Assessment of Namakhvani HPP Agreement

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Acknowledegement
For a long time, the Ministry of Economy and Sustainable Development (hereinafter - the Ministry of Economy) did not make public the Agreement of April 2019 concluded between the Government and the project implementing company, Enka Renewables Ltd., on the Namakhvani HPP project. Consequently, the public was unaware of the content of the Agreement between the Government and a private company on one of the largest projects, considered to be important for the country's energy security. The Agreement was only made public on February 7, 2021, when the ifact- Association of Investigative Journalists obtained the contract and published it. It should be noted that the full content of the Agreement is still not public, as some parts Agreement provided to journalists by the Ministry are redacted, including information on the guaranteed purchase price of electricity, although this information became known from other sources and the company’s statement.

EMC has studied the terms of the Agreement and, our assessment of the provisions that we found particularly problematic along with general information about the Agreement, is presented below. However, it should be noted that this document cannot be considered as a comprehensive critique of the Agreement, as some issues require further in-depth study and analysis, therefore we have refrained from evaluating them at this stage. Moreover, the content of individual clauses of the contract should be considered systematically and in a broader context, which will take into account the importance of substantiating the project with appropriate arguments, its benefits, as well as the country's energy needs and public interest, in general. We believe that in decision-making process regarding the projects with scale and importance similar to Namakhvani HPP project and in assessing how much this project is “worth” for the state, and, consequently, on what terms it may agree with an investor, broad, democratic public participation should be ensured,[1] where apart from professionals, local population, field specialists, public organizations and other stakeholders will be involved. We believe that, sooner or later, the state will have to initiate such public discussions and introduce the need for fundamental reform in the energy sector to its agenda, because the enforcement of decisions on energy projects taken without public consensus only by repressive methods and police force will become increasingly difficult. This paper aims to merely prepare the ground for such a discussion and to contribute to it.

[1] The right to participate in decision-making on environmental issues is a right enshrined in the Constitution of Georgia and international law.

Introduction

On April 25, 2019, the Government of Georgia, JSC "Georgian Energy Development Fund", JSC "Namakhvani", JSC " Electricity System Commercial Operator ", JSC "Georgian State Electro system" and LLC "Clean Energy Group Georgia" (renamed - Enka Renewables Ltd. (Hereinafter - "Enka", the "Company")) signed an Agreement on construction, ownership, and operation of the Namakhvani hydropower cascade (hereinafter - the "Agreement", "2019 Agreement"). The conclusion of the agreement was preceded by the selection of Clean Energy Group Georgia LLC[2] through expression of interest (selection process) announced by JSC Georgian Energy Development Fund (GEDF).[3]

The role of GEDF in the project implementation and investor selection process is also deserving attention. As the public is aware, at one of the stages of the Namakhvani HPP project implementation, GEDF subsidiary JSC Namakhvani was involved in the process. In 2015, the conclusion of the environmental expertise (license) was obtained by this company. Later, mentioned license together with other documents owned by JSC Namakhvani, was handed over to Enka Renewables Ltd.[4]

Thus, although the details of the expression of interest are not fully public, it can be assumed that JSC "Georgian Energy Development Fund" by the expression of interest selected the company to which the shares and assets of JSC "Namakhvani" and, consequently, the project should have been transferred. Accordingly, by this mechanism, the GEDF was practically granted the authority to select the company implementing the energy project instead of the state. Although it is true that the state owns 100% of GEDF shares, GEDF is still a commercial entity; And in our opinion, whether the practice of disposing of the state's natural resources by the company, is justified, should be the subject of further discussion. Moreover, even though GEDF exercised public authority, the company's management did not consider itself bound by administrative law and contended that the Georgian Energy Development Fund was a Joint Stock Company and had no obligation to disclose public information about expression of interest related to Namakhvani HPP.[5]

Consequently, by the decision of the Fund the criteria for selecting the winner, the proposals of the participants of the expression of interest, and the composition of the selection commission would remain confidential. It should be noted, that the closure of essential information about an energy project of state importance[6] in this form with the state company deciding whether or not to make it public should be considered as non-transparent and undemocratic practice.

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[2] Clean Energy Group Georgia Ltd. is a company based in Georgia (s / n: 404507495), 100% of which was originally owned by the Norwegian Clean Energy Group AS (a closely affiliated company of this Norwegian company, Clean Energy Invest AS owns the right to implement another project in Georgia, Adjaristskali Cascade HPPs (including Shuakhevi and Skhalta HPPs) that was transferred under another Agreement signed with the Government). Later, Turkish company Enka buys the shares (90%) of Clean Energy Group Georgia Ltd; Currently Norwegian Clean Energy Group A.S. owns a 10% stake in the company. In May 2019, after signing an agreement with the government, Clean Energy Group Georgia Ltd. changes its name and becomes Enka Renewables Ltd.

[3] The state owns 100% of GEDF shares, relevant information is available at: https://bit.ly/3aTcAN9.

[4] Order # N 2-451 of the Minister of Environment Protection and Agriculture of Georgia of May 27, 2019 on the transfer of the environmental decision issued to JSC Namakhvani to Enka Renewables Ltd; https://bit.ly/2NVGRCe.

[5] Ifact, „Details of Namakhvani Dam Cascade Tender are confidential", 2017 წლის 31 იანვარი; http://bit.ly/2MvSJKy/.

[6] The Namakhvani HPP cascade is declared a project of state importance by the text of the agreement itself, Annex 5, paragraph "g", p. 120.

According to the Agreement itself, the Namakhvani HPP Cascade Project is a Public-Private Partnership (PPP) project. It should be noted that the Georgian Public-Private Partnership[7], legislation which entered into force several years ago,[8] regulates the implementation of a part of the energy investment projects. Mainly, in practice, the scope of the law covers energy projects that envisage the ***guaranteed purchase of electricity*** generated by the power plant. Thus, although the work on implementation of the Namakhvani HPP project started before the law entered into force, the project was still fell within the scope of Public-Private Partnership legislation and was defined as a PPP project, which is an important factor for evaluation of the Agreement.

