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# Hydropower Investment Promotion Project (HIPP)

## GEORGIA

### HYDROPOWER INVESTMENT ENABLING LEGISLATION

#### Executive Summary

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# **GEORGIA**

## **HYDROPOWER INVESTMENT ENABLING LEGISLATION EXECUTIVE SUMMARY**

USAID HYDROPOWER INVESTMENT PROMOTION PROJECT  
(HIPP)

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IN COLLABORATION WITH BLACK & VEATCH AND

PIERCE ATWOOD LLP

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### **DISCLAIMER:**

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# 1. EXECUTIVE SUMMARY

## 1.1.1.1 INTRODUCTION

One of the principal objectives of Georgia’s energy policy is to attract investments into the country’s hydropower sector. In order to achieve this goal the Government of Georgia (“GoG”) has developed a scheme called the State Program for Renewable Energy of 2008 (the “RE Program”) for small and medium-sized plants and has initiated competitive tender procedures for large hydropower plants (“HPPs”) of 100 MW or more. All new greenfield sites for HPPs are awarded to investors on a Build-Own-Operate (“BOO”) basis.

This document describes GoG policy and the legislative framework for hydropower development in Georgia, as well as summarizing all of the steps a potential investor is required to take to secure an HPP site, beginning with the expression of interest and concluding with the commencement of commercial operations. The Report upon which this Executive Summary is based can be accessed on the Ministry of Energy’s web-site ([www.minenergy.gov.ge](http://www.minenergy.gov.ge)).

## 1.2 GOVERNMENT SUPPORT

Because Georgia is rich in hydro power resources, one of the nation’s long-term goals is to use those resources to satisfy its electricity demand. The GoG’s specific efforts to realize this objective include:

- Establishing a BOO scheme to attract investment in HPPs and promoting competition among potential investors;
- simplifying licensing procedures and eliminating red tape;
- gradually deregulating the sector;
- establishing tariff policies that protect consumers from monopoly prices while ensuring the sustainability of long term financial and technical development;
- ensuring third party access to the transmission and distribution networks and gradually reducing the threshold for third party access to the grid (expressed in volume of annual consumption);<sup>1</sup>
- improving technical capabilities with the aim of increasing energy trading with neighboring countries; and
- developing an energy transportation infrastructure that will ensure interconnection between Europe-Asia, East West and North-South and the diversification of electricity sources.

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<sup>1</sup> Over 20 years, the threshold for eligibility will be gradually reduced from 30 Million kW/h to 1 Million kW/h of annual consumption in 2016, ultimately reaching symbolic 1 kW/h by 2017.

These goals and objectives are reflected in a series of laws and regulations specifically related to hydropower investment projects (“HIPs”). With respect to HPPs under 100 MW, the GoG’s energy policy is spelled out in the RE Program under which the Ministry of Energy of Georgia (“MoE”) approves a list of potential sites that may be the subject of expressions of interest by potential investors. The MoE has established specific procedures and four model documents for use in the RE Program. Those documents are: (1) an Application Form; (2) a Bank Guarantee; (3) a Memorandum of Understanding (“MOU”); and (4) a Guaranteed Power Purchase Agreement (“PPA”).

For HPPs of 100 MW and over, the BOO structure is the same but the process is less standardized. For some large projects, the MoE has actively promoted projects by funding pre-feasibility and, on occasion, feasibility studies, as well as environmental and social impact assessments, prior to tendering the sites. Others have older data associated with them. Each HPP of 100 MW or more for which a Notice inviting Expressions of Interest (“EOI”) has been posted on the MoE’s website has been preceded by an Order from the MoE stipulating specific Terms and Conditions for that particular tender.

### **1.3 THE SELECTION PROCESS**

The RE Program selection process is an ongoing process, rather than a one-time auction of any one or more of the greenfield sites. The MoE posts on its website<sup>2</sup> a regularly updated list of potential sites and makes available general studies and technical parameters for each posted site. Any interested party may submit a Hydropower Plant Construction Application Form (“Application”) expressing interest in up to seven HPP sites. Until an Application is received with respect to a specific HPP site, there is no deadline for receipt of the Applications and potential investors are invited to submit an Application to the MoE at any time. Once an Application for an HPP site is received, however, the MoE posts a notice on its website within two working days and announces a 30-day deadline for submission of expressions of interest (“EOI”) by other potential investors.

