

**DOCUMENT OF THE EUROPEAN BANK  
FOR RECONSTRUCTION AND DEVELOPMENT**

Approved by the Board of Directors on 22 July 2020<sup>1</sup>

**GEORGIA**

**POWER GRID ENHANCEMENT PROJECT**

*[Redacted in line with the EBRD's Access to Information Policy]*

*[Information considered confidential has been removed from this document in accordance with the EBRD's Access to Information Policy (AIP). Such removed information is considered confidential because it falls under one of the provisions of Section III, paragraph 2 of the AIP]*

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<sup>1</sup> As per section 1.4.8 of EBRD's Directive on Access to Information (2019), the Bank shall disclose Board reports for State Sector Projects within 30 calendar days of approval of the relevant Project by the Board of Directors. Confidential information has been removed from the Board report.

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**ABBREVIATIONS / CURRENCY CONVERSIONS**

AA	Association Agreement
CAGR	Compounded Annual Growth Rate
CPI	Consumer Price Index
DCFTA	Deep and Comprehensive Free Trade Agreement
DSCR	Debt Service Cover Ratio
EBITDA	Earnings before Interest, Tax, Depreciation and Amortisation
EBIT	Earnings before Interest and Tax
EC	European Commission
EIB	European Investment Bank
ESAP	Environmental and Social Action Plan
ESCO	Electricity System Commercial Operator
ESIA	Environmental and Social Impact Assessment
ESMP	Environmental and Social Management Plan
EU	European Union
FEF	Front End Fee
FX	Foreign Exchange Rate
FY	Financial Year
GDP	Gross Domestic Product
GNEWRC	Georgian National Energy and Water Regulatory Commission
GoG	Government of Georgia
GSE	Georgian State Electrosystem
HPP	Hydro Power Plant
IFRS	International Financial Reporting Standards
KfW	Kreditanstalt für Wiederaufbau
LARCF	Land Acquisition, Resettlement and Compensation Framework
LCU	Local Currency Unit
MoESD	Ministry of Economy and Sustainable Development
NIP	Neighborhood Investment Platform
OHL	Overhead Line
RAP	Resettlement Action Plan
SDGs	Sustainable Development Goals
SEP	Stakeholder Engagement Plan
USAID	US Agency for International Development
WB	World Bank

**CURRENCY CONVERSIONS**

Country's Currency Unit = Georgian Lari (GEL)

1 GEL = 100 Tetri

February 2020

EUR 1 = GEL 3.2

USD 1 = GEL 2.9

**WEIGHTS AND MEASURES**

1 Megawatt (MW) = 1,000 kilowatts ( $10^3$  kW)

1 Gigawatt (GW) = 1 million kilowatts ( $10^6$  kW)

1 Megawatt-hour (MWh) = 1,000 kilowatt-hours ( $10^3$  kWh)

1 Gigawatt-hour (GWh) = 1 million kilowatt-hours ( $10^6$  kWh)

1 Terawatt-hour (TWh) = 1 billion kilowatt-hours ( $10^9$  kWh)

## **PRESIDENT'S RECOMMENDATION**

This recommendation and the attached Report concerning an operation in favour of Georgia (the “Borrower”), are submitted for consideration by the Board of Directors.

The facility will consist of a sovereign loan to Georgia (represented by the Ministry of Finance) in the amount of up to EUR 90 million to be on-lent to Georgian State Electrosystem, the national electricity transmission and dispatch company. The project is co-financed with the Kreditanstalt für Wiederaufbau (KfW) for EUR 125 million and the EU Neighbourhood Investment Platform providing a EUR 10 million grant for the Project.

The operation will enable Georgian State Electrosystem to construct (i) a 500 kV overhead line (OHL) Tskaltubo-Akhaltsikhe-Tortum; (ii) the North Ring; and (iii) reinforcement of transmission infrastructure in the Guria region. The expected transition impact of the project stems from supporting integration of the renewable capacity under development in Georgia and maintaining reliability and stability of the Georgian transmission network (Resilient and Green).

TC support for a total amount of EUR 811,000 has been provided by the EBRD Shareholder Special Fund to assist the Project Company to undertake an Environmental and Social Impact Assessment (ESIA) in accordance with EBRD Performance Requirements. The TC was essential to ensuring integration of both technical and environmental and social (E&S) considerations in assessment of transmission line routing to avoid impacts, to assess impacts and develop mitigation measures as required by the PRs.

I am satisfied that the operation is consistent with the Country Strategy for Georgia, the Bank’s Energy Sector Strategy and with the Agreement Establishing the Bank.

I recommend that the Board approve the proposed loan substantially on the terms of the attached Report.

