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**Hydropower Investment
Promotion Project (HIPP)**

REPORT ON TRANSMISSION AND DISPATCH AGREEMENT RELATING TO THE KHUDONI HYDROPOWER PLANT

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REPORT ON TRANSMISSION AND DISPATCH AGREEMENT RELATING TO THE KHUDONI HYDROPOWER PLANT

USAID HYDROPOWER INVESTMENT PROMOTION PROJECT
(HIPP)

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The author's views expressed in this publication do not necessarily reflect the views of the United States Agency for International Development or the United States Government.

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1.0 ACRONYMS

B-A Line	Borcka-Akhaltsikhe Interconnection Line
CBETA	Cross-Border Electricity Trade Agreement
ET	Energotrans LLC
GoG	Georgian Government
GSE	Georgian State Electrosystem JSC
IOA	Interconnection Operation Agreement (IOA) and
PC	Project Company
SP	Service Provider
TDA	Transmission and Dispatch Agreement
TEIAS	Turkish Electricity Transmission Corporation
UNCITRAL	United Nations Commission on International Trade Law

2.0 INTRODUCTION

This is the recently signed “EXPORT POWER TRANSMISSION AND DISPATCH AGREEMENT relating to the transmission and dispatch of electricity generated by the Khudoni hydroelectric power plant via the Georgian power transmission network,” (TDA) between

TRANS ELECTRICA (G.E) LIMITED as Project Company (or PC)

GEORGIAN STATE ELECTROSYSTEM JSC as Dispatch Licensee (GSE)

And

ENERGOTRANS LLC (ET)

GEORGIAN STATE ELECTROSYSTEM JSC

GEORGIAN RUSSIAN ENERGO COMPANY JSC as Transmission Licensees.

The Dispatch Licensee and Transmission Licensees are Service Providers.

3.0 COMMENTS ON TDA

As a general comment, the Khudoni TDA is not easily understood and therefore the respective rights and obligations of the parties to it are not completely clear.

Further, transmission capacity rights for electricity to be transmitted to Turkey are covered in different agreements – the Implementation Agreement between the GoG and the Project Company, and the Interconnection Operation Agreement (IOA) and Cross-Border Electricity Trade Agreement (CBETA). This ad hoc approach risks creating mismatching rights and obligations. An analysis of the different approaches to and descriptions of obligations under these agreements needs to be performed.

The Agreement is based on a Take-or-Pay Principle under which (i) if a Service Provider fails to provide the Services, it will pay the Project Company’s Loss of Profit incurred, by paying Contractual Compensation, and (ii) if the PC utilizes less Services than the amount of Service Fees for the Services to be provided, it will pay the Contractual Compensation.

However, the Services are to be provided not only in accordance with the Agreement, but in accordance with the terms and conditions of any agreements between Service Providers and TEIAS. This creates uncertainty as to the scope of the Service Providers’ obligations, including the applicability of payment of Contractual Compensation.

The Take-or-Pay Principle is “mandatory, only to the extent that” the scheduled volume is “within the permitted ranges of interflows” of energy between the systems of Georgia and Turkey. The permitted ranges are determined by the existing or future agreements with TEIAS.

The volumes of energy to be exported to Turkey are described in numerous, slightly differently-worded sections, and so it is not possible to be sure as to exactly what quantities are covered by the Agreement.

The term “emergency situation” is used several times, yet is not defined. Yet the Service Providers are not liable to pay Contractual Compensation if the counterparty to an Export PPA refuses or is unable to accept electricity because of an “emergency situation” in Turkey’s energy system (also if Turkish customs authorities refuse to clear the electricity). The definition of Force Majeure also uses the term “system emergency,” such that if a Service Provider is prevented from performing capacity, transmission and dispatch services for this reason, it is absolved from liability. No Party is obligated to pay Service Fees or Contractual Compensation if Turkey has an “emergency situation” confirmed by GSE, which makes the transfer of energy to Turkey's network impossible.

Either party may request a bank guarantee only after non-payment, and only to cover future payments.

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4.0 ANALYSIS

It is understood that the Agreement was signed on 20 April, 2012 (the copy reviewed does not contain signatures). The Agreement is for a **Term** of 20 years (assuming the Agreement is registered by GSE as stated in Article 19). It documents the parties’ obligations relating to:

- (i) the provision of **Services** or the payment of **Contractual Compensation** by the SPs to the PC in accordance with the **Take-or-Pay Principle**; and
- (ii) payment of the **Service Fee** and/or **Contractual Compensation** by the Project Company to the Service Providers in accordance with the **Take-or-Pay Principle**.

