas Supply and Purchase Agreement, which will guarantee a specific amount of gas at a specified price and specified quality to the gas-fired thermal power plant. USAID is contributing to the fuel supply effort through a \$30 million, on-budget grant to the Ministry of Mines to begin development work in the gas fields. Once the contractor has completed the development work under the anticipated contract, the gas wells will be turned over to the Afghan Gas Enterprise for operations and maintenance. Documents produced in support of the gas field development suggest that additional development work beyond the \$30 million offered by USAID will be necessary to ensure sufficient supplies of pipeline quality gas to the power plant. Aside from the recommendations

¹⁵¹ Chapter 1, Article 4: Scope of application. Procurement Law. 2009.

mentioned above, there is nothing in the Hydrocarbons Law and Hydrocarbon Regulations that will adversely impact the IPP transaction.

IV. CONSTRUCTION, LAND & WATER ISSUES

A. Customs Law

In Afghanistan, as in other countries, the customs administration and regime are crucial to international trade, as well as the economic and social development of the country. Customs duties are also critical to the revenues of GoIRA. Customs duties and taxes have grown from Afs 7.7 billion for the fiscal year (commencing 21 March) of the year 1384 to Afs 19.6 billion for the year 1387. In the first two quarters of the year 1388 (2009), customs duties and taxes were approximately Afs 17.4 billion¹⁵² (approximately USD 383 million¹⁵³). Despite the important role customs duties play in the economy, customs collection has been plagued by antiquated procedures, poor facilities, ill trained staff, and chronic corruption. However, the situation is improving. Reform efforts at the Afghanistan Customs Department (“ACD”) began in 2002-2003, and customs reform has been assigned a high priority by the GoIRA. In 2005, implementation of the Automated System for Customs Data (“ASYCUDA”) began. The ASYCUDA Declaration Processing System has been installed in six of Afghanistan’s custom houses/areas (where customs declarations are received). This automated system improves transparency, reduces the opportunity for arbitrary imposition of delays by customs personnel for purposes of bribery, and streamlines the process, reducing the previous declaration processing procedure from 14 steps and signatures to three.

The Customs Law was adopted March 20, 2005, pursuant to Article 42 of the Constitution to ensure collection of customs revenues of the State, and the Ministry of Finance (“MoF”) was given the responsibility for collection of customs revenues and enforcement of the Customs Law (Article 2). Within the MoF, the ADC is the primary implementing body for the control of the flow of goods into and out of Afghanistan and collection of custom duties and taxes. The Customs Law sets out the organization and authority of the customs administration, the process for appeal of custom decisions, the procedures for import and export and the imposition of duties, and the penalties for customs violations.

Customs areas are established at border crossing points, international airports, duty free zones, customs warehouses and other points where goods may enter the country; and goods may cross the State border and designated customs borders only at staffed customs areas. The responsibilities that principally fall to ACD as identified in Article 11 are:

- Determining the value of goods and collecting the related customs debt (*i.e.*, duties, penalties, charges, dues, and other financial obligations that attach to specific goods or actions);
- Supervising, detecting, reporting and preventing smuggling;
- Detecting and evaluating violations of this law;
- Participating in preparing and signing international agreements and conventions in customs matters;

¹⁵² Afghanistan Customs Department Statistics.

¹⁵³ Calculated using the exchange rate of USD 1 to Afs 45.28.

- Preparing, collecting and, upon agreement of the Minister of Finance, distributing foreign trade statistical data
- Supervising customs goods, throughout the customs territory of the state;
- Exercising customs control over customs areas;
- Maintaining customs records;
- Carrying out all other activities determined in customs legislation.

When a commercial transport carrying goods for import or export enters or exits a customs area the pilot (for transportation by air) or driver (if by land) must submit a manifest of goods for the goods carried. The manifest of goods contains information concerning the nationality, flag, and crew of the means of transport, as well as the information necessary to identify the cargo. At that point the goods become subject to the control and supervision of the ADC and will remain so until determination of their final customs designation (Article 34). Goods believed by customs officials to be smuggled or prohibited may be seized, and upon a final decision by an authorized authority, sold or other authorized action (Article 52). Prohibited goods are those the customs authority has adopted restrictions to entry “for reasons of public morality, public security, protection of environment, health and life of humans, animals or plants, the protection of national treasures possessing artistic, historic or archaeological value or the protection of industrial and commercial property and other state policies.” (Article 53) A broker program has been instituted nationwide and importers and exporters are to execute customs clearance of goods by a regulated and licensed customs broker (Article 15).

Travelers, except diplomatic couriers, are to declare goods in their possession, show them upon request, and customs officials may inspect the goods to verify the declaration (Articles 45 and 58). The owner or agent of goods is to submit a customs declaration within one hour after presentation of the goods at customs. If the owner or agent cannot complete the customs declaration in that time, a summary customs declaration shall be submitted within one hour of presentation of the goods (which time for submission of a summary declaration may be extended to the next working day). If a summary customs declaration is submitted a full customs declaration must be submitted within five days of submission of the summary declaration (Article 48). Customs declarations are to be accompanied by any required customs documents governing the requested customs process (Article 55), for example all imported goods and products must have an original bill of lading and inventory documents,. Goods entered into customs supervision under a summary customs declaration will be placed in temporary storage until the completed customs declaration is received, and the owner may be required to provide security to ensure payment of any customs debt (Article 50).

For purposes of assigning a customs designation, customs officials are to identify the goods and assure themselves of their nature. Declarations are to be accepted by the customs authority without delay so long as the goods to which the declaration applies can be made available for inspection. Customs officials may verify any customs declaration and accompanying documents and may require additional documentation, or examine the goods and take samples for detailed examination (Articles 47 and 58).

The customs officials must then calculate the customs debt owed on non-exempt goods. Exemptions to customs duties are provided, among them are items intended for personal use by foreigners working in Afghanistan according to the terms and conditions of their contract; permitted books, gazettes, magazines and newspapers; travelers' personal goods in accordance with the Customs Tariff; used movable property belonging to natural persons, who transfers their normal place of residence from another country to the State, as provided in the Customs Tariff; and other goods as may be included in exempted goods upon recommendation of Ministry of Finance and approval of Council of Ministers, as required. A full list of exemptions is contained in Article 27.

Computing the customs debt owed on non-exempt goods is done by determining the category of the good, and applying the customs duty rate applicable to the good to the value of the good. ACD employs the Harmonized System of classification of goods. Different tax rates apply to different categories of goods. ACD employs the Harmonized System of the World Customs Organization for classification of goods. The Customs Tariff is approved by the Minister of Finance and no treaty, international agreement, law, regulation, or other legislative document can affect the Customs Tariff without an amendment or annex to the Tariff (Article 23). However, favorable tariffs may be granted if implemented by amendment or annex to the Customs Tariff (Article 27). The Customs Tariff can be downloaded from the website of the ACD at http://www.customs.gov.af/downloads/tariff/tariff_2008_english.pdf.

The Customs Tariff lists 21 Sections and 97 subsections of goods that extend from live animals to nuclear reactors, with multiple goods listed under each subsection and their respective import duty rate. The duties are relatively low. The rates range from 0% to 40% percent, with the vast bulk of goods carrying an import duty rate of between 2.5% and 10%. When a consignment involves goods falling into different classifications (mixed goods), and preparation of a declaration for each tariff classification would be time-consuming and expensive, the customs authority, with the consent of the declarant, may charge the highest tariff rate for goods in the consignment to the entire consignment based on the declarant's estimate of the proportionate amount of each type of goods in the consignment. World commodity indices, catalog costs, and lists of acceptable values for purposes of valuing goods. The value of goods is computed in Afghan currency. If the value of goods is expressed in foreign currency, the exchange rate used is the exchange rate of Da Afghanistan Bank (the central bank of Afghanistan), updated monthly (Article 25). To calculate the customs debt, the relevant duty rate is applied to the value of the goods.

The ACD is to calculate customs duty within 48 hours after the customs declaration is accepted, "or for such other period of time as may be fixed in the Procedure for [customs] valuation of goods." (Article 151) Customs official will releases the goods as soon as the particulars of the declaration have been verified, and the customs debt, and any penalties or other obligations paid or security is provided (Article 62). If the customs debt is deferred on provision of security and the period of deferral is over 30 days, the ACD may collect a charge of .01% per day "or such other amount as is fixed by relevant procedures." If the customs debt is not paid when due, the ACD is take all actions permitted by law to collect the debt plus interest. This includes notifying any registry of property or banks of a security interest in the

registered movable and immovable property of the customs debtor. It may also collect the customs debt as a preferred creditor from a third party with obligations to the customs debtor (Article 158).

Chapter 11 relates to duty free zones and free warehouses. According to Article 124, “[D]uty free zones, free warehouses and duty free shops shall be a separate part of the customs territory of the State, in which non-Afghan goods are considered, for purposes of import duty and commercial policy measures, as not being on Afghan customs territory.” However, they are subject to ACD control and supervision (Article 126). The MoF is authorized to designate parts of the customs territory of the State as free zones and approve construction of any building in a free zone, as well as duty free shops for the sale of goods with exemption from import duty. There do exist some duty free shops, but there are no duty free import zones or ports in Afghanistan.

Violations of the Customs Law fall into two categories: (i) administrative violations, and (ii) smuggling. Administrative violations are divided into three classes punishable by fines, with the size of the fine increasing with the seriousness of the violation.

Commission of the following acts is deemed smuggling:

- Introduction of goods into the customs territory of the State, or the exit of goods, in violation of the provisions of this Law and other customs legislation, with the intent of avoiding customs control or supervision.
- To carry prohibited goods for the purpose of import, export, or storing without permission of the relevant authorities.
- Selling or purchasing of goods in transit without paying customs duties

Additionally, carrying out certain acts repeatedly or showing intent to carry them out, as well as certain acts committed by an airline Captain are considered smuggling. See Article 172 for a list of such activities.

The penalties for smuggling are (i) confiscation of the smuggled goods; (ii) a fine of two to five times the customs debt that would have applied; and (iii) imprisonment depending on the value of the smuggled goods and whether they are banned goods. If imprisonment is applicable, the sentence is increased for the perpetrators that are government employees; or if there are aggravating circumstances (two or more additional persons were involved, armed resistance by the smuggler, or the death of a customs official). (Article 173 and Articles 179-181)

Any decision of a customs official (including decisions related to the assessment of fines) is reviewable. A party may request review of a disputed decision to the General Directorate of Customs. If the party objects to the decision of the General Directorate of Customs, the dispute may be submitted to the Customs Arbitration Administration consisting of three members appointed by the President, and the Administration’s decision is final if the contested amount is Afs 50,000 or less. If the amount involved is greater than Afs 50,000, the party may refer the matter to the relevant commercial court (Articles 18, 20, and 186).

It must be acknowledged that, although improving, customs procedures remain complex and inefficient. While training of customs personnel is on-going, there is more to do to increase their professionalism. Customs facilities lack proper equipment and laboratories, and classification of goods and other decisions are inconsistent. There are still reports of Provincial interference with customs operations. Enforcement is weak and, given the significant discretionary authority, corruption is a continuing problem. These problems reduce revenues to the government, deter foreign investment, and thwart economic growth. However, the Customs Law does represent progress, as does the continuing implementation of ASYCUDA.

Impacts on the IPP

The IPP will need to import equipment and goods in significant amounts and of significant value, and will benefit from the relatively low tariffs in Afghanistan. However, the IPP must be mindful of the problems described, be prepared and include the potential for customs delays in its planning, should use licensed brokers, and pay particular attention to the necessary paperwork to minimize delays.

B. Procurement Law

The Procurement Law was enacted in July 2008, repealing the previous Procurement Law of 2005. However, the World Bank (“WB”) expressed strong reservations concerning the new Law and urged its amendment, going so far as suspending the Afghanistan Reconstruction Trust Fund (“ARTF”) of which the WB was a major contributor and the administrator of the fund. After securing an official and reliable English translation of the 2008 Law from the Dari, the WB responded with 66 substantive observations. After discussion with the MoF, it was agreed many of the observations could be satisfied through policy circulars, procedural rules and standard bidding documents modification. But there remained issues that could only be resolved by amendments to the Law. A solution was proposed in which 27 of the 66 WB observations would be addressed by amendments and the remainder through later legal and policy documents. The solution was ultimately adopted, amendments drafted, and necessary steps for a Presidential decree taken. The cabinet of Ministers accepted the amendments and the amendments were enacted by Presidential decree in January 2009.

The Law’s stated objective is “to regulate the public procurement of goods, services and coordination of works, both domestic and foreign, for administrations, institutions, and mixed companies.” The Law was developed to fulfill the objective by ensuring transparency in procurement, effectively controlling public expenditure, ensuring best value for money through the procurement procedures, and providing all eligible bidders the opportunity to participate in the tendering process. In the context of the proposed IPP, the primary question is whether the purchase of electric power and capacity by DABS from the IPP falls within the Procurement Law and its procurement procedures, and, if so, what procurement methods may be used for the purchase.

In scope the Procurement Law requires all “entities,” municipalities, and other units funded under the government budget to procure goods, works and services pursuant

to its procedures, except (i) where such procurement requires confidentiality for the protection of the nation, (ii) where procurement rules of an international institution conflict with the Procurement Law (in which case the GoIRA may agree to apply the procurement rules of the international institution), and (iii) where government entities abroad apply the procurement rules of the host country (Article 4). Under Article 3, Terminology, procurement by definition is “the acquisition of goods, works or services by entity or through a contractor by use of public funds”, while an entity is “any ministry, independent head departments, state owned enterprises, other budgetary unit, and also municipality, government companies and mixed companies in which the share of State ownership exceeds twenty-five percent (25%).”

Does the purchase of electric power and capacity by DABS from the IPP fall within the Procurement Law and its procurement procedures?

To be within the Law’s scope it must be an entity, and funded under the government budget. First it must be determined whether DABS is an entity. Based on the definition in the Law it appears clearly to be, since it is wholly owned by the State and its Board of Directors is entirely composed of state officials.

Procurement, as noted, requires the use of public funds, and entities funded under government budget must procure goods, works and services in accordance with the Law. So it must be considered whether DABS is using public funds in its procurement and funded under the government budget. This issue is more problematic. According to the Comprehensive Agreement between DABS and the MoF dated 22 February 2009, to sustain DABS for the first five years of its operations it is to receive subsidies from the Core budget to cover fuel costs. So until 30 March 2014, DABS is to receive Core budget subsidies. Therefore, its acquisition of fuel would appear to be subject to the Procurement Law, but because it is receiving money from the Core budget, under the language of the scope of the Law it may be considered to be within that scope at least for the first five years of its existence. If the Regulations are to be relied on, it would certainly be within the Law beyond the first five years. The term Public Funds is undefined in the Law but a definition is provided by the Procurement Regulations. The regulations define Public Funds as “moneys or other financial assets defined in Article 8 of the Public Finance and Expenditure Management Law (“PFEML”), and includes any monetary resources appropriated to procuring entities through budgetary processes, as well as extra budgetary funds including aid grants and credits put at the disposal of procuring entities by foreign donors, and revenues of procuring entities.” According to Article 8 of the PFEML, money means “money or other financial assets in the custody or under the control of the state, or money or assets in the possession or under the control of any person acting for or on behalf of the state in receipt of the custody or control of the money.” Thus, the Regulations, in the definition of Public Funds, treat money in the custody and control of the state or any person acting on its behalf, equivalent to public money under the PFEML, although it is not clear in the context of that law whether the definition is appropriate here. However, consistent with the expansive approach taken by the Regulations as to the application of the Law, the definition of Public Funds also includes revenues of procuring entities. DABS’ procurements would according to the Regulations continue to be regarded as under the Procurement Law beyond 2014.

To be within the scope of the Procurement Law, DABS would have to be acquiring goods, works or services from the IPP. Works are activities that essentially involve construction or renovation of a structure, the installation of equipment or materials or services incidental to construction, provided the value of those services does not exceed the value of the construction itself. Since DABS is not acquiring construction or equipment from the IPP, there is no procurement of works.

Goods constitute “objects of every kind including raw materials, products and equipments, whether in solid, liquid or gaseous form, as well as services incidental to the provision of the goods, provided the value of such incidental services does not exceed that of the goods.” This definition is very broad and identical to the definition of goods contained in the 2005 Procurement Law, which this Law replaced, except that the 2005 law specifically referenced electricity. Thus this 2008 Law repeated verbatim the earlier Law but intentionally deleted electricity arguably because it was not intended to be included in the definition of goods, and this Law.

The only definition in the Procurement Law referencing Services is the definition of Consultant’s Services, which are activities of a professional or advisory nature, and include design, supervision, training, auditing, software development, expert proposals and advice. However, as in the case of Public Funds, the Procurement Regulations implementing the Law go on to include a definition of Non-consultancy Services in a catch-all fashion as any object of procurement other than goods, works, or consultancy services. Thus, the Regulations appear to take the position everything acquired by an entity is subject to the Procurement Law. It can be argued that the Regulations apply an overbroad interpretation of the Law and that, when referring to goods, works or services, the services the Law is referring to are consultancy services and services incidental to the provision of goods and works. Therefore, there is not a definitive answer to whether the acquisition of electric power and capacity by DABS from the IPP is within the Procurement Law under the terms of the Law itself. Such an acquisition by DABS is clearly under the Law only if the interpretation of the Law embodied in the Regulations is accepted as correct. However, it should be noted that the draft Electricity Law speaks in terms of electricity service.

Additional General Provisions

The Procurement Policy Unit (“PPU”), a unit within the Ministry of Finance, is to issue standard bidding documents, contracts and other forms for use in procurement. Goods, works or services are to be procured from national sources unless the price is higher than imported procurement by a set percentage, and bidders having a resident representative or are otherwise subject to Afghanistan taxes is also provided a preference in procurement. The PPU is to implement measures for the use of information technology (“IT”) and procuring entities are to cooperate with the PPU in the employment of IT; and the PPU may issue procurement proceeding guidelines for environmental protection.

Procurement Planning

Entities are to develop procurement plans considering appropriate limitations and submit them in accordance with the PFEML. Procurement details, needs, and the

allotment of budget must be approved before initiation of a procurement proceeding, except that such allocation of funds prior to initiation of a proceeding, in exceptional circumstances, may be waived with the approval of the Treasury Department. Planned multi-year contracts must have the approval of the MoF prior to their conclusion.

The bid documents should clearly describe detailed requirements, such as quality, quantity, technical specification, etc., but to avoid biasing the procurement proceedings in favor of particular bidders such information should describe the goods, works or services in terms of performance desired, and national and international standards; and technical standards should avoid reference to particular manufacturers, service providers, or design, unless unavoidable, in which case a term such as “or the equivalent” must be used.

A procurement contract may be split up or disaggregated if technically or financially warranted, but may not be done to avoid competitive methods of procurement and such disaggregations will be audited by the PPU.

Prequalification of Bidders

In order to participate in a procurement, a bidder must demonstrate that it possesses the necessary qualifications, competence, and experience; financial resources; personnel; equipment; managerial capacity; and business capacity to fulfill the contract.

Further, to be eligible the bidder, including its directors and officers, shall:

- Have the capacity to contract;
- Not be insolvent or subject to legal proceedings that could lead to insolvency;
- Have no conflict of interest;
- Not have been convicted for business or professional misconduct, or for making false representations of its qualifications within the prior three years;
- Not be subject to debarment or have been associated with or a relative of a bidder/contractor currently subject to debarment. (Article 17)

For complex procurements or for groups of contracts, an entity may hold a prequalification proceeding to evaluate the qualifications of bidders responding to an invitation to bid containing application for prequalification. Written responses to requests for clarification must be sent to all bidders within 10 working days for national tenders and 14 working days for international tenders, and all bidders that prequalify will be invited to submit bids in the associated procurement proceeding (Article 18). For ease in identifying eligible bidders, the MoF and other entities will develop a data base into which eligible bidders may request registration at any time. The data base details will also include those bidders debarred for violation of this Law (Article 19).

Procurement Methods and Procurement Proceedings

The Procurement Law specifies seven methods of procurement, with the selection of the appropriate method included in the procurement plan of the entity (Article 20). The seven methods are:

- Request for quotations;

- Open tendering;
- Restricted Tendering;
- Single source procurement;
- International tendering;
- Invitation to bidders for two stage tendering;
- Procurement of infrastructure and award of concessions.

There is also a Request for Proposals Proceeding for use in all consultancy procurements (except those meeting the conditions for use of single source procurement (Article 37)).

The Law provides that the prequalification documents, bidding documents, contract, and contract conditions be in one of the official languages of Afghanistan. In case of an international procurement, at the discretion of the procuring entity, they may be in English or another language used in international trade. Note that Rule 50 of the Regulations provides that where an international tender is involved, the tender notice shall be in English. However, if a document in a foreign language is submitted, a translation into one of the official languages must accompany it, translated by a certified translator,

Requests for Quotations

Requests for quotations may be used when the estimated value does not exceed Afs 500,000 for the procurement of works, services, or readily available commercially standard goods. The request for quotations stating the quality, quantity, terms, delivery time, time for submission, and any other requirements shall be submitted to at least three qualified bidders, and should be national if at least three qualified Afghan sources can satisfy the procurement at appropriate prices. The bidder that submits the lowest-priced quotation meeting the requirements is the winner, and its written acceptance of the purchase order constitutes the contract.

Single Source Procurement

A single source procurement is only permitted when the estimated value does not exceed Afs 3,000 or the estimated value exceeds Afs 3,000 but (i) it is demonstrated on the record that only one contractor is able to meet the procurement requirement in the time required; (ii) the contractor has exclusive rights to the required goods, works or services; or (iii) there is an emergency need involving an imminent threat to public health, welfare or safety, or an imminent threat to property (Article 24). Because of the difficulties associated with working in Afghanistan, the complex financing, and the need to coordinate all infrastructure projects, investors may be able to bring themselves into item (i) above, if DABS, as the procuring entity agrees.

Open Tendering

Open tendering is the default procurement method under the Procurement Law, and a written justification is required for use of any other procurement method (Article 22).

Restricted Tendering

Restricted tendering may be used when the goods, works or services are only available from a limited number of bidders; the time and cost of evaluating a large number of bids outweighs the procurement value; or unforeseeable circumstances (not attributable to the procuring entity) renders open tendering impractical (Article 23).

International Tendering

International tendering may be used when the goods, works or services required are not available at competitive prices from at least three Afghan bidders; or a national tendering failed (Article 25).

Two Stage Tendering

Two stage tendering may be used when the procuring entity is not certain of how best to meet its needs and seeks proposals as to the means; or because of the technical character of the procurement; or the nature of the services it needs to negotiate with the bidders (not normally permitted in other tender methods); or where the procurement involves non-commercial research and development.

The bidding documents in the initial stage shall request technical information only outline details of the requirement, indicating any technical, performance or contractual parameters, but not a bid price. The entity may negotiate with the bidders to understand their proposals.

After the end of the first stage, the procuring entity may finalize the technical and contractual terms and send them to bidders whose first stage bid was not rejected a second invitation to bid on the procurement, which shall include prices (Article 39).

Request for Proposals Proceedings

As noted, this method is used for procurement of consultants. A request for expressions of interest will be published containing scope of the assignment, criteria for short listing, and other necessary details. Based on the response to the expression of interest, a request for proposals for consultancy services will be sent to at least six short listed respondents. The request for proposals will contain information bidders need to submit responsive bids, including the criteria for selection. The bidder whose proposal best meets the criteria is awarded the consultancy (Article 37).

Procurement of Infrastructure and Award of Concessions

Special procedures apply to contracts for private investment in construction or operation of public works and other public goods, and contracts for service concessions. These include, among others, identification of special technical and financial evaluation criteria, identification of exceptional circumstances where the contract may be awarded without competition, and procedures for non-solicited proposals. The special rules are contained in Annex-6 of the Regulations (Article 40).

Most pertinent for purposes of the IPP, Annex-6 addresses (i) Negotiation of contracts without competitive procedures (Section D of Annex-6), and (ii) Unsolicited proposals (Section E of Annex-6).

The procuring entity may negotiate a procurement contract without using competitive procedures in the following instances:

- (a) There is an urgent need for ensuring continuity of service and competitive bidding is impractical.
- (b) The project is of short duration and the anticipated initial investment value does not exceed an amount set by the PPU.
- (c) There is only one source capable of providing the required service, such as when the use of intellectual property, trade secrets or other exclusive rights owned or possessed by a certain person is needed.
- (d) Cases of unsolicited proposals under section E of this Annex.
- (e) When pre-qualification proceedings or a request for proposals has been issued but no applications or proposals were submitted or all proposals failed to meet the evaluation criteria and, in the judgment of the procuring entity, issuance of a new proceeding and a new request for proposals would be unlikely to result in a project award within a required time frame.

Unsolicited proposals can be entertained without pursuing the tender procedures if they do not relate to a project already initiated or announced and the procuring entity determines the proposal is potentially in the public interest and it meets the other requirements of Section E of Annex-6. If the procuring entity considers that the proposal does not involve intellectual property, trade secrets or other exclusive rights, and the proposed concept or technology is not truly unique or new, if it decides to implement the project it will initiate a procurement proceeding for prequalification of bidder (who, after they have been prequalified will be allowed to form consortia), and a request for proposals employing a single stage or two stage procedure. The proponent will be invited to participate in the procurement proceedings and may be given an incentive for having developed and submitted the proposal. If the entity determines that the unsolicited proposal involves intellectual property, trade secrets or other exclusive rights, and the proposed concept or technology is truly unique or new, it may still seek to obtain elements of comparison by publishing a description of the essential output elements of the proposal with an invitation for other interested parties to submit proposals. If no proposals are received, the procuring entity may negotiate with the original proponent. If proposals are received, the procuring entity shall invite the proponents to negotiations, and if a significant number of proposals are received, the entity will initiate procurement proceedings subject to any incentive that may be given to the original proponent.

Looking at the requirements for negotiated contracts without competition and for unsolicited proposals, a negotiated contract would not be possible unless the investors can demonstrate that they are the only source capable of providing the required service, primarily resulting from their possession of intellectual property, trade secrets or other exclusive rights. Or alternatively, a prequalification or tender proceeding is initiated by the procuring entity, it fails and the entity considers a new procurement proceeding will be unlikely to result in an award.

Tendering Procedures

Bids are invited by a procurement announcement containing a description of the procurement, means of obtaining bidding documents, deadline for submission, provisions for any security required, and other information to permit submission of bids published in a manner calculated to reach its target audience. If there are no respondents to the prequalification announcement or no responses to the request for proposals, the Procurement Office will investigate, and adjust the bidding documents, or choose a new method of procurement.