The Application requires the identity (including the location and description) of the site(s), the estimated dates for commencement and completion of construction, the estimated commercial operations date (“COD”) and the applicant’s agreement to be bound by the terms of the MoU. In addition, an incorporated entity must include a notarized copy of the company’s charter, a certificate of incorporation, the resolution appointing the executive body, a power of attorney and financial statements with auditors’ reports. For individuals, a copy of the individual’s passport or other form of identification is required.

Large HPPs of 100 MW or more are tendered through announcements on the MoE’s website inviting EOIs by a date certain. The notice incorporates Terms and

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<sup>2</sup> ([www.minenergy.gov.ge](http://www.minenergy.gov.ge)).

Conditions that have been approved by an order issued by the MoE specific to the particular HPP site being tendered. Those Terms and Conditions set forth the investor's rights and obligations, including the amounts of the guarantees required to be posted.

If more than one application is filed with the MoE in respect of a given site, the MoE gives preference to the potential investor that:

- proposes the shortest period for construction and the achievement of commercial operations; and
- submits the largest bank guarantee for each MW of the plant capacity.

The two criteria described above are equally weighted for both large HPPs and those falling under the RE Program. If the GoG decides that two or more applications are equivalent in ranking, the MoE can notify the applicants and ask them to improve and re-submit their proposal within 10 working days.

Applicants may also select sites not currently on the list that are identified by potential developers themselves and bring them to the MoE's attention, at which point the MoE will perform a technical analysis of the site and, if it meets the MoE's criteria, add the site to the list and the selection process proceeds as detailed above.

## **1.4 BANK GUARANTEE**

Following the decision selecting the successful bidder under the RE Program, the MoE notifies the winner, who must provide a bank guarantee within five (5) working days to ensure timely construction and commercial operation of the HPP. The bank guarantee may be from any bank in Georgia or abroad licensed by OECD<sup>3</sup> and must be in the amount of USD 170,000 or EUR 120,000 for each megawatt of installed capacity. For HPPs of under 100 MW, the bank guarantee requirement amounts to approximately ten per cent (10%) of the total project cost and originally was intended to stay in place until two months following the start of commercial operations. Following an amendment to the RE Program issued 27 July 2010 by Resolution #205, the GoG can agree to reduce the bank guarantee at the time construction begins.

For large HPPs of 100 MW or more, the bank guarantee is not established by law and is subject to negotiation. In at least two cases, a one million USD bank guarantee was required not later than 30 calendar days following execution of the MOU, followed by a five million USD bank guarantee not later than 30 days after issuance of the construction permit.<sup>4</sup> The five million USD bank guarantee amounts to approximately one per cent (1%) of the total project cost of a 100 MW HPP. The MoE has also agreed to a performance bond of one per cent of the Engineering,

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<sup>3</sup> The amount of the guarantee should not exceed 15% of bank's charter capital.

<sup>4</sup> Adjaristkali Cascade (115.4 MW) and Tekhuri Cascade (105.7 MW)

Procurement and Construction costs,<sup>5</sup> and to a bid guarantee of USD 5 million, followed by a pre-construction guarantee of USD 5 million.<sup>6</sup>

## **1.5 PRE-QUALIFICATION CRITERIA**

There are no pre-qualification criteria for bidders under the RE Program but the MoE has required bidders to meet pre-qualification criteria for at least one large HPP project and may do so again on a case-by-case basis, depending on the size or complexity of the project. In the case of the Upper Mtkvari Cascade, the pre-qualification criteria for potential investors were: (1) average annual turnover for the prior five years had to exceed USD 300 million; and (2) paid-in capital had to amount to no less than USD 100 million.

## **1.6 MEMORANDUM OF UNDERSTANDING**

In the notification to the winning bidder, the MoE sets a date for the signing of the MoU, which shall not be later than three months from the date when the winning bidder was chosen. The MoE drafts the MoU and submits it to the GoG for its approval and execution. The MoU binds the investor on the following matters:

- the site location;
- the plant's installed capacity;
- the investment amount and recovery period;
- timeframes within which to obtain a construction permit, to complete construction and commence commercial operations; and
- the plant's annual generation capacity.

