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# REGULATORY REVIEW OF DRAFT POWER PURCHASE AGREEMENT

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9 August 2018

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CONTRACT NUMBER: AID-OAA-I-13-00018

DELOITTE CONSULTING LLP

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USAID CONTRACTING OFFICER'S

REPRESENTATIVE: NICHOLAS OKRESHIDZE

AUTHOR(S): JULIA WELLER

LANGUAGE: ENGLISH

9 AUGUST 2018

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# DATA

**Reviewed by:** Daniel Potash, Jake Delphia

**Practice Area:** Recommendations on Power Purchase Agreement

**Key Words:** Power Purchase Agreement

## ACRONYMS

ESCO	Electricity Market Operator
GoG	Government of Georgia
ICSID	International Center for Settlement of Investment Disputes
LOC	Letter of Credit
MoESD	Ministry of Economy and Sustainable Development of Georgia
MoU	Memorandum of Understanding
PPA	Power Purchase Agreement
UNCITRAL	United Nations Committee on International Trade Law
USAID	United States Agency for International Development

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## EXECUTIVE SUMMARY

This deliverable provides a purely regulatory, high-level review of the English translation of the Draft Guaranteed Power Purchase Agreement (PPA) Between Infinite Energy and Electricity Market Operator (ESCO). ***It does not purport to be an opinion of counsel nor does it provide advice on what steps should be taken to mitigate potential liability under the PPA.*** No English-language translation was provided of the comments that appear in Georgian in the margins nor were the Memorandum of Understanding (MoUs) and the Annexes that are referenced in the PPA provided for context. The review is therefore solely limited to the English version of the PPA and does not address items that remain to be negotiated (such as price, term, winter months' production, etc.).

# COMMENTS

The following items deserve closer review by legal counsel for the Infinite Energy Wind Farm:

1. **Preamble.** The off-taker of the PPA is ESCO, which is thinly capitalized and has minimal assets. As the default purchaser from all new generating plants and any existing plants that cannot find a commercial off-taker under the current Law on Electricity and Natural Gas, it has significant liabilities. Absent credit-enhancements (such as a Letter of Credit (LOC), escrow account or guaranty by a credit-worthy party), ESCO is unlikely to be a credit-worthy off-taker acceptable to commercial lenders.
2. **Article 6: Metering and Settlement of Electricity.** The PPA is for energy only so there are no capacity or availability payments anticipated. There is no limit specified as to the volume of electricity that the Seller can deliver during the “Purchase Period” (defined as the Winter Months, which are to be determined). Yet there is nothing in this Article about dispatch instructions and how the Wind Farm will be dispatched, even though the Dispatch Licensee has to sign any “Electricity Delivery-Acceptance Act.”
3. **Article 4(b): Obligations and Rights of Selling and Buying Generated Electricity and Article 6(c)(2) The Electricity Tariff; Payment.** Under Article 4(b) the Buyer is allowed to reject Purchase Energy for the following reasons: (i) failure to be registered as required under applicable laws; (ii) no longer being a Qualified Enterprise; or (iii) failing to execute a tariff reduction amendment to the PPA. The first reason appears to refer to registration with the Dispatch Licensee under the Market Rules and/or inclusion in the Ministry of Economy and Sustainable Development of Georgia (MoESD) Annual Energy Balance. Under the Market Rules, the Dispatch Licensee is also entitled to reject registration of a generator’s energy. The second reason is unclear because the status of Qualified Enterprise should not change once an entity is licensed and operational. The third reason may be the most problematic since under the Article 6(c)(2) it appears that the Government of Georgia (GoG) and ESCO have the right to reduce the tariff without the consent of the Seller and to affect an amendment to the PPA even though the GoG is not a party to the PPA.
5. **Article 2(a): Lifetime.** The Buyer’s obligation to purchase electricity comes into effect on the “Starting Date of Commercial Operations.” The definition of “Starting Date of Commercial Operation” in the Definitions Article includes multiple conditions, two of which could be problematic. The first is that the Buyer shall have granted the Seller the status of Qualified Enterprise under the Market Rules. The current Electricity (Capacity) Market Rules governing the rights and obligations of market participants and the conditions applicable to Qualified Enterprises are extremely opaque and complex. There is no handbook available for new market entrants on how to navigate the byzantine procedures. The second problematic condition precedent to the Starting Date of Commercial Operations is that either the GoG and ESCO have an agreement that the tariff to be paid remains unchanged or they have executed an agreement on a tariff reduction. Any agreement involving the tariff should obviously include the Seller, since it affects its revenue stream.
6. **Article 8: Events of Default; Remedies.** The only remedy for a default appears to be termination of the PPA if the default is not remedied within the period specified, which is a draconian remedy. In the event of a default by the Seller, lenders to the project will want the right to step in and cure the default to avoid termination of the contract and loss of the revenue stream needed to repay the loan. In the event of default by the Buyer short of insolvency, recourse should have other security (such as LOC) provided as a condition of executing the PPA. If the contract is terminated due to insolvency of one party, Section 8(b)(3) provides that the defaulting party “shall fully compensate the other party for the damages caused by the underlying breach that resulted in termination of this contract.” The only way to recover “damages” would be court, which is likely to be a protracted process with uncertain result. Customarily, PPAs contain a liquidated damage clause specifying the amount payable in the event of default to avoid proof of damage court cases.
7. **Article 12: Dispute Resolution.** Any dispute that cannot be amicably resolved is to be submitted under this Article to the “Common Courts of Georgia having relevant jurisdiction or arbitration.” Investors in emerging markets—and their lenders—customarily require that arbitration, before an international tribunal, be the venue for dispute resolution. Litigation in a country without a lengthy history of rule of law in a court, without significant experience in

commercial disputes, is likely to be expensive, complex, time-consuming and likely to favor the domestic party. Its decisions may also be unenforceable. If the GoG executes the PPA, the arbitration can be under International Center for Settlement of Investment Disputes (ICSID) Rules since Georgia is a contracting party to the ICSID Convention.<sup>1</sup> If the GoG is not a party to the PPA, resort can be other international tribunal using the United Nations Committee on International Trade Law (UNCITRAL)<sup>2</sup> arbitration rules. Georgia is a contracting party to the New York Convention<sup>3</sup> and arbitral awards can therefore be enforced.

- 8. Article 13: Force Majeure.** The definition of Force Majeure in Article 13(a) could be tightened to include language that is customarily found in Force Majeure provisions by: (1) qualifying “affects the fulfillment of the obligations of either Party” by adding “materially and adversely” before the word “affects”; (2) adding after “either Party” the following phrase: “and could not have been avoided or overcome by the Party, acting reasonably, prudently and with due diligence.”; and (3) adding after the words “which shall include” the customary phrase: “but are not limited to,”.

### **Interpretation**

An “Interpretation” section is missing. It is customary in PPAs to have an interpretation provision which defines how terms of the document will be interpreted.

### **Article 1: Definitions**

There are numerous terms which are imprecise and subject to dispute. Among them are:

- The term “Calculation period” is defined as “period determined by the Applicable Laws and/or Market Rules” which is unacceptably vague;
- The term “Market Rules” is defined as including amendments. The Market Rules are undergoing significant changes due to the reconfiguration of the design of the electricity market in Georgia. The risk of any changes in market design and in the Market Rules that occur following the execution of the PPA should be addressed appropriately;
- The same comment applies to the definition of “Applicable Laws”—the risks of any change in law occurring after the execution of the PPA need to be addressed appropriately;
- There is a definition of “Electricity (Capacity) Forecast Balance” which is not used elsewhere in the document; however, it is understood that power generators are required to have their annual forecasted generation volumes included in the “Electricity (Capacity) Forecast Balance” approved by the Ministry at the beginning of each year, or they are prohibited from selling such volumes on the Georgian market. This procedure should be explained either in the PPA of the MoU so that the risks are understood;
- The “Grid Code” is undergoing significant changes. The risks should be evaluated;
- The definition of “Receipt Point” in English is unclear. It is defined as “in accordance with the Grid Code, point(s) of balancing separation between the networks of power plant(s) and network owner licensee(s).” More customary definitions refer to metering stations.

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<sup>1</sup> Convention on the Settlement of Disputes between States and Nationals of Other States. Georgia ratified the Convention in 1992. The participation of ESCO, as a State-owned entity, is likely sufficient to invoke ICSID.

<sup>2</sup> The United Nations Commission on International Trade Law.

[http://www.uncitral.org/uncitral/en/uncitral\\_texts/arbitration/NYConvention\\_status.html](http://www.uncitral.org/uncitral/en/uncitral_texts/arbitration/NYConvention_status.html)

<sup>3</sup> Convention on the Recognition and Execution of Foreign Arbitral Awards <http://www.newyorkconvention.org/countries>



## **CONCLUSION**

The PPA is a key agreement in obtaining debt for the construction of the project. As such the PPA must meet international standards. Based on the issues identified above, this PPA, in its current formulation, does not meet those standards.

**USAID Energy Program**

**Deloitte Consulting Overseas Projects LLP**

**Address: 29 I. Chavchavadze Ave., 0179, Tbilisi, Georgia**

**Phone: +(995) 595 062505**

**E-mail: [info@uep.ge](mailto:info@uep.ge)**