The requirements of the Law of Georgia on Public-Private Partnership are relevant to the selection of the company "Clean Energy Group Georgia" as a project promoter. According to Article 27 of the “Rules for Development and Implementation of Public-Private Partnership Project” approved by Resolution # 426 of the Government of Georgia on August 17, 2018, a person who has not fulfilled its duties during the implementation of the public-private partnership project over the last five years, is not allowed to participate in the selection process. The rule approved by the resolution refers that the projects that were implemented before the enactment of the public-private partnership legislation, however, according to the definition established by the law, they are still considered as PPP projects. As mentioned, in the energy sector, such projects are mainly those that provide for the guaranteed purchase of electricity by the state. Shuakhevi HPP project is one of such projects. As it is known, the right to implement Shuakhevi HPP was granted to the Norwegian company "Clean Energy Invest". This company, together with Clean Energy Group A.S. (a shareholder in Enka Renewables), is part of Clean Energy Group.[9] Thus, even though the issue of the fulfillment of its obligations by Clean Energy Invest in the Shuakhevi HPP project, due to the collapse of the tunnel two months after the opening of the HPP is questionable, and the local population is actively talking about the damage caused by the Shuakhevi HPP,[10] the state selected Clean Energy Group - the company affiliated with the Clean Energy Invest - to implement the large-scale Namakhvani HPP project. Given that, as stated in the preamble to the agreement, the process of selecting a private partner was completed before the law on public-private partnership came into force, it is difficult to allege direct violation of the law. However, the provision in the Law, which requires that a private partner in breach of the PPP project obligations should not be allowed to the selection process, reflects the general principle of good governance that a company that is already in default before the state should not be selected to implement another project. Consequently, the decision to transfer the Namakhvani HPP project to Clean Energy Group Georgia is questionable and requires at least additional justification from the side of the state. Furthermore, the affiliation of the Namakhvani HPP project with the company responsible for the construction and operation of the Shuakhevi HPP raises well-founded and legitimate fears in the public regarding the company's capabilities and qualifications.

In sum, under the 2019 Agreement, Enka was officially granted the exclusive right to implement the Namakhvani project. The Agreement regulates the legal relationship between the Government and

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[7] Includes the Law of Georgia on Public-Private Partnership and related by-laws; http://bit.ly/3uvWrF7.

[8] The main provisions of the law are effective from July 1, 2018.

[9] Relevant Information is accessible at: https://bit.ly/3uGnvBS.

[10] Radio Tavisufleba, "Why the Shuakhevi HPP, which was completed two years ago, is still not working?" April 25, 2019; http://bit.ly/3b1qcpR.

the company around the Namakhani HPP project, sets out and defines in detail the rights and obligations of the Government and the company, the obligations of other parties to the Agreement, the terms of the Guaranteed Power Purchase Agreement (PPA), (tariff, duration) project implementation periods, terms, etc.

Sale of electricity generated by Namakhvani HPP cascade and the country's energy security

While discussing the need for Namakhvani HPP the representatives of government agencies, among other issues, often emphasize the importance of the project in strengthening the country's energy security and the opportunities that the project will create for the employment of the local population. In the context of energy security, arguments relate the necessity of increasing the number of generation facilities and decreasing the volume of imported electricity. In this respect, the Agreement contains noteworthy provisions.

First of all, according to the Agreement, the duration of the electricity Guaranteed Purchase Agreement (PPA) is the first 15 years following the commencement of operation of HPP, and for each year - 8 months. For the rest of the period, the company is entitled to freely dispose of energy generated by the plant by selling it to any purchaser on the Georgian market or by exporting such electricity (Article 4.3.2.2 c).

It should be noted that the Agreement does not oblige the company to sell electricity in the Georgian domestic market during the non-PPA period; Moreover, various provisions indicate that the company intends to export electricity to Turkey after 15 years and also during the first 15 years in non-PPA months (May, June, July, August). Such provisions are:

- Article 4.3.2.i.b - The Government acknowledges that the Company is entering into the project on the assumption that the capacity of the transmission system between Georgia and Turkey will be further extended in line with the Intergovernmental Agreement signed in 2012;
- Article 3.2.12.b - The Government shall use its best endeavours to ensure that by January 1, 2022, the transmission capacity to Turkey is increased to 1400 MW.

For most large-scale energy projects, a 15-year PPA is a common practice, although, in the interest of meeting Georgia's domestic electricity demand, part of the same Agreements stipulate that outside the period of the guaranteed electricity purchase agreement, the company is required to sell the electricity generated by the station on the local market of Georgia. The existence of such clause would have been logical in the case of Namakhvani as well: a) Government officials and expert groups affiliated with the government stress the large volume of Namakhvani energy generation and how it would reduce Georgia's financial burden, due to the imported expensive electricity; The same groups contend that electricity consumption is on the rise and further growth is expected. Given that Namakhvani HPP is considered one of the ways to reduce the volume of imported electricity and achieve energy security, the question is why does the company have the right to fully export electricity after 15 years? b) The Namakhvani Agreement contains numerous guarantees, favorable terms for the company, risk insurance, not to mention the transfer of land, water, and other natural resources to the company, which will be discussed in the following chapters. Therefore, in these conditions, it

would be logical and fair for the state to have required from company to leave the energy generated by the station in Georgia during the non-PPA period, thus promoting the country's energy security. However, despite the state's assertion about the role of Namakhvani HPPs in the country's energy security, the content of the Agreement demonstrates the complete opposite.

Contractual obligations and risk distribution between the parties

The subject of the 2019 Agreement is the implementation of the Namakhvani HPP cascade project. As mentioned, based on the Agreement, the state and state companies, on the one hand, and Enka Renewables Ltd, on another, undertake various obligations to this end.