Bidding documents will be sent to all eligible bidders responding to the invitation to bid and provide the basis for the tendering procedure. The time for submission of bids shall be from 21 days to 90 days. The Regulations the minimum bidding periods as follows:

- Twenty-one (21) working days for open tendering, where the tendering is National;
- Thirty (30) working days for open tendering, where the tendering is international;
- Fourteen (14) working days for restricted tendering, where the tendering is national;
- Twenty one (21) working days for restricted tendering, where the tendering is international.

The bids will be signed, sealed and submitted. Any late bids will be returned unopened.

The bids will be opened in a public proceeding in the presence of bidders and evaluated according to the terms of the bidding documents by the evaluation of bids committee. The successful bid will be the lowest evaluated responsive bid taking into consideration the matters itemized in Article 33 of the Law. The evaluation of bids committee shall prepare a report demonstrating the advantages and disadvantages of each bid, and include any dissenting opinions, which report will be submitted to the Procurement Committee for decision on contract award. If the successful bidder fails to conclude a contract, the contract award will be offered to the other bidders according to their evaluation ranking.

A procuring entity may reject all bids before acceptance, or cancel the procurement, and it shall have no liability for such actions.

Security

A bid security may be required in the bidding document to secure the bidder's obligation to enter into a procurement contract; a bidder may also be required to provide a performance security to secure its contractual obligations; and, if a contractor receives an advance payment, it may be required to provide a guarantee to secure the obligation to repay. The security may be in the form of cash, a bank guarantee or equivalent instrument.

Contract Administration

The standard forms issued by the PPU or a contract containing specified terms tailored to the specific procurement. Contract pricing may be stated as a unit price applied to the quantities delivered or a lump-sum for all or part of the contract, and may provide of a provisional price and include incentive clauses. Contract variations above certain levels may modify the contract and a modification that exceeds 25% of the contract value requires initiation of a new procurement proceeding or a single source procurement approval. Contracts longer than 12 months may permit price adjustment for cost changes and their timing, and may be terminated or re-negotiated if the adjustment is over a certain amount or percentage. The contract may provide for progress payments or advance payments subject to a guarantee. According to the Law the contractor may subcontract up to 20% of performance with consent of the entity, and shall subject the contractor to liquidated damages for delay.

Chapter VIII, Section B identifies the types of contracts a procuring entity may use. The only contract listed that would seem remotely applicable to the IPP and for the sale and purchase of electric power or capacity is the Framework Contract. Payments under a framework contract shall be for the actual quantity delivered or performed during the time period covered by the contract, using the fixed unit prices specified in the contract. According to the regulations:

The Framework contract may include an estimated quantity or value, but shall not commit to purchasing this estimated quantity or value. Framework contracts may commit to purchasing a minimum quantity or value or to purchasing all similar requirements from the contractor, where this is necessary or preferable to obtain competitive prices.

This conflicts with the intent of the proposed power purchase agreement for the project that contemplates that DABS will agree to take the capacity of the plant.

Transparency

The Law contains strong transparency measures regarding communication; maintenance of records; the obligations of procurement officials, as well as bidders and contractors. It calls provides for the right of unsuccessful bidders to receive explanation; development of websites by entities; the right to review and the to be followed; and the debarment of bidders.

Functions of Procurement Entities and the Responsibility of Award Authority and Special Procurement Commission

The Law sets forth the functions of the procurement bodies at the entity level and above. It further establishes threshold limits of award authorities. An award authority is defined as “the person with authority to award a contract or approve a contract modification concerning the procurement of goods, services or works, pursuant to provisions of this Law and the PFEML.”

The current threshold limits of an award authority are:

Threshold Limits

Procurement Method	Approval Authority of Minister		
	Goods	Works	Services
	Afs.		
<i>(i) National Open Tendering</i>	20,000,000	100,000,000	20,000,000
<i>(ii) International Open Tendering</i>	40,000,000	200,000,000	40,000,000
<i>(iii) National Restricted Tendering</i>	8,000,000	16,000,000	8,000,000
<i>(iv) International Restricted Tendering</i>	16,000,000	32,000,000	16,000,000
<i>(v) National Single Source Procurement</i>	5,000,000	25,000,000	5,000,000
<i>(vi) International Single Source Procurement</i>	10,000,000	50,000,000	10,000,000
<i>(vii) Request for Proposals for Consultancy Services National and International</i>			40,000,000
<i>(viii) Request for Quotation</i>	500,000	500,000	500,000

Additionally, the Law created the Special Procurement Commission, which has the responsibility for approval of contract awards that exceed the threshold level of award authorities. The Special Procurement Commission is composed of the Ministers of Justice, Economy, and Finance, with the Minister of Finance as chair. The Commission is to review procurement contracts submitted to them by the relevant award authority for approval, and decide to approve or reject the contract. Any procurement submitted for review that is not rejected in 21 days is deemed approved. Among the duties of the PPU is the annual review and propose revisions to the threshold limits to the Special Procurement Commission.

Impacts on the IPP

The answer to the question of whether the purchase of electric power and capacity by DABS from the IPP falls within the Procurement Law and its procurement procedures is clearly answered yes, if the Regulations are considered. The issue is more problematic if only the Law is relied upon. No legislative or regulatory history has been accessible as a guide on the matter, however, if the IPP wishes to press the issue, they could request or try to persuade DABS or MEW to request an opinion from the Attorney General's office. The second prong of the primary question asks if the transaction between DABS and the IPP is within the law, what procurement methods may be used for the purchase. Certainly all of them, if the investors are willing to go through a tender. However, given the constraints entailed in working in Afghanistan, the complexity of the project, the integration of the current infrastructure projects required, and the complicated financing arrangement involved, an argument can be made that the project qualifies for the single source financing method, if

DABS agrees. Further, since the project would exceed the threshold value of the award authority, it would have to be approved by the Special Procurement Commission. Unless the investors can demonstrate that they are the only source capable of providing the required service, primarily resulting from their possession of intellectual property, trade secrets or other exclusive rights, they will likely not qualify for a negotiated contract under the negotiated contract without competition or the non-solicited proposal provisions of Annex 6-1 of the Regulations. But if the investors are willing to submit a proposal and wait to see if the procurement process fails at an early stage, without likelihood of an award, a negotiated contract may be possible under the provisions of Annex 6-1. Even with a negotiated contract, if the entity must use one of the types of contracts set out in the Regulations, it may not fit the needs and its provisions limited in an unsatisfactory manner.

C. Land and Land Acquisition

Land in Afghanistan - Generally

The system of land ownership in Afghanistan has been a difficult social problem for the Afghan rulers prior to the civil war, during the Soviet occupation, and was even a challenge under Taliban rule. Property rights are addressed in three places in the Afghan Constitution: Article 38, Article 40 and Article 41. Article 38 states that personal residences shall be immune from trespassing, and requires permission from a court to enter and search a private residence.¹⁵⁴ Article 40 states that property shall be safe from violation and no one can be forbidden from owning property except as limited by law.¹⁵⁵ Article 40 also provides the State the right of eminent domain, which allows a taking only for the sake of public interests, and in exchange for prior and just compensation.¹⁵⁶ Article 41 states that “[F]oreign individuals shall not have the right to own immovable property in Afghanistan.”¹⁵⁷ Article 41 does allow lease of immovable property for the purpose of capital investment in accordance with the law.¹⁵⁸ In addition to the constitutional provisions, Afghanistan is currently working to revise its land laws. There are several competing land laws in Afghanistan, dating back to before the 1970’s. The most recent land law that could be located was one for the Islamic Emirate of Afghanistan, published during the Taliban times and of questionable validity now. There is a Draft Land Policy that addresses some of the issues associated with land ownership and property rights.

Contained within the 2007 Draft Land Policy, there are two issues which affect property rights that are important for the IPP transaction. The first is a lack of a unified system of deeds and title to land. In Afghanistan, proof of land rights is based upon tax records, *Amlak*¹⁵⁹ registration, customary deeds, formal deeds, and local knowledge.¹⁶⁰ Further, some formal deeds are suspect or fraudulent, and some of the registered deeds have been destroyed during the 30 years of conflict.¹⁶¹ The

¹⁵⁴ Chapter 2, Article 38. Constitution of the Islamic Republic of Afghanistan.

¹⁵⁵ Chapter 2, Article 40.

¹⁵⁶ *Id.*

¹⁵⁷ Chapter 2, Article 41.

¹⁵⁸ *Id.*

¹⁵⁹ *Amlak* is a Dari word for “properties.”

¹⁶⁰ 2007 Draft Land Policy, page 7.

¹⁶¹ *Id.* at page 8.

government is planning to re-create documentation regarding land ownership based on clarification and certification processes conducted at a local level.¹⁶²

The Draft Land Policy also addresses the constitutional limitation that foreigners cannot own land in Afghanistan. The Policy states that “it is national policy as enshrined in the Constitution that foreigners may not own land, and may only obtain property rights to commercial, retail and industrial property, and agricultural and residential land in the form of a leasehold. Such leases may be for a term of up to but not to exceed 50 years.”¹⁶³ The leasehold is designed to facilitate foreign investment in Afghanistan without actually transferring property rights to foreign citizens.

Land in Afghanistan – Impacts on the IPP Transaction

The Sheberghan Gas Field Development Project and the Ministry of Mines have had direct correspondence regarding the status and ownership of the land for the proposed IPP. The SGFDP team received an official letter from the Deputy Minister of Mines which stated in relevant part: the area surrounding the Garquduq gas field, including your proposed site for the IPP, belongs to Afghan Gas Enterprise, and is accordingly considered property of the Government.¹⁶⁴ Since this information comes from the Deputy Minister of Mines, and after reviewing the project site during subsequent field visits, the SGFDP team is proceeding on the assumption that the proposed project site belongs to the Afghan Government and there are no further property ownership claims or issues that would adversely impact the IPP transaction.

The land ownership issue could have been a serious problem for the IPP because it would have been difficult, given the problems listed above, to determine the rightful owner and negotiate a lease for the IPP. However, since the land appears, for all intents and purposes, to be the property of the Government of Afghanistan, there should be no adverse property issues that would affect the ability of the IPP to conclude a lease of up to 50 years with the Afghan Government, specifically Afghan Gas and the Ministry of Mines who are claiming to be the property owners. Obtaining clear title in Afghanistan will be very difficult, but one of the provisions of the lease could be that if another individual makes a successful claim on the property, that the Afghan Government will immediately acquire the property using its power of eminent domain, at its own expense. Such a provision would allow the most certainty in title to the land as can be reasonably expected in Afghanistan.

D. Water Law & Related Issues

Water in Afghanistan - Generally

Afghanistan has an arid to semi-arid climate and water resources throughout the country are scarce. Afghanistan is the headwaters for many river systems in the region. The use of water for the IPP and for the gas processing plant could have significant impacts on the usage of water in local communities. Afghanistan has a

¹⁶² Id.

¹⁶³ Id. at page 10.

¹⁶⁴ Translated correspondence between the SGFDP and Deputy Minister of Mines, Dep. Engr. Akram “Ghyasy” dated March 31, 2010.

water law in order to regulate water usage and provide for some certainty in water use by domestic, commercial and industrial users. The Water Law was designed to best allocate water, given local circumstances and conditions, among various water users and ensure sustainable use of water supplies for the various demands on the water system.

The Water Law - Generally

The Water Law was enacted on April 26, 2009. The Law was enacted under Article Nine of the Afghan Constitution, which states in relevant part: “Protection, management and proper utilization of public properties as well as natural resources shall be regulated by law.”¹⁶⁵ The purpose of the law is “conservation, equitable distribution, and the efficient and sustainable use of water resources.”¹⁶⁶ Under the law, water is considered a public property, making the government responsible for its protection and management.¹⁶⁷ The use of water for drinking water and livelihood is given priority, but water can also be used for industry, public services and energy production.¹⁶⁸ The use of water is free, but service providers can charge for operation and maintenance of water systems.¹⁶⁹

The Water Law – Roles of Relevant Ministries

MEW has primary responsibility for planning, management and development of water resources, in cooperation with other ministries and institutions.¹⁷⁰ MEW also has responsibilities related to collection, analysis and evaluation of hydrological data for surface water, construction and maintenance of hydropower facilities, and preparing water resources policies and strategies, among others.¹⁷¹ MEW is responsible for issuing Water Usage Licenses¹⁷² under the Water Law.¹⁷³

MoM is responsible for planning and implementation of activities to survey, explore, investigate, research and assess groundwater reserves and provide for their protection from pollution in cooperation with the Ministry of Public Health and NEPA.¹⁷⁴ MoM does not have a section on specific duties or responsibilities, like those listed for MEW above, in the Water Law. At one point, drafts of the water law contained a distinction between surface water and groundwater and allocated responsibility for surface water to MEW and groundwater to the MoM. That distinction has not disappeared entirely in the final version of the law. MoM has the responsibility for the survey, exploration, and research of groundwater resources, and their protection from pollution or contamination, in Afghanistan.¹⁷⁵ MoM is also given the authority to issue permits/licenses for the operation of “deep” wells for

¹⁶⁵ Chapter 1, Article 9. Constitution of the Islamic Republic of Afghanistan.

¹⁶⁶ Chapter 1, Article 1: Preamble. The Water Law. 26 April 2009.

¹⁶⁷ Chapter 1, Article 2: Ownership and Management of Water. The Water Law.

¹⁶⁸ Chapter 1, Article 6: Public Use of Water Resources. The Water Law.

¹⁶⁹ Chapter 1, Article 7: Fees for Water Services. The Water Law.

¹⁷⁰ Chapter 1, Article 8: Responsibilities of Government Institutions, subpoint 2. The Water Law.

¹⁷¹ Chapter 2, Article 10: Duties of the Ministry of Energy and Water. The Water Law.

¹⁷² A “Usage License” is defined in the Water Law as: “an official written document issued for usage of water resources according to the provisions of this law.”

¹⁷³ Id. at subpoint 13.

¹⁷⁴ Chapter 1, Article 8: Responsibilities of Government Institutions, subpoint 3. The Water Law.

¹⁷⁵ See supra, note 146.

agriculture, commercial, industrial and urban water supply purposes, once agreement of line Ministries has been obtained. In this sense, it would appear that the distinction between surface water and groundwater is still very much intact in the current version of the law.

The Water Law – River Basin Agencies & Councils

The Water Law contains a section on the formation and duties and authorities of River Basin Agencies and Councils.¹⁷⁶ River Basin Agencies are responsible for developing plans to manage water resources in accordance with national policies, implement decisions of the River Basin Councils, develop local programs for management and allocation of water resources, and develop mitigation strategies for droughts, floods and other natural disasters.¹⁷⁷ River Basin Councils are established by the Ministry of Energy and Water and are composed of representatives of water users, relevant central and local departments of the line ministries, and other relevant stakeholders in the river basin.¹⁷⁸ River Basin Councils are responsible for water resources management in the respective basin (according to national water policy), determining water allocations in the basin (also according to national water policy), managing and monitoring the right to use water in the basin, and establishing conditions to evaluate, adjust and deny use permits in the basin, among other duties.¹⁷⁹ The River Basin Council also has the duty to “issue, register, modify or cancel permits and archive related documents; and supervise the written terms of the permit.”¹⁸⁰ Finally, the River Basin Council is also the forum for resolving disputes arising from the distribution and use of water in the basin.¹⁸¹ Parties to a dispute can appeal the decision of the River Basin Council to MEW, and then to the court.¹⁸²

The Water Law allows for the formation of River Sub-Basin councils composed of water users, government institutions and other relevant stakeholders.¹⁸³ The River Sub-Basin Councils can develop water resource plans and handle dispute resolution, but cannot be involved with the permits and adjustments to water usage.¹⁸⁴ In addition to River Sub-Basin Councils, water users can form Water User Associations and Irrigation Associations with their respective rights established by charter in accordance with the Water Law.¹⁸⁵ Under the River Sub-Basin Council section, the number of members and method of election for both River Basin Councils and River Sub-Basin Councils are to be established by a charter.¹⁸⁶

¹⁷⁶ See Chapter 3: River Basin Agencies and Councils. The Water Law.

¹⁷⁷ Chapter 3, Article 12: River Basin Agencies, subpoint 2. The Water Law.

¹⁷⁸ Chapter 3, Article 13: River Basin Councils, subpoint 1. The Water Law.

¹⁷⁹ Chapter 3, Article 14: Duties of the River Basin Councils. The Water Law.

¹⁸⁰ *Id.* at subpoint 5.

¹⁸¹ *Id.* at subpoint 6.

¹⁸² Chapter 3, Article 16: Implementation of River Basin Council Decisions. The Water Law.

¹⁸³ Chapter 3, Article 17: River Sub-Basin Council. The Water Law.

¹⁸⁴ *Id.*

¹⁸⁵ Chapter 3, Article 18: Water User Association.

¹⁸⁶ Chapter 3, Article 17: River Sub-Basin Council, subpoint 3.

The Water Law – The Use of Water and Water Permits

A permit is required for any use of water except the following: 1) drinking water, livelihood and other needs, if the total daily consumption does not exceed 5 cubic meters per household; 2) use for navigation as long as no damage is done to either the banks/right-of-way or the quality of water; 3) fire extinguishing; 4) existing rights that are pending conversion to permits.¹⁸⁷ Following the implementation of the Water Law, existing water rights will be converted to permits “gradually” and Water User Associations can obtain water permits after proper registration.¹⁸⁸

An Activity Permit¹⁸⁹ and Usage License is required for: 1) surface and groundwater use for newly established development projects; 2) use of water for commercial and industrial purposes; 3) digging and installation of shallow and deep wells for the commercial, agricultural, industrial and urban water supply purposes; and other purposes (remaining described purposes are not relevant to the proposed IPP transaction).¹⁹⁰ The sale and purchase of an Activity Permit and Usage License is prohibited.¹⁹¹ The procedure to issue Activity Permits and Usage Licenses is to be prepared by MEW, in coordination with other Ministries.¹⁹² A River Basin Council can cancel or modify a permit under the following conditions: 1) when the water user, without a justified reason, does not utilize or over utilizes the allocated water; 2) when adequate water is not available; or 3) when national interest requires.¹⁹³

The Water Law has a provision for use of water for power generation. According to the Law, water use for generating energy on micro and macro scales, based on a feasibility study, must be managed in accordance with the Water Law.¹⁹⁴ However, this section appears to describe hydropower facilities, but could be interpreted to include other forms of energy as well.

The Water Law has a built in mechanism for resolution of disputes among water users.¹⁹⁵ The dispute resolution process proceeds along a specified path, with a specified number of days for each actor to make a decision before the issue moves to the next actor in the process.¹⁹⁶ At the Water User Association level, the dispute is resolved with the help of the Head Water Master (*Mirab Bashi*) and a Water Master (*Mirab*).¹⁹⁷

¹⁸⁷ Chapter 4, Article 19: Right of Use of Water.

¹⁸⁸ Chapter 4, Article 20: Permit.

¹⁸⁹ An “Activity Permit” is defined in the Water Law as: “an official written document issued to undertake activities related to storage and other associated uses according to the provisions of this law.”

¹⁹⁰ Chapter 4, Article 21: Application for Activity Permit and Usage License.

¹⁹¹ Id.

¹⁹² Id.

¹⁹³ Chapter 3, Article 15: Cancellation or Modification of Issued Permits.

¹⁹⁴ Chapter 4, Article 25: Use of Water for Power Generation.

¹⁹⁵ See Chapter 6, Article 34: Dispute Resolution.

¹⁹⁶ Id.

¹⁹⁷ Id.



Impacts on the IPP

A gas-fired thermal power plant will require differing amounts of water based on the ultimate design and choice of technology for the generator units. Regardless of the technology choice, the IPP will need to source some water from the Sheberghan area to fulfill basic demands, and will thus need to follow the procedures in the Water Law to obtain a permit. Based on a feasibility study conducted by AEAI in 2006, the water supplies for the power plant would come from a series of deep wells drilled in the Quarakent area, approximately 10 kilometers from the proposed IPP site. Conversations with the Hydrogeology Department at the Ministry of Mines suggest that each well in Quarakent is capable of producing 10 liters of water per second, up to a maximum of 60 liters per second, without causing significant impacts on the aquifer.

Based on the information above, the IPP will need to obtain an Activity Permit and Usage License to draw water to support the power plant operations. Unfortunately, it is not clear from the law who has authority to issue these permits and licenses. MoM has the authority, after “obtaining agreement” of line Ministries, to issue permits and licenses for deep wells for commercial and industrial purposes. Further, “deep” is not defined in the law, meaning that there is no clear division of authority between MEW and the MoM as to who issues the necessary Activity Permit and Usage License for groundwater usage.

Making the issue more complicated is the division of Activity Permits and Usage Licenses between MEW and the River Basin Councils. The issuance of Water Usage Licenses is listed under the duties of MEW, and the issuance, registration, modification and cancellation of the Activity Permits is listed under the duties of the River Basin Councils. The definitions of Activity Permits and Usage Licenses in the Law only beg the question regarding what rights are granted under either of the devices. Further, language in the law seems to confuse both the permits and licenses, and it is never clear whether one or both are needed for a water project.

MEW, in cooperation with “other relevant institutions and line Ministries” is tasked with developing the procedure to issue Activity Permits and Usage Licenses. Before beginning construction on the anticipated water project, it will be necessary to obtain these procedures from MEW. However, based on the distinction between surface water and groundwater listed above, it will also be necessary to discuss the project with MoM in order to make an informed judgment as to whether MEW needs to be consulted at all for a groundwater development project.

There are no statutory maximums for usage of water written into the Water Law, but there appears to be at least some provisions suggesting a “no injury” standard for water usage. The stated goal of the Water Law is to ensure the equitable distribution

of water and one of the conditions that can be cited by the River Basin Council for cancelling or modifying a permit is that adequate water is not available for use for various purposes. The Hydrogeology Department of MoM has suggested that the maximum withdrawal for the project area, without mining the aquifer at Quarakent, would be approximately 60 liters/second. If these numbers are correct, then it can be safely assumed that, as long as no injury occurs to existing users, the power plant should have access to sufficient water for its operations.

As the law is written, the IPP, as a major water user and stakeholder in the river basin, should be included as a member of the River Basin Council, which will have the right to issue the Activity Permit and will be responsible for monitoring and adjusting the use of water by the IPP. River Basin Councils are also responsible for some planning and strategy development for water resources management, so it would certainly be in the IPP's interest to have representation in that process. The IPP will also want to be a part of a Water Users Association to take advantage of the dispute resolution procedures and active planning functions regarding water resources management that occur at that level.

Overall, while the water law lacks the type of clarity that would be needed to ensure business security, there are sufficient mechanisms, such as memberships in River Basin Councils and Water Users Associations that should allow the IPP to be an active participant in water resource management and protect its rights under the law. In addition, the IPP can request, as part of an Implementation Agreement or other binding project document that MEW and relevant River Basin Council provide it with both the necessary documentation to apply for an Activity Permit and Usage License and an expedited process for approval of the permit and license. The Water Law is a less than ideal legal structure, but, if included with some field work with relevant Ministries, should be sufficient to support the IPP transaction.

V. CORPORATE ISSUES

A. Law on Private Investment (as amended December 6, 2005)

The Law on Private Investment in Afghanistan (“Private Investment Law”) was adopted in 2005 and represented a significant step toward encouraging private investment, both foreign and domestic, in the country. The Private Investment Law was passed for the express purpose of:

...maximizing private investment, both domestic and foreign, in the economy. It aims to create a legal regime and administrative structure that will encourage and protect foreign and domestic private investment in the Afghan economy in order to promote economic development, expand the labor market, increase production and export earnings, promote technology transfer, improve national prosperity and advance the people’s standard of living.

The High Commission on Investments (“Commission”) is the investment policy-making body and the highest authority with respect to implementation of the Private Investment Law. The Commission may adopt rules that create additional incentives for investment in certain sectors or regions. However, the Commission may not provide more attractive fiscal incentives than those already in the Private Investment Law absent the consent of the Ministry of Finance. The Afghanistan Investment Support Agency (“AISA”) was established under the Commission to carry out the Commission’s administrative duties. AISA serves as a “one-stop shop” for business registration and for investment promotion and facilitation. AISA reviews and recognizes enterprises as Registered Enterprises, which enterprises can be organized under the laws of Afghanistan or of another nation, but the enterprise must be registered in order to do business in Afghanistan. The law makes it clear that a Registered Enterprise can be wholly owned by private investors or may be a joint venture between investors and the GoIRA. Once recognized as a Registered Enterprise, its registered status can only be revoked if it is dissolved or ceases to exist, or for a substantial violation of the provisions of the Private Investment Law.

Unless otherwise provided, the Private Investment Law expressly prohibits discrimination against foreign investors, and all natural or legal persons, foreign or domestic, may invest in all sectors of the economy with certain exceptions. Investments involving nuclear power, gambling, or production of narcotics or other intoxicants are prohibited. More importantly, investment in certain sectors is restricted. As to those sectors, the Commission must consult with the relevant ministries, and approve investments in such sectors on a case-by-case basis with the consent of such ministries. And the Commission may apply terms to such investments that are different than those commonly applied. Natural Resources and infrastructure, which includes power generation or transmission facilities, are among the restricted sectors, until special laws have been promulgated that are applicable to such investments, after which the special laws will govern. For this reason the draft Electricity Law includes provisions important to investors very similar to those in the Private Investment Law (see Section V. A.).

To the extent permitted by the Income Tax Law, a Registered Enterprise may carry forward a net operating loss as a deduction from its taxable income, and be entitled to accelerated deduction for depreciation on capital assets. It may also enjoy exemption from export duties on products it manufactures or assembles in Afghanistan to the extent permitted by the Customs Law.

In accordance with the Constitution, foreigners may not own real property; however, Registered Enterprises are permitted to lease real property for up to 50 years. A Registered Enterprise has the right to maintain bank accounts in foreign currency in Afghan banks, as well as to maintain bank accounts in foreign currency outside of Afghanistan for all purposes not contrary to Afghan law. An investor in a Registered Enterprise, after settling his legal and financial obligations, has the right to sell or transfer all or part of its ownership interest; provided the purchaser's investment is not in violation of the law. An investment in or assets of a Registered Enterprise may be expropriated by the State for an overriding public purpose and on a non-discriminatory basis. In case of such appropriation, the State is to promptly provide compensation according to international law principles at the fair market value of the expropriated property including interest from the date of expropriation to complete payment.

There are virtually no restrictions on the conversion of currency or transfer of funds related to investment. Foreign investors may freely transfer out of Afghanistan distributions of capital, dividends, and the proceeds from the sale or transfer of a Registered Enterprise. A Registered Enterprise may freely transfer out funds for the payment of principal, interest and fees associated with a foreign loan, and a foreign investor or a Registered Enterprise over 25% of which is owned by foreign investors can freely transfer out compensation for expropriation free of taxes.