**Suma Chakrabarti**

## BOARD DECISION SHEET

<b>GEORGIA – POWER GRID ENHANCEMENT PROJECT - DTM 51422</b>	
<b>Transaction / Board Decision</b>	Board approval <sup>2</sup> is sought for a senior loan of up to EUR 90 million, in favour of Georgia (the “Borrower”), represented by the Ministry of Finance, with the proceeds subsequently being on lent to Georgian State Electrosystem JSC (“GSE” or “Project Company”).
<b>Client</b>	Georgia (represented by the Ministry of Finance) and GSE, the state-owned power transmission and dispatch company. Georgia has S&P and Fitch ratings of BB. [REDACTED]
<b>Main Elements of the Proposal</b>	<ul style="list-style-type: none"> <li>- <u>Transition impact</u>            Primary Quality – <i>Resilient</i> - The project envisions strengthening of the transmission infrastructure in Georgia. The project aims to increase the system’s reliability and flexibility.            Secondary Quality – <i>Green</i> – The project supports integration of new renewable capacity into the grid as well as reduction of transmission losses resulting in substantial CO2 emission savings.</li> <li>- <u>Additionality</u>  <i>Financing structure:</i> EBRD provides financing needed for the project to materialize which is not available from commercial banks. EBRD is complementary with other IFIs and closes the funding gap.  <i>Standard-setting: environmental and procurement standards</i>            The project involves building transmission infrastructure in a complex terrain. The ESIA has included the development of a detailed E&amp;S management plan, defining both Client and Contractor responsibilities which will be included in the procurement documentation.            All components of the project are expected to be tendered through competitive public procurement and will be supervised by EBRD.</li> <li>- <u>Sound banking</u> – The project is structured to address implementation risk, regulatory risk, electricity demand, and FX risks. Ultimately sovereign recourse.</li> </ul>
<b>Key Risks</b>	[REDACTED] Local currency depreciation [REDACTED], but the sensitivity analysis conducted for local currency devaluation shows sufficient resilience. Ultimately, this is a sovereign loan.
<b>Strategic Fit Summary</b>	The Project is in line with the Bank's Energy Sector Strategy which stresses that ensuring network reliability and flexibility is a key priority for the Bank. The Project is also compliant with the Bank's Country Strategy for Georgia, which stresses that the Bank will “ <i>support power infrastructure enhancing Georgia’s internal capabilities and integration with regional markets.</i> ”

<sup>2</sup> Article 27 of the AEB provides the basis for this decision.

## ADDITIONAL SUMMARY TERMS FACTSHEET

<b>EBRD Transaction</b>	Up to EUR 90 million sovereign loan to Georgia (“Borrower”) arranged in two tranches committed at signing, to be on-lent to GSE, the state-owned power transmission and dispatch company.
<b>Existing Exposure</b>	<p>The exposure to sovereign power sector projects in Georgia is EUR 62.5 million.</p> <ul style="list-style-type: none"> <li>• OpID 4304: Enguri HPP Rehabilitation Project[REDACTED]</li> <li>• OpID 49649 – Enguri Climate Resilience Upgrade[REDACTED].</li> <li>• OpID 39579: Black Sea Transmission[REDACTED].</li> <li>• OpID 45181: Jvari Khorga Interconnection[REDACTED].</li> </ul> <p>The exposure under municipal projects to Georgia sovereign is EUR 60.9 million. [REDACTED]</p>
<b>Maturity / Exit / Repayment</b>	15 year tenor [REDACTED]
<b>AMI eligible financing</b>	None
<b>Use of Proceeds</b>	<p>The purpose of the Power Grid Enhancement Project is to strengthen the power transmission grid in Georgia, including improved reliability and stability of the transmission network and to support integration of a number of renewable energy plants that are either planned or under development in Georgia (the “Project”).</p> <p>The Project consists of the following components: (1) Construction of the 500 kV overhead line (OHL) Tskaltubo-Akhalsikhe-Tortum; (2) Construction of the North Ring; and (3) Reinforcement of the transmission infrastructure in the Guria region.</p> <p>The proceeds of EBRD’s loan are expected to finance the North Ring component, including construction of up to 200 km of 500/200/110kV transmission lines and 500/220/110kV substations.</p>
<b>Investment Plan</b>	The Bank’s procurement and engineering team, as well as externally mobilized consultant have evaluated the costs of the project. The project components will be awarded based on competitive public procurement and be supervised by the Bank’s procurement team.
<b>Financing Plan</b>	[REDACTED]
<b>Key Parties Involved</b>	<p>Ministry of Finance – representing the Government of Georgia</p> <p>GSE – Project Company</p> <p>KFW – co-lender to the Project</p> <p>NIP – donor to the Project</p>
<b>Conditions to subscription / disbursement</b>	<p>Disbursements to be made in two tranches of EUR 35 million (Tranche 1) and EUR 55 million (Tranche 2).</p> <p>Key conditions to [REDACTED]disbursement:</p> <p style="padding-left: 40px;">Approvals/authorisations in place; execution of the Project Agreement with the Company; execution of Subsidiary Loan Agreement between the Borrower and the Company; PIU and ESAP satisfactory to the Bank [REDACTED]</p>
<b>Key Covenants</b>	[REDACTED]
<b>Security / Guarantees</b>	Sovereign loan

<b>Other material agreements</b>	Project Agreement with GSE Subsidiary Loan Agreement between Georgia and GSE Loan Agreement between KfW and Georgia including EU NIP financing arrangements (the “Co-financing Agreement”)
<b>Associated Donor Funded TC and co-investment grants/concessional finance</b>	TC support [REDACTED] has been provided [REDACTED] to support the Client to undertake an Environmental and Social Impact Assessment (ESIA) in accordance with EBRD Performance Requirements to satisfy the requirements of the Lenders (EBRD and KfW).