Major obligations of the Company

Terms related to the construction of the HPP

The Company's obligations under the Agreement can be divided into several main categories. First of all, it is the duty to take the necessary actions for the construction and commissioning of hydropower plants. According to Article 3.1.1 of the Agreement, the company shall ensure the implementation of the project, which includes the carrying out of a detailed design, financing, construction, testing, commissioning, ownership, operation, and maintenance of the HPPs. Enka shall implement the project at its own expense or by the application of financing procured by the company. Under Article 4.2.8, the Company will conduct the commissioning of the HPPs in accordance with the legislation of Georgia.

The second category of provisions relates to the obligations of the company to take the necessary measures for the purposes of commencememt of construction. According to Article 4.1.1, the company shall obtain required land rights, permits to start construction[11] and financing for the implementation of the project.

Certain provisions impose the obligation upon the company to comply with the Georgian legislation and lawful requirements of the the government in the process of fulfilling its primary obligations. For example, in accordance with Article 4.2.7, the Company shall ensure the prevention and/or control of environmental pollution caused by construction works, dispose of waste in accordance with Georgian law, ensure access of government and other agencies to the construction site, provide the required documentation and reports to the government. Article 4.2.11 requires the company to ensure compliance of construction materials with the requirements of Georgian legislation, etc.

According to the Agreement, the company is obliged to construct and commission the Namakhvani-Alpana section of the Kutaisi-Alpana-Mamisoni highway instead of the section of the road affected by Namakhvani HPPs. According to Governmental Decree # 2404 of November 21, 2019, the existing road should be flooded by the company only after the new road is put into operation.[12]

[11] It should be noted that these obligations of the company are subject to the condition that the government fulfills its obligations. Government obligations related to land and permits are discussed in the next chapter.

[12] LEPL "Technical and Construction Supervision Agency" of the Ministry of Economy and Sustainable Development of Georgia issued a permit for the construction of a new road on February 18, 2020. It should be

The obligations related to the Project's impact on the social environment

It should be noted, that the Agreement contains only a few provisions regarding the social impact of the project and the measures to be taken by the company to mitigate/compensate for this impact. In particular, according to Article 5.1 of the Agreement, compliance of the project with environmental and social standards shall be ensured by the joint cooperation of the parties. Annex 5 to the Agreement states that in compliance with the Environmental and Social Standards[13] land users will be compensated equally with. It should be noted that this amount is actually not compensation, but a fee for the land purchased by the company, which it has to pay, naturally.

As for compensation, in line with the same "Environmental and Social Standards" and the principle of international law in general, which assumes the existence of permanent rights of people to natural resources, in addition to land fees, the company is also obliged to compensate the affected population in various forms.

This principle applies to both, directly and indirectly, affected residents, including those whose access to natural resources has been restricted and living conditions, have deteriorated.[14] In March 2019, after the conclusion of the negotiations on the Agreement, the then Deputy Minister of Economy and Sustainable Development, Natela Turnava, stated that "the investor committed to extensive social responsibility conditions and this was [the ministry] 's principal position."[15] It should be noted that the specific provisions regulating Company's social responsibility can not be found in the Agreement and it is likely that such an agreement between the parties was made only orally.

Employment of Georgian citizens

Regarding the employment of local people, it should be noted that the text of the Agreement does not create actual guarantees for the employment of Georgian citizens. More precisely, the provisions related to the employment of the population of Georgia on the project are given per phases of the project implementation.

- The obligation to employ Georgian citizens in the preconstruction phase:

The company shall take reasonable commercial effort to ensure that on average of 70% of the employees working on the plant shall be Georgian citizens. This obligation shall be subject the

noted that an environmental decision and a permit for the construction of the HPP were not issued neither when the road construction permit nor the above-mentioned government order were adopted.

[13] "Environmental and Social Standards" is the term defined in the Agreement, includes the standards and policies of financial institutions in the relevant field and its specific meaning depends on the identity of the project sponsor (EBRD, IFC).

[14] See, for example, EBRD, Environmental and Social Policy, April 2019, document available at: http://bit.ly/2NVQe4F.

[15] Ministry of Economy and Sustainable Development of Georgia, "Negotiations between the Ministry of Economy and Namakhvani HPP Investors Completed", March 19, 2019; http://bit.ly/3uT680T.

availability of sufficiently qualified Georgian citizens who on commercial terms comparable to those of the employment of the foreign citizens.

- Employment obligation in the construction phase - on average 50%, the above preconditions also apply to this stage.
- Employment obligation in the operation phase: a) the first 10 years - on average 70% - the above preconditions apply; b) From the 11th year - on average 80% - the above preconditions apply.

Thus, the provisions of the Agreement related to the employment of Georgian citizens in practice mean that the company does not have any strict obligation to employ a certain percentage of Georgian citizens (of all workers).

a) " reasonable commercial effort" - the company is obliged to apply a reasonable commercial effort, which in practice can be interpreted in such a way that it simply would not be worthy for the company to employi Georgian citizens, "it would be an extra burden", "it would be unreasonable to make more efforts", etc. All of these arguments will meet the standard given here and the Company will not be held liable for breach of the obligation. Besides, such provisions ("take action", "make every effort", "attempt ", etc.) is focused on the process rather than the result: The company will present evidence before the arbitral tribunal that it has made some effort and the state has to demonstrate what else company could have done and what was not done to establish the violation, and this is very difficult and the burden of proof is shifted entirely on the side of the state; Thus, it becomes virtually impossible to establish a breach of this obligation.

b) "Sufficient Qualification Condition" - The above condition would have been sufficient for the Company to evade this obligation, although the Agreement contains additional provisions. While the company does not have an obligation to train Georgian citizens, it is very unlikely that sufficient qualified personnel for the construction of the power plant can be found in the proximity to the site. Therefore, even if the company shows goodwill, the citizens of Georgia will be employed in the most "low-skilled" jobs, or so-called blackwork.

c) "Commercial terms comparable to those of employment of foreign citizens" - this wording goes even further and implies that even the existence of sufficiently qualified personnel is not enough for their employment; Additionally, these individuals must agree to the same pay rate that, for example, citizens of another country would agree to. This means that if the company is not able to get a cheap workforce on the ground, it is completely free to employ foreigners as such workers. It should be noted that the presence of such a provision in the Agreement concluded by the State is particularly problematic. This clause promotes poor working conditions and establishing inadequate remuneration practices by the company (given that the company does not have a strict obligation to employ locals, with the prospect of bringing in cheap workers from outside, locals will easily agree to a minimum wage) instead of requiring from the investors to adhere with decent working conditions.