The Private Investment Law also contains rather progressive provisions for dispute resolution. In any agreement an investor or Registered Enterprise may agree (i) to any dispute resolution procedure; (ii) that the place of arbitration may be outside Afghanistan; and (iii) that the law of a jurisdiction other than Afghanistan may apply. If provided in the agreement:

- Any award resulting from the dispute resolution procedure will be final and enforceable according to the Arbitration Law.
- If a dispute arises from an agreement between an investor or Registered Enterprise on the one hand, and the State (which includes any constituent subdivision, agency, or instrumentality) involving an investment or expropriation claim, the dispute will be resolved according to Afghan law.
- Except that, if the dispute arises from an agreement between a foreign investor or a Registered Enterprise with foreign equity ownership and the State involving a foreign investment or an expropriation claim by such foreign investor or Registered Enterprise, which cannot be settled amicably, then, unless the parties to the dispute otherwise agree, the dispute shall be submitted either:
 - (i) to the to the International Centre for Settlement of Investment Disputes ("ICSID") for settlement by arbitration pursuant to the Convention on the Settlement of Investment Disputes between

States and Nationals of Other States of March 18, 1965, as such may have been or may be amended from time to time (the “Convention”)

- (ii) if ICSID rules preclude the Foreign Investor from arbitrating before ICSID or if the Foreign Investor otherwise prefers, to arbitration in accordance with UNCITRAL Rules. The Government, by operation of this article subsection (a), consents to the submission of any such dispute to ICSID for settlement by arbitration in accordance with Article 25(1) of the Convention.

For purposes of the foregoing, a Registered Enterprise owned over 25% by a foreign investor is to be treated as a national of a state other than Afghanistan. The dispute resolution provisions appear to be particularly beneficial to foreign investors since they provide the parties an opportunity to negotiate the dispute resolution or arbitration mechanism to be applied, the venue for such arbitration, and the law to be applied. It allows the foreign investor to avoid Afghan courts where bias, or lack of capacity or commercial experience could be detrimental. However, it appears that this is not possible with regard to disputes arising under contracts between Afghan nationals or Registered Enterprises without foreign equity ownership and the State

AISA and the Private Investment Law do seem to have made it easier to start a business in Afghanistan. According to the World Bank’s “Doing Business in Afghanistan 2011”¹⁹⁸ Afghanistan ranked 25 out of 183 countries on ease of starting a business, involving only four steps and seven days on average. While this may be a reflection of the effects of the Law in the area of starting a business, it can be misleading. Afghanistan was also ranked 167 out of 183 economies in the ease of doing business and 183 out of 183 in the categories of protecting investors, trading across borders, and closing a business.

The Afghanistan National Development Strategy 2008-2013/Afghanistan National Development Strategy Prioritization and Implementation Plan

The Law on Private Investment represents recognition by the GoIRA of the importance of the private sector and foreign investment in rebuilding its crippled economy. The Law is consistent with the emphasis placed on encouraging competition, development of a market economy, and strengthening the legal framework in the Afghanistan National Development Strategy 2008-2013 (“ANDS”) issued in 2008. As applied to the energy sector, the strategic vision and goal for the sector within ANDS is expressed as follows: “An energy sector that provides drivers of growth in the economy with long term reliable, affordable energy based on market-based private sector investment and public sector oversight.”

ANDS recognized that the institutional arrangements and policy framework were inadequate for a market-based system and correctly identified the primary obstacles as:

¹⁹⁸ “Doing Business in Afghanistan 2011,” World Bank, Retrieved 2011-3-28.

- Dispersed institutional support with seven ministries having a role in the energy sector;
- No divestiture or meaningful commercialization of state energy assets;
- A drain on budgetary resources, when the sector should be generating revenues;
- Inefficient and wasteful use of electricity due to underpriced electricity and inadequate cost recovery;
- Lack of a regulatory framework—an absence of a legal and regulatory framework to guide operations in the sector; and
- Limited opportunities for private participation

As to the last obstacle, ANDS observed there were no legal impediments to private investment in the energy sector, but acknowledged the weak legal and regulatory structure, unclear policies and corruption were barriers to investment. The strategy noted that “[A]reas where private sector engagement has immediate potential with appropriate regulatory (*sic*) include independent power production and oil and gas concessions”. ANDS promised restructured energy sector governance that foresaw for the sector, among other things, a workable legal and regulatory regime to include market-based power purchase and production sharing agreements, together with legal reform and regulatory standards, and an improved enabling environment for private investment. An improved enabling environment was particularly important to attract private sector financing for and operation of emerging projects that local capacity could not support. A sector regulator was to be created to fashion licensing procedures and other conditions necessary for private investment in such projects, including electricity generation.

On 20 June 2010, the GoIRA at a gathering of the international community in Kabul presented and obtained endorsement of a new approach to achieve the goals of ANDS—the ANDS Prioritization and Implementation Plan Mid-2010 – Mid-2013. It is characterized as an Afghanistan developed plan that prioritizes the goals of ANDS, with Afghanistan assuming greater control of the methods of reaching those goals, as well as the needed resources to be provided by the international community (*i.e.*, more on-budget financing). The plan focused on a smaller number of large scale National Priority Programs to permit delivery in the next three years. A limited number of Programs would be placed within five Cluster groupings of ministries – Governance, Economic and Infrastructure Development, Agriculture and Rural Development, Human Resource Development, and Security. The Plan includes, in addition to the National Priority Programs within the five clusters, three additional initiatives to be pursued. The proposed investments in the national priority programs are the focus of the GoIRA’s transition strategy. The investments are designed to overcome the challenges to socio-economic recovery and permit the creation of an enabling environment to attract investment and industry sufficient to provide the needed revenues to support government programs as it transitions from foreign development assistance.

For the purposes of this analysis, the Economic and Infrastructure Development (“EID”) Cluster is the most relevant. It involves six National Priority Programs, most importantly, the National Energy Supply Program (“N-ESP”). The goal of EID is to: “support Afghanistan’s transition to financial independence and develop a business climate that enables private investment.” Among the outcomes the N-ESP seeks to

achieve is an “increased private sector investing” and the related implementing action is “support for the creation of an enabling environment for private investment.” Within the scale and scope of the N-EPS is the establishment of a National Energy Policy to include “a clear framework for private investment,” and improvement regulatory oversight and capacities through laws. The N-EPS continues to maintain that one of the activities to overcome policy, regulatory and legal constraints will be the establishment of a “viable legal and regulatory framework” including development of market-based power purchase agreements and production sharing contracts. Further, to overcome sustainability constraints market-based pricing systems will be instituted. Finally, the N-EPS identifies the Sheberghan Gas Power Plant as among the key investments to support the objectives of the program.

The energy sector goals of ANDS are appropriate and it accurately identified the obstacles to their realization. There has been some progress since ANDS was issued in 2008 but it has been exceedingly slow. The Hydrocarbons Law was adopted, and draft implementing regulations have been prepared. However, the draft Law on Electricity Services has not been finalized, and other laws and regulations, as well as improvements in the judiciary and reduction of corruption, are required for a legal structure to support investment, including foreign investment. It is too early to judge the effectiveness of the National Priority Program approach, but it is extremely aggressive. Although the plan says it understands that years of work will be needed, it tends to focus on relatively short-term goals (those that can be delivered in three years). It is also disturbing that, in discussing sector governance, both ANDS and N-EPS accept the need for transparency, and the need for separation and rationalization of the functions in government organization. However, they speak of a two function separation of policy and regulatory oversight from delivery, while best practices suggest a three function separation of policy, regulation, and operations.

Impact on the IPP

As expressed in ANDS, Afghanistan recognizes that private investment, including foreign investment, is critical for its socio-economic growth, and that attraction of private investment depends on a legal framework to support it – a framework which at this time is sadly deficient. The right words are there, but progress is glacial. The Private Investment Law complements the ANDS and suggests some degree of commitment behind the words. The Law prohibits discrimination against foreign investors, meets the needs of investors to freely transfer funds in and out of the country and to freely convert currency at market clearing rates. The initial registration process is relatively simple and short, and AISA will provide assistance. Vitally important dispute resolution procedures are in place. The parties can agree on any dispute resolution mechanism and, if they cannot agree, the default mechanism is ICSID, or arbitration under UNCITRAL rules. There has been some concern expressed regarding the provision that permits an investor to sell all or part of the interest in a Registered Enterprise after settling the investor’s legal and financial obligations, fearing that this may prevent the sale of an on-going business. While this is a legitimate worry, settling one’s obligations can be interpreted as being accomplished upon assumption by the purchaser of the obligations of the enterprise or investor, with the consent of the financing parties. But any uncertainty is cause for concern, and for that reason it does not exist in the draft Electricity Law. The primary

problem for the IPP is that power generation is a restricted investment. Before investment in generation, the investment must be considered and approved on a case-by-case basis by the High Commission on Investment after consulting with the relevant ministries and with their consent. This will also change upon adoption of a specific sector law in the form of the draft Electricity Law.

B. Corporations and Limited Liability Companies Law and Licensing from Afghan Investment Support Agency

Afghanistan has a Corporations and Limited Liability Companies Law to regulate the creation and activities of corporations and limited liability companies registered in Afghanistan. According to the Law, a business license registered in the Central Registry is required before a person can transact business or advertise as a corporation or limited liability company.¹⁹⁹ A “corporation” is defined in the Law as: “a business company whose capital is definite and divided into shares, with the share and responsibility of each shareholder limited to the proportion of his share.”²⁰⁰ A “limited liability company” is defined in the law as: “a business company whose capital is not divided into shares with the responsibility of each shareholder limited to the amount of capital agreed to [by such shareholder] in the company.”²⁰¹ The Articles of Incorporation of Foreign companies can be in a foreign language, but must be accompanied by an accurate translation into Dari or Pashto when they are submitted to the Central Registry office.²⁰²

The Certificate of Existence, which is issued by the Central Registry, includes the following: 1) activity of the corporation in Afghanistan; 2) that the corporation has not dissolved or terminated its activities; 3) the name of the corporation as registered in Afghanistan; 4) the date of the establishment of the corporation; 5) that the corporation is authorized to transact business in Afghanistan; and 6) the date of registration of the Articles of Incorporation in the Central Registry.²⁰³ Corporations are required to do the following to maintain their existence: 1) have a business license; 2) pay all fees, fines, penalties and interest in accordance with the provisions of this Law; 3) file annual reports with the Central Registry; and 4) not dissolve or withdraw from activities.²⁰⁴ A failure to meet these requirements will result in the dissolution or termination of the activities of the corporation by the Central Registry.²⁰⁵

Under the Law, a domestic corporation can be established for any lawful purpose in accordance with the Law and the relevant Articles of Incorporation.²⁰⁶ The corporation must have definite capital that is divided into shares and the responsibility of each Shareholder is limited to the value of his or her Share.²⁰⁷ Corporations have perpetual duration, unless the Articles of Incorporation provide

¹⁹⁹ Chapter 1, Article 02: Having License. Corporations and Limited Liability Companies Law of Afghanistan.

²⁰⁰ Chapter 1, Article 04: Definitions, subpoint 1.

²⁰¹ Id. at subpoint 2.

²⁰² Chapter 2, Article 05: Registration of Documents.

²⁰³ Chapter 3, Article 14: Certificate of Existence.

²⁰⁴ Chapter 3, Article 15: Requirement of the Existence of the Corporation.

²⁰⁵ Id.

²⁰⁶ Chapter 5, Article 18: Establishment of a Corporation.

²⁰⁷ Id.

otherwise, and have the same powers to operate legally and execute business transactions and other affairs as an independent entity.²⁰⁸ The Articles of Incorporation must include the following: 1) the name of the corporation; 2) the name and address of each incorporator and director; 3) the address of the corporation's registered office in Afghanistan and the name of the agent at the office; 4) the number and types of shares the corporation is authorized to issue; and 5) the duration of the corporation, which is assumed to be infinite unless expressly provided otherwise.²⁰⁹ The corporate existence begins when the Articles of Incorporation are signed by the incorporators and the Articles have been registered with the Central Registry.²¹⁰ The Law maintains personal liability for debts and liabilities created by persons purporting to act on behalf of the corporation prior to its establishment, with an exception for liabilities owed to persons who knew that no corporation had yet been formed.²¹¹

The remaining sections of the Afghan Corporations and Limited Liability Companies Law will be familiar to Western corporate lawyers and businesspeople. The sections include issuance of shares, the board of directors, shareholder meetings, and distribution of dividends, among others.²¹² The structure, though not always the content, of Afghanistan's corporate law generally follows established western models and practices. However, there are some issues regarding the law itself, as well as the process of establishing a corporation in Afghanistan.

The first issue is that the process for establishing a corporation in Afghanistan, as written in the Law, is incomplete. The primary agency for establishing businesses in Afghanistan is the Afghan Investment Support Agency (AISA). This agency is responsible for assisting all foreign and domestic businesses in establishing their business in Afghanistan. This agency is also not mentioned at all in the Corporations and Limited Liability Companies Law.

The second issue is that the law, as drafted, contains some significant ambiguities. For example, the law requires that Articles of Incorporation be registered with the Central Registry, but does not define who or where the Central Registry is located. It does not provide for any oversight of the business registration process or an agency that should be responsible for business registration. Fortunately, AISA has taken charge of the business registration process and is, perhaps the entity contemplated by the Law to be charged with enforcement and administration of the Law.

Impacts for the IPP

At this time, it is not anticipated that the corporation that will be responsible for building and constructing the IPP will be registered as an Afghan corporation, therefore this Law would not apply. The laws that would apply to the anticipated joint venture between the investors would be either the laws of the state or country where the joint venture is incorporated or another law as specified in the joint venture

²⁰⁸ Chapter 5, Article 19: Activities of the Corporation.

²⁰⁹ Chapter 5, Article 21: Articles of Incorporation.

²¹⁰ Chapter 5, Article 22: Signing the Articles of Incorporation, subpoint (1).

²¹¹ Chapter 5, Article 23: Pre-Incorporation Activities.

²¹² See Chapter 7: Issuance of Shares; Chapter 8: Board of Directors; Chapter 10: Shareholder Meetings; and Chapter 11: Distribution of Dividends to Shareholders.

agreement. However, the corporation will still need to acquire a license from AISA. The procedures for acquiring an AISA license are attached as Appendix C.

VI. OPERATIONS ISSUES

A. Draft Electricity Law

By Presidential Order No. 4239 dated 28 September 2008, “[T]he Ministry of Energy and Water is tasked with drafting the regulations, organizational structure and terms of reference of the Power Regulation Authority, and in line with relevant authorities determine the operational procedures (of the Power Regulation Authority).” In response to this mandate the MEW initiated preparation of the draft Electricity Law with the support of USAID. The Law has been in preparation for over one and a half years, and has undergone numerous iterations. The draft Law is approaching finalization but has not been approved by the MEW as yet. This analysis is based on the latest draft of the Law, but it has not yet been approved by the MEW. Accordingly, it still must be reviewed by the Ministry of Justice, passed by the Parliament and signed by the President. Therefore, the draft Law is subject to change. The latest draft of the Law is attached as Appendix B.

Chapter 1 General Provisions expresses the rationale and purpose of the Law. The purpose is (i) to promote generation, transmission, distribution, and supply of electricity; (ii) establish the Afghanistan Electricity Regulatory Authority (“AERA”) to regulate the sector; and (iii) to define certain electricity sector policy duties of MEW. It states the policy of the GoIRA, which parallels the Afghanistan National Development Strategy (“ANDS”) that, to the extent possible, citizens have a safe, adequate and reliable supply of electricity at fair and reasonable prices. From the beginning the Law authorizes provision of electricity services by private enterprises, as well as government owned enterprises, and emphasizes movement toward a competitive market. Chapter 1 also defines the terms used in the Law.

Chapter 2 Duties and Authorities of the Ministry of Energy and Water addresses the duties and authorities of the MEW with respect to the electricity sector. Article 4.1 of Chapter 2 identifies the general policy responsibilities of MEW, and Article 4.2 identifies various activities and programs to be conducted by MEW.

Under Article 4.1, MEW is responsible for development of national electricity policies; strategic planning consistent with those policies, including attraction of private investment; and evaluation of the sector status and forecast of its needs. Article 4.1 also contains an MEW non-policy related responsibility that contradicts best practices and logic. Under a Memorandum of Understanding (“MOU”) among MEW, DABS, and the MoF, dated 30 September 2009, it was agreed that MEW would be responsible for surveying, planning, designing, engineering, supplies and construction of new generation and transmission projects. DABS, for its part, would be responsible for management, maintenance, and commercial operation of electricity infrastructure, as well as expanding and strengthening of the existing distribution network. MEW has included reference to the MOU at Article 4.1.4 of the Law and attached the MOU as an annex. Under the MOU it appears responsibility for infrastructure is basically on a life cycle basis with MEW responsible for construction through commissioning and DABS responsible for operation and maintenance. According to the Law, the MOU will continue to operate, as from time to time amended, until terminated by the parties.

This responsibility for acquisition, design, and construction of its infrastructure is typically assigned to the utility, and included in its investment plan, which it would submit to the regulator for a determination of whether the planned investments are appropriate for inclusion in its rate base. Once approved the utility executes the plan. A utility needs the ability to control the assets it will acquire or construct in order to ensure reliability of supply in a commercially practicable manner. In fact, the Articles of Incorporation of DABS anticipate that it would perform these functions (see Articles 2 and 7 of the Articles of Incorporation). However, as a 100% State-owned corporation it would be expected to conform its plans to the policy guidance provided by the MEW. This underscores the need for cooperation and coordination between the bodies.

Article 4.2 sets out more specific policies and programs MEW is to develop. These include creation and implementation of national development programs for: renewable and alternative energy resources (in cooperation with MRRD); energy efficiency, conservation and demand-side management; and a public education program on electricity issues. MEW is to prepare and publish an annual National Energy Assessment and a biennial National Energy Plan. The annual National Energy Assessment essentially looks back and provides data and information on the status of the electricity sector as of the end of the prior year, while the biennial National Energy Plan includes an indicative strategy for sector development over five, ten, and twenty years. The Assessments and Plans called for in the Law are complex tasks, particularly in what hopefully will become a more competitive market, that will tax the capacity of the MEW staff.

The MEW is to review retail electricity tariffs, consider their effect on the most vulnerable of the population, and, at least annually, recommend direct subsidies by the Government to the relevant service providers. This is the most transparent method of subsidy, and a recognition that, while the sector regulator deals with tariffs, the issue of subsidies is a policy issue and political judgment. The Law, therefore, seeks to distinguish the role of regulation by the AERA, from that of the MEW's policy realm. Additionally, MEW is to engage in negotiation of international treaties, and develop policies governing international trade. With respect to international power purchase agreements ("PPAs"), MEW may facilitate talks, but DABS is responsible for the negotiation of such agreements with international counterparts, since as a government-owned commercial entity, the terms of the PPAs can affect its financial viability. MEW is also to: assist the MRRD in promotion of a national development program for rural electrification; collect / maintain electricity sector data in the Afghanistan Energy Information Center ("AEIC") with the information open to all; and coordinate donor capacity building efforts.

As provided in Article 5, the MEW must act transparently employing procedures and instructions to be adopted after website posting, open public meetings, and opportunity to offer verbal and written comments.

Chapter 3 Duties and Authorities of the Electricity Regulatory Authority provides for the establishment of the AERA, as the electricity regulator, and details its duties and authority. It should be noted that from the beginning the AERA was conceived as an independent regulatory body. Subsequently, the MEW determined that it should be described as an independent regulatory body within the framework of the MEW, and ultimately determined that it should not be an "independent" body for at least the first

five years. However, many of the attributes of an independent regulator were retained. The AERA is to be led by a Commission consisting of 5 qualified members (to include at least one woman) proposed by MEW and appointed by the President to serve staggered 5 year terms, with the opportunity for one reappointment and subject to early removal only in limited and defined circumstances. The AERA is to develop its annual budget in a transparent fashion by estimating its operating and capital expenses for the upcoming year, detailing each expense component, publishing the proposed budget on its website, and finalizing the budget only after opportunity for comment. The AERA is to be supported by dedicated revenues from fees on Licensees and grants from donors and IFIs. The expenses of the AERA as reflected in its budget will be funded by Licensee fees based on a fee per unit of electricity sold or transported annually by a Licensee not to exceed 1% of total expected revenues of each Licensee or to exceed in total 1% of the price paid by any Customer. Since the AERA is part of the MEW for at least the first five years the Licensee fees will go to the general budget and be appropriated to MEW. However, since those fees are based on the projected budget of the AERA, if amounts appropriated and authorized from the general budget were used by MEW for purposes other than to fund the AERA, the Licensees could reasonably object. Accordingly, the Law requires MEW to annually allocate appropriated funds in an amount equivalent to the revenues from Licensee fees to be used exclusively for the operating and capital expenses of the AERA. Additionally, AERA's revenues and expenses are to be audited according to international standards, published, and the audit report submitted to Parliament.

The AERA, as regulator, is, among other things, to: balance the interests of private investors, electricity enterprises, customers, and the environment; issue licenses and regulate the activities of licensees; develop cost of service tariff methodologies, and approve or adjust tariff schedules; resolve disputes; investigate alleged violations and enforce fines; require use of a Uniform System of Accounts; and establish procedures for determining significant market power ("SMP") and defining markets (SMP is defined in Article 3.1.34 as a market share of 40% or more held by a Service Provider in a specific electricity market as defined by the AERA). It is also to form consultative committees; develop model form contracts; renew, suspend and revoke licenses; submit annual reports of activities to the House of People; approve investment plans of transmission and distribution licensees; and exercise independent decision-making in an objective and non-discriminatory manner. The AERA is to develop service standards, criteria for system dispatch services, and technical standards, including a Distribution Code, Grid Code and Metering Code. The development of technical standards is to be done in cooperation with the Afghanistan National Standards Authority ("ANSA") and will, wherever possible, reference ANSA accepted international standards. AERA is to also establish procedures for contracting with third party consultants, in the event it needs to outsource part of its duties, particularly early in the life of the regulator. Case Docket Procedures are to be established, according to which the AERA will adopt rules and regulations to fulfill its duties, settle issues, and address electricity sector matters that come before the Commission in a transparent fashion based solely on the record and supported by a reasoned written decision posted on the AERA website. The Law in Articles 6.18 through 6.23 provides for a transition of the AERA to an independent regulatory body. Three years from promulgation of the Law an inter-ministerial council will be formed to establish, by majority vote, benchmarks to be

substantially fulfilled for the AERA to assume the status of an independent regulatory authority under the executive branch. The inter-ministerial council is to be composed of the Minister of Energy and Water, Minister of Finance, Minister of Commerce, Minister of Economy, and Minister of Rural Rehabilitation and Development. Five years from the promulgation of the Law the council will evaluate whether the AERA has substantially met the benchmarks. If a council majority concludes that the criteria has been met, it will recommend to the President that the AERA formally become an independent authority under the executive branch, and upon Presidential approval of the recommendation the AERA will assume independent status.

If the council determines that the benchmarks have not been met at the five year review, they will provide AERA a written evaluation identifying the shortcomings, and, conduct an annual progress review thereafter. At such time as a majority of the council determines the benchmarks have been substantially satisfied they will make their independent authority recommendation, to become effective upon approval of the recommendation by the President.

Upon becoming an independent regulatory authority under the executive branch, Article 6.23 of the Law provides all provisions in the Law relating to the AERA will continue to be effective except the AERA will no longer be within the framework of the MEW, and those concerning the council and those specifying the method of appointment and removal of Commissioners will no longer apply. Commissioners will be appointed by the President and approved by the House of People, and removal for cause will be by the House of People. Article 6.23 is to apply prospectively only, and is not to affect previous Commissioner appointments or removals, or the validity of prior Commission actions or decisions.

It is very unfortunate that the MEW determined not to characterize the AERA as an “independent” regulatory authority and to place it within the framework of the MEW for a minimum of five years, since that decision could deter private investment. Private investors view an independent regulator as evidence of a commitment by government to protect investors from government interference. And unless government has made a credible commitment to ensure the ability of investors to earn a reasonable return on potentially significant, long term investment in infrastructure assets, private investment will not materialize. This is supported by the following table, which contains a list of characteristics that various researchers and forums considered necessary or desirable in a regulator:

Table 1 – Desired characteristics / best practice principles / cultural values

WFER 2003 ¹	World Bank ²	USAID Nexus study	CEER	PURC ⁴	Utility Regulators Forum ⁵	Stern (1997)
Independence	Independence	Independence	Independence	Legal Mandate, Values	Independence	Informal Independence
A minimum set of functions & public service obligations		Legal mandate & financial resources	Enforcement Powers	Legal Mandate		
Impartiality, transparency & simplicity	Legitimate / Accountability	Transparency	Transparency & Accountability	Values	Accountability & Transparency	Accountability & Transparency
Diligence and ethics	Competency / Expertise	Expertise	Competency	Resources	Effectiveness & Efficiency	Expertise
Appeals		Public involvement ³	International activities		Communication	
Dispute resolution in individual cases					Consultation	
Benchmarking					Consistency	
Predictability					Predictability	
Flexibility					Flexibility	

¹World Forum on Energy Regulation held in Rome in 2003.

²Primarily from Bertolini (2004) and Estache (1997) but these factors are also discussed by Smith (1997a-c) as well as other World Bank publications.

³Public involvement is the central theme of the Nexus study (AEAI and PA Government Services, 2005). It can be seen as the necessary condition for transparency and accountability, but it is a necessary condition for success according to the study.

⁴PURC list is mostly based on *Designing an Independent Regulatory Commission* by Berg et al.

⁵Office of Water Regulation (1999), Perth, WA, Australia.

Table from Gürcan Gülen, Ruzanna Makaryan, Dmitry Volkov, Michelle Foss. *Improving Regulatory Agency Efficiency And Effectiveness*, Center for Energy Economics, Bureau of Economic Geology, University of Texas at Austin. (2007).

As can be seen, independence of the regulator was listed by virtually all. Additionally, in a World Bank survey of power investors, independence of the regulator and protection from arbitrary government interference was listed among the top 4 priorities and characterized as critical.²¹³ Of course, an independent regulator provides no assurance of reform. It cannot be separated from overall governance. In some countries a regulator that is independent on paper may still be effectively controlled by a ministry or be captured by the industry it is to regulate.