[REDACTED]

## INVESTMENT PROPOSAL SUMMARY

### 1. STRATEGIC FIT AND KEY ISSUES

#### 1.1 STRATEGIC CONTEXT

Georgia has a developed power sector, which has been largely unbundled since the mid-90s with the power market currently undergoing liberalization. In June 2014, the EU and Georgia signed a landmark EU Association Agreement (AA), including a Deep and Comprehensive Free Trade Area (DCFTA). The AA entered into full force as of 1st July 2016. The EU-Georgia Association Agenda was also agreed to help implement the AA/DCFTA through joint priorities for 2020-2022.

Georgia's primary source of electricity is hydropower, of which only about 20-30% of the economically feasible potential is utilised at present. Due to its seasonal generation pattern, Georgia is dependent on imports to meet demand during the August-April period. With the aim to strengthen its security of supply, the Government is focused on i) securing private investments for the construction of new wind, solar and hydro power plants, ii) diversifying its fuel supply sources and routes without increasing its fossil fuelled generation capacity, and iii) simultaneously seeking to rehabilitate the existing hydro capacity. Georgia's energy policy reflects its international commitments, in particular to climate action. Under the Paris Agreement by 2030 Georgia committed to unconditionally reduce Greenhouse Gas Emissions by 15% below the business as usual scenario.

Georgia's renewable energy potential and ability to utilize this potential makes the country well-placed to meet the growing electricity demand with renewable energy sources thus contributing to tackling climate change and air pollution – the two of the most important challenges worldwide. The Project is proceeding in parallel with the Bank's policy dialogue activities for development of renewable energy auctions in Georgia, with the first auction for up to 50MW solar capacity expected to be launched in the fourth quarter of 2020. The Government is set to demonstrate progress on the transmission network, a key pre-requisite for the renewables investor confidence and success of the forthcoming auctions. The Project is part of a broader GSE's plan for strengthening and rehabilitating the transmission network to improve its reliability, increase its capacity and support introduction of new renewable energy into the system.

In addition to a very pronounced seasonal generation pattern, Georgia is characterised by the generation assets geographically located relatively far from the main consumers. The hydropower plants with large water storage and the potential wind and solar sites are located in western Georgia while consumption centres are located in eastern Georgia. This imbalance has a negative impact on the flexible and reliable operation of the transmission grid. Through the Jvari-Khorga Interconnection project (OpID 45181), the Bank supported strengthening of the transmission network by creating an alternative power evacuation route from western Georgia to eastern Georgia thus contributing to flexible and reliable operation of the network. The proposed Project will continue supporting the country with reinforcement of the electricity grid. Multiple dimensions of the project contribute to the United Nations Sustainable Development Goals ("SDGs"): 7. Affordable and Clean Energy, 9. Industry, Innovation and

Infrastructure, 13. Climate Action and 17. Partnerships for the SDGs, as presented in Annex 1.

The impact of the COVID-19 crisis on the Georgian economy is expected to be significant. Uncertainty and tightening of global financial markets, reduced foreign demand for exports of goods and services leading to lower FX receipts and pressure on domestic FX market has already led to currency volatility. With tourism receipts amounting to nearly one fifth of overall GDP, the negative impact of containment measures will be widespread across many sectors. The expected drop in remittances will likely further suppress the household disposable income.

The Project is part of the Government's efforts to mitigate long-term impacts of the COVID-19 pandemic on the private sector, scale up renewables and support job creation. Reliable electricity infrastructure is central for the country's post-crisis recovery and setting the Georgian economy on a sustainable and resilient pathway.

The loan builds upon the successful implementation of the Black Sea transmission line jointly financed by the Bank, EIB and KfW and Jvari Khorga Interconnection, jointly financed with KfW and support of EU NIP. The Black Sea Transmission project was completed ahead of schedule and under budget. All components of Jvari Khorga Interconnection except for package B have been completed, while package B (construction of 8 km of 500 kV double circuit and 60 km of 220 kV double circuit Overhead Lines) is 75% completed. The start of construction works was delayed due to COVID-19 crisis and is expected to commence in July 2020 as Georgia lifted all lockdown measures in June 2020. The proposed Project builds on the existing positive relationship with GSE and partner IFIs.

## 1.2 TRANSITION IMPACT

The Project builds on the Bank's involvement in the Georgian transmission sector through the Black Sea Transmission Line Project (MG/Negligible), and Jvari Khorga Interconnection Project (Good/High). Transition impact scoring chart is presented in Annex 2.

### Primary Quality: Resilient

Obj. No.	Objective	Details
1.1	<i>The project will allow the connection of planned renewable energy installations which currently are not possible due to inadequacy of the grid, or lead to a decrease in the curtailment of existing renewable energy installations, as verified by ESD.</i>	The project is going in parallel to the policy dialogue activities for development of renewable energy auctions, and serves as a backbone for the upcoming tenders to come. Grid connection remains to be one of the key challenges for upcoming renewable energy projects. Integration of potential solar and wind plants constitutes a key part of this project.
1.2	<i>The project entails a policy dialogue initiative</i>	The Bank has launched a technical assistance programme for the Ministry of Economy and

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	<i>that has been assessed as Strong Good by the sector economist.</i>	Sustainable Development which engages a team of experts to assist the Ministry with reforms in the energy sector in line with the Energy Community treaty of which Georgia is a signatory. In particular the team of experts will be supporting the ministry in developing new policies for (i) introduction of RE auctions in Georgia, (ii) Georgia's electricity and gas market liberalisation process and (iii) National Renewable Energies Action Plan.
1.3	<i>Project will help client move towards international best practice in terms of system reliability or flexibility.</i>	Several regions of Georgia have transmission infrastructure that is frequently overloaded, causing power outages, in some cases for several days. The project aims to increase system reliability and flexibility in order to avoid overload of the transmission lines and ensure uninterrupted supply of electricity to the population as well as guarantee security of the system.