Regarding the financial obligations of the company under the Agreement, in general, it should be mentioned that the content of these obligations is clearly and precisely defined. In other words, the company knows exactly what actions to take and what costs to incur under the Agreement. Below, when reviewing the obligations and financial guarantees of the government, it will be evident that there is a contrast between the obligations of the company on the one hand and the obligations of the government on the other. The latter assumes virtually all the financial risks associated with the

unfavorable development of a project scenario. Consequently, unlikely from the duties of the company the scope of government's obligations, is not clear and predetermined, as they are related to various events that might take place in the future, and the occurrence of all these events triggers different legal consequences and compensation regimes.

Government Obligations and Guarantees

Under the Agreement, the state company JSC "Electricity System Commercial Operator" (ESCO) [16] is shall purchase the electricity generated by Namakhvani HPP in full - for 15 years after the commissioning of the HPP, in the following months: September, October, November, December, January, February, March, April. Another state-owned company, JSC Georgian State EnergoSystem, is obliged to build the electricity transmission lines required to connect Namakhvani HPP to the Georgian electricity transmission network. Under the Agreement, Enka is fully exempt from value-added tax.

Furthermore, the government shall assist the company in general in the project implementation process, including in obtaining permits and land rights. In addition to these obligations, under the Agreement the government consents to various provisions, based on which it: a) transfers rights over natural resources to the company; b) pledges significant financial guarantees/responsibilities to the company.

Natural Resources

The Company's land-related rights

According to Article 3.2.6 of the Agreement, the Government is obliged, including:

- Transfer state-owned "required land" plots to the company;
- If the transfer of ownership is not possible, transfer land plots with superficies (in both cases the value of each land plot should not exceed 1 GEL);
- If the land has agricultural status, change the status and then transfer it to the company.

According to Annex 5 of the Agreement, the Government additionally:

- is obliged to assist the company in purchasing "required land" plots from private individuals;
- acknowledges the state significance of the project and declares its readiness to assist the company in obtaining the "required land", including through expropriation.

It should be noted that the term "required land", which provides the government's obligations related to the transfer of land, is defined very broadly in the Agreement and includes the plots needed not only for the construction of hydropower plant, design, removal, and storage soil but also the area

[16] Under the Agreement, the liabilities of state-owned companies as well as public institutions are ultimately defined as those of the government. The government is obliged to ensure the fulfillment of ESCO's obligations, and if it is unable to pay the electricity tariff for the company, this obligation is automatically transferred to the government.

needed to extract natural resources (including sand-gravel). According to the same definition, the necessary land area can go beyond the location of the site. Moreover, the "need" for the necessary land is determined by the company and is limited only by the most general standard of reasonableness. Also, the term "land-related rights" is widely defined, which further stipulates that the restriction on the necessary land area is that it should be limited to the boundaries of the Rioni Valley, Imereti, and Racha-Lechkhumi. Accordingly, considering the government's numerous commitments on "required land", according to the Agreement if, for example, the company deems it necessary to obtain natural resources away from the site, but still within the Rioni Valley (Racha-Lechkhumi and Imereti regions) and this land will be the property of a private individual who refuses to sell, the state is obliged to assist the company in obtaining the land through expropriation.

In addition, the paragraph "I" of Annex 5 of the Agreement is rather problematic, which states that if the company fails to reach an agreement with the land users (persons who own the land without formal title), the government will have the obligation to register the land plots under its ownership. As the provisions of the Agreement show, the "required land" owned by the state must be transferred to the company. Therefore, the mentioned provision in practice means that land users who refuse to transfer land to a company can be deprived of the land they have traditionally used without any compensation.

Rights Related to the Water Resources

According to Article 3.2.2.b of the Agreement, the company has the right to harness, utilize, divert, the water resources of Rioni and its tributaries, as well as the river Tskhenistskali, as it will be necessary to achieve the maximum capacity of the project. Besides, Article 3.13.iv of the Agreement contains a rather problematic condition that stipulates that diverting water from the Tskhenistskali River is the obligation of the government. In particular, according to this Article, "subject to natural availability of the water and the maintenance on the existing tunnel, the Government shall to ensure that the water is diverted from the Tskhenistskali River through the said tunnel which forms part of the Lajanuri hydropower plant into the Namakhvani cascade."

In addition, the Government undertakes not to grant any authorization in the future on the utilization of water upstream of the site, in any way, that could adversely affect the Namakhvani production, and the government represents that such rights have not been granted before (Article 3.13.ii). Moreover, the state undertakes to indemnify the company from any "losses" arising from the claims by any persons related to water resources if this claim is not a direct result of the company's negligence or breach of the Agreement.