The **Services** are to be provided not only in accordance with the Agreement, but “in accordance with the terms and conditions set out in any agreement existing and/or to be entered into between the relevant Service Providers and TEIAS.” This creates uncertainty as to the scope of the Service Providers’ obligations, including the applicability of payment of Contractual Compensation. This could work as a useful “out” for GSE if the IOA that is presently being negotiated with TEIAS and future agreements do not give GSE guaranteed capacity rights. See also below in relation to Article 12.6.

Services are:

- (i) in respect of the **Transmission Licensees**
 - reservation of sufficient capacity on ET’s portion of the Power Transmission Network (PTN, being the transmission lines and substations including the Akhaltsikhe substation) for the Project Company to export the relevant portion of the Annual Volume (which is the amount of electricity the PC intends to generate and deliver each year to export to Turkey through the PTN);
 - the transmission of these quantities for export to Turkey via the PTN; and
- (ii) in respect of the **Dispatch Licensee**, the dispatch of such quantities for export to Turkey,

in each case, in accordance with applicable Laws.

Presumably, the description of “reservation” to the Akhaltsikhe substation is sufficient to provide the PC with reservation rights on the Borcka-Akhaltsikhe Interconnection Line (B-A Line).

“Laws” means all Georgian normative acts and all international treaties. Therefore, the SPs are bound by any restrictions or limitations on the Services contained in the CBETA.

The **Service Fee** is the applicable per kWh electricity transmission and dispatching tariffs.

Articles 12 and 13 cover quantities of electricity for transmission and quantities to be accepted by the SPs, and contain detailed provisions relating to the reductions and suspensions of transmission or dispatch.

Contractual Compensation is compensation to be paid as follows:

(i) if a Service Provider fails in any month to provide the “capacity, transmission and dispatch services”¹ it pays compensation to the Project Company equal to the full amount of the **Loss of Profit** incurred by the Project Company as a result, taking account of losses in the network. **Loss of Profit** is –

- the kWh sales price stated in the relevant Export PPA, which shall not be higher than the Maximum Sales Price, multiplied by the quantity not transmitted
- *minus* any income received through sales in the Georgia domestic market
- *minus* the amount of the relevant Service Fee
- *minus* quantities not generated during the relevant period as a result of the Project Company's Fault [not defined] or Force Majeure (at the Export PPA sales price, not to exceed the Maximum Sales Price),

in each case, taking into account transmission losses.

(ii) if the Project Company fails to export the required portion of the **Annual Volume** in any month, it pays to all relevant Service Providers an amount equal to the corresponding Service Fees payable for the portion of the **Annual Volume** to be transmitted.

Notably, **Force Majeure** (FM) is any event beyond a Parties' reasonable control, the occurrence of which could not have been reasonably foreseen at the Effective Date [not defined], and includes “system emergency in Turkey and/or Georgia and any other similar event.” Official confirmation of a FM occurrence by the Chamber of Commerce of Georgia must be provided. No breach occurs if FM prevents performance of an obligation, and the other Parties cannot claim Contractual Compensation. However, the Party claiming FM must use commercially reasonable efforts to continue to perform its obligations and minimize adverse effects. The key term “system emergency” is not defined, and it seems unlikely to be the term “System Emergency Situation” used to

¹ Note that the defined term **Services** is not used, meaning that, technically, the obligation to reserve sufficient capacity is not covered; this should have no effect, unless GSE were to maintain that it has no obligation to transmit electricity for which capacity is not reserved.

determine reductions and suspensions. This at least opens the possibility for a SP to argue that major faults or transmission system failures in Turkey or Georgia that prevent it from performing capacity, transmission and dispatch services absolve it from liability. Otherwise Force Majeure is limited to events of war, civil commotion, armed conflict, biological contamination, epidemic, plague, and weather-related events.

The **Take-or-Pay Principle** simply states that (i) if a Service Provider fails to provide the Services, it will pay the Loss of Profit incurred by paying the Contractual Compensation, and (ii) if the PC utilizes less Services than the amount of Service Fees for the Services to be provided, it will pay the Contractual Compensation.

However, **Article 12.6** states that the **Take-or-Pay Principle** is “mandatory, only to the extent that” the scheduled volume is “within the permitted ranges of interflows” of energy between the systems of Georgia and Turkey. The permitted ranges are determined by the existing or future agreements with TEIAS. Presumably, “permitted ranges” refers to the quantities in these agreements, and not to quantities technically able to be transferred or actually transferred between GSE and TEIAS.