**Secondary Quality: Green**

Obj. No.	Objective	Details
2.1	<i>The percentage of EBRD use of proceeds allocated to the project that qualifies as GET is 15% or higher.</i>	The percentage of EBRD use of proceeds allocated to the project is 100% GET as confirmed by GET Clearinghouse.

**1.3 ADDITIONALITY**

The Bank's participation in the Project is vital due to the unavailability of long term financing from commercial banks. The Georgian transmission infrastructure sector relies on IFIs as the main source of funding.

Identified triggers	Description
A subsequent/consecutive transaction with the same client/group either with the same use of proceeds or in the same country	The project represents a continuation of the Jvari Khorga Interconnection (45181) and Black Sea Energy Transmission Project (39579), which are the Bank financed investments for upgrading the Georgian transmission infrastructure.

Additionality sources	
<p><b>Financing Structure</b></p> <ul style="list-style-type: none"> <li>EBRD offers financing that is not available in the market from commercial sources on reasonable <b>terms and conditions</b>, e.g. a longer grace period that is rarely available in the market, restricted foreign currency</li> </ul>	<ul style="list-style-type: none"> <li>EBRD offers financing of 15 years, [REDACTED]. Financing of this type is not available in the region from commercial banks. Long-term financing is necessary to structure the project because the repayment schedule</li> </ul>

<p>financing etc. Such financing is necessary to structure the project.</p> <ul style="list-style-type: none"> <li>– EBRD offers a <b>tenor</b>, which is above the market average and is necessary to structure the project.</li> <li>– Public sector: EBRD investment is needed to close the <b>funding gap</b>. At the same time, EBRD does not crowd out other sources, such as from IFIs, government, commercial banks and/or complements them.</li> </ul>	<p>is tied to increase in transmission and dispatch tariffs.</p> <ul style="list-style-type: none"> <li>– EBRD does not crowd out other sources of funding and closes the funding gap. The project is co-financed with KfW as parallel lender. GSE is also working with other IFIs on other investment projects.</li> </ul>
<p><b>Standard-setting: helping projects and clients achieve higher standards</b></p> <ul style="list-style-type: none"> <li>– Client seeks/makes use of EBRD expertise on <b>higher environmental standards</b>, above ‘business as usual’ (e.g. adoption of emissions standards, climate-related ISO standards etc.).</li> <li>– Client seeks/makes use of EBRD expertise on <b>best international procurement standards</b>.</li> </ul>	<p>EBRD environmental team is closely involved in project structuring, as the transaction involves building transmission infrastructure in a complex terrain. Environmental and social due diligence of this project was being prepared for several years and GSE has heavily relied on EBRD expertise to identify and mitigate potential environmental and social concerns.</p> <p>All components of the project will be tendered through open tendering. GSE will be assisted by an external consultant in the tenders. In addition, the procurement process will be supervised by EBRD procurement team.</p>

#### 1.4 SOUND BANKING - KEY RISKS

Risks	Probability / Effect	Comments
COVID-19 impact	Low/High	<p><i>COVID-19 containment measures might affect the project timeline and cause delays in procurement and construction.</i></p> <p>Despite introduction of lockdown measures due to COVID-19 the Government of Georgia continued implementation of strategic infrastructure projects. In June 2020 the lockdown measures were lifted.</p>
Implementation risks	Medium/ Medium	<p><i>Implementation risks include cost overruns, delays in procurement and failure to achieve technical outcomes.</i></p> <p>The Project is technically challenging however the Bank has a track record of successful delivery of complex project with GSE (Black Sea Energy Transmission Project). The Project’s capital expenditure estimates have been verified during technical due diligence and thus reduce the risk of future cost increases.</p> <p>The Bank will require GSE to appoint and maintain a Project Implementation Unit (PIU). The PIU will be supported by the international consultant to provide assistance during project preparation and implementation. This structure will strengthen project implementation capacity within GSE and mitigate possible procurement delays.</p>