Other Natural Resources

The government exempts the Company from the obligation to obtain license for extracting natural resources from the quarries or any other natural resources[17] (Article 3.2.4), which means that the Company does not pay the license fee and obtains natural resources free of charge. Besides, the same Article states that the Government must ensure that the relevant public authority issues an order on

[17] An essential prerequisite is that these resources are needed for construction.

the exemption from license within a maximum of 30 days from application by the company. Also, this exemption must remain in force for the maximum period allowed by law. Under Section 3.2.5 of the Agreement, the government shall facilitate a meeting between the company and relevant public authorities aimed at allocating the timber storage areas located as close as practically possible to the site. The right to cut timber is not explicitly mentioned in this Article. However, given the title of the article ("tree felling and storage rights), one can assume that the company can cut timber on the plots under its ownership/use, and this article provides additional right to claim warehousing – on someone else's land.

Grounds for government responsibility and Financial Guarantees

Change in Law and Taxes

According to Article 8.2.5, if the amendment of legislation has a material adverse effect on the company's economic and financial position, the government is obliged to negotiate with the company to change the terms of the Agreement to reflect the changed circumstances caused by the legal amendments. However, under the Agreement, the impact will be considered materially adverse if it results in a decrease in the company's revenue by at least 1% per year (or an increase of expenses with the same amount) or with a total of 5 million over the term of the Agreement. If the parties fail to agree, the Company is entitled to claim compensation for the sustained "loss" as the unresolved change in law constitutes a compensation event, or may terminate the Agreement, and in this case, the Agreement will be deemed to be terminated due to breach of obligation by the Government (the case of default) and the strictest compensation regime will be activated.

The following problematic issues are identified in the contractual regulation of change in law:

- *International Standards and duty to compensate*

It should be noted that according to the Georgian legislation, the international agreement to which Georgia has consented to be bound by, is also an integral part of the Georgian legislation.[18] Consequently, if, for example, Georgia ratifies an international agreement which imposes the responsibility to adhere to stricter standards in the field of environment, construction, energy, or any other field, and, as a result, the company's costs increase, Georgia will be obliged to compensate this case as well. In general, according to the norms of international investment law, the existence of risk for both sides is a necessary component for a business operation to be considered as an investment. The company usually bears commercial risk, while the state insures political risks. However, the political risk, which is evident from the outset and the probability of its realization is high, is also the responsibility of the company. This is related to the company's duty to conduct a risk assessment with due diligence before investing; Otherwise, as a general rule, the host State is not responsible for the loss of the company. The exception is the case when there is a specific agreement between the investor and the state (Change in Law clause of Namakhvani BOO Agreement and other similar provisions are an example of such specific agreement). And the issue of concluding The such an Agreement should be widely discussed, especially given the fact that Georgia, within the Association Agreement with the European Union, is actively working to on approximation of national legislation

[18] Law of Georgia on International Agreements, Article 6.

to European standards and, therefore, substantial legislative amendments, including in the energy sector, are expected. The question is whether it is worth it for the state to compensate the "loss" caused by all such changes.

- *The changes in the market rules*

A more specific case of change in law is regulated by the Article 4.3.2.g of the Agreement, according to which, if the laws of Georgia regulating operation of the electricity system and/or electricity trading are changed during the term of the Agreement, the parties must negotiate to reflect the changes in the terms of realization of electricity, so that the economic and financial position of the company under the Agreement is maintained.

In relation to this article it should be further noted that an internationally accepted precondition for imposing change in law related risks on a government is that the investor is not aware of such an amendment. The main point of the so-called “stabilization clause” is that it entails unforeseen, unexpected costs for the company, which could not have been planned for and taken into account when concluding the Agreement. It should be noted that the Georgian energy market liberalization reform has been planned for a long time; According to the information posted on the website of the Ministry of Economy, the mentioned reform should be implemented by Georgia in accordance with the terms of becoming a member of the Energy Community,[19] and Georgia joined this organization in 2017. Regulating the change of market rules in separate article (and not including it in change in law clause, while the circumstances described here essentially falls within the scope of contractual definition of change in law) and its wording provides a basis to assume that indeed, parties knew about the expected changes and that is exactly why this particular article was introduced to the Agreement – to safeguard company’s positions. Consequently, given that the state should compensate the additional costs caused by the legislative amendments, if the company was unaware of such amendments, a contractual obligation to negotiate a change in the terms of the electricity sale (e.g., a tariff increase) in the event of a change in market rules should be considered unjustified.

- *Changes in taxes*

Under Article 3.2.16, the Company and the “Project Participants” are entitled to claim compensation from the Government for any damages incurred by the tax increase or the introduction of any such regulation that would increase their tax burden.

Concerning this provision, it should be noted that if the project is really of strategic and state importance and its implementation is in the public interest (which is the subject of a separate assessment), tax increase risk might be insured by the state. However, even with the above assumption, the provision of the Namakhvani Agreement is problematic for the following reasons: a) Article 3.2.16 of the Agreement defines the tax change as a "compensation event ", which means that the state is not only obliged to compensate for reduced revenue or increased costs but also additional "loss". The loss is as broadly defined as possible in the Agreement and, in addition to the direct loss, includes loss of revenue, loss of profits, and even lost opportunity. Such an expansion of the state's

[19] Information on the Reform is available at: http://bit.ly/2ZSp0ic.

financial responsibility is unusual even for important Public-Private Partnership projects. b) The government is obliged to pay compensation not only to the company but also to the project participants, and according to the Agreement, the participant of the project is the company (together with the affiliates), the financing parties, and the contractors of the company. Including contractors in this definition is especially problematic: a company can commission numerous contractors to perform different works and, under the Agreement, the state has the duty to pay compensation to all of them.

Force majeure events

Article 8.1 of the Agreement sets out the definition of force majeure event and includes such characteristics as lack of control of the parties over such an event, consequent non-performance or delayed performance, attempt to mitigate the effect of such event, absence of culpability of either party, etc. In the event of force majeure, the party is released from performance and shall shall not be construed to be in default of the Agreement as long as such failure is caused by force majeure event. Besides, in case of prolonged force majeure, the company has the right to terminate the Agreement. In parallel with the setting out standard legal elements of force majeure event, the Agreement follows a recently established practice that aims at transferring the force-majeure related risks to the state to the maximum extent possible. In particular, the Agreement distinguishes between physical and "non-physical" (political) force majeure events and subjects them to different legal and financial consequences.