As previously stated the AERA bears many of the earmarks of an independent authority despite the fact that it is intentionally not characterized as such. While inclusion in a Ministry and the absence of an explicit statement of independence heightens the potential for political influence or interference, the Law does emphasize objective independent decision-making and stresses transparency. This is important in that what makes a regulator truly independent is its competence and credibility. If it gains the respect of the government, the regulated community and the public because it is competent and consistent; and it is credible to stakeholders because it conducts its affairs according to transparent procedures, its decisions are difficult to overturn. But if it lacks competence and credibility, it is nonetheless subject to political interference and its decisions suspect. It is no easy task to develop the capacity of the regulator and ensure that the legally required transparency is observed. It will require considerable time and a commitment of money and effort to build capacity in a country with no experience in regulation of the

²¹³ Source: Lamech, Ranjit and Kazim Saeed. *What International Investors Look for When Investing in Developing Countries: Results from a Survey of International Investors in the Power Sector, Energy and Mining Sector Board Discussion Paper No. 6*, The World Bank Group. (2003).

energy sector. A study by Colin Kirkpatrick, David Parker and Yin-Fang Zhang entitled “Foreign direct investment in infrastructure in developing countries: does regulation make a difference?” concluded that “[T]he main policy implication of our findings is the need for supporting capacity building and institutional strengthening for robust and independent regulation in developing countries”.²¹⁴

Chapter Four Licenses deals with Licenses to perform Electricity Services. The Law seeks to keep the barriers to entry low, to promote competition, and to avoid regulatory burdens from driving out existing small entrepreneurs, who may be the only source of electricity for some consumers. If such small entrepreneurs fail, it should be the result of competition, not regulatory encumbrances.

The principal licensing concepts embodied in the Law are:

- Anyone willing to construct, own or operate any Electricity Service at their own financial risk may do so, provided they comply with the subject Law and the other laws of Afghanistan.
- Not all electricity service providers require a License, with the requirement for License primarily dependent on size.
- Transmission System or Distribution System Licensees must provide open access at fair tariffs and on non-discriminatory basis, which effectively requires an accounting unbundling of services.
- Any high voltage Transmission System of a Government-owned electricity enterprise will remain in Government ownership, but must meet the requirements of fair and open access to all potential shippers.

Functions for which a License will be required are:

- Operation of Generation units of more than 500 kW
- Operation of a high voltage Transmission System
- Operation of a Distribution System with more than 500 connected customers
- Operation of a Transmission or Distribution System with more than 500 kW of generation capacity attached by alternating current

Any electricity enterprise connected to a Licensee by alternating current must comply with all Codes, whether or not it is required to have a License. The provisions specifically relate to alternating current because of the special technical requirements dictating the interconnections meet certain standards to protect the interconnected systems. Interconnections by direct current devices of smaller systems to larger networks can serve to protect the larger network from technical faults on smaller systems. The distinction is made in the Law since in Afghanistan there appear to be a number of small private distribution systems.

Functions, in addition to those above, for which a License may be issued are:

- Operation of a an organized electricity market at wholesale (if one emerges)
- Import or export of electricity
- Supply or trade of electricity when the volume of a single supplier is more than 2% of the total Afghan market or a supplier has SMP in any defined market

²¹⁴ *Transnational Corporations*, Vol. 15, No. 1. (April 2006).

The term of any License, except a Supply License, is 25 years and it is renewable. A Supply License carries a term of 10 years, and is renewable. Investments in electricity services tend to be large and service life of facilities long. To permit financing arrangements and encourage private investment, the duration of Licenses must be long. A 25 year term for most Licenses applied in the Law is toward to lower range of the spectrum of License periods among countries.

AERA is to issue a rule defining application procedures for a License, which rule must include a procedure by which an electricity enterprise may register through the Internet and, upon completion, shall be deemed to have received a License; provided the AERA may remove registration and revoke the License if the registration information is not accurate and truthful. AERA will post on its website information on Licensees (including any regulated tariffs). The Licensing provision of the Law provides that Distribution Licensees are required to provide electricity service to any Customer in its Service Territory; the Service Territory cannot be larger than the Licensee can reliably service; the Service Territory may not be more than one province; but a Licensee can hold more than one Distribution License (even within a Province, if it has more than one distribution system in the Province); and Service Territories by definition (Article 3.1.33) are non-exclusive. Further, essentially, anyone providing electricity service before the Law comes into force is to receive a License to continue activities.

The Law provides for what it refers to as “Special Services Contracts.” Community Development Councils, municipalities, industrial park authorities or similar local authorities may own, for example, generation facilities and/or distribution systems, or may be otherwise responsible for providing electricity to an area. The draft Law confirms the legal capacity of such public authorities to contract for the operation of the generation facilities, distribution systems or other electricity services. An electric service provider operating under such a contract before the Law’s passage, or awarded a contract after passage of the Law through competitive bidding meeting the standards of the Procurement Law will receive a License. However, the draft Law makes clear that it is not to be construed as otherwise requiring public tender for contracts for electricity service.

The draft Law provides that any Licensee determined by the AERA to possess SMP will have 60 days to obtain an amended License designed to prevent monopolistic practices. It also prohibits anti-competitive practices by any electricity service providers (Licensed or otherwise), including price fixing, collusion in contract awards, or apportioning markets. The AERA is to adopt rules describing how it will interpret and enforce its duties to prevent monopolistic and anti-competitive practices, which may include regulation of Tariffs or control of prices, requiring Licensing of electricity enterprises not otherwise required to be Licensed, or imposing License conditions to control abuse or anti-competitive behavior. In case of breach of License or violation of prohibitions without correction in a reasonable time, the AERA may revoke the License requiring closure or sale of the business.

Electricity enterprises may co-locate alternating current systems (i.e., share their use) if they can reach agreement on sharing of common costs, and meet certain other requirements including technical standards. This provision of the Law is

designed to allow the realization of the potential benefits of an integrated system when there is diverse ownership of the system parts.

Chapter 5 Prices and Tariffs describes the principles and procedures for setting Tariffs. A Licensee having SMP or otherwise required to have regulated Tariffs must publish their current Tariffs. Those otherwise required to have regulated rates would, for example, include transmission and distribution companies required to convey electricity over their lines “at fair Tariffs and terms of access established according to the Tariff principles stated in this Law” (Article 9.2), and electricity enterprises subject to regulated Tariffs by AERA in response to anti-competitive practices (Article 13.3). A Licensee may only charge its AERA approved tariff rates. The General Principle applied in establishing Tariff rates is the recovery of cost of service plus a reasonable rate of return. The Tariff or Tariffs are established by application of the principle at a level that allows a competent operator to charge a rate for the service involved sufficient to recover all the reasonable direct and indirect costs of providing the service together with a fair profit. AERA is to develop a detailed methodology(ies) for establishing Tariffs and may consider incentives and disincentives to encourage reduction in losses, improved collections, and other efficiency measures. The Licensee develops its Tariff using the appropriate methodology and submits the Tariff to AERA for review. AERA may approve the proposed Tariff or, if necessary, adjust it to properly conform to the methodology. If there is no action in 90 days from the receipt of the application for approval and all documentation requested by the AERA, the Tariff is deemed approved. Unless otherwise provided by AERA, Tariffs remain in effect for at least six months but must be readjusted at least annually. The Tariff procedures to be employed AERA is follow the transparent procedures that govern all of its actions under the draft Law.

Setting Tariffs under the cost of service principle addresses two potential evils. On one hand, it prevents a party with SMP from taking advantage of its market position to charge unreasonable rates or impose onerous conditions on Customers. On the other hand, the reasonable costs of a service are recovered. Under the Tariffs currently in effect, DABS is not recovering the cost of providing service. This deters expansion, results in poor and unreliable service; requires postponement of necessary operation and maintenance leading to the deterioration of infrastructure and ultimately failure of the system. Any subsidies involved should be targeted to those least able to afford to pay the full Tariff rates. For this reason, as previously discussed, the MEW is to review retail Tariff rates and recommend subsidies be paid by the Government to the service provider to defray the costs to the most vulnerable.

Chapter 6 Relations Between Market Participants speaks to the rights of Electricity Enterprises including Licensees, and the rights and obligations of Customers. An Electricity Provider (whether or not it is required to be Licensed) is under no obligation to provide service to any Customer:

- Who has refused to sign a contract;
- Who does not timely pay for services;
- For whom a subsidy has been promised but not paid to the provider;
- Who has tampered with a meter; or
- Who has by-passed a meter.

AERA is to adopt a method to establish the amount of connection cost to be absorbed by a Transmission or a Distribution Licensee, with the remainder, if any, to be paid by the Customer. If a Person seeking Interconnection with a Transmission or Distribution Licensee is willing to pay any cost of Interconnection above the amount to be borne by the Licensee, Interconnection can be denied by the Licensee only if it is technically infeasible or there is a lack of capacity.

The Law also provides that a Transmission or Distribution Licensee is to have right of way access to public lands so long as it does not unreasonably interfere with other public uses. If use of private land is needed for right of way purposes, and the Transmission or Distribution Licensee and landowner cannot come to terms, the matter may be referred to the AERA for resolution; provided that the landowner cannot be deprived of the economic use of the property without just compensation.

Customers are entitled to Electricity Service in accordance with their contract with the Service Provider, but they must pay for the service received, and failure to do so for 30 days subjects them to interest. If an illegal connection is discovered it may be disconnected, the misappropriating party charged for the estimated electricity taken, and a non-payment penalty levied by the Service Provider.

Chapter 7 Private Investment parallels with some modification several provisions of the Private Investment Law. Under that Law, the High Commission on Investment is the investment policy-making body, and the highest administrative authority for implementation of the Private Investment Law. The provisions of Chapter 7 in this draft Law on Electricity Services was seen as advisable since the Private Investment Law provides in its Article 5 (c):

The Commission (*referring to the High Commission on Investment*) must discuss with appropriate ministries and institutions, and approve with the consent of such ministries and institutions, on a case-by-case, investment in certain sectors of the economy (and certain types of investment). With respect to such investments, the Commission may choose to apply terms that are different from those generally applied to Investments pursuant to this Law (*the Private Investment Law*), provided, however, that the Ministry of Finance must approve any fiscal incentives that are more generous than those set forth in the Law.

Investment in Natural Resources and infrastructures are among the sectors listed (and Infrastructure by definition includes power generation or transmission facilities), “but only until special laws, if any, have been promulgated that are applicable to and govern such Investments after which such Investments shall be governed by such special laws.” This draft Law on Electricity Services is intended as such a special law applicable to and to govern investments in the sector.

The Private Investment Chapter 7 specifically permits private investment electricity infrastructure, including generation, transmission, distribution, and supply by any natural or legal domestic or foreign person willing to make the investment at its own financial risk so long as it complies with the Law on Electricity Services and other applicable laws of Afghanistan. It also clarifies that and Electricity Enterprise, including an Independent Power Producer may be registered under the Private

Investment Law, thereby becoming an Approved Electricity Enterprise. (An Independent Power Producer is defined as an Electricity Enterprise owned by a private investor(s) or by a joint venture between the GoIRA and private investors (i) that owns or operates an Electricity Facility for the generation of electricity; (ii) that does not own or operate Transmission or Distribution Systems; and (iii) that sells electricity or generating capacity to other Electricity Enterprises under negotiated contracts.) The registered Approved Electricity Enterprise then assumes rights and obligations closely duplicating (with some modifications) those included in the Private Investment Law (see Section V.A. above) with respect to:

- Tax concessions and customs relief (with the potential for additional tax incentives and concessions, customs relief, and financial assurances if recommended by the Minister of Finance and such recommendation is granted in accordance with the laws of Afghanistan)
- Banking rights
- Employment rights
- Land use
- Transfers of capital and profits associated with foreign investment, expropriation, and sale of approved enterprises
- Compensation in the event of expropriation
- Dispute resolution, including dispute resolution through international arbitration for Approved Electricity Enterprises with foreign equity investment

However, an Approved Electricity Enterprise is required to obtain the approval of the AERA if the enterprise holds a License under the Law on Electricity Services. This Law also provides slightly more flexibility than provided in the Private Investment Law concerning agreed methods of dispute resolution.

Chapter 8 Administration seeks to reinforce transparency under the Law by:

- Requiring the MEW and AERA to support their actions and decisions by providing a written statement of the basis and reasons for same
- Authorizing MEW and AERA to require Electricity Service Providers to maintain data on operations for up to five years, and to request from them any relevant data
- Requiring posting of documents submitted to the MEW and AERA on a public website, except information determined by the AERA to be Confidential and Commercially Sensitive, and requiring Licensees to maintain a publicly available website on which its fees, charges and terms of service are to be posted.
- Requiring the AERA to establish by regulation narrowly defined criteria to be met in order for information to be considered Confidential and Commercially Sensitive

All documents submitted to MEW or AERA must be in one of the official languages of Afghanistan.

Chapter 9 Transitional Provisions supersede Presidential Order 4239 (tasking the MEW with drafting regulations and terms of reference for a Power Regulatory

Authority. Chapter 9 also voids any documents claiming authority of Law defining the duties and authorities of the MEW with respect to electricity sector policy or programs issued before the effective date of the 2004 Constitution. All technical Codes required are to be issued by AERA with 42 months of the Law's effective date, provisions dependent on the performance of AERA are to come into effect upon appointment of at least three Commission members and are to apply to existing Electricity Enterprises not later than one year from said appointment.

Chapter 10 Final Provisions and Requirements provides the Law will become effective on its publication in the Official Gazette, and for the repeal of any other laws, regulations or provisions contravening the Law.

Status of the IPP under Afghan Law

There is nothing in Afghan law to prohibit the operation of IPPs, but that is mainly because there is no law that directly governs the sector. A draft Electricity Law is in preparation and still undergoing changes. The rules of the game, therefore, are uncertain. The electricity sector currently is largely self-regulated by the two main players in the electricity sector: MEW, the ministry with responsibility for the sector, and DABS, the wholly state-owned corporatized utility formed from DABM, the former utility arm of MEW. DABS is now to operate on a commercial basis. This is not an easy recalibration, since capacity in DABS is low, as are collections, and losses are high, although the situation is rapidly improving with USAID's help. Yet, as has been discussed, under the MOU of 30 September 2009, the MEW has retained responsibility for planning, designing, and constructing new generation and transmission infrastructure, which DABS is to manage and maintain. A non-commercial decision concerning construction of electricity infrastructure made by MEW can affect the ability of DABS to gain commercial status, which creates tension. To complicate matters, the MRRD is responsible for rural electrification, and has taken the lead in the development of renewable energy by virtue of its efforts in the area of non-grid sources of power. Accordingly, there are overlaps and gaps in assumed authority, and a need for significant realignment and clarification of responsibilities in the sector. But significant change predictably leads to significant resistance.

Given the legal vacuum and the limited access to power, particularly in rural areas, there are numerous small micro hydro facilities and diesel generators that generate and distribute electricity. Many are community-owned but some are privately-owned. Private ownership of generation facilities is not a new concept. But with the proposed Sheberghan generation facility, everything else is, from the purchaser – DABS – which is still a monopoly, to the contracting, to the financing, to the scale on which the plant will operate. In the absence of law and regulations and lack of effective, predictable governance, investors in the IPP should attempt to build their own regulatory regime through their contractual arrangements.

B. Income Tax Law

The current Income Tax Law, which was adopted in 2005 and amended in 2009, is modeled after the U.S. tax law. The associated Tax Manual issued by the Ministry of Finance is an official source to use in interpreting the tax.

The sources of income subject to taxation and the tax rate depend on a number of factors, principal among them being whether the person for tax purposes is a “legal person” or a “natural person and the residency of the person. Legal persons are corporations, limited liability companies (“LLCs”) and other legal entities. Natural persons include individuals, sole proprietors, and partners in a partnership, whether it is a general or a special partnership. Income tax is imposed on the income from Afghan sources of all natural and legal persons whether in Afghanistan or abroad, and on the foreign income of residents of Afghanistan. A natural person is resident in Afghanistan if the person has their principal home in Afghanistan any time during the fiscal year; is present in Afghanistan for a period of 183 days during the fiscal year; is a government employee or official assigned abroad anytime during the fiscal year. A legal person resident in Afghanistan is one that was established in Afghanistan or “has the center of its administrative management in Afghanistan at any time during the fiscal year.” The taxable or fiscal year runs from the first day of Hamal (21 March) to the last day of Hoot (20 March). If a legal person wants to use a different twelve month period as the taxable year, it must apply to the Ministry of Finance, which may grant the request if justifiable.

Resident persons, whether legal or natural, are taxed on their taxable income from all sources within or outside Afghanistan, however, any income tax paid to the government of a foreign company may be taken as a credit against that part of its annual income tax attributable to foreign income. Non-resident legal and natural persons are taxed only on taxable income from sources within Afghanistan, and they are exempt from income tax if their home country grants a similar exemption to non-resident Afghans.

The income of agencies, departments of the State, and of municipalities is exempt from taxation, however, the income of Government enterprises, such as DABS, is not. Taxability of foreign governments and international organizations, and their non-resident employees is governed by the treaties, agreements and protocols in effect with the GoIRA. (The General Agreement for Technical Cooperation between the U.S. and Afghanistan, dated 7 February 1951, as amended, is discussed later in this analysis.) Further, contributions, and income from necessary operations of non-profit organizations are exempt if: (i) they are established under the laws of Afghanistan, (ii) are organized and operated exclusively for educational, cultural, literary, scientific, or charitable purposes; and (iii) contributors, shareholders, members or employees do not benefit from the organization. Pensions of government employees are also exempt.

The standard tax rates applicable are as follows:

For a legal resident person:	20% of taxable income from sources within and outside of Afghanistan.
For a legal non-resident person:	20% of taxable income from sources in Afghanistan.
For a natural resident person:	A progressive tax rate on taxable income from sources with and outside Afghanistan:

From Afs.0 to Afs.5,000 monthly 0%

From Afs.5,001 to Afs.12,500 2%

From Afs. 12,501 to Afs. 100,000 10% + Afs. 150 fixed amount

From Afs. 100,000 and above 20% + Afs.8,900 fixed amount

For a natural non-resident person: The same progressive tax rates as above on taxable income from sources in Afghanistan.

Taxable income is defined as “is the total of all receipts of an individual, corporation, limited liability company, or other legal persons less those exemptions and deductions authorized under this Law.” Receipts include not only money, but also the fair market value of any property received as compensation. Taxable income includes salaries, wages, fees and commissions; all receipts derived from business, industry, construction and other economic activities; receipts from sale of movable and immovable property; interest, dividends, rents, royalties, rewards, prizes, winning from lotteries, *bakhshishis* (gratuities, bonus payments etc.); distributive shares of partnership income; any other income from labor, capital, or economic activity; income from other circumstances provided in this Law; and any other receipts from labor or economic activity. (Note that dividends include any tangible or intangible assets; shares in the company; discounts on any purchases from the company; loans to shareholders; and the use of any company property.)

Non-taxable income includes grants, gifts, and awards of the State; various grants, gifts, and awards of foreign governments, international organizations, or nonprofit organizations; all scholarships, fellowships, and other grants for professional and technical training; health, accident, and unemployment insurance benefits; life insurance paid on death; compensation or damages for personal injuries or sickness or restitution of reputation; proceeds of borrowing; proceeds of issues of stocks and bonds by companies; acquisition of assets in connection with mergers of domestic corporations and other legal persons; acquisition of movable or immovable property through expropriation of property of debtors by creditors; payments on principal received from debtors; interest on bonds issued by the State and by municipalities; and other receipts exempted from taxation by the Tax Law.

Afghanistan, like many other countries, relies on withholding as a major collection mechanism. Accordingly, all natural or legal persons, whether they are for profit or non-profit, as well as ministries, state enterprises, municipalities or other governmental bodies, if they have two or more employees during any month, must withhold the standard income tax from the wages and salaries paid and remit same to the Government. Legal persons organized under the laws of Afghanistan must also withhold a 20% tax from interest, dividends, royalties, prizes, rewards, lotteries, *bakhshishis* (gratuities), bonuses, and service charges. Additionally, rental payments for buildings and houses, where the renter is a legal or natural person using the property for business purposes, are subject to withholding. The tenant is to withhold the taxes from the rent and pay the taxes according to rulings of the

Ministry of Finance. The taxes collected and paid by the tenant on behalf of the landlord and are treated as prepayment of tax by the landlord. The tax to be withheld is 10% of the monthly rent where the monthly rent is from Afs 10,000 to Afs 100,000; and 15% of the monthly rent where the monthly rent is more than Afs 100,000.

Ordinary and necessary business expenses are deductible from income in calculation of the tax owned. The Tax Law defines deductible expenses as “[d]eduction of all ordinary and necessary expenses of production, collection, and preservation of income of natural and legal persons...”; provided they were incurred during the tax year or one of the three previous years. Deductible expenses include:

- Any expense related to the cost of production or trade and business
- Cost of supplies, materials, fuel, electricity, water, and other necessary expenses incurred in the production of income
- Wages, salaries, commission, and fees paid for services rendered by employees
- Interest paid on business loans
- Rent paid on property used for business purposes, and the cost of repairs and maintenance on such property
- Depreciation of property (except agricultural land) used in trade or business, or held for the production of income, not to exceed its cost to the taxpayer
- Any tax or charge (not including Income Tax) that is a necessary expense of doing business or producing income (e.g., Business Receipts Tax)
- Damages to property caused by disaster of any kind, over a period of three years, to the extent the loss was not covered by insurance
- Losses from bad debts
- Dividends paid in money (rather than stock) by a legal person established under the laws of Afghanistan

Personal expenses are not deductible.

Gain on the sale or exchange of a capital asset or investment is taxable. This includes gains from the sale, exchange or transfer of a business; a factory including equipment, machinery, buildings and land; equipment used in the business of transporting persons and goods; and shares of stock in corporations or LLCs, as well as the assets of a corporation or LLC when the company is liquidated. The form of the transfer has no effect on the taxability of the gain, except transfer by inheritance, which is exempt from taxation. In determining taxable gain from the sale, exchange or transfer of a capital asset, the taxpayer may deduct the cost of the asset or investment sold less the total amount of allowable depreciation from acquisition, and the expenses of sale (commissions, legal fees, transaction and document taxes, etc.). Losses from the sale or exchange of a capital asset used in a business are deductible from taxable income in the year of the transaction, so long as any gain from the sale or exchange would have been taxable. Losses from the sale or exchange of stock are only deductible from gains from the sale or exchange of stock in the same year. If such gains exceed such losses, the excess gain is taxable; if such losses exceed such gains the excess losses are not deductible. Certain capital gains are taxed at special tax rates, rather than the standard tax rates. The price

receivable from the sale or transfer of movable or immovable property by a natural person is subject to a one percent tax at the time of transfer in lieu of income tax. The price receivable for the sale or transfer of movable or immovable property by a legal person is subject to a one percent tax at the time of transfer, but the tax paid will be allowed as a credit against tax payable when the return is filed. The taxable Income of any person that realized gain in a tax year from the sale or transfer of an asset owned for at least 18 months will be subject to a special tax rate (in no event to be less than two percent) calculated in accordance with Article 29.3 of the Tax Law if one or more of the following conditions apply:

- the transfer of property (except by inheritance) was not a sale;
- the asset transferred was a capital asset;
- the asset was transferred on sale or liquidation of a business.

Under the Income Tax Law a general partnership is one in which the partners are individually and collectively liable for the payment of the all debts of the partnership, while a special partnership is one in which one or more of the partners have unlimited liability for partnership debts while the other partners are liable only to their individual share of the partnership capital. General and special partnerships as legal entities are not subject to the income tax. Rather, income of a general or special partnership is taxable as income to the partners individually as natural persons with each liable for income tax only on their individual capacities, and each must include their share of partnership income in their taxable income.

A corporation “is a company which has its capital determined and divided by shares and liability of each...(shareholder) is limited to their shares.” A limited liability company is one whose capital is not divided into shares, and in which its shareholders are not individually liable for debts of the company but each has liability limited to their shares of capital of the company. Chapter 6 of the Tax Law contains special provisions for corporations and LLCs. A few of these special conditions are noted below.

It should be noted that corporations and LLCs are required to use the accrual method of accounting in calculating their taxes, which recognizes income and expenses when due, even if not paid on that date. All others are to calculate their taxes using the cash method of accounting at the time of income receipt and expense payment. A corporation or LLC that incurs a net operating loss (the amount that exceeds income after allowance of deductions in a tax year) may deduct the loss from its taxable income of the three succeeding years, deducting one-third of the loss in each year. The distribution of the assets of a corporation or LLC to its shareholders, except in the circumstance of liquidation, shall be treated as a reduction in capital or the cost of stocks. In liquidation of a corporation or LLC, a distribution of assets to its shareholders is treated as proceeds from the sale or exchange of assets, and the amount of money and the market value of other assets distributed less the shareholder’s cost of stock or share of capital on which the distribution is made is treated as taxable income of the shareholder. A dividend is any distribution of money or assets from a corporation or LLC to shareholders from its earnings. If the dividend is in cash from a corporation or LLC established under the laws of Afghanistan, it is deductible by the company. If the dividend is in the form of securities for shares or loans, it shall not be deductible from the income of

the company. Dividends paid in cash are taxable income to the recipient on receipt, but dividends in the form of securities for shares or loans are not considered as taxable income at the time received. As noted previously, persons established under the laws of Afghanistan are required to withhold income tax of 20% from dividends. It appears that enterprises registered under the Law on Private investment are entitled to accelerated depreciation of assets.

The Tax Law also contains specific provision related to taxation of insurance companies; banks, loan and investment corporations; and qualifying extractive industry taxpayers

The Tax Law imposes a Business Receipts Tax (“BRT”) and the scope of coverage of the BRT was recently expanded. The BRT is imposed on the total gross income before any deduction. The BRT applies varying rates depending on the nature of the goods or services. The BRT rates applicable are as follows:

- It is generally imposed at a rate of two percent of the gross receipts of a legal person and two percent of the gross receipts of a natural person if they provide goods or services for consideration. However, the two percent BRT applies to a natural person only if its revenue is Afs 750,000 or more per quarter. Persons referred to in the remaining bullets are excluded from the threshold amount referenced in this bullet.
- Two percent of income received (before any deductions) from hotels or guest houses and restaurants the quarterly income of which is less than Afs 750,000.
- Five percent of income received (before any deductions) from hotels or guest houses and restaurants income of which is more than Afs 750,000.
- Five percent of income received (before any deductions) from services provided by clubs and halls where events are held.
- Ten percent of income received (before any deductions) from telecommunication, airline services, and hotel and restaurants providing superior services.