Under the RE Program, a standard form MoU is executed by the potential Investor, the GoG and the Electricity System Commercial Operator ("ESCO").<sup>7</sup> The MOU with investors in large HPPs is subject to negotiation and may be superseded entirely by an Implementation Agreement which details the investor's rights and obligations with regard to technical and economic feasibility studies, social and environmental impact assessments, financing, construction, testing, commissioning, ownership, operation and maintenance.<sup>8</sup> In both cases, the MoE, acting on behalf of the GoG, is bound by the MoU or Implementation Agreement to assist the potential investor to obtain documents and information required to carry out the project and in acquiring relevant permits, licenses and the land plot (if required).

For the first ten years of commercial operations, the investor is required to sell the plant's output during three winter months for consumption within Georgia, either

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<sup>5</sup> Namakhvani Cascade (450 MW)

<sup>6</sup> Upper Mtkvari Cascade (137 MW – 219 MW)

<sup>7</sup> As of the date of this Executive Summary, the standard MOU was undergoing revision, based on comments received from potential investors. However, the primary obligations of the investor will remain the same.

<sup>8</sup> Upper Mtkvari Cascade and Adjaristkali Cascade

pursuant to a PPA with the ESCO<sup>9</sup> or to another off-taker. The price under the PPA with ESCO is a tariff determined by applicable law and may not exceed 4.8 US cents per kWh. Alternatively, the potential investor may, at its discretion, elect to sell its electricity production to any buyer in Georgia under a deregulated price during the three winter months. Whichever approach is selected, the investor may either export or sell its electricity domestically during all other months of the year.

By signing the MoU, the investor agrees to:

- comply with all technical, economic, financial, legal and other terms related to the plant (provided in the annex of the MoU);
- carry out a feasibility study (technical, economic, commercial, legal) and submit the corresponding report to the GoG;
- secure the total investment amount required for implementation of the investment project;
- implement the project within the established timeframe;
- submit quarterly progress reports to the GoG; and
- restrict electricity exports during the three winter months identified by the MoE.

The investor is responsible for all costs associated with the HIP. In the event that the investor breaches any condition of the MoU, the MoE may elect either to call the investor's bank guarantee<sup>10</sup> or to terminate the MoU. Upon termination, if the land plot transferred to the investor had previously been State property or in the possession of a local self-governing body, the plot shall be returned without compensation. As a final consequence of the breach, the investor shall cease to have the right to complete the project. The MoU is governed by Georgian law and any dispute is subject to the jurisdiction of Georgian courts.

In response to comments received from potential investors, the MoE is revising the model MOU. This new MOU may significantly clarify the rights and obligations of investors and the GoG.

## **1.7 CONSTRUCTION PERMIT**

The laws relating to construction permits for HPPs are currently in flux. The Law on Construction Permits was abolished on April 8, 2010 and replaced by a new Law on Control of Technical Hazards. The Architectural and Technical Supervision Inspectorate, which previously issued construction permits, was also abolished in favor of a new Technical and Construction Inspectorate. Under the old law, HPPs of 2 MW or more required a construction permit by virtue of being defined as "objects of special importance." Objects of special importance were, in turn, classified as

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<sup>9</sup> The standard form guaranteed PPA is attached to the MoU.

<sup>10</sup> The Bank Guarantee will not be called if the investor's failure to perform is determined to have been caused by *force majeure* or unlawful actions by the GoG or any State body.

“objects of increased hazard,” which required a construction permit. Under the new Law on Control of Technical Hazards, “objects of special importance” are still classified as “objects of increased hazard” but under the transitional provisions of the new law, the GoG is required to issue a resolution defining the objects that will qualify as “objects of special importance.” That GoG resolution was still pending as of the writing of this Executive Summary but it is anticipated that HPPs over 2 MW will again be included in the definition of “objects of special importance.” The procedures for obtaining a construction license from the new Technical and Construction Inspectorate are also as yet undefined because the Technical and Construction Inspectorate has not yet adopted bylaws and supplementary normative acts. All subsidiary legislation that derives from the primary legislation requires amendment in order to comply with the new law. As a result, changes to the existing permitting regime are expected in the near term.