According to Article 8.1.3 of the Agreement, the physical, or non-political force majeure includes events such as fire, flood, earthquake, storm, other natural disasters, epidemic, and others. Political force majeure includes any hostilities, armed conflict, revolution, insurgency, civil unrest, blockade, embargo, and more. Also, public agitation or protest is considered a political force majeure, that interferes with the construction or operation of a project or the project in general and lasts for more than 21 days in aggregate in any 6 months period.

The following problematic issues are identified in contractual regulation of force majeure events:

- *Political force majeure as a ground subject to a strict compensation regime*

As mentioned above, according to Article 8.2.2 of the Agreement, compensation events, among other things, includes political force majeure. The political force majeure, in turn, covers the events that are potentially independent from the government, such as war, armed conflict, invasion, a campaign of terrorism, rebellion, blockade, and embargo. Separating force majeure events into political and non-political circumstances is mainly conditioned by the degree of state control over such events and this control is what determines the different legal consequences. In this case, the state may have no or very little control over the listed events. Nevertheless, under the Agreement, political force majeure is a compensable event, and at its occurence the government is obliged to compensate the company for the specific costs as well as damages or "loss", which is an extremely broadly defined term under the Agreement. Thus, according to the Agreement, the state is not only <u>not</u> excused from performance of its obligations during a political force majeure, but moreover, if the company suffers damage for reasons not attributable to the state, the government has to compensate the company.

- *Fulfillment of obligations by the government and public institutions during force majeure*

Article 8.1.6 of the Agreement instructs that neither the government nor any public institution[20] is released from duties due to political force majeure. It should be noted, that considering the nature of the contractual definition of political force majeure and events it includes (war, foreign invasion, armed conflict, blockade, uprising ...), it is unclear why the state is not released from its responsibilities in case of their occurrence. As mentioned, the state has very little control over some of the political force majeure events and no control - over the rest. Therefore, maintaining its duties in force, while excusing the company's non-fulfillment of its obligations is an unbalanced regulation that maximally protects the interests of the company, at one hand, and, neglects those of the state, on another.

- *Force majeure and monetary obligations*

According to Article 8.1.5 of the Agreement, force majeure does not release either party from the fulfillment of monetary obligations (unless the force majeure impedes the functioning of the banking system). This article lays down the exceptional rule only applicable to monetary obligations (payment to the other party) and does not extend to other duties under the Agreement, the non-fulfillment of which is generally excused in case of force majeure.[21] It should be noted that the monetary obligations under the Agreement are mainly on the side of the state, including the obligation of the state company - JSC "Electricity System Commercial Operator" (ESCO) - to pay the price of electricity to the company. Thus, given that force majeure may affect the solvency of ESCO or any public agency, the decision to leave monetary obligations in force during force majeure event has a negative effect on interests of the state primarily. Furthermore, it should be noted that the major monetary obligation of the company - to pay a penalty for the delayed performance of its obligations, in this case, is not relevant, because both types of force majeure events release the company from the obligation to perform and, consequently, it can not be penalized.

Compensation events

The Agreement provides a list of events occurence of which obligates the Government to compensate the "loss" (this term used in the text of the Agreement has essentially the same meaning as "damages") of the company caused by such circumstances This obligation must be distinguished from the compensation that is paid upon the termination of the Agreement. The compensation events clause regulates the situation where the Agreement is valid (the company does not terminate it) and, consequently, the obligations under it, remain in force.[22]

According to the Article 8.2.1. the company is also entitled to receive compensation from the government in the following cases in addition to other legal remedies that it has under the Agreement:

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[20] According to the contractual definition of the term, it, together with state agencies and other public institutions, refers to state-owned companies, including JSC "Energy System Commercial Operator" (ESCO) and JSC "Georgian State Energy System" (GSE).

[21] The exceptions are government commitments that remain in force during a political force majeure.

[22] Termination of a contract due to the compensable case and the consequences of such termination are the subject of a separate regulation and will be discussed further.

a) breach of any "project agreement" by the government or any "public institution"[23];
b) political force majeure event;
c) expropriation (i.e. deprivation of company's property by the state);
d) Introduction of legislative amendments due to the geographical, geological, hydrographic peculiarities of the project location, which apply only to the company and its contractors;
e) unresolved change in law;
f) any other event described in the agreement as a compensation event (such as, for example, tax increases).[24]

Within 15 days from the Company's compensation notice, the Government is required to negotiate with the Company the amount of compensation to be paid.

In general, it is not uncommon for Public-Private Partnership (PPP) contracts to determine cases to be compensated by a public partner (in this case, the government). This approach is based on the fact that the PPP project is of public benefit and public support, "public partnership" is *inter alia* reflected in the promise of compensation, which increases the chances of financing the project, which, as a rule, should be in the public interest. The cases where the obligation to compensate arises is called "Material Adverse Government Action". However, what is crucial in determining these events is not necessarily the "hostile" attitude of the government, but the fact that a particular event (which is considered a compensation event) is under government control or at least the government has more control over it than a private partner (company). Due to this control, the government is believed to manage the risk associated with this event better, and, consequently, this risk is transferred to its side, which is ultimately reflected in the financial responsibility of the government.