However, certain income is exempt from the BRT. Income exempted from the BRT is set forth below:

- Income from interest;
- Fees earned from exchange of currency, operation of savings or other bank accounts, deposits and withdrawal transactions, issuance of checks or letters of credit, internet banking, provision of mortgages or loans, and provision of lines of credit;
- Issuance of cash settled futures contracts;
- Issuance of futures contracts settled by physical delivery of the goods;
- Premiums from the provision of any insurance or re- insurance;
- Distributions received by a shareholder from a corporation, limited liability company or partnership with respect to shareholder’s stocks or partnership interest;
- Income from export of goods and services;
- Income from provision of tax withholding services;

- Income received from lease of residential property to a natural person provided that the tenant uses the property for residential purposes for more than six months of the tax year; and
- Income from sale of property by a natural person outside the ordinary course of the natural person's business.

The BRT is payable regardless of whether the taxpayer experiences a profit or loss, but it is a deductible expense against taxable income for the same tax year.

Persons engaged in certain commercial activities are subject to fixed tax in lieu of income tax and BRT. The fixed tax varies with commercial activities involved. The activities subject to fixed taxes include importation of goods; transport passengers or goods for business purposes; entertainment services (theatre, films, radio, television, music, or sports) in Afghanistan provided by resident natural persons, and non-resident natural and legal persons; natural persons engaged in small businesses activities of all types; and contractors who provide supplies, materials, construction and services.

The Income Tax Law provides for assessments, filing of returns, protests and payment of the income tax, as well as fines and penalties for violation, anti-avoidance measures, and strong enforcement provisions, including, in the event a company has failed to pay taxes, collection of taxes due from any or all directors who have failed to exercise due care.

Impact on the IPP

As initially noted, the Income Tax Law is based on the income tax law of the United States and adapted to Afghanistan. It applies a flat tax rate to corporations and LLCs, while adopting a progressive tax on the income of natural persons, with tax rates that are reasonable by regional standards. Overall, it represents a modern and relatively simplified taxation system that should appeal to investors. The IPP investors should, and presumably will, work with the Ministry of Finance to pursue the opportunities for exemption from income taxes, as well as customs duties and taxes for a period of time.

C. Environment Law

The Environment Law – Generally

Afghanistan enacted an updated Environment Law on January 25, 2007. The Environment Law has five main purposes: 1) improve livelihoods and protect the health of humans, fauna and flora; 2) maintain ecological functions and evolutionary processes; 3) secure the needs and interests of present and future generations; 4) conserve natural and cultural heritage; and 5) facilitate the reconstruction and sustainable development of the national economy.²¹⁵ The implementing agency for the Environment Law is NEPA, which acts as an independent institutional entity, and is responsible for coordinating and monitoring conservation and rehabilitation of the

²¹⁵ Chapter 1, Article 2: Purpose. The Environment Law. January 25, 2007.

environment.²¹⁶ The Environment law contains a supremacy clause which states: “where there is inconsistency between the provisions of this Act and any other law that affects the environment, other than the Constitution of Afghanistan, this Act shall prevail.”²¹⁷ This addition makes the Environment Law a very powerful law when planning projects and activities that could implicate the environment.

In addition to NEPA, the Environment Law created the Committee for Environmental Coordination to promote the integration and coordination of environmental issues into everyday decisions from the national to the local levels.²¹⁸ Membership on the Committee is extremely broad, encompassing all relevant ministries, national institutions, provincial, district and village councils and civil society organizations.²¹⁹ The Committee serves a broad policy function, rather than being tasked with specific enforcement actions, but is responsible for making recommendations on a wide variety of environmental issues.²²⁰ The members of this committee are appointed by the president on recommendation of the director-general of NEPA.²²¹

The Environment Law also created the National Environmental Advisory Council to advise NEPA on financial, regulatory and environmental measures that are of national public importance.²²² This Council meets once a year and members may include governors, chairpersons of provincial, district and village councils, Islamic scholars and tribal elders.²²³ The members of the National Environmental Advisory Council are appointed in the same manner as those of the Committee for Environmental Coordination.²²⁴

Finally, the Environment Law created Subnational Environmental Advisory Councils in each province to make recommendations regarding financial matters and environmental issues that are of local public importance.²²⁵ These councils are designed to function at the provincial, district and village levels and are to meet every six months, with the governor of each province as the chair.²²⁶ The Councils report their activities to NEPA.²²⁷

The Environment Law – Management of Activities Affecting the Environment

The Environment Law contains a blanket prohibition on two types of activities. The first is that “no person may undertake an activity or implement a project, plan or policy that is likely to have a significant adverse effect on the environment” unless the provisions of Article 16 are followed.²²⁸ The second is that “no ministry or

²¹⁶ Chapter 1, Article 3: Implementing Agency; also see *National Environmental Protection Agency* in section 2 of this report; Chapter 2, Article 9: Functions.

²¹⁷ Chapter 9, Article 76: Supremacy of the Act.

²¹⁸ Chapter 2, Article 10: Committee for Environmental Coordination.

²¹⁹ *Id.*

²²⁰ *Id.*

²²¹ *Id.*

²²² Chapter 2, Article 11: National Environmental Advisory Council.

²²³ *Id.*

²²⁴ *Id.*

²²⁵ Chapter 2, Article 12: Subnational Environmental Advisory Councils.

²²⁶ *Id.*

²²⁷ *Id.*

²²⁸ Chapter 3, Article 13: Prohibited Activities.

national authority may grant an authorization for the execution or implementation of a project, plan or policy that is likely to have a significant adverse effect on the environment” unless the provisions of Article 16 are followed.²²⁹ The language in the Afghan Environment law is substantially similar to that of the National Environmental Policy Act (hereafter U.S.-NEPA) in the United States and the standard of “significantly affecting the quality of the human environment.” Also similar to the U.S.-NEPA process, the Afghan Environment Law requires that the person or agency make an informed choice regarding the proposed action, rather than requiring a specific course of action or no action. The Afghan Environment Law, again similar to U.S.-NEPA, requires that environmental issues be integrated into all national and local land use plans and natural resource management plans developed by relevant ministries and national institutions.²³⁰

One of the requirements of the process under the Afghan Environment Law is the submission of a preliminary assessment. The preliminary assessment should contain accurate information to allow NEPA to determine the potential adverse effects and positive impacts of the project, plan, policy or activity.²³¹ NEPA will review the brief and solicit advice from the EIA Board of Experts (see below) before making a decision to authorize the project, plan, policy or activity.²³² NEPA can also place conditions on the proposed project, plan, policy or activity, without requiring further action by the proposing party.²³³ However, if NEPA considers the adverse effects likely to be significant, it can require the proposing party to submit an Environmental Impact Statement²³⁴ or a Comprehensive Mitigation Plan under the Law.²³⁵ If NEPA chooses to require a comprehensive mitigation plan, it must include the following: 1) a description of the mitigation measures that will be implemented in order to prevent, reduce or otherwise manage the environmental impacts of a project, plan, policy or activity; 2) how these measures will be implemented; and 3) any other information prescribed by NEPA.²³⁶ The costs incurred in preparing the preliminary assessment, an environmental impact statement, a final record of opinion or a comprehensive mitigation plan are the responsibility of the applicant proposing the project, plan, policy or activity.²³⁷

On the basis of the preliminary assessment and any required follow –up documentation, such as an environmental impact statement or comprehensive mitigation plan, NEPA can choose to either grant or refuse to grant the permit for the project, plan, policy or activity. If NEPA, acting on the advice of the EIA Board of Experts, finds that the environmental impacts and concerns are adequately addressed by the environmental impact statement/preliminary assessment it can

²²⁹ Id.

²³⁰ Chapter 3, Article 22: Integrating environmental issues into development planning.

²³¹ Chapter 3, Article 14: Preliminary Assessment.

²³² Id.

²³³ Id.

²³⁴ Under the Afghan Environment Law, an Environmental Impact Statement is defined as: “the procedures used for evaluating the likely adverse or positive environmental and social impacts of proposed projects, plans, policies, or activities in order to improve the quality and development impact of such projects by identifying ways of improving project selection, siting, planning, design and implementation.” (Chapter 1, Article 4: Definitions, subpoint 33.)

²³⁵ Chapter 3, Article 14: Preliminary Assessment.

²³⁶ Chapter 3, Article 15: Comprehensive Mitigation Plan.

²³⁷ Chapter 3, Article 18: Costs borne by proponent.

grant the permit subject to any conditions recommended by the EIA Board of Experts.²³⁸ If NEPA, acting on the advice of the EIA Board of Experts, finds that the implementation of the project would bring about unacceptable significant adverse effects or that the proposed mitigation measures would be inadequate, it can reject the proposed project, plan, policy or activity, and the reasons for rejection must be provided in writing.²³⁹ A permit may also be withdrawn if the applicant fails to comply with any of the terms and conditions of the permit.²⁴⁰ Permits will lapse if the applicant fails to implement the project, plan or policy or undertake the activity within three years from the date of issuance.²⁴¹

Similar to the U.S.-NEPA process, the Environment Law requires that affected persons be given the opportunity to comment on the proposed project, plan, policy or activity, as well as the preliminary assessment, the environmental impact statement, the final record of opinion and a comprehensive mitigation plan (if one was required) before NEPA approves the permit.²⁴² The applicant must also demonstrate to NEPA that there has been an appropriate time and meaningful opportunity, in both individual consultations and public hearings, for affected persons to comment on the proposed project, plan, policy or activity.²⁴³ If the proposed project is likely to have “highly significant adverse effects on the environment,” affected persons must have the opportunity to participate in each of the phases of approval by NEPA.²⁴⁴

NEPA is assisted by a Board of Experts who review, assess and consider applications and documents submitted by proponents for obtaining permits and make technical requirements regarding the permits, as well as conditions that should be attached to any permit that is granted.²⁴⁵ The Board of Experts is composed of up to eight appropriately technically qualified members, appointed by the General-Director of NEPA, with expertise in environmental science.²⁴⁶ There are also provisions in the Environment Law for the general-director to appoint up to four additional temporary members to the EIA Board of Experts.²⁴⁷

The Environment Law – Integrated Pollution Control

The Afghan Environment Law requires that a person be in possession of and in compliance with a valid pollution control license before discharging or causing to be discharged a pollutant into the environment if that discharge causes or is likely to cause a significant adverse effect on the environment or human health.²⁴⁸ A pollutant is defined in the law as: “any substance, solid, liquid, gas, micro-organism, noise, vibration, heat, radiation, light or other energy, or thing, or combination of them that has or has the potential to have an adverse effect, and anything deemed to be a

²³⁸ Chapter 3, Article 16: Approval Procedure, subpoint 1.

²³⁹ Id. at subpoint 2.

²⁴⁰ Id. at subpoint 3.

²⁴¹ Id. at subpoint 4.

²⁴² Chapter 3, Article 19: Public Participation, subpoint 1.

²⁴³ Id.

²⁴⁴ Id. at subpoint 2.

²⁴⁵ Chapter 3, Article 20: EIA Board of Experts, subpoint 1.

²⁴⁶ Id. at subpoint 2.

²⁴⁷ Id. at subpoint 3.

²⁴⁸ Chapter 4, Article 27: Prohibition Against Discharges, subpoint 1.

pollutant under the provisions of this Act.”²⁴⁹ Of course, the granting of a license to emit a pollutant does not affect requirements for other authorizations necessary to undertake an activity or implement a project.²⁵⁰ If pollutants are discharged, the Environment Law requires that the polluter “take all reasonable measures to ensure that the best practicable environmental option” is adopted.²⁵¹ “Best practicable environmental option is defined in the Law as: “the best method for preventing or minimizing adverse effects on the environment, having regard to, among other things: the nature of the discharge and the sensitivity of the receiving environment to adverse effects; comparison of financial and environmental implications of one option compared with other options; and the current state of technical knowledge and the likelihood that the option can be successfully applied.”²⁵²

NEPA evaluates applications for pollution control licenses and has the authority to either: 1) grant a license, with or without conditions, depending on whether the pollutant that is the subject of the license will either not have a significant adverse effect or that the adverse effects have been adequately mitigated; or 2) refuse to grant the license and provide written reasons for the refusal to the applicant.²⁵³ If the necessary and relevant information required by NEPA to make a decision was provided by the applicant, NEPA must either grant or deny the license application within 30 days of submission by the applicant.²⁵⁴ NEPA also has the authority to amend, revoke or impose new conditions in the pollution control license, and the license is only valid for a period of five years.²⁵⁵ Any discharges outside the permitted amounts or outside the parameters of the license must be immediately reported to NEPA, either by the polluter or by any other person that discovers the discharge, and all practicable steps to contain, mitigate and remedy the adverse effects must be taken, to the reasonable satisfaction of NEPA.²⁵⁶

The Environment Law – Compliance and Enforcement

NEPA is authorized to appoint inspectors, in accordance with relevant regulations and procedures, to ensure compliance with the Environment Law and its regulations.²⁵⁷ Inspectors are given broad powers under the Environment Law to enforce the Law, including the power to: 1) enter a premises, after showing identification (except in relation to a dwelling); 2) take samples, photographs and record or copy any information in order to carry out the tests and inspections required; 3) to require the production of any document, record or other thing that is required to be kept under the Environment Law and remove it for the purposes of making copies; 4) to seize and take copies of any documents which may constitute evidence of an offence under the Act; 5) make reasonable inquiries of any person, orally or in writing; and 6) require assistance and facilities to enable the inspector to carry out their duties, among others.²⁵⁸

²⁴⁹ Chapter 1, Article 4: Definitions, subpoint 22.

²⁵⁰ Chapter 4, Article 28: Prohibition Against Discharges, subpoint 2.

²⁵¹ Id. at subpoint 3.

²⁵² Chapter 1, Article 4: Definitions, subpoint 4.

²⁵³ Chapter 4, Article 28: Pollution Control Licenses, subpoint 1.

²⁵⁴ Id. at subpoint 2.

²⁵⁵ Id. at subpoints 3 and 4.

²⁵⁶ Chapter 4, Article 29: Reporting and containing discharges.

²⁵⁷ Chapter 8, Article 67: Appointment of inspectors, subpoint 1.

²⁵⁸ Id. at subpoint 2.

NEPA also has two devices it can use to stop activities that are causing significant adverse effects. NEPA may issue abatement orders for activities that are not authorized under the Environment Law and may result in significant adverse effect.²⁵⁹ The abatement order must contain: 1) the nature of the condition, practice or activity in question; 2) the date by which abatement must occur; and 3) remedial and environmental restoration action required.²⁶⁰ NEPA can also issue a compliance order if it has reasonable grounds to believe that the condition of a permit, license or other authorization has been breached by a licensee or permittee.²⁶¹ The compliance order can either require that the breach be remedied within a specific period or, in cases of immediate risk, suspend the license with immediate effect to prevent immediate harm to human health or the environment.²⁶² Failure to comply with a compliance order can result in NEPA taking the necessary steps to remedy the breach, at the permittee's expense, alter or revoke the permit or license, or refer the matter for prosecution.²⁶³

The Environment Law allows legal action to be brought by any person "affected by damage or threatened by potential harm to natural resources or the environment or by violations of this Act and any regulations adopted pursuant to it, on that person's own behalf or on behalf of that person and other affected persons having similar or common interests in the proceedings."²⁶⁴ This provision is significant because it both confers standing on behalf of citizens to challenge projects and proposals that would affect the environment, and also seems to dispense with the ripeness requirement in the United States (that the action is imminent or immediate, speculative harm will not be sufficient to sustain the action). These are not requirements, at least not yet, in the Afghan court system, but it is important that citizens are allowed to resort to legal action to protect the natural resources and environment.

The Environment Law – Impacts for the IPP Transaction

As stated above, the Environment Law in Afghanistan bears many similarities to the U.S.-NEPA process. An American corporation that is familiar and has experience with the U.S.-NEPA process should have little or no trouble operating in Afghanistan. Unfortunately, as with many of the laws in Afghanistan, what is written on paper for the law and what is actually enforced by the government agents do not always match. The overall condition of the environment in Afghanistan is poor and actual enforcement of the terms of the Environment Law is spotty and inconsistent at best. However, the presence of the supremacy clause in the Environment Law and the way it has attempted to integrate itself into the decision-making processes of the ministries creates a risk that not following the law could have major consequences for an individual and/or company should the Law be enforced to the letter.

The standards, "having a significant adverse effect on the environment" and "significantly affecting the quality of the human environment," are almost exactly the

²⁵⁹ Chapter 8, Article 68: Abatement Order, subpoint 1.

²⁶⁰ *Id.* at subpoint 2.

²⁶¹ Chapter 8, Article 69: Compliance Order, subpoint 1.

²⁶² *Id.*

²⁶³ *Id.* at subpoint 2.

²⁶⁴ Chapter 8, Article 71: Legal action, subpoint 1.

same. The Afghan Environment Law goes one step beyond U.S.-NEPA by applying to not just federal actions, but to everyone. This means that a private entity operating in Afghanistan, even without government or ministerial involvement, would be subject to the Afghan Environment Law and bound to undertake the same pollution control measures and environmental impact assessments as if it had been done by a ministry or government agency. The construction and operation of a piece of critical infrastructure like a power plant will require sufficient government involvement to implicate the Environment Law in the relevant ministries, so compliance with the terms and processes will be in the best interest of the IPP anyway.

Under the Environment Law, the IPP will need to file a preliminary assessment that contains accurate information for NEPA to evaluate the environmental effects of the project. Once the preliminary assessment has been reviewed by NEPA and the EIA Board of Experts, they will grant the application, with or without conditions, or request additional information in the form of an environmental impact assessment or comprehensive mitigation plan. For a gas-fired power plant, it is likely that NEPA will require a more detailed environmental impact assessment, including public participation in the evaluation of the project. In addition to the environmental impact assessment, NEPA may require a comprehensive mitigation plan to reduce or mitigate the environmental impacts of the facility. Whether the comprehensive mitigation plan is required will depend on several factors including the choice of generation technology by the IPP, the anticipated emissions and emissions composition from the facility, and any other environmental impacts.

The IPP will also need to obtain a pollution control license for the facility. While emissions from a gas-fired power plant are not likely to be hazardous or unusually harmful, the Environment Law requires that any discharge of a pollutant (which is defined very broadly in the Law) be done under a permit issued by NEPA. The IPP will need to fill out an application for the license, including a description of the “best practicable environmental option,” the types of pollutants that will be emitted by the facility, and any mitigation measures that will be undertaken to minimize their effects. Once the application for a pollution control license is submitted, NEPA must either grant or deny the application within 30 days. Once the license is granted and any conditions or mitigation measure required are met, the plant will have the necessary environmental clearances to begin operations. The pollution control license will need to be renewed every five years, according to the Law.

In terms of recommendations, the Afghan Environment Law is one of the most clearly written and consistent laws on the books in Afghanistan. Few other laws are so clear on what licenses, permits and other administrative procedures are necessary for the operation of a facility or the implementation of a plan or policy. The law contains appropriate definitions, clear procedures, aggressive integration with government decision-making processes and rational standards of enforcement. While the actual, on-the-ground enforcement of the provisions of the law may be lacking, there is no doubt that the Law was appropriately drafted to accomplish its objectives.

Despite the shortcomings in actual enforcement of the law, in the case of Afghanistan, the cost of compliance appears to be minimal and complying with the Environment Law from the beginning avoids the risk of the Law being applied later,

to the detriment of the project, by NEPA. Further, the aggressive integration of the Environment Law into all aspects of local, district, provincial and national decision-making processes likely means that the provisions of the Environment Law will necessarily be part of the overall IPP project planning anyway. Of the laws that are included in this analysis, the Afghan Environment Law will be one of the least concerning for a foreign investor.

The Environment Law – A Special Note on 22 CFR 216

Chapter 22 of the Code of Federal Regulations Part 216, hereafter 22 CFR 216, was designed to implement U.S.-NEPA requirements as they apply to activities of USAID.²⁶⁵ 22 CFR 216 requires an initial environmental examination as the first review of a proposed USAID action or project.²⁶⁶ On the basis of that initial environmental examination, USAID will make the decision as to whether an Environmental Assessment or Environmental Impact Statement will be required for the proposed action.²⁶⁷ There are other relevant portions of 22 CFR 216 that would have to be followed under certain circumstances. Critically, 22 CFR 216 applies to “all new projects, programs or activities authorized or approved” by USAID.²⁶⁸ In this case, the IPP transaction is being developed without the authorization or approval of USAID necessary to trigger applicability of 22 CFR 216.

The only circumstance that would subject the proposed IPP project to the requirements of 22 CFR 216 would be if USAID were contributing direct funding to the IPP project, over a threshold of 25% of the total project cost. Further, the preliminary assessment required by the Afghan Environment Law and the initial environmental examination required by 22 CFR 216 would be substantially similar such that compliance with both requirements would not result in significant additional expense. Therefore, in the proposed IPP transaction described above, in which USAID makes no direct financial contribution to the project, 22 CFR 216 would not be triggered and there would be no need for compliance with its terms by the project company.

²⁶⁵ 22 CFR 216.1(a).

²⁶⁶ 22 CFR 216.1(c)(2).

²⁶⁷ 22 CFR 216.1(c)(3)-(4).

²⁶⁸ 22 CFR 216.2(a).

SECURITY PROVISIONS

A. Security – Generally

The security situation in Afghanistan has been well documented by international aid organizations, news media reports and military sources. Afghanistan is currently battling an insurgency comprised of Taliban fighters and Al Quada operatives, with the support of the International Security Assistance Force (ISAF). The United States has committed 90,000 soldiers to the military effort, in addition to approximately 40,000 soldiers from North Atlantic Treaty Organization (NATO) member states. For the past nine years, private security companies (PSCs) have been providing security for military organizations, diplomatic missions and international aid organizations. Following an incident with a private security company in August 2010, President Hamid Karzai issued Presidential Decree No. 62, which demanded the disbanding of all private security companies in Afghanistan within 90 days. That decree has since been amended to provide extensions to allow private security companies to continue to operate until the details of a transfer of their responsibilities could be organized with international military and aid organizations.

B. The Bridging Strategy

On March 21, 2011, the United States Ambassador to Afghanistan, Karl Eikenberry, released the “Bridging Strategy for Implementation of Presidential Decree 62.”²⁶⁹ The Bridging Strategy outlines a one year plan for transitioning from private security companies to an “Afghan Public Protection Force” or APPF.²⁷⁰ Under this strategy, Afghan employees of existing private security companies will be incorporated into the APPF and all private security companies will be dissolved by March 20, 2012.²⁷¹ According to the Bridging Strategy, the Afghan Public Protection Force is:

“a GoIRA [Government of the Islamic Republic of Afghanistan] security service provider intended to protect people, infrastructure, facilities and construction projects. The APPF will be organized as a state-owned company and does not have a police mandate to investigate crime or arrest suspects.”²⁷²

The Bridging Strategy is specific to diplomatic, ISAF and development entities and makes no mention of private individuals wishing to provide security for their installations and personnel. Under the definition provided in the Bridging Strategy, there is nothing that would preclude a private entity from contracting with the APPF for security for installations, infrastructure and employees. However, it is clear that the goal of Presidential Decree No. 62 and the Bridging Strategy is to accomplish the dissolution of private security companies in Afghanistan by March 20, 2012.²⁷³

²⁶⁹ The Bridging Strategy for Implementation of Presidential Decree 62 (Dissolution of Private Security Companies) Bridging Period March 22, 2011 to March 20, 2012.

²⁷⁰ Id.

²⁷¹ Id.

²⁷² Id. at Definitions, Afghan Public Protection Force (APPF).

²⁷³ See generally The Bridging Strategy.

C. Impacts on IPP Transaction

Recent reports regarding the security situation in Jowzjan Province, the proposed site of the IPP, suggest that it has been one of the most secure and relatively peaceful provinces in Afghanistan. However, the insurgency situation in Afghanistan is continually evolving and areas of relative peace cannot be automatically assumed to continue. As a key component of critical infrastructure, the power plant will certainly need some form of security for the installation and infrastructure associated with the plant.

With the implementation of Presidential Decree No. 62, a private company developing a power plant will need to have an arrangement with the Afghan government or ISAF, or both, to provide security for the construction, and completed installation, as it will be impossible to rely on private security after March 20, 2012. As the implementation of the Bridging Strategy proceeds over the coming months, the ability of a private business entity to contract with the Ministry of Interior and APPF to provide security will become clearer. Further, the ability of the APPF to operate without the assistance of private security companies will not be known until after the transition has been completed in 2012. Finally, American military forces are due to begin the withdrawal from Afghanistan beginning in July of 2011, with the withdrawal of combat forces due to be complete in 2014.

As the security situation in Afghanistan continues to evolve, and ISAF forces begin to scale down their involvement in counter-insurgency efforts, there is a risk that the costs of securing the power plant and related infrastructure will increase substantially. Such security costs could impact the ultimate profitability of the investment, particularly if other key pieces of infrastructure in the gas fields and power transmission systems are impacted by deteriorating security and insurgent activity. At the very least, the provision of security for the project will have to be studied more to reflect the changing circumstances and regulations in Afghanistan.

VII. CONCLUSIONS

Afghanistan is at an early stage in the process of rebuilding, modernizing and reforming its legal and regulatory system, and any investor entering Afghanistan must recognize the fact. There are large gaps in the laws, especially in the electricity sector. Laws that look good on paper are often ignored or feebly enforced. A legal framework is beginning to emerge to support commerce, industry, investment and society at-large. But it is weak and progress is hard won. Another barrier to overcome is corruption, which in Afghanistan is endemic. It afflicts virtually all institutions and activities from commerce to courts to customs. As pointed out Afghanistan ranks 179 out of 180 countries on Transparency International's Corruption Perception Index. For the foregoing reasons, investors must build strong dispute resolution mechanisms into their plans and contracts.

Governance is underdeveloped, administrative skills are inadequate, and cooperation is insufficient among government bodies. The electricity sector is a prime example. There is a lack of clear division of authority among MEW, MRRD, and DABS which translates into confusion and inconsistency. MEW is the ministry with responsibility for the sector, and DABS is the wholly state-owned corporatized utility formed from DABM, the former utility arm of MEW. DABS is now operating on a commercial basis. This is not an easy recalibration, since capacity in DABS is low, as are collections, and technical and commercial losses are high, although the situation is rapidly improving with USAID's help. Yet, as has been discussed, under the MOU of September 30, 2009, the MEW has retained responsibility for planning, designing, and constructing new generation and transmission infrastructure, which DABS is to manage and maintain. A non-commercial decision concerning construction of electricity infrastructure made by MEW can affect the ability of DABS to attain commercial status, which creates tension. To complicate matters, the MRRD is responsible for rural electrification, and has taken the lead in the development of renewable energy by virtue of its efforts in the area of non-grid sources of power. Accordingly, there are overlaps and gaps in assumed authority, and a need for significant realignment and clarification of responsibilities in the sector. But significant change predictably leads to significant resistance.