Under **Article 15** the SPs are “not liable” if the counterparty to an Export PPA refuses or is unable to accept electricity because of an “emergency situation” (not defined) in Turkey’s energy system or if Turkish customs authorities refuse to clear the electricity. The PC is not relieved from payment of Service Fees.

No Party is obligated to pay Service Fees or Contractual Compensation if Turkey has an “emergency situation confirmed by GSE, which makes the transfer of energy to [Turkey's] network impossible.”

The **Maximum Sales Price** equals the average value of the 3 most expensive hour price values (the hourly price values (SMF – “Sistem marjinal fiyatı” / DGP) on PMUM’s official web page), fixed during each full day of the month in which Loss of Profit is calculated one year prior, determined by a formula.

Article 2.1(b) has implications for future GSE, Energotrans and Sakrusenergo agreements entered into with TEIAS, as it requires the Service Providers to provide the Services not only in accordance with the Agreement, but also in accordance with the terms and conditions in any existing agreement, and any future agreement, the SPs enter into with TEIAS. Article 12.2 also states explicitly that *electricity transmission* from Georgia to Turkey shall be carried out in accordance with such TEIAS agreements (and also in accordance with the Export PPA).

While the wording is not ideal, it could be argued that this clause lessens the strength of GSE’s obligations to the PC if the terms and conditions of the agreements with TEIAS are not as strong as those in the Agreement (eg. enable TEIAS to refuse to accept deliveries on the B-A Line).

5.0 SUMMARY OF REMAINING ARTICLES

Article 9 requires the Parties to cooperate in the planning and execution of scheduled outages (not defined).

Article 10 requires the Parties to comply with the Market Rules, which are defined to include any amendments made during the duration of the Agreement.

Article 11 entitles a SP or the PC to request a bank guarantee (not defined) only after non-payment of (in the case of the PC) the Service Fee or Contractual compensation, and (in the case of an SP) of the Contractual Compensation., and only to cover future payments. Of course, a bank may refuse to issue a guarantee if the relevant party is having payment difficulties.

Article 11.3 entitles a SP to suspend Services if the PC fails to pay and/or a guarantee is not issued or able to be drawn upon.

Article 12 has several provisions regarding volumes of electricity for *transmission* to Turkey. It states that:

- transmission to Turkey will be carried out in accordance with the Laws of Georgia and the relevant Export PPA (which the PC signs with an entity in Turkey);
- the volume of electricity to be exported is determined in accordance with the Export PPA;
- transmission is to be carried out pursuant to a 24 hour schedule developed on the basis of the monthly volumes in Schedules 1A and 1B (which we do not have). As mentioned, the **Take-or-Pay Principle** is “mandatory, only to the extent that” the scheduled volume is “within the permitted ranges of interflows” of energy between the systems of Georgia and Turkey;
- the scheduling procedure is to be carried out in accordance with the Market Rules;
- the determination of volumes to be transmitted and dispatched must “take into account” the **Annual Volume** (the amount of electricity the PC intends to generate and deliver each year to export to Turkey through the PTN) and losses.

Article 13.1 covers amounts to be *accepted* by each SP:

- the net electricity generated by the PC in accordance with the –
 - Agreement
 - Export PPA
 - **Annual Energy Balance** of Georgia approved under the Market Rules
 - terms and conditions in any agreement between the relevant SP and TEIAS, or to be entered into with TEIAS
 - Laws of Georgia.

Article 13 refers to the Annual Energy Balance, whereas **Article 12** refers to the Annual Volume. Without discussing with GSE, it is not clear how these amounts are reconciled, except that the PC, in submitting the Annual Volume it intends to generate and have transmitted to Turkey for each month, must take into account the Annual Energy Balance and the **Export Forecast Volume**. This is the forecast of gross and net electricity to be exported to Turkey each month (and is set out in Schedule 6). The PC submits the Export Forecast Volume at least 3 months prior to 1 September each year.

Increases in the Annual Volume are not accepted except where: the SPs do not have “opposite contractual or judicial obligations” for the increase; if there is insufficient

available transmission capacity “it is envisaged to invite auction/bid for such increased volume;” and the SPs are free of any obligations and liabilities with respect to reserving the capacity.