		The Bank has already engaged with GSE to ensure compliance of the procurement process with the Bank's PPRs. A detailed Project Implementation Plan will be referenced in the Project Agreement and help mitigate implementation delays. Procurement plan and details on procurement arrangements are presented in Annex 3.
Environmental and Social risk	Medium/ Medium	[REDACTED] During the ESIA disclosure period for the Project, there have been no comments submitted related to the application of PR7. Considering that the Project crosses areas with Svan communities there is, however, a risk that external stakeholders (including Civil Society Organisations) may also challenge the Project until the PR7 applicability has been re-assessed in accordance with the Bank's requirements [REDACTED]. The client has committed to participate and assist in the implementation of this re-assessment through the Environmental and Social Action Plan. Structural elements have been introduced to the Grid Project to offer the Board of Directors comfort to consider the project in parallel to the approval of the MAP by the Board [REDACTED] and the ESAP (see Section 6.1 for further details).
Regulatory risk	Medium/ Medium	<i>Any adverse implementation in the approved tariff methodology would negatively impact the financial results of GSE.</i>  The current tariff methodology allows GSE to recover its actual operating and administrative costs as well as depreciation and financing costs. The profit element is calculated as a return on GSE's regulated asset base, which is calculated as the net book value of assets. The methodology is accepted by the Georgian authorities, with whom the Bank has an excellent working relationship and is tested – GSE transmission tariff increased by ca 52% over 2017-19 and dispatch tariff increased by ca 400% over the same period. The total transmission and dispatch tariff in Georgia increased to GEL 0.0174/kWh in 2019. This is still low compared to EU single market's average of EUR 0.012/kWh <sup>3</sup> (GEL 0.0357). Ultimately this is a sovereign recourse.
Sovereign risk	Low/Low	<i>The Borrower's ability to repay the loan is directly related to the Sovereign.</i>  Georgia's sovereign-credit rating is BB [REDACTED] The country's external public sector debt is 27% of GDP. Georgia is supported by the precautionary arrangements with IMF.
FX risk	Medium/ Medium	<i>The currency of the loan is denominated in Hard Currency whilst most of the Company's revenues are in the Local Currency. This exposes GSE to FX risk that could affect its debt service capacity in case of adverse movement of the foreign exchange rate.</i>

<sup>3</sup> Overview of Transmission Tariffs in Europe: ENTSO-E (2019)

		The current tariff methodology is based on the full cost recovery. Therefore GSE will be compensated by tariff increase in case of adverse movements of FX rate. [REDACTED]
Interest rate risk	Medium/ Medium	[REDACTED]

## 2. MEASURING / MONITORING SUCCESS

### Primary Quality: Resilient

Obj. No.	Monitoring indicator	Details	Base line	Target	Due date
1.1	<i>Number of new/improved electricity/energy service(s) connections</i>	[REDACTED] wind and solar to be integrated into the grid	[REDACTED]	[REDACTED]	[REDACTED]
1.2	<i>Policy dialogue platform is operational</i>	Capacity building of the Ministry of Economy	[REDACTED]	[REDACTED]	[REDACTED]
2	<i>Practices of the relevant stakeholder improved (system reliability)</i>	The Project involves participation of an experienced consultant that will not only monitor the construction process but also will train GSE staff on operation of additional lines, achieving efficiency and making sure Georgia is in compliance with the EU's Third Energy package.	[REDACTED]	[REDACTED]	[REDACTED]
3	<i>Legal, institutional or regulatory frameworks in target areas improved</i>	Energy Community certification of the unbundled TSO in line with the Third Energy Package;	[REDACTED]	[REDACTED]	[REDACTED]

### Secondary Quality: Green

Obj. No.	Monitoring indicator	Details	Baseline	Target	Due date
1	CO2 Emissions reduced (tonnes/yr)	25,000 tonnes of CO2 emission savings as confirmed by GET clearinghouse	[REDACTED]	[REDACTED]	[REDACTED]

### 3. KEY PARTIES

#### 3.1 BORROWER / INVESTEE COMPANY

The Borrower is Georgia, rated BB by S&P and Fitch, with the latest S&P country rating revised from BB- to BB in October 2019 with a stable outlook. In light of the COVID-19 pandemic, on April 24 2020 Fitch has maintained Georgia's rating [REDACTED].

GSE is the state-owned electricity transmission and dispatch operator established in 2002 through the merger of national electricity company 'Electrogadatsema' and the national dispatch company 'Electrodispatcherizatsia-2000'. The transmission infrastructure of GSE consists of 3,423 km transmission lines and 93 substations. [REDACTED] Currently the Georgian management team, led by Mr. Ucha Uchaneishvili, substantially reorganised the company's operations resulting in improved financial and operational performance. The shareholding structure of GSE is presented in Annex 4.

[REDACTED] Today GSE is focused on the capital investment program aimed at increasing reliability and promoting export and trade. In 2015 GSE developed a 10-year Network Development Plan (the "Plan") approved by the Minister of Economy and Sustainable Development. The Plan is reviewed and approved annually and the Ministry controls its implementation.

GNEWRC, the independent regulatory authority, is responsible for tariff setting for regulated activities and licensing. In 2014, with support from the EU financed Twinning project, GNEWRC updated existing transmission tariff methodology by bringing it in line with international best practice. GSE is remunerated on the principle of full cost recovery plus a regulated profit. The tariff methodology allows GSE to recover its actual operating and administrative costs as well as depreciation and financing costs. The profit element is calculated as a return on GSE's regulated asset base, which is calculated as the net book value of assets.

The GSE financial statements are prepared in accordance with IFRS and audited by KPMG on an annual basis. [REDACTED]

### 4. MARKET CONTEXT

The power sector is regulated by the Georgian National Electricity and Water Regulatory commission (GNEWRC), which also regulates the gas and water sectors. The regulatory regime for generation companies ranges from the cost plus based tariffs for old assets to unregulated prices for the post-2008 assets. The Ministry of Energy (which from 22 December 2017 merged into the Ministry of Economy and Sustainable Development) sets the overall energy policy and facilitates investments in the sector. Wholesale power is sold under direct physical contracts and any uncontracted energy is cleared at monthly weighted average balancing prices by ESCO.