However, even considering the above, the Agreement contains several problematic issues which will be addressed below:

- *Amount of compensation*

Under Article 8.2.3 of the Agreement, the Government shall compensate for increased costs, reduced revenue, or any other "loss" caused by the compensation event to the Company. "Loss" is a term defined by the Agreement that includes, but is not limited to, any loss, damage, financial liability, penalty, other costs, lost profits, missed opportunity, loss of business, etc. It should be noted that the concept of "fault" is important in determining the financial responsibility of a party to the Agreement. In particular, when a specific event is triggered by the government's culpable action against the company, the compensation for the "loss," i.e. damages, together with increased costs and reduced revenue can be logical. Article 8.2.2 (a) (default by the government or another "public institution)" and "c" (expropriation) can be considered as such cases, although the same amount of compensation is unjustified for the government in other cases listed in the article. In the event of an unresolved change in law or force majeure, the government's financial liability should be limited to the

[23] According to the Agreement, the project agreements include: the basic agreement, the agreement on guaranteed purchase of electricity, the agreement on connection to the grid to be signed with JSC "Georgian State Energy System", the agreement on land transfer and others.
[24] Contractual regulation of legal amendments and changes in taxes will be considered separately.

compensation of increased costs and reduced revenues, and in such cases, obliging the government to pay the damages additionally should be considered as a less equitable model of risk distribution.

• *Absence of the "materiality" criterion*

Under the Agreement, the government's financial liability is triggered by any deterioration of the financial position of the company caused by the listed events, and no threshold of liability or material impact criteria is established. The implementation of a large-scale and long-term project is always accompanied by certain risks, some of which may be insured by a public partner, but some of the risks must be borne by the company itself, especially since the compensation events in the discussed Agreement simultaneously represent the ground for the term extension set for the company to fulfill the duties. Therefore, the company will not be liable for the overdue caused by the compensation event. Besides, if the deadlines set for the liabilities remained in force, the company might have had to incur additional costs to ensure that the obligation is performed timely. In the present case, the company is released from such an obligation.

- *Non-exhaustive list*

Article 8.2.2 of the Agreement does not contain an exhaustive list of compensation events and states that any other event deemed to be compensable in the Agreement will be included in the scope of this Article. It should be noted that this seemingly technical detail is an important issue, given that these events directly give rise to the financial responsibility of the government, so it is essential that these grounds are provided in one article explicitly and comprehensively. Also, from the perspective of legal teqnique, it is not a difficult task to include compensation events, referred to in other articles, here as well (as, for example, in the case of an "unresolved change in law), to exclude the possibility of heterogeneous interpretation.

<u>*Grounds and consequences of termination of the Agreement*</u>

Under Article 9 of the Agreement, the parties are entitled to terminate the Agreement in case of breach of obligations by the other party. Notably, in the event of a breach of an obligation by the company, the government's right to terminate the Agreement is subject to several conditions. Firstly, the company is entitled to submit a remedial plan. Besides, the financing parties (lenders) have the right to use temporary administration of the Agreement in case of breach of the obligation by the company or to name a substitute company that will continue to fulfill its obligations while the Agreement remains in force.

1) Termination of the Agreement by the Government

In the event of a breach of duties by the Company and termination of the Agreementby the Government due to this, the Government shall pay to the Company the "Company's default termination amount" and the Company shall transfer the project assets to the government.[25] Upon

[25] Under the agreement, the definition of "transferable assets" includes physical property that belongs to the power plant, [non-transferable] roads, land rights, transferable permits and contracts.

the termination of the Agreement on the ground of the breach of obligation by the company, the compensation that has to be paid by the Government comprise the following components:

I. In the preconstruction or construction phase

a) base amount (which includes the debt owed by the company to the borrowers, including principal amount, accrued interest, the expenses related to the termination of the Agreement, other costs);
b) provided that the loan amount does not exceed 50% of the base amount and equity investment - 50% of the product of the fair market value of the project minus thel oan amount;
c) all taxes payable on the transfer of transferable assets;
d) tax gross-up amount.

II. In the operation phase - the government is required to pay greater of (A or B):

A.

a) base amount
b) all taxes payable on the transfer of transferable assets;
c) the tax gross-up amount

B.

a) 90% of fair market value
b) all taxes payable on the transfer of transferable assets;
c) the tax gross-up amount

2) Termination of the Agreement by the Company

2.1. In case of termination of the Agreement on the ground of government's default, prolonged political force majeure event, and unresolved change in law, the government is obliged to pay the company:

a) greater of the base amount and fair market value of transferrable assets
b) compensation for damages incurred to the company;
c) all taxes payable on the transfer of transferable assets;
d) the tax gross-up amount.

2.2 In case of termination of the Agreement due to prolonged physical force majeure, the government must compensate the company:

a) base amount
b) all taxes payable on the transfer of transferable assets;
c) equity investment
d) tax gross up amount

The main problematic issues of the termination regime provided under the Agreement are:

- The inevitability and scope of state financial responsibility

Under the Agreement, no matter what will be the developments related to the project and regardless of whether the Agreement is breached by the government or the company, the financial responsibility is imposed on the state. Even if the Agreement is terminated due to non-fulfillment of obligations by the company, the government is obliged to repay the loan borrowed by the company in full despite the fact that attracting the funding for the project and accountability before the borrowers must be the Company's responsibility. It should also be noted that the role of the state is important in the process of securing this funding: based on the guarantees provided in the Agreement, one can conclude that the government ensures virtually all political risks of the company and thus contributes to the financial attractiveness (bankability) of the project.

It should be noted that the consequences of termination of the Agreement due to physical force majeure are also unbalanced. In such a case, the company, in addition to the loan amount, also receives remuneration for equity investment from the government. As a rule, natural disasters and the resulting force majeure situation are considered as a shared risk of the parties to the Agreement, in this case, by imposing the obligation to the government to pay the investment, this risk is fully transferred to its side.

The same can be said on political force majeure, while, as noted, it is true the state has relatively more control over political force majeure than over physical force majeure, this control is so insignificant that it does not justify safeguarding the risk fully by the state. Also, it is problematic that according to the Agreement, in case of termination due to prolonged political force majeure, the government shall pay the company full costs as well as the damages. Hence, the liability regime is equated with the government's default regime which is absolutely unbalanced and completely adjusted to the company's interests.

