

LEGAL NEWSLETTER

December - March
2013 - 2014

Dear reader,

The objective of this newsletter is to inform you on recent developments of Georgian legislation with regards to renewable energy, property, competition and tax regulations. This edition of our Legal Newsletter analyses the major amendments introduced to the respective laws and implementing legislation of Georgia. We further explore the potential problems associated with such amendments in practice. Suggestions and comments are welcome.

Hoping to have added some value to your reading on legal framework of Georgia.

Sincerely,

BLC Team

Highlights of major legal amendments effected throughout December-March 2013 - 2014:

- *Extensive amendments were introduced to the main legal acts regulating Georgian renewable energy market.*
- *New decree N423 on "Valuation of International Controlled Transactions" was adopted on December 18, 2013 by Georgian Finance Minister.*
- *Amendments have been made to the Tax Code of Georgia.*
- *New mortgage regulations have been adopted.*
- *Amendments have been made to the Law of Georgia on Property of Agricultural Lands.*
- *Georgian Government presented to the Parliament of Georgia bill on the amendments to the law "On Free Trade and Competition".*

Energy Law

In December 2013, new 400KV Borcka - Akhaltsikhe interconnection (transmission) line was brought into operation. The transmission line was built within the scope of the Georgia-Black Sea Transmission Network project. The line connects to the Turkish 400KV grid at the border enabling the export of excessive power. In order to ensure non-discriminatory access to this new infrastructure, as well as to bring Georgian legislation in compliance with the corresponding rules applicable in the Republic of Turkey, extensive amendments were introduced to the main legal acts regulating Georgian renewable energy market.

The amendments were introduced to the 2006 Order No.77 of the Minister of Energy of Georgia on Energy (Power) Market Rules ("Market Rules"). The amendments mainly relate to the access to and allocation of the capacity for export of electricity through the transmission line. According to the ranking provided in the Market Rules, the renewable energy plants (including HPPs) built in Georgia since 2010, with effective long term Transmission and Dispatch Agreements, gained first priority on access to the capacity in the transmission line, except in case of emergency. Capacity is reserved on "take or pay" basis. Most importantly, if prior to amendments, the renewable energy plants under construction were obliged to pay only for the capacity actually used, now they

also fall under the “take or pay” rule. Such plants will also have to pay for the capacity reserved, even though they might not be using this capacity throughout the respective year, until the plant is fully set into operation. The Market Rules also provide for the detailed regulation of the transmission line capacity allocation by dispatch license holder through auction or otherwise.

In addition to the above, amendments to the Market Rules introduced a bank guarantee requirement for export of electricity by Qualified Enterprises. The guarantee must be submitted to the electricity market operator, in the amount determined by the latter authority but in any event, not exceeding 10% of the total value of the export agreement.

Another novelty in the field of renewable energy sector is substantial alteration of 2008 Decree No.107 of the Government of Georgia on State Program “Renewable Energy 2008.” To begin with, the scope of application of the Decree was extended. Prior to adoption of the amendments, the compliance with the procedures outlined in the Decree was only compulsory in case of power plants with an estimated generation below 100 MW. However, as a result of the amendments, the Decree applies to power plants irrespective of their estimated generation capacity. Also, amount of the bank guarantee to be submitted by the investor for taking up the renewable energy project in Georgia, was reduced from USD170,000 per 1 MW to USD100,000 or its equivalent in EUR.

Most importantly, the Decree sets out the default events such as delay in commencement of construction works of the renewable energy plant within the time frame specified in the MOU or delay in putting the facility into operation. Penalty of 0.5% of the bank guarantee amount per each delayed day shall be charged on the investor and if the accumulated amount of the penalty reaches at least 50% of the total guarantee amount, the Government of Georgia is entitled to: (a) unilaterally terminate the MOU, and (b) claim the bank guarantee in full. The main drawback of this rule is that the revocation of concession is unconditional and particularly risky at the final stage of construction, when the investor has carried out substantial part of investment. Delay in commencing operation of the plant may result in termination of the MOU. However, no fair and reasonable compensation is envisaged for any such termination. Inability of the investor to recover his investments will make project financing rather difficult, if at all possible.

