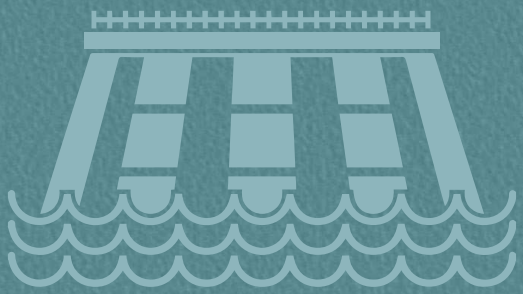
CHAPTER 2.
THE NAMAKHVANI HYDRO POWER PLANT AND ENERGY INDEPENDENCE



INTRODUCTION

While discussing the benefits of the Namakhvani Hydroelectric Power Plant, representatives of government bodies often refer to its importance for bolstering the country's energy independence.[25] They emphasize the need to raise the number of electricity-generating facilities and reduce the share of imported energy.[26] Members of the government and government-affiliated expert groups argue that the Namakhvani HPP will generate large amounts of electricity and that this would ease the financial burden related to importing expensive electricity. This is yet another in the set of pompous claims by representative of the government which are not supported by the contents of the agreement between the investor and the state.

WHAT DOES THE AGREEMENT HAVE TO SAY ON THE REALIZATION OF THE ELECTRICITY GENERATED BY THE NAMAKHVANI HPP?

On 25 April 2019, the Georgian government, JSC Georgian Energy Development Fund, JSC Namakhvani, JSC Electricity Market Commercial Operator, JSC Georgian State Electrosystem and LLC Clean Energy Group Georgia signed a Build-Own-Operate agreement on the Namakhvani Hydroelectricity Power Plant (hereinafter referred to as "agreement"). In the agreement the duration of the Power Purchase Agreement (PPA) is set for the period of 15 years after the launch of the HPP's operations. Such an arrangement is common in agreements on large-scale energy project development. However, the Namakhvani agreement also contains a clause that gives the company a right to freely dispose of electricity generated by the plant in the period beyond the PPA, through sales to any buyer within Georgia or exports (4.3.2 c).

Further, various clauses of the agreement reveal that the company intends to export electricity to Turkey. Specifically, the agreement states that:

> The government acknowledges that the company is entering into the Project on the assumption that the Transition System capacity between Georgia and Turkey will be further expanded in line with the Intergovernmental Agreement between Georgia and Turkey dated 20 January 2012; (4.3.2.c.i.b)

25 „Natia Turnava – The Namakhvani HPP is a Significant Contribution to Strengthening Energy Independence of Georgia". 30.01.2021. Link: https://bit.ly/3ffZc7Y

26 „We cannot Attain Energy Independence without Large Plant Similar to the Namakhvani HPP". 31.01.2021. Link: https://bit.ly/3425t0S

> [The Government of Georgia shall] use its best endeavours to ensure that by 1 January 2022 the transmission capacity to Turkey is increase to 1400 MW. (3.2.12.b.i.C)

A systemic interpretation of these clauses makes clear that, unfortunately, the agreement, the main document regulating legal relations between the investor and the state, does not guarantee that electricity generated by the HPP will stay in Georgia.

GEORGIAN LEGISLATION AND THE ABILITY TO EXPORT

The disclosure of the agreement on the Namakhvani HPP to the public has revealed that the government granted the company the right to export the energy generated by the HPP. In response, representatives of the government started arguing that the company would nevertheless leave the electricity inside the country based on Georgian legislation, despite the clauses of the agreement that state the opposite. To be more exact, in its response to the assessment of the Namakhvani HPP agreement by the Social Justice Center[27] the Ministry of Economy and Sustainable Development stated that the government grants the company the right to export electricity based on its discretion and in accordance to Georgian law. First, this claim is not fully accurate: the issue of potential sales of generated electricity is a subject of several clauses within the agreement. In the statement, the Ministry of Economy seemingly refers to the clause 3.2.22, a general provision that lists the main obligations of the government, including granting the company the right to export the full volume of electricity generated by the HPP. This clause is indeed preceded by a reference to the government's discretion and Georgian legislation.