Prior to adoption of the new law on Control of Technical Hazard, the grant of an environmental impact permit was included in the process of obtaining a construction permit. As of the date of this Executive Summary, the environmental impact permitting system had not changed.

## **1.8 ENVIRONMENTAL IMPACT PERMIT**

Various pieces of primary and secondary legislation form the legal framework governing environmental protection. The primary legislation is the Law on Environmental Impact Permits. This law establishes:

- a comprehensive list of activities that are subject to mandatory expert review;
- a list of documents that are required to obtain an Environmental Impact Permit (“EI Permit”);
- procedures for the issuance of an EI permit;
- the conduct of an environmental impact assessment; and
- rules on public participation and public hearings.

Under this law, an EI Permit is required in order to construct an HPP greater than 2 MW. Issuance of the EI Permit is subject to an “ecological examination” by the Ministry of Environmental Protection and Natural Resources (“MEPNR”), the preparation of an environmental impact assessment (“EIA”) by the applicant, and public hearings on the EIA with the results of the incorporated in a hearing protocol. If the investor proposes to use hydropower technology that differs from standard technology currently in use, the proposed project will require an ecological examination of the project regardless of the size of HPP capacity (i.e. even if it is below 2 MW).

Because the law on the Control of Technical Hazard requires a construction permit for the construction of an HPP greater than 2 MW, the Law on Licenses and Permits requires the agency issuing the construction permit to act as a “one-stop shop” and involve any other agencies responsible for issuing permits to participate in the issuance of the construction permit. Thus, the HPP developer should submit all of

the documentation required under the Law on Environmental Impact Permits to the Technical and Construction Inspectorate. Upon conclusion of the hearing on the EIA Report and the “ecological examination,” the MENR provides the “ecological examination” report to the Technical and Construction Inspectorate in the form of an administrative legal act and the EI Permit comprises an integral part of the construction permit.

## **1.9 LAND AND LAND USE RIGHTS**

An applicant for a construction permit will be required to demonstrate that it has legal possession or ownership of the land where the generating facility will be sited.<sup>11</sup> Depending on whether the land is held by the state or a private person, land use rights will be granted either by a public entity by way of privatization or from a private entity through a simple purchase. Under the Civil Code of Georgia, various types of land use rights may be involved, ranging from the right to construct and the transfer of rights under a long-term lease, to the transfer of full ownership rights.<sup>12</sup>

If an HIP involves state-owned land, the GoG may, under the RE Program, assign a land plot for a nominal charge, provided that the use of the land is for HPP purposes only. However, such an assignment must comply with Georgian law, legal restrictions on the state’s right to transfer certain types of property and finally, the legal qualifications of the transferee. Generally speaking, state-owned property may be privatized unless it involves property of strategic importance.<sup>13</sup>

Georgian law distinguishes between agricultural and non-agricultural land, and places some limitations on land ownership and use. For example, only a Georgian person (including an individual, a family unit or Georgia-registered legal entity) may own agricultural land.<sup>14</sup> In addition, Georgian law prohibits the use of agricultural land for non-agricultural purposes. However, an investor may apply to change the functional designation of agricultural land to non-agricultural land. Upon registration of such a change, ownership restrictions are removed. There are no legal restrictions placed on the use of non-agricultural land.

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<sup>11</sup> This requirement was included in the Law on Construction Permit (which, as noted above, was abolished on April 8, 2010) but appears in the subsidiary legislation on issuance of a construction permit. Although amendments to this subsidiary legislation are anticipated, it is not expected that the changes will affect this requirement.

<sup>12</sup> The different types of land usage rights are: lease, tenancy, servitude, and usufruct.

<sup>13</sup> These include water resources, the state forest fund, the reservation, national parks, natural monuments, habitat/species management areas.

<sup>14</sup> Rights of foreign natural or legal persons to own agricultural land in Georgia are restricted. Foreign citizens are legally entitled to own agricultural land to which they have succeeded, or if such land was under their lawful possession during the time they were Georgian citizens. Foreign entities can also own agricultural land by way of succession. With respect to the acquisition of agricultural land in any other manner, foreign owners are required to transfer such land plots to Georgian citizens, households (families) of Georgia or Georgia-registered legal persons within six months of acquiring the title to such land. Failure to comply with this requirement may result in expropriation pursuant to a court decision and subject to the payment of adequate compensation.