- Inequality of the parties to the Agreement

The inequality of the parties is manifested through various important articles. First of all, the company has the right to terminate the Agreement due to prolonged force majeure events, while the government does not.

Moreover, under the Agreement, the government cannot claim damages from the company for violating the deadline of the start and completion of the power plant construction; According to article 4.4.4 of the Agreement, the penalty imposed for overdue days should be the only and exclusive legal remedy of the government and it has no access to other ways. This provision differs from the regulation established under Georgian civil legislation; According to Article 419 of the Civil Code of Georgia, the creditor (in this case - the government) has the right to claim damages in addition to the penalty, In addition, the Agreement limits the scope of application of the penalty: No matter how long the company delays the performance according to Article 4.4.3 of the Agreement, the sum of the imposed penalty should not exceed the amount of the contract security, and if the penalty reaches the amount of the guarantee,[26] the company is additionally given the time to fulfill the obligation and the penalty imposition process is suspended (for maximum 18 months). Thus, the government cannot

[26] Regarding the amount of the guarantee, it is noteworthy that according to the Agreement, when the project implementation process reaches 50%, the company is entitled to request a halving of the guarantee.

claim the damages even in the event of a breach of Agreement by the company, while the company is entitled to claim damages not only in case of default by the government but also in case of unresolved change in law and political force majeure.
According to Article 21 of the Agreement, neither party has the right to claim compensation for indirect damages (unearned income, lost profit, lost business opportunity ...), unless it is explicitly specified in this Agreement. According to the Agreement, only the company has the right to claim compensation for the "loss", which includes elements of indirect damages in addition to direct damage. Thus, the restriction laid down in Article 21 applies only to the Government.

- The ability to transfer project assets to third parties

Article 13 of the Agreement regulates the transfer of rights and assets under the Agreement to third parties. According to this article, neither party shall transfer the rights and obligations to third parties without the consent of the other party. However, it specifies, that the consent of the Government is not required (i) when the Company pledges the Agreement in favor of the financing parties, and (ii) for any transfer of rights in accordance with the financing documents or direct agreement. This article in practice means that the company is free to pledge any contractual rights and project assets to secure a loan borrowed from third parties without the consent of the government, and in case of non-repayment of the loan, the assets might fall into the hands of third parties over whose identity the government has no control. Also, it should be noted that although this mechanism would insure the risks associated with the company's breach of obligations before them at least partially. The agreement does not require the prior consent of the government on who will be the project financers.[27] And Article 6.1, which deals with the ownership title of a power plant, explicitly states that the transfer of ownership of a power plant is allowed in accordance with the financial documents. Given the declared state importance of the project, such provisions imply contain potential risks in terms of energy security.

Conclusion: Public interest and advisability of the implementation of the project

According to the Law of Georgia on Public-Private Partnership, when deciding on the implementation of a PPP project, the Government of Georgia must, among other things, take into account the strategic or public importance of the project and the fiscal risks that might arise from the project.[28]

based on the Agreement it is clear that the content of the commitments undertaken by the company is plain and predetermined, for example, it is known that the company is responsible for the construction and commissioning of the power plant, purchase of land, road rehabilitation, etc., which requires investing a certain amount. On the other hand, the financial obligations of the Government of Georgia are extremely abundant and indefinite. The state, among others, has an obligation to compensate the company for damages caused by an unresolved change in law, tax increase, political force majeure, or breach of liability by the government itself and other public institutions (which, in turn, have multiple obligations). And the damage, or " the loss" is defined broadly and a very wide range of expenses can be covered. As a result, the scope of the government's financial liability is

[27] Under Article 10 of the Agreement, the company only has to provide information regarding the sponsors and does not need the consent or permission from the government.
[28] Law of Georgia on Public-Private Partnership, Article 23, https://bit.ly/3uvWrF7.

virtually unclear. It is interesting whether the direct or indirect fiscal risks arising from the agreement were calculated and analyzed, and, more specifically, what was the position of the Ministry of Finance on the Namakhvani agreement, which, based on *prima facie* assessment poses a threat to the country's fiscal stability.

Also, in the light of the entitlements of the company including over real property and natural resources, guaranteed tariffs and essential financial guarantees undertaken by the state as well as various contractual provisions favorable to the company, it is particularly interesting what is the content of the cost-benefit analysis prepared for the project, which is required under the legislation governing Public-Private Partnership projects,[29] and Namakhvani HPP, according to the preamble of the Agreement, is the PPP project.

Since the 2019 Agreement on the Namakhvani HPP project regulates the essential aspects of the legal relationship between the government and ENKA, determines the benefits to be received by the state and the costs to be incurred in various forms, the content of the Agreement says a lot about the project itself. The provisions of the 2019 agreement call into question the benefits that the project is supposed to bring to the country in terms of strengthening energy security and creating new employment opportunities. furthermore, one should consider the numerous financial guarantees scattered in the Agreement which create fiscal risks for the country as a counterweight to the general economic benefits to be obtained from the implementation of the project. **At the same time, we believe that the fact that the government undertakes certain risks under the Agreement cannot be a ground for criticism *per se*, as granting financial guarantees and undertaking related risks may be justified by the exceptional public importance of the project. In our view, the main question around the Namakhvani HPP controversy is to what extent does the public benefit of the project justifies the extent of its impact on the natural and social environment, entitlements, guarantees, and resources as prescribed by the Agreement and insuring such a number of risks by the government?**

based on the initial assessment, the 2019 Agreement is tailored to the interests of the private company to the maximum extent. Unfortunately, the content of the Agreement further exacerbates the questions and concerns that have already existed around the project. Convincing arguments based on proper research, scientific knowledge, and the text of the Agreement itself on the public benefits of the Namakhvani HPP project have not been heard so far.

[29] Resolution # 426 of the Government of Georgia on the Approval of the Rules for the Development and Implementation of the Public-Private Partnership Project, Article 10, L http://bit.ly/3uyoa8s.