The Georgian power sector has been unbundled and separated into generation, transmission and distribution in mid-90s. Generation is mainly privatised except for the state-owned Enguri HPP and Vardnili HPP, which supply c.30% of Georgia's

electricity. There are three electricity transmission license holders in Georgia: the core domestic network is currently owned by the state-owned Georgian State Electrosystem (GSE), also a holder of the dispatch license. The two other transmission companies, Sakrusenergo and Energotrans own and operate all interconnectors with the neighbouring countries and related infrastructure. Sakrusenergo is owned 50% by the Georgian State and 50% by the Russian Federal Grid Company, whereas Energotrans is owned 100% by the Georgian state. The transmission licensees are obliged to transmit electricity from the authorized generators to customers based on the transmission tariffs established by the independent regulator.

## **5. FINANCIAL / ECONOMIC ANALYSIS**

### **5.1 FINANCIAL PROJECTIONS**

[REDACTED]

### **5.2 SENSITIVITY ANALYSIS**

[REDACTED]

### **5.3 PROJECTED PROFITABILITY FOR THE BANK**

[REDACTED]

## **6. OTHER KEY CONSIDERATIONS**

### **6.1 ENVIRONMENT**

Categorised A (2014 ESP). The Project is categorised A requiring an Environmental and Social Impact Assessment ("ESIA") and disclosure thereof for a minimum of 120 days. The ESIA disclosure package, which considers the entire programme including the Project, was disclosed on 9 August 2019. Disclosure has included consultation meetings in the Project area.

The Project components financed by EBRD are located in Upper Svaneti, Racha Lechkhumi-Lower Svaneti and Imereti regions and integrate into the transmission network a number of planned HPP and other renewable energy projects.

The Project has taken an iterative approach to selecting and optimising the proposed routes of the transmission lines, considering a number of alternatives in accordance with a defined set of routing principles with the aim of avoiding Environmental and Social (E&S) sensitivities whenever possible through the route selection. The ESIA has assessed potential E&S impacts on a corridor centred on the transmission line routes which is anticipated to accommodate Project refinements during the detailed design process and the majority of any temporary facilities for which the exact locations are yet to be defined.

Through the routing it has not been possible to fully avoid physical displacement on the components financed by EBRD due to the need to connect to existing infrastructure or

other constraints. 7 households are anticipated to be subject to physical displacement due to the land use restrictions in the Right of Way (RoW) established around the operating transmission lines. 33ha of Permanent land acquisition is required and an area of 1500ha will be affected by land use restrictions in the RoW, where normal agricultural activities will however be permitted to continue. Across all the components of the Project, 16 households are anticipated to be subject to physical displacement, 106.4ha of land will be potentially needed, whether permanently (44.5 ha) or temporarily (60.9ha) and land use restrictions will cover 3,200ha on the RoW. However, the permanent land requirements for the entire Project only represent 0.002% of the total surface area of all the municipalities crossed by the Project. The final design and the definitive land needs for the Project Components are not yet available. Therefore, the figures provided above are intended to give a high-level estimate of the order of magnitude of the potential land requirements. A Land Acquisition, Resettlement and Compensation Framework (LARCF) has been developed and detailed Resettlement Action Plans (RAP) will be prepared and implemented in line with the principles and standards described in LARCF based on PR 5 requirements. Overhead transmission lines have also been designed so that the Electric and Magnetic Fields (EMF) will meet guideline values based on good international practice.

Consistent with other projects in Georgia and the Nenskra HPP, the ESIA considered that Performance Requirement 7 was not applicable to the Project. No issues have been raised or comments submitted related to the application of PR7 during the disclosure period. The Bank Management received the final PCM (Project Complaint Mechanism) Compliance Review Report of the Nenskra HPP on 1 May 2020. While the Grid Project is independent from the Nenskra HPP project, these two projects have progressed on a similar timeline. The E&S impact assessment and appraisal procedures followed, respectively by each client and EBRD were also aligned. The Government of Georgia is the key party in both projects through minority shareholding via Partnership Fund in the Nenskra project and Georgian State Electrosystem, developer of the Grid Project, being a State owned enterprise. The projects are linked geographically, and physically, therefore the findings of non-compliance related to the Nenskra HPP have implications for the Grid project. Specifically, findings of the PCM report and the actions within the draft Management Action Plan (MAP), including as they relate to the applicability of PR7 for the Project, extend also for this Project, specifically the components located in Upper Svaneti to which a number of renewable energy plants, including Nenskra HPP, plan to connect. These have been addressed through a combination of updating the ESIA as far as possible to address any similar issues (which relate to PR 1, 5, 8 and 10); the loan structure; [REDACTED]and provisions included in the Environmental and Social Action Plan (ESAP). The ESAP commits GSE to supporting and participating in a re-assessment of PR7 applicability (jointly with the Nenskra HPP and which will be co-ordinated by the Bank) and, if required, implementing the conclusions and recommendations of the re-assessment prior to commencement of construction of the sections in Upper Svaneti region.

The ESAP has been agreed with GSE and the comments received from the Government of Georgia indicate that the MAP and ESAP items related to PR7 applicability re-assessment are acceptable. However, some risk remains for project implementation, in particular if the client does not fully accept the findings of the PR7 applicability re-assessment. This risk is in principle mitigated by remedies embedded in the legal documentation arising as a result of failure to comply with obligations under the ESAP, [REDACTED]but disagreements regarding implementation cannot be excluded. The

updated ESIA documents have been published in English in mid-June 2020 and will be published in Georgian shortly.