### 1.9.1 STATUTORILY PROTECTED LAND

Certain types of land are legally protected or subjected to various use restrictions on the basis of cultural, cultural or environmental criteria.<sup>15</sup> Depending on the type of statutory protection involved and the significance of a project, numerous state authorities may be involved in the decision of whether a given clearance should be granted.<sup>16</sup> A potential investor should ascertain whether land required for an HPP development is subject to any of these protections.

### 1.9.2 PRIVATIZATION

Privatization of land may be carried out either by way of an auction or a direct sale. In the majority of cases, when the MoE signs an MOU with a potential investor, state-owned land is transferred by way of a direct sale for a nominal price and auction of state-owned land for HPPs is not the norm.

In the event of an auction, the right of ownership is transferred to the highest bidder. Sometimes an auction will be subject to certain conditions over and above mere price terms. Auctions for state-owned properties are held by and decisions are taken by the Ministry of Economic Development of Georgia. Where a property is owned by a unit of local self-government, it will make the relevant decision.

If a direct sale is involved, priority will be given to the purchaser the seller believes will fully and in good faith comply with the sales terms. If a direct sale is conducted on the basis of a competitive selection, title will pass to the person who satisfies the sales terms on the basis of a competitive selection. Only the President of Georgia may make a decision on or attach conditions to the direct sale of a parcel of property owned by the state (including a local self-government unit).

### 1.9.3 EMINENT DOMAIN

The constitution of Georgia protects the right of a natural person or a legal entity to own, acquire, transfer and inherit property. If negotiations to acquire property from a private party fail, an extreme alternative may be for the potential investor to apply to acquire the property through expropriation by way of an eminent domain proceeding.<sup>17</sup> It should be noted however, that Georgia has only rarely employed eminent domain proceedings and in those circumstances, only for projects characterized as being of extremely high state importance.<sup>18</sup> Under the Law on Rules of Expropriation of Ownership for Urgent Public Necessity, the grounds of public necessity include:

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<sup>15</sup> This includes water resources, resort areas, state forest fund, cultural heritage and religious monuments, mineral resources and protected territories.

<sup>16</sup> For example, legislation permits privatization of livestock trails, the first level of sanitary protection zones of water-supply objects, forest fund land and recreational land strictly for the purposes of projects of high significance. In each of these circumstances the Gog makes a specific decision on the privatization. Under the Law of Georgia on *State Promotion of Investments*, an investment to construct an HPP is characterized as an *investment of special importance*. This implies that such a project would fall under the definition of a project of *high significance*.

<sup>17</sup> Envisaged by the Constitution and further detailed in the Law of Georgia on the *Rules of Expropriation of Ownership for Urgent Public Necessity*.

<sup>18</sup> The only case on the record deals with the BP Oil Pipeline.

- to extract mineral resources;
- to build roads, highways, railway lines;
- to build oil and gas pipelines, electricity transmission and distribution lines, water supplies, effluent disposal and atmospheric precipitates collection lines;
- to build telephone lines, telecast cables;
- to build other buildings; and
- for the purpose of national security.

State authorities and the courts will determine whether a particular project is a proper subject for a proceeding in eminent domain. By law, the right to expropriate comes by way of a Presidential decree and a respective court decision. The burden of proving “public necessity” lies with the applicant. A land owner that is subject to an eminent domain decree is entitled to receive adequate compensation.<sup>19</sup> In the event that the value of the property cannot be determined, the matter will be resolved by a Georgian court of competent jurisdiction.

## **1.10 WATER AND WATER USE RIGHTS**

Georgia’s water resources are comprised of rivers, lakes, natural and artificial reservoirs, canals, ponds, underground water, glaciers and wetlands. Jurisdiction to protect, manage, control and monitor water resources lies with the MEPNR. Until continuing reforms produce new legislation, the water sector will be governed principally by the Water Law of 1997.

