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COMMENTS ON THE DRAFT AGREEMENT BETWEEN GOVERNMENT OF GEORGIA AND LKS SOLAR LLC

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DATA

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ACRONYMS

EnCT	Energy Community Treaty
EU	European Union
GoG	Government of Georgia
MoESD	Ministry of Economy and Sustainable Development of Georgia
MW	Megawatt
PPA	Power Purchase Agreement
PPP	Public-Private Partnership
SPP	Solar Power Plant
USAID	United States Agency for International Development
VRE	Variable Renewable Energy

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1. INTRODUCTION

In October 2016, Georgia signed an Energy Community Treaty (EnCT) with the European Union (EU), signaling the country's commitment to direct future energy planning and market development toward approximation. This treaty commits Georgia to enhance the security of its energy supply by promoting the development of relevant infrastructure, increasing market integration, gradually approximating key regulatory elements in the EnCT, and promote the use of renewable energy sources. In order for Georgia to meet its strategic commitments in the energy sector, the US Agency for International Development (USAID) is providing the country with technical assistance and policy advice on legal, regulatory, and institutional reform issues, including facilitating investment structuring, deal structuring, engineering analyses, environmental analyses, financial planning, outreach, and other consulting services. This technical assistance ("USAID Energy Program") is being rendered by Deloitte Consulting LLP under USAID contract AID-OAA-I-13-00018.

The objective of the USAID Energy Program is to support Georgia's efforts to facilitate increased investment in power generation capacity as a means of ensuring national energy security, facilitating economic growth, and enhancing overall national security. The project will have a significant impact on the Government of Georgia's (GoG) energy market reform efforts aimed at complying with EnCT obligations. The investment objective will be achieved through the provision of technical assistance to a variety of stakeholders in the energy sector.

The USAID Energy Program is tasked to: 1) Support energy market development in Georgia per the country's obligations under the EnCT; 2) Build the GoG's capacity to evaluate the fiscal and long-term impacts of regulatory changes; 3) Promote energy investment, especially in Variable Renewable Energy (VRE) development; 4) Support the integration of non-hydro renewable energy into Georgia's power system; and 5) Provide strategic advisory services to the GoG to increase Georgia's energy security.

The goal of this program is to enhance Georgia's energy security by improving the legal and regulatory framework for the energy market and increasing investments in the energy sector. Ultimately, the expected outcome of this program will be the implementation of a legal and regulatory framework that complies with the EnCT and other applicable EU requirements, encourages competition within the energy market, and stimulates private sector investment.

Under the contract, AID-OAA-I-13-00018, USAID Energy Program under the Energy Investment Optimization Task (Task 3) assists the counterparts in the development of enabling environment in the Renewable Energy Sector.

To support the Variable Renewable Energy Developers in the agreement signing process for the renewable power project development, the USAID Energy program provides comments on the draft Agreement between the GoG and LKS Solar LLC.

The recommendations below represent the USAID Energy Program's view based on the common practice in emerging markets, developing their wind and solar energy sectors.

2. EXECUTIVE SUMMARY

The solar developer LKS Solar LLC reached out to the USAID Energy Program with the request to support in the process of signing the Agreement with the GoG on the development of 7 Megawatt (MW) Solar Power Project (SPP) Plavi. The Developer requested the revision of the draft Agreement, offered by the Ministry of Economy and Sustainable Development of Georgia (MoESD).

The USAID Energy Program offers its own views and recommendations on the draft Agreement, based on the common practice of wind and solar energy sector developments in the emerging markets.

The draft Agreement complies with the Resolution of GoG No. 515 on “Rules and Conditions for Submit to the Ministry of Economy and Sustainable Development and Reviewing the Proposals on Conducting Construction Feasibility Studies, Construction, Ownership, and Operation of those Power Plants that Are not Public-Private Partnership Projects (PPP),” enacted on October 31, 2018. The power generation project that does not meet the PPP criteria, but is initiated by private developers, is not the subject of Power Purchase Agreement (PPA).

Since the government is not the off-taker, the Agreement seems somewhat onerous to the Developer. Within contracts, guarantees/bonds/penalties are generally used to "make whole" a party when they have been harmed. In this case, if Developer does not complete the project, the Government is not - and cannot - be harmed. Thus, there is no harm to "make whole". Only the Developer stands to be potentially harmed, and the Agreement provides no clauses to "make whole" the Developer in the event they are harmed by the Government.

Under the Agreement, the government is curing (non-existent) harm in multiple ways:

- Preconstruction guarantee;
- Construction guarantee;
- Penalties related to the guarantees;
- Termination fees;
- Transfer of all the work and intellectual property when either the Government terminates or when the Developer terminates.

The timeline in the Agreement is unclear - there are commitments requested before the Feasibility Study is agreed by the Government, etc.

The Ministry does not take responsibility, except transferring the state-owned land plots required for the implementation of the project to the Company and the Company's support in obtaining the license(s) or the permit(s) required for the implementation of this project. Therefore, nothing is mentioned about the GoG's support on getting access to the network.

Overall, this Agreement would not attract the top level of reputable and well-capitalized companies. An entrepreneurial company might take it up, but then they need to transfer and bring in another party and the Ministry could prevent that.

The table below provides comments from USAID Energy Program on the draft Agreement between GoG and LKS Solar LLC.

3. COMMENTS ON DRAFT AGREEMENT BETWEEN GOG AND LKS SOLAR LLC

No.	Reference and Text of the Agreement	USAID Energy Program Comment
1	2. The purpose of the Agreement is the implementation of the project by the Company in accordance with the laws of Georgia and the terms and conditions of this Agreement .	<p>The Purpose should be that:</p> <ul style="list-style-type: none"> - Power plant as described in this Agreement is consistent and desirable with respect to government policy, law, regulations, and strategy - Company commits to take development steps towards building the power plant - Government commits to support company with legal and appropriate steps - Power Plant realized should be technically and economically sound
2	<p>3. In compliance with the time frames and terms and conditions defined in Annex N1 and Annex N2 to the Agreement, the Company shall be bound to:</p> <p>3.1. Determine the project area or/and the project affected land plots and locations thereof;</p> <p>3.2. Study the solar data within the appropriate area;</p> <p>3.3. Conduct and complete a full feasibility study within the time frames set out in Annex 2 to the Agreement (within the technical parameters of the power plant under the Agreement) and submit a respective report to the Ministry;</p> <p>3.4. Provide the Ministry with the proposal on power plant construction within technical parameters of the contracted power plant.</p>	<ul style="list-style-type: none"> • This entire section is onerous given that the government is not a party to the PPA. • Feasibility Study Report should survey and confirm revenue support schemes and market conditions that will establish revenue streams for the project.
3	4.6 The estimated amount of the investment required for power plant construction, ownership and operation and the appropriate financial model;	<ul style="list-style-type: none"> • The point of private sector financial mobilization is that government sheds its care about investment – it is someone else’s problem. • Recommend reducing this list of required documents, and especially this information regarding the level of investment. Project financial information could be considered confidential info. Thus, since the government is not a party to the PPA, they would not seem to have a right to see this info.
4	5. If, on the basis of the feasibility study report or/and the environment impact assessment report (if any), it appears that the power plant construction and operation is not commercially and technically feasible for the Company , the Company may, at its own discretion, decide to refuse the implementation of the project , in which case the Company shall send a relevant notice to the Ministry prior to submission of the proposal provided for	<ul style="list-style-type: none"> • Why is there a preconstruction guarantee? Guarantees / Bonds are implemented to protect the government against possible losses in the event the contractor fails to deliver the project. In this case, the government will not suffer a loss if the developer does not complete the project (the government is not a buyer of the power, thus the government will not be harmed in the event the project is not completed). Thus, we would expect a strong developer with

	<p>by the Article 4 of the Agreement. In this case, the Ministry shall ensure that the preconstruction guarantee (in the amount available at the moment of returning the guarantee) to be returned to the Company.</p>	<p>alternative options for project opportunities, would strongly object to this clause.</p> <ul style="list-style-type: none"> Feasibility Study Report should survey and confirm financing terms from reputable and experienced debt and equity investors whose identity and ultimate ownership is made known.
5	<p>6. Within 5 (five) months after submission of the proposal by the company in accordance with Article 4 of the agreement, the Ministry and the Company will jointly discuss the feasibility of the power plant construction, and if the parties agree in this regard, the issue shall be submitted to the Government for a final decision, and if the Government approves to sign the agreement on power plant construction feasibility and commencement of a construction phase, the parties shall execute the contract on commencement of a construction phase. The decision made by the government shall rely upon the proposal and feasibility study report provided by the Company.</p>	<ul style="list-style-type: none"> If the government is not the purchaser under the PPA, why does the government have the power to determine if the project proceeds? This review is separate from permitting / licensing / etc., which is of course required. Not clear what contract is of concern? This contract? A separate contract? Based on the wording throughout the document, the current document is to be signed far before the commencement of construction.
6	<p>7.1 For ensuring the obligations undertaken by the Company within the preconstruction phase, including as regards to the submission of feasibility study report and the construction guarantee, the Company shall, no later than within 30 (thirty) days from signing this Agreement, provide the Ministry with the preconstruction guarantee in favor of the Government according to the aggregate installed capacity of the contracted power plant, in the amount not less than 5,000.00 (five thousand) USD or its equivalent in EUR per MW (according to the currency exchange rate fixed by the National Bank of Georgia on the day of submission of the preconstruction guarantee). The preconstruction guarantee period shall be 5 (five) months longer than the deadline for concluding the contract on the commencement of construction phase. The preconstruction guarantee shall be granted by the licensed bank or /and by the Bank of a member state of "Organization for Economic Cooperation and Development" („OECD"). The amount of preconstruction guarantee shall not exceed 15% of the share capital of the issuing bank.</p>	<ul style="list-style-type: none"> Confused on timing here – the company is to submit a preconstruction guarantee BEFORE the feasibility study is submitted and before both parties agree to the project? Same comment as above regarding the pre-construction guarantee applies to this entire section. The pre-construction guarantee seems an unnecessary and heavy burden.
7	<p>8. During the construction phase, the Company shall: 8.1 Obtain the rights to use the land within the area of project;</p>	<p>Assuming there are some government approvals in this process, this is partially within the power of the government. The developer may push back that they cannot be held to this term.</p>

8	8.2. Within the time frames set out in the Annex N3, obtain the construction permit and on the basis of such permit, start construction of the power plant ;	This is partially within the power of the government, so the developer may push back they cannot be held to this term.
9	<p>9. Construction Guarantee</p> <p>9.1 For ensuring the commencement of the power plant construction and putting it into operation under the construction permit specified in the Annex N3 hereof, on the day of signing the contract on commencement of the construction phase, the Company shall present the construction guarantee in favor of the Government according to the aggregate installed capacity of the power plant in question, in the amount not less than 100,000.00 (one hundred thousand) USD or its equivalent in EUR per MW (according to the currency exchange rate fixed by the National Bank of Georgia on the day of submission of the preconstruction guarantee). The construction guarantee period shall be 5 (five) months longer than the deadline for commissioning of the power plant under the Annex M3. The construction guarantee shall be granted by the licensed bank or /and by the Bank of a member state of "Organization for Economic Cooperation and Development" („OECD"). The amount of the construction guarantee shall not exceed 15% of the share capital of the issuing bank</p>	<p>Same comment as above – why is there now a second guarantee (the construction guarantee)?</p> <p>Guarantees / Bonds are implemented to protect the government against possible losses in the event the contractor fails to deliver the project. In this case, the government will not suffer a loss if the developer does not complete the project (the government is not a buyer of the power, thus the government will not be harmed in the event the project is not completed). The developer might strongly object to this clause.</p> <p>Construction guarantee of \$100,000/MW is inappropriate and purposeless. Someone else not Ministry is committing to establish the basis for revenues. By the time of commencing construction, company will be paying engineers, lawyers, insurers, equipment deposits, and other development costs. Company will be well-committed. If there is a commitment to deliver power to a power purchaser, the power purchaser deserves a deposit. If Company is using up some fixed pool of support scheme payment, that entity deserves a deposit. Ministry that is offering nothing, only extracting a toll, does not deserve a deposit.</p>
10	10.3 At its own expense, ensure preparation of the auditor's report and submission to the Ministry no later than 90 days after the commissioning of the power plant;	Why is Ministry getting auditor's report? this seems overreaching as no capacity is promised.
11	11. In order to implement the project , in accordance with this Agreement and the legislation of Georgia, the Government , within its competence and provided that the Company fully meets the requirements of the legislation of Georgia and this Agreement , shall ensure:	<p>Obligations are almost all on the side of the Company. All the government does is provide land.</p> <p>The Agreement is unequal. The Government takes minimum commitments and controversially requires a lot from the company.</p>
12	11.1 Transfer of state-owned land plots required for the implementation of the project to the Company in accordance with the legislation of Georgia;	Is the government committing free state-owned lands? Or stating transfer for payment if the land selected happens to be state-owned?
13	11.2 The Company's support in obtaining the license(s) or the permit(s) required for implementation of this project .	<p>This clause is supposed to state the Government's obligations. The government cannot promise the Company's support.</p> <p>Is this clause supposed to state the Government's support in obtaining licenses and permits? If yes, that is helpful, but that should be a given under the licensing process. Meaning, I</p>

		assume this support exists whether it is stated here or not.
14	12. The Government is entitled unilaterally, by giving a written notice to the Company , to immediately terminate the Agreement in the following cases, if:	This seem quite onerous. Why does the government have the unilateral right to terminate the agreement – and thus withdraw project approval – when the government will not be harmed by noncompliance?
15	12.1. The Company repeatedly has failed to fulfill the assumed obligation or/and to pay the penalty within the defined term;	Same comments as above regarding the guarantees. What right does the government have to enact penalties when the government is not harmed (and cannot be harmed) in any way?
16	12.6. Despite the approval from the Government pursuant to Article 6 of the Agreement , the contract on the commencement of the construction phase has not be signed within the period specified in the same Article by the Company or through the fault of the Company;	Again, not clear what contract?
17	13.1 The company will be deprived of the right to implement the project upon termination of the Agreement ;	Same comment as above. This seem quite onerous. Why does the government have the unilateral right to terminate the agreement – and thus withdraw project approval – when the government will not be harmed by noncompliance? Expect developers to strenuously object to this entire section. The penalties here are quite harsh. Penalties are usually enacted to resolve a harm to a party – again, the government is not harmed.
18	13.2 The exclusive ownership right to the Company's Feasibility Study Report and Relevant Environmental Impact Reports (if any), as well as to any other project related document and drawing, including those developed by the Company , (including project-related intellectual property rights)) will be transferred to the Government free of charge, within no later than 1 (one) month after termination of the Agreement ;	<ul style="list-style-type: none"> • The government should not be entitled to seize the work of the Developer. • Obligation to transfer the project implementation right is inconsistent with the value of the Agreement. If there was a value conveyed to Company with this Agreement, then some transfer restrictions would be reasonable.
19	13.3 Relevant rights (including property rights) to the project, land plots needed for the project and / or its affected areas, as well as project-based property, which must be legally flawless at the time of the transfer, shall be transferred to the State free of charge, without any payment obligation to the Company within no later than 3 (three) months from termination of the Agreement .	The government should not be entitled to seize the land.
20	15.2 The exclusive ownership right to the Company's Feasibility Study Report and Relevant Environmental Impact Reports (if any), as well as to any other project related document and drawing, including	The government should not be entitled to seize the work of the Developer.

	those developed by the Company , (including project-related intellectual property rights)) will be transferred to the Government free of charge, within no later than 1 (one) month after termination of the Agreement ;	
21	15.3. Relevant rights (including property rights) to the project, land plots needed for the project and / or its affected areas, as well as project-based property, which must be legally flawless at the time of the transfer, shall be transferred to the State free of charge, without any payment obligation to the Company within no later than 3 (three) months from termination of the Agreement ;	The government should not have the right to seize the land.
22	15.4. In case of termination of the Agreement in accordance with the Article 14.2 and 14.3, the Ministry shall return the pre-construction guarantee / construction guarantee submitted by the company to the government (in the amount available at the time of returning the guarantee) after the company fully fulfills its obligations under Articles 15.2 and 15.3.	Return it to who? This is poorly phrased. "to the government" Does this mean the guarantee is returned "to the government" or is it referencing the guarantee paid "to the government"? Poor phrasing.

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