One of the lines passes through the Svaneti Important Bird Area and some priority biodiversity features have been identified. Habitat loss will occur due to the clearance of vegetation from the RoW; construction activities are likely to cause disturbance to fauna and there is the potential for impacts on certain bird species due to the risk of collision with the Project towers or lines. In addition to the impact mitigation inherent to the route selection, further mitigations include the use of biodiversity specialists to supervise works; seasonal constraints on certain construction activities; the implementation of vegetation clearance and reinstatement plans; and a reforestation management plan, to achieve no net loss of priority biodiversity features. Impacts on birds will be mitigated via installation of bird deflectors on towers and transmission lines in areas identified as high collision risk and a post-construction monitoring programme and adaptive management will be implemented.

Stakeholder consultations were undertaken as part of ESIA Scoping and the ESIA disclosure package including the ESIA, LARCF, Stakeholder Engagement Plan (SEP), Non-Technical Summary (NTS), Environmental and Social Management Plan (ESMP) was disclosed in accordance with the SEP. Feedback received from stakeholders during the disclosure period included queries related to land acquisition and compensation which will be addressed through implementation of the RAP; visual impacts which will be reviewed during detailed design; and restrictions in the RoW and EMF which will be the subject of further communications as included in the SEP. The Company will continue to undertake further stakeholder engagement as outlined in the SEP.

An ESMP has been developed and includes the responsibilities for E&S management for both the Project Company, the construction contractors and the mitigation measures required during construction and operation. Construction contractors will be required to develop corresponding implementation plans. The ESMP also establishes a defined process for managing any Project changes e.g. during the detailed design, which will be mitigated through application of the defined management plans and any additional measures if appropriate.

An ESAP, which among others includes the mitigation measures described above, has been developed and disclosed with the ESIA package. The ESAP has been agreed in principle with the Project Company [REDACTED]. The Bank will undertake regular monitoring of the project to assess E&S performance during construction in accordance with the PRs and the implementation of the ESAP. Monitoring will continue as necessary during the operation period.

Through the measures outlined above, the Grid Project has been structured to meet the Bank's PRs. Robust mitigation measures have been put in place to avoid or minimise the environmental and social risks of the project in line with the ESP and PRs. [REDACTED].

## **6.2 INTEGRITY**

Integrity due diligence was undertaken on the Project Entity, senior management and other relevant parties. [REDACTED] The review did not identify any material integrity

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issues and therefore it was concluded that this project does not pose an unacceptable reputational risk to the Bank.

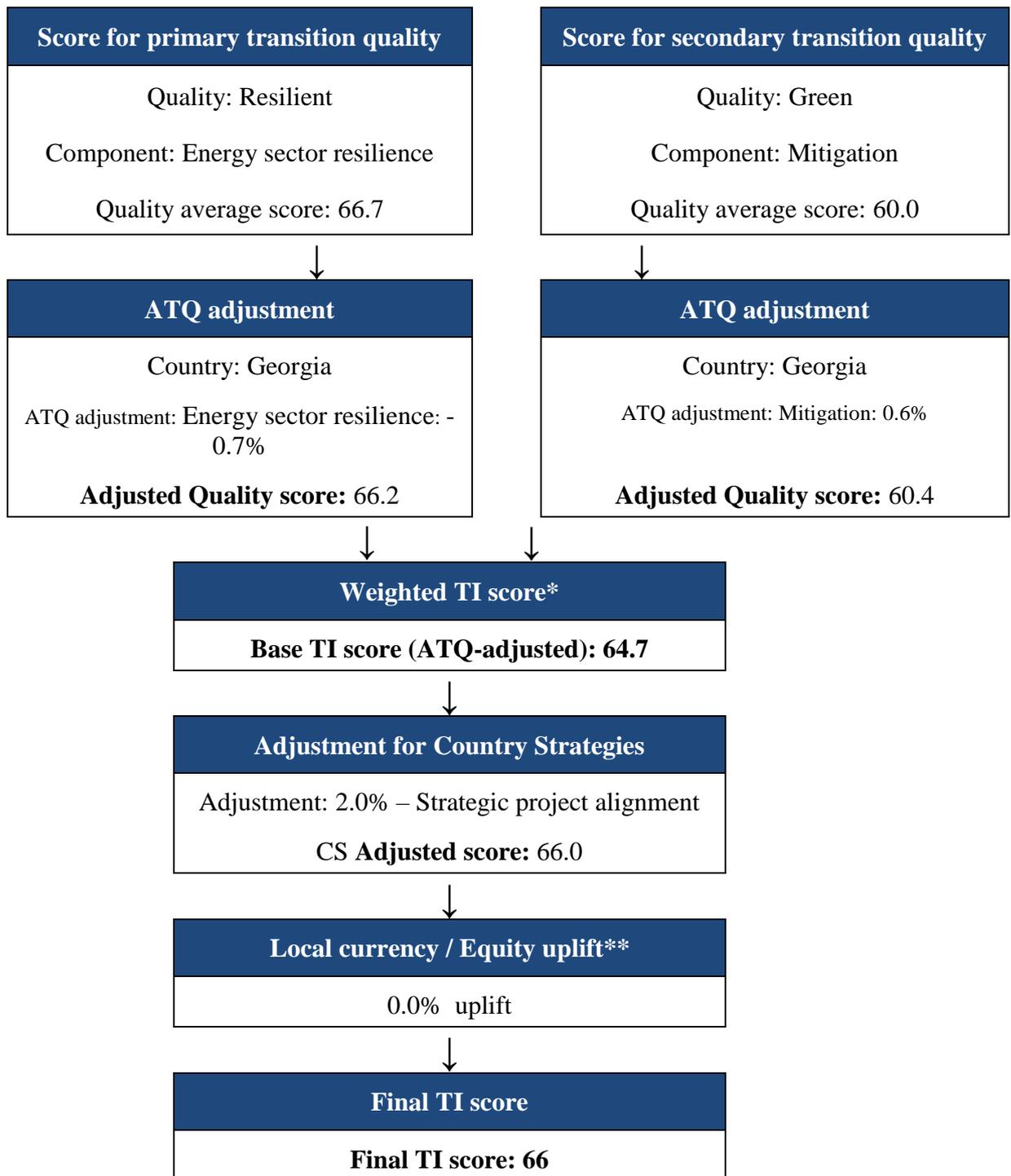
All actions required by applicable EBRD procedures relevant to the prevention of money laundering, terrorist financing and other integrity issues have been taken with respect to the project, and the project files contain the integrity checklists and other required documentation which have been properly and accurately completed to proceed with the project.