Currently, the water law categorizes the following types of water:

- Category 1: water of special state importance (including mountain tops and land permanently covered by snow; surface waters that are of significant scientific and aesthetic importance);
- Category 2: water of state importance (including wetlands, surface water areas that are located on more than one administrative-territorial unit, trans-border water areas, territorial waters, waters of within a special economic zone, significant amounts of ground waters); and
- Category 3: water of local importance (including all water objects not defined under categories 1 and 2).

Category 1 water is subject to full or partial restriction on water use. Its limited uses do not include hydropower development. Restrictions related to Category 2 water are linked to various environmental and safety criteria and are therefore subject to MEPNR’s regulations as well as the requirements of territorial units, authorities of autonomous republics or bodies of local self-government.

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<sup>19</sup> The law defines adequate compensation as being the real market price of the property.

The MEPNR has established a list of bodies of water that fall into Category 1 and 2. Most of the nation's rivers (56) and nine water reservoirs fall into Category 2. A list of ground waters that fall into Category 1 or 2 has been adopted under a joint order of the Geology Department and the MEPNR.

### 1.10.1 WATER ABSTRACTION AND DISCHARGE

No licensing or permitting is required for water abstraction or discharge in connection with electricity generation.<sup>20</sup>

### 1.10.2 FEES FOR WATER USE

The right to use water is subject to the payment of a small fee, based on a formula, which differs by the category of water source:

<u>Types and Groups of Water Resources</u>	<u>Fee for 1m<sup>3</sup></u>
	LARI
Group I: (Caspian Basin Rivers, Lakes and other Water Reservoirs)	0.01
Group II: (Black Sea Basin Rivers, Lakes and other Water Reservoirs)	0.005
Group III: (Black Sea water)	0.003

Fees are paid to the state budget on monthly basis, on or before the 15th day of the month following the usage. Collections are administered by the Georgian Tax Authorities (except for the fees paid prior to acquiring a license or permit for which MEPNR is responsible). Violations are punishable under the Georgian Tax Code.

### 1.10.3 REGIONAL IRRIGATION COMPANIES

The Ministry of Economic Development of Georgia has established four state-controlled regional irrigation companies:

- (i) Alazani M: operating in the Kakheti Region;
- (ii) Sioni M: operating in the KvemoKartli Region;
- (iii) Mtkvari M, LLC: operating in the ShidaKartli; and
- (iv) Kolkheti M, LLC: operating in Western Georgia.

The GoG has allocated charter capital to each of these companies. Another newly-established company, Hydrogeology LLC, is tasked with providing hydro-geological services and rehabilitating systems throughout the country.

Irrigation companies are required to provide rehabilitation services to the associations and individual users and to collect fees for the rendering of such services. HPPs that require water from the irrigation systems will be required to enter into direct contracts with the relevant irrigation company and to pay the

<sup>20</sup> Although the initial version of the Law on Licenses and Permits included a permitting system for surface water abstractions and discharges, it was removed from subsequent versions.

relevant service fee. This fee, subject to negotiation, may be as high as ten per cent (10%) of the revenues collected from the sale of electricity.

## 1.11 GENERATING ELECTRICITY

An HPP with a capacity greater than 13 MW is required to obtain a generation license prior to commencing electricity generation activities. At the same time, the Law of Georgia on Electricity and Natural Gas (“the Electricity Law”) envisages full or partial deregulation. For generators, deregulation means the right to sell electricity in the absence of a tariff or the right to operate under a marginal tariff.<sup>21</sup> For a “small capacity power plant”,<sup>22</sup> full deregulation means the right to operate subject to a marginal tariff, but license-free. A small capacity power plant may only sell electricity to a “qualified enterprise”<sup>23</sup> or a “retail consumer”.<sup>24</sup>

A generation license authorizes the license holder to generate electricity and subject to agreement with the transmission or distribution licensee, to connect to the transmission or distribution network. A generation license is issued for an indefinite term. The timeframe for issuance of a license following the filing of an application is 30 calendar days.