A number of the pertinent laws that affect electricity sector investors have been examined. Investors should be particularly cognizant of certain of them. Perhaps the most important with respect to the Sheberghan project is the Procurement Law. According to that law's implementing Regulations, it appears the purchase of capacity/electricity by DABS from the IPP will be regarded as subject to the Procurement Law. While this may be debatable, and investors may consider seeking, or requesting the procuring entity (DABS) to seek an opinion from the Attorney General's office regarding the issue, it is likely compliance will be expected. The IPP may also have arguments that it qualifies for a procurement method other than a tender. However, if the transaction is covered by the law, the fact remains that, among the types of contracts to be applied, only one (the framework contract) would seem to remotely fit the operations of the IPP, and certain regulatory limitations on its provisions may not be satisfactory. The investors should prepare a strategy that would permit them to live within this law.

The Customs Law should also be kept in mind. The tariffs are relatively low, but the law is complex. There are frequent complaints that goods are held at the border for

long periods due to inefficiencies, inexperienced customs officials, and corruption. As previously observed, investors should take the potential for customs delay into account in their project plans.

The Private Investment Law for the most part strongly benefits the investors. However, investment in power generation is restricted under that law and permission for such an investment considered and decided on a case by case basis. This will require the High Commission on Investment to review and approve the investment after consultation with and the consent of the relevant ministries. If there was a sector specific law, that law would govern the investment, rather than the Private Investment Law.

Afghanistan does not have an Electricity Law as yet. One is under development, and is nearing finalization, but after the law emerges from the Ministry of Energy and Water, it must be reviewed by the Ministry of Justice, passed by Parliament, and signed by the President. The draft Electricity Law is flawed in a number of ways, some of them described in the discussion of the law. But the draft law also expressly recognizes IPPs, adds flexibility to the dispute resolution procedure, institutes open access, and keeps low the barriers to entry in the electricity market for anyone willing to bear the financial risk. The fact that the draft Electricity Law is still pending, highlights the fact that there is no Electricity Law.

Investors should take note of this absence of a law. There is nothing in Afghan law to prohibit the operation of IPPs, but that is mainly because there is no law that directly governs or systematically regulates the sector. Although there are a number of small private power producers, employing micro hydro facilities or diesel generators, the proposed Sheberghan generation facility will be the first large IPP in Afghanistan. In the absence of law and regulations and lack of effective, predictable governance, investors in the IPP should attempt to build their own regulatory regime through their contractual arrangements with the various shareholders.

APPENDIX A: Memorandum of Understanding (MoU) between DABS, MEW and MoF, dated September 30, 2009.

Islamic Republic of Afghanistan

**Memorandum of Understanding
(MoU)**

Between

**Ministry of Energy and Water (MEW), Da Afghanistan Breshna
Sherkat (DABS)**

**and Ministry of Finance (MoF)
Kabul**

Date: 30 September 2009

MEW and DABS have agreed on the MoU which covers the following points:

- Mutual understanding and cooperation;
- Preventing duplication of activities through ensuring consultation on future programs and work plans, specific issues and other relevant affairs (if any occurs);
- Seeking solutions to sustainable problems on the way of the parties' common interests;
- Ensuring that necessary information shall be shared regularly and transparently between the parties.

The Ministry of Finance is a witness to this MoU and shall reassure on its effective implementation while considering the following points:

- Ministry of Energy and Water is responsible for implementation of the following items:
 - Preparation and management of the national policies and laws of the energy sector;
 - Guiding and planning development of the energy sector;
 - Determining and evaluating needs in the energy sector (such as coal, gas, renewable energy, energy sufficiency, financial issues, human resource capacity) so that the work frame of the IRA is supported and socio-economic growth further accelerated;
 - Establishment of standards for better management and issuance of licenses.
- Da Afghanistan Breshna Sherkat (DABS) is a newly established corporation that is responsible for management and operation of the energy sector, including power production from existing facilities, transmission, dispatch, distribution and supply of electric energy throughout Afghanistan.
- Da Afghanistan Breshna Moasesa (DABM) was a state enterprise reporting to the Ministry of Energy and Water. This entity shall be closed by the government of Afghanistan. After its closure, all its assets, loans and staff shall be transferred to DABS. DABM's legal entity shall be dissolved.
- All responsibilities, activities, assets and staff of DABM shall be transferred to DABS on 30 September 2009 (8 Meezan 1388).
- DABS shall be responsible to keep DABM assets and staff (acting as a body responsible for keeping the assets and staff of DABM) meanwhile work as a dissolver entity of DABM with the Ministry of Finance (and other members of Liquidation Committee) till 20 March 2010 (29 Hoot 1388) or if necessary for a longer time.

MEW, DABS and MoF have agreed on the following Articles:

Article 1: Planning, Engineering, Supplies, Construction and Assembling of new Infrastructure of Energy Sector

- 1.1 MEW shall continue to be responsible for surveying, planning and designing of the new Generation and Transmission Infrastructure.
- 1.2 MEW shall also be responsible for engineering, supplies, construction and assembling of new projects. It is agreed that the forthcoming Infrastructure of Energy Sector is to be planned in a commercially and economically effective and sustainable manner.
- 1.3 Since DABS is responsible for management therefore every relevant entity is to consult with it in each phase of development projects.

1.4 For the time being, MEW shall have responsibility for import of power from outside the country in close consultation and understanding with DABS.

Article 2: Management & Maintenance of Assets, Expansion and Strengthening of Existing Infrastructure

2.1 DABS shall perform activities such as; management, maintenance and all commercial affairs related to operation or activity of infrastructure, sale and transmission of electric energy.

2.2 DABS shall be responsible for expansion and strengthening of the existing distribution network of electricity.

Article 3: Management of Agreements with Donors

3.1 According to the agreement signed between MEW, MoF and MoE; all assets of DABM, as assistance, shall be transferred from governmental assets to DABS on 30 September 2009. These assets are transferred to DABS as its assets shall be incorporated into a Memorandum of Transfer that will be signed by MEW, MoF and other shareholders of DABS.

3.2 The assets and properties that are not in ownership of DABM (not known as DABM properties), their transfer shall take shape all in one phase from contractors to the Ministry of Energy and Water and from the Ministry of Energy and Water to DABS in presence of MOF representative. A Memorandum of Transfer to be signed shall be a proof for its transfer and an increase made thereby in the capital of DABS.

3.3 If new projects are launched in different sections and if those segments of projects that are activated could be used beforehand, they shall be transferred to DABS (transfer of these segments is to be included in the Memorandum of Transfer and also added to the capital of DABS) meanwhile MEW shall undertake responsibility for completion and assembling of the remaining segments of the projects.

Article 4: Coordination of Activities & Energy Database

4.1 MEW and DABS have agreed to hold official meetings at least on a quarterly basis. The parties shall hold their first meeting within 90 days from the execution date of the Memorandum of Transfer (30 September 2009) for assessment of future plans, discussion on relevant issues and joint decision making concerning feasibility study and operation of new projects.

4.2 The parties have agreed on the following points as well:

- Nomination of focal points to each others' relevant offices. It is to be noted that these focal points shall be responsible for documents and information sharing.
- Preparing a proper Terms of Reference (ToR) for the focal points.
- The Parties shall work on Items 4.1 and 4.2 within 90 days from the execution date of the Memorandum of Transfer (30 September 2009).

4.3 MEW has responsibility for management, collection and analysis of information in energy sector of Afghanistan and maintains a Database for Energy Sector of Afghanistan.

4.4 DABS is responsible for collection and provision of information on its activities to MEW Database for Energy Sector of Afghanistan. The format and schedule for collection of information by DABS to MEW shall be prepared and agreed on within 90 days from the execution date of the Memorandum of Transfer (30 September 2009).

Article 5: Changes in this MoU

Any amendment and correction in this MoU shall be made based on mutual agreement of both Parties. Any type of proposal for correction is to be in writing. One copy of the proposal for corrections needs to be sent to the Ministry of Finance. The receiving Party is to respond on time to the proposing party. However, the said response is to be provided within 30 days from the receipt date of the proposal for correction and amendment.

Article 6: Dispute Resolution

If any disagreement or dispute arises between the Parties and they fail to agree on its solution, within 60 days from the date of such dispute rising, it shall be referred to the Management Board of the Corporation. The Management Board shall decide what measures are to be taken for resolution of disputes. If the Parties do not agree on other solution, the decision to be taken by the Management Board shall be enforced on both parties.

The Parties signed this MoU in witness of

Dr. Omar Zakhilwal
Minister of Finance and Chief Advisor of President in Economic Affairs

Ismail Khan
Minister of Energy & Water

Dr. Jalil Shams
Chief Executive Officer of DABS

APPENDIX B: The draft Electricity Law

Electricity Law

CHAPTER ONE GENERAL PROVISIONS

Article 1. The Rationale and Purpose of the Law

- 1.1 This Law has been enacted pursuant to Article 10 of the Constitution of the Islamic Republic of Afghanistan.
- 1.2 The purpose of this Law is;
 - 1.2.1 To promote and develop Electricity Services, including generation, transmission, distribution and supply of electricity, and to encourage development of renewable energy sources;
 - 1.2.2 To establish an Afghanistan Electricity Regulatory Authority (AERA) with power to regulate the Electricity Services market as set forth in this Law in order to assure a properly functioning market for such Electricity Services; and
 - 1.2.3 To establish certain Policy duties of the Ministry of Energy and Water (MEW) with respect to the Electricity sector.
- 1.3 This law applies to any Electricity Enterprise that is providing or seeking to provide Electricity Service in Afghanistan.
- 1.4 It is the policy of the Government of the Islamic Republic of Afghanistan that, to the maximum extent practicable, citizens of Afghanistan have access to safe, adequate and reliable Electricity Services, at fair and reasonable prices. Such services may be provided by Government owned and operated, or privately owned and operated enterprises or a combination thereof, operating under competitive market conditions.

Article 2. Legislation on Electricity Services

- 2.1 Legislation on electricity services shall consist of this Law and other legal acts adopted in conformity with this Law.

Article 3. Definitions

- 3.1 In this Law, the following terms shall have the following meanings:
 - 3.1.1 “**Afghanistan Electricity Regulatory Authority**,” or “AERA”, the regulatory body by that name defined by this Law.
 - 3.1.2 “**ANSA**” means the Afghanistan National Standards Authority.
 - 3.1.3 “**Approved Electricity Enterprise**” for purposes of Chapter 7 of this Law means an Electricity Enterprise registered as an approved enterprise under the Private Investment Law of Afghanistan.
 - 3.1.4 “**Confidential and Commercially Sensitive Information**” means information concerning the financial status, trade secrets, or other information of the Licensee that could competitively harm the Licensee if revealed, as well as private information on Customers served by the Licensee, and which has been found to be protected from disclosure under Article 25.4 of this Law.
 - 3.1.5 “**Customer**” means a Person or a local or central government body that requests, receives or uses Electricity Services.
 - 3.1.6 “**Decision**” means any final and conclusive pronouncement by the AERA or MEW, issued on a temporary or permanent basis concerning relevant issues, and implemented by the relevant authorities.

- 3.1.7 **“Dispatch”** means the notification, regulation and scheduling of generation capacity, electricity import, and transmission capability to effect the most reliable and economical supply of electricity to meet demand.
- 3.1.8 **“Distribution”** means the transport of electricity on medium voltage and low voltage Electricity Networks with a view to its delivery to Customers, but not including Supply.
- 3.1.9 **“Distribution Code”** is the set of technical rules issued by the AERA that among other things, sets forth the technical rules establishing the minimum technical design and operational requirements for any substation at or other connection to a Customer, including any connection of such Customer to the transmission or distribution network. Wherever possible the Distribution Code will refer to ANSA accepted international standards instead of including technical details in the Distribution Code itself.
- 3.1.10 **“Distribution System”** means a combination of electricity power lines and electricity units of medium and low voltage to serve the distribution of electricity.
- 3.1.11 **“Distribution System Operator”** means a Person responsible for operating, ensuring the maintenance of and, if necessary, developing the Distribution System in a given area and, where applicable, its interconnections with other systems and for ensuring the long-term ability of the system to meet reasonable demands for the distribution of electricity
- 3.1.12 **“Electricity”** means any form of produced or obtained electricity intended for supply or sale using a Transmission or Distribution system within Afghanistan, or intended for transit across the Territory of Afghanistan using such systems.
- 3.1.13 **“Electricity Enterprise”** or **“Service Provider”** means a Person, which performs one or more of the activities of generation, transmission, distribution, or supply of electricity on the basis of a License granted by the AERA or without a License if no License is required.
- 3.1.14 **“Electricity Facility”** means a complex of buildings, installations and equipment designed to generate electricity.
- 3.1.15 **“Electricity Network”** means a Transmission System or Distribution System, switching or routing equipment and other equipment which permit the conveyance of electricity by wire, or by cable, including terrestrial networks and aerial cable systems.
- 3.1.16 **“Electricity Service”** means the provision of services for remuneration which consists partially or mainly of the conveyance of Electricity on Electricity Networks, the Supply, or the generation of electricity by a generating unit of larger than 500kW.
- 3.1.17 **“Equipment”** means Electricity Network equipment, electrical generation equipment, and Customer connection equipment.
- 3.1.18 **“Financial year”** is the period from 01 Hamal up to end of Hoot of the same calendar year.
- 3.1.19 **“Foreign Investment”** for purposes of Chapter 7 of this Law means investment in the form of freely convertible foreign currency or contributions in kind, transferred from outside Afghanistan by a natural or legal foreign Person to the country.
- 3.1.20 **“Foreign Investor”** for purposes of Chapter 7 of this Law means a natural or legal foreign Person who has provided Foreign Investment in the country.
- 3.1.21 **“Generation”** is the production of electricity by any means.
- 3.1.22 **“GIRoA”** or **“Government”** shall mean the Government of the Islamic Republic of Afghanistan.
- 3.1.23 **“Grid Code”** is the set of technical rules issued by the AERA that includes the following: a) the technical rules establishing the minimum technical design and operational requirements for operation and connection to the network and Interconnection and operation of other networks, taking into account the

required system reliability; b) identification of economic criteria for dispatch; and c) the procedures applicable for network operation in contingency situations. Wherever possible the Grid Code will refer to ANSA accepted international standards instead of including technical details in the Grid Code itself.

- 3.1.24 **“Independent Power Producer”** means an Electricity Enterprise owned by a private investor(s) or by a joint venture between the GIRoA and private investors (i) that owns or operates an Electricity Facility for the generation of electricity; (ii) that does not own or operate Transmission or Distribution Systems; and (iii) that sells electricity or generating capacity to other Electricity Enterprises under negotiated contracts.
- 3.1.25 **“Interconnection”** is the physical, technical and logical linking of one Electricity Network to other Electricity Networks.
- 3.1.26 **“Legislation”** means this Law on Electricity Services and other primary legislation, or secondary legislation to be issued in execution of primary legislation, regulating the electricity sector.
- 3.1.27 **“License”** means authorization for a Person to provide specified Electricity Services, or other specific activities provided for by this Law in accordance with the provisions of this Law; and for which the right to retain such License may contain additional provisions related to maintenance of technical standards or other matters if required by AERA under this Law.
- 3.1.28 **“Metering Code”** means the set of technical rules issued by AERA which set forth the standards for metering reliability; safety; comprehensibility; and access to, ownership of, and other matters related to meters installed at the interface between a Distribution System and any Customer, as well as any metering between and among generation, transmission, and distribution facilities. Wherever possible the Metering Code will refer to ANSA accepted international standards instead of including technical details in the Metering Code itself.
- 3.1.29 **“Person”** includes:
- Any natural domestic person: meaning a person who holds Afghan nationality;
 - Any legal domestic person: meaning a person including a corporation, a partnership, sole proprietorship, limited liability company, joint venture, association, joint stock private or public company, trust, or any other entity established under applicable laws;
 - Any natural foreign person: meaning a person who has a citizenship of other than Afghanistan;
 - Any legal foreign person: meaning a person the legal personality of which is specified under the legal framework of a law other than those of Afghanistan.
- 3.1.30 **“Policy”** means a plan or course of action developed and published by the MEW to guide and influence decisions and activities in the electricity sector, taking into consideration the information gained after the process of gathering public opinions.
- 3.1.31 **“Producer of Electricity”** means a Person that holds a Generation License.
- 3.1.32 **“Renewable Energy Sources”** are naturally replenishing, non-fossil resources, including but not limited to hydropower from generating stations whose combined generation capacity of all units at that station is less than 500 kW, solar energy, wind power, geothermal energy, biomass, and biofuel.
- 3.1.33 **“Service Territory”** means a geographic area in which a Licensee is allowed by a License to conduct the activities stated therein, on a non-exclusive basis.
- 3.1.34 **“Significant Market Power”** or “SMP” means a Service Provider having a market share of 40% or more in a specific electricity market, as defined by the AERA as a service category or, as a geographic area.

- 3.1.35 "**Supply**" means the sale, including resale, of electricity to Customers, including end use Customers.
- 3.1.36 "**Tariffs**" means prices approved by the AERA and published. These may include any one or a combination of the following: producer prices, charges for dispatching, transmission, distribution and supply, as well as import prices.
- 3.1.37 "**Transmission**" means conveyance of electricity through a Transmission System.
- 3.1.38 "**Transmission System**" means a combination of electricity power lines and electricity units of high voltage serving the transmission of electricity.
- 3.1.39 "**Transmission System Operator**" means a Person responsible for operating, ensuring the maintenance of and, if necessary, developing the Transmission System in a given area and, where applicable, its Interconnections with other networks, and for ensuring the long-term ability of the system to meet reasonable demands for the transmission of electricity.

CHAPTER TWO DUTIES AND AUTHORITIES OF THE MINISTRY OF ENERGY AND WATER

Article 4. Policy and Program Implementation

- 4.1 For the purpose of supporting socio-economic growth of the Islamic Republic of Afghanistan, the Ministry of Energy and Water (“MEW”) is responsible for:
 - 4.1.1 Development of national electricity sector policies that promote an open and competitive market for electricity services in Afghanistan in an environmentally sustainable manner
 - 4.1.2 Electricity sector strategic planning consistent with national energy policies, including attraction of private investment and establishment a competitive market environment for the benefit of all stakeholders in the electricity sector.
 - 4.1.3 Identifying, evaluating, and forecasting electricity sector status and needs.
 - 4.1.4 Planning, procurement and construction of new electricity Generation and Transmission infrastructure projects in accordance with the terms of the Memorandum of Understanding (“MOU”) between MEW, Da Afghanistan Breshna Sherkat, and the Ministry of Finance dated 30 September 2009, attached hereto as Annex A, which MOU shall continue in effect as from time to time amended, until terminated by the parties thereto. MEW shall undertake the planning, procurement, and construction of such infrastructure projects in collaboration with the relevant government-owned Electricity Enterprise, or other entity to which ownership, operation or maintenance of the infrastructure is intended to be transferred upon completion.
- 4.2 The following activities and programs shall be undertaken by the MEW:
 - 4.2.1 Continually monitor and provide real-time advice to the GIRoA on electricity sector activities through various approved methods of reporting and communications.
 - 4.2.2 Promote and develop private investment opportunities and sustainable programs in infrastructure, research, equipment manufacturing, and materials and services in the electricity sector.
 - 4.2.3 Assist and cooperate with the Ministry of Rural Rehabilitation and Development in the creation and promotion of a national development program for rural electrification.
 - 4.2.4 Create and promote, in cooperation with the Ministry of Rural Rehabilitation and Development, a national development program to advance the use of renewable and alternative energy resources.
 - 4.2.5 Engage in the negotiation of electricity sector treaties, develop policies governing international power trade, and facilitate talks regarding international power purchase and sale agreements between the relevant government-owned Electricity Enterprise responsible for negotiating such agreements and its international counterparts.
 - 4.2.6 Create and implement a national development program to increase awareness, attract investment, and accelerate growth in energy conservation, energy savings, and demand-side management techniques and technologies.
 - 4.2.7 Create and implement a public education program on electricity issues, including energy efficiency and conservation.
 - 4.2.8 Collect and maintain electricity sector data and information in the Afghanistan Energy Information Center, which will serve as an open center for all Persons.
 - 4.2.9 Coordinate donor capacity building efforts in the electricity sector in cooperation with other governmental bodies.
 - 4.2.10 Annually publish a National Energy Assessment by Hoot 01 of each year. The National Energy Assessment will provide detailed data, information, and reports on the status of activities from the previous period. The Afghanistan

Energy Information Center will assist in compiling the data for use in the National Energy Assessment and posting it on its website. The National Energy Assessment will include the following data and information: a) electricity generation, transmission, distribution, and usage data and information, with an emphasis on security of supply; b) all publicly-funded, privately-funded, and donor-funded electricity service projects and activities; c) electricity generation fuel supplies consumed, including costs, pricing, and volumes; d) rural electrification activities and progress; e) programs on renewable and alternative energy resources and energy conservation activities; f) any AERA approved tariff methodologies for generation, transmission, distribution, and supply; g) AERA approved tariff sheets by Customer class and service territory; h) AERA established Customer service rights in the electricity sector.

- 4.2.11 Every two years publish a National Energy Plan by 01 Hamal of each second year. The National Energy Plan will include an indicative strategy for development of the sector over a time horizon of 5, 10, and 20 years. In developing this biennial report, the MEW will consult closely with the government-owned Electricity Enterprise(s). As part of the indicative strategy, the National Energy Plan shall: analyze power system operations, reliability, and availability of supply systems of Afghanistan; forecast future supply and future loads in Afghanistan; assess international electricity supply and market conditions affecting Afghanistan; analyze what is required to meet reliability standards; discuss the condition of the generation market and market structure in, and affecting, Afghanistan; assess the mineral, hydrocarbon, hydropower, and renewable resources of Afghanistan for their relative ability to support electricity generation capacity, and the potential markets for such capacity both within and outside of Afghanistan, including an assessment of the relative costs to develop such resources; and otherwise fully inform the Government and the public of the conditions affecting electricity markets of Afghanistan.
- 4.2.12 Annually, or more frequently as deemed warranted by MEW, review the levels of retail electricity tariffs and their effect on those citizens least able to pay for electricity. If, as a result of its review, the MEW finds the cost of electricity for a geographic area or classification or classifications of end use Customer should be subsidized, it shall recommend to the Cabinet direct subsidy from the Government to the electricity provider, stating the justification therefor and the cost to the Government of the recommended subsidy.

- 4.3 The MEW policies and programs under this Article 4 shall be implemented through written procedures and instructions, as described in Article 5 of this Law.

Article 5: Procedures and Instructions of the Ministry of Energy and Water

- 5.1 The MEW is required, as described in Article 4 of this Law, to develop written procedures and instructions to adopt policies and undertake programs under its authority. The MEW shall establish an MEW website and post a schedule of its development of procedures and instructions for public access. The MEW website will serve as a public information base for all activities of the MEW, including the posting of approved procedures and instructions that are signed by the Minister of Energy and Water.
- 5.2 Final drafts of all MEW written procedures and instructions shall be posted on the MEW website for 60 days. Additionally, the MEW shall hold public meetings to discuss the intent and purpose of the procedures and instructions at specified locations for open public attendance. All persons can attend the public meetings and will have the opportunity to offer verbal and written comments.

5.3 After considering all comments, the MEW shall post copies signed by the Minister of Energy and Water of all approved procedures and instructions.