Reductions and Suspensions of electricity transmitted and/or dispatched may be as a result of factors affecting the parties:

- in the case of the SPs, System Emergency Situations [as defined in the Market Rules], Sub-System Emergency Situations, material damage to the PTN, lines and equipment, including in Turkey, and other required facilities, and SP Scheduled Maintenance;
- in the case of the PC, Sub-System Emergency Situations and material damage to the Facility or lines or equipment required to generate;

so long as the reduction or suspension in each case is for the purpose of repairing damage or remedying the emergency, and the period does not exceed specified periods of time – for the SPs, 12 hours in the case of system emergencies and 72 hours in the cases of sub-system emergencies, material damage and scheduled maintenance; for the PC, 12 hours in the case of Sub-System Emergency Situations and 48 hours in the case of material damage. Payment of Contractual Compensation by the SPs, and of Service Fees and **Contractual Compensation** by the PC, is required if the period of reduction or suspension is *longer* than these periods.

While these provisions appear to provide the SPs with some allowance for failing to deliver electricity because of conditions and faults occurring in relation to the PTN (eg. frequency and voltage fluctuations), the SPs are also subject (Article 13) to meeting an obligation to transmit to Turkey and dispatch the Annual Volume. Amounts transmitted in December, January and February will be in accordance with restrictions imposed under the Implementation Agreement between the GoG, Transelectrica Limited (BVI), Transelectrica Georgia Ltd (is this different from Transelectrica (G.E) Limited?), ESCO and Energotrans.

Article 13 also deals with the standards of performance of obligations of the SPs:

- each SP must provide “high quality conditions for the delivery of its Services required for the uninterrupted and efficient transmission of electricity through the” PTN;
- ET must take the Agreement into account when planning its annual capacity transmission reserve plan and must reserve capacity for the Annual Volume for export purposes on its portion of the PTN; and
- The SPs must ensure that the Annual Volume and/or equivalent monthly volume is transmitted and dispatched and exported through their portions of the PTN.

Article 15, as mentioned, makes it clear that liability is limited to payment of the Contractual Compensation.

Interest on late payment (of Service Fee or Contractual Compensation) is payable at 0.01% per day of the outstanding amount.

Article 16 contains a fairly typical **Force Majeure** clause, but does include “or system emergency in [Turkey] and/or in Georgia” and any other similar event, as mentioned

above. A party may terminate should a Force Majeure event continue for 180 days during any period of 12 months.

Under **Article 17, Disputes** are resolved by the Georgian courts under Georgian law if under GEL 200,000, and by final, binding arbitration (3 arbitrators) under UNCITRAL Rules conducted in Geneva if over GEL 200,000 (also under Georgian law).

Article 18, Amendments requires “corresponding corrections to the respective provisions” of the Agreement to be made if amendments to legislation “directly causes a change in” the Service FEE, the Contractual Compensation, or other changes to the terms and conditions of the Services. Although no Party is bound by any amendment unless it agrees, the PC has a right to suspend the Agreement until amendments are made. In practice this could cause problems because the wording is so broad for such a potentially important provision. Presumably, the Take-or-Par Principle does not apply if suspension occurs.

Article 18.6 entitles the PC to transfer all its rights to a **Substitute Entity** nominated by the Lenders if the **Implementation Agreement** between Transelectrica Limited (BVI), Transelectrica Georgia Ltd (is this the same company as the PC?), the Gog, ESCO and Energotrans (not GSE?) signed on 28 April, 2011 (IA) is terminated and the Substitute Entity enters into a new implementation agreement. Linkages between the IA and the TDA appear in Article 19. The TDA automatically terminates if the IA is terminated unless the PC transfers its rights and obligations under the TDA to the Substituted Entity, which becomes responsible for all payments that accrued before transfer (unless paid by the PC)

Under **Article 19, Duration and Termination**, the **Term** is 20 years commencing from the **Commercial Operation Date**. However the Agreement only comes into force as of execution “and after its proper registration by” GSE. The PC is entitled to terminate the TDA unilaterally for breach or non- or improper-performance by a SP of a material condition or requirement if not remedied within 10 business days of notice, by giving two weeks’ notice. The SP has reciprocal rights to suspend (not terminate) the Agreement, except that the PC is given 21 days in which to remedy.

Systematic breach by the PC (3 suspensions by the SPs in any one calendar year constitutes systematic breach) entitles the SP to terminate on giving 30 business days notice (during which the PC may remedy).

English is the prevailing language of the Agreement.

Article 21 entitles the PC to **assign** its rights under the Agreement by way of security to the Lenders. Further, the SPs “undertake to cooperate with the PC and may enter into a direct agreement” with the Lenders giving the Lenders certain rights, including to step in and to remedy PC defaults. Note that this clause does not obligate the SPs to enter into direct agreements.

Under **Article 24**, payments will be grossed up to cover any amounts a party is required to deduct for taxes. Each Party is responsible for VAT that is or becomes chargeable for any service.

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