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**ANNEXES TO OPERATION REPORT**

ANNEX 1	Transition Impact Scoring Chart
ANNEX 2	Project implementation
ANNEX 3	Shareholding Structure
ANNEX 4	Historical financial statements of GSE

## ANNEX 1 – TRANSITION IMPACT SCORING CHART



\*The Primary Quality score is weighted 75% for the calculation of the Base TI Score. The Secondary Quality is weighted 25%.

## ANNEX 2 – PROJECT IMPLEMENTATION

### Procurement classification – *Public Sovereign*

[REDACTED] GSE/Energotrans is able to demonstrate earlier successful experience in procurement and contracting under EBRD financed projects. The most recent EBRD financed project was the Black Sea Energy Transmission Line Project and Jvari Khorga Interconnection Project.

This is the third project with the Company (GSE/Energotrans) applying procurement practices in line with EBRD's PP&R. Hence the Company has been able to gain useful experience in successfully procuring contracts in accordance with the Bank's procurement procedures. By applying PPD's developed toolkit the client's risk on procurement has been assessed as Low. All categories i.e. legal framework, organisation of procurement function, support/control systems, staffing, record keeping, procurement planning, procurement cycle, general assessment of the client, and project risk have been assessed.

#### 1. Contracts risk assessment: - Moderate Low

The contracts under the Project fall in the risk category *Moderate Low* since all contracts included in the Project are relatively standard for this sector. All Bank-financed contracts under the project will be procured through open tendering in compliance with the Bank's Procurement Policies and Rules (the PP&R) via ECEPP under which all interested suppliers or contractors are provided with an equal opportunity to participate.

The Procurement Plan consists of three tenders for works contracts, each of them based on design and build approach using FIDIC Yellow Book following Open, two-stage tendering procedures.

Apart from the above, the Project envisages hiring an Environmental and Social consultant to monitor and ensure adherence to the ESAP. This Consultant will work in parallel with the PIU Consultant (as described in the below para).

#### Project implementation arrangements:

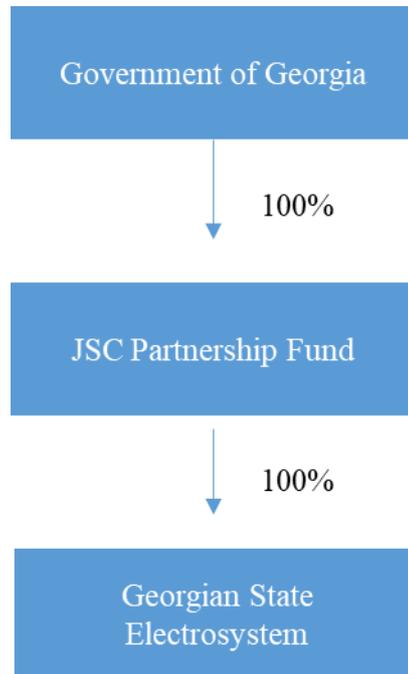
The Company's Project Implementation Unit (PIU) based in Tbilisi will have the overall responsibility of the project. The PIU is being assisted by a PIU Consultant who is already in place to coordinate and manage all procurement activities under the project. [REDACTED] The PIU Consultant is engaged to support the Company with the (i) procurement process for EBRD financed project components to ensure compliance with the Bank's PP&R, (ii) contract management and implementation supervision of those contracts, and (iii) commissioning activities.

#### Procurement arrangements:

All Bank-financed contracts will be procured by following open tendering and competitive selection procedures in accordance with the requirements of the Bank's Procurement Policies and Rules (PP&R) for public sector operations via ECEPP. Advance contracting and retroactive financing is not envisaged. All contracts included in the Project will fall under prior review.

### ANNEX 3 – SHAREHOLDING STRUCTURE

The shareholding structure of JSC Georgian State Electrosystem (“Project Entity”, “GSE”) is presented below.



### ANNEX 4 – GSE HISTORICAL FINANCIAL STATEMENTS

[REDACTED]