CHAPTER THREE

DUTIES AND AUTHORITIES OF THE ELECTRICITY REGULATORY AUTHORITY

Article 6. Establishment of the Electricity Regulatory Authority

- 6.1 The Afghanistan Electricity Regulatory Authority (“AERA”) shall be established by this Law to regulate the provision of Electricity Service in Afghanistan, and shall perform the duties and functions defined by this Law in an open, objective, transparent, and non-discriminatory manner, following the procedures required by this Law within the framework of the MEW.
- 6.2 The AERA shall have an organizational structure in the framework of the MEW, and shall be supported by dedicated revenues from electricity service Licensee fees and by grants from donor agencies and international financial institutions (IFIs) processed in accordance with the provisions of law.
- 6.3 In order to lead and regulate the relevant affairs of the AERA, a Commission composed of five (5) members shall be established. Each Commission member shall by education, background, and experience be a qualified professional, with not less than five years of professional experience in the Electricity Service sector. By professional qualifications, the Commission shall consist of at least one power system engineer, at least one attorney, at least one economist, accountant or financial analyst, and at least one person with experience in an organization which is a significant consumer of electricity. The remaining position shall be filled on an at-large basis, and the total number of Commissioners shall include not less than one woman.
- 6.4 The terms of the Commissioners shall be staggered. A Commission member shall be appointed for a term of 5 years, and may be reappointed once. On initial appointment only when first constituting the Commission, one Commission member shall have a term of two years, one of three years, one of four years, one of five years, and one of six years.
- 6.5 After the initial terms of appointments of members to the Commission, as stated in Article 6.4 of this Law, every member appointed to the Commission shall have a term of five years. An appointment of one member of the Commission shall be made on an annual basis on 01 Hoot of each year to replace the position of the member whose term has expired. An existing member may be reappointed for one more term on the Commission.
- 6.6 Commission members shall be proposed by MEW and appointed by the President, and they shall be full-time officers of the Commission. When there is a vacancy on the Commission, the President shall appoint a new Member within 60 days of the occurrence of said vacancy based on the proposal of MEW.
- 6.7 A Commission member can only be removed from office by the President based on the proposal of MEW due to the conviction of such Commission member of a felony crime, a violation of the Code of Ethics established under Article 6.10 by such Commission member, failure to attend Commission meetings more than five times during a one year period without an acceptable excuse, or the incapacitation of such Commission member by a permanent medical condition that makes the member’s intellectual participation in affairs of the Commission not practical.
- 6.8 If a Commission member has been replaced due to resignation, death, or removal under Article 6.7, the newly appointed Member shall serve the remaining term of the Member so replaced; such period shall be considered the first term of such appointee.
- 6.9 Commission members shall not be members of any representative body, accept any other Government position, or perform any work for or receive any compensation from an Electricity Enterprise subject to regulation under this Law. Nor shall any Commission member during his/her term of office or any staff of the AERA directly or indirectly own shares in any regulated Electricity Enterprise, make any other

- investments or have any material interest in the operations of any such Enterprise or transactions necessary for its operations.
- 6.10 The AERA shall establish a Code of Ethics governing the behavior of the Commission of the AERA and of its staff. Such Code shall prohibit any acts that are, or have the appearance of being, a conflict of interest with the purposes of the AERA.
- 6.11 The President shall appoint one (1) Commission member as the Chairperson of the AERA. The Chairperson is the Chief Executive of the Commission and is responsible for management of AERA day-to-day administrative issues. The Chairperson is also responsible for conducting meetings of the Commission. The Chairperson is an equal member of the Commission and shares the same decision-making responsibilities of each member on all Commission matters. A Vice-Chairperson shall be selected annually by a vote of the Commission members and shall perform all of the duties of the Chairperson in the absence of the Chairperson. In the absence of both the Chairperson and the Vice-Chairperson, the most senior Commission member shall perform the duties of the Chairperson.
- 6.12 The revenues of the AERA may consist of revenues collected from Licensee fees, and contributions from donor agency and IFI grants. The total expenses of the AERA shall be as computed by methods defined in Articles 6.13 and 6.14, and adopted pursuant to the public processes required by Article 6.13. The AERA shall establish a fee at a rate per unit of electricity sold or transmitted by each Licensee set at a level to permit recovery of its expenses, but in no event to exceed an amount equal to one percent (1.0%) of the total expected revenue of each Licensee. The AERA shall apportion the total fees so that the percentage of the total Tariff paid by any Customer does not include more than one percent (1.0%) of their total price. Such fee shall be set annually by the AERA.
- 6.13 Not less than 30 days prior to the start of each financial year, the AERA shall estimate its total annual operating and capital expenses for the 12 month period starting 01 Hoot of that year, and shall publish this estimate on its website. The AERA shall receive public comments on that budget for at least 30 days following the date of publication. Upon receipt of comments, it may then revise the proposed budget, if appropriate, and issue a final budget. Such budget shall also state the Licensee fee as a rate per kWh as constrained by Article 6.12.
- 6.14 The estimated budget stated in Article 6.13 shall detail a line for each component of its expenses, as defined by International Accounting Standards for governmental organizations, and shall include a detailed note describing the nature and purpose of each expense component.
- 6.15 The AERA shall engage, by transparent tender, an independent audit firm to conduct an annual audit of its expenses in accordance with international audit standards, and shall submit such audit report to the MEW, the House of the People of the National Assembly, and other concerned ministries and departments each year at the same time as it submits its Annual Report to the House of People of the National Assembly, and shall publish such audit on its website.
- 6.16 MEW shall annually allocate appropriated funds in an amount equivalent to the revenues from Licensee fees to be exclusively used for the operating and capital expenses of the AERA.
- 6.17 The AERA shall define a procedure for management of its funds which is fully transparent, and which facilitates audit by the independent General Audit Authority of Afghanistan and by other independent auditors.
- 6.18 Three years from the date of promulgation of this Law an inter-ministerial council shall be established to meet and agree by majority vote on operational and regulatory benchmarks to be substantially fulfilled in order for the AERA to function as an independent regulatory authority under the executive branch of the GIRoA,
- 6.19 The inter-ministerial council shall be composed of the following Ministers or their designees:
- a) The Minister of Energy and Water;

- b) The Minister of Finance;
 - c) The Minister of Commerce
 - d) The Minister of Economy
 - e) The Minister of Rural Rehabilitation and Development
- 6.20 The AERA Commissioners shall strive to substantially fulfill the benchmarks established by the inter-ministerial council.
- 6.21 On the fifth anniversary of the promulgation of this Law or as soon thereafter as possible, the inter-ministerial council shall meet to determine whether the AERA has substantially fulfilled said previously established benchmark requirements. If a majority of the inter-ministerial council determines the benchmarks have been substantially fulfilled, they shall recommend to the President that the AERA be established as an independent regulatory authority under the executive branch of the GIRoA, and, effective upon approval of the recommendation by the President, the AERA shall assume independent status.
- 6.22 Should it be determined by the inter-ministerial council that the AERA has failed to substantially fulfill the established benchmarks, the council shall thereafter annually review the progress of the AERA toward satisfaction of the benchmarks. The inter-ministerial council will provide to AERA a written evaluation identifying needed improvements to meet the benchmarks. At such time as the majority of the inter-ministerial council determines that the benchmarks have been substantially fulfilled, they will recommend independent authority status for the AERA, and the AERA shall assume such independent status upon approval by the President of the council recommendation.
- 6.23 All provisions of this Law with respect to the AERA shall remain effective subsequent to the date the AERA becomes an independent regulatory authority under the executive branch of the GIRoA, with the following exceptions:
- 6.23.1 The AERA will no longer be “in the framework of the MEW” as provided in Articles 6.1 and 6.2.
 - 6.23.2 The inter-ministerial council referenced in Articles 6.18, 6.19, 6.20, 6.21, and 6.22 shall cease to exist and those Articles of this Law shall no longer apply.
 - 6.23.3 The AERA shall continue to compute its budget in accordance with the methods defined in Articles 6.13 and 6.14, provided that Article 6.16 of this Law shall no longer apply, and the AERA shall become an independent budgetary unit whose budget is processed in accordance with the laws of Afghanistan,
 - 6.23.4 The procedure for appointment of Commission members set forth in Article 6.6 shall no longer apply. Rather, Commission members shall be appointed by the President and approved by the House of People of the National Assembly. When there is a vacancy on the Commission, the President shall appoint and nominate to the House of People a new Member within 60 days of the occurrence of said vacancy.
 - 6.23.5 The procedure for removal of a Commission member set forth in Article 6.7 will no longer apply. Rather, a Commission member can only be removed from office by the House of People of the National Assembly, upon a finding by the House of People that such Commission member has been convicted of a felony crime, has violated the Code of Ethics established under Article 6.10, has failed to attend Commission meetings more than five times during a one year period without an acceptable excuse, or such Commission member has become incapacitated by a permanent medical condition that makes their intellectual participation in affairs of the Commission not practical.
 - 6.23.6 The provisions of this Article 6.23 shall be prospective only, and shall not affect previous appointments or removals of Commission members, or the validity of previous Commission actions and decisions. The procedure for appointment of Commission members under Articles 6.23.4 shall be applied as the terms of then serving Commission members expire, they are removed

under the procedure set forth in Article 6.23.5 they resign, or die while in office.

- 6.23.7 A plan for the transfer from MEW to the independent AERA of all equipment, software, records, and other materials and commodities used or relevant to the functioning of the AERA, as well as a plan for the transition of appropriate AERA staff under the MEW to the independent AERA will be developed by the AERA, MEW, and Ministry of Finance.

Article 7. Role of Regulation

- 7.1 Through a process for the development and adoption of regulations, as defined by Article 8 of this Law, the AERA shall:
- 7.1.1 Provide balance to all of the varying interests of the Electricity Service sector, which is necessary to attract private investment, protect the environment, allow for economically and financially healthy Electricity Service operations, and ensure quality Customer services in the sector.
 - 7.1.2 Perform the duties and functions defined by this Law by exercise of independent decision-making, based upon international regulatory practices and standards, and in an objective, transparent, and non-discriminatory manner
 - 7.1.3 Issue Licenses, and regulate the activities of Licensees, in accordance with the provisions of this Law.
 - 7.1.4 Monitor compliance by Licensees with international treaties, agreements, contracts, and obligations entered into by the GIRoA in the electricity sector.
 - 7.1.5 Determine tariff methodologies, categorize Customers for purposes of tariffs, approve or adjust tariff schedules of Licensees in accordance with the provisions of this Law.
 - 7.1.6 Respond to complaints of Customers and the Electricity Service Providers and resolve disputes.
 - 7.1.7 Promote and develop the norms, including technical standards for transmission and distribution electrical equipment and devices, service standards, and criteria for system dispatch services, while preparing for a competitive wholesale electricity market. Technical standards in this field will be developed, where possible, in cooperation with the ANSA Electrotechnical Committee.
 - 7.1.8 Establish technical, economic, financial, marketing, or other consultative committees, as deemed necessary, to focus and advise on the resolution of Electricity Service sector issues. Any technical consultative committee(s) established will operate in close cooperation with the ANSA Electrotechnical Committee as to technical issues covered by international standards.
 - 7.1.9 Develop and approve model form contracts for retail Customers of Licensees, and such other model form contracts that the AERA deems advisable for purposes consistent with this Law.
 - 7.1.10 Investigate any matters necessary to determine the existence or absence of violations of the provisions of this Law.
 - 7.1.11 Employ inspectors to verify compliance with any decision of the AERA or the provisions of this Law, or with any conditions imposed in the License of a Licensee.
 - 7.1.12 Issue interim or final orders to prevent the occurrence or continuation of a breach of a License or any condition thereof.
 - 7.1.13 Renew, suspend or revoke licenses, in accordance with this Law and other enforced laws.
 - 7.1.14 Publish and enforce fines for breach of any condition of a License, or any violation committed by a Person under this Law.

- 7.1.15 Annually collect the relevant actual fees due from Licensees through a transparent, simple, and non-discriminatory process.
- 7.1.16 Submit annual reports on its activities and finances to the House of People of the National Assembly within three months of the end of the Financial Year.
- 7.1.17 Collaborate with and support the efforts of the MEW to attract private investment, develop renewable and alternative energy resources, encourage energy conservation and cost savings incentive programs, and promote a competitive electricity market environment.
- 7.1.18 Design a methodology to allow for the approval by AERA of the sale of Licensee and/or Customer service related assets of a Licensee.
- 7.1.19 Regulate cross-border exchanges of electricity, subject to provisions of this Law, to conditions of international agreements, and to policies stated in international treaties to which the GIRoA is a party.
- 7.1.20 Establish AERA Case Docket procedures, according to Article 8 of this Law, which serve as the framework for filing cases, conducting hearings, and making regulatory decisions by the Commission.
- 7.1.21 Require all regulated entities to use a Uniform System of Accounts for regulatory accounting purposes.
- 7.1.22 Establish procedures for the determination of Significant Market Power and the definition of markets for purpose of such determination.
- 7.1.23 Establish criteria for treatment of information filed with the AERA as confidential or commercially sensitive and that may be excluded from the public record upon request in accordance with Article 25.4.
- 7.1.24 Develop an AERA website that posts all filings in the Case Docket, publications, notices, Commission public hearings and meetings schedules, and all other regulatory matters that pertain to the Electricity Service sector.
- 7.1.25 Require and approve investment plans of Transmission and Distribution Licensees.
- 7.1.26 Develop general policies and procedures, including but not limited to procedures for the employment of competent and qualified staff and other personnel policies, to govern the operations of the AERA.
- 7.1.27 Establish procedures for contracting with third party consultants, as deemed necessary or advisable, to assist the AERA in the performance of its responsibilities.
- 7.1.28 Adopt and issue such other rules and regulations as the AERA deems necessary or advisable to carry out its responsibilities under this Law according to the procedures set forth in Article 8.

Article 8. Case Docket Procedures

- 8.1 The AERA shall establish Case Docket Procedures to apply to all rules; regulations; license application issues; Customer service issues; violations of Licenses or this Law; tariff applications, issues and procedures; cost of service and rate-base concerns; fuel procurements; audit and performance issues; and any other matters that may potentially affect Customer service, including challenges on costs and pricing, and economic and financial well-being of a Licensee; and other issues of significant concern or dispute in the Electricity Service sector.
- 8.2 The AERA shall have a Case Docket Department that is open during regular business hours to receive written applications for case filings meeting minimum approved guidelines and required criteria to be established and published by the AERA.
- 8.3 Any person, including the staff or a Commission member of the AERA, may file a written case application into the Case Docket Department for AERA consideration. The case application is to be timely reviewed, accepted, and officially stamped for the case docket in accordance with the Case Docket procedures, if it meets all of the

required criteria. The accepted case and all material collected on record must be posted on the AERA website for public review, with the exception of confidential or commercially sensitive data and information that AERA has excluded from the public record. The AERA will then post notice of a period for public comment of up to 60 days during which all persons with interest are open to file written comments and attend public hearings where they will be provided the opportunity to enter verbal and written comments into the record. Public hearings shall be held at times and locations determined and publicized by the Commission. The AERA staff will study the record and draft a decision, based only on the record in the case, for the Commission to consider within 120 days from the case filing into the case docket.

- 8.4 The Commission shall hold a public meeting, monthly, unless the Commission establishes a more frequent schedule, at the same time and same location to review, discuss, and consider all pending matters, and cases that have draft written decisions prepared by the AERA. A meeting shall be legally valid if at least three Commission members are present, including the Chairperson, Vice-Chairperson or Commission member performing the duties of Chairperson pursuant to Article 6.11. All Commission decisions must be clearly supported by and be made based solely on the evidence in the public record of the case. Each member is allocated one vote for each case that is considered, however each member can also choose to abstain from voting. Each member has the right to introduce written comments and provide verbal comments into the case record at the public meeting. The Chairman or presiding Commission member can call for a vote on any case with a written decision prepared and if a vote is taken on a written decision in a case, the written decision shall be adopted if approved by at least a majority of the appointed Commissioners. If adopted, the written decision is signed at the public meeting by the members, and the signed written decision on the case becomes a matter of public record and posted on the AERA website.
- 8.5 Any person may file a written appeal to a Commission decision in any case at the Case Docket Department within ten days of a signed written decision. The appeal must meet all AERA approved guidelines. The appeal may only be accepted by the AERA into the case docket for two (2) causes: (1) new evidence has been submitted to the Commission with a request to enter it into the case record, such evidence was not available at the time the Commission made its decision, and such new evidence could substantially change a Commission decision, or (2) the AERA has violated this Law in the course of making a Commission decision. The AERA may publically announce a shortened time period to make a written decision on a case that has been appealed. All appeals will be conducted in accordance Article 8.4, at which the Commission is authorized to make a final written decision on the case. Any future appeals of the case must be filed in the Courts.

CHAPTER FOUR LICENSES

Article 9. License Eligibility

- 9.1 Any Person willing to construct, own or operate any Electricity Service at their own financial risk shall have the right to do so, provided they comply with the conditions of this Law, and with other applicable laws of Afghanistan.
- 9.2 Any Licensee operating any electricity Transmission System or electricity Distribution System authorized by this Law must make that system available to any Person who seeks use of such system on equal terms to any other Person, at fair Tariffs and terms of access established according to the Tariff principles stated in this Law.
- 9.3 Any high voltage Transmission System owned by the Government of Afghanistan or by a government-owned Electricity Enterprise on the date of passage of this Law, or subsequently acquired or owned by the Government of Afghanistan or by a government-owned Electricity Enterprise following the date of passage of this Law, shall not be transferred to non-government ownership, and must meet other conditions of fair and open access to all potential shippers as required by this Law.
- 9.4 The Electricity Services that may be issued Licenses by the AERA shall be defined by the AERA based on the functions performed, and the relative significance of those functions to the purposes of this Law. Such functional definitions shall include but are not limited to the following functions:
- a) the operation of generation units or generation stations of greater than 500 kW for other than consumption solely by the owner, manager, or operator of the Electricity Facility;
 - b) the operation of a high voltage Transmission System;
 - c) the operation of a Distribution System with 500 or more connected Customers;
 - d) the operation of an organized electricity market at wholesale;
 - e) the supply or trade of electricity when the volume of sales by a single supplier is more than 2% of the total market of Afghanistan or has or would have Significant Market Power in any defined market of Afghanistan;
 - f) the import or export of electricity.
- 9.5 License issued by the AERA will be required for:
- a) the operation of generation units or generation stations of more than 500 kW for other than consumption solely by the owner, manager, or operator of the Electricity Facility;
 - b) the operation of a high voltage Transmission System;
 - c) the operation of a Distribution System with 500 or more connected Customers;
 - d) the operation of any Transmission or Distribution System having more than 500 kW of generation capacity attached to it by alternating current connections.
- 9.6 Any Licensee, and any Electricity Enterprise attached to any Licensee by an alternating current connection, must meet operational and technical standards under codes that are issued by the AERA.

Article 10. Issuance of License

- 10.1 The duration of any Generation, Transmission, Distribution or other License shall be a renewable term of 25 years, except for any Supply License, which shall be for a renewable term of 10 years.
- 10.2 The AERA shall issue a rule defining the procedures to be followed for application to receive a License. Such rule shall assure that any person who is entitled to, or

required to, obtain a License under this Law or regulations of the AERA adopted in accordance with this Law, may receive such License by following such procedure.

- 10.3 The rule issued under Article 10.2 shall include a procedure by which a Person seeking a License may do so by means of registration using an Internet based facility, with no fee for the act of registration, and that any Person completing such registration shall be deemed to have received such License. The information required to be provided during the registration process will be defined and adopted by AERA. AERA shall verify all such registrations, and may remove registration, and revoke the License, for any Person who has not fully and honestly completed all required information.
- 10.4 AERA shall post on its publicly available website, the names, addresses and other contact information for all Licensees. If the Tariffs of the Licensee are regulated by AERA under this Law, then such posting on the website shall also state the most current information on the Tariffs of each such Licensee.
- 10.5 With respect to Distribution Licenses, a Licensee may receive more than one Distribution License if it is serving more than one Service Territory.
 - 10.5.1 A Distribution License is required for each Service Territory a Distribution Licensee serves.
 - 10.5.2 A Distribution License shall require that the Distribution Licensee will provide electricity service to any Customer in that Service Territory who requests service and is willing to and does pay a reasonable connection fee and who agrees to and does pay the standard fees of the Licensee.
 - 10.5.3 A Service Territory defined by a Distribution License shall not be for a larger geographic area than that for which the Licensee can assure such connections and provide reliable service to such Customers. Nor shall a Service Territory be larger than a single province.

Article 11. Operational Licenses

- 11.1 The AERA shall issue to any government-owned Electricity Enterprise a Generation License for each generation plant owned or operated by that enterprise.
- 11.2 The AERA shall issue to any government-owned Electricity Enterprise a Transmission License for each integrated Transmission System or isolated transmission equipment, owned or operated by that enterprise.
- 11.3 The AERA shall issue to each government-owned Electricity Enterprise a Distribution License meeting the criteria of Article 10.5 for Distribution Licenses, for each Service Territory in which such enterprise owns or operates a Distribution System; for purposes of this provision, such Service Territory shall be defined as the geographic area on which it is actually providing service at time the Law goes into force, but in no case shall a single Distribution License state a Service Territory larger than a single province.
- 11.4 Any Person who existed prior to the date on which this Law was passed, and who was providing Electricity Service prior to that date, for which a License is required under this Law, but who had not been issued a License before this Law was passed, shall be entitled to seek and receive a License issued under this Law. If the AERA determines such Person is in some manner deficient relative to a requirement of this Law for issuance of such License, the AERA shall provide a reasonable time for such Person to comply with and remedy any deficiency noted.
- 11.5 The AERA shall issue a Distribution License and a Supply License, to any entity which held an MEW permission as a Main Customer as defined in the "Provision for Consumption of Power in Democratic Republic of Afghanistan" (PCP), Official Gazette (239) 7/11/1363. Such License shall allow said Main Customer to continue to provide services to Minor Consumers as defined by the PCP, provided the Main Customer pays any required Tariffs and fees applicable to its total consumption including that for resale to Minor Customers. Such License shall require that the

resale rate of the Main Customer to Minor Customers shall be at a price set according to the principles stated in Article 14 of this Law, based on cost to the Major Customer for providing such service.

Article 12. Special Service Contracts

- 12.1 Community development councils or group of such councils, a municipality or group of municipalities, an industrial park authority, or similar local public authority shall have the legal capacity to contract with Electricity Service contractors to operate under special service contracts to provide electricity services for their respective purposes, locations or communities served.
- 12.2 Any Electricity Service contractor operating under a special service contract issued by such public authority prior to the passage of this Law, or operating or to operate under a special service contract awarded after passage of this Law by such public authority through a bidding process meeting the standards of the Procurement Law will receive a License from the AERA suitable to the activities it is or will be conducting.
- 12.3 This Article applies only to special service contracts entered into by public authorities described in Article 12.1 and nothing in this Article 12 shall be construed as otherwise requiring public tender for contracts for Electricity Service.

Article 13. Significant Market Power and Prohibition of Anti-Competitive Practices

- 13.1 Any Licensee who has been determined by the AERA to possess Significant Market Power ("SMP") shall, within sixty (60) days of such determination by the AERA, submit a written application to the AERA for obtaining an amended License, in accordance with the relevant Procedures.
- 13.2 No Licensee or other Electricity Service Provider shall engage in a practice restricting or distorting competition in electricity markets, including, but not limited to, the following:
 - 13.2.1 Fixing prices or other terms or conditions of service in Electricity Service markets;
 - 13.2.2 Colluding to determine which Person will win a contract in an Electricity Service market;
 - 13.2.3 Apportioning or allocating Electricity Service markets.
- 13.3 The AERA may act to prevent abuse of SMP or enforce the prohibition of anti-competitive practices by devices including control of prices of a Person determined to possess SMP or found to engage in anti-competitive practices, placing reasonable conditions on Licenses of such Persons to constrain monopolistic or anti-competitive behavior, requiring non-Licensed or otherwise exempt Persons to obtain a License, and other appropriate means reasonably designed prevent abuse and enforce the prohibition of anti-competitive practices.
- 13.4 If a Person who has been found to possess SMP or to have engaged in anti-competitive practices and a condition or correction has been imposed by the AERA, which the Person fails to implement within a reasonable time, then the AERA may revoke any License involved and require such Person to no longer conduct a business in Electricity Service. A Person subject to such requirement must close its business, or may sell it to a Person who is not in violation of this Article.
- 13.5 The AERA shall issue a rule or rules defining how it will interpret and enforce its duties related to prevention of monopolistic and anti-competitive practices under this Article 13, AERA actions to determine violations, and the AERA actions if violations are found to be present.
- 13.6 When Electricity Enterprises co-locate their alternating current systems or facilities using facilities and property belonging to the Electricity Networks of other Electricity Enterprises, they shall obtain the agreement of the said Enterprises. Such co-

location requires that prior agreement is reached on expenses, that both the enterprise seeking to connect and the enterprise whose facilities would be shared, meet the technical standards for operation of alternating current systems, and that the enterprise seeking connection have operating losses from all sources less than those of the system to which they seek to connect. When no agreement on cost sharing can be reached, the parties shall refer the issue to the AERA for decision.

- 13.7 Licensees or other Electricity Enterprises found to have SMP shall file Tariffs, rates, terms, and conditions of co-location with the AERA.

CHAPTER FIVE PRICES AND TARIFFS

Article 14. Principles and Procedures for Setting Tariffs

14.1 Any Licensee having Significant Market Power, or if otherwise required by this Law to have regulated Tariffs, shall publish up-to-date Tariffs for all Electricity Services as follows:

14.1.1 General Principle: Licensee may set Tariffs which, charged over the annual volume of sales, collectively reflect the justified total annual costs of Licensee for the provision of Licensed services, plus a reasonable rate of return, including (but not limited to): operation and maintenance costs; debt service; Licensee fees; reasonable levels of depreciation expense; the estimated statutory level of taxes which would be charged on the estimated before-tax profits; other taxes and fees paid by Licensee for doing business; costs of any fuels used; costs of any electricity purchased or generated for the purpose of resale to Customers; costs of a reasonable level of technical and commercial losses on the Licensee's system; and all other reasonable costs necessary and proper to the conduct of the Licensed activities.

14.1.2 The AERA shall develop and issue a detailed methodology or methodologies for use in establishing tariffs incorporating the general principle described in Article 14.1.1, as well as a requirement for maintenance of a chart of accounts meeting international regulatory accounting standards. In developing said methodology or methodologies, AERA may consider the inclusion of incentives and disincentives to encourage reduction of the level of technical and commercial losses, improved collections, and other enhanced efficiencies.

14.1.3 Tariff Setting: The AERA shall publish procedures for the review of Tariffs. Licensee shall submit an application for review of Tariffs developed by the Licensee in accordance with the relevant detailed methodology issued by the AERA, together with all supporting documentation required by the AERA. AERA shall review the Tariffs, supporting documentation, and any other information it may request or receive. Upon review, AERA shall approve the Tariffs or adjust the Tariffs of a Licensee to conform to the relevant methodology. If the tariffs are adjusted by the AERA, it shall provide a written explanation of the adjustments and the reasons therefor. If the AERA does not act within ninety (90) days from the application and receipt of all documentation required or requested the Tariffs will be considered approved, unless the period is extended by the AERA. In the event the AERA adjusts the proposed Tariff, the Licensee may seek a hearing to reconsider the adjustment. Tariffs shall remain in effect for a minimum of six (6) months from the decision of the AERA, except as provided in Articles 14.1.5 and 14.1.6, or as otherwise permitted by AERA. Tariffs of a Licensee shall become effective ten (10) days after AERA final approval or adjustment.

14.1.4 Readjustment of Tariffs: Tariffs shall be readjusted periodically by the Licensee to reflect the actual costs incurred in the most recent time period; such adjustment shall occur not less often than annually, except as provided in Article 14.1.6 or as otherwise permitted by AERA, subject to approval or adjustment by the AERA as provided in 14.1.3 above.

14.1.5 Licensee shall readjust its Tariffs whenever costs of purchased fuel or purchased electricity changes by more than 10% from the cost level at the previous computation. AERA shall verify any cost adjustment(s) of the Licensee for purchased fuel or electricity at the next periodic Tariff readjustment under 14.1.4 above.

- 14.1.6 In the event a Licensee breaches the conditions of its License, the AERA may adjust the Licensee's Tariffs prior to the expiration of the effective period and the Tariffs so adjusted shall remain in effect until the breach is corrected. AERA may establish by rule other circumstances under which Tariffs can be reviewed by the AERA on its own initiative.
- 14.2 Licensee may set other terms, conditions or charges as approved by the AERA.
- 14.3 A Licensee whose rates are regulated by the AERA under this Law may charge only those rates set out in a Tariff approved by the AERA.