Tax Law

On December 18, 2013 Georgian Minister of Finance adopted new decree N423 on "Valuation of International Controlled Transactions", which clarifies transfer pricing principals set forth in the Tax Code of Georgia. The decree consists of 34 articles and intends to regulate transfer pricing matters in cross border transactions (between a Georgian resident company and a foreign company which is a related party or a resident of an offshore/law tax jurisdiction as per the list defined by the Government of Georgia), among others, covering topics such as the use of market principles, criteria of comparability of transactions, criteria meeting of which shall make transaction price deemed as market price, specific types of transactions, rules for using the price ranges, documentations regarding the valuation of transactions and procedures for avoidance of double taxation. According to the Article 1.2 of the decree, its principles are based on the transfer pricing guidelines for multinational companies and tax bodies created by the Organization for Economic Co-operation and Development (OECD).

According to the effective Tax Code of Georgia, limitation period for tax infringements is set at 6 years term. However, recent amendments to the Code (carried out on 26.12.2013) decreased this period to 5 years from January 1, 2015 till January 1, 2016 and to 4 years period from January 1, 2016 till January 1, 2017. Limitation period is expected to be 3 years from January 1, 2017.

Property law

As of 28 June 2013 Law of Georgia on Property of Agricultural Lands prohibits non-Georgian citizens, foreign legal entities and Georgian legal entities owned by foreigners to obtain land with an agricultural status until 31 December 2014. By virtue of amendments carried out to the law on February 20, 2014, exceptions are applicable to this ownership restriction. In particular, non-Georgian entities and individuals may acquire agricultural lands if the owner is a commercial bank as determined by Georgian legislation(1); or if the owner has a special permission granted by the Government of Georgia, in cases of special state or public needs (2).

New mortgage regulations

By virtue of the amendments carried out to the Civil Code of Georgia and Law on Enforcement Proceedings in December 2013, mortgage secured loan agreements must be notarized and the notary, while executing such agreements, is obliged to explain to the parties legal consequences of violating their contractual responsibilities. Further, amendments envisage direct transfer of ownership to the creditor on the secured property if the debtor fails to fulfil its obligations under the agreement (burden of proof lies on the debtor to prove contrary), through enforcement document issued by the Notary.

Amendments have also defined the limited interest rate applicable to the loan agreements on monthly bases, adjusted to the market interest rate within the framework of those loans issued by microfinance institutions. These amendments are not applicable to commercial banks, microfinance and non-depository institutions.

Rules regarding forced sale of property through auction have been amended, allowing for first and second repeated auctions. Also, alternative rules of realization of the property have been introduced, such as preliminary/early auction service.

Competition law

Georgian Government presented to the Parliament of Georgia bill on the amendments to the law “On Free Trade and Competition”, prepared with the purpose to facilitate free competition and competitive market development and improve regulatory framework in this field. Amendments establish new independent body - Competition Agency, which is accountable to the Prime Minister and which serves to prevent the abuse of dominant position, responds to the violations of competition legislation and ensures effective implementation of measures to support small businesses, as well as the interests of economic agents.

The bill defines the scope of application of the law more precisely, the law applies to: economic agents, the state government, those acts/decisions of the Autonomous Republic and local government bodies and/or its officials which, except as provided by law, cause and / or can lead to restriction of free trade and competition, exclusion and deprivation of access to service and commodity markets. In addition, the law applies to acts committed outside the country, which affect or restrict competition in the domestic market, and/or cause significant deterioration of the competitive environment.

The bill also provides for criteria, to assess those agreements which are considered to be slightly restrictive to the competition, in line with the European legislation.

The abovementioned amendments, if implemented, are of a significant importance for effective regulation of the competitive environment in Georgia.

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