In order to obtain a generation license, an applicant submits a standard application form to the Georgian National Energy and Water Regulatory Commission (“GNEWRC”), together with the following documents:

- a document certifying possession (usage of generation assets);
- a report on compliance of the technical condition of the generation assets with the applicable standards;<sup>25</sup>
- a list of fixed assets and audit report on the enterprise;
- an environmental impact assessment report;
- a technical condition for connection to the power grid;<sup>26</sup>
- a scheme of the power grid relevant to the license application.

The holder of a generation license is required to make its generation facilities available to the dispatch licensee, to provide continuous services,<sup>27</sup> and to comply with applicable laws and regulations including the Market Rules. In addition, a

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<sup>21</sup> The term “marginal tariff” means a tariff with an upper limit.

<sup>22</sup> Defined by the Electricity Law as a plant with the design capacity of less than 13 MW.

<sup>23</sup> A *qualified enterprise* is an entity authorized under the Market Rules to participate in the wholesale trade (sale) of electricity. The definition covers generation and distribution licensees, direct customers, importers, exporters, ESCO, small capacity PPs who are authorized to engage in wholesale trading under Market Rules.

<sup>24</sup> A *retail consumer* is defined as any person, other than a direct consumer that receives electricity (capacity) from a generation, transmission or distribution licensee for its own consumption and not for re-sale.

<sup>25</sup> This document is issued by the Technical and Construction Inspection.

<sup>26</sup> This document is issued by the transmission or distribution licensee, depending on the connection point.

<sup>27</sup> Except where licensee’s counterparty defaults on a payment obligation or for technical or safety reasons.

generation licensee must conduct its activities in an economically efficient manner, fully meter electricity flowing through its facilities and minimize costs. Other obligations include making public information related to the licensee's past and future activities and the payment of regulatory fees determined by GNEWRC annually.<sup>28</sup> GNEWRC is entitled to issue preliminary license which guarantees the rights to be conferred by the generation license with the condition of subsequent observance of the license terms.<sup>29</sup>

## 1.12 SELLING ELECTRICITY

Trading in electricity and capacity from generation plants connected to the Georgian power grid and imported in to Georgia is carried out by way either of a direct contract between the parties or by the ESCO.<sup>30</sup> The Market Rules issued by the MoE require parties to direct contracts to register their contracts with the dispatch licensee.<sup>31</sup>

ESCO is a party to the MoU and the Guaranteed PPA pursuant to which, for three winter months during first ten years of operation newly constructed HPP must sell and ESCO must purchase the investor's electricity under a tariff approved by GNEWRC.<sup>32</sup> During those three winter months, a generation licensee may also sell electricity to the local market through a direct contract under a deregulated tariff, but may not export power. Beyond the three winter months, newly constructed HPPs are free to contract and sell electricity to under a free tariff either locally or by way of export.

Electricity export is carried out on the basis of a direct contract and, for a new HPP project, is subject neither to licensure nor to tariff regulation. An exporter must register its contracts with the dispatch licensee which may, for system security, hold in reserve a certain amount of the transmission line capacity. The dispatch licensee allocates capacity on the basis of the Market Rules.

All market participants are required by contract to provide system capacity of reserve which is used by the dispatch licensee to balance electricity supply and consumption. In order to ensure reliable operation of the power grid and to balance supply and consumption, ESCO tops up reserves that have not been covered by qualified enterprises. Those costs associated with the top-up are covered by such qualified enterprises.

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<sup>28</sup> The fee for issuing generation license by GNEWRC is 200 GEL. Fee is also paid for tariff setting services provided by GNEWRC.

<sup>29</sup> The guarantee of a preliminary license is covered by the law on investment promotion.

<sup>30</sup> ESCO is a state-owned enterprise organized as a limited liability company. Its activities are licensed by GNEWRC and governed principally by the Market Rules.

<sup>31</sup> Market Rules is a sub-legislative normative act adopted by the MoE and governing operations and relations of the market participants.

<sup>32</sup> Pursuant to the electricity law, GNEWRC sets tariffs in accordance with the national energy policy and the regulator's tariff methodology and rules. GNEWRC's tariff methodology, based on the principle of full cost recovery for generation and supply, comprises detailed procedural rules as well as a formula for the development of a tariff.

Electricity sales are taxed at Zero Rated VAT and no VAT applies to export of electricity.

**USAID Hydropower Investment Promotion Project (USAID-HIPP)**

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