CHAPTER SIX RELATIONS BETWEEN MARKET PARTICIPANTS

Article 15. Rights of Licensee

- 15.1 Any Licensee of a Transmission or Distribution System shall have the right to use, and sell rights for use of, any communication capacity on or using, any networks owned or operated by Licensee, at terms and conditions not regulated by this Law; provided that Licensee shall maintain a complete set of separate accounts for such business; and provided that Licensee meets the requirements of any other law which may regulate such services. In setting Tariffs, the AERA may, by rule, allocate common assets used in such separate business and the Licensee's electricity business, so that only that portion used to serve electricity Customers in electricity operations is charged through allowed Electricity Service Tariffs.
- 15.2 No Electricity Service Provider shall be required to provide Electricity Services or electricity, to any Person or local or central government body:
- (a) who has not agreed to pay for such services;
 - (b) who does not pay for services delivered in a commercially reasonable period of time;
 - (c) for whom an intended subsidy has been promised but has not been paid in a commercially reasonable time;
 - (d) who has tampered with a metering device which has resulted in decrease of the electricity registered by the metering device; or
 - (e) who has consumed electricity without the required metering device or who has by-passed such device.
- 15.3 The AERA shall publish a rule stating a method under which an amount of connection cost by a Transmission or a Distribution Licensee, to a generator or a Customer, up to which amount a Transmission or a Distribution Licensee must connect without requiring such generator or Customer to pay costs of connection to their network. All costs of connection greater than the amount stated in the rule cited shall be paid by the Customer or the generator seeking to connect to their network.
- 15.4 A Transmission or Distribution Licensee shall be entitled to refuse a request for Interconnection only if the requested Interconnection is technically infeasible, there is a lack of capacity on the system, or if the cost of connection is greater than the amount established under Article 15.3 and the person seeking connection is unwilling to pay the additional costs. The burden of proving that any requested Interconnection is technically infeasible or there is a lack of capacity on the system rests with the Licensee. If disputed, the AERA shall determine whether the Licensee does or does not satisfy such burden.
- 15.5 A Transmission or Distribution Licensee may use any highway or property owned by the state for the purpose of constructing, maintaining or operating an Electricity Network, provided that it does not create unacceptable interference to the public. If a complaint is made to the AERA, the AERA shall decide if there is interference and whether any such interference is unacceptable.
- 15.5.1 When requested by any legally responsible government administration, or other affected Person, the AERA may issue a decision ordering a Transmission or Distribution Licensee, subject to any such reasonable conditions the AERA may impose, to alter the route of any Electricity Network, or alter its construction, maintenance or operation by a Licensee which is situated within the jurisdiction of the relevant administration, provided the otherwise planned or existing facility violates the standard of Article 15.5.

- 15.6 If a Transmission or Distribution Licensee requires the use of private land for construction, operation, or maintenance of an Electricity Network, Licensee shall seek permission of the owner of such private land and if, after negotiations between the Licensee and the private landowner, consent of the private landowner cannot be obtained, the landowner or the Licensee may bring this matter to the AERA for resolution as a dispute. In settling the dispute the AERA may not deprive the owner of economic value or economic use of his/her property without just compensation, and must assure the property owner is paid fair economic value by the applicable Licensee for the right of use of property granted to the Licensee. The AERA shall by rule establish the method for determining fair economic value.
- 15.7 Subject with the provisions of Articles 15.5 and 15.6, the AERA may authorize the Transmission or Distribution Licensee to construct or excavate works, or to erect towers and install lines on the surface, above or under the land, or along the Electricity Network of a Licensee or any lands used for purposes of an Electricity Network, pursuant to any conditions that may be imposed by the AERA. The AERA shall issue a rule setting forth the conditions under which it shall issue such authorizations.
- 15.8 A Licensee may benefit from the use of land as provided for by this Article 15 only if it does not adversely interfere with the operation or maintenance of existing Electricity Networks or other existing facilities used to maintain public ways, water supply and sewerage lines, oil and gas pipelines, electrical facilities and other structures that have a public use.
- 15.9 Alteration of the route of existing facilities of an Electricity Network in accordance with this Law shall be carried out at the expense of the party requesting the alteration.

Article 16. Rights and Obligations of Customers

- 16.1 Electricity Services to a Customer shall be conducted in compliance with the contract for service between the Electricity Service Provider and the Customer according to which the Electricity Service Provider is obligated to supply Electricity Service. Any disputes between the Electricity Service Provider and the Customer that cannot be resolved through negotiation may be filed with the AERA in accordance with the provisions of Article 8.
- 16.2 If an Electricity Service Provider finds any entity connected to its facilities or system that has not signed a contract for such use, then such connection may be removed by the Electricity Service Provider upon discovery of that connection.
- 16.3 An Electricity Service Provider may charge to a user who has not signed a contract for service, the costs of the disconnection, and an estimated value of electricity taken, based on the average usage of similar entities that are paying Customers, over a six month period. A user who has received such charge shall pay such charge within 30 days. An Electricity Service Provider who has not been paid such charge within 30 days from date of delivery of request for payment may add non-payment penalties of 5% of the total unpaid amount, cumulatively for each month of non-payment. A user who has not paid such claims shall not be entitled to receive Electricity Services from any Licensee or other Electricity Service Provider.
- 16.4 Electricity Service Providers may charge interest on the amount of bills to Customers that have not been paid for 30 days or longer, at rate not to exceed 2% per month. Payments made against unpaid due amounts shall be attributed to the oldest amount due.

CHAPTER SEVEN PRIVATE INVESTMENT

Article 17. Investment in Electricity Infrastructure and Services Permitted

- 17.1 Investment in the Electricity sector and related services and infrastructure, including generation, transmission, distribution, and supply, by any Person willing to undertake the investment at their own financial risk in compliance with the conditions of this Law and with other applicable laws of Afghanistan is permitted.
- 17.2 Investment in the Electricity sector and related services and infrastructure shall be promoted and protected in accordance with the enforced laws of Afghanistan.

Article 18. Approved Electricity Enterprises

- 18.1 An Electricity Enterprise, including an Independent Power Producer, may be registered as an approved enterprise under the Private Investment Law of Afghanistan ("Approved Electricity Enterprise") and may be owned one hundred percent (100%) by investors or be owned by a joint venture between the GIRoA and private investors. In the event of conflict between the provisions of this Chapter Seven and the Private Investment Law of Afghanistan, the provisions of this Chapter Seven shall prevail.

Article 19. Tax Concessions and Customs Relief

- 19.1 An Approved Electricity Enterprise which incurs a net operating loss may carry this loss forward to the next fiscal year, and apply it as a deduction from its taxable income to the extent permitted in the Income Tax Law of Afghanistan.
- 19.2 An Approved Electricity Enterprise shall be entitled to an accelerated deduction for depreciation on capital assets to the extent permitted in the Income Tax Law of Afghanistan.
- 19.3 An Approved Electricity Enterprise shall be exempted from export charges on products that are manufactured or assembled in Afghanistan to the extent permitted in the Customs Law of Afghanistan, provided that it has obtained an export license.
- 19.4 To promote and protect investors, the Ministry of Finance may consider and recommend additional tax incentives and concessions, customs relief, and financial assurances regarding the stability of taxes, levies, duties and charges, and any such incentives, concessions, relief and assurances recommended by the Ministry of Finance may be granted in accordance with the provisions of the enforced laws of Afghanistan.

Article 20. Banking

- 20.1 An Approved Electricity Enterprise shall have the right:
- 20.1.1 To open accounts in foreign currency at banking facilities in Afghanistan and to use these banks to receive loans and credit in foreign currency from outside Afghanistan to advance its investment.
- 20.1.2 To open bank accounts in foreign currency outside of Afghanistan for the purpose of purchasing needed equipment and machinery, raw materials, spare parts, and for services, and for payment of salaries and benefits to expatriate employees, and for all other payments that are not contrary to the enforced laws of Afghanistan.

Article 21. Employment and Lease of Immovable Property

- 21.1 An Approved Electricity Enterprise shall:

- 21.1.1 Have the right, directly or indirectly, to employ foreign managerial and expert staff, in accordance with the enforced laws of Afghanistan.
- 21.1.2 Have the right to enter into service contracts with foreign Persons in order to conduct its business activities. Work permits will be granted to such foreign personnel according to the applicable legislative document, provided such foreign persons comply with Afghan laws while in Afghanistan.
- 21.1.3 Be encouraged to hire Afghan personnel.
- 21.1.4 Have the right to lease immovable property in Afghanistan for a period up to fifty (50) years, in accordance with law.

Article 22. Transfers of Foreign Exchange

- 22.1 A Foreign Investor shall have the right to freely transfer out of Afghanistan, in one or more transactions, the equivalent of the aggregate amount of its investment in an Approved Electricity Enterprise in foreign currency at the prevailing exchange rate upon payment of all taxes due, and subject to the obligation of the Enterprise to notify the Central Bank or other entity designated by law of the transfer in order for the Central Bank or other entity to record the reduction in principal of the investment by the amount that has been transferred.
- 22.2 A Foreign Investor shall have the right to freely transfer out of Afghanistan dividends, or distributions treated as dividends under the Income Tax Law, received from investment, in foreign currency at the prevailing exchange rate, upon fulfillment of its tax obligations.
- 22.3 An Approved Electricity Enterprise shall have the right to freely transfer out of Afghanistan funds for payment of the principal, interest, and fees relating to a foreign loan provided to such Enterprise in accordance with Afghan law, in foreign currency at the prevailing exchange rate after satisfying its tax obligations.
- 22.4 A Foreign Investor shall have the right to sell all or a part of its ownership interest in an Approved Electricity Enterprise to Domestic or Foreign Persons or to the GIRoA; provided, however, such sale shall be subject to approval of the AERA if the Approved Electricity Enterprise holds a License under this Law and the sale is to a party that does not already hold an ownership interest in such Enterprise. The investor shall notify the Afghan Investment Support Agency of the sale or transfer of the ownership interest in order that the purchaser be recorded as a new investor.
- 22.5 A Foreign Investor shall have the right to transfer freely out of Afghanistan the proceeds of any sale described in Article 22.4 in the currency of the investment at the prevailing exchange rate after satisfying its tax obligations and compliance with the terms of Article 22.4.
- 22.6 A Foreign Investor may freely transfer out of Afghanistan any payments for compensation of damages related to any Foreign Investment or for expropriation under Article 23.

Article 23. Expropriation

- 23.1 An investment in or the assets of an Approved Electricity Enterprise may not be expropriated directly or indirectly except in accordance with the provisions of enforced laws of Afghanistan, on a non-discriminatory basis, and only for the purpose of the public interest.
- 23.2 In case of expropriation, the State shall provide prompt compensation in conformity with international law and internationally accepted principles equivalent to the fair market value of the expropriated investment or assets immediately before the expropriating action was taken. Such compensation shall include interest at the one-year LIBOR rate for the period from the date of expropriation to the date of complete payment of compensation. In case of an investment made in foreign currency, such

compensation shall be made to the investor in the currency in which the investment was made.

Article 24. Dispute Resolution

- 24.1 An electricity sector investor or an Approved Electricity Enterprise may, in any contract or other agreement with a third party, specify (i) any arbitration or other dispute resolution procedure agreed to, (ii) that the place of such arbitration may be outside of Afghanistan, and (iii) that the law of a jurisdiction other than Afghanistan may apply to the resolution of such dispute. Any award resulting from such arbitration or other dispute resolution procedure shall be final and binding, unless said contract or agreement provides otherwise, and the award shall be enforceable by the Government upon application by any party to such arbitration or other procedure.
- 24.2 Except as otherwise provided in Article 24.3, if a dispute arises pursuant to a contract or other agreement entered into between an electricity sector investor or an Approved Electricity Enterprise on the one hand and an administration or organization (including any wholly government-owned enterprise) of the State on the other hand with regard to an electricity sector investment, or a claim relating to expropriation under Article 23 of this Law, the parties will endeavor to settle the dispute amicably by negotiation. Failing amicable settlement of the dispute, and unless the parties to the dispute otherwise agree or have otherwise agreed in the contract or other agreement pursuant to which the dispute arises, the dispute shall be settled in the local courts of justice.
- 24.3 If a dispute arises pursuant to a contract or other agreement entered into between a Foreign Investor in the electricity sector or an Approved Electricity Enterprise with foreign equity ownership on the one hand and an administration or organization (including any wholly government-owned enterprise) of the State on the other hand with regard to a Foreign Investment in the electricity sector, or a claim relating to expropriation under Article 23 of this Law, the parties will endeavor to settle the dispute amicably by negotiation. Failing amicable settlement of the dispute, and unless the parties to the dispute otherwise agree or have otherwise agreed in the contract or other agreement pursuant to which the dispute arises, the parties shall submit such dispute to:
- (i) The International Centre for Settlement of Investment Disputes ("ICSID") for settlement, pursuant to the Convention on the Settlement of Investment Disputes between States and Nationals of Other States of March 18, 1965 ("the Convention");
 - (ii) Arbitration in accordance with UNCITRAL Rules if ICSID rules preclude the Foreign Investor from arbitrating before ICSID. The GIRoA, in such cases, consents to the submission of any such dispute to ICSID for settlement by arbitration in accordance with Article 25(1) of the Convention.
- 24.4 If an Approved Electricity Enterprise is owned over twenty-five percent (25%) by a Foreign Investor or Investors, the entrepreneur of the Enterprise shall be treated as a national of a state other than Afghanistan, and the disputes mentioned in Article 24.2, unless the parties to the dispute otherwise agree or have otherwise agreed in the contract or other agreement pursuant to which the dispute arises, shall be submitted to ICSID for settlement in accordance with Article 25(1) of the Convention. If more than twenty-five percent (25%) of the ownership interest is owned by the State, the disputes mentioned in Articles 24.2, unless the parties to the dispute otherwise agree or have otherwise agreed in the contract or other agreement pursuant to which the dispute arises, may be submitted to ICSID for settlement in accordance with Article 25(3) of the convention, upon agreement of the State.

CHAPTER EIGHT ADMINISTRATION

Article 25. Market Participants' Data Collection and Information Sharing Responsibilities

- 25.1 Any document submitted to the AERA or to the MEW in compliance with any part of this Law must be in one of the official languages of Afghanistan. Where the MEW or AERA takes any decision or any action required or authorized by this Law, it shall do so under procedures of Article 5 and 8, respectively. AERA and MEW shall render such decisions in writing and shall give the full statement of the reasons and actual basis for all decisions or actions.
- 25.2 All documents submitted to the AERA or the MEW in compliance with this Law, in compliance with rules and regulations issued under this Law, or issued by the AERA or the MEW in compliance with this Law, must be posted by the respective authority on a public website of that authority, unless specifically exempted from such display by this Law. Neither the AERA nor the MEW shall charge any fees for access to documents posted on the agency web site. All Electricity Services Providers which are required to obtain a License under this Law shall create and maintain a publicly available web site, and shall post on their respective websites with no fee for access, all of its fees, charges, and terms of service.
- 25.3 The MEW and the AERA each may require any Electricity Service Provider to maintain copies of all operational, accounting, planning or other data on their operations, to maintain such data for a period of up to five years. Further, the MEW or AERA on 14 days advance written notice may request any information relevant to the performance of their responsibilities under this Law from any Electricity Service Provider and require same be provided.
- 25.4 AERA in consultation with the MEW shall establish by regulation clear criteria for determining whether any information received by AERA or MEW may properly be considered as confidential or commercially sensitive, which criteria will assume all information is public, except under narrowly defined exceptions. Upon a claim to the AERA by the submitting party that certain information provided to AERA or MEW is confidential or commercially sensitive, AERA shall determine whether the information meets said criteria. If AERA determines that the information meets the criteria, the information will be treated as confidential and not be publicly disclosed, and MEW will honor the determination of the AERA.

CHAPTER NINE TRANSITIONAL PROVISIONS

Article 26. Transitional Provisions and Requirements

- 26.1 On the effective date of this Law, Presidential Order 4239 becomes void and of no further effect.
- 26.2 On the effective date of this Law, any rule, law, regulation, Cabinet or Presidential Order, Cabinet or Presidential Decree, or other similar document claiming authority of law, issued prior to the effective date of the existing Constitution of the Islamic Republic of Afghanistan, defining duties of the Ministry of Energy and Water as related to Policy or programs for electricity sector development, are declared void and of no effect.
- 26.3 The AERA shall issue all Codes required by this law not later than 42 months from the effective date of this Law.
- 26.4 The provisions of this Law dependent on the performance of the duties and functions of the AERA, shall come into effect upon the appointment and approval of not less than three AERA Commission members, and shall apply to Electricity Enterprises existing and operating prior to the creation of the AERA at a date to be determined by AERA, but not later than one year from the appointment and approval of such three members.

CHAPTER TEN
FINAL PROVISIONS

Article 27. Final Provisions and Requirements

27.1 This law shall be enforced upon promulgation and shall be published in the Official Gazette. Upon its publication, any other laws, regulations, or provisions contravening this Law shall be repealed.

**ANNEX A
TO THE LAW ON ELECTRICITY SERVICES**

**Islamic Republic of Afghanistan
Memorandum of Understanding
(MoU)
Between
Ministry of Energy and Water (MEW), Da Afghanistan Breshna
Sherkat (DABS)
and Ministry of Finance (MoF)**

Kabul

Date: 30 September 2009

MEW and DABS have agreed on the MoU which covers the following points:

- Mutual understanding and cooperation;
- Preventing duplication of activities through ensuring consultation on future programs and work plans, specific issues and other relevant affairs (if any occurs);
- Seeking solutions to sustainable problems on the way of the parties' common interests;
- Ensuring that necessary information shall be shared regularly and transparently between the parties.

The Ministry of Finance is a witness to this MoU and shall reassure on its effective implementation while considering the following points:

- Ministry of Energy and Water is responsible for implementation of the following items:
 - Preparation and management of the national policies and laws of the energy sector;
 - Guiding and planning development of the energy sector;
 - Determining and evaluating needs in the energy sector (such as coal, gas, renewable energy, energy sufficiency, financial issues, human resource capacity) so that the work frame of the IRA is supported and socio-economic growth further accelerated;
 - Establishment of standards for better management and issuance of licenses.
- Da Afghanistan Breshna Sherkat (DABS) is a newly established corporation that is responsible for management and operation of the energy sector, including power production from existing facilities, transmission, dispatch, distribution and supply of electric energy throughout Afghanistan.
- Da Afghanistan Breshna Moasesa (DABM) was a state enterprise reporting to the Ministry of Energy and Water. This entity shall be closed by the government of Afghanistan. After its closure, all its assets, loans and staff shall be transferred to DABS. DABM's legal entity shall be dissolved.
- All responsibilities, activities, assets and staff of DABM shall be transferred to DABS on 30 September 2009 (8 Meezan 1388).
- DABS shall be responsible to keep DABM assets and staff (acting as a body responsible for keeping the assets and staff of DABM) meanwhile work as a dissolver entity of DABM with the Ministry of Finance (and other members of Liquidation Committee) till 20 March 2010 (29 Hoot 1388) or if necessary for a longer time.

MEW, DABS and MoF have agreed on the following Articles:

Article 1: Planning, Engineering, Supplies, Construction and Assembling of new Infrastructure of Energy Sector

- 1.5 MEW shall continue to be responsible for surveying, planning and designing of the new Generation and Transmission Infrastructure.
- 1.6 MEW shall also be responsible for engineering, supplies, construction and assembling of new projects. It is agreed that the forthcoming Infrastructure of Energy Sector is to be planned in a commercially and economically effective and sustainable manner.
- 1.7 Since DABS is responsible for management therefore every relevant entity is to consult with it in each phase of development projects.
- 1.8 For the time being, MEW shall have responsibility for import of power from outside the country in close consultation and understanding with DABS.

Article 2: Management & Maintenance of Assets, Expansion and Strengthening of Existing Infrastructure

- 2.3 DABS shall perform activities such as; management, maintenance and all commercial affairs related to operation or activity of infrastructure, sale and transmission of electric energy.
- 2.4 DABS shall be responsible for expansion and strengthening of the existing distribution network of electricity.

Article 3: Management of Agreements with Donors

- 3.1 According to the agreement signed between MEW, MoF and MoE; all assets of DABM, as assistance, shall be transferred from governmental assets to DABS on 30 September 2009. These assets are transferred to DABS as its assets shall be incorporated into a Memorandum of Transfer that will be signed by MEW, MoF and other shareholders of DABS.
- 3.2 The assets and properties that are not in ownership of DABM (not known as DABM properties), their transfer shall take shape all in one phase from contractors to the Ministry of Energy and Water and from the Ministry of Energy and Water to DABS in presence of MOF representative. A Memorandum of Transfer to be signed shall be a proof for its transfer and an increase made thereby in the capital of DABS.
- 3.3 If new projects are launched in different sections and if those segments of projects that are activated could be used beforehand, they shall be transferred to DABS (transfer of these segments is to be included in the Memorandum of Transfer and also added to the capital of DABS) meanwhile MEW shall undertake responsibility for completion and assembling of the remaining segments of the projects.

Article 4: Coordination of Activities & Energy Database

- 4.1 MEW and DABS have agreed to hold official meetings at least on a quarterly basis. The parties shall hold their first meeting within 90 days from the execution date of the Memorandum of Transfer (30 September 2009) for assessment of future plans, discussion on relevant issues and joint decision making concerning feasibility study and operation of new projects.
- 4.2 The parties have agreed on the following points as well:
 - Nomination of focal points to each others' relevant offices. It is to be noted that these focal points shall be responsible for documents and information sharing.

- Preparing a proper Terms of Reference (ToR) for the focal points.
- The Parties shall work on Items 4.1 and 4.2 within 90 days from the execution date of the Memorandum of Transfer (30 September 2009).

4.3 MEW has responsibility for management, collection and analysis of information in energy sector of Afghanistan and maintains a Database for Energy Sector of Afghanistan.

4.4 DABS is responsible for collection and provision of information on its activities to MEW Database for Energy Sector of Afghanistan. The format and schedule for collection of information by DABS to MEW shall be prepared and agreed on within 90 days from the execution date of the Memorandum of Transfer (30 September 2009).

Article 5: Changes in this MoU

Any amendment and correction in this MoU shall be made based on mutual agreement of both Parties. Any type of proposal for correction is to be in writing. One copy of the proposal for corrections needs to be sent to the Ministry of Finance. The receiving Party is to respond on time to the proposing party. However, the said response is to be provided within 30 days from the receipt date of the proposal for correction and amendment.

Article 6: Dispute Resolution

If any disagreement or dispute arises between the Parties and they fail to agree on its solution, within 60 days from the date of such dispute rising, it shall be referred to the Management Board of the Corporation. The Management Board shall decide what measures are to be taken for resolution of disputes. If the Parties do not agree on other solution, the decision to be taken by the Management Board shall be enforced on both parties.

Ismail Khan
Minister of Energy & Water

Dr. Jalil Shams
Chief Executive Officer of DABS

The Parties signed this MoU in witness of

Dr. Omar Zakhilwal
Minister of Finance and Chief Advisor of President in Economic Affairs

APPENDIX C: Afghan Investment Support Agency (AISA) Business Registration

AISA Business Registration for all private sector businesses, except:

Trading companies (registered with MoC) and small retail businesses (registered with the Kabul Municipality)

By law, AISA registers all private sector enterprises, whether foreign or local, or joint ventures of any nature between foreigners and locals.

With it private businesses – whether local or foreign – define the legal status of their business and obtain a tax number with the Ministry of Finance. With it they are obliged to pay corporate taxes in line with the Afghanistan Tax Law. Enterprises with initial capital of US\$ 3mil and above require the approval of the High Commission on investment before we can register them. AISA has succeeded at streamlining the procedure for obtaining the **AISA business registration**. Generally investors receive it within 5 working days.

Certain businesses require an additional “**Operation License**” from the respective ministries. **These are in addition to the AISA registration, not in its place.** AISA is now able to give clear advice on these additional government licenses. The **Ministry of Commerce** is legally not authorized to issue any license or business registration except **Traders’ Licenses** for trading companies only.

Steps to acquire a Business Registration at the Afghan Investment Support Agency

1. Establish investor’s legal identity
 - a. for an Afghan citizen, an individual investor presents a National ID card, passport or other documents that certify the identity of the applicant.
 - b. a foreign *individual* can present a passport as identification but must also provide a background check through the nearest embassy.
 - c. a foreign company (i.e., a company that is incorporated and has operations outside Afghanistan) obtains a corporate background check through its nearest embassy.
Once obtained, a certification from the Economic Department of the Ministry of Foreign Affairs will be sent to AISA which then enables us to register the foreign entity or foreign individual.
2. The investor fills out the AISA application form for a business registration with such information as the name and address of the company and its contact person, business plan for investments over ten thousand dollars (output, number of workers, amount of investment, etc), industry in which it will operate, type of business ownership, and so on.
3. AISA provides the investor with a “Request for Tax Identification Number” form to be filled out by the investor. AISA uses this form to obtain a Tax Identification Number (TIN) for the investor.
4. The investor also fills out a standard “company statute”, similar to an “Articles of Association.” This form is provided by AISA.
5. AISA checks in its data base as to whether the chosen company name has already been used in Afghanistan. If it has been used already, the investor must choose another name.
6. The investor can choose the firm’s form of incorporation: sole proprietorship, partnership, corporation or limited company. Relevant documents should be attached by the investor to the application form to establish which form of business structure the investor has chosen.

7. AISA arranges for the publication of a "public information summary" of the information contained in the investment license application form in one of the newspapers in the city in which the firm proposes to operate.
8. AISA, on the investor's behalf, registers the company at the Commercial Court (check to see if there are any outstanding cases against the applicant and to register the firm as a legal entity). AISA also has the company's information published in the official government Gazette.

Annual Licensing and Renewal fees:

1. Manufacturing and Services: Licensing fees for investment in Manufacturing and Services (Industry, Agriculture, Animal Husbandry and Construction Materials, Film Industry, Pharmaceutical, Hospital and Health Clinics, Telecommunication, Banking, Hotel, Restaurant, Travel Agency, Consolation and Accounting and Information Technology etc.....)

Amount of Initial Capital	Classification	Licensing Fee
5000\$ to 10000\$ or 26000 Afs to 520000 Afs	Small Size Business	100\$ or 5200 Afs
10001\$ to 1000000\$ or 520052 Afs to 52000000AFs	Medium size Business	700\$ or 36400 Afs
1000001\$...or more	Large size Business	1000\$ or 52000

-Annual Renewal fee for Manufacturing and services Sector will be 25% of actual licensing fee.

3. Construction Service: Licensing fee for Construction Companies:

Amount of Initial Capital	Classification	Licensing Fee
200001\$ to 1000000\$ or 1040000 Afs to 52000000AFs	Medium size Business	700\$ or 36400 Afs
1000001\$...or more	Large size Business	1000\$ or 52000

-Annual Renewal fee will be 50% of actual licensing fee.

Note: Moreover, the applicant is expected to pay a sum of Afg 1500 in fees for Afghan advertisements and for official Gazette of Ministry of Justice.

4. Fees for security companies: 5000 \$ or 260000 Afs

The renewal fees for security companies are 100% of the actual licensing fee.

- \$ 10 fee is applicable for a certified copy of the Investment License.

Note: If the applicants agree with terms and conditions of license acquisition, they should declare their acceptance on this sheet.

¹ Industry, Agriculture, animal husbandry, construction materials, film industry, pharmaceutical, hospital, health clinics, etc.

² Security services, telecommunications, banking, hotel and restaurant, travel agency, accounting and information technology.