However, this does not hold true for the clauses of the agreement that regulate the issue of potential sales directly and exclusively. Namely, 4.3.2.2.c.i.A states that the company has a right to dispose of the full volume of the electricity generated by the HPP freely and that this includes the right to export it outside Georgia. Particularly important in this regard is the clause of the agreement that states that the government acknowledges that the company is entering into the project on the assumption that the transition system capacity between Georgia and Turkey will be further expanded in line with the intergovernmental agreement. This term not only exposes the company's intention to export electricity generated by the Namakhvani HPP, but can also serve as a source for defining

27 „Assesment of the Namakhvani HPP Agreement". Social Justice Center, 4 March 2021. Link: https://bit.ly/3iqErbN.

the nature of the agreement between the sides and their intentions in arbitration.[28] It is clear that as exporting electricity is a primary interest of the company (the reason why it is investing in the project in the first place), the parties do not intend to subject the right to export electricity to the requirements of Georgian law. Further proof can be found in the fact that the clauses regulating sales of electricity in the period not subject to the PPA do not at all refer to Georgian legislation. Moreover:

> If the parties considered the right to export electricity as subordinate to the need to satisfy internal demand in Georgia, this should have been expressed in the agreement with a provision that would clarify that while the company has a right to export electricity, this right can be restricted based on the energy needs of Georgia. The agreement does not contain such statement.

This matter attains further significance due to the fact that the agreement defines "Laws of Georgia" as a totality of legislative acts that will be in effect from time to time during the term of the agreement. Therefore, if the government intended to keep electricity generated by the Namakhvani HPP inside Georgia, it should have expressly stated this in the agreement, rather than turning it into a matter of general legislative regulation (assuming that Georgian legislation applies in this case), which does not directly pertain to the Namakhvani HPP and can change periodically.

Further, references to legislative regulations by representatives of the government are misleading in this context, as refusing obligations stemming from an agreement with a foreign investor cannot be legally justified based on a country's internal legislative regulations. One of the fundamental principles of international investment law is Fair and Equitable Treatment. The principle has a rather broad nature and both breaking with the investor's expectations as well as inconsistencies in the government's actions towards the investor can be considered its violations.[29] Due to this standard, neglecting an obligation that is of essential importance to the investor ("the government acknowledges that the company is entering into the Project on the assumption that the Transition System capacity between Georgia and Turkey will be further expanded in line with the Intergovernmental Agreement between Georgia and Turkey dated 20 January 2012") will be

28 The Namakhvani HPP Agreement sets arbitral tribunal as the forum for settling disputes between the sides.

29 Técnicas Medioambientales Tecmed, S.A. v. The United Mexican States, ICSID Case No. ARB (AF)/00/2. Link: https://bit.ly/2T5FRh5

unequivocally considered a violation of the FET principle. And as breaking this pledge constitutes a violation of international law and of an international agreement (a bilateral investment treaty between Georgia and Turkey),[30] it obviously cannot be justified by the requirements of internal legislation.[31] In other words, restriction of the company's right to export electricity by the state after it has already granted this privilege cannot be legally permissible.

STATE CONTROL OF TRANSMISSION NETWORKS AND FINANCIAL LIABILITY FOR RESTRICTIONS OF THE RIGHT TO EXPORT

In its response to the assessment by the Social Justice Center, the Ministry of Economy also stated that as the electric transmission system is managed entirely by a state company (Georgian State Electrosystem), „the country's electrosystem is under full strategic control and first and foremost provides for the internal demand and needs". The fact that the electric grid is under state control does not refute in any meaningful way the argument that granting the company a right to export electricity is problematic. The point of the matter here is neither the future actions by the state nor whether it will simply refuse to pass the generated electricity through its grid, but the rights the state has granted to the company with the agreement.

> The company has full rights to export the electricity generated by the Namakhvani HPP in the non-PPA period and restricting this right will engender, including through international mechanisms, government responsibilities (this can also include financial responsibilities).

The grounds for financial responsibility can be formed by general regulations set by the agreement, based on which violations of its obligations by the state (restricting the company's right to export electricity will be considered such a violation) gives the company a right to demand compensations, including reimbursements for damages and lost profits. Further, the agreement contains statements that directly address the issue of the right to export.

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30 See "Agreement Between the Government of the Republic of Turkey and the Government of Georgia Concerning the Reciprocal Promotion and Protection of Investments". Link: https://bit.ly/3uWJ3sA

31 According to a fundamental principle of international law, a party of an international treaty A party may not invoke the provisions of its internal law as justification for its failure to perform a treaty. See Vienna Convention on the Law of Treaties, article 27. Link: https://bit.ly/2RsyLmD; and Responsibility of States for Internationally Wrongful Acts, article 3; 22. Link: : https://bit.ly/3puvtMd.

The Namakhvani HPP agreement regulates the construction of transmission networks required for the plant by GSE. Further, GSE is obligated to ensure proper functioning of the transition system and avoid interruptions in distribution of electricity generated by the Namakhvani HPP. Failure to meet this obligation will be considered a "Transmission System Event", which forms the grounds for GSE's, and, ultimately, the state's responsibility.[32] Two additional terms related to the export of electricity are of interest here: a) according to the agreement, transmission system also comprises of the infrastructure responsible for exporting electricity, including lines connecting the Georgian electric grid to Turkey. Consequently, as the Transmission System Event is defined as any interruption or restriction that results in changes in project operations, this term can clearly encompass restrictions on company's export rights that would engender state financial responsibility; b) further proof for this can be found in clause 3.2.12 of the agreement, which introduces additional regulations for Transmission System Events. Subclause b of this clause is titled Transmission System Event. Along with setting obligations for a proper functioning of the transmission system and for the company's unrestricted access to the electric grid, the subclause includes the following statement : "[The Georgian government shall] use its best endeavours to ensure that by 1 January 2022 the transmission capacity to Turkey is increase to 1400 MW". What makes this statement especially problematic in terms of the state's financial liability?

In its response, the Ministry of Economy argued that the pledge to increase the transmission capacity to 1400 MW is not a strict obligation. Indeed, the formulation "use one's best endeavours" signifies the so-called "soft" obligation in common practice. However, systemic analysis of the Namakhvani HPP reveals that it could still lead to state financial responsibility. The reason for this lays in the fact that contrary to all legal logic this "soft" obligation appears in the Transmission System Event subclause. All other conditions set in this subclause are, without any doubt, firm commitments on part of the state. Moreover, violating the obligations stated in this subclause triggers the obligation to compensate the company. Transmission Network Event is found in section 3.2, "Obligations of the GOG", and, therefore forms a basis for financial responsibility for GSE and the Georgian Government.

32 In case GSE fails to reimburse the company for damages, compensating the company becomes the state's responsibility.

EXPORT OF ELECTRICITY AND AUCTIONING

In its response the Ministry of Economy points out that the company is not guaranteed access to export lines and has to participate in an auction to obtain it. Regarding this matter, the 3.2.12.b.i. section of the agreement states that based on the GSE Connection Agreement the company has unrestricted right to utilize necessary capacity on the transmission system at all times. As discussed above, the transmission system includes lines connecting the Georgian power grid to neighboring countries (see clause 1.1, "Definitions"). Therefore, whether or not the company is entitled to access to the export lines can at the very least become a matter of legal dispute between the company and the state, as the text of the agreement clearly allows for an interpretation that would favor the company. It is worth noting that the state has unequivocally granted the company the right to export electricity and the requirement for an auction in itself obviously does not necessarily mean that the state will restrict this right (in case it wins the auction, the company will still be able to export electricity). The legal and financial consequences of restricting this right have already been discussed above.

CONCLUSION

These considerations make clear that the company has full rights to export electricity generated by the Namakhvani HPP in the non-PPA period based on the terms of the agreement. As this right has already been granted to the company by the agreement, it is not legally permissible for the state to break this pledge and restrict the company's ability to export. Such an action would likely lead to the state's financial responsibility.

The Namakhvani HPP Cascade agreement provides the company with numerous guarantees, concessions, risk protection, transfers of land, water and other natural resources. It would have been only logical and justified for the state to require the company to keep the generated electricity inside Georgia in the non-PPA period in return. Had this demand been present in the agreement, we could have argued that the state's incentive for granting the concessions was indeed bolstering Georgia's energy independence. In its absence the pompous statements regarding energy independence and energy security appear as arguments formulated in response to the growing protests against the project, not reflective of the chief concerns of the government at the time when the agreement was being drafted.