How GEORGIA'S ENERGY potential could become a potential liability

Georgia is one of the top countries in the world and second in Europe for its water resources per capita. The country has around 300 rivers suitable for electricity generation. However, the country utilizes just 20% of its total hydro potential. While more than 100 hydropower projects are in the pipeline, either at the development or construction stage, almost all of them are stalled due to strong resistance from local populations who question the benefits of such projects from an economic perspective, raise environmental and livelihood concerns. Such protests are sometimes caused by targeted campaigns of certain interest groups, but often times they come about as a result of a lack of information caused by their late or negligible involvement in the decision making process, as well as due to the absence of institutionalized incentives and a corporate social responsibility framework.

In the meantime, electricity consumption is increasing in Georgia dramatically and the country is falling short of demand. To compare, in 2012, electricity consumption was ***circa*** 10 bln kWh, of which 614.59 mln kWh electricity was imported. In comparison, in 2019 consumption reached ***circa*** 13 bln kWh, out of which 1626.5 mln kWh was imported, evidencing a tripling of imports. In order to achieve energy independence and reduce the role of imported electricity, Georgia has to develop large hydropower plants with reservoirs for stable generation and the possibility of covering peak time consumption throughout the country. This requires significant foreign investment.

Georgia is an emerging economy, where almost 20% of the entire population still lives beyond the national poverty line. Georgia's Sovereign ratings are ranked as BB/B (Stable) by Standard & Poor's, BB- (Stable) by Fitch Ratings and Ba2 (Stable) by Moody's Investors Service, which means that Georgia is regarded as a non-investment grade, speculative economy, to which the attraction of international investors without proper sovereign guarantees is very difficult, if not impossible. This also limits Georgia's bargaining power when negotiating with international investors.

Stalled hydropower projects are detrimental to the interests of the country for many reasons, but perhaps most importantly because: ***firstly,*** imported electricity is more expensive compared to electricity produced in Georgia; ***secondly,*** imports make Georgia dependent on neighboring countries, especially on Russia since more than 70% of the imported electricity comes from Russia and ***thirdly,*** this may trigger contractual, as well as international liability of Georgia towards investors. This article focuses on the latter.

Georgia's strive for energy independence started as early as 2008 with the deregulation of the energy sector at large and hydropower in particular, with the declaration of energy independence as a top priority of the country. Since then, the Government has packaged and tendered out many hydropower projects to local and international investors. Georgia has also adjusted its legal framework to implement EU regulations and directives per the EU Association Agreement, Deep and Comprehensive Free Trade Agreement (DCFTA) and Protocol of Accession to Energy Community Treaty signed in 2014. Georgia has adopted a number of new laws and regulations, on the basis of which certain reforms are to be undertaken: the unbundling of generation from distribution and distribution from facility ownership; the increase of competition; the implementation of day ahead and intraday markets; the implementation of an energy exchange; the increase of energy efficiency; prioritizing consumption from renewable sources and others. These are all aimed at establishing a legal framework to ensure the proper operation of the sector.

From a contractual perspective, the State's liability is usually differentiated in case of physical (non-political) and non-physical (political) force majeure events. While customarily the State cannot be held liable for non-political force majeure (natural occurrences like earthquake, flood, etc.), in most cases investors seek certain relief from the State in case of political force majeure similar to riots and social turbulence. The extent of contractual remedies, as well as the list of negotiated political force majeure events, is largely dependent on the bargaining power of the investor, which is often in direct correlation with the overall significance and scale of the project in question. However, notwithstanding the contractual remedies or the lack thereof, the State of Georgia may not be shielded from international liability derived from the investor protection instruments below.

In pursuit of attracting foreign direct investments, Georgia has entered into around 38 bilateral investment treaties with different countries, including major capital exporting countries, such as USA, UK, China and the UAE, just to name a few. Georgia is also a party to the 1994 Energy Charter Treaty (ECT) that provides a multilateral framework for energy cooperation and investment protection that is unique under international law. Currently there are fifty-three signatories and contracting parties to the ECT, including the European Union.

Such bilateral or multilateral investment treaties offer foreign investors substantive protection against the host state's potentially unlawful actions, which, on certain instances, may include inaction or failure of the host state to ensure physical security of the investment from unlawful interference of third parties. Treaties also offer foreign investors access to international arbitration for settlement of their disputes against host states. Depending on the applicable treaty regime, such tribunals are the World Bank's International Centre for Settlement of Investment Disputes (ICSID), the International Chamber of Commerce (ICC), or an ad hoc tribunal constituted under the United Nations Commission on International Trade Law (UNCITRAL).

In terms of substantive rights, for instance, under Article 10 (1) ECT: ***"Each Contracting Party shall, in accordance with the provisions of this Treaty, encourage and create stable, equitable, favourable and transparent conditions for Investors of other Contracting Parties to make Investments in its Area. [...] Such Investments shall also enjoy the most constant protection and security [...]."*** Similar requirement of a host state to afford foreign investors stable environment and fair and equitable treatment is found in most bilateral investment treaties. It generally involves consideration of the consistency, transparency, fairness and proportionality of governmental measures, and places decisive weight on investor's "legitimate expectations" when investing in the host state. This standard of protection is arguably breached when the reality is at odds with what the investor was led to believe would be the case when investing in the host country.

Further, host state has an obligation of full legal and physical protection of investor's investment. It is generally accepted that the standard extends to the liability of the host state to protect the investment from riots, violence, or similar destructive actions from third parties. Host state will have to exercise "due diligence" and will have to take such measures to protect the foreign investment as are reasonable under the circumstances. The degree of diligence expected of states is high, and it is not necessarily proportionate to the resources available. Lack of resources to take appropriate action, generally will not serve as an excuse for the host state. In one of the first cases interpreting this standard, the tribunal noted that due diligence ***"is nothing more nor less than the reasonable measures of prevention which a well-administered government could be expected to exercise under similar circumstances."*** [Asian Agricultural Products Ltd. (AAPL) v. Republic of Sri Lanka ICSID Case No. ARB/87/3].

Therefore, even though the hindrance is caused by local population, it is very important to analyze and understand the obligations of Georgia, as a host state, under the international law. Providing reasonable assistance to the investors to ensure access to and peaceful enjoyment of their investment is clearly an obligation of the State, breach of which may result in not only the lost opportunity of developing Georgia's water resources to achieve energy independence and attract significant volumes of foreign direct investment, but also, investment disputes piling up against Georgia before international tribunals.

Ironically enough, damaging Georgia's reputation as a favorable investment destination will, in the end, have negative effect on the quality of life of very population vigorously protesting against development of hydropower resources. Alas, by then, it may be too late.

Tamta Ivanishvili
Partner | Corporate and Finance

Lasha Uplisashvili
Senior Associate | Head of Energy, Real Estate & Construction Practice

Rusa Tchkuaseli
Senior Associate | Head of M&A, Banking and Finance Practice

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FOR MORE INFORMATION AND ADVISE PLEASE CONTACT US:
129[3] David Aghmashenebeli Ave, Tbilisi, 0102, Georgia
Tel.: +995 32 292 24 91, 292 00 86, 200 04 91
blc@blc